ADDITIONAL INFORMATION ON ESKOM CHAIRMAN'S STATEMENT ISSUED TODAY

11 June 2016

BACKGROUND TO ARNOT POWER STATION COAL SUPPLY

Exxaro Arnot Colliery had a contract with Eskom to supply coal to Arnot Power Station for 40 years. This contract expired in December 2015. The cost of coal at expiry was R1132/ton. The tonnages supplied under the contract were below contractual volumes necessitating Eskom to supplement the supply with other contracts to mitigate security of supply which was a continuous challenge. In anticipation of the expiry of the contract, a Request for Proposal (RFP) was issued to the market in August 2015. This RFP is currently under evaluation and is expected to be awarded by September 2016. It should be noted that Tegeta has not responded to this RFP.

TEGETA AND UMSIMBITHI TRANSACTION

1. Independent intelligence obtained of a potential protest action at Rietkuil and surrounding areas increased the security of supply risk, prompting a declaration of an emergency in December 2015.

2. Continued monitoring of the security of supply risk from January to March revealed the need to build up stock requirements also coincided with strike action at Umsimbithi. This placed a further strain on stock levels prompting an immediate need for additional coal.

3. Subsequently initiatives were pursued which resulted with several suppliers, namely Hlagisa, South 32 (BECSA), Exxaro - North Block Complex Colliery (NBC), Umsimbithi, Glencore Arthur Taylor Colliery, Just Coal (Pembani and Bankfontein), Keaton Mining (Pty) Ltd, Vunene Mining (Pty) Ltd Colliery, Tegeta Brakfontein, Optimum Coal Mine supplying coal to Arnot Power Station in January 2016.

4. This was a temporary and sub-optimal measure as the coal was not all of the required coal quality for Arnot Power Station. Hence an alternative solution was needed to source the required coal quality due to the adverse effect on generation plant performance and maintenance.

5. In April 2016 the following suppliers (Exxaro (NBC), Hlagisa, Umsimbithi and Tegeta (Optimum)) remained supplying Arnot while the balance of the suppliers indicated above were redirected to supply their original designated Power Stations.

Issued by: Eskom Media Desk
Tel: +27 11 800 3304/3343/3378
Cell: +27 82 805 7278
Fax: 086 664 7699
Email: mediadesk@eskom.co.za

6. Exxaro (NBC), Hlagisa, Umsimbithi and Tegeta (Optimum) continued to supply Arnot, however, a deficit of 2.1M tons remained for the winter supply plan.

7. Exxaro (NBC) and Hlagisa were supplying the maximum quantities possible from their respective mines and consequently could not increase supply to mitigate the 2.1M ton shortfall.

8. The two remaining suppliers, namely Umsimbithi and Tegeta, were approached to increase supply to mitigate the shortfall. Both suppliers were able to meet Eskom's requirements for additional coal quantities at the required coal quality which resulted in approval for extension of both contracts.

9. Tegeta indicated that the required coal quality can only be sourced if they divert their export quality coal to supply Eskom. In addition, there was an indication that additional equipment was needed to reach the required tempo of coal delivery to Eskom that would mitigate the shortfall. These factors led Tegeta to request a prepayment from Eskom.

10. Umsimbithi indicated that they are able to supply additional coal with no additional resource requirements.

11. Eskom concluded a contract with Tegeta to supply 1 250 000 tons of coal from April to September 2016 and have approval to extend the contract with Umsimbithi to supply 540 000 tons from June to September 2016. These two contracts in our view sufficiently address the winter shortfall and security of supply risk relating to coal procurement.

12. The cost of coal from Tegeta was R19.70/GJ and the cost from Umsimbithi was R18.50/GJ, the price difference being explained by the higher rejection level requirement for Tegeta. In both instances we would like to point out that the cost is far lower than the cost of approximately R51/GJ from the original Exxaro Arnot colliery that expired in December 2015.

13. The Tegeta prepayment request was considered on its merits, the current security of supply risk circumstance and previous transactions of a similar nature which is discussed below.

14. Additional conditions relating to the prepayment included a 3% prepayment discount on the coal price and sufficient security guarantees. The coal CV requirement was increased due to the prepayment request. In addition penalties are applicable in the event that Tegeta does not provide the contracted qualities.

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15. Tegeta performance against the contract indicates that they are supplying coal with the contracted specification and are expected to deliver all tons, possibly ahead of the contract period.

