

CREDIT ANALYSIS

Rate this Research



RATINGS

Ekurhuleni, Metropolitan Municipality

	Foreign Currency	Local Currency
Issuer	-	-
Sr. secured	-	-
Sr. unsecured	-	-
Nat. Scale Rating(s)	-	Aa3.za
Outlook	-	Negative

Table of Contents:

OVERVIEW AND OUTLOOK	1
BASELINE CREDIT ASSESSMENT	2
Financial Performance and Debt Profile	2
Governance and Management	4
Economic Fundamentals	4
Institutional Framework	5
EXTRAORDINARY SUPPORT	
CONSIDERATIONS	5
NATIONAL PEER COMPARISON	5
ABOUT MOODY'S SUB-SOVEREIGN	
RATINGS	6
National and Global Scale Ratings	6
APPENDICES	7
Chart Pack	7
Rating History	8
Annual Statistics	9
MOODY'S RELATED RESEARCH	12

Analyst Contacts:

JOHANNESBURG +27.11.217.5470

Daniel Mazibuko +27.11.217.5481
Associate Analyst
daniel.mazibuko@moodys.com

MILAN +39.02.9148.1100

Francesco Soldi +39.02.9148.1149
Vice President - Senior Analyst

francesco.soldi@moodys.com
This Credit Analysis provides an in-depth discussion of credit rating(s) for Ekurhuleni, Metropolitan Municipality of and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on [Moody's website](#).

Ekurhuleni, Metropolitan Municipality of

South Africa

Overview and Outlook

The Aa3.za/P-1.za national scale issuer and debt ratings of Ekurhuleni Metropolitan Municipality reflect its relatively large and diversified economic base, its strong liquidity, and its traditionally conservative approach to financial management. Ekurhuleni's ratings also reflect its historically moderate debt levels relative to those of rated peers, as well as its robust liquidity position.

However, the ratings also consider the challenges associated with a growing, albeit moderate, debt levels (including municipally owned entities) and the city's high expenditure requirements over the medium term. The city increased spending on infrastructure projects to ZAR2.3 billion in 2013 from ZAR2.0 billion in 2012. Going forward, the city plans to further increase its annual capital expenditure to an average of ZAR3.7 billion in the medium term. Gross debt will likely reach ZAR7.5 billion in 2016 compared with ZAR5.1 billion in 2013. Despite such an increase, however, Ekurhuleni's debt ratio will only moderately increase thanks to a constantly growing revenue base.

The negative outlook on Ekurhuleni's rating mirrors the negative outlook on South Africa's sovereign rating and reflects systemic pressure. A stabilisation of the outlook or an upgrade of the rating could result from a stabilisation or upgrade of the sovereign rating. Ekurhuleni's rating is likely to follow the trajectory of South Africa's government rating. A downgrade of the sovereign rating would likely lead to downward adjustments of Ekurhuleni's rating. The city's rating would also come under pressure in the event of fiscal slippage, a weakening of its financial position and/or a higher-than-anticipated increase in financial leverage.

This Credit Analysis elaborates on Ekurhuleni's credit profile in terms of the main analytical factors in Moody's Regional and Local Government Methodology.

Baseline Credit Assessment

Financial Performance and Debt Profile

Good financial performance, which reflects strong revenue growth

Based on a total revenue of ZAR22.2 billion (\$2.1 billion) for the fiscal year ending (FYE) June 2013, Ekurhuleni ranks third among the five metropolitan municipalities rated by us in South Africa, after Cape Town (Aa3.za negative) and Johannesburg (A1.za negative). The city recorded a robust revenue growth of 16% on average during 2011-13. The strong budgetary performance was underpinned by growing revenue base, which is largely driven by service charges, property rates charges as well as consistent growth in fiscal transfers from national government. Combined with continued fiscal discipline, these key revenue drivers contributed to an improvement in gross operating margins to 8.5% in FYE 2013 from 6.6% in FYE 2012.

