Credit Analysis

Moody's
International Public Finance
Government-Related Issuers

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This Credit Analysis provides an in-depth discussion of credit rating(s) for South African National Roads Ag. Ltd (The) and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. Click here to link.

South African National Roads Agency Ltd (The)

Pretoria, South Africa

Summary Rating Rationale

The A3/P-2 (Global scale, local and foreign currency) and Aa2.za/P-1.za (South African national scale) issuer ratings assigned to the South African National Roads Agency Ltd. ("SANRAL") are underpinned by the company's public legal status, its key role for and close financial links with the central government. The ratings also take into account the potential increase in business risk arising from SANRAL's expansion strategy in the toll roads sector, with the accompanying substantial increase in leverage.

As a reflection of the application of Moody's Joint Default Analysis methodology for Government-Related Issuers, SANRAL's rating is composed of two principal inputs: a baseline credit assessment (BCA) of 8 (on a scale of 1 to 21, where 1 represents the lowest credit risk); and a high likelihood of support from the South African government (A3 stable outlook) to prevent a default in case of need.

The high likelihood of support primarily reflects SANRAL's status, which implicitly guarantees the 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.

Rating Outlook

The rating outlook is stable.

Moody's Investors Service

Issuer Overview

SANRAL is a public company, wholly owned by the Republic of South Africa, with the Minister of Transport representing the government as the sole shareholder. The company is accountable to central government, which has determined its mandate to develop and maintain the national road infrastructure. SANRAL's mission is to provide and manage a world class, sustainable national road network as cost-efficiently as possible, in order to stimulate economic growth and improve the quality of life of all the country's inhabitants.

The national roads network managed by SANRAL comprises about 16,200 kilometres of roads. Although national roads account for around 4% of non-urban roads in the country, approximately 25% of the vehicle kilometres travelled in the country are on national roads. The national roads link all the country's major centres to one another as well as to neighbouring countries. The other roads are primarily managed by the nine provinces and municipalities. However, SANRAL has successfully assisted provinces in managing those roads that are considered strategic to the economy.

Key Rating Considerations

Institutional Framework

Status of public entity within a supportive legal framework

SANRAL was established in 1998 by an Act of Parliament (the SANRAL Act) as an independent statutory company operating along commercial lines and at arm's length from the central government. SANRAL previously operated within the Department of Transport as the Chief Directorate, Roads. The company is incorporated as a public company under the Companies Act 1973. As a national public entity under the Public Finance Management Act (PFMA), it is not subject to privatisation and bankruptcy, it does not pursue profit as a business objective and it is tax exempt. It also enjoys a legal public status and is listed as a national public entity under the Public Finance Management Act (PFMA) which regulates the wider public sector bodies. Given SANRAL's strategic role, we do not expect relevant changes in the company's ownership structure in the medium to long term.

Strong role for and oversight by central government

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 – mainly through the transport and finance ministries as well as Parliament – approves new projects, annual transfers for non-toll road operations, toll charges, public-private partnership (PPP) initiatives, new debt and guarantees for new debt. SANRAL's remit encompasses (i) strategic planning of the national road system; (ii) planning, design, construction, operation, management, control, maintenance and rehabilitation of national roads for the Republic; and (iii) financing of all those functions in accordance with its business and financial plans to ensure that the government's goals and policy objectives are achieved.

The company is governed and controlled by a Board of Directors appointed by the Minister of Transport, who receives regular reports from the Board's Chairman. Committees are in place to ensure adequate checks and balances. For finances, the most important internal body is the Asset and Liability Committee (ALCO), which sits every month and is chaired by a representative of the Department of Finance. The ALCO prepares the overall strategy for financial assets and liabilities, performs regular reviews of all aspects of financial risk management and exposures, and reports to the board on treasury operations.

The government recognises that transport plays a central role in the creation of jobs and promoting economic transformation, sustainable growth and resource development. The strategy is to consolidate and expand the national roads network, with a focus on toll roads, particularly in view of South Africa's hosting of the Football World Cup in 2010. 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.

