COMMERCIAL AND OPERATIONAL PERFORMANCE ASSESSMENT OF SELECTED SAPP POWER UTILITY MEMBERS

LOAN/CREDIT # 2031109-12

CREDIT RATING AGENCY PROCUREMENT CRITERIA DOCUMENTS

Prepared for:

SOUTHERN AFRICAN POWER POOL

Prepared by:

MERCADOS – ENERGY MARKETS INTERNATIONAL

August 2010
No. MI1148
# CREDIT RATING AGENCY PROCUREMENT CRITERIA DOCUMENTS

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I INTRODUCTION

This Credit rating procurement report is one of the key documents as part of the SAPP’s and World Bank’s “Operational and Performance Assessment of selected power utility firms” aiming at providing the following:

- Comprehensive information concerning the potential contractual engagement of one or more global credit rating agencies (CRAs) with a view of requesting the assignment of a rating
- Guidance with regards to the different types of available credit ratings and impact on the firms involved
- Like-for-like comparison of the costs involved for various options available from each rating agency

II INFORMATION SOURCES

The information in this report is based on verbal conversations as well as written correspondence of the consultant’s (Mercados EMI) credit rating expert with the relevant CRA contacts (Business development representatives for fee quotes and/or Senior analytical staff for ascertaining the current rating criteria and other relevant methodologies that are used by the CRAs in order to derive the ratings), both in London and Johannesburg.

These talks with the CRAs were held between July and the first week of August 2010 and as such contain information as of 08/2010. The current rating criteria and methodologies relevant for this project are included as Appendix to this report and are separately referred to in the section for each individual CRA. Fee quotes as of July/August 2010 are indicative, based on the limited information that has been provided to the CRA and hence can be subject to change, particularly as more detailed information is provided to them by the respective utility.

No utility specific-information has been provided to the CRA other than the names of the firms (BCP, EDM, LEC, ZESCO) and the country of domicile.

The conversations were earmarked as confidential but the CRAs are aware that the information provided by them to the consultant is to be reflected and included in this report which will be used as basis by the SAPP and the utilities that are part of this project for their decision-making process.

The proposals presented in this report and in the attached supporting documentation are in no way intended to create a legal arrangement between the CRAs and the utilities involved in this project.

Whilst until early 2009 CRAs have been able to undertake advisory work themselves in order to prepare corporate issuers of the credit assessment exercise, regulation has now globally changed as such that the CRAs are not able to act as advisors to issuers any more and issuers cannot rely on the CRAs advice going forward. Nothing in this report or the attached CRA documents is intended or should be construed as creating a fiduciary relationship between the utilities and the CRAs.

For good order’s sake and to avoid any bias for the purpose of an impartial report, we herewith declare that the consultant’s expert has worked for Fitch Ratings from 2004 to 2006, however, he...
III RATING SCOPE

The purpose of this rating procurement report was to provide guidance with regards to request the assignment of a ‘private rating’ from one or more of the Credit rating agencies (Moody’s, Standard & Poor’s and Fitch Ratings). However, as a ‘Private rating’ is typically one of the first steps for a ‘Public rating’, it appears sensible to provide a comparison of the scope and limitations of those different types of ratings to aide the utility firms decisions making process.

1. CREDIT ASSESSMENT (CA)

A Credit Assessment is nowadays often the first steps of an issuer in the rating assessment by a CRA. A credit assessment (or CA) provides an indication of the likely rating that an entity may receive if it were to request a full rating. The CA is a rating-level opinion carried out by analysts from the same group that would assign a full rating, and can consider all materials that the requesting entity is prepared to provide for the assessment process.

CAs are hence preliminary point-in-time indicators (i.e. at the time of the CRA analysis). They are not formal ratings as the CRA would typically not have access to (and hence disregard in their analysis) future strategy, management etc. Furthermore, CAs are not published or disclosed into the public domain.

Most frequent users of CAs/PCAs are investment banks or governments when they use the CRA’s service to evaluate the creditworthiness of specific corporates, constructors, counterparties etc.

The agencies have confirmed during the initial discussion that they have recently experienced requests for CAs from unrated corporates as a first step in their plans to undertake full public credit ratings.

As part of the CRA analysis to provide a CA, the agencies will review summary public information and undertake an evaluation of the general strengths and weaknesses of the company that is assessed.

A short report (please see attached sample from S&P ‘Carmel S.A.’ for illustrative purposes) is produced thereafter which summarises Business & Financial review, Strengths and Weaknesses, Vulnerabilities and Key Financial Ratios.

Due to its private nature of this credit assessment report, public dissemination is not permitted.

