

Credit Rating Announcement

GCR places City Of Johannesburg Metropolitan Municipality's rating of AA_(ZA) on Negative Outlook due to liquidity concerns.

Rating Action

Johannesburg, 11 July 2019 – GCR Ratings ("GCR") has placed City of Johannesburg Metropolitan Municipality's rating on Negative Outlook, with the national scale ratings affirmed at AA_(ZA) and A1+_(ZA) in the long term and short term respectively.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
City of Johannesburg Metropolitan Municipality	Issuer Long Term	National	AA _(ZA)	Negative Outlook
	Issuer Short Term	National	A1+ _(ZA)	-

Rating Rationale

The ratings on City of Johannesburg Metropolitan Municipality ("CoJ" or "the metro") are underpinned by its position as the economic hub of South Africa, with the largest population and generally higher standard of living. The Negative Outlook reflects GCR's concerns regarding the persistent high gearing and weak liquidity, which weighs on the overall rating.

The CoJ is the largest city in South Africa and the centre of economic activity in South Africa, accounting for 15% of domestic GDP and housing numerous domestic and international businesses. This has facilitated steadier economic growth (on average), and generally strong social services and access to amenities. Despite the sustained economic growth, this has not been sufficient to satisfy the rising population, and the metro continues to grapple with high incidences of unemployment and poverty, as well as the challenges of delivering services and maintaining infrastructure.

The CoJ's well diversified sources of income are credit positive, with strong underlying growth in key income sources such as water and sewage income, as well as rates. This has been somewhat countered by the high growth in expenditure over the review period, albeit that recent efforts to actively contain expenditure are positively noted. GCR does anticipate that managing electricity will become more challenging as tariffs rise sharply from FY20. Strong operating surpluses are an important underpin to the rating, but will depend on consistent cost rigour. However, the operating performance has been negatively impacted by persistent debtors collection challenges, which has reduced the cash flow available for service delivery and project implementation. Improving collections is critical for future rating progression.

Counterbalancing the metro's strength, is the very high debt of R20.1bn at FY18 (FY17: R20.3bn) and relatively weak gearing metrics. Although net debt to income was moderate at 33.8% at FY18 (FY17: 33.3%), cash flow based metrics are weaker. Thus operating cash flow ('OCF') covered net debt by a relatively low 29.3% (FY17: 31%), while OCF cover of net interest was also low at 2.8x (FY17: 2.2x). GCR anticipates a moderate weakening of these metrics in FY19, due to higher expected debt, contrasted against slightly improved cash generation.

Liquidity is a rating weakness, as the CoJ's cash holdings have trended downwards since FY14 due to persistent working capital absorptions. Thus, cash holdings declined to R2.2bn (FY17: R3.1bn), compared to the high of R5.3bn in FY14, resulting in a decrease in cash coverage to a very low 16 days at FY18 (FY17: 24 days). GCR expects cash holdings to increase by FY19, but this is likely to be offset by a similar increase in debt.

Outlook Statement

The Negative Outlook reflects GCR's concerns as to the persistent high levels of gearing and the weak liquidity, most evident in the very low days cash coverage ratio.

Rating Triggers

Positive rating action could arise if there is a sustained improvement in debtor collections, which in turn would bolster operating cash flow and allow CoJ to fund a greater portion of capex internally.

Negative rating action could arise if 1) there are further cash outflows from operations that lead to even lower cash holdings and cash coverage; 2) gearing metrics increase for any reason; 3) a deterioration in collections amidst the more challenging economic environment.

Analytical Contacts

Primary analyst Johannesburg, ZA	Eyal Shevel Shevel@GCRratings.com	Sector Head: Corporate & Public Sector Ratings +27 11 784 1771
Secondary analyst Johannesburg, ZA	Alan Mananga AlanM@GCRratings.com	Associate Analyst +27 11 784 1771
Committee chair Johannesburg, ZA	Patricia Zvarayi Patricia@GCRratings.com	Deputy Sector Head: Corporate & Public Sector Ratings +27 11 784 1771

Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
 Criteria for Rating Local and Regional Governments, June 2019
 GCR Country Risk Scores, June 2019
 City of Johannesburg Metropolitan Municipality rating report, 2018

