



GCR affirms King Cetshwayo District Municipality's* rating of A(ZA); Outlook Stable.

Johannesburg, 05 June 2018 — Global Credit Ratings has today affirmed the national scale ratings assigned to King Cetshwayo District Municipality* of A_(ZA) and A1_(ZA) in the long term and short term respectively; with the outlook accorded as Stable.

* uThungulu District municipality was renamed King Cetshwayo District Municipality effective from 1 July 2016.

SUMMARY RATING RATIONALE

Global Credit Ratings ("GCR") has accorded the above credit ratings to King Cetshwayo District Municipality ("KCDM") based on the following key criteria:

KCDM's mandate entails the provision of water services to the four municipalities in the district, as well as the rollout of infrastructure and the provision of free services to indigents. In this regard, while the district benefits from the inclusion of the industrial town of Richard Bay, over 80% of the population lives in rural area, where poverty levels remain high. Efforts to stimulate economic activity are positively noted, but any benefits in terms of reducing unemployment and poverty will only accrue over the medium to long term, and will not have major impact on internally generated income.

Whereas income has historically risen faster than expenditure leading to strong operating surpluses, a combination of lower grant income and high staff costs and input expenditure saw the surplus narrow in FY17. Although such income trends are expected to persist in FY18, KCDM is still projected to generate strong surpluses. Trade debtors performance was marginally better in FY17, thus reflecting some efforts to improve collections and the initial impact of pre-paid metering. Positively, the collection of non-trade receivables supported robust cash inflows in FY17.

Indications by the National Treasury that grant funding to local authorities will be reduced pose a significant risk to KCDM, as grant funding accounts for 90% of its income. However, it is unlikely that grants will be cut drastically, while operational grants continue to increase, thereby providing the resources for the district to continue with service provision.

KCDM continues to amortise historic debt facilities, with gross debt falling to R55m at FY17 (FY16: R68m). This compares to the increase in cash holdings to R503m at FY17, placing the district in a very strong net cash position. Even on a gross basis, net debt to income is negligible at 5.9% (FY16: 6.7%). Although, KCDM may be required to fund a portion of capex off its own balance sheet, this is unlikely to have a material impact on gearing in the short to medium term.

KCDM's robust cash position is partly a consequence of underspending on its capex budget. Nevertheless, the very high cash coverage reported over the review period continues to support the rating. Days cash coverage (excluding unspent conditional grants) climbed to 290 days at FY19, in



line with the review period average of 309 days, while even assuming the full capex budget was met in FY17, cash coverage would remain in excess of 180 days.

Positive rating movement is only likely over the longer term and dependent on the development of internally generated revenue sources, which would serve to diversify the KCDM’s earnings base and reduce dependence upon the National Treasury. Conversely, a material reduction in the level of government funding would have dire consequences for KCDM, rendering it unable to meet its service delivery commitments. A significant increase in debt financing could also lead to negative rating action.

NATIONAL SCALE RATINGS HISTORY		
Initial rating (December 2006)		
Long term: A _(ZA) ; Short term: A1 _(ZA)		
Outlook: Stable		
Last rating (April 2017)		
Long term: A _(ZA) ; Short term: A1 _(ZA)		
Outlook: Stable		

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APPLICABLE METHODOLOGIES AND RELATED RESEARCH



Global Master Criteria for Rating Public Entities, updated February 2018

uThungulu District municipality /KCDM rating reports, 2006-2017

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GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S CORPORATE GLOSSARY

Budget	Financial plan that serves as an estimate of future cost, revenues or both.
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.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
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.
Debt Financing	Raising capital by selling debt instruments such as bonds, bills or notes.
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.
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.
National Scale Rating	The national scale provides a relative measure of creditworthiness for rated entities only within the country concerned. Under this rating scale, a 'AAA' long term national scale rating will typically be assigned to the lowest relative risk within that country, which in most cases will be the sovereign state.
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.
Risk	The possibility that an investment or venture will make a loss or not make the returns expected. There are many different types of risk including basis risk, country risk, credit risk, currency risk, economic risk, inflation risk, liquidity risk, market or systemic risk, political risk, settlement risk and translation risk.



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.

SALIENT FEATURES OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating process 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.

King Cetshwayo District 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 rating/s has been disclosed to King Cetshwayo District Municipality with no contestation of the rating.

The information received from King Cetshwayo District Municipality and other reliable third parties to accord the credit ratings included;

- Audited financial results of King Cetshwayo District Municipality 2016/2017 (Plus four years of comparative numbers);
- Budget reports up to 2018;
- The Integrated Development Plan;
- Schedule C accounts to December 2017; 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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