

BAYAKHA INVESTMENT PARTNERS QUARTERLY UPDATE ESKOM'S CEO, BOARD CHANGES AND THE RENEWABLE ENERGY IMPASSE

There has certainly been no shortage of news around Eskom recently. The events have ranged from confusion regarding the former CEO's resignation status, corruption allegations linked to senior executives, the appointment of a new interim Board and most recently, the appointment of new Acting Chief Executive, Mr. Johnny Dladla, on the 22nd of June. All this, against a backdrop of Eskom's continued reticence in relation to the signing of the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) agreements.

This client bulletin provides an update on:

1. New Interim Board and Acting CEO
2. Progress to resolving the Eskom / IPP Impasse
3. The Bayakha Investment Partners ("Bayakha") View

It is worth emphasising that Bayakha's Renewable Energy Funds, have from inception targeted the financing and where possible, re-financing of projects from Bid Window 1 to 4, as detailed in previous communications.

New Acting Chief Executive Officer

- Mr. Johnny Dladla – A Chartered Marketer, with 22 years of experience within Eskom, 17 years invested in various non-regulated businesses and 5 years as the Chief Executive Officer of Eskom Enterprises and its subsidiaries. He has successfully executed major projects, built sustainable relationships and has a legacy of service delivery with major local and international private and public-sector organisations.

New Interim Board: The entire board is now an interim board until Cabinet approves them next month. This raises the possibility that some or all of the four reappointed directors may yet lose their board seats next month.

Minister of Public Enterprises, Lynne Brown, appointed 4 new interim members to bring the Board to 9, however noting that the full board should, in fact, consist of 15 members.

Below are the brief profiles of the new Board members as communicated by Eskom.

- **Dr. Pulane Molokwane** – PhD in Chemical Technology (Environmental), Environmental Engineering, Dr. Molokwane is with the Scientific Profession Council of South Africa as a Professional Natural Scientist. Her expertise in Environment, Project Management, research, Nuclear Fuel Management, Corporate Governance, Water and Waste Management is expected to add value to the Board.
- **Mr. Simphiwe Dingaan** – Bcom degree from the University of Natal. Entrepreneur whose skills are in Corporate Financial Management, Auditing, Risk and Project Management is expected to add value to the Board.
- **Dr. Banothile Makhubela** – PHD in Chemistry from the University of Cape Town in 2011. Dr. Makhubela is currently advising\supervising scientific research projects at BSc Honors. She is a non-executive director at Petro SA, her skills in the energy industry is expected to add value to the board.
- **Mr. Sathiaseelan Gounden, (CA) SA** – BCompt from University of South Africa; Certificate in Forensic Accounting & Fraud Examination from the University of Pretoria; Executive Leadership Development Institute at Harvard Business School and an Accredited Mediator. He has extensive auditing, accounting, forensics, consulting and tax experience; His knowledge in risk management, the PFMA & Treasury Regulations; Financial reporting and King Code of Good Corporate Governance is expected to add value to the Board.

Board Resignations and Rotations

- **Dr. Ben Ngubane** – ex Eskom Chairperson
- **Ms. Chwayita Mabude** – Longest serving member of Eskom Board

Reappointed Board Members

- **Mr. Anoj Singh** - Chief Financial Officer
- **Mr. Zethemba Khoza** - Acting Chairperson
- **Dr. Pat Naidoo** – Independent Non-executive
- **Mr. Giovanna Leonardi** – Independent Non-executive

UPDATE ON ESKOM / IPP IMPASSE

Eskom's Position: A Summary by the Department of Energy

Since June 2016 Eskom has communicated, both publicly and in direct correspondence to the Minister of Energy, its reluctance to continue its participation in the REIPPPP. Through various correspondences and through media statements, Eskom has made the following assertions:

1. REIPPPP projects resulted in higher cost to Eskom than it could recover through tariffs paid by its customers and thus had an adverse impact on its balance sheet.
2. The REIPPPP would cost the South African consumer more than would otherwise be charged for electricity, adding 4.9% to tariffs.
3. The REIPPPP is not needed as there is an over-supply of electricity and lower demand as a result of low GDP growth.
4. Shutting down of 5 coal fired power stations is a consequence of the renewable IPPs.
5. In January 2017, Eskom verbally indicated willingness to only sign the agreements pertaining to projects whose price, in nominal 2016 terms, is equal to or less than 77kW/h.

