

Financial review

Financial performance overview

Performance of Eskom and its subsidiaries

The operating profit for the year for the Eskom group, before the impact of embedded derivatives and net finance costs, was R3 215 million (2007: R6 452 million) and for the company R3 132 million (2007: R5 815 million) after taking into account the following:

- a dividend of R800 million (2007: R200 million) from a subsidiary is included in the net profit for Eskom (but eliminated for the group)
- the change in the projected asset lives of coal-fired generation plant from 35 to 50 years impacted the profit by a favourable amount of R484 million
- the increased amount spent on primary energy. The costs of coal and diesel increased from R13 040 million in 2007 to R18 314 million in 2008

The profit for the year for the Eskom group was R974 million (2007: profit of R6 476 million) after taking into account the fair value loss on embedded derivatives of R143 million (2007: fair value gain of R4 305 million).

The profit for the year for the company was R1 333 million (2007: profit of R6 030 million) after taking into account the fair value loss on embedded derivatives of R149 million (2007: fair value gain of R4 131 million).

The forward electricity price curve used to value the embedded derivatives was 27,5% for the 2008/9 year, 25% for the next three years, 18% for the 2012/13 year and CPI plus 2% thereafter. A sensitivity analysis for the embedded derivatives appears in note 3.

The debt:equity ratio including long-term provisions weakened from 0,14 to 0,30 at the end of the current year.

Highlights

- the group capital expenditure (including interest capitalised) of R24 764 million for the year was significantly higher than the R17 707 million in the previous year and exceeded the target by R218 million, indicating that the capital expansion programme is on track
- the BEE spend was R25 447 million compared with a target of R18 955 million
- strategic sourcing savings of R3,1 billion against the target of R1,5 billion

Lowlights

- the impairment provision for trade and other receivables increased from R1 533 million in 2007 to R1 877 million
- primary energy costs increased significantly during the year
- a rating agency placed Eskom on credit watch during February 2008
- the revised price increase of 14,2% for 2008/9, announced by Nersa in December 2007, was lower than the 18% requested by Eskom
- the return on assets for the year was 3,3% compared to 7,8% last year

Refer to www.eskom.co.za/annreport08/003 for more details on capital expenditure.

Income statement

Group business performance for the year ended 31 March 2008¹

	Eskom Holdings	Eskom Enterprises	Escap	Gallium	Inter-company eliminations	Consolidated
	Rm	Rm	Rm	Rm	Rm	Rm
2008						
Revenue	43 584	5 456	560	–	(5 152)	44 448
Other income	1 744	254	23	–	(1 790)	231
Net fair value (loss)/gain on financial instruments excluding embedded derivatives	(729)	25	16	–	4	(684)
Operating expenditure	(41 467)	(5 357)	(622)	8	6 658	(40 780)
Operating profit/(loss) before net fair value (loss)/gain on embedded derivatives	3 132	378	(23)	8	(280)	3 215
Net fair value (loss)/gain on embedded derivatives	(149)	10	–	–	(4)	(143)
Operating profit/(loss) before net finance costs	2 983	388	(23)	8	(284)	3 072
Finance income	2 811	201	140	55	(274)	2 933
Finance expense	(4 815)	(94)	–	–	188	(4 721)
Share of profit of equity accounted investees	–	20	–	–	10	30
Profit before tax	979	515	117	63	(360)	1 314
Income tax expense	354	(149)	(30)	–	30	205
Profit for the year from continuing operations	1 333	366	87	63	(330)	1 519
Discontinued operations	–	(13)	–	–	(532)	(545)
Profit for the year	1 333	353	87	63	(862)	974
2007						
Operating profit before interest and finance charges	9 946	1 012	169	107	(477)	10 757
Included in above is:						
Net fair value gain on embedded derivatives	4 131	174	–	–	–	4 305
Profit for the year	6 030	840	186	199	(779)	6 476
Other key information						
					Actual 2008	Actual 2007
Sales						
Eskom electricity sales (GWh)					224 366	218 120
Eskom electricity sales growth (GWh %)					2,86	4,90
Eskom electricity sales growth (Rm %)					10,61	11,30

¹ Due to the insignificant amounts involved, the figures for PN Energy, a wholly owned subsidiary of Eskom Holdings, have not been included in the above table.

