Research Update:

# South Africa-Based Coal Miner Exxaro Resources National Scale Ratings Raised To 'zaA/zaA-1'

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## Overview

- Exxaro Resources Ltd. continues to deliver stable operational and financial performances, maintaining S&P Global Ratings-adjusted debt to EBITDA close to 1.5x.
- The company recently refinanced its syndicated bank debt facility, extending maturities by five years and strengthening its liquidity position.
- We believe that the lingering risks of payment delays or non-payment from Eskom, Exxaro's biggest customer, have stabilized for now.
- We therefore raised our South Africa national scale ratings on Exxaro to 'zaA/zaA-1' from 'zaA-/zaA-2'.

## Rationale

**Exxaro has built a track record of stable operational and financial performance despite headwinds from Eskom SOC Holdings Ltd. (CCC+/Negative/--).** The South African electricity company is Exxaro's largest customer, representing more than 60% of its revenue. This made Exxaro vulnerable to payment delays or non-payments from Eskom due to the utility's liquidity challenges. While we continue to see this as Exxaro's largest risk, we recognize that the coal miner has delivered a stable performance over the past three years and has benefited from reliable and timely payments from Eskom, underscoring its importance to Eskom and to South Africa's energy supply. Exxaro's relationship with Eskom was tested in 2020, when the utility declared a force majeure event on its contractual obligations, following reduced energy demand due to the pandemic-related lockdown. However, we understand that Exxaro did not experience payment delays nor a reduction in off-take below contractual minimums in 2020. Furthermore, Exxaro's liquidity position and ability to manage high-impact events have strengthened following the April 2021 refinancing of its syndicated bank facilities. The company extended maturities on its South African rand (ZAR) 2.5 billion bullet loan, ZAR2.25 billion amortizing loan, and ZAR3.25 billion to 2026.

**Exxaro's debt metrics over the coming three years should stay supportive of its current credit quality.** We forecast debt to EBITDA and funds from operations (FFO) to debt will remain between 1.0x-2.0x and 50%-60%, respectively, on average. Long-term take-or-pay contracts with Eskom give pricing visibility, while strong export spot prices (about 20% of production) are likely to boost Exxaro's margins over the short term. We expect coal sales volume will remain flat at about 46 million tons per year over the medium term given long-term take-or-pay contracts already in place and constrained rail capacity availability for increasing export volumes. The company's capital expenditure (capex) cycle is expected to normalize below ZAR2 billion per year by 2023, following a heavy investment cycle between 2017-2020, leading us to forecast stronger free operating cash flow.

**We think Exxaro will focus on mine-level portfolio optimization and diversifying exposure away from coal in the coming years.** Exxaro declared its higher cost ECC and Leeuwpan mines, which do not have long-term off-taker agreements in place, as non-core assets. The company is in the final states of concluding the sale of ECC and believe it will look to divest from Leeuwpan in the coming quarters as it manages the long-term energy transition from coal. We assume the company is likely to focus on capital investment projects and acquisitions in early stage renewable energy projects. However, uncertainty over the timing and size of these investments remains high.

**Liquidity and debt metrics will continue to be key considerations in our assessment of Exxaro's creditworthiness.** Our rating on Exxaro reflects its track record in delivering solid operational and financial performances, despite its concentration to Eskom. We expect Exxaro to maintain adequate liquidity with debt to EBITDA of 1.3x-1.7x and FFO to debt close to 50%. We could lower the rating if we expect Exxaro's FFO/debt will fall below 30% or if we expect Exxaro's liquidity position were likely to weaken. This could result from Exxaro experiencing payment delays or nonpayment on sales to Eskom, lower-than-expected export market prices and volumes, or a large debt-funded acquisition. We see limited rating upside given Exxaro's concentration to Eskom, which remains in a weak liquidity position. However, we would consider raising our rating on Exxaro if liquidity improvements at Eskom prompt us to upgrade the utility, or if there is broader certainty that Eskom's suppliers would be paid in a timely manner in the event of an adverse funding gap at Eskom.