Summary of Discussions to Resolve the Impasse

- The Department of Energy (DoE) / National Treasury (NT) / Eskom / and IPP Office have engaged to try narrow the gap between their varying positions.
- Insofar as over-capacity is concerned, there is consensus regarding how to address the issue:
 - Medium term outlook for period to 2021
 - IRP Update for period beyond 2022
- Insofar as financial impact on Eskom is concerned, a process has been initiated as outlined in the below **steps and timelines**:

	Intervention	By	When
1	Proceed with tariff and RCA application	Eskom	May 2017
2	Approach NERSA regarding Eskom hardship	Eskom supported by DoE/DPE/NT	July 2017
3	Develop the case for Eskom soft support until tariff adjustment in 2018 and submit to NT, then to Eskom Board	Eskom supported by DPE/DoE/NT	July 2017

	Intervention	By	When
4	Conclude the update of the Integrated Resource Plan (IRP), to define the pace and scale of new generation capacity from 2021 onwards	DoE	Feb 2018
5	Review the pace and scale of rollout under the circumstances of Eskom hardship and overcapacity up to 2021	DoE	Aug 2017
6	Review the level of participation by Black Industrialists and develop a strategy to increase it.	DoE	Aug 2017

Source: Department of Energy

BAYAKHA INVESTMENT PARTNER'S VIEW:

It will be some time before a permanent Eskom CEO is appointed as the job can only be re-advertised after the Brian Molefe case is finalised.

We welcome the appointment of Mr. Dladla as Acting CEO of Eskom. Mr. Dladla is described as having a solid reputation and impeccable credentials. His experience includes a variety of achievements at Eskom since 1992 in marketing, customer care and communications. He has also served in the CEO's and chairman's office at various times in the past. His commendable knowledge of Eskom intricacies, will ensure continuity and add value.

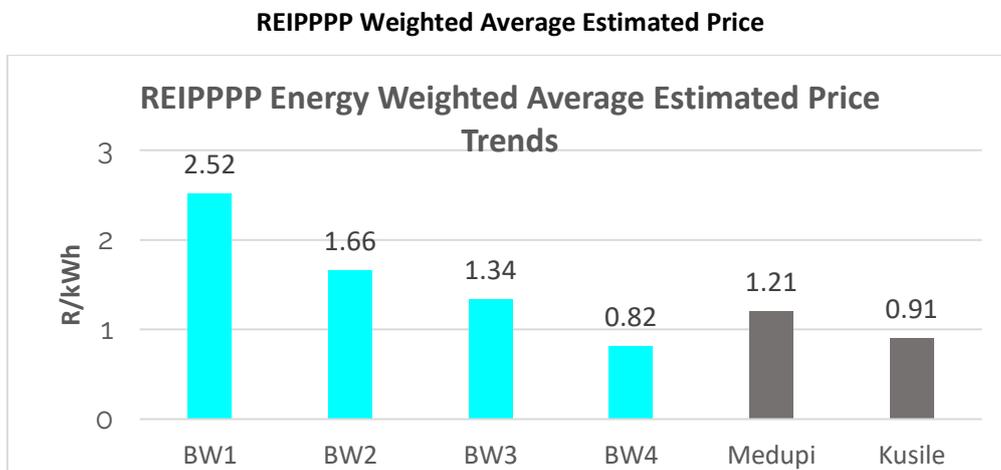
We also welcome the board rotations and additional board members. We expect the Minister to announce 6 additional board members next month to bring the Board to 15 members. The resignation of Dr. Ben Ngubane, the previous Eskom chairperson, a week before the annual AGM and subsequent rotation of Ms. Chwayita Mabude seem to have kept the rest of the old board safe, at least up until Cabinet approval of the final Board next month.