Ratings History

City of Johannesburg Metropolitan Municipality					
Rating class	Review	Rating scale	Rating class	Outlook	Date
Issuer Long Term	Initial	National	AA _(ZA)	Stable	Oct 2018
	Last	National	AA _(ZA)	Stable	Oct 2018
Issuer Short Term	Initial	National	A1+ _(ZA)	-	Oct 2018
	Last	National	A1+ _(ZA)	-	Oct 2018

RISK SCORE SUMMARY

Risk score	16.50
Operating environment	15.00
Country risk score	7.50
Sector risk score – approximates country risk	7.50
Business profile	3.50
LRG Profile	3.00
Operating Performance	0.50
Management and governance	0.00
Financial profile	-2.00
Leverage & Capital Structure	-1.00
Funding & Liquidity	-1.00
Comparative profile	0.00
Government support floor	0.00
Peer comparison	0.00

Glossary

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.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
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.
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.
Mandate	Authorisation or instruction to proceed with an undertaking or to take a course of action. A borrower, for example, might instruct the lead manager of a bond issue to proceed on the terms agreed.
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.

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

The credit rating has been disclosed to City of Johannesburg Metropolitan Municipality. The rating above was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating.

City of Johannesburg Metropolitan Municipality 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 Johannesburg Metropolitan Municipality and other reliable third parties to accord the credit rating included:

- The audited financial results up to 30 June 2018
- Four years of comparative audited numbers,
- Economic facts and figures
- Market presentations
- Budget reports up to 2021/2022;
- The Integrated Development Plan 2018/2019; and Schedule A accounts to March 2019.

ALL GCR CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS, TERMS OF USE OF SUCH RATINGS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS, TERMS OF USE AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://GCRRATINGS.COM](http://GCRRATINGS.COM). IN ADDITION, RATING SCALES AND DEFINITIONS ARE AVAILABLE ON GCR'S PUBLIC WEB SITE AT WWW.GCRRATINGS.COM/RATING_INFORMATION. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. GCR'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THIS SITE.

CREDIT RATINGS ISSUED AND RESEARCH PUBLICATIONS PUBLISHED BY GCR, ARE GCR'S OPINIONS, AS AT THE DATE OF ISSUE OR PUBLICATION THEREOF, OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. GCR DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL AND/OR FINANCIAL OBLIGATIONS AS THEY BECOME DUE. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: FRAUD, MARKET LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND GCR'S OPINIONS INCLUDED IN GCR'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS AND GCR'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND GCR'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL OR HOLD PARTICULAR SECURITIES. NEITHER GCR'S CREDIT RATINGS, NOR ITS PUBLICATIONS, COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. GCR ISSUES ITS CREDIT RATINGS AND PUBLISHES GCR'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING OR SALE.

Copyright © 2019 GCR INFORMATION PUBLISHED BY GCR MAY NOT BE COPIED OR OTHERWISE REPRODUCED OR DISCLOSED, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT GCR'S PRIOR WRITTEN CONSENT. Credit ratings are solicited by, or on behalf of, the issuer of the instrument in respect of which the rating is issued, and GCR is compensated for the provision of these ratings. Information sources used to prepare the ratings are set out in each credit rating report and/or rating notification and include the following: parties involved in the ratings and public information. All information used to prepare the ratings is obtained by GCR from sources reasonably believed by it to be accurate and reliable. Although GCR will at all times use its best efforts and practices to ensure that the information it relies on is accurate at the time, GCR does not provide any warranty in respect of, nor is it otherwise responsible for, the accurateness of such information. GCR adopts all reasonable measures to ensure that the information it uses in assigning a credit rating is of sufficient quality and that such information is obtained from sources that GCR, acting reasonably, considers to be reliable, including, when appropriate, independent third-party sources. However, GCR cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall GCR have any liability to any person or entity for (a) any loss or damage suffered by such person or entity caused by, resulting from, or relating to, any error made by GCR, whether negligently (including gross negligence) or otherwise, or other circumstance or contingency outside the control of GCR or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits) suffered by such person or entity, as a result of the use of or inability to use any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained in each credit rating report and/or rating notification are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained in each credit rating report and/or rating notification must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY GCR IN ANY FORM OR MANNER WHATSOEVER.