Discretionary own-source revenues constitute 83%, indicating the city's relatively high revenue autonomy. On the expenditure side of operations, non-discretionary items, such as employee costs for its approximately 15,000 staff members and bulk purchases, represent a large and growing proportion (62%) of total expenditure. Ekurhuleni's spending on repairs and maintenance constitutes 9% of total expenditures, higher than that of its rated peers.

Historically strong liquidity position

Continued focus on revenue collections and tight control over expenditure dynamics have allowed Ekurhuleni to consolidate its strong liquidity position. The city's liquidity ratio improved to 1.2x in FY 2013, up from a four-year low of 0.6x in FYE 2010 (see Exhibit 1).

Accompanied by the city's historical policy strategy to keep expenditure within revenue-generating capacity levels, increased revenue collection (92%) has helped the city to record robust cash reserves of ZAR4.3 billion in FY 2013, equivalent to 21% of total expenditure. Going forward, the city projects cash and cash equivalents to increase moderately notwithstanding the expected increase in cash contributions from its own sources in funding capital investments, which will drive the projected decline in cash financing results.

EXHIBIT 1

Liquidity Ratios

	2008	2009	2010	2011	2012	2013
Ekurhuleni	1.6	0.9	0.6	1.0	1.2	1.2
Johannesburg	0.6	0.5	0.4	0.5	0.7	0.9
Nelson Mandela	1.3	0.7	0.9	0.7	0.9	1.1
Cape Town	1.1	1.2	1.3	1.4	1.3	1.4
Tshwane	0.9	0.8	0.7	0.7	0.6	0.7

Note: (Current Assets/Current Liabilities - Net off 50% of Balance sheet Debtors)

Sources: Moody's calculations, issuers

High capital expenditure pressure for service delivery

On the capital side of the budget, the city increased spending on infrastructure projects to ZAR2.3 billion in 2013 from ZAR2.0 billion in 2012. Nonetheless, going forward, the city plans to substantially increase annual capital expenditure to an average of ZAR3.7 billion per annum in the medium term. It will fund this capital expenditure largely through capital grants (55%), new

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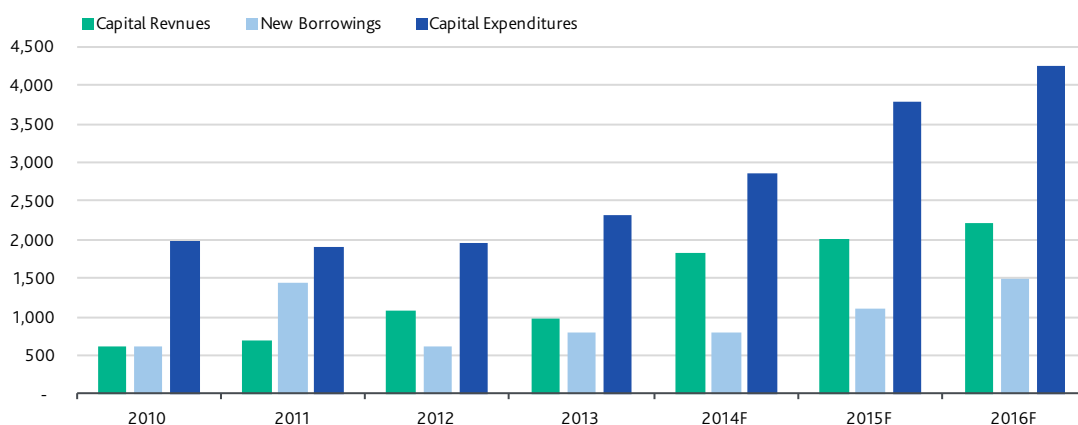
borrowings (32%) and from own funds (13%), supported by a constantly growing revenue base, which will mitigate the fiscal pressure stemming from rising debt levels.

We note that the historically lower level of capex was due to poor planning and a weaker supply chain management which dampened the progress of infrastructure implementation. The city has recently taken actions to address these challenges and set the conditions for the smooth implementation of its large capital budget of ZAR15.2 billion in FY 2014-17. Ekurhuleni's borrowing plans will remain moderate despite growing capital budgets (see Exhibit 2).