We regard all these changes as steps in the right direction towards better corporate governance at Eskom.

On the Eskom / IPP Impasse

Our view is that PPA’s will be signed and a new signing date will be announced in line with the timelines given by the Task Team i.e. post Aug 2017 but before Feb 2018, when the new IRP is expected to be concluded. The potential financial, development and credibility losses to the State simply do not justify an indefinite impasse.

The graph below outline’s The Department of Energy’s price comparison of renewable versus coal-fired power plants. This makes evident the increasing competitiveness of renewable energy.



Source: Department of Energy

The DoE has further acknowledged that the State is in fact obliged to sign the PPAs at a recent parliamentary committee meeting (20 June 2017). Particularly, it is worth noting that risks to government for not signing include possible litigation should IPPs decide to pursue their claims in court, **which they have not done thus far**. Senior counsel opinions have already confirmed that Eskom has no authority to review or reject the duly procured PPAs.

Thus while we recognise that organs of the State have communicated different messages regarding the matter, our view remains positive because the State’s fundamental policy position has remained consistent. As reiterated by the DoE and National Treasury, Eskom is not a policy-making institution. The custodians of policy in this case are the DoE and it is their consistency that provides ultimate assurance. Indeed, signature of the PPAs will signal policy consistency and more importantly, the continued commitment to renewables as part of the long-term energy mix, The National Development Plan, United Nations Climate Change Convention Conference, and the Paris Accord.

Our Expectations Regarding The Yield/Returns Of The Asset Class, Given The Increase In Perceptions Of Government Risk

The ratings downgrade has had little impact in the short-term as they had largely been priced in by the market.

Declines in the institutional strength of government State-owned Enterprises (SOE's) and departments (Eskom included), if not checked, are likely to have the effect of increasing the risk premium on both local and foreign denominated South African debt in the long term.

As infrastructure and renewable energy projects are highly geared, I expect the required yields/returns from equity investors to increase by more than the increased premium on debt not only because they are assuming greater government risk, but also because their cashflows are back ended as well.

The REIPPPP PPA revenue is inflation-linked offering further long-term protection to investors.

South Africa's Local Currency Debt Rating

	Moody's rating scale	S&P rating scale	Fitch rating scale
Investment Grade	Aaa	AAA	AAA
	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
	A1	A+	A+
	A2	A	A
	A3	A-	A-
	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
	Baa3	BBB -	BBB -
Non-Investment Grade	Ba1	BB+	BB+
	Ba2	BB	BB
	Ba3	BB-	BB-
	B1	B+	B+
	B2	B	B
	B3	B-	B-
	Caa1	CCC+	CCC+
	Caa2	CCC	CCC
	Caa3	CCC-	CCC-
	Ca	CC	CC
	C	C	C

Future Ability To Invest And/Or Capacity For Investment In The Renewable Energy Space

Our portfolio construction strategy remains unaffected. That includes managing risk through a combination of (i) investments in brownfield projects that are already operating and generating stable cash-flows (currently Bid Window 1 – 3) along with, (ii) investments in greenfield projects (Bid Window 3.5-4.5), with strong potential of generating expected returns but involving construction risks. Various off-grid / private PPA opportunities are also being investigated.

In conclusion, it remains our view that robust debate regarding the country's energy mix is a worthwhile process. It is through robust and transparent policy-making processes that the private sector gains a more conclusive view on how to allocate its funds. We therefore support such a process, with the hope that it will produce more certain market conditions for future Bayakha products.

Bayakha's Renewable Energy Funds are currently fund-raising. Please do not hesitate to contact us should you require further details.

Sincerely,

Mr Ngoku-Sakhile Mazwi

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28 June 2017, Johannesburg, South Africa

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