MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Transnet's CFR to Ba3 from Ba2; outlook remains negative

03 Nov 2021

Paris, November 03, 2021 -- Moody's Investors Service ("Moody's") has today downgraded the corporate family rating (CFR) of Transnet SOC Ltd. (Transnet) to Ba3 from Ba2 and the national scale senior unsecured MTN programme (Medium-Term Note) rating to A2.za from Aa2.za. All short term ratings were affirmed, including the national scale other short term rating of P-1.za Transnet's baseline credit assessment (BCA), a measure of standalone credit quality prior to any assessment of potential extraordinary government support, has been lowered to b1 from ba3. The outlook remains negative.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The lowering of Transnet's BCA to b1 from ba3 and the downgrade of the CFR to Ba3 from Ba2 reflect Moody's view that Transnet's liquidity profile has continued to weaken since the last rating action in June 2021. The ratings downgrade also reflects Moody's view of weaknesses in certain aspects of corporate governance that Transnet's new management team, along with the South African Government, has not sufficiently addressed.

These weaknesses include the company's repeated delays in publishing audited financial statements, its inability to obtain unqualified audit opinions and recurring breaches of debt covenants. Moody's recognizes that the new management team that joined in 2020, including a new CEO, CFO and the Board have strengthened internal controls and oversight processes and are focused on resolving the legacy irregular expenditure related to non-compliance with South Africa's Public Finance Management Act (PFMA). However due to Transnet's status as a South African state-owned enterprise it is subject to oversight of the National Treasury and the Auditor General of South Africa whose own decision making processes are lengthy and outside of the company's control.

Moody's believes these governance failings heighten uncertainty around the company's ability to access international capital markets in a timely manner ahead of a USD1 billion international bond maturity in July 2022 (which was fully cross-currency hedged at the time of issuance). The outlook remains negative because liquidity pressure will continue to intensify unless Transnet raises a substantial amount of new long-term financing in the coming months.

Since June, the liquidity profile has weakened because of 1) a delay in plans for raising new long term debt to bolster liquidity; 2) operational disruptions, that have led Moody's to lower its expectation for operating cash flow generation; and 3) exposure to near-term debt maturities with the July 2022 maturity of the $1 billion international bond having become a current obligation now due within nine months.

For the twelve months ending September 2022, we estimate Transnet will have total debt maturities of c. ZAR22 billion, including the $1 billion bond maturity in July 2022. This is in addition to outstanding amounts under its ZAR13.3 billion short-term liquidity facilities, of which Moody's estimates several billion rand were drawn at the end of September 2021. Moody's considers these liquidity facilities as due over the short-term, as lenders can request repayment at any point upon 360 days' notice, even though lenders have in the past routinely rolled over these facilities. Transnet will not be able to meet most of these maturities from free cash flow or other available committed liquidity sources and will therefore continue to significantly rely upon maintaining access to the domestic and international bond and loan markets for regular roll overs, refinancing and new issuances. The maturity profile remains concentrated in the following years as well, with a total of c. ZAR40 billion due between October 2022 and March 2026.

Transnet continues to actively work on a funding plan and Moody's believes the company will be able to secure financing commitments that will allow it to meet all obligations due until September 2022, however as sizable maturities draw closer without refinancing secured, the risk of default increases. Delays in raising new financing in the six months from April to September 2021 were mainly caused by covenant breaches under various debt agreements, including a breach of a ratings downgrade trigger and delays in releasing audited financials for the year ending March 2021. Audited financials were published on 29 October, 1 month after expiry of the 180-day period after close of the financial year during which financials have to be released under the South African Companies Act. This is the second year in a row that Transnet is breaching the requirement to release audited financials within this timeframe and it is also the fourth year in a row that auditors have issued a qualified opinion due to irregular expenditure under the PFMA. The delay in publishing financials and the qualified audit opinion both trigger breaches of debt covenants.

The company benefits from access to South Africa's deep financial market and maintains good relationships with its bank lenders, who Moody's understands remain supportive. Nevertheless processes to obtain required waivers or covenant resets take time and will further delay the raising of new debt beyond the publication date of audited results. During this time, Transnet remains exposed to event risks that are out of the company's control and could make accessing new financing temporarily more difficult.

