The interplay between industry structure and both new and legacy financing

PCC JET Dialogue Series

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Researching Capital Markets and Financial Services

Choices

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Financing

Electricity industry structure

Bankability
Risk
Price discovery

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Interdependcy

- Choice of industry structure affects financing available
  - SOE-led system will receive far less financing than a private sector-led one with appropriate reforms
  - However, finance industry still needs to get accustomed to liberalisation
- Financing available affects choice of industry structure
  - Need to maximise financing available for whatever industry structure is chosen
  - Will naturally see most rapid growth of pockets with most financing/cheapest
- External constraints important
  - Realistic view of fiscal constraint for instance – cash and guarantees
  - Municipals (in general) very weak indeed
- Other considerations can flex the choice of both from optimal path
  - Political economy and vested interests
  - Policy maker choices might be 'ahead of curve' vs moves in finance industry (requires advocacy, research and reforms to unlock more financing)
  - Or, choices might be 'behind the curve' (eg Eskom 2.0 etc)

Everything is interlinked

- Delicate balance/keystone problem on electricity system:
  - Everything kicked off by energy system liberalisation
  - Liberalisation creates risks for financing in legacy system that must be dealt with

Shifting funding model

Current model

- Single entity (Eskom)
- Guaranteed (or quasi-guaranteed)
- Largely predictable, pooled risk (balance sheet funding not project)

→

New industry structure

- Multiple entities (public and private)
- Unguaranteed
- More unpredictable, less pooled risk (project financing)

- Transition is made smoother by:
  - Clear and transparent processes
  - Policy certainty
  - Clear price discovery within system (private and public)
  - De-risking options (eg multiple off-takers and buyers of last resort/spot market