South African National Roads Agency Ltd (The)

Financial Position and Performance

Key indicators

	2005	2006	2007	2008	2009F [2]
Total assets (ZAR million)	9076.1	9,270.2	9,826.3	16,690.0	30,603.7
Operating margin (%)	45.3	15.5	9.0	18.3	41.0
Surplus (deficit) for the year / total income (%)	18.4	-9.4	-1.1	10.1	21.5
Total debt / total assets (%)	71.5	71.7	63.1	66.2	67.7
Debt / cash flow from operations (x)	7.3	8.7	17.5	8.2	21.5
Cash interest cover ratio (x) [1]	1.8	1.6	1.0	2.1	1.7
Current assets / current liabilities (x)	1.0	0.8	1.2	1.3	2.3

Note: [1] Cash flow from operations / Net finance expenditures; [2] 2009 figures and ratios are inflated by a ZAR1 billion one-off revaluation of investment properties, which translates into an equivalent increase in non-cash income. F: Forecasts.

Budget expansion primarily reflects the government's financial commitment for non-toll roads

SANRAL's budget has doubled in the past five years. Excluding the ZAR1 billion one-off income due to a change in accounting policy[1], total income reached ZAR3.6 billion in 2009, with high and increased allocations from the central government to finance the ongoing expansion of operations and capital projects for non-toll roads – 64% of the company's adjusted income in 2009. During 2005-09, non-toll revenue increased by a compound annual growth rate of 15%, driven by growing government grants to face the high and increasing costs of the maintenance of the ageing infrastructure network. High and increasing maintenance costs are expected to foster an increase in the operating expenditure to capital expenditure ratio from the current 20-80% to 30-70% by 2012. This trend will continue to influence SANRAL's budget and the government's allocations are projected to reach ZAR8.2 billion in 2011/2012.

SANRAL's toll road operations are profitable, while the non-toll roads are provided as a public asset funded by the fiscus and do not generate revenue for their usage. Toll road activities are split into two distinct categories: (i) roads operated and financed by SANRAL; and (ii) roads operated and financed by concessionaires through PPPs on a Build, Operate and Transfer (BOT) basis. Currently, some 11% of the 16,170km roads under SANRAL's control are managed by the company itself and 8% are allocated to concessionaires. Whilst the first category of toll roads is reflected in SANRAL's budget, BOT contracts are off-balance sheets.

Toll roads – 36% of SANRAL's adjusted income in 2009 – are mostly financed by toll levies and debt issued by SANRAL with and without the explicit guarantee of the Republic of South Africa. During 2005-09, revenue for toll roads increased by a compound annual growth rate of 10%, primarily supported by inflation-linked tariff adjustments and continued growth in traffic volumes. Future revenues from existing toll roads are based on realistic assumptions as regards traffic volumes and expected to grow at an average annual rate of approximately 10% over the next ten years. The N1 Gauteng Freeways will be the first of the new toll roads that will come into operation in 2010 but will only start contributing significantly to revenue in 2011. Revenue contributions from the other new toll roads will grow slowly but will only contribute a minor portion of the budgeted toll revenue of ZAR5.5 billion in 2011/2012.

[1] In 2009, SANRAL mandated an independent company to assess the value of its investment properties, including freehold properties which are not part of construction projects. The valuation of its properties at market value instead of nominal value resulted in an increase in assets of ZAR1,074 million in 2009 and an equivalent increase in total income in the company's income statement.

Toll roads: Expansion strategy will increase business risk and leverage

SANRAL's strategy is geared towards expanding the management of the South Africa's national road network to about 20,000km by 2010. Toll roads will play a pivotal role in SANRAL's expansion strategy, with consequent increase in the company's exposure to toll business risk and financial leverage.

Long-term projections for toll road projects indicate the debt burden climbing rapidly during the construction phase of the toll roads and net operating cash flows adversely affected by the rising interest costs. Given that toll revenues will increase gradually, SANRAL expects the net operating cash flows – after interest payments – to be negative till 2023 for existing and new toll road projects. Thereafter, net operating cash flows should become positive and total debt should start to decline as new borrowings stabilise and the positive net cash flows are utilised to reduce the debt burden. Although in the coming years we expect a deterioration of credit protection measures due to the start-up of the investment projects, SANRAL's good track record in past projects, established traffic patterns and the ultimate backing of the central government provide comfort with regards the sustainability of these projects in the long run and the company's ability to meet its obligations.

Debt & Liquidity

Rapidly growing debt burden, including non-guaranteed debt

Long-term borrowings at July 2009 amounted to ZAR16.5 billion, including primarily domestic bonds with (ZAR5.5 million) and without (ZAR9.9 billion) the government's guarantee and ZAR1 billion CPI-linked loan due 2018 and secured by government guarantee. In addition to long-term borrowings, in 2009 SANRAL resorted to short-term debt for ZAR230 million. Discounting liquid assets, the total financial exposure reduces to ZAR12.8 billion. The majority of the borrowings (78%) are at a fixed rate, thus reducing its exposure to the volatile interest rate environment in South Africa, with no exposure to foreign currency risk. Excluding the CPI-linked loan, all debt is amortising and maturities are relatively long, with 32% maturing between five and ten years and 54% after ten years.