Performance review continued

Eskom

The growth in electricity sales (GWh) was 2,9% compared to the sales growth of 4,9% in the previous year. The electricity price increase for 2007/8 was 5,9%. Primary energy costs increased from R13 040 million in 2007 to R18 314 million in 2008. This is mainly due to the steep increase in coal prices and the extended use of the diesel-powered open-cycle gas turbines due to the reduced reserve margin in October 2007 and at the beginning of 2008.

Eskom received a dividend of R800 million (2007: R200 million) from its subsidiary Gallium Limited.

At the end of March 2008 an amount of R1 978 million (2007: R1 446 million) of the electricity trade debtors was older than 75 days, a substantial portion of which relates to pre-2001 service-level agreements. Refer to the financial statements on pages 131 to 133 for further information. Adequate provision has been made for impaired electricity debtors.

Eskom is not in a tax-paying position and the tax credit to the income statement was R354 million (2007: a tax charge of R2 407 million), which is mostly deferred tax. Some R417 million (2007: R1 377 million) in tax was paid to the South African Revenue Service during the review period.

Change in asset lives of generation plant

With many of Eskom's power stations in the 30-year age group, the board deemed it prudent to extend the economic life of the power stations from 35 to 50 years. This change was treated as a change in estimate in terms of International Financial Reporting Standards. The impact of this adjustment was a reduction of R484 million in the depreciation charge for the current year.

International experience indicates that power stations generally have an economic life greater than 50 years, and there are examples of stations much older than this. The major indicator of the economic life of a power station is not the age of the plant, but rather the availability and cost of coal. It is much more cost-effective to refurbish a power station than to build a new one, and with refurbishment it is possible to both significantly extend the life and improve the efficiency of a power station.

Embedded derivatives

The net impact on the income statement of changes in the fair value of the embedded derivatives of the company is a fair value loss of R149 million (2007: R4 131 million fair value gain) and a fair value loss of R143 million (2007: R4 305 million fair value gain) for the group. At 31 March 2008, the embedded derivative assets amounted to R12 713 million (2007: R8 686 million) and the embedded derivative liabilities to R5 084 million (2007: R914 million) for the group.

The forward electricity price curve used to value the embedded derivatives was 27,5% for the 2008/9 year, 25% for the next three years, 18% for the 2012/13 year and CPI plus 2% thereafter. A sensitivity analysis for the embedded derivatives appears in note 3.

Revenue and credit management

Eskom maintains systems, procedures, processes, and training programmes to ensure efficient and effective revenue management. In addition, adequate cash collection and investment management processes were in place throughout the period under review.

This is covered in detail in note 3 of the financial statements (refer to page 125).

Valuation of assets and impairments

There is cross-subsidisation between certain customer categories (depending on electricity consumption, geographical location and voltage supply). However, Eskom recovers all the costs of supplying electricity to its overall customer base and earns a positive return on assets. On this basis, the directors believe that no adjustment is required to the value of assets relating to any particular customer category.

The directors believe that, based on the principle of cross-subsidisation, there is no need to raise a provision for the impairment of certain classes of property, plant and equipment in the current period. It might, however, be necessary for Eskom to raise a provision for impairment in respect of certain classes of assets in future years, depending on the nature of the planned restructuring of the electricity distribution industry.



Primary energy costs increased from R13 040 million in 2006/7 to R18 314 million in 2007/8.

Subsidiaries

Eskom Enterprises (Pty) Limited group

Turnover for the year was R5 456 million (2007: R4 457 million). Net profit after tax from continuing operations was R366 million (2007: R896 million) while the loss from discontinued operations was R13 million (2007: R57 million), resulting in a total profit of R353 million (2007: R840 million). Of this, R311 million (2007: R845 million) is attributable to the equity holder and R42 million (2007: loss of R5 million) is attributable to minorities. (The profit for 2007 was favourably impacted by the reversals of impairment provisions raised in previous years.)

The actual performance of the group for the year was substantially better than expected due to additional maintenance and the capital expansion programme work received from Eskom divisions, Anglo Coal and the Department of Minerals and Energy. The turnaround strategy implemented at Arivia.kom (Pty) Limited (arivia.kom) during the previous year has reaped tremendous benefits, with the company achieving a profit before tax of R88 million (2007: loss of R7 million).

Disposal of MKC

Eskom Enterprises disposed of its investment in Mountain Kingdom Communications (Pty) Limited (MKC) on 31 March 2008, for R68 million, resulting in a loss at group level of R142,7 million. Eskom Enterprises was released from its letter of support for a R156 million loan from Standard Lesotho Bank to Telecom Lesotho as part of the MKC disposal.

