



Credit Rating Announcement

City of Ekurhuleni assigned an initial South African National Scale Issuer Credit Ratings of BBB_(ZA)/B_(ZA) with a Stable Outlook balancing its weak performance in recent years against expectations of a strengthening financial profile.

Rating Action

Johannesburg, 20 April 2022 – GCR Ratings (“GCR”) has accorded the City of Ekurhuleni national scale long and short-term Issuer ratings of BBB_(ZA) and A3_(ZA) respectively. The outlook is Stable.

Rated Entity / Issuer	Rating class	Rating scale	Rating	Outlook / Watch
City of Ekurhuleni	Long Term Issuer	National	BBB _(ZA)	Stable Outlook
	Short Term Issuer	National	A3 _(ZA)	

Rating Rationale

The ratings on the City of Ekurhuleni (“Ekurhuleni; the Metro”) balance the deterioration in financial performance over the past few years that has weakened its liquidity position, against the expectation of an improved (albeit still somewhat constrained) operating performance going forward. The risks are also somewhat mitigated by Ekurhuleni’s large and diversified economy, notwithstanding current economic pressures.

The credit ratings take cognisance of Ekurhuleni’s position as one of the five large South African metropolitan municipalities, with a GDP of around R334bn accounting for just below 20% of Gauteng’s economic output and 6.85% of national output (as at 2018). The Metro incorporates a diversity of industrial enterprises, which have traditionally underpinned economic performance and employment. Having the OR Tambo International Airport within its boundaries also provides a strong economic catalyst, with numerous transport, finance and hospitality businesses located in its proximity. Ekurhuleni’s transport and logistics advantage is also underpinned by a number of highways running through the Metro, which have made the area a prime location for the development of modern warehousing facilities.

Nevertheless, the slowdown in economic activity over the past 10 years has led to the closure of many industrial businesses, not fully compensated for by growth in transport and logistics activities, resulting in rising unemployment and greater poverty levels amongst its residents. Thus, the Metro reports slightly weaker social statistics (average income, access to electricity, water, education levels etc.) than the other large metropolitan municipalities.

Ekurhuleni’s ratings are negatively impacted by income constraints that have impacted operating performance and credit protection metrics. In this regard, whilst total income has grown at moderate levels over the review period, expenditure has risen faster. This has resulted in operating deficits over recent periods, which has been further compounded by a substantial increase in gross debtors and ongoing working capital absorptions. As a result, and despite a reduction in capex, substantial net cash outflows have been reported each year.

However, GCR has considered Ekurhuleni’s revised medium-term budgets in mitigation of these concerns. In this regard, the budget indicates relatively strong growth in income, accompanied by tight expenditure management and various initiatives to improve debtor collections. Together, these measures are expected to result in small cash

surpluses for the Metro over the medium term, which will be used to rebuild reserves. While projections of lower capex will also support financial sustainability over the short term, over the longer term, this may negatively impact Ekurhuleni's ability to expand its economy and meet its social delivery mandate.

As a result of the cash outflows, gross debt increased from R5.7bn at FY17 to R10.1bn at FY21, whilst cash and liquid securities fell from R7.5bn to R1.8bn. Net debt to income remained moderate at 21.2% at FY21 (FY20: 20.6%), but cash flow coverage of interest fell to 4.5x (FY20: 4.6x) and operating cash flow coverage of debt is around 25%. As new debt raised will remain limited to R750m -R1bn per annum over the medium, after netting off annual amortization, GCR expects debt to remain between R10bn to R10.5bn range over the rating horizon. This would leave credit protection metrics around current levels, but with some moderate improvement due to growing income. Debt is diversified by capital markets, bank funders and the DBSA, although increasing reliance on the latter to refinance maturing facilities is somewhat of a concern. As most debt is amortising, there are no maturity concentrations aside from the DMTN maturities, which are covered by a sinking fund.

Liquidity is negative because of the decline in cash reserves over the review period, as a result of which days cash on hand fell to just 17 days in FY21, from 60 days in FY18, well below the National Treasury's 1–3-month guidance. Coverage would be just 10 days if the liquid assets set aside in the sinking funding are excluded. While the adjusted budgets indicate that cash reserves should increase on account of the operating surplus, GCR expects cash coverage to remain low. Sources versus uses coverage is adequate at around 1.4x over the next 12 months, but this is dependent on debtors collection target being achieved, as well as continued access to external debt funding. If collections fall below budget, renewed liquidity constraints are likely.

GCR has also included a positive peer adjustment as Ekurhuleni is the only metropolitan municipality to have received a clean audit outcome. This points to enhanced levels of operational controls within the Metro, which should support initiatives to strengthen the financial position.

Outlook Statement

The Stable Outlook reflects GCR's expectation that adjustments made to the budget should support a strengthening of Ekurhuleni's financial performance and liquidity position. Gross debt and credit protection metrics are also expected to remain around current levels.

Rating Triggers

A rating upgrade is dependent on the Metro achieving or exceeding its medium-term budgets. In this regard, GCR would positively view diversified income growth, that reflects an expansion of the rates based, and increased service utilization (rather than tariff increase). GCR would expect to see the improved cash flows strengthen cash coverage of interest to around the 5.5x level and operating cash flow coverage of debt to around 50%. The liquidity score would improve if days cash coverage rises above 30 days on a sustainable basis.

A rating downward is likely if 1) Ekurhuleni reports another operating deficit and further reduction in cash reserves, 2) there is an increase in debt, or utilization of the sinking fund to meet operational requirements, 3) there is evidence of limited access to external debt funding.

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Related Criteria and Research

Criteria for the GCR Ratings Framework, Jan 2022
Criteria for Rating Local and Regional Governments, June 2019
GCR Rating Scales, Symbols and Definitions, May 2019
GCR Country Risk Scores, December 2021

Ratings History

City of Ekurhuleni					
Rating class	Review	Rating scale	Rating class	Outlook	Date
Long Term Issuer	Initial/ last	National	BBB _(ZA)	Stable Outlook	April 2022
Short Term Issuer	Initial/ last	National	A3 _(ZA)		

RISK SCORE SUMMARY

Rating Components & Factors	Risk scores
Operating environment	14.00
Double country risk score	14.00
Adjustments	0.00
Business profile	(0.25)
LRG Profile	1.25
Operating Performance	(1.50)
Management and governance	0.00
Financial profile	(3.50)
Leverage and capital structure	(1.00)
Liquidity	(2.50)
Comparative profile	0.50
Group support	0.50
Government support floor	0.00
Total Risk Score	10.75

Glossary

Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
Income	Money received, especially on a regular basis, for work or through investments.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.

Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Issuer	The party indebted or the person making repayments for its borrowings.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Offset	A right (Right of Offset) to set liabilities against assets in any dispute over claims.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.
Short Term	Current; ordinarily less than one year.
Upgrade	The rating has been raised on its specific scale

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the ratings were influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to City of Ekurhuleni. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

Subsequent to an appeal, the rating was revised as reflected in the announcement.

City of Ekurhuleni participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from City of Ekurhuleni and other reliable third parties to accord the credit ratings included:

- Audited financial results of City of Ekurhuleni 2020/2021 (Plus four years of comparative numbers);
- Auditor General reports for of City of Ekurhuleni
- Schedule A accounts to February 2022;
- Select debt and cash figures as at 31 December 2021;
- Adjusted Medium Term Revenue and Expenditure Framework 2022-2025
- The Integrated Development Plan 2020/2021;
- Long term planning reports

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