EXHIBIT 2

Moderate Borrowing Plans Despite Growing Capital Budgets

Aggregate data



Sources: Moody's calculations, issuers

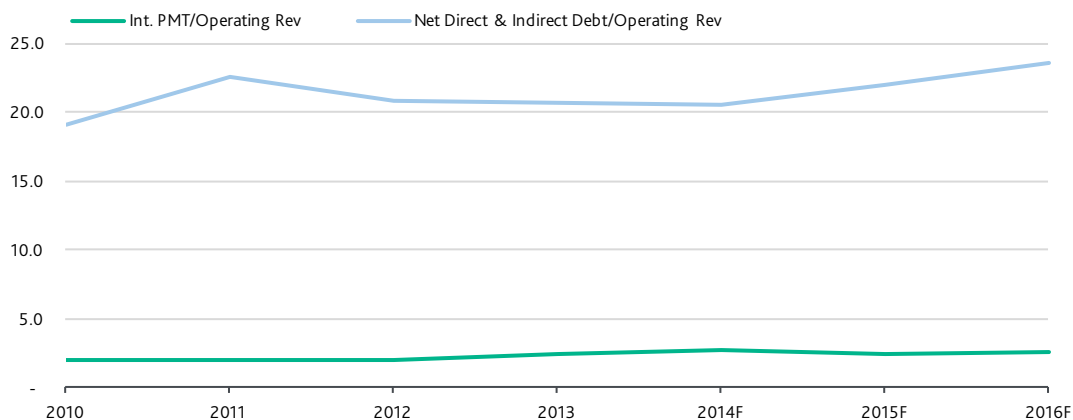
Gradually increasing debt levels, but yet moderate

Ekurhuleni's net direct debt amounted to ZAR4.4 billion as of 30 June 2013, which is equivalent to a moderate 21% of operating revenue and a slight decrease from 23% in FY 2011. The new bond issuance of ZAR785 million in April 2014 increased total debt stock of ZAR5.7 billion or an equivalent of 22% of debt to operating revenues at FYE 2014. Although Ekurhuleni's debt stock is moderately increasing year on year, its debt ratio remains flat, thanks to constant revenue growth.

Ekurhuleni's debt stock is 53% bonds and 47% amortising bank loans, with an average debt maturity of six years. The city has thus far issued five bonds totaling ZAR4 billion, leaving a balance of ZAR4 billion under its ZAR8 billion domestic medium-term note program. Sinking fund deposits and/or long-term cash investments established for the redemption of its bullet maturities increased to ZAR819 million in FYE 2013 from ZAR464 in 2012, and about half of this will be utilised to redeem a ZAR400 million bullet loan that matured on 30 June 2014. Ekurhuleni will continue to make periodic payments towards its sinking fund and/or long-term cash investments in order to beef up necessary funds required to redeem future maturities on its bond portfolio, with the first one (EMM01) scheduled for the year 2020.

We expect that Ekurhuleni's debt burden will remain moderate in the medium term (see Exhibit 3), despite the acceleration in capital expenditure and the consequent increase in borrowing requirements. Interest expenses will amount to approximately ZAR620 million, or 2.5% of operating revenue, for FYE 2014. They will likely remain moderate and grow in line with financial leverage in the medium term.

EXHIBIT 3

Ekurhuleni's Indebtedness 2014-16

Sources: Moody's calculations, issuers

Governance and Management

Conservative financial management

Ekurhuleni has traditionally displayed conservative financial management and good budgetary planning. The city consistently provides annual financial statements, including balance sheets, income statements and cash flow statements, which the Auditor General always independently audits and has received unqualified opinion for four years in succession to FYE 2013.

Whilst the municipal administration was able to focus on strengthening revenue collection and prudently continued to manage its spending dynamics, the city's intention to reduce infrastructure backlogs via annual capex increases in the medium term will likely suppress financial performance and exert modest pressure on financial leverage.