Disposal of arivia.kom

Transnet and Eskom are currently working on the outsourcing and disposal of the arivia business. Following a public release of an expression of interest document and a rigorous adjudication process, a shortlist of prospective bidders has been drawn up. It is expected that the sale will be completed by 31 March 2009.

Refer to www.eskom.co.za/annreport08/004 for details of other Eskom Enterprises group business interests earmarked for sale.

Escap Limited and Gallium Insurance Company Limited

Eskom's captive insurance subsidiary companies, Escap and Gallium, continue to provide a full range of customised short-term insurance products to the Eskom group.



Exhibits at major conferences are used for awareness campaigns and stakeholder engagement.

While Escap's underwriting loss for the year is R54 million (2007: underwriting profit of R86 million), it showed a net profit after tax of R87 million (2007: R186 million), reflecting the effect of investment returns.

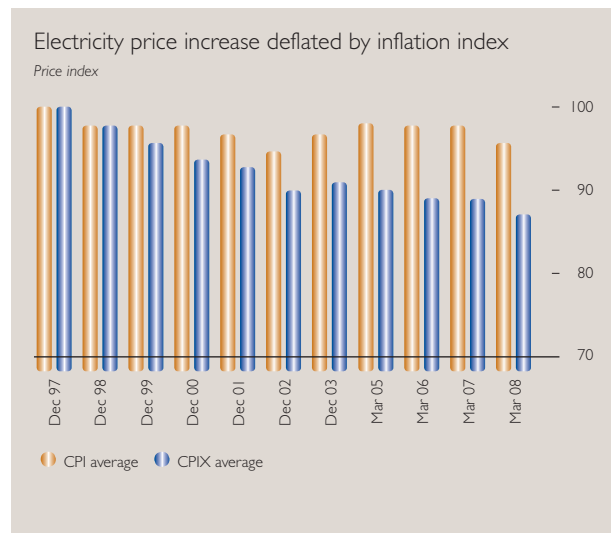
Gallium continues to be used on a limited basis, with Escap fulfilling substantially the full insurance mandate for Eskom. The ongoing role of Gallium is considered on a year-by-year basis.

Gallium's underwriting profit for the year is R10 million (2007: R109 million), with a net profit of R63 million (2007: R200 million). Gallium paid a dividend of R800 million to Eskom during this financial year (2007: R200 million).

Achieving the requested price increases

In December 2007, Nersa awarded Eskom a revised price increase of 14,2% for the year to March 2009, being the third year of the first multi-year price determination (MYPD 1). This was less than the increase of 18% that Eskom requested. In addition, Nersa did not allow the rule changes for MYPD 1 applied for by Eskom, stating that the rule changes would be addressed in the second multi-year price determination (MYPD 2), which will only be finalised by September 2008. Refer to page 37.

Refer to www.eskom.co.za/annreport08/005 for details on Eskom's average tariff adjustments for the last 15 years compared to CPI.



Steep increases in the short-term contract price of coal and general coal inflation over the past year placed operating costs under enormous pressure. The power shortages at the end of 2007 necessitated the increased operation of the open-cycle gas turbines, which consume large volumes of diesel that had to be purchased at a time when the oil price was at a record high, coupled with a weakening rand against the dollar.

Revenues from electricity sales are first used to cover operating costs, with the balance being applied to the funding required for the expansion programme commitments. The balance of the funding will be sourced from borrowings on the local and foreign markets and from the shareholder, which is the government of South Africa.

The borrowing capacity for debt finance is dependent on the market's willingness to lend and Eskom's ability to service the debt. The cost of servicing the debt, and the market's willingness to lend, are directly linked to Eskom's credit rating from rating agencies. A limitation on the borrowing capacity of Eskom both in the local and foreign markets has been quantified at R150 billion over the next five-year planning period.

Rating agencies, aware that the 14,2% price increase for 2009 was inadequate to cover the enormous increase in operating costs, let alone contribute towards the servicing of loans necessary for the capital expansion, placed Eskom on credit watch in February 2008.

The Minister of Finance announced a R60 billion shareholder support programme during the annual budget. Terms and conditions are being finalised. Following the announcement of the lower than expected price increase of 27,5% for 2008/09, the drawdown from the shareholder loan is expected to be bigger than originally expected for 2008/09.