The long-term borrowing requirements of SANRAL are very ambitious given its corporate structure and budget volumes. Based on SANRAL's expansion plans and the increase of the roads under its management, a substantial increase in its borrowings is required to meet these objectives. The main focus will initially be on the development of the Gauteng Freeway Improvement Scheme (GFIS). The scheme will involve the construction of new roads, namely the PWV9 and PWV10, the declaration of certain provincial roads as national roads and the incorporation of certain of these sections as well as existing national roads into the toll road network.

In recent months, SANRAL obtained authorisation from the central government to issue guaranteed debt of up to ZAR31.9 billion through 2012. After the ZAR9.8 billion non-guaranteed DMTN programme launched in 2008, the extension of the government's guarantee on SANRAL's debt issuances for the next three years reflects the financial and strategic commitment of the central government towards the company and evidences the implicit approval by the government of SANRAL's investment plan.

Even though SANRAL's liabilities exceed its assets and the company would, under normal circumstances, be termed technically insolvent, the focus on its ability to repay its liabilities is on its cash flow generation capabilities. Its long-term projections indicate positive net cash flows after the initial period of heavy capital spending and mounting debt (on average, between 12 to 20 years after the construction is completed). Whilst the SANRAL Act uniquely protects the company from liquidation, and thus its creditors cannot seek final redress through this mechanism, the state by implication has to provide SANRAL with the means to honour its obligations, notwithstanding the potentially large shortfall over time; in this there lies an implied state guarantee.

Low risk from off-balance sheet PPP projects

As mentioned above, SANRAL is involved in public-private partnerships (PPP), under which toll road concessions are offered to private companies under BOT contracts. Through PPP initiatives, SANRAL can negotiate investments for periods well beyond the government's three-year budgeting horizon and to expand its network. Moody's views off-balance sheet PPP projects as low risk. BOT contracts basically transfer operational risks to third parties, as the concessionaire is responsible for all matters relating to the road including construction and funding, whilst SANRAL remains accountable for administrative-related delays. Revenues are collected by the concessionaire for its own account. Ownership of the physical asset remains with SANRAL, while all assets and obligations revert to SANRAL at the end of the concession (normally 30 years). SANRAL may not proceed with a PPP agreement without the approval of the central government.

SANRAL has so far successfully completed three PPP projects (N1/N4 Platinum Highway, N4 Maputo Development Corridor, and N3 Cedara to Heidelberg) with a combined value of ZAR6.2 billion and a total financial exposure of the private companies involved of about ZAR5.8 billion. These three roads account for less than 10% of SANRAL's existing network (1,375km) and are performing well. Within SANRAL's expansion strategy, three more concession projects for around ZAR10 billion are being considered. Reportedly, existing PPP contracts generate an average return-on-equity (ROE) for the contractors of 15-20% and, in line with the principles of skills creation and empowerment, a large proportion of the contractors' family (about 80%) is represented by SMEs.

Governance and Management Factors

The management structure and governance clearly point to a high degree of operational integration with the government. SANRAL's management practices are oriented towards improving operational efficiency, albeit within limits and principles embedded in its social mission and its instrumental role. SANRAL consistently provides highly informative and comprehensive financial documents, which do not include qualifications by the Auditor General. SANRAL has so far adequately managed operational risks associated with its business. Going forward, prudent financial management, combined with continued strategic and financial commitment from the government, will be core to supporting SANRAL's ability to sustain its expansion strategy without impairing its finances.

