MOODY'S
INVESTORS SERVICE

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

Global Credit Research - 03 Oct 2012

Pretoria, South Africa

Ratings

Category	Moody's Rating
Outlook	Negative
Issuer Rating	Baa2
NSR Issuer Rating -Dom Curr	A2.za
ST Issuer Rating	P-3
NSR ST Issuer Rating -Dom Curr	P-2.za

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Key Indicators

South African National Roads Ag. Ltd (The)

	2007	2008	2009	2010	2011	2012 (P)
Total Assets (ZAR million)	9,826.3	16,690.0	30,603.7	187,084.0	220,490.6	269,264.7
Operating margin (%)	14.1	18.3	41.0	24.1	8.5	2.7
Surplus (Deficit) for the Year / Total income (%)	29.2	10.1	21.5	-9.6	-29.1	-35.3
Total Debt / Total Assets (%)	63.1	66.2	67.1	12.8	14.4	13.3
Debt / Cash flow from operations (x)	17.5	8.2	21.3	27.1	18.4	18.4
Cash interest cover ratio (x)	1.0	2.1	1.7	0.6	0.8	0.9
Current Assets / Current Liabilities (x)	1.2	1.3	2.3	1.5	1.2	1.5

P - 2012 results are preliminary

Opinion

SUMMARY RATING RATIONALE

The Baa2/P-3 (Global scale, local and foreign currency) and A2.za/P-2.za (South African national scale) issuer ratings of the South African National Roads Agency Ltd (SANRAL) are underpinned by the company's public legal status - which is regulated by the Public Finance Management Act (PFMA) -, its close financial and operational linkages with the South African government, and SANRAL's good historical financial management. The ratings also take into account the entity's high debt levels resulting from the company's largest toll road project, the Gauteng Freeway Improvement Project (GFIP), as well as pressures derived from high maintenance costs.

On 1 October 2012 Moody's affirmed SANRAL's ratings of Baa2/P-3 and A2.za/P-2.za, notwithstanding the recent downgrade of South Africa's sovereign rating to Baa1, from A3. Nevertheless, SANRAL's rating maintain the negative outlook, in line with the sovereign rating.

Credit Strengths

The credit strengths for SANRAL include:

- State-ownership and public-policy mandate

- Close integration with the central government

- Traditionally adequate management of operational risks and low risks from existing off-balance sheet public-private partnership (PPP) projects

Credit Challenges

The credit weaknesses for SANRAL include:

- Very high debt levels

- Uncertainties over Gauteng e-tolling operations

- Large debt exposure, partially guaranteed by the national government

- Expenditure pressure from maintenance of existing infrastructure

Rating Outlook

The negative outlook on SANRAL's ratings mirrors the negative outlook on South Africa's sovereign rating and reflects systemic pressure.

What Could Change the Rating - Up

Stabilization of SANRAL's ratings will likely require stabilisation of South Africa's government bond ratings.

What Could Change the Rating - Down

SANRAL's ratings could come under pressure in the event of a downgrade of South Africa's government bond rating. Although unlikely, given the recent credit positive events, an unfavorable resolution of the GFIP toll issue resulting in a further material deterioration of the company's financial metrics and cash flows will also exert downward pressure on SANRAL's rating.

Recent Developments

The one-notch downgrade of South Africa's sovereign rating to Baa1 on 27 September 2012 has not had any impact on SANRAL's rating, although it indicated a deterioration of the operating environment for sub-sovereign issuers. Moody's decision to affirm SANRAL's ratings, notwithstanding the sovereign downgrade, reflects eased concerns over the company's financial prospects following the recent Constitutional Court decision to lift the embargo on e-tolling operations on the country's largest toll road project, the Gauteng Freeway Improvement Project (GFIP).

Issuer Profile

SANRAL is a public company, 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

The rating assigned to SANRAL reflects the application of Moody's Joint Default Analysis (JDA) rating methodology for government related issuers (GRIs). In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) for the entity and then considers the likelihood of support coming from the national government to avoid an imminent default by SANRAL, should this event ever occur.

Baseline Credit Assessment

SANRAL's BCA of ba1 reflects the following factors:

Institutional Framework

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 PFMA, it is not subject to privatisation and bankruptcy; 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, PPP initiatives, new debt and guarantees for new debt. 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 nor would it be practical to do so.