In March 2008, Eskom submitted an application to Nersa for a revision of the price increase for the year to March 2009 from 14,2% to a nominal 60% (53% real). This is to enable Eskom to recover the full primary energy and other operating costs, and

to earn a realistic return to enable it to fund both servicing and scheduled repayments of the capital expansion programme.

The capital expansion plan has a high risk of escalation due to the tight supply market, exchange rate movements, higher inflation, skills shortages, the acceleration of projects and higher commodity prices.

Eskom's proposed tariff increase of 53% real to Nersa resulted in the urgent call for Nedlac to convene a "national energy summit". The meeting was in response to a call by the African National Congress (ANC) and other stakeholders for further consultation and explanation of the request by Eskom for the tariff increase.

The summit raised the point that electricity tariffs should ensure the sustainable development of the industry but that it must avoid imposing unacceptable costs to the poor/or an excessive shock to the economy.

The way forward as suggested by the summit is summarised as follows:

- constituencies to work together and agree on price increases over the next five years
- the increases granted will be subject to Nersa regulatory processes
- price increases to be phased in
- Eskom would require fiscal injections to support the credit rating
- demand-side management funding to be excluded from the tariff
- special arrangements are needed to protect low-income households

Nersa announced on 18 June 2008 an additional increase in the electricity tariff of 13,3% for the year ending March 2009 which resulted in a 27% average increase year-on-year. Nersa also ruled that the price increase to "poor" residential customers be limited to 14,2%.

A substantial price increase is essential to strengthen electricity supply in South Africa.

Nersa made the following comments in their announcement:

- they recommended that in order for Eskom to maintain a strong balance sheet to support its borrowing capabilities, that the drawdown profile for the R60 billion funding from government be reviewed so that Eskom maintains a healthy credit rating
- that a mechanism be developed by Nersa that will take into account unforeseen changes in primary energy and other costs. This mechanism must also take into account the efficiency of costs, the prudence with which the costs are incurred, Eskom's measures to control these costs and its ability to predict such costs at the time of application
- the principle of smoothing the prices is supported as part of the MYPD
- if the current economic climate continues to prevail and Eskom's capital expenditure remains as is, then tariff increases of 20% to 25% per annum are projected over the next three years
- Eskom's conditions of licence will be amended with the objective of ensuring that Eskom manages its risks efficiently and optimally, particularly in regard to primary energy costs
- accelerated demand-side management (DSM) of R2,5 billion was disallowed by Nersa. The DSM programme is a vital component of ensuring security of supply. In order to continue with these programmes, government would need to fund the initiatives

The chief executive's response to the announcement by Nersa was that it sets Eskom and the energy sector in general on the path to long-term financial sustainability. However, even with the 27,5% price increase, Eskom will make a loss in 2009. Increased shareholder support will make up for lower cash flows from operating activities.

Refer to www.eskom.co.za/annreport08/006 for more information regarding the capital expenditure programme.

Second multi-year price determination (MYPD 2)

The existing MYPD 1 will conclude at the end of the 2009 financial year. We are in the process of applying for the second multi-year price determination (MYPD 2) for the three years ending in March 2010, 2011 and 2012.



Coal trucks offloading at the Majuba power station stockyard.

In the MYPD 2 application we ask Nersa to take into account the current operating conditions when determining the new prices. To do this, we have requested Nersa to consider the following MYPD rule changes:

- the current MYPD rules allow for volume changes in primary energy costs while rate/price changes are not allowed. Eskom proposed that we also be allowed to recover primary energy price increases when setting the tariffs
- the current rule allows for compensation of capital expenditure only in the following MYPD cycle. As a result of the accelerated expansion programme, Eskom requested that the rule be changed to allow for compensation when the capital expenditure is made
- the trigger for reopening prior years be changed from one which focuses only on the revenue amount, to one that will be based on an earnings band which includes costs as well
- the other critical rule change is to allow depreciation on modern equivalent replacement value. At the moment Nersa uses an indexing method based on historical values

These rule changes were requested by Eskom and disallowed by Nersa in the December 2007 ruling.

Performance review continued

Nersa clawback

Nersa pre-determines revenue limits based on prudent costs that it allows to be recovered through the tariff and a fair rate-of-return calculation on the regulated asset base. In 2008, higher sales growth resulted in revenues higher than the pre-determined limits. In terms of the regulatory rules, this is deemed to be a clawback or over-recovery. Nersa uses these over-recoveries to reduce future price increases.

