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Ratings

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Research Update:

enX Leasing Investments South Africa National Scale Rating Lowered To 'zaBBB'; Remains On CreditWatch Negative

August 17, 2020

Rating Action Overview

- We believe enX Leasing's (enX) Industrial Equipment (EIE) and Fleet Management and Logistics (FML) businesses will suffer due to lower economic activity in South Africa and the U.K. as a result of the COVID-19 pandemic.
- We anticipate a 5%-15% revenue decline in fiscal 2020, resulting in average funds from operations (FFO) to debt falling to below 30%.
- We view enX's liquidity as less than adequate based on its current maturity profile, but understand the company is in discussion with lenders to refinance its funding structure and address refinancing risk on upcoming debt maturities.
- We are therefore lowering our rating on enX to 'zaBBB' from 'zaA-'.
- The CreditWatch negative indicates that we could lower the ratings this quarter if enX does not successfully refinance its funding structure in a timely manner.

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Rating ActionRationale

We expect revenue will decline by about 10% in fiscal 2020 (ending Aug. 31, 2020) and EBIT margins will fall to about 13% on average, representing a 15% decline in EBIT compared with South African rand (ZAR) 780 million in fiscal 2019. We believe revenue will drop due to lower demand for direct sales in EIE, as well as slower equipment and vehicle turnover at the end of the lease life in both EIE and FML. We expect fleet utilization rates will remain in line with historical levels, but anticipate the total lease book size will reduce in line with demand due to lower capital investment. Although the benefits of lower interest rates will be passed on to customers, we believe the low-interest-rate environment will assist with customer retention and enhance enX's competitiveness relative to financial institutions.

While enX retains flexibility to reduce capital investment in its lease book to levels commensurate with demand, boosting short-term cash flows, we expect the COVID-19 pandemic will result in more volatile profitability and higher leverage in the short term. enX's flexibility to reduce capital expenditure (capex) in line with demand has allowed it to maintain its cash position since implementation of COVID-19-related lockdown measures in late March 2020. The company has also introduced other cash-preservation and efficiency measures such as reduction of overhead costs, the size of supplier orders, and stock levels.

We think a recovery in economic activity in South Africa from 2021 will support revenue stabilization. Both EIE and FML have diverse corporate customer bases that are spread across industries, and both benefit from three-to-five year terms on lease contracts, which provides good revenue visibility. The sale of equipment and vehicles at the end of the initial lease term also generates a material component of the company's revenue. We expect the forecast recovery in GDP in both South Africa and the U.K. in 2021 will translate to mid-single-digit growth in 2021.

enX's overall liquidity position is dependent on the company refinancing its funding structure in a timely manner. Following termination of FML's planned divestment in May 2020, we understand enX has re-engaged with lenders to refinance its South African debt. We understand enX had agreed to refinance EIE as a condition precedent to the divestment, but will now extend the refinancing to include FML. The company has debt maturities of ZAR3.4 billion in South Africa the period up to fiscal 2022. In our opinion, there remains a risk that enX is unable to conclude refinancing on favorable terms.

We acknowledge a high degree of uncertainty about the evolution of the coronavirus pandemic. The consensus among health experts is that the pandemic may now be at, or near, its peak in some regions but will remain a threat until a vaccine or effective treatment is widely available, which may not occur until the second half of 2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

CreditWatch

In resolving the CreditWatch, we will continue to assess developments in enX's debt refinancing and the effect of COVID-19 on earnings forecasts, credit metrics, liquidity position, and covenants.

We could lower the ratings by one or more notches if we believe that enX will not successfully refinance its debt maturities due in fiscals 2021 and 2022. We could also lower the ratings if we think the company's credit metrics will deteriorate further, such that adjusted funds from operations (FFO) to debt is likely to fall below 20% on average, with limited prospects for the company to restore metric headroom by fiscal 2022.

We could affirm the ratings once we have more certainty on the company's execution of its debt refinancing and reprofiling strategy.

Company Description

enX Leasing is an operating leasing company with equipment and vehicle fleet leasing operations in South Africa and the U.K.(only equipment). The company generated ZAR5.6 billion in revenue in 2019.

The company is 100% owned by enX Group Ltd., a JSE listed company with ZAR850 million market capitalization. enX Group also operates power, wood and oil segments that fall under enX Trading Investments (Pty) Ltd.

Our Base-Case Scenario

Assumptions

- Real GDP contraction in South Africa of 6.9% in 2020, recovering to 4.7% growth in 2021. Consumer price index inflation (CPI) of 3.7% in 2020 and 4.0% in 2021.
- Real GDP contraction in U.K. of 8.1% in 2020, recovering to 6.5% growth in 2021. CPI inflation of 0.5% in 2020 and 1.8% in 2021.
- Revenue contraction of 5%-15% in fiscal 2020, with mid-single-digit recovery in 2021 commensurate with GDP growth.
- EBIT margin of 13%-14%, compared with 14% in fiscal 2020.
- Working capital inflows of about ZAR200 million in both fiscals 2020 and 2021, primarily driven by sale of assets classified as inventory at the end of their lease periods.
- Capex of ZAR1.4 billion-ZAR1.6 billion in fiscals 2020 and 2021, down from ZAR2.2 billion in fiscal 2019, due to a slowdown in economic activity.

Key metrics

Based on these assumptions, we arrive at the following average S&P Global Ratings-adjusted credit measures over fiscals 2020 and 2021:

- Adjusted EBIT margin of 13%-14%.
- Adjusted EBIT interest coverage of about 1.8x.
- Adjusted debt to total capital of about 66%.
- Adjusted FFO to debt of 22%-26%.

Liquidity

We assess enX Leasing's liquidity as less than adequate. We forecast that sources of liquidity will be less than its uses of liquidity for the 12 months starting June 1, 2020, because enX is yet to complete the refinancing of its South African debt maturing in this period..

For the 12 months started June 1, 2020, we calculate that enX Leasing has the following principal liquidity sources:

- Cash and cash equivalents of about ZAR400 million. The company is fully drawn on its committed lines.
- Forecast cash FFO of about ZAR1.3 billion.
- Working capital inflows of ZAR200 million.

For the same period, we calculate the following principal liquidity uses:

- Debt maturities of about ZAR1.1 billion.
- Capex of ZAR1.4 billion–ZAR1.5 billion.

Covenants

The financial covenants on external bank borrowings in South Africa and the U.K. include net debt to EBITDA, EBIT to net interest coverage, and other capital structure related covenants. Under our base case, we forecast that enX will remain in compliance with its covenants, albeit with limited (less than 10%) headroom.

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 | Industrials: Key Credit Factors For The Operating Leasing Industry, Dec. 14, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded

	To	From
enX Leasing Investments (Pty) Ltd.		
Issuer Credit Rating		
South Africa National Scale	zaBBB/Watch Neg/--	zaA-/Watch Neg/--

Regulatory Disclosures

enX Leasing Investments (Pty) Ltd.

Primary Credit Analyst: Rishav Singh, Associate

Rating Committee Chairperson: G.Andrew Stillman

Date initial rating assigned: Sept. 20, 2018

Date of previous review: May 12, 2019

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).
- Capital: The sum of equity and debt.
- 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.
- CreditWatch: This highlights the potential direction of a short- or long-term rating over the short term, typically less than three months. Ratings may be placed on CreditWatch where, in our view, an event or a deviation from an expected trend has occurred or is expected and additional information is necessary to determine the rating impact.
- Creditworthiness: Ability and willingness of a company to meet its debt and debt-like 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.
- Economies of scale: This is the cost advantage that arises with increased size or output of a product.
- 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 takes into account 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).
- 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.