



## GCR accords a rating of A(ZA) to Buffalo City Metropolitan Municipality; Outlook Stable

Johannesburg, 21 November 2016 — Global Credit Ratings has today accorded national scale ratings to Buffalo City Metropolitan Municipality of A<sub>(ZA)</sub> and A1<sub>(ZA)</sub> in the long term and short term respectively; with the outlook accorded as Stable.

### **SUMMARY RATING RATIONALE**

Global Credit Ratings (“GCR”) has accorded the above credit rating(s) to Buffalo City Municipality based on the following key criteria:

BCMM’s status as a metropolitan municipality since 2011 is positively considered given the greater operational freedom it offers, as well as the increased government support through grant funding. This has been demonstrated by the 13% CAGR in grant receipts since F11. Aside from this, the metro has evidenced strong growth across all income items over the review period. Moreover, as expenditure growth has been below income, BCMM has recorded surpluses in each year under review, with the net surplus rising by 41% to R687m in F16. Of some concern, the electricity and water profit margins continue to contract, as rising bulk purchase costs cannot adequately be passed on to consumers. However, forecast tariffs indicate that there should be some margin claw-back over the medium term by a programme that is in place to reduce distribution losses.

BCMM evidences a very strong liquidity profile, with total cash of R2.4bn at FYE16 (FYE15: R2.2bn). The build-up of cash has been a deliberate strategy to ensure sufficient resources for replacement capex and/or economic development projects. Thus, the metro reports substantial gearing capacity. Gross debt decreased to a new low of R497m at FYE16 (FYE15: R543m), while gross debt to income declined to just 8% at FYE16 (FYE15: 10%). BCMM has, however, indicated that it may assume debt for specific development opportunities that have the potential to increase income to the metro, but would not do so for general capex requirements.

Although efforts to improve debtors collection are positively noted, with collections of current debtors exceeding 90%, BCMM’s debtors book has continued to grow. Of concern is the persistence of debtors outstanding more than 120 days (69% of the total). While this has partly been driven by interest accrued on outstanding amounts, new debtors originated have also contributed to the relative increase. BCMM is seeking approval to write off historical debtors, in an effort to clean up and better manage the current book.

The AG again issued another “qualified” audit opinion on BCMM’s accounts for F15, citing two qualifying issues, namely irregular expenditure and commitments. In addition, notwithstanding progress at improving compliance, amounts included under irregular expenditure remain relatively high.

Improving the audit outcome from the AG, would bode positively for the ratings. In addition to this, the successful implementation of ongoing operational projects that improve efficiencies and aid



debtor’s collection would be positively considered. In the medium term, an upgrade would be dependent on capex projects that stimulate economic activity and employment growth, and enhance sources of income. In contrast, failure to adequately address infrastructure backlogs through capex would indicate that the cash resources are not being employed efficiently and will bode negatively for the ratings.

<b>NATIONAL SCALE RATINGS HISTORY</b>		
Initial rating (August 2003)		
Long term: BBB <sub>(ZA)</sub> ; Short term: A3 <sub>(ZA)</sub>		
Outlook: Stable		
Last rating (May 2015)		
Long term: A <sub>(ZA)</sub> ; Short term: A1 <sub>(ZA)</sub>		
Outlook: Stable		

## **ANALYTICAL CONTACTS**

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## **APPLICABLE METHODOLOGIES AND RELATED RESEARCH**

Criteria for Rating Public Entities, updated February 2016

Buffalo City Metropolitan Municipality reports (2003-2015)

## **RATING LIMITATIONS AND DISCLAIMERS**



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**GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S Local Authorities GLOSSARY**

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.
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.
International Scale Rating LC	International local currency (International LC) ratings measure the likelihood of repayment in the currency of the jurisdiction in which the issuer is domiciled. Therefore, the rating does not take into account the possibility that it will not be able to convert local currency into foreign currency or make transfers between sovereign jurisdictions.
LC	An LC is a guarantee by a bank on behalf of a corporate customer that payment will be made if that entity cannot to meet its obligations.
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	A long term rating reflects an issuer's ability to meet its financial obligations over the following three to five year period, including interest payments and debt redemptions. This encompasses an evaluation of the organisation's current financial position, as well as how the position may change in the future with regard to meeting longer term financial obligations.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Short-Term Rating	A short term rating is an opinion of an issuer's ability to meet all financial obligations over the upcoming 12 month period, including interest payments and debt redemptions.
Under Review	Failure to carry out a full review of a rated entity within the designated timeframe, either through lack of information or delays in finalisation, i.e. review is ongoing.

**SALIENT FEATURES 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.

Buffalo City 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 credit ratings has been disclosed to Buffalo City Municipality with no contestation of the ratings.

The information received from Buffalo City Metropolitan Municipality and other reliable third parties to accord the credit rating(s) included;

- Audited financial results of BCMM 30/06/2016;
- Five years of comparative numbers;
- The AG report on the municipality for 2014/2015;
- Medium term budgets;
- Statutory documentation for the category A municipalities; and
- Industry comparative data.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.

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