In terms of International Financial Reporting Standards, the clawback cannot be recognised as a charge to the income statement nor can the corresponding liability (or asset) be raised.

Tariff restructuring

Our strategy for tariffs is to build on cost-reflective signals that promote economic efficiency and sustainability. Our tariffs support both energy and capacity efficiency, through time- and seasonally-differentiated energy rates with cost-reflective network charges, to optimise the use of networks.

The tariffs are designed to be as non-discriminatory as possible by taking into account the needs of all customers on a fair and equitable basis. This is why our tariff options are based on consumers' demand sizes with charges differentiated by location and voltage for the larger supplies.

Eskom standard tariffs already include various pricing signals for efficiency, but will be reviewed to ensure maximum support for the latest energy conservation initiatives. Initiatives to enhance energy efficiency include the development of the following pricing efficiency signals:

- the update of the notified maximum demand rules will ensure a strong pricing incentive not to exceed the notified maximum demand
- a price signal to incentivise customers to improve low power factors that will encourage the efficient use of electricity and promote energy savings

In the medium term we are moving into a period of high annual price increases. We fully recognise that the proposed increases could have a negative impact on the poorer customers, with

undesirable social impacts. In order to address this concern we have proposed that the impact of the proposed price increases be limited for poorer customers by minimising the increase to the Homelight tariff (mostly prepayment customers). Nersa limited the price increase for these customers to 14,2%.

Refer to www.eskom.co.za/annreport08/007 for more information regarding tariff restructuring.

Explaining tariff subsidisation

Tariff subsidies

Statements have been made in the press that industrial customers are subsidised by residential customers by comparing the average prices between the two categories. The fundamental mistake is to ignore the fact that the cost to supply the average industrial customer is significantly less than the cost to supply a residential customer. When considering the average price of electricity for different customer categories, it is important to understand the electricity supply cost chain and where exactly in this chain the different customers take their supply.

Smaller customers have a much higher cost per kWh than larger customers for the following reasons:

- typically a residential customer is supplied on the network at a low voltage whereas a large industrial customer would be supplied on the network at a high voltage. This means that many more electrical networks have to be built, maintained and operated to supply smaller customers than those that are required for larger customers on higher voltage networks
- more electrical losses occur at the lower voltages as the electricity has to travel greater distances
- as a ratio of overall consumption, smaller customers also tend to use much more electricity in the more expensive peak periods and have a poorer load factor than larger customers. This means that their average cost of electricity per kWh is higher than that of a larger customer who uses electricity more evenly throughout the day

Refer to www.eskom.co.za/annreport08/008 for further explanation as to how the cost of supply is determined and justified.

Actual savings from the strategic sourcing initiative were R3,1 billion, against a target of R1,5 billion.

Capital and funding strategies

The capital expenditure plan of R343 billion (nominal) over the next five years requires significant access to all funding sources ie, equity, debt and appropriate revenue. Eskom has determined that it can realistically raise directly from the capital markets up to R150 billion during this timeframe, which addresses both market appetite and maintenance of credit rating metrics. The remainder will thus need to be sourced from equity and electricity price increases. Eskom has undertaken much financial modelling to determine the optimum mix of equity and electricity tariffs within the context of maintaining its credit rating to ensure sustainable access to and cost-effective pricing of debt. The Nersa decision in June 2008 has informed us of the residual funding gap, which will require shareholder assistance beyond the R60 billion already committed. The terms and conditions of this assistance are currently under negotiation but it is certain to provide a funding foundation from which rating agencies and other lenders can take comfort.

Eskom's funding philosophy remains to responsibly maximise our access within the local market and diversify our international borrowing opportunities.

Late in the financial year 2006/7 Eskom launched a new bond, the ES26, and proceeded to tap the market predominantly via this instrument throughout the year. Eskom was rewarded by the Bond Exchange of South Africa (BESA) via its members by receiving a Spire Award for the best new issuance for 2007.

This was achieved purely via local financing. During the year new international facilities were negotiated and are linked to spending on particular projects and hence will be drawn as projects progress.

Eskom found it necessary to increase the authorised volume of the ES26 and ES33 within the R65 billion domestic multi-term note programme listed with BESA from R10 billion to R15 billion each in order to meet ongoing investor demand.



Workers remove wet coal jamming conveyor belts at Duvha power station.