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1 Please note that this is also referred to as ‘Private Credit Analysis’ (PCA) by S&P which differs from the term ‘Private Rating’ that Fitch Ratings uses.
S&P suggest that the undertaking & completion of a CA takes generally 10 to 15 business days.

Due to the point-in-time nature of the CA cost/fees for the CRAs analysis are typically a one-off payment with no additional annually re-occurring costs.

2. PRIVATE RATING

In the event that a Credit assessment is undertaken, the next step can be to continue the process towards a full corporate rating – which can either be private or public (see next header).

Private ratings undergo exactly the same analysis, committee process and ongoing surveillance as public ratings, unless otherwise disclosed as ‘point-in-time’ in nature (see section Credit Assessment above).

The CRAs are typically able to assign private ratings where the circumstance around the rating and issuance are solely for private use by the issuer and private placement. These ratings are assigned where justified and subject to international regulatory rules. Fitch for instance requires prior approval by the CRA’s Credit committee before it is able to assign a private rating.

Private ratings are generally provided directly to the rated entity (i.e. the Utility itself), which is then responsible for ensuring that any party to whom it discloses the private rating is updated when any change in the ratings occurs.

After the engagement of the relevant CRA, an information list is provided to the utility (which includes management strategy, historical and future projected financials, Management CVs etc) to enable the CRA’s analysts to commence the rating process.

This is followed by a pre-arranged management meeting (also know as ‘due diligence’ or ‘servicer review’) which takes between ½ and ¾ of a day. Subsequently, the analysts complete their analytical report and present the credit to an internal rating committee.

The private rating exercise takes typically between four to six weeks, however if the utility was to require the rating more urgently and subject to available analytical staff at the CRA the completion of the rating process may be undertaken in a shorter period. The utility has ultimately got to make the choice whether it would like the rating to be made public or if it prefers maintaining the rating on a confidential basis.

As opposed to the point-in-time nature of the CAs, the private rating (as well as the public rating) are ongoing ratings, requiring ongoing monitoring and surveillance activities by the CRAs. The agency(ies) will also at least annually confirm/affirm the rating which involves more analytical work and subsequently will lead to annually recurring additional costs. Please refer to the cost/fee section of this report for further information.

3. PUBLIC RATING

The process in order to derive at a public rating is exactly the same as for the private rating, but the output of the analysis, i.e. the rating itself is published and hence not confidential. In fact, the CRA
will disseminate the rating including an initial (pre-sale) report and eventually the final (New issue) rating report accompanied by a press release to the CRAs website as well as a network of approx. 45 globally active news agencies (for instance Reuters and Bloomberg).

Similarly, to a private rating, the public rating is ‘ongoing’ and not ‘point-in-time’, hence requires continuous monitoring and surveillance activities by the CRA – these are all activities of the CRA that come at an annual cost to the utility (more on fees/cost in the following sections).

4. CREDIT RATING DECISION MAKING TREE

The following credit rating decision making tree provides a decision aid to the utility taking into account the comments made in sections ‘Rating scope’ and ‘Cost/Fee comparison’.

From an utility perspective, it is important to understand the various areas that are likely to impact the credit rating. These include amongst others:

- Should the utility firm become rated or not?
- What is the nature of the credit rating sought? Private or Public?
- What is the desired time horizon? Point-in-time or continuous?
- Is there an ongoing monitoring of the rating by the CRA? Credit assessment or Private rating?
- Last but not least, what are the cost implications of those choices? Low vs higher cost?

Exhibit 1 shows the above mentioned tree

IV COST/FEES ANALYSIS

1. GENERAL APPROACH

All fees quoted in the following section are indicative fee arrangements for discussion purposes only as of July/August 2010. The CRA advise that they will be in a better position to provide firmer quotes.

Fitch has advised that they would be able to ‘cap travel fees should all meetings held within the same period’. Given that this project/ SAPP may potentially be looking at rating request for up to four utilities, it may be possible to negotiate a reduced fee for getting four utilities rated at the same time.
Exhibit 1 Credit Rating decision making tree

Credit Rating Roadmap

- Utility remains unrated.
- Should we be rated?
  - Yes
  - Nature of Rating?
    - Cost of Rating?
      - Time Horizon?
        - Highest
        - Continuous
        - Lowest
        - Point in time
          - Yes
            - Higher
          - No
            - Continuous
  - Private
    - Ongoing monitoring?
      - Yes
      - Private Rating
      - Public Rating
      - Credit Assessment
2. COST COMPARISON

Where available, fee quotations and rating fee schedules from the credit rating agencies have been included to this report which enables the utilities to understand the pricing and cost implications of the chosen rating types.