16. Therefore, the transactions concluded with Tegeta and Umsimbithi are considered to be;
    - on an arms-length basis
    - with significant commercial benefits accruing
    - Eskom has mitigated security of supply risk, the commercial aspects while
    - Ensuring generation performance and reduced maintenance due to high quality coal

17. These transactions have enabled Eskom to commit to no load shedding during the winter peak period which is a significant commitment to the country.

18. To ensure long term security of supply to Arnot Power Station the current RFP process is projected to be complete by September 2016. It is noteworthy that Tegeta is not one of the respondents to this RFP that has been issued to the market.

PRE PAYMENT FOR COAL – COMMON PRACTICE

19. Prepayment is a common commercial practice that is used widely and not unique to Eskom contracts. It is used in in large projects, coal mining contracts and emergency supply contracts. The first Eskom coal emergency arose is 2008 after load shedding due to constrained coal supply conditions.

20. During the 2008 emergency, Eskom Board approved advance payments to the value of R400M to enable suppliers to undertake projects needed to supply coal. To this end, Eskom concluded a coal processing contract with Isambane (Pty) Ltd with prepayment terms. Three loans were granted to Isambane. Isambane was then required over a period of time to conduct beneficiation and stockpiling services. The agreement was that Isambane would perform these services and eventually pay off the prepayment.

21. Furthermore, a prepayment in the form of a loan was provided to Liketh in 2008 to buy equipment to process coal from Kleinkopje Pit 5 West. The loan was recovered in 12 consecutive instalments from 1 March 2008.

22. Eskom has also entered into loan agreements to assist Rand Mines for capital expenditure. The first loan was payable over a period of 20 years until 31 December 2013. The second loan was in 1998, and it will be paid in full by December 2017. Eskom also assisted another Rand Mines operation with a loan for bridging finance. This loan is paid up.

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23. In cost-plus mine contracts, Eskom pre-paid the mines to start up the mining operations. It subsequently pays for the operating costs and a management fee. In return Eskom receives security of supply at the right qualities and volumes. The cost plus mines future investment/prepayment capital requirement is R38bn. The beneficiaries of the R38bn are Anglo, Exxaro and South 32 (formerly BHP Billiton). This up-front payment is in line with the agreed 40 year long term contracts.

24. In October 2015, Exxaro requested full funding of its Matla cost-plus operation capital requirement. The estimated cost requested by Exxaro is R1.8bn for the establishment of a new mining shaft.

COAL QUALITIES AN INDUSTRY-WIDE ISSUE

25. Eskom continues to measure and monitor the coal qualities from all its suppliers. Tegeta coal qualities are monitored in accordance with Eskom's Coal Quality Management Procedure. This includes Tegeta Brakfontein Colliery and Optimum Coal Mine. The Brakfontein colliery is dedicated to Majuba and it meets Eskom's coal quality requirements. This coal, like any other, is periodically diverted on a short term basis to alternative Power Stations to meet minimum coal stock requirements.

26. The Optimum Coal Mine provides two coal qualities to Eskom. The Optimum – Hendrina supply is a blended product of run-of-mine and washed product. This is supplied under the existing Optimum-Hendrina contract that expires in 2018.

27. The second product from Optimum from their export mining compound. It is a higher quality coal and this is supplied to Arnot under the current short term agreement.

28. It should be noted that Eskom has a claim against Optimum for R2bn relating to out of specification coal delivered. Eskom has vigorously pursued this claim with the previous owners of Optimum, registered its rights with the business rescue practitioners and also indicated its intention with the new owners of Optimum being Tegeta that Eskom will be pursuing this claim.

ESKOM'S RESPONSE TO COAL SUPPLY CHALLENGES

29. In general, Eskom has experienced numerous coal quality challenges with various suppliers, including long-term tied collieries. To mitigate this exposure, Eskom has, over time, improved on coal quality monitoring, assurance, and lately risk transfer. A number of changes are being considered and will be implemented for all new contracts and renegotiated for all contracts. These changes are as follows:
    - transfer of coal quality certification and payment point to receiving point, power stations versus current quality pre-certification at the supply point by an Eskom-appointed and -managed laboratory contractor;

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- withholding of payment or coal price adjustment in the event that coal quality at the delivery point is inferior to contractual qualities; and
- up-front payment of a quality deposit by suppliers to Eskom.

30. Eskom continues to engage the industry on coal quality, as well as coal pricing, in order to ensure receipt of an optimal coal product at the right price. To this end, current coal contracting discussions are aligning coal pricing and escalations in line with Nersa coal cost determinants. Commercial decisions that consider security of supply, risks associated with coal costs, and optimal cost of coal continue to be balanced, ensuring that the optimal decisions are in the interests of Eskom and the South African consumer.

ENDS.

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