Financial Performance

SANRAL's budget has expanded considerably over the past five years, primarily supported by rising fiscal transfers from the national government and some growth in toll revenues. The current revenue composition (approximately 70:30 non-toll to toll revenues) illustrates a high degree of dependence on allocations from the national government for non-toll roads. In FY2011, government grants amounted to ZAR3.4billion, or 56% of SANRAL's revenue. Preliminary results for FY2012 indicate a 25% increase in revenue, underpinned by continued growth in fiscal transfers and some (approximately 5%) organic growth in existing toll operations. This provides comfort that existing tolls are operating well and were not affected by recent social opposition to GFIP e-tolls.

Within the remainder of the three-year period covered by the Medium-Term Expenditure Framework (MTEF, 2013-2015), we expect SANRAL's budget to reflect consistent fiscal transfers for non-toll roads as well as growing revenue from existing toll roads (excluding GFIP). FY2012 preliminary results show some resilience despite the delay in e-tolls for the longer part of the financial year. Growing cash flow from operations partially offset the high finance costs of ZAR3.4 billion for the year.

The e-toll on GFIP has generated extensive debate in the country. Public opposition prompted the national government to reduce toll road tariffs and postpone June 2011 implementation of e-toll collections. As of April 2012, delayed implementation and lower-than-anticipated tolls resulted in SANRAL reporting a revenue loss of about ZAR2.7 billion ($325 million), which is equal to 40% of its 2012 annual revenue. The South African government responded by providing SANRAL ZAR5.8 billion ($745 million) to compensate for the lack of e-toll revenue and to defray operating costs, including debt service payments on the GFIP debt, a large proportion of which the South African government guarantees. More recently, the South African Constitutional Court overturned a lower court's April order blocking the implementation of electronic tolling on the GFIP. The ruling enabled SANRAL to begin collecting e-toll revenues, and eases concerns on SANRAL's financial prospects and business model. However, the recent ruling does not entirely resolve the e-toll saga, as GFIP awaits a full review by the courts in November.

Besides the contentious GFIP Projects - SANRAL is also involved in PPP projects, under which toll road concessions are offered to private companies under build-operate-transfer (BOT) contracts. Of the total current toll road network of 3,120 km, about 60% is managed by SANRAL directly, whilst the balance relates to concessions. Moody's views off-balance sheet PPP projects as low risk, as BOT contracts basically transfer operational risks, including construction and funding, to third parties.

Debt and Liquidity

Preliminary results show that SANRAL's debt stock amounted to ZAR37.5 billion for FYE2012, up from ZAR32.6 billion in FY2011. 57% of interest-bearing liabilities are bonds guaranteed by the South African government, with the balance (43%) made up of senior unsecured debt. Excluding total cash and cash equivalents as at 30 June 2012, SANRAL's total financial exposure falls to ZAR30.4 billion. The majority of this debt is based on fixed rates and is rand-denominated. Maturities for SANRAL's debt are long dated, with 47% maturing between five and 10 years and 53% after ten years.

SANRAL relied extensively on borrowed funds to finance its operations and capex, benefiting from the implicit guarantee of the government of South Africa. In the past five years, the agency raised over ZAR31.3 billion funds from local investors and is currently one of the largest borrowers in the country. SANRAL has historically reflected sufficient liquidity, underpinned by robust cash generated from operations and has recently been able to record positive cash flows despite e-toll delays.

Governance and Management

The management structure and governance clearly point to a high degree of control and operational integration with the government. SANRAL's management practices are oriented towards improving operational efficiency, albeit within limits inherent in its public policy mandate. SANRAL consistently provides highly informative and comprehensive financial statements which usually do not include qualifications by the Auditor General.

Albeit relatively sophisticated and effective in managing enterprise-wide risks, the challenges associated with GFIP proved to be outside of the control of SANRAL's management and highlight the operational limits embedded in its arm's length nature with the national government. Prudent financial management, coupled with a clear policy strategy and financial commitment from the government is crucial for SANRAL to financially sustain itself.

Extraordinary Support Considerations

Moody's assigns a high likelihood of extraordinary support from the South African government, reflecting primarily SANRAL's status, which implicitly guarantees 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 impact 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 ".za" for South Africa. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Methodology published in March 2011 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.

Country Ceilings for Foreign Currency Obligations

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, in cases where foreign-currency denominated securities benefiting from special characteristics are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

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%).