## Company Description

Exxaro is primarily a South African-domiciled coal mining company. The company is forecast to sell 46 million tons of coal in 2021, with about 70% of sales by volume to South African energy utility Eskom, 20% to export markets, and 10% to other domestic buyers.

The company has notable interests in:

- Cennergi (100% shareholding), an independent power producer operating two wind-farms in South Africa.
- Sishen Iron Ore Co. (SIOC; 20%)

## Our Base-Case Scenario

### Assumptions

- Realized domestic and Eskom thermal coal selling prices ranging from ZAR470-ZAR550 per ton on average over 2021-2023.
- Prices at Exxaro's Eskom tied-mine to remain above ZAR500 per ton on average.
- Realized export sale prices will remain at a discount to benchmark export prices, closer to an average price of about $60 per ton.
- Overall, thermal coal sales to Eskom of 31 Mtpa-34 Mtpa, domestic thermal and metallurgical sales of about 4 Mtpa, and export sales of 9 Mtpa–11 Mtpa from 2021-2023.
- CPI inflation of 3.9% in 2021 and 4.4% in 2022 and 2023.
- Expected EBITDA of ZAR850 million-ZAR900 million per year from Cennergi.
- Dividends from SIOC of ZAR1.5 billion-ZAR2.5 billion per year over 2021-2023. We include dividends received in our adjusted EBITDA calculation.
- Working capital outflow of about ZAR500 million per year.
- Capex in line with guidance of about ZAR3.3 billion in 2021, declining to about ZAR1.8 billion-ZAR2.3 billion in per year thereafter.
- In line with guidance, a 2.5x-3.5x dividend cover on its core coal earnings, with SIOC dividends passed through to shareholders.
- No divestments of non-core assets over 2021-2023.

## Key metrics

### Exxaro Resources--Key Metrics*

| | --Fiscal year ends December 2020-- | | | | |
|---|---|---|---|---|---|
| **(Mil. ZAR)** | **2019a** | **2020a** | **2021e** | **2022f** | **2023f** |
| Coal sales volume (Mil. Tons) | 44.5 | 46.8 | 46-48 | 46-48 | 46-48 |
| Revenue | 25.7 | 28.9 | 30-31 | 31-33 | 32-35 |
| EBITDA | 10 | 10.7 | 9-10 | 9-10 | 9-10 |
| Capital expenditure | 5.6 | 2.8 | 2.8 | 1.8 | 1.5 |
| Dividends | 7.2 | 4 | 7.5 | 3-4 | 2.5-3.5 |
| Debt | 10.5 | 15.6 | 14-15 | 14-15 | 14-15 |
| Debt/EBITDA (x) | 1 | 1.4 | 1.5 | 1.5 | 1.5 |
| FFO/debt (%) | 75 | 52 | 50-60 | 50-60 | 50-60 |

*All figures adjusted by S&P Global Ratings. Insert here footnotes highlighting the key debt adjustments. a--Actual. e--Estimate. f--Forecast.

## Liquidity

We assess Exxaro's liquidity as adequate. For the 12 months started April 1, 2021, the company's liquidity sources should exceed uses by more than 1.2x. Our assessment considers Exxaro's recent refinancing of its syndicated bank facilities, which extended maturities by five years to 2026. We also consider Exxaro's prudent risk management, continued access to South African banks, and capital markets, and ample covenant headroom. Exxaro remains vulnerable to payment delays from Eskom, but we believe that Exxaro retains flexibility to delay expansionary capex projects or adjust its dividend policy to manage its liquidity position.

Principal Liquidity Sources:

- Cash and cash equivalents of around ZAR10.9 billion, of which ZAR5.3 billion are proceeds from the sales of its shares in Tronox Ltd.
- Available committed facilities of ZAR3.0 billion with a maturity of greater than 12 months.
- Cash FFO, including forecast dividends from SIOC, of about ZAR8.0 billion.