Investor concerns regarding the vastness of the funding requirement and sources thereof, resulted in Eskom spreads versus government bonds widening significantly during the year. During the year under review our funding strategy unfolded well, however, the final quarter brought rating agency actions that provided an additional challenge. Eskom postponed an intended international loan pending the outcome of rating agency deliberations. This is expected to be resolved in July 2008.

In January, in a bid to broaden liquidity of Eskom bonds, Eskom formalised five banks to act as supplementary market makers alongside Eskom. As this is a new endeavour Eskom will evaluate it on an ongoing basis and encourage its success in the interests of our investors.

Procurement and supply chain

The objective of procurement and supply chain management is to secure supply while balancing the competing objectives of lowering the total cost of ownership and ensuring the quality, timing and safety of our purchases, while at the same time meeting Eskom's Asgisa objectives. These include broad-based black economic empowerment targets and the initiation of competitive supplier development programmes. (Refer to page 43 for the Asgisa objectives.)

Performance review continued

Strategic sourcing strategy

Eskom launched a strategic sourcing initiative during 2006 in support of our objectives of maintaining quality and continuity of supply, capacity expansion and building sustainable supply chain security.

Supply market volatility has seen suppliers struggling to meet demand and an increase in prices, quality concerns and delivery lead times. As supply tightens, many of Eskom's traditional suppliers are increasingly declining to tender for work, thereby increasing the need for global sourcing for new suppliers¹.

Within this volatile climate, multiple long-term contracts have been placed, ranging up to 10 years, and additional commodity strategies are at various stages of development to ensure that long-term requirements and savings targets are met.

Actual savings from the strategic sourcing initiatives were R3,1 billion, against the target of R1,5 billion for the year. This brings the total inception-to-date savings to R3,9 billion against the overall savings target of R7,8 billion over the five years to 2011.

Competitive supplier development programme

Eskom has implemented the competitive supplier development programme (CSDP) of the Department of Public Enterprises, which aims to increase the competitiveness, capacity and capability of the local supplier base in South Africa. The CSDP obliges suppliers with import contracts exceeding USD10 million, to invest 30% of the imported contract value within the power industry and related supplies.

In line with this programme, Eskom will select established equipment manufacturers that are willing to develop local factories. By having equipment manufactured in South Africa, we will benefit from the improved competitiveness of the products and the securing of long-term local supply options with local industry.

The improvement in the capacity and competitiveness of our local supplier base will contribute to the Asgisa goals of shared growth, employment creation, poverty reduction, skills development, and broad-based black economic empowerment (BBBEE). South African partners will participate in Eskom's expected R1,3 trillion spend on power infrastructure up to 2025 and create about 66 000 jobs.

Black economic empowerment (BEE) performance

Eskom makes a significant contribution to black economic empowerment by supporting black-owned businesses and black women-owned businesses. This is reflected in the group procurement spend of R25,4 billion against a target of R19 billion, being 67% of discretionary spend. (This excludes procurement from Eskom group businesses, public enterprises and state departments, as well as costs relating to human resources such as salaries and wages. It includes expenditure on coal and demand-side management.)

	Target 2008 Rm	Actual 2008 Rm	Actual 2007 Rm
BEE expenditure			
Eskom company			
Total BEE expenditure	17 855	23 492	15 429
Black women-owned businesses (included in total BEE expenditure)	3 214	3 083	2 039
Eskom group			
Total BEE expenditure	18 955	25 447	16 557
Black women-owned businesses (included in total BEE expenditure)	3 412	3 188	2 096

The 2009 target is that 70% of all discretionary expenditure should be with BEE businesses, and 20% of that with black women-owned businesses. Eskom will continue to empower black women-owned businesses to accelerate their participation in the mainstream economy.

¹ Source: Power Advocate Market Intelligence Report March 2008.

The company recorded a productivity loss of 9% or R4 060 million.

Information technology

Information and the management thereof is integrated in all aspects of Eskom's business and supports about 30 000 users.

In the past year we have kept all the mission-critical systems operational with high availability and reliability. Diligent disaster recovery and redundancy planning ensured that critical systems, such as the National Control Centre, remained operational at all times. New solutions and communication mechanisms have been implemented with extensive upgrades to the load shedding website, in response to the electricity challenges. We are building and deploying world-class information technology infrastructure and systems that will enhance efficiency and effectiveness in the new power stations being built.