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Funding options

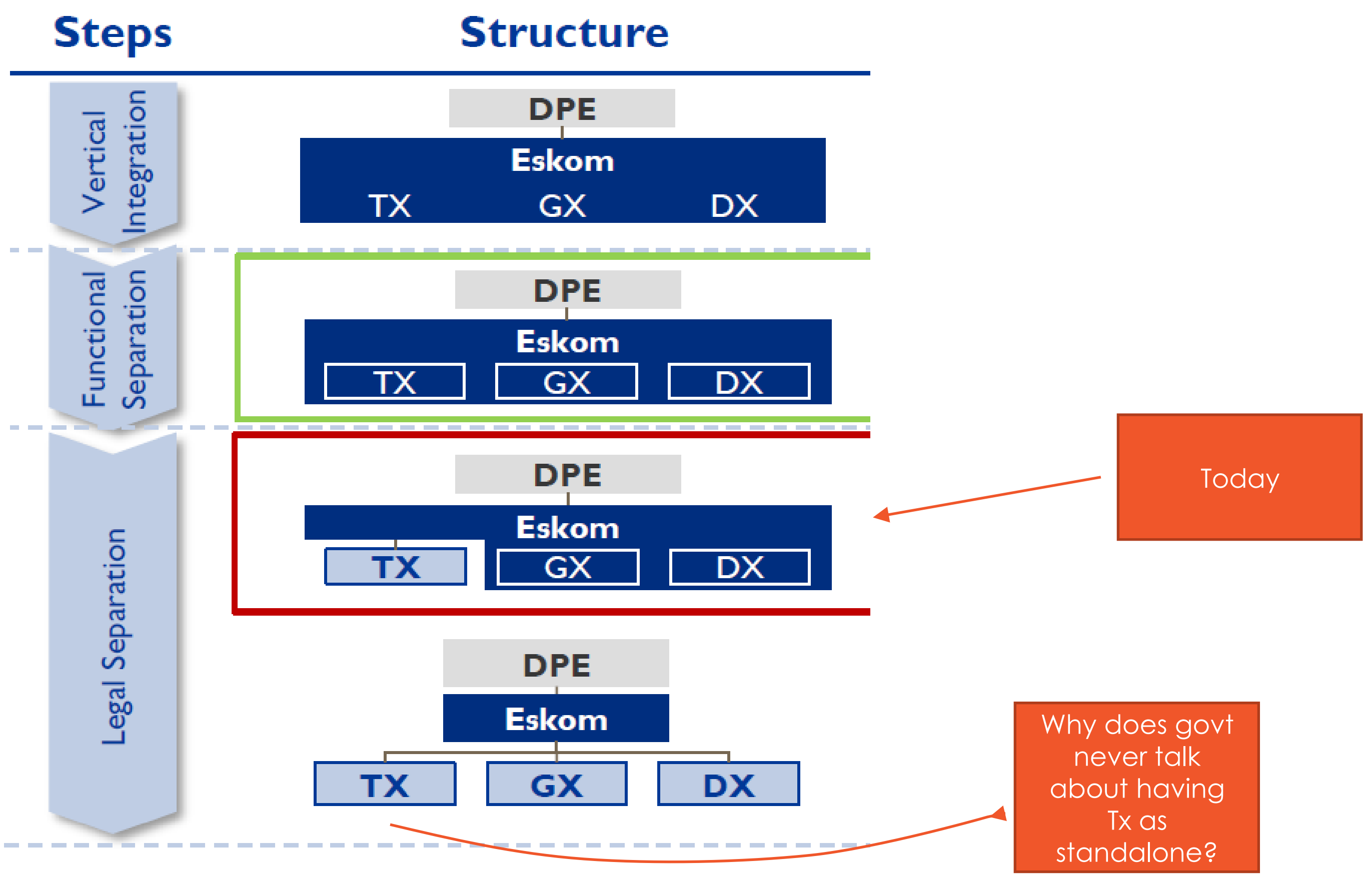
- Approximately ZAR500bn needed to end loadshedding by 2024, plus ZAR175bn in next decade for transmission, plus ongoing operations etc:
  - Offshore IFIs, governments, JETP etc – largely one off
  - Onshore DFIs – need to be more strategic to derisk private sector
  - Key heavy lifting from private sector financing
    - Banks (onshore and offshore)
    - Debt and equity capital markets
    - Problem of achieving scale – lack of pipeline (yet) has meant financial innovation has been dormant. Many issues will become apparent including exclusion lists (Eskom, Sasol etc), SOE funding problems, etc.
- Change in mindset for private sector needed
  - Funding carbon pathways not just low carbon intensity
  - Wean banks off REIPPPP guarantees (has infected broad views on energy financing)
  - Lots of demand for derisking can be solved with wheeling and multiple offtakers/traders
  - Liquid pooled instruments needed (index eligible, both bank and sovereign green bonds)