Some of these documents are quite comprehensive (i.e. ‘Moody’s Application & Fee Schedules for Corporate Issuers EMEA’ contains 17 pages) and providing the full documentation to the utilities will ensure full pricing transparency.

Whilst this procurement report focuses on gaining a indicative rating assessment or private/public rating for the utility firm in the first instance, some of the utilities may eventually wish to look towards the issue of utility bonds or similar debt instruments. The pricing/fee information for some CRAs contains information with regards to such issuance and although not part of this project, the consultant feels it may useful to pass this information on to the utility firm if and where available.

2.1. CREDIT ASSESSMENT

<table>
<thead>
<tr>
<th>Description of Charge</th>
<th>Fitch Ratings</th>
<th>Moody’s</th>
<th>Standard &amp; Poor’s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fee</td>
<td>USD 25,000 (+ VAT)</td>
<td>EUR83,200</td>
<td>USD 15-20,000²</td>
</tr>
<tr>
<td></td>
<td>n/a</td>
<td>EUR103,000 for ‘complex’ ratings</td>
<td>n/a</td>
</tr>
<tr>
<td>Update Rating</td>
<td>n/a</td>
<td>EUR24,900</td>
<td>n/a</td>
</tr>
<tr>
<td>Travel fees</td>
<td>Reimbursable by Issuer</td>
<td>No information given</td>
<td>(assumed reimbursable)</td>
</tr>
<tr>
<td>Legal fees ³</td>
<td>Reimbursable by Issuer</td>
<td>No information given</td>
<td>(assumed reimbursable)</td>
</tr>
</tbody>
</table>

GRAND TOTAL

USD 25,000 + VAT + ...

USD 15-20,000 + (VAT) + ...

² S&P has not stated whether VAT is added to the fee

³ Whilst the agencies have indicated that legal fees are reimbursable, it is also worth noting that the CRAs would typically consult their legal in-house counsel as part of the rating process and only were to consult an external lawyer (at additional reimbursable cost) if the in-house legal team is not able to conclude on legal issues.
2.2. **Private or Public Rating**

<table>
<thead>
<tr>
<th>Description of Charge</th>
<th>Fitch Ratings</th>
<th>Moody’s</th>
<th>Standard &amp; Poor’s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Rating Fee</td>
<td>USD 30,000 (+ VAT)</td>
<td>EUR 49,400</td>
<td>USD 70-80,000⁴</td>
</tr>
<tr>
<td>Issuance Fee (One-off)</td>
<td>4bps, min. of USD10,000 and max of USD 30,000</td>
<td>n/a</td>
<td>4.75bps up to USD1bn. Issuance above USD1bn is quoted separately.</td>
</tr>
<tr>
<td>Surveillance Fee (Annually occurring)</td>
<td>USD 30,000 p.a. (Annually in arrears)</td>
<td>EUR 49,400p.a.</td>
<td>USD 40-50,000 (p.a.) (Annually at anniversary of initial rating)</td>
</tr>
<tr>
<td>Travel fees</td>
<td>Reimbursable by Issuer</td>
<td>No information given</td>
<td>(assumed reimbursable)</td>
</tr>
<tr>
<td>Legal fees</td>
<td>Reimbursable by Issuer</td>
<td>No information given</td>
<td>(assumed reimbursable)</td>
</tr>
<tr>
<td><strong>GRAND TOTAL</strong></td>
<td>USD 30,000 + VAT + Issuance fee + USD30,000p.a. + Other fees</td>
<td>EUR 49,400 + (VAT) + EUR 49,400p.a.</td>
<td>USD 70-80,000 + (VAT) + Issuance fee + USD 40-50,000p.a. + Other fees</td>
</tr>
</tbody>
</table>

Similarly, Fitch has stated this as ‘Issuance’ fee without any further qualifying statement to see whether this would only apply to issuance of debt instruments such as long-term bonds, preferred stock etc. and should be clarified with the agency.

Details of costs calculation from different agencies can be found in Annex 2.

**V Rating Methodologies**

The following section provides a detailed overview of the currently applying rating methodology and criteria that are used by the CRAs in order to assess the creditworthiness of the utility(ies). This is

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⁴ S&P has not stated whether VAT is added to the fee

⁵ S&P calls this ‘Debt issuance fee’ which applies to long-term bonds, syndicated loans, preferred stock, private placements etc. and is based on the ‘size of the issue’. Implicitly, it would appear that this fee does not apply to corporate ratings – but would require clarification with the agency.
correct as of July/August 2010 and based on information that has been provided by the CRAs analytical staff.