Economic Fundamentals

A relatively large economy, with a strong industrial base

Ekurhuleni displays a large and relatively dynamic economic base. The local economy is driven by manufacturing, with a focus on the production of structural steel and fabricated metal products. Notwithstanding the predominance of manufacturing, contribution by wholesale and retail trade as well as finance and business services to the local economy is significant and provides some diversification.

The municipality has a population of about 3.2 million, accounting for 26% of Gauteng Province's and 6.2% of South Africa's total population and it contributes around 7% to national economic output. Transport networks are well developed and have contributed to notable industrial growth in the area over the years. The metropolitan municipality is home to the Oliver Tambo International Airport, the busiest airport in Africa. The Local Economic Development plan of the city identified a number of economic development projects, which will largely take place around the airport precinct. Typical of large municipalities in South Africa, migration into the area is an inherent challenge, with growing informal settlements in the area putting significant expenditure pressure on provision services, including housing.

Institutional Framework

South Africa's institutional framework, which encompasses the arrangements determining intergovernmental relations and jurisdictional powers and responsibilities, features moderate financial predictability and stability. The municipal system in South Africa comprises eight metropolitan municipalities (category A), 226 local municipalities (category B) and 47 district municipalities (category C). The administration system and associated policies are generally consistent and oriented towards enhancing accountability at the local level. Municipal oversight regarding budget approval and monitoring is performed by provincial governments, assisted by the National Treasury.

Spending responsibilities and the revenue structures of South African municipalities are difficult to alter due to a consolidated legal framework. The high degree of revenue autonomy enjoyed by metros and large local municipalities – with transfers from the national government accounting for 5%-20% of total revenue – compensates for the rigidity of their expenditure profile as a result of their statutory responsibilities (which are chiefly related to the delivery of basic services and municipal infrastructure). Conversely, district and small to medium-sized municipalities - whose primary role is to facilitate, fund and execute infrastructure development in the local municipalities within their jurisdiction – demonstrate moderate-to-high fiscal dependence on government grants. Municipal budgets are sensitive to economic cycles due to the nature of their own revenue sources, which primarily include property taxes and service charges for electricity, water, refuse and sewage. Municipalities are responsible for the collection of local taxes and charges and enjoy the discretion to set tax rates and tariffs. This allows for a moderate degree of revenue flexibility, particularly for metros and large municipalities.

The combination of fiscal transfers and own-source revenues at most metros and local municipalities has proved insufficient to provide the comprehensive range of services required. However, despite these pressures, municipal debt levels have generally remained low to moderate.

Extraordinary Support Considerations

Ekurhuleni's Aa3.za/P-1.za issuer and debt ratings takes into account the moderate likelihood that the central government of South Africa (Baa1 negative) would act to prevent a default by the metropolitan municipality. The moderate likelihood of support reflects, at the jurisdictional level, Moody's assessment of the national government's policy stance of promoting greater accountability and financial sustainability for South African municipalities. Reputation risk for the central government is deemed modest, mainly in view of the large predominance of bank loans instead of bonds. Although the new legal framework regulates the recovery of municipalities experiencing financial difficulties, it does not suggest timely extraordinary bail-out actions to avoid defaults on debt obligations. However, Moody's recognises some interest of the government in addressing major financial problems that could be experienced by the metropolitan municipalities, in view of their relative importance countrywide.

National Peer Comparison

The City of Ekurhuleni is rated at the high end of the range of South African municipalities, whose ratings span from Aa3.za to Baa2.za. Ekurhuleni's relative position reflects debt and debt service levels that are lower than the median of the rated metropolitan municipalities, its strong liquidity position and its conservative financial management.

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 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.