Funding constraints

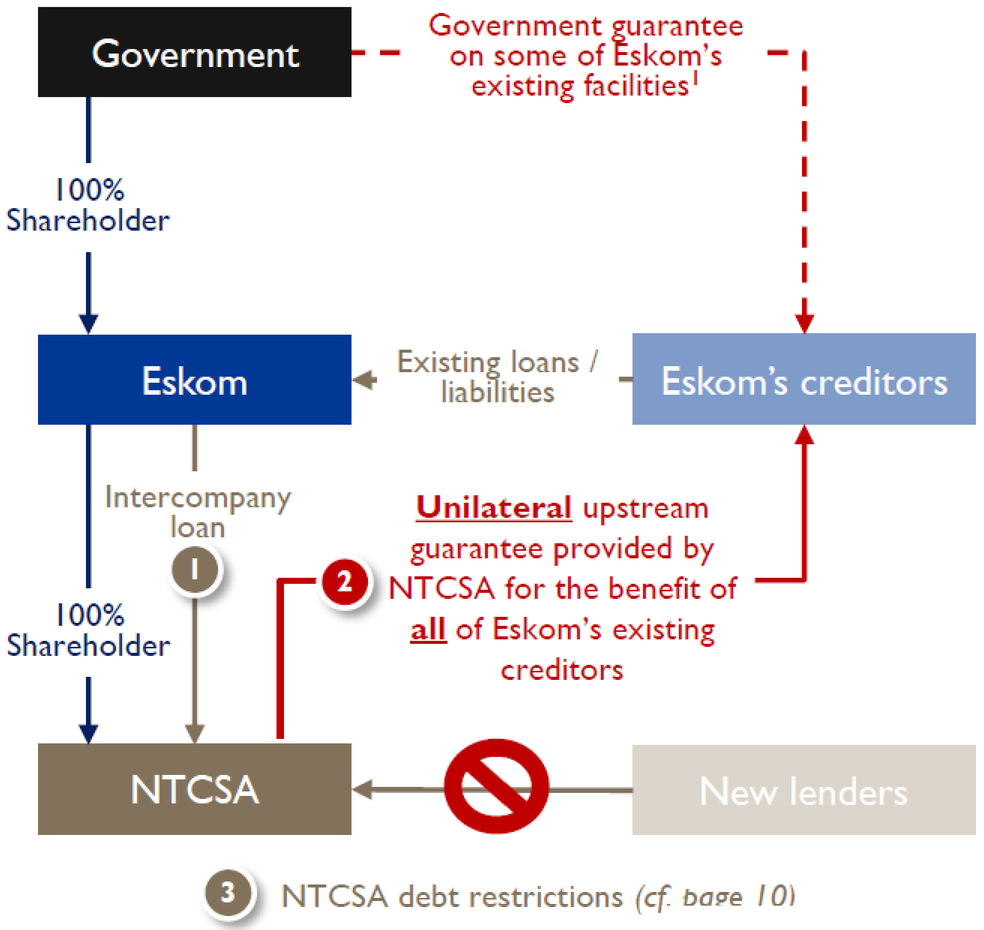
- Relatively few dedicated pots for infrastructure/energy
  - Reg28 change shifting debate on this
  - New industry structure will demand funding goes ‘overweight’ electricity (vs other infrastructure)
- Money for new SOEs (Eskom 2.0) does not exist
  - From public or private sector, including from foreign governments nor BEE funds
- Recourse vs non-recourse problem still exists
  - Full view on tariffs and offtakers required → Must have a merchant market
- Markets (asset managers) still want easy projects
  - Banks can be better at seeing winners and losers of JET and provide support for both
  - ESG can be a problem – too much focus on E not S
- Political choices (eg private sector transmission financing models remaining taboo) close off interest
- Taxonomies are of little use in reality (to banks or asset managers)

Eskom unbundling

- Promoted as a panacea but need to be careful – solves efficiency, costing, profit/loss allocations but doesn't change operations
- Generation (Gx) will in effect become a 'bad bank'
- Transmission (Tx - NTCSA) including system market operator is interesting component – high credit quality, liquid (tariffs flow in here), investors want to partner, where most enabling climate financing will flow
- But design problems creeping in – Tx not allowed to borrow on its own for foreseeable future – upstream guarantee problem
- **Unbundling (and Lazard) has nothing to do with legacy debt.**



