MOODY'S
INVESTORS SERVICE

Credit Opinion: South African National Roads Ag. Ltd (The)

Global Credit Research - 17 Nov 2014

Pretoria, South Africa

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa3
NSR Issuer Rating -Dom Curr	A3.za
ST Issuer Rating	P-3
NSR ST Issuer Rating -Dom Curr	P-2.za

Contacts

Analyst	Phone
Daniel Mazibuko/Johannesburg	27.11.217.5470
David Rubinoff/London	44.20.7772.5454

Key Indicators

South African National Roads Ag. Ltd (The)

	2010	2011	2012	2013	2014
Total Assets (ZAR million)	187 084.0	220 490.6	268 713.7	275 914.7	310 991.9
Operating margin (%)	24.1	8.5	2.9	31.9	-2.1
Surplus (Deficit) for the Year / Total income (%)	-9.6	-29.1	-35.1	7.9	-30.5
Total Debt / Total Assets (%)	13.4	14.8	14.0	13.1	12.7
Debt / Cash flow from operations (x)	28.4	18.9	19.2	-49.9	49.9
Cash interest cover ratio (x) [1]	0.6	0.8	0.9	-0.3	0.2
Current Assets / Current Liabilities (x)	1.5	1.2	0.9	0.4	0.4

[1] Cash flow from operating activities

Opinion

SUMMARY RATING RATIONALE

The South African National Roads Agency SOC Ltd's (SANRAL) ratings of Baa3/P-3 (global scale, local and foreign currency) and A3.za/P-2.za (South African national scale) are supported by the company's legal status as a public-sector entity, its close financial and operational linkages with the South African government, which also guarantees 60% of the company's debt, and the traditionally prudent financial management. The ratings also take into account the entity's high debt levels, which we expect to grow further and volatile revenue collection from e-toll project.

The ratings are supported by the very high probability of extraordinary support from the national government in the event that the entity faced acute liquidity stress.

On 10 November 2014, Moody's affirmed the long-term issuer ratings of SANRAL at Baa3/P-3 and A3.za/P-2.za.

Credit Strengths

The credit strengths for SANRAL include:

- State ownership and public-policy mandate

- Close integration with the central government, which also guarantees a sizeable proportion of SANRAL's debt

Credit Challenges

The credit weaknesses for SANRAL include:

- Limited track record of e-toll collection, mitigated by supportive legal framework

- Expenditure pressure from maintenance of existing infrastructure

- Very high debt levels and expected increase in borrowing needs

Rating Outlook

SANRAL's outlook is stable.

What Could Change the Rating - Up

A rating upgrade will require evidence of SANRAL's capacity to consolidate toll revenue collections. A structural improvement in the company's financial position, leading to lower than anticipated borrowing needs, could also exert upward pressure on the ratings.

What Could Change the Rating - Down

Any failure by SANRAL to generate sufficient e-toll revenue leading to deteriorating cash flows and growing borrowing needs, would exert downward pressure on the ratings.

Issuer Profile

SANRAL has the status of a public-sector entity, wholly owned by the Republic of South Africa, with the Ministry of Transport representing the government as the sole shareholder. The company is ultimately accountable to the central government, which established SANRAL's mandate to develop, finance and manage the national road infrastructure in South Africa.

DETAILED RATING CONSIDERATIONS

SANRAL's rating combines (1) a baseline credit assessment (BCA) for the entity of ba3, and (2) our assessment of a very high probability of extraordinary support from the national government in the event that the entity faced acute liquidity stress.

Baseline Credit Assessment

STATE OWNERSHIP AND PUBLIC-POLICY MANDATE

SANRAL was established in 1998 by an Act of Parliament as an independent statutory company operating along commercial lines and at arm's length from the central government. As a national public entity under the Public Finance Management Act, SANRAL is not subject to privatisation and cannot be declared bankrupt; it does not pursue profit as a business objective, and it is tax exempt. SANRAL's legal status is also regulated by the South African National Roads Agency Limited and National Roads Act, No 7 of 1998.

The company operates under a mandate from the central government and operates under well-defined treasury-related corporate governance rules. The government is responsible for overall policy, and it approves new projects, annual transfers for non-toll road operations, toll charges, public and private partnership (PPP) initiatives, new debt and guarantees for new debt.

In South Africa, transport has traditionally played a central role in the creation of jobs and promoting economic transformation, sustainable growth and resource development. The government mandated SANRAL to consolidate and expand the national roads network, with a focus on maintaining the network in good order and resourcing finance from alternative sources to that of tax-based revenues. According to official sources, the national roads network is an integral part of the state infrastructure and there is no political will to privatise the network, nor would it be practical to do so.

CLOSE INTEGRATION WITH THE CENTRAL GOVERNMENT, WHICH ALSO GUARANTEES A SIZEABLE PROPORTION OF SANRAL'S DEBT

SANRAL's management structure and governance clearly indicate strong controls by the South African government. SANRAL receives regular transfers from the national government for the non-toll road network under management. The non-toll business accounted for approximately 60% of SANRAL's revenue in 2014, while tolls accounted for the remaining 40%, of which around 25% is associated with the Gauteng Freeway Improvement Project (GFIP) scheme.

In April 2014, the national government revised the wording of its guarantee on SANRAL's debt - granting note holders direct recourse to the national government. This change further clarifies the national government's commitment to sustaining SANRAL financially and backing its financial obligations. Approximately 60% of SANRAL's total debt stock is guaranteed by the national government.

