Moody's

Rating Action: **Moody's confirms Transnet's Ba3 rating; outlook negative**

25 Jan 2024

London, January 25, 2024 -- Moody's Investors Service (Moody's) has today confirmed Transnet SOC Ltd.'s ("Transnet" or "the company") corporate family rating (CFR) of Ba3 and downgraded the company's Baseline Credit Assessment (BCA) to b3 from b2. At the same time, the probability of default rating (PDR) was confirmed at Ba3-PD and the global and national scale senior unsecured MTN programme (Medium-Term Note) ratings were confirmed at (P)Ba3/A2.za, the global and national scale subordinated MTN programme ratings were confirmed at (P)B1/Baa2.za, the senior unsecured and the backed senior unsecured ratings were confirmed at Ba3 and the national scale other short-term rating was confirmed at P-1.za. The Not Prime (NP) short term issuer rating, the (P)NP other short-term rating and NP commercial paper rating were affirmed.The outlook is negative. Previously, the ratings were on review for downgrade. This rating action concludes the review that was initiated on Transnet on 10 November 2023.

RATINGS RATIONALE

Today's rating action reflects Moody's view that the ZAR47 billion government debt guarantee facility announced on 1 December 2023 will alleviate Transnet's acute liquidity pressure over the next 12 to 15 months and gives the company time to progress with its turnaround plan and start improving operating performance. At the same time, the company's interest burden remains unsustainably high and will increase. Moody's expects that over the next 1-2 years strategic steps which could require equity support will need to be taken to reduce the company's interest burden and reposition the capital structure on a more sustainable footing. Asset sales and operational improvements could reduce some of the equity required, but these remain exposed to execution risk. While Moody's expects the government would provide a degree of additional support if required, no further measures have been announced so far and this creates uncertainty.

Transnet's liquidity has improved following an agreement by the National Treasury and the Department of Public Enterprises to provide the company with a guarantee facility of ZAR47 billion, to fund capex under its turnaround plan as well as debt maturities. In December the company drew down on a portion of this facility to guarantee a new 1-year syndicated bank loan. This will be sufficient to cover Transnet's liquidity needs until the end of the 2023/24 financial year (FY2024) in March 2024.

The guarantee facility is available for 2 years to issue long term guaranteed debt and can be redrawn during the availability period if guaranteed debt has been repaid. Moody's expects that during FY2025 and FY2026 the company will draw down on the entire facility and issue new guaranteed long-term debt of ZAR47 billion.

The agency understands that the total facility was sized to comfortably cover the gap between operating cash flow generation, capex and debt refinancing requirements until the end of FY2025, while factoring in an increase in capex to ZAR17 billion for FY2024 and ZAR27 billion in FY2025, to start addressing some of the company's capex backlog. The additional capex should lead to an increase in net debt of around ZAR15 billion until the end of FY2025.

While the guarantee facility will help the company secure new debt commitments in a timely manner and likely reduce the interest cost of such facilities against the interest Transnet would have to pay on an unguaranteed basis, the increase in net debt by an expected ZAR15 billion will still lead to an overall increase in interest expense over the next 1-2 years.

Transnet's capital structure had become unsustainable, even before the expected increase in net debt because the company's EBIT/ interest coverage ratio has been materially below 1x for the past 3 years and has continued to decline to 0.5x as of September 2023 from 0.6x six months earlier. This means the company is unable to meet regular capex and interest payments from its earnings. Moody's expects this ratio will continue to weaken to around 0.4x for at least the next 1-2 years because the company will face higher interest costs in the coming years, while operating performance will take some time to recover, even if some of the capex backlog starts to be addressed.

Moody's also notes that assuming Transnet refinances all remaining FY2024 and FY2025 debt maturities of ZAR27 billion with long term guaranteed debt, the company will still have a concentrated debt maturity profile of ZAR66 billion over the following three years until the end of FY2028. To access unguaranteed funding again, the company will likely have to demonstrate substantial operational improvements as well as reduce its interest cost to a more sustainable level. This could lead to renewed liquidity pressures after the guaranteed facility has been exhausted.

Transnet falls under Moody's Government-Related Issuers Methodology given its 100% government ownership and importance to the South African economy. The strong link between Transnet and the Government of South Africa (Ba2 stable) is reflected by Moody's assumptions of 'Very High' default dependence with the Government of South Africa and 'High' extraordinary support from the government. The assumption for extraordinary support was revised to 'High' from previously 'Strong' following the announcement of the ZAR47 billion guarantee facility and supports the increase of the uplift from the BCA of b3 to three notches from previously two.

NEGATIVE OUTLOOK

The negative outlook reflects that there will remain negative pressure on the rating until the company's operating performance sustainably improves and EBIT/ interest coverage trends towards 1x. During this period, we expect that Transnet will continue to rely on liquidity support from the government.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Given the negative outlook an upgrade is currently unlikely. We would consider stabilizing the outlook if the company's operating performance starts to sustainably improve, while liquidity remains adequate. For an upgrade we would expect EBIT/ interest expense to sustainably exceed 1.0x.

Transnet's rating is likely to face downward pressure if the company's operating performance does not sustainably improve or if liquidity materially weakens. There would also be downward pressure if Moody's became concerned about the government's ongoing commitment of supporting Transnet in its transition to a sustainable capital structure and solid operating performance. A downgrade of South Africa's government bond rating would also likely lead to a downgrade of Transnet's ratings given our assessment of high credit linkages between the two.

PRINCIPAL METHODOLOGY

The methodologies used in these ratings were Government-Related Issuers Methodology published in February 2020 and available at https://ratings.moodys.com/rmc-documents/64864, and Surface Transportation and Logistics published in December 2021 and available at https://ratings.moodys.com/rmc-documents/360641. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

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The local market analyst for this rating is Lisa Jaeger, +971 (423) 796-59.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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