The attached Rating methodologies and rating criteria are the agencies’ description of the analytical framework that they are using in order to derive at the respective credit rating. These methodologies provide transparency for the rated firm and investors in the company to understand the rating outcome and the relevant drivers behind the rating.

It is important to understand that the qualitative elements are crucial to the analysis and such emphasise the interactive nature of the rating – this is one of the reasons, why the management or due diligence meeting is an important key rating driver.

Rating methodologies as such provide the analytical basis for the ratings without constraining the true focus on the credit worthiness of the company in question.

By including the rating methodologies in this report, the utilities are given full transparency with regards to the rating agency expectations.

Whilst the consultant is currently not aware of any foreseeable changes to these rating methodologies, please note that CRAs can in theory change those at any time without giving much notice. The consultant strongly advises to request confirmation from the agencies that the following rating criteria still apply at the time of entering a formal commercial relationship with one or more of the CRAs.

The documents referred in the section below have all been included in the Appendix to this report.

1. RATING CRITERIA: FITCH RATINGS

1. Corporate Rating Methodology, published 24 November 2009
2. Credit Rating Guidelines for Regulated Utility Companies, 31 July 2007
3. Rating EMEA Utilities – Sector credit factors, 14 May 2010
4. The Rating Process, July 2006
5. Definitions of Ratings and Other Forms of Opinion, July 2010
6. Inside the Ratings: What Credit Ratings Mean, August 2007

Rating example reports provided by the CRA:

- Namibia Power Corporation (Proprietary) Limited – Credit Update, 29 April 2010
- Eskom Holdings Limited – Credit Update, 5 May 2010
2. RATING CRITERIA: STANDARD & POOR’S

2. Enhanced Methodology and Assumptions for Rating Government-Related Entities, 29 June 2009

Rating example reports provided by the CRA:
- Carmel S.A. – Credit Estimate (i.e. Credit assessment), 6 August 2008
- Botswana (Republic of), Sovereign rating report, 11 March 2010
- Mozambique (Republic of), Sovereign rating report, 22 January 2010

3. RATING LINKAGE TO SOVEREIGN RATINGS

Given the nature and standing of the Utilities with each of the countries where they reside (i.e. Botswana for BCP, Lesotho for LEC, Mozambique for EDM and Zambia for ZESCO), the firms’ creditworthiness are expected to be linked to the ratings of the relevant Sovereigns.

Hence, the CRAs are likely to reflect this linkage in the rating that is ultimately assigned to the utility(ies).

Of course, this is a fairly simple exercise for a country that where the sovereign has already been rated by the respective CRA.

However, were this is not the case, S&P advises the consultant that the CRA generally does not undertake ratings for corporates if the agency does not have a ‘full and interactive rating on the Sovereign’ (for instance S&P currently does not rate Lesotho and Zambia).

S&P further advises that there have been selected exceptions to this general rule in the past due to the CRA having access to government personnel/information or ‘availability of intelligence within Standard & Poor’s’.

The CRA further advised us that final decisions on rating entities in a country without a S&P sovereign rating are made on a case-by-case basis ‘under reference to Senior global management’.

In stark contrast, Fitch has advised the consultant that in cases were the CRA does not currently rate the Sovereign in which the Utility resides, the agency may be able to undertake a ‘Shadow rating exercise’ that could be used in order to determine

1. The Rating of the Sovereign (which will not be published)
2. The Rating of the Utility.

Unfortunately, Moody’s is not disclosing its policies regargin the link with the sovereign rating.
In conclusion, whilst S&P generally requires a Sovereign rating as part of rating a GSE-related entity (such as a utility), Fitch would appear to be able to overcome such issues for countries without Sovereign ratings.

**VI  THE RATING PROCESS**

The following section provides a brief overview and discusses the operational steps that form part of the rating process and that would follow if the utility was to choose to become a rated entity.

They are not CRA-specific and meant for guidance only. As CRA regulation changes constantly and agencies update their processes/procedure, deviations from some of those steps are of course possible.

The rating process itself is typically iterative and lasts between eight to twelve weeks. Most of the actual analysis takes place off-site, but an integral part of the analysis is the due diligence visit (see more information below).

This is handled slightly differently by each credit rating agency involved and also depending the type of rating (i.e. Credit Assessment, Private rating or Public rating) the utility is looking to get assigned to, Fitch for instance indicate that for a Credit Assessment several telephone calls between the agency and utility management may be sufficient.

The utility would also have the right (Moody’s) to refuse the publication of the rating – but of course the agency would still charge for their analytical work.