The revised wording of the aforementioned guarantee follows an extraordinary grant of ZAR5.8 billion in 2012 to compensate SANRAL (1) for the revenue loss associated with the delay of its biggest toll project (the GFIP) amidst legal challenges as well as public opposition to the e-toll project; and (2) for the government's decision to lower the GFIP toll fees. This extraordinary allocation sustained the entity's finances and enabled SANRAL to cover operating costs, including finance charges on the large debt the entity accumulated for the construction of GFIP.

LIMITED TRACK RECORD OF E-TOLL COLLECTION, MITIGATED BY SUPPORTIVE LEGAL FRAMEWORK

The recent implementation of electronic tolling operations on the GFIP, resulted in a substantial increase in SANRAL's total toll revenue to ZAR3.5 billion for the financial year ended March 2014 (FYE2014), from ZAR2.1 billion at FYE2013. Revenue from e-tolls improved cash flows from operations to approximately ZAR794 million as at FYE2014, from a deficit of ZAR726 million in 2013.

Since e-tolls were implemented on 3 December 2013, SANRAL has collected ZAR678 million for the first six months ending on 31 May 2014, which was well above projections, however we do not expect the momentum to last for the rest of 2014. In addition, Moody's notes that e-toll collections have declined significantly since July 2014, following the Gauteng premier's decision in July to establish a panel to review the economic impact of doing business in the region, which sparked concerns among the general public that the project may be put into question. As a result, SANRAL has revised collections from e-tolls down to ZAR907 million from ZAR1.4 billion initially projected by FYE2015, a more realistic target given the strong public opposition to the GFIP. While Moody's will continue to monitor e-toll collections in the coming months to assess the impact that a prolonged decline in e-toll collections could have on the rating, we take comfort in the fact that the Transport and Related Matters Amendment Bill of 25 September 2013 provides SANRAL with the necessary legislative instruments to enforce e-toll payments and that the outcome of the review panel is unlikely to have any impact on the project, since the provincial tier has no jurisdictional power on SANRAL.

The toll business has grown over the years and contributed 40% of SANRAL's total revenue in 2014. The remaining 60% of SANRAL's revenue was comprised of government transfers for non-toll roads. The two budgets are not fungible. In addition to the contentious e-tolls under the GFIP, SANRAL is also involved in PPP projects, under which the company offers toll road concessions to private companies under build-operate-transfer (BOT) contracts. Of the total current toll road network of 3,120 km, SANRAL directly manages about 60%, and offers the remainder under concessions. We view off-balance sheet PPP projects as low risk, as BOT contracts basically transfer operational risks, including construction and funding, to third parties.

EXPENDITURE PRESSURE FROM MAINTENANCE OF EXISTING INFRASTRUCTURE

Maintenance of the national road network remains a challenge for SANRAL. The BCA of ba3 reflects SANRAL's ambitious capital program and the consequent anticipated increase in debt stock in the medium term. The company plans to spend ZAR4.3 billion on maintenance of the existing toll road network and ZAR12.1 billion on capital expenditures in the period 2014-17. That said, we note SANRAL's commitment to prudently manage the execution of its capital programme and adjust expenditure according to budgetary resources and borrowing plans.

VERY HIGH DEBT LEVELS AND EXPECTED INCREASE IN BORROWING NEEDS

SANRAL is one of the country's largest borrowers, as indicated by debt stock amounting to ZAR39.6 billion at FYE2014. The South African government guarantees 60% of these interest-bearing liabilities, and the remaining

40% is composed of senior unsecured debt. The unutilised portion of the guarantee, whose terms were revised in April 2014 in favour of note holders, is ZAR15.0 billion and will reduce further to ZAR12.8 billion by FYE2015. Moody's expect the entity's debt stock to rise to ZAR41.5 billion by FYE2015, following planned issuances of ZAR5 billion under government guarantee and the redemption of ZAR2.8 billion debt.

SANRAL has relied extensively on borrowed funds in order to finance its operations and capital expenditure (capex), benefitting from the South African government guarantee. The ZAR20 billion debt incurred for GFIP construction contributed the most to SANRAL's debt growth in recent years.

Extraordinary Support Considerations

Our assessment of the very high probability of extraordinary support from the South African government primarily reflects SANRAL's status, which, combined with the government guarantee on 60% of SANRAL's debt stock, suggests ultimate support of the central government. SANRAL performs its role - a critical component of the government's social and economic policy - on behalf of the central government. In contrast to other state-owned South African companies, there is no risk of migration towards a corporate structure.

Moody's also assigns a very high level of default dependence between SANRAL and the South African government, as SANRAL is subject to the same political and economic risks that can affect the country.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".mx" for Mexico. For further information on Moody's approach to national scale credit ratings, please refer to Moody's Rating Methodology published in June 2014 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings".

The Moody's Global Scale rating for issuers and issues allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Baseline Credit Assessment

Baseline credit assessments (BCAs) are opinions of entity's standalone intrinsic strength, absent any extraordinary support from a government. Contractual relationships and any expected ongoing annual subsidies from the government are incorporated in BCAs and, therefore, are considered intrinsic to an issuer's standalone financial strength.

BCAs are expressed on a lower-case alpha-numeric scale that corresponds to the alpha-numeric ratings of the global long-term rating scale.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0 - 30%), moderate (31 - 50%), strong (51 -70%), high (71 - 90%) and very high (91 - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases GRIs demonstrate moderate to very high degrees of default dependence with their supporting governments, which reflects the existence of institutional linkages and shared exposure to economic conditions that draw credit profiles together.

Default dependence is described as either low (30%), moderate (50%), high (70%) and very high (90%).

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