Appendices

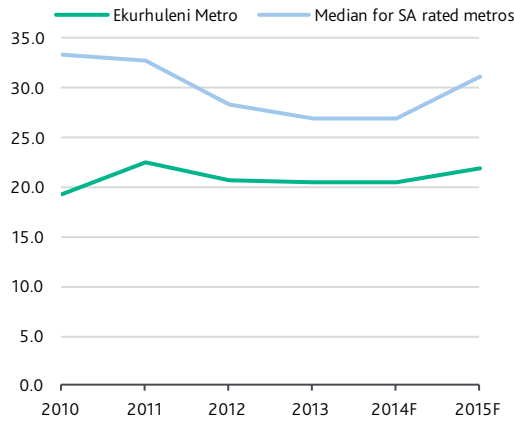
Chart Pack

Ekurhuleni, Metropolitan Municipality

EXHIBIT 4

Moderate Debt Levels

Net Direct and Indirect Debt/Operating Revenue

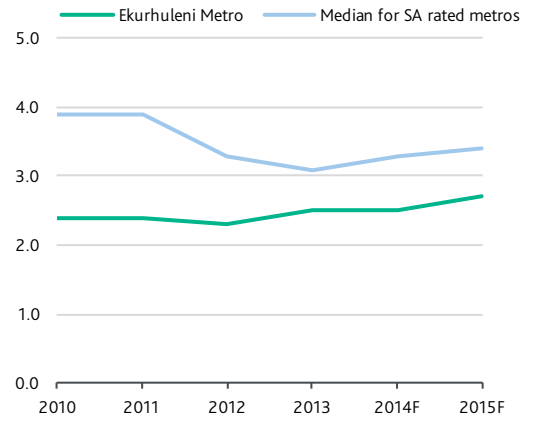


Sources: Moody's calculations, issuers

EXHIBIT 5

Moderate Interest Charges

Interest Payments/Operating Revenue (%)

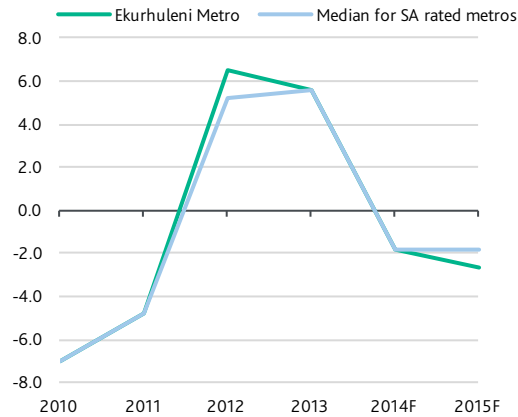


Sources: Moody's calculations, issuers

Exhibit 6

Volatile Financing Balances

Cash Financing Surplus (Requirement)/Total Revenue (%)

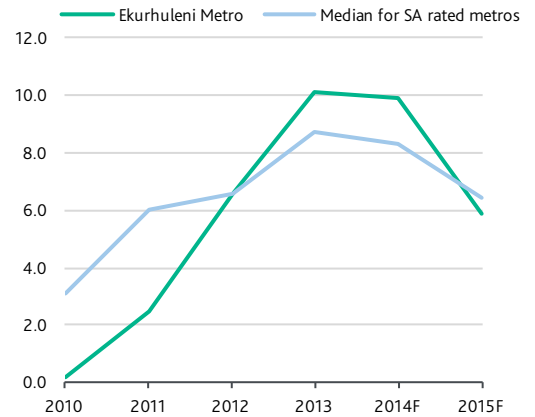


Sources: Moody's calculations, issuers

Exhibit 7

Improving Operating Balances

Gross Operating Balance/Operating Revenue (%)



Sources: Moody's calculations, issuers

Rating History

Ekurhuleni, Metropolitan Municipality

Date	Rating
1 October 2012	Aa3.za Negative
9 November 2011	Aa2.za Negative
18 January 2008	Aa2.za Stable