The operating environment in South Africa remains challenging given ongoing coronavirus related uncertainty and a high level of socio-economic inequality and political division. Transnet's revenue, EBITDA and cash flow were significantly reduced in the financial year ending March 2021 and Moody's expects recovery to pre-pandemic levels to take 2-3 years. Operations were negatively affected by several periods of outages in the six months to September 2021, including due to civil unrest and a cyber attack in July. In addition, the rising occurrence of cable theft and other capacity constraints due to underinvested infrastructure keep Transnet from benefitting to the full extent from the recovery in commodity prices and increased demand for rail and shipping capacity from exporters.

Transnet's Ba3 CFR continues to reflect the company's solid business profile with ownership of long-term infrastructure assets and a monopoly position in South Africa that provides a degree of cash flow visibility.

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 negative) is reflected by Moody's assumptions of 'Very High' default dependence with the Government of South Africa and 'Strong' extraordinary support from the government, which supports a one-notch uplift from the BCA.

Transnet's Ba3 CFR is supported by its (1) monopoly on the South African railway infrastructure and freight services; (2) ownership of South Africa's eight seaports and operation of a large part of South Africa's stevedoring services; and (3) operation of strategically important hydrocarbon pipelines

At the same time, the ratings also reflect (1) intensifying liquidity pressure over the short term and large debt maturities over the next five years which requires strong access to debt markets to refinance; (2) weak free cash flow generation due to high capital spending requirements; (3) aging infrastructure causing operational disruption and reducing capacity; and (4) regulatory uncertainty on tariff structures.

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

Given the negative outlook, an upgrade is unlikely at this time. Moody's would consider raising Transnet's BCA if the company's liquidity profile substantially improved and corporate governance strengthened. To consider an upgrade, Moody's would also expect adjusted debt/EBITDA to reduce below 5.0x and EBIT/ interest expense to exceed 1.5x, all on a sustained basis. A raising of the BCA would lead to an upgrade of the ratings if the sovereign bond rating of South Africa remains Ba2 or improves.

Transnet's BCA is likely to face downward pressure if the company's liquidity position continues to deteriorate. The BCA would also be under pressure if debt/EBITDA remains above 6.0x while EBIT/interest expense remains below 1.0x. A lowering of the BCA could lead to a downgrade of Transnet's ratings. A downgrade of South Africa's government bond rating could also lead to a downgrade of Transnet's ratings given our assessment of strong credit linkages between the two.

PRINCIPAL METHODOLOGY

The methodologies used in these ratings were Surface Transportation and Logistics published in May 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1113382 , and Government-Related Issuers Methodology published in February 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1186207 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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

Moody's National Scale Credit Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale credit ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale credit ratings, please refer to Moody's Credit rating Methodology published in May 2016 entitled "Mapping National Scale Ratings from Global Scale Ratings". While NSRs have no inherent absolute meaning in terms of default risk or expected loss, a historical probability of default consistent with a given NSR can be inferred from the GSR to which it maps back at that particular point in time. For information on the historical default rates associated with different global scale rating categories over different investment horizons, please see https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1280297 .

LIST OF AFFECTED RATINGS

Downgrades:

..Issuer: Transnet SOC Ltd.

....LT Corporate Family Rating, Downgraded to Ba3 from Ba2

....Probability of Default Rating, Downgraded to Ba3-PD from Ba2-PD

....NSR Senior Unsecured Medium-Term Note Program, Downgraded to A2.za from Aa2.za

....Subordinate Medium-Term Note Program, Downgraded to (P)B1 from (P)Ba3

....NSR Subordinate Medium-Term Note Program, Downgraded to Baa2.za from A2.za

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba3 from (P)Ba2

....Senior Unsecured Regular Bond/Debenture, Downgraded to Ba3 from Ba2

....BACKED Senior Unsecured Regular Bond/Debenture, Downgraded to Ba3 from Ba2

....Baseline Credit Assessment, Downgraded to b1 from ba3

Affirmations:

..Issuer: Transnet SOC Ltd.

....ST Issuer Rating, Affirmed NP

....NSR Other Short Term, Affirmed P-1.za

....Commercial Paper, Affirmed NP

....Other Short Term, Affirmed (P)NP

Outlook Actions:

..Issuer: Transnet SOC Ltd.

....Outlook, Remains Negative

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 at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288235 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the UK and is endorsed by Moody's Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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Paco Debonnaire
Asst Vice President - Analyst
Financial Institutions Group
Moody's France SAS
96 Boulevard Haussmann
Paris 75008
France
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

David G. Staples
MD - Corporate Finance
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's France SAS
96 Boulevard Haussmann
Paris 75008
France

JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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