

### CREDIT RATING ANNOUNCEMENT

GCR places the Ekurhuleni Water Care Company ratings of BBB<sub>(ZA)</sub>/ A3<sub>(ZA)</sub> on Negative Outlook, given the ongoing financial constraints and political instability within City of Ekurhuleni

#### Rating Action

Johannesburg, 26 April 2023 – GCR Ratings (“GCR”) has affirmed the national scale long and short term issuer ratings assigned to Ekurhuleni Water Care Company at BBB<sub>(ZA)</sub> and A3<sub>(ZA)</sub> respectively. The outlook has been revised to Negative from Positive.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Ekurhuleni Water Care Company	Long Term	National	BBB <sub>(ZA)</sub>	Negative Outlook
	Short Term	National	A3 <sub>(ZA)</sub>	

#### Rating Rationale

The ratings on the Ekurhuleni Water Care Company’s (“ERWAT”) are equalised with those of the City of Ekurhuleni (“Ekurhuleni”, “the Metro”) as it is a municipal entity controlled by the Metro. In April 2023, GCR affirmed Ekurhuleni’s national scale long and short-term Issuer ratings at BBB<sub>(ZA)</sub> and A3<sub>(ZA)</sub> respectively. However, the outlook was amended to Negative from Stable.

GCR’s designation of ERWAT as an essential municipal entity of Ekurhuleni stems from its mandate to treat the waste water the Metro generates, one of the most important municipal responsibilities. Ekurhuleni has a 97% membership share in the company, making it the controlling member, with the remaining shares split between City of Johannesburg and Lesedi Municipality, for whom it also provides some water treatment services. While treating waste water is always important to ensure residents can live within a safe environment, it is critical to supporting the industrial base of Ekurhuleni’s economy, as industrial companies cannot operate without a means to treat waste water.

GCR positively considers ERWAT’s large water purification infrastructure in support of the rating, as it cannot practically be replicated. Moreover, the company has substantial experience in waste water treatment, employing many skilled professionals that are able to operate the treatment plants. However, a key constraint to operations, is the aging infrastructure and the fact that the plants are already operating above design capacity, with the water treatment requirement expanding annually as the population grows. Management has indicated that around R8bn would be required to fully modernise and expand the facilities. While historical capex has been around R150m per annum, it fell below R100m in FY21 and FY22. Medium term budgets indicate that capex will again register above R100m over the medium term, but even if achieved, this is unlikely to be sufficient to meaningfully address the infrastructure backlog.

ERWAT’s financial profile is very closely integrated with Ekurhuleni, from which it derives around 90% of income. Moreover, payment for services is not exactly linked to a variable amount of service deliver. Rather, ERWAT submits its operating budget to the Metro as part of the annual budgeting process, the Metro then approves the amount necessary for operations and thereafter the allocated amount is paid monthly. Positively, these payments have been sufficient for ERWAT to meet its expenditure, with operating surpluses reported in recent years. ERWAT also generates some outside income by consulting to other municipalities, providing water testing and treatment services to private entities, as well as grey water to some surrounding farms, but these amounts remain small and are not consistent.

ERWAT indicated that payments by Ekurhuleni are largely received on time, which has supported favourable cash flow from operations.

Currently, ERWAT receives all its funding through Ekurhuleni. However, the company does have debt on its balance sheet, being R319m from Nedbank (originally R550m) and R22.7m remaining from INCA. Both facilities are being amortised semi-annually, with the repayments included in the operating budget. Accordingly, GCR considers debt service risks to be low.

ERWAT does maintain separate bank accounts from the Metro, with one used for day-to-day transactions and the other for capital projects. Cash in the capital account tends to fluctuate depending on when grants are received, or projects are implemented, but is all earmarked for specific expenditure. The amounts in the transactional account are generally low, and the company does not have a liquidity reserve to cover day to day expenditure. Accordingly the company is reliant on the timely transfer of funds from Ekurhuleni to meet its operating costs. This exposes ERWAT to the liquidity constraints currently being experienced by Ekurhuleni.

### Outlook Statement

The negative outlook reflects the risk that the ongoing financial challenges faced by Ekurhuleni will further erode the Metro's liquidity and limit its ability to deliver infrastructure and services to residents. In addition, renewed political instability presents a risk to the implementation of its recovery programme. This could negatively impact ERWAT.

### Rating Triggers

As ERWAT's ratings are equalized with the Metro, any change in Ekurhuleni's rating will result in a concurrent change in ERWAT's rating.

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### Related Criteria and Research

Criteria for the GCR Ratings Framework, January 2022  
GCR Rating Scales Symbols and Definitions, May 2022  
Criteria for Rating Local and Regional Governments, June 2019  
GCR's Country Risk Scores, March 2023

### Ratings History

Ekurhuleni Water Care Company					
Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long Term Issuer	Initial	National	BBB <sub>(ZA)</sub>	Stable Outlook	April 2023
Short Term Issuer		National	A3 <sub>(ZA)</sub>		
Long Term Issuer	Last	National	BBB <sub>(ZA)</sub>	Stable Outlook	April 2023
Short Term Issuer		National	A3 <sub>(ZA)</sub>		

## Risk Score Summary

Rating Components & Factors	Risk scores
<b>Operating environment</b>	<b>n.a</b>
Country & sector risk score*	n.a
Adjustments	n.a
<b>Business profile</b>	<b>n.a</b>
LRG Profile	n.a
Operating performance	n.a
Management & governance	n.a
<b>Financial profile</b>	<b>n.a</b>
Leverage and capital structure	n.a
Liquidity	n.a
<b>Comparative profile</b>	<b>10.50</b>
Government support floor	10.50
Peer analysis	n.a
<b>Total score</b>	<b>10.50</b>

\*The country risk score serves as a proxy for sector risk.

## Glossary

Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Capital	The sum of money that is invested to generate proceeds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
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.
Issuer	The party indebted or the person making repayments for its borrowings.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.

## SALIENT POINTS OF ACCORDED RATING

GCR affirms that a.) no part of the rating process was 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 the rated entities. The ratings above were solicited by, or on behalf of, the rated entities, and therefore, GCR has been compensated for the provision of the ratings.

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

- City of Ekurhuleni Audited 2022 financial results (plus four years of comparative, audited financials)
- City of Ekurhuleni Auditor General report for June 2022
- City of Ekurhuleni YTD accounts to 31 January 2023
- City of Ekurhuleni Adjusted Medium Term Revenue and Expenditure Framework 2023 to 2025
- City of Ekurhuleni Integrated Development Plan 2023;

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