Principal Liquidity Uses:

- No debt maturities over the next 12 months and a ZAR350 million medium-term note maturity in 2022.
- Working capital outflow of about ZAR500 million.
- Capex of about ZAR3.0 billion.
- Ordinary dividends, including SIOC dividend pass through, of about ZAR3.8 billion.
- Special dividends and share-repurchases of ZAR3.5 billion, using proceeds from the Tronox disposal.

## Covenants

We expect that headroom under its banking facility, which includes net debt-to-equity, net interest coverage, and net debt-to-EBITDA covenants, will remain adequate (greater than 15%).

Debt from the Cennergi acquisition is excluded from the Exxaro's debt covenant ratios because it is limited recourse funding with no additional security from Exxaro.

## Issue Ratings--Recovery Analysis

### Key analytical factors

- Despite recovery prospects being over 70%, we cap the recovery rating on Exxaro's senior unsecured debt at '3' due to our view of South Africa's insolvency regime.
- We assume meaningful (50%-70%; rounded estimate: 65%) recovery prospects. The recovery rating is supported by a lack of encumbrances on Exxaro's core coal assets by other commercial debt in the capital structure. We view debt in Cennergi as non-recourse to Exxaro's core coal business.

- Under our hypothetical default scenario, we assume a default in 2025, triggered by revenue and margin contraction, owing to an unfavorable price environment, leading to liquidity issues.
- We value the company as a going concern, reflecting Exxaro's long-term take-or-pay contracts with Eskom, its access to the coal export market, and the substantial coal reserves at its largest operating assets.

### Simulated default assumptions

- Year of default: 2025
- Jurisdiction: South Africa
- Exxaro's RCF: 85% drawn at default

### Simplified waterfall

- Emergence EBITDA: About ZAR3.1 billion (capex represents 5% of three-year average sales and cyclicality adjustment is 15%, in line with the specific industry subsegment. No operational adjustment was used)
- Multiple: 4.5x
- Gross recovery value: ZAR13.9 billion
- Net recovery value for waterfall after administrative expenses (5%): ZAR13.2 billion
- Estimated priority claims at Cennergi of ZAR5.0 billion
- Estimated senior unsecured debt: ZAR8.0 billion
- Recovery range: 50%-70% (rounded estimate: 65%).

*All debt amounts include six months of prepetition interest.

## Ratings Score Snapshot

### National Scale Rating: zaA/--/zaA-1

**Business risk: Weak**

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Weak

**Financial risk: Significant**

- Cash flow/Leverage: Significant

**Modifiers**

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Liquidity: Adequate (no impact)
- Comparable rating analysis: Negative (-1 notch)

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

**Upgraded**

| | To | From |
|---|---|---|
| **Exxaro Resources Ltd.** | | |
| Issuer Credit Rating | | |
| South Africa National Scale | zaA/--/zaA-1 | zaA-/--/zaA-2 |

## Regulatory Disclosures

Exxaro Resources Ltd.

Primary Credit Analyst: Rishav Singh, Associate

Rating Committee Chairperson: G.Andrew Stillman

Date initial rating assigned: March 12, 2014

Date of previous review: May 12, 2020

## Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

This credit rating is solicited. The rated entity did participate in the credit rating process. S&P Global Ratings did have access to the accounts, financial records and other relevant internal, non-public documents of the rated entity or a related third party. S&P Global Ratings has used information from sources believed to be reliable but does not guarantee the accuracy, adequacy, or completeness of any information used.

Materials Used In The Credit Rating Process: Sufficient information in general consists of both (i) financial statements that describe the Issuer's financial condition, results of operations and cash-flows, and (ii) a description of the activities and obligations of the entity including of its governance and legal structure.

This credit rating was disclosed to the rated entity or related third party before being issued.

