MOODY'S & MINI-BUDGET PROVIDE SOME CHEER AT ESKOM

By Dr Roelof Botha, Joint Managing Director, GOPA Group SA (2 November 2022)

October ended on a high note for South Africa's embattled electricity utility, with two welcome windfalls in quick succession.

The first was the announcement by the Minister of Finance, Enoch Godongwana that government would take over a significant portion of Eskom's debt. The debt relief is expected to account for between one-third and two-thirds of Eskom's current debt, which is around R400 billion (6.1% of annualised GDP at the end of the 2nd quarter of 2022).

The second was the decision by international ratings agency Moody's Investors Service to affirm the utility's long-term corporate family rating at Caa1 and, more importantly, to also raise the outlook on Eskom's debt rating from negative to positive, ending a 15-year downward spiral.

It is evident that much deliberation still needs to take place before the transfer of this sizeable debt portion, especially due to the complex and apparently unsustainable capital structure of Eskom, but Moody's did not waste any time in a further lifting of the mood at Eskom.

The ratings agency has clearly acknowledged the advantages of National Treasury's debt relief, stating that its revised positive outlook is based on a clear commitment by the South African government to address Eskom's debt dilemma. Significant debt relief will improve Eskom's balance sheet and reduce pressure on cash flows through lower interest payments.

Eskom turnaround on track

The main reasons behind the fortuitous turnaround in Eskom's debt rating outlook (which still has a long uphill battle) are firstly, the improvements in the overall management and imminent operational structure of the utility.

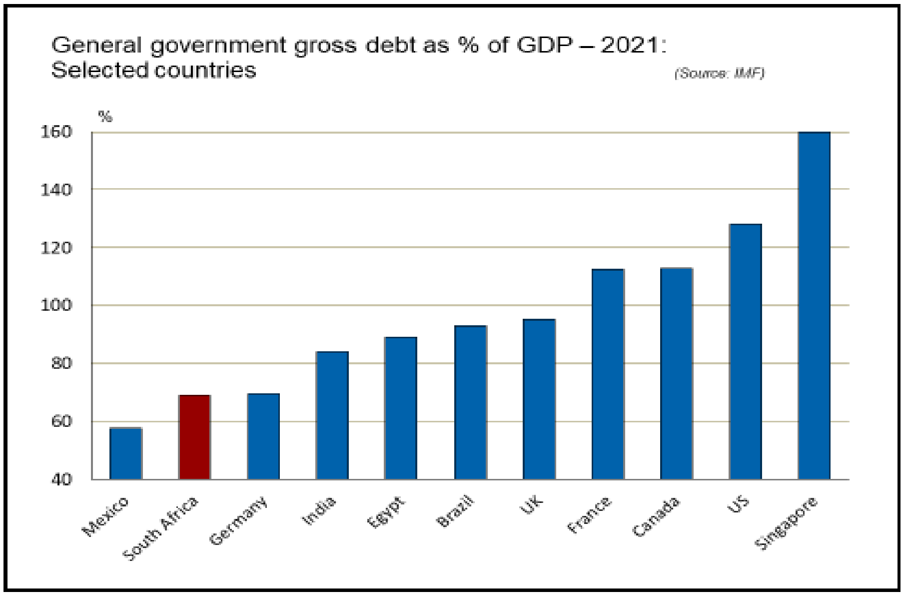
These include the finalisation of the Electricity Regulation Amendment Bill, which provides for the establishment of an independent transmission and system operator aimed at fundamentally transforming the electricity sector. Reducing South Africa's reliance on a single monopoly utility and unlocking new private investment in generation capacity is expected to contribute significantly to long-term energy security.

No doubt Moody's are also aware of other policy and regulatory changes aimed at creating a competitive energy market in South Africa. These include the removal of the licensing threshold for embedded generation projects, where the pipeline has grown to 100 projects, representing over 9,000 MW of capacity.

Secondly, a mid-term budget was tabled at the end of October that confirmed the stabilisation of South Africa's public debt/GDP ratio at around 70%. This key objective was reached much sooner than anticipated and was made possible by a combination of tax revenue windfalls and a measure of new-found restraint with regard to public sector wage increases.

Eskom would simply not have received a provisional thumbs-up from Moody's in the absence of fundamental fiscal stability having been achieved. This is reflected, inter alia, in a primary budget surplus of 0.7% of GDP that is anticipated in the next fiscal year (defined as revenue exceeding non-interest government spending).

South Africa's public debt/GDP ratio compares favourably to several of its major trading partners, although the country's bond yield has remained stubbornly high ever since the relentless strengthening of the US dollar during 2022.



Next steps

Although technical problems relating to very poor workmanship done during the construction of the Kusile and Medupi coal-fired power stations will continue to place pressure on the availability of electricity for at least the next two years, enhanced financial viability will facilitate progress with the introduction of renewable energy into the grid.

Further improvements to the rating status of Eskom's debt may be forthcoming if government prioritises the return to functionality of a large number of municipalities, which should eventually incorporate a structured programme of debt repayments to Eskom. At the end of October, municipalities owed Eskom close to R50 billion, a figure that has been climbing at a rate of more than one billion rand every month.

The Free State and Mpumalanga are the main culprits in the non-payment for bulk electricity. In combination, these two provinces account for more than 62% of the total outstanding municipal debt owed to Eskom. Municipalities in KwaZulu/Natal and Gauteng only account for 1.7% and 1.5% of the debt, respectively, and the Western Cape is the shining star with a share of only half of a percentage point.

Fixing the dysfunctional municipalities is long overdue and should commence with the identification and replacement of incompetent and dishonest employees, many of whom are paid huge salaries without adding any significant value to the economy.