Rating History

South African National Roads Agency Ltd (The)

Date	Rating
August 2009	A3/P-2
March 2007	Aa2.za/P-1.za

South African National Roads Agency Ltd (The)

Annual Statistics

SANRAL

Fiscal year ended 31 March (ZAR million)	2005	2006	2007	2008	2009F
BALANCE SHEET					
Cash and cash equivalents	1,007	468	1,313	1,462	3,873
Receivables and prepayments	147	188	168	699	2,699
Current assets	**1,154**	**657**	**1,481**	**2,161**	**6,572**
Non-current receivables	116	0	0	0	0
Long term investments	1,121	1,422	319	150	1,203
Fixed assets	6,685	7,192	8,027	14,379	22,829
Non-current assets	**7,922**	**8,614**	**8,345**	**14,529**	**24,032**
TOTAL ASSETS	**9,076**	**9,270**	**9,826**	**16,690**	**30,604**
Trade and other payables	271	448	868	956	1,399
Grants and funding	250	311	278	239	204
ST Financial liabilities	543	0	0	0	202
Current portion of deferred income	120	102	108	415	496
Other	2	0	0	0	582
Current liabilities	**1,186**	**862**	**1,254**	**1,610**	**2,884**
Deferred income	3,403	3,888	4,672	5,843	7,980
LT Financial liabilities	6,493	6,648	6,199	11,041	20,532
Other	5	7	7	7	7
Non-current liabilities	**9,900**	**10,543**	**10,878**	**16,891**	**28,519**
Capital	1,091	1,091	1,091	1,091	1,091
Reserves (accumulated loss)	-3,102	-3,225	-3,398	-2,903	-1,890
Equity	**-2,011**	**-2,134**	**-2,307**	**-1,812**	**-799**
TOTAL LIABILITIES & EQUITY	**9,076**	**9,270**	**9,826**	**16,690**	**30,604**

South African National Roads Agency Ltd (The)

SANRAL

Fiscal year ended 31 March (ZAR million)	2005	2006	2007	2008	2009F
INCOME STATEMENT					
Revenue [1]	**2,209**	**2,356**	**2,782**	**3,387**	**4,708**
from Toll operations	886	969	1,102	1,211	1,314
from non-Toll operations	1,323	1,387	1,680	2,175	2,320
Operating expenditures	**1,209**	**1,991**	**2,391**	**2,768**	**2,780**
from Toll operations	56	433	597	666	465
from non-Toll operations	1,153	1,558	1,798	2,102	1,241
Net operating income	**1,001**	**365**	**391**	**619**	**1,929**
from Toll operations	830	536	505	545	849
from non-Toll operations	171	-171	-118	73	1,079
Net finance costs	**595**	**587**	**421**	**276**	**916**
from Toll operations	602	597	429	300	864
from non-Toll operations	-7	-10	-8	-24	52
PROFIT/LOSS	**406**	**-222**	**-30**	**343**	**1,013**
CASH FLOW STATEMENT	2005	2006	2007	2008	2009F
Revenues	2,041	2,298	2,403	3,338	4,225
Expenditures	1,151	1,530	2,049	1,988	3,261
Cash flow from operations	**890**	**767**	**354**	**1,351**	**964**
Net finance expenditure	495	471	357	644	567
Net cash flow from operations	**395**	**297**	**-3**	**707**	**397**
Acquisition of fixed assets	-338	-467	-1,068	-2,829	-8,972
Disposals of fixed assets	3	9	18	7	13
Increase in LT receivables	-26	-26	-25	25	3
Net cash flow from investments	**-362**	**-485**	**-1,075**	**-2,797**	**-8,956**
Capital portion of government grants	214	440	906	1,543	2,359
Net borrowings	325	-736	882	748	9,405
Other funding	40	-55	134	-53	-795
Net cash flow from financing activities	**579**	**-350**	**1,923**	**2,239**	**10,970**
Net increase in cash and cash equivalents	612	-538	845	149	2,411
Cash at beginning of year	395	1,007	468	1,313	1,462
CASH AND CASH EQUIVALENTS AT YEAR END	**1,007**	**468**	**1,313**	**1,462**	**3,873**

Notes: [1] In 2009, it includes ZAR1,074 million one-off revaluation of investment properties, which translates into an equivalent increase in non-cash income.

South African National Roads Agency Ltd (The)

Moody's Related Research

Credit Opinions:

- Government of South Africa, July 2009
- Eskom Holdings, August 2008

Analyses:

- Autobahnen-Und Schnellstrassen Fienanzierungs AG, March 2009 (155349)

Press Releases:

- South Africa's foreign currency rating upgraded to A3; local currency rating lowered to A3
- Moody's downgrades Transnet to A3/Prime-2 stable following sovereign action

Rating Methodology:

- The application of Joint-Default Analysis to Government Related Issuers, April 2005 (92432)

Moody's Global Financial Risk Perspectives:

- On the Hook – Update on Moody's Global Macroeconomic Risk Scenarios for 2009-2010, May 2009 (117203)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

South African National Roads Agency Ltd (The)

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