Annual Statistics

Ekurhuleni, Metropolitan Municipality

	2009	2010	2011	2012	2013
BALANCE SHEET					
Funds and reserves	43,322.7	42,445.0	38,275.5	38,581.1	39,657.0
Long-term liabilities	1,945.6	2,446.9	3,715.7	4,333.2	4,503.8
Consumer deposits	373.2	420.4	487	532.6	620.5
Long-term provision and other liabilities	1,781.6	1,758.6	1,881.3	2,151.5	2,396.1
Deferred income	-	-	-	-	-
Non-current liabilities	4,100.3	4,625.9	6,084.0	7,017.3	7,520.3
Creditors and provisions	2,423.9	2,860.7	2,830.4	3,972.3	4,844.9
Short-term debt	131.3	434.2	175.4	182.3	629.4
Current liabilities	2,555.2	3,294.9	3,005.7	4,154.6	5,474.3
Total liabilities	49,978.2	50,365.8	47,365.2	49,753.0	5,2651.7
Fixed assets	46,706.5	47,209.3	42,625.3	42,678.4	42,963.1
Investments	279.2	88	230.9	472.2	804.2
Other non-current assets	213	203	160	257.7	300.3
Non-current assets	47,198.7	47,500.3	43,016.3	43,408.3	44,069.6
Inventory	177.1	160	132.5	145	128.8
Account receivable	1,168.8	1,485.1	2,447.5	3,008.1	3,552.5
Bank and short-term investments	1,131.4	950.4	1,358.9	2,859.7	4,397.1
Other	302.2	270	410.2	331.9	503.7
Current assets	2,779.5	2,865.5	4,349.0	6,344.8	8,582.1
Total assets	49,978.2	50,365.8	47,365.2	49,753.0	52,651.7
INCOME STATEMENT					
Revenue					
Property rates	1,886.6	2,201.4	2,493.6	2,644.2	2,875.0
Grants and subsidies	2,477.0	2,886.0	3,397.7	4,557.5	4,746.6
Electricity	4,054.2	5,583.8	7,589.0	9,086.6	9,693.0
Water	1,180.9	1,457.6	1,184.4	2,061.8	2,158.5
Other	970.4	1,033.5	1,348.5	1,492.0	1,648.8
Other income	995.2	838.6	802.8	961.8	1,121.6
Total revenue	11,564.3	14,000.9	16,816.0	20,804.0	22,243.4
Expenditure					
Employee and councilor costs	3,506.9	4,157.20	3,867.4	4,188.9	4,364.5
Bad debts charges	1,453.6	1,425.20	1,445.3	1,442.0	929.3
Bulk purchases	4,122.0	4,951.20	6,435.2	7,930.5	8,852.9
Depreciation	2,134.4	2,112.30	2,068.8	1,984.7	2,014.3

Ekurhuleni, Metropolitan Municipality

	2009	2010	2011	2012	2013
Interest paid	196.7	327	382.6	453.4	522.9
Other expenses	1,478.7	1,563.60	1,888.1	2,308.3	2,628.5
Repairs & maintenance	1,059.9	1,010.70	1,781.7	1,737.2	1,840.0
Total expenses	13,952.1	15,547.10	17,869.1	20,045.1	21,152.3
Surplus/(deficit)	(2,387.8)	-1,546.20	(1,053.1)	758.8	1,091.1

CASH FLOW STATEMENT

Cash generated from operations	237.8	1,019.5	1,169.8	3,414.0	3,893.4
Investment income	198.7	366.2	331.8	353.6	497.2
External interest paid	-181.8	-327	-382.6	-453.4	-522.9
Cash available from operations	254.7	1,058.7	1,119.0	3,314.3	3,867.7
Proceeds on sale of fixed assets	6.1	66.3	84.6	0.8	-
Other	60.9	185.8	13.1	-281.8	-393.0
Cash retained from operations	321.7	939.1	1,216.7	3,033.3	3,474.7
Fixed assets and investments	(2,559.4)	(1,975.1)	(1,913.7)	(1,961.2)	(2,310.8)
Net cash from operating & Investing Activities	(2,237.7)	(1,036.0)	-696.9	1072.1	1,163.9
Financing activities					
Loans increase/ (decrease)	949	607.30	1,178.3	624.4	617.7
Consumer deposits/ (decrease)	35.3	56.50	70	45.6	87.9
Cash resources (increase)/decrease	1,253.4	372.20	-551.3	(1,742.1)	(1,869.5)
Net cash from financing activities	2,237.7	1,036.0	696.9	(1072.1)	(1,163.9)