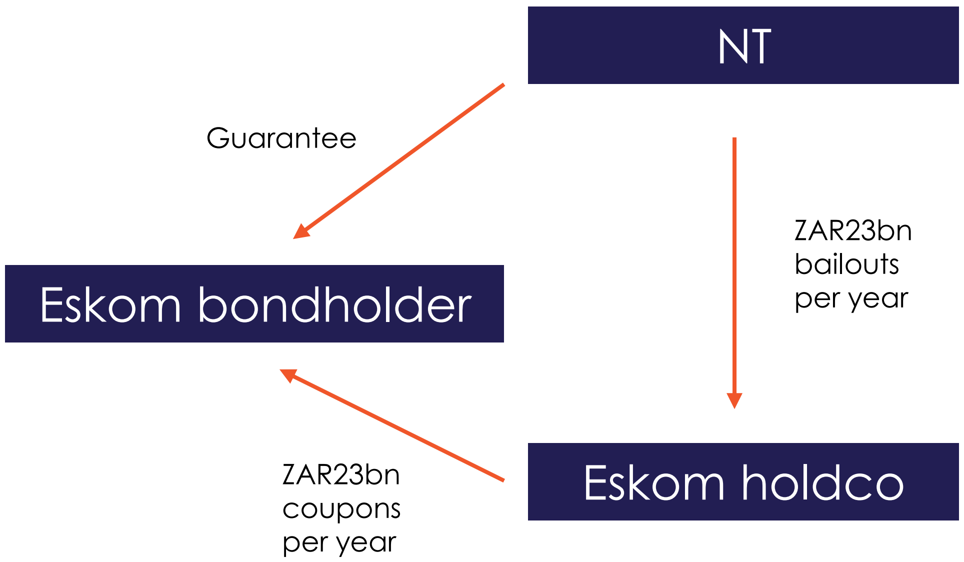
Eskom unbundling

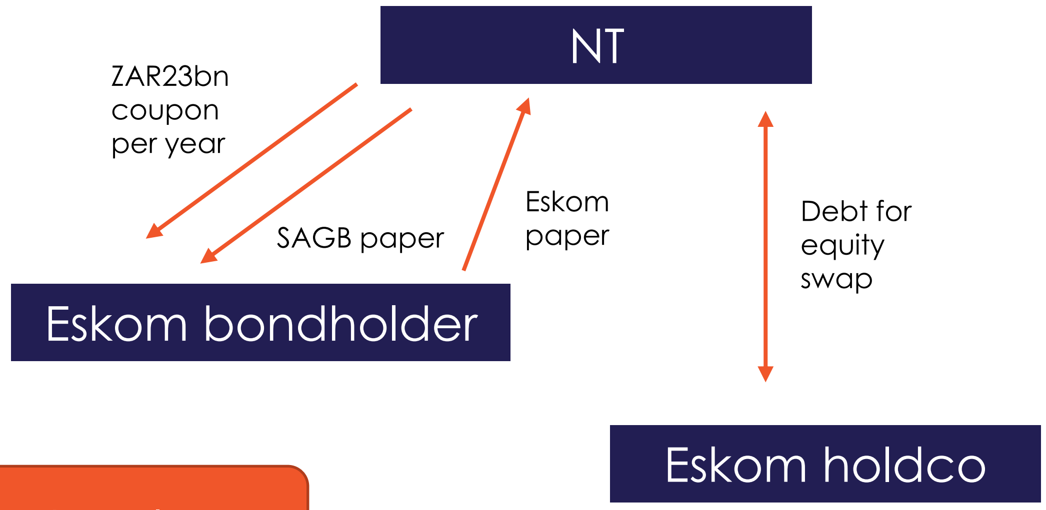


- ➢Structure presented is problematic
  - ➢Upstream guarantee
  - ➢Borrowing restrictions for NTCSA
- ➢Eskom between rock and hard place –
  - ➢No certainty on tariff
  - ➢No certainty on debt deleveraging
- ➢As such structure is overly creditor protective
  - ➢Outcome is restricted investment for transmission incl PPPs for transmission
  - ➢NTCSA credit quality becomes tied to worst parts of Eskom holdco
  - ➢Investors want to fund high credit quality NTCSA (low cost, tight spreads)
- ➢**Eskom/NT need to shift to different structure quickly when there's certainty on tariff and deleveraging**
- ➢**Need 'Thuma Mina' conversation with creditors**

Debt solution on the way

- Private (incl PIC) involvement in a debt-for-equity swap is politically and practically impossible
- Debt forgiveness is completely nonsensical in a deep, liquid market like SA
- Voluntary sovereign debt swap is simplistically fiscally neutral – upsides with lower financing costs of sovereign
- Investors already assume (correctly) Eskom debt is part of sovereign balance sheet – no ratings impact
- Solution outline in October 22 (MTBPS) execution into new fiscal year (April 2023 and beyond)





Delever to relever

What do we need to see?