Our systems have withstood a significant increase in system attacks and global hacker activity. A business impact risk assessment ensured that critical systems are identified and monitored for all possible intrusions and disruptions. Virus infections have been prevented and no mission-critical system unavailability occurred during this period.

Productivity performance

The measurement of productivity improvement provides a better understanding of business performance by analysing the change in net income between two accounting periods in terms of the impact of productivity, inflation (price recovery) and growth.

Productivity improvement occurs through the more efficient and effective use of all operating and capital resources, which include coal, employees, other expenses and assets.

Price recovery refers to the relationship between the price increases passed on to customers and the inflationary impact on the cost of resources to Eskom. Growth represents the change in net profit when resource quantities and prices change at the same rate as electricity sales quantities and prices.



Healthy coal stockpiles at Matimba power station.

Overall productivity performance for Eskom

	March 2008 Rm	March 2007 Rm
Net profit before tax	979	8 437
Net profit before tax for the previous period	8 437	7 167
Change in net profit before tax	(7 458)	1 270
Adjustments not impacting on overall performance ¹	3 036	(1 206)
Change in adjusted net (loss)/profit before tax	(4 422)	64
This is attributable to:		
Net productivity (decline)/gain	(4 060)	667
Price under-recovery	(731)	(1 139)
Growth	369	536
Total	(4 422)	64

¹ Fair value gains/losses on financial instruments, asset impairments, insurance proceeds, depreciation restatement in compliance with IFRS and other adjustments are specifically excluded because they do not impact productivity.

Performance review continued

Productivity and price recovery

The company recorded a productivity loss of 9% or R4 060 million. This was due to the difference between the substantial increase in resource costs compared to a more moderate sales growth. The actual weighted sales growth was 3,2%, while the actual resource quantities over the same period increased by 13,3%. Sales quantity growth would have been higher were it not for the recent aggressive demand-side management focus and load shedding.

The price under-recovery was 1,8% or R731 million and resulted from the difference between a weighted tariff increase of 7,8% (the Nersa tariff increase for 2008 was 5,9%) and the 9,8% inflation which Eskom was subjected to in terms of the price of resources. The weighted sales price increase is higher than the Nersa-approved increase mainly due to the impacts of commodity-linked pricing deals with certain key customers that fall outside the Nersa price determination parameters. These commodity-linked price deals have made a favourable contribution to the price recovery, though insufficient to make a total price over-recovery.

The contribution to productivity performance from the major resource categories is set out below and is split between capacity utilisation and efficiency.

	March 2008		March 2007	
	Rm	%	Rm	%
Total productivity (loss)/gain	(4 060)	(9,0)	667	1,9
Primary energy (including electricity purchases)	(2 781)	(14,7)	(162)	(1,2)
Manpower	(284)	(3,1)	(273)	(2,9)
Other operating expenses	(309)	(3,3)	906	14,2
Capital	(686)	(8,5)	196	3,2
Total productivity	(4 060)	(9,0)	667	1,9
Capacity utilisation	715	1,6	1 029	2,9
Efficiency	(4 775)	(10,5)	(362)	(1,0)

Primary energy reflects a productivity decline of R2 781 million or 14,7%. This resulted from an increased usage of gas turbine power stations (diesel) and increases in both the quantities and price of coal burnt. The price under-recovery for primary energy was R1 573 million.

Operational manpower costs increased by 6,6% in 2007/8 while recorded sales quantities increased by 3,2%, resulting in a productivity decline of R284 million or 3,1%. This reflects the impact of additional staffing to cater for expanding operational needs.

Other operating costs reflect a productivity loss of R309 million or 3,3%. This is attributable to increased maintenance and demand-side management costs.

Capital (depreciation, interest and finance charges) reflects a productivity loss of R686 million or 8,5%, largely attributable to increased borrowing costs.

The unfavourable efficiency of R4 775 million reflects the short-term impact of the accelerated capacity expansion drive, demand-side management, increased utilisation of expensive diesel-fired power stations and lower grade coal, and the impact of load shedding against the tide of resource increases.

Long-term Eskom competitive position

This year's productivity loss has reversed the 10-year positive trend, to record a cumulative productivity loss of R1 056 million. This reversal reflects the effect of supply issues and unsustainable price under-recovery from less-than-optimal price increases of electricity.

Refer to www.eskom.co.za/annreport08/009 for a graph of Eskom's competitiveness over 10 years.