KEY RATIOS AND INDICATORS

ECONOMIC STRUCTURE AND PERFORMANCE

Population ('000s)	2699.4	2800	3,178.5	3,178.5	3,178.5
GDP per capita as a % of national average (%)	158.7	150.6	145.4	146.4	-
Unemployment rate (% - at provincial level)	25.8	26.8	26.3	26.3	-

FINANCIAL PERFORMANCE

Total revenue growth rate (%)	12.0	21.0	20.1	23.7	6.9
Total expense growth rate (%)	27.0	7.0	15.0	13.0	7.1
Total expenses per capita (ZAR)	5326.8	5709.5	5,573.1	6,306.5	6,654.9
Primary operating balance/operating revenues (%)	-4.8	2.6	4.9	9.5	11.0
Gross operating balance/operating revenues (%)	-6.6	0.2	2.5	7.2	8.5
Net operating balance/operating revenues (%)	-8.0	0.2	0.9	5.6	7.6
Cash Financing deficit (surplus)/total revenue (%)	-22.5	-8.4	-4.8	3.7	5.6
Intergovernmental transfers/operating revenue (%)	18.0	17.4	17.2	16.6	16.5
Tax revenues/operating revenue (%)	17.0	16.0	15.4	13.6	13.8

Ekurhuleni, Metropolitan Municipality

	2009	2010	2011	2012	2013
Transfers (op. related)/operating expenses (%)	18.0	17.4	17.7	17.8	18.0
Capital expenses/total expenses (%)	18.0	13.0	10.8	9.8	10.8
Net operating balance/capital expenses (%)	Neg	1.0	7.7	62.1	69.0
Self-financing ratio (%)	Neg	0.3	0.6	1.4	1.3
Gross new borrowings/capital expenses (%)	43.0	31.0	75.2	40.8	34.6

DEBT PROFILE

Total direct and indirect debt growth rate (%)	84.0	39.0	35.1	16.0	13.7
Net direct and indirect debt growth rate (%)	124.0	47.0	42.2	10.5	6.5
Net direct and indirect debt per capita (ZAR)	652.1	955.8	1,153.7	1,274.5	1,357.2
Short-term direct debt /direct debt (%)	6.3	15.1	4.5	4.0	12.3
Foreign currency direct debt (after swaps)/direct debt	0.0	0.0	0.0	0.0	0.0
Net direct and indirect debt/operating revenue (%)	15.9	19.2	22.6	20.8	20.6
Net direct and indirect debt/total revenue (%)	15.2	18.4	21.8	19.5	19.4
Net direct debt /operating revenue (%)	15.9	19.2	22.6	20.8	20.6
Net direct debt/total revenue (%)	15.0	18.0	21.8	19.5	19.4
Net direct debt / gross operating balance (years)	Neg	110.4	9.0	3.2	2.9
Interest expense growth rate (%)	9.2	66.3	17.0	18.5	15.3
Interest payments/operating revenue (%)	1.8	2.4	2.4	2.3	2.5
Debt service growth rate (%)	39	-9.0	96.6	-2.3	11.0
Debt service/operating revenue (%)	3.2	2.4	4.0	3.2	3.3
Debt service/total revenue (%)	3.1	2.3	3.8	3.0	3.1
Debt repayment/gross operating balance (%)	1.0	2.3	1.6	12.6	9.9

Moody's Related Research

Credit Opinion

- » [City of Johannesburg](#)
- » [City of Tshwane](#)
- » [East Rand Water Care Company](#)

Credit Analysis:

- » [City of Cape Town, February 2014 \(164323\)](#)
- » [Nelson Mandela, Metropolitan Municipality, April 2014 \(167934\)](#)

Rating Methodology:

- » [Moody's Statistical Handbook- Non U.S. Regional and Local Government, June 2014 \(170794\)](#)

Rating Methodology:

- » [Regional and Local Government, January 2013 \(147779\)](#)

Moody's Website Links:

- » [Sub-Sovereign Group Webpage](#)

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Rate this Research



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Author
Daniel Mazibuko

Editor
Mina Kang

Senior Production Associate
Ginger Kipps

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