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## Glossary

- Anchor: The starting point for assigning an issuer a long-term rating, based on its business risk profile assessment and its financial risk profile assessment.
- Business risk profile: This measure comprises the risk and return potential for a company in the market in which it participates (its industry risk), the country risks within those markets, the competitive climate, the company's competitive advantages and disadvantages (its competitive position).
- Comparable rating analysis: This involves taking a holistic review of a company's stand-alone credit risk profile (SACP), because each of the subfactors that ultimately generate the SACP can be at the upper or lower end, or at the midpoint, of such a range. It may also touch upon the overall comparative assessment of an issuer in relation to its peers across industry and jurisdiction and may capture some factors not (fully) covered, such as a short operating track record, entities in transition, unusual structures, or contingent risk exposures.
- Competitive advantage: The strategic positioning and attractiveness to customers of the company's products or services, and the fragility or sustainability of its business model.
- Competitive position: Our assessment of a company's: competitive advantage; operating efficiency; scale, scope, and diversity; and profitability.

- Corporate Industry and Country Risk Assessment (CICRA): Derived by combining an issuer's country risk assessment and industry risk assessment.
- Country risk: This measures a country's influence on the overall credit risks for a rated company with regards to a country's economic, institutional and governance effectiveness, financial system, and payment culture/rule of law risks.
- Creditworthiness: Ability and willingness of a company to meet its debt and debtlike obligations; measured by assessing the level current and future resources relative to the size and timing of its commitments.
- Diversification/portfolio effect: Applicable to conglomerates. An assessment of the extent to which an entity's multiple core business lines are correlated and whether each contributes a material source of earnings and cash flow.
- Earnings: Proxy for profit or surplus yielded by an entity after production and overhead costs have been accounted for in a given period.
- EBITDA margin: This is EBITDA as a fraction of revenues.
- EBITDA: This is earnings before interest, tax, depreciation, and amortization.
- Efficiency gains: Cost improvements.
- Financial headroom: Measure of deviation tolerated in financial metrics without moving outside or above a predesignated band or limit typically found in loan covenants (as in a debt-to-EBITDA multiple that places a constraint on leverage) or set for the respective rating level. Significant headroom would allow for larger deviations.
- Financial risk profile: This measure comprises our assessment of a company's cash flow/leverage analysis. It also considers the relationship of the cash flows the organization can achieve given its business risk profile. The measure is before assessing other financial drivers such as capital structure, financial policy, or liquidity.
- Free operating cash flow: Cash flow from operations minus capital expenditure.
- Funds from operations: EBITDA minus interest expense minus current tax.
- Group rating methodology: The assessment of the likelihood of extraordinary group support (or conversely, negative group intervention) that is factored into the rating on an entity that is a member of a group.
- Industry risk: This addresses the major factors that affect the risks that companies face in their respective industries.
- Issuer credit rating: This is a forward-looking opinion of an obligor's overall creditworthiness.
- Leverage: The level of a company's debt in relation to its earnings before interest, tax, depreciation, and amortization.
- Liquidity: This is the assessment of a company's monetary flows, assessed over a 12- to 24-month period. It also assesses the risk and potential consequences of a company's breach of covenant test, typically tied to declines in EBITDA.
- Management and governance: This addresses how management's strategic competence, organizational effectiveness, risk management, and governance practices shape the issuer's competitiveness in the marketplace, the strength of its financial risk management, and the robustness of its governance.
- Operating efficiency: The quality and flexibility of the company's asset base and its cost

management and structure.

- Outlook: This is the assessment of the potential direction of a long-term issuer rating over the short to intermediate term (typically six months to two years).
- Profitability ratio: Commonly measured using return on capital and EBITDA margins, but can be measured using sector-specific ratios.
- Scale, scope, and diversity: The concentration or diversification of business activities.
- Stand-alone credit profile (SACP): S&P Global Ratings' opinion of an issue's or issuer's creditworthiness, in the absence of extraordinary intervention or support from its parent, affiliate, or related government or from a third-party entity such as an insurer.