Eskom Holdings SOC Ltd. (/gws/en/esp/issr/80464056)

FitchRatings

Fitch Places Eskom on RWN; Affirms Guaranteed Debt at 'BB+'

Fitch Ratings-London-17 November 2017: Fitch Ratings has placed Eskom Holding SOC Ltd's Long-Term Local Currency Issuer Default Ratings (IDR) and unguaranteed local currency senior unsecured ratings of 'BB+' on Rating Watch Negative (RWN). Fitch has affirmed the government-guaranteed local currency senior unsecured debt ratings at 'BB+'. We have also placed the National Long-Term Rating of 'AAA(zaf)' and the National Short-Term Rating of 'F1+(zaf) on RWN.

The RWN reflects our intention to reassess the strengths of Eskom's links with the government of South Africa (BB+/Stable) due to Eskom's weakening liquidity and funding access partially stemming from unresolved corporate governance issues, weak cash flows driven by lower-than-expected tariff increases due to delays in implementing outstanding regulatory clearing account applications. The Guarantee Framework Agreement continues to support the company's ratings overall and in particular the affirmation of the guaranteed debt rating.

We may affirm the IDR if there are improvements to corporate governance and liquidity (for instance through additional government support) over the next three to six months or, failing that, downgrade it by up to two notches.

KEY RATING DRIVERS

Corporate Governance, Liquidity Challenges: Fitch understands Eskom began a recovery programme to address the findings relating to the qualified audit opinion in the 2017 annual results. The most recent CEO rotation and their increasing frequency increase uncertainty about the continuity of the recovery plan. The programme has not yet provided confidence that the

targets will be met despite our understanding that the milestones set by the committee had been achieved at end-September 2017, improving corporate governance. This is also affecting Eskom's funding and liquidity position.

Fitch expects the Minister of Public Enterprises to appoint a permanent board before end-November 2017. Eskom has an interim board of nine members rather than 15. Fitch expects the new board to appoint permanent management. The company plans to improve its liquidity position and has started to defer some capex to reduce its short-term cash flow drain. However, failing improvement in liquidity and corporate governance and further support from the government we would be likely to reassess the strength of Eskom's links with the government and downgrade the IDR.

Double-Digit FY19 Tariff Expectation: Fitch expects a low double-digit tariff adjustment for end-March 2019 (FY19). Eskom has received approval from the National Energy Regulator of South Africa to submit a one-year tariff application for FY19, following the conclusion of Multi-Year Price Determination Three at end-March 2018.

DERIVATION SUMMARY

Fitch views Eskom's standalone creditworthiness as 'B-', reflecting its high leverage and weak interest coverage credit metrics, which are among the lowest in the peer group.

Eskom is similarly positioned to peers due to its monopolistic position in power generation and transmission for South Africa. Its strong position in the domestic electricity market, together with 100% government ownership and Fitch's assessment of strong links with the parent (notably supported by the Guarantee Framework Agreement) lead to Eskom's rating alignment with the sovereign.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:

- low-single-digit overall growth in energy sales volume for FY18;
- energy export to support the growth, although transmission capacity constraints likely;
- tariff adjustment for FY18 of 2.2% and low double digits for FY19;
- no dividend payments;
- share of guaranteed debt to increase to about 50%.

RATING SENSITIVITIES

As the ratings are on RWN (except for state-guaranteed debt) we do not anticipate an upgrade. Future developments that may, individually or collectively, lead to a rating affirmation:
- An improvement in corporate governance, liquidity and funding position, possibly with further support from the government and higher tariff increases

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action
- A negative sovereign rating action
- Weakening links with the government, such as the latter's failure to provide timely liquidity and funding alongside unresolved corporate governance issues while tariff increase delays add to pressure on Eskom's financial profile and debt-service capability

South Africa Sovereign Rating Sensitivities

The following risk factors could, individually or collectively, result in negative rating action:

- A marked increase in the government debt/GDP ratio or in contingent liabilities
- A further deterioration in South Africa's trend GDP growth, for example, due to sustained uncertainty about economic policy
- Net external debt rising to levels that raise the potential for serious financing strains

The following risk factors could, individually or collectively, result in positive

rating action:

- A substantial strengthening in trend GDP growth
- An improvement in governance that is supportive of public finances and the business climate
- A marked narrowing in the budget deficit and a reduction in the government debt/GDP ratio

LIQUIDITY

Liquidity Dependent on External Funding: Liquidity has deteriorated, with cash balances likely to reduce to about ZAR1.2 billion at end-November 2017 (after operating and financing cost) from ZAR31 billion at end-March 2017. Eskom has access to committed funding of about ZAR16 billion, which it expects to draw down before end-March 2018. The utility aims to borrow about ZAR24 billion and expects cash balance to increase to about ZAR10 billion by end of March 2018. We expect free cash flow to remain negative and for Eskom to need to access external funding on continuous basis.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017)
(https://www.fitchratings.com/site/re/901296)
National Scale Ratings Criteria (pub. 07 Mar 2017)
(https://www.fitchratings.com/site/re/895106)
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