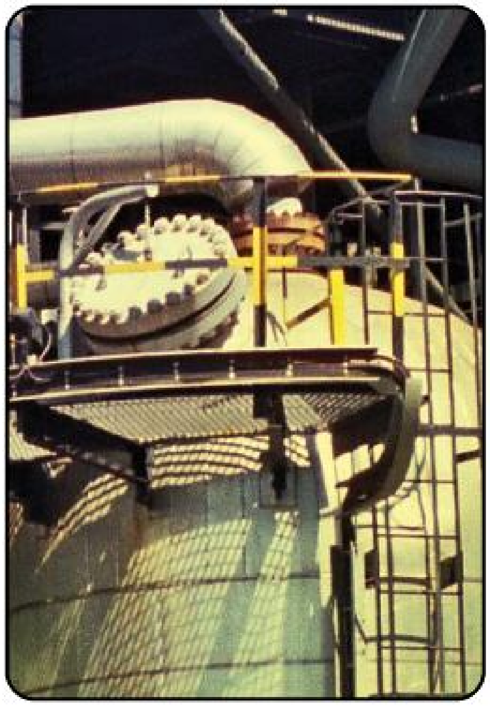
NATIONAL ENERGY REGULATOR OF SOUTH AFRICA

Utility Financial Equilibrium vs. Customer Interests



Presented by:
Thembani Bukula - NERSA

Objectives of regulation

- To ensure efficient, effective, sustainable and orderly development and operation of the infrastructure

- To facilitate investments in the and universal access to the infrastructure

- To facilitate a **fair** balance between the interests of consumers, utilities/licensees, investors and the general public

Utility Finances

- Cost to supply
  - Operating & Maintenance costs (including Manpower costs)
  - Working Capital
  - Depreciation
  - Primary Energy

- Other payment obligations
  - Loan instalments and Interest payment
  - Dividends payout

- Retained Earnings
  - Profits
  - Derivatives
  - Balance sheet (healthy)

Utility Financial Assessment

- Historical and future trends more important than specific ratios at a given point
    - Volatility and/or stability

- Emphasis on Cash-flow or Funds from Operations rather than equity or earnings based ratios
    - Pre & post-tax interest coverage and debt service coverage
    - EBITDA
    - Capital expenditure (Local and foreign component)
    - Fixed charges
    - Capital structure (balance between Debt, Equity & Capital required)
    - Liquidity (Sufficient funds to meet business activities)
    - Profitability (Return on assets and equity)
- Stress or abnormal scenarios
    - Impairment during adverse occurrences (e.g. lower industrial sales)

Utility Financial Equilibrium

Measure	Range
Pre-Tax interest cover ratio	1 to 5
FFO interest cover ratio	1.5 to 7
FFO to total debt (%)	5 to 40
Total debt to total capital (%)	20 to 80
Debt to Equity ratio (OPTIMAL)	80:20
Return on assets (MINIMUM)	8%
Primary Energy as a % of total costs	26% to 35%
Manpower costs as a % of total costs	30% to 42%
Operating Margin (%)	15 to 35
EBITDA	1 to 15

Notes:
FFO = Funds From Operations
EBITDA = Earnings Before Interest Taxes Depreciation & Amortization

Shareholder interests

- Profitability
  - As high as possible
- Dividends payout
  - Maximum payouts
- Interest and Debt maturity profiles
  - Lowest interest
  - Longest maturity requirements

Other factors

- Regulatory Risk
  - Transparency
  - Predictability
- Operating Risk
  - Status of the assets
  - Outage planning
- Commodity Price/Market Risk
  - Primary energy costs fluctuations
  - Pass-through mechanisms
- Political Risk

Consumers

- Demographics
  - Urban vs. rural
  - Wealthy vs. poor
- Types of customers
  - Energy intensive
  - Quality of supply sensitive
  - Domestic vs. commercial

Consumer interest

- Prices as low as possible
- No risks or limited risks allocation
- Inflation related or linked price increases
- No price spikes
- Highest quality and availability of supply
- 2-3 years advance warnings
- Lowest profits for State Owned Entities
- Efficient operators

Utility Financial Equilibrium vs. Consumer interests

Measure	Utility Preference	Consumer Preference
Profitability	High	Low
Prices	High (Cost reflective)	Low
Dividends payments	Maximum	Minimum
Manpower costs	High	Low
Operating Margins	High	Low
Pre-Tax interest cover ratio	High	Low
Return on Assets	High	Low

Case Study – Eskom 60% price increase application

- Eskom applied for 18.7% increase, NERSA awarded 14.2% increase in Dec 2007
- Applied in Mar 08 for a revision of 14.2% increase to 60%.
- 60% increase = $15billion additional revenue
- Capex increase from $9bn to $15bn to $34.5bn
- Primary Energy costs increased by $.3bn to 34% of the total costs from 27%.

Eskom’s Financial Equilibrium

Measure	Range	Eskom (BBB+ Rating) 2007
Pre-Tax interest cover ratio	1 to 5	1.14
FFO interest cover ratio	1.5 to 7	1.34
FFO to total debt (%)	5 to 40	7.16
Total debt to total capital (%)	20 to 80	66.74
Debt to Equity ratio (OPTIMAL)	80:20	74:26
Return on assets (MINIMUM)	8%	8%
Primary Energy as a % of total costs	26% to 35%	32%
Manpower costs as a % of total costs	30% to 42%	31%
Operating Margin (%)	15 to 35	28.4
EBITDA	1 to 15	1.1

Notes: Eskom Financials 2007

Result of 27% vs 60% increase

Measure	Eskom (BBB+ Rating) 2007	Eskom (27% increase)	Eskom (60% increase)
Pre-Tax interest cover ratio	1.14	1.88	3.4
FFO interest cover ratio	1.34	2	2.5
FFO to total debt (%)	7.16	10.16	18.16
Total debt to total capital (%)	66.74	75.74	71.32
Debt to Equity ratio (OPTIMAL)	74:26	76:26	77:26
Return on assets (MINIMUM)	8%	8%	9%
Operating Margin (%)	28.4	29.4	34
EBITDA	1.1	1.1	2.1

Consumer viewpoints

- No increases
- Full increase to secure the supply
- Government must pay as the shareholder and cause of the problem
- Increase must be phased in over a 5 year period
- Privatise Eskom and the prices will be lower
- Implement different prices for different customers

Final outcome

- No increase for the poor (limited to 14.2%)
- 27% increase for all other consumers
- $1bn required from the Shareholder for Eskom to sustain and operate
- Eskom Profitability in the “Black”

Thank you

Questions???