

Research Update:

South African Eqstra Holdings 'zaBBB/zaA-2' National Scale Ratings Affirmed On Capital Increase And Improved Financials

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Overview

- Eqstra Holdings Ltd.'s equity increase of South African rand (ZAR) 650 million has alleviated downward pressure on its ratings.
- In our opinion, this capital increase, alongside an improvement in financial performance, has helped to address the company's short-term funding vulnerabilities.
- We are affirming our 'zaBBB/zaA-2' long- and short-term South African national scale ratings on Eqstra.

Rating Action

On Aug. 20, 2010, Standard & Poor's Ratings Services affirmed its 'zaBBB/zaA-2' long- and short-term South Africa national scale ratings on Eqstra Holdings Ltd.

Rationale

The affirmation factors in a South African rand (ZAR) 650 million capital increase for the company in the first half of 2010, alleviating near-term funding and liquidity vulnerabilities, although longer term sustainable improvements in Eqstra's funding profile, profitability, and cash flow would be more positive for the ratings.

The affirmation reflects that the national scale ratings on Eqstra continue to be supported by good levels of capitalization--albeit with high leverage--and a good market position and customer franchise.

The ratings are constrained by a still-concentrated funding profile, which is reliant on the limited number of South African bank counterparties, cyclical earnings vulnerabilities, and adequate cash flow for the leverage of the company. The ratings factor in our assessment of the company's stand-alone credit profile, and do not include any uplift for extraordinary external support. Furthermore, due to Eqstra's nonbank status the institution does not benefit from the soft benefits of banking regulation including access to central bank liquidity.

Eqstra raised ZAR650 million of new capital in the first half of 2010, which was well supported by existing shareholders. In our opinion, this capital increase, alongside an improvement in financial performance, has started to address some of the company's funding vulnerabilities, especially near-term

liquidity risks. Leverage subsequently decreased on the back of the capital raising, and this reduction has translated in an improvement in the cash cushion, the removal of the dependence on short-term debt facilities, and has increased the cushion above its existing debt covenants. Reduced indebtedness and lower capital expenditure (capex) have also improved Eqstra's cash flow, which is a key factor for the management of liquidity. Funds from operations (FFO) are improving while free operating cash flow (FFO minus changes in working capital and capex) has become positive against net debt.

Standard & Poor's believes that cash flow and profitability are likely to improve in the next financial year as the pipeline for projects remains strong and capital expenditure needs are limited and linked to the working capital cycle only.

Consequently, because of lower leverage, and improved cash flow and financial performance, the funding profile is in our opinion somewhat less reliant on the willingness of the major banks to provide ongoing short-term finance. Nevertheless, funding concentrations remain a persistent restraint on ratings.

Funding is, in our view, overly concentrated on the major South African banking groups, which supply 77% of total funds--including a standby liquidity facility for the commercial paper program. Issues of funding concentrations are aggravated by high refinancing risk in 2013 when the ZAR3.3 billion bullet payment is due unless Eqstra can renegotiate the debt package. Positively, we view the willingness of South African banks to support Eqstra as high, demonstrated by the successful renegotiation of funding covenants in 2009.

We could raise our ratings if Eqstra improves its financial performance on a sustainable basis and if it demonstrates that its working capital cycle does not erode cash flow to aggressive levels once more. This would entail free operating cash flow to remain positive, while FFO improves to modest levels.

We could also raise the rating if the vulnerabilities in the company's funding structure are addressed, including the diversification of both the maturity profile and concentration of counterparties.

However, it would be negative for the ratings if during this time leverage increases aggressively, profitability and cash flow deteriorate to levels where funding covenants are threatened, or if the company approaches the bullet repayment without refinancing options being addressed.

Related Criteria And Research

- South Africa (Republic of), Jan. 19, 2010
- Understanding National Rating Scales, April, 14, 2005
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009

Ratings List

Ratings Affirmed
Eqstra Holdings Ltd.
South Africa National Scale Ratings zaBBB/zaA-2

NB: This list does not include all ratings affected.

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