- Rapid and well communicated implementation of President's crisis energy plan
  - Omnibus bill
  - Sort wheeling framework – needs to be cross country standardised
  - Feed-in tariffs etc
- New ERA passed swiftly
  - Will Parliament be massive blockage timing wise?
  - Remove ministerial discretion (influencing industry structure)
- NERSA tariff structure finalised
- Eskom debt swap announced (and executed)
- Remove guarantees
- Clear NTCSA pathway –
  - Being outside holdco state owned
  - Properly independent
  - No upstream guarantees or borrowing restrictions
- NTCSA board finally appointed

Heart of issue is Eskom and ERA

IRPs and JETP investment plans have their places but shouldn't be overplayed

Choices

Scale and pace of change

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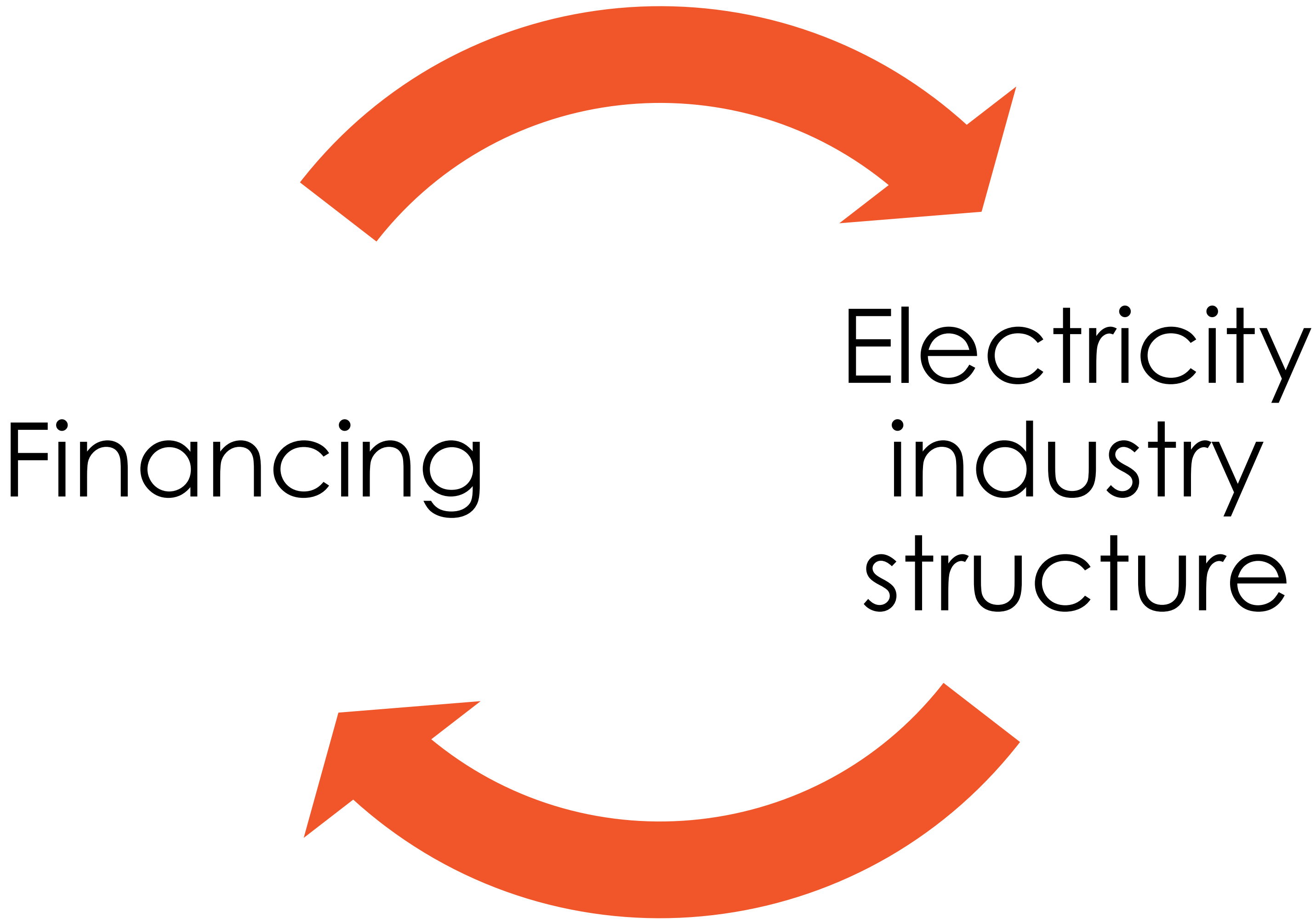
Scale and pace of decarbonisation



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