**1. PRELIMINARY DISCUSSIONS WITH THE CRA(S)**

Following the initial information gathering phase (i.e. which tis report is trying to achieve), the utility would need to formally engage with the selected credit rating agency(ies), The CRA needs to know and understand which analytical the utility requires. As part of this process, the utility will be required to complete a ‘Rating application form’ or similar template that will be provided by the agency. This form will, amongst other things contain the following information:

- Issuer name, postal address and contact details
- Title of issues (if debt instrument issuance)
- Estimated Sale date (if issue of debt pp
- Type of rating required (Monitored or un-monitored)
- Nature or required rating (Private or Public)
2. PREPARATION OF BACKGROUND MATERIALS AND PRESENTATION

As CRAs can only base their analysis and ultimately the credit rating on the information that has been provided to them by the utility, the will require and request considerable amounts of corporate information from the utility. The materials are largely identical to the information that has been collected/gathered as part of this SAPP project. Generally speaking, anything that can support/evidence claims made by the utility is considered particularly useful. Furthermore, the following section on ‘Due diligence’ provides an overview of the areas that are to be considered by the CRAs as part of their analysis.

Principally, it is better to provide the CRAs with information on specific areas of the business – assuming of course, it is actually available, if the CRAs requests information that is not available, but necessary for the CRAs’ analysis, they are likely to make – usually conservative – assumptions. This, however, ultimately increases the likelihood that the utility will be somewhat penalised in the agencies’ analysis simply because it did choose not to disclose information that would otherwise be readily available.

As general rule, if the utility has got required data/information, then it is recommended to provide it to the CRA.

3. DUE DILIGENCE MEETING/ VISIT

The following list provides an overview of the key analytical items that will be closely examined by the CRA(s) as part of their analysis. The information has been compiled using various documents from the CRAs (mainly Fitch and Moody’s) and is thought as guidance only. Some deviation of this possible and the agency will adapt for regional as well as sector-specific issues.

The ‘due diligence visit’ format itself can either be an initial discussion in form of an initial telephone conference follow by follow-on calls with the responsible CRA analyst or, alternatively an actual visit of the utility by the CRA.

These visits typically tend to be split into an initial meeting with senior management and CRA analytical staff (2 to 4 CRA representatives) for a tour of major operational areas.

Whilst the following topic list looks at more objective areas, please note that the CRA staff will unavoidably pick up on ‘soft’ factors such as the manager’s confidence, professionalism and business attire etc. It is important that the utility staff that meets with agency staff comes across as very proficient in their area of expertise. Slip ups in the due diligence where possible should be avoided and the management needs to prepare itself as good as possible for such a meeting.

Corporate Organisation

- Ownership structure and strategic implications (see next header)
- Minority interests and equity investments
- Relationship with affiliates
- Medium-term view
- Circulation/Distribution of cash-flows within the group
- Debt at operating company’s vs. debt at holding company’s level
Management and Business Strategy
- Description of structure and business units. Management and board structure.
- Working relationship between management, the board, and members, among others.
- An assessment of the competitive strategies (short- and long-term).
- Management’s approach to growth: external vs. organic
- Acquisition parameters
- Product and geographic distribution of business portfolio
- Optimal financial structure, financial parameters, share buybacks?
- Areas of growth
- New product development and product obsolescence

Rates
- Rate design and pricing strategies.
- Rates by customer class and actual rates for key customers.
- Future projections.
- Rate comparison with other regional suppliers.
- Wholesale systems; review of rates for power supplier and distribution systems.
- Rate-making body.
- Rate-setting procedures and history.
- Level of involvement by federal, state or local agencies in utility affairs.

Generation and/or Distribution Facilities
- Review of generating facilities and how they meet system load requirements.
- Power sales contracts.
- Discussion of the regional power market and the utility's position.
- Potential alliances.
- New projects under consideration.
- Fuel contracts and transportation agreements.
- Transmission and distribution issues.
- Plant production costs.
- Environmental issues.
- Reliability of distribution system

Demographics
- Population and customer growth rates; usage trends.
- Income levels, employment trends and unemployment level.
- Customer relations: 5'On
- Service area franchise provisions.
- Economic development.

Financial Performance
- Five-year historical financial summary.
- Financial projections for five years.
- Financial projections
- Income- and Cash-flow statements, Balances sheet
- Capital expenditure program
- Liquidity management
- Dividend policy
- Off-balance-sheet commitments
- Rental expense on Operatin lease
- Capital requirements.
- Financial policies and management targets.
- Policy on short-term debt usage.
- Debt retirement or restructuring strategies.
- Contractual obligations.

**Risk-Management Practices**

- Fuel supply
- Wholesale market activity.
- Hedging policies
- Financial liquidity resource

**Industry**

- Competitive environment
- Outlook for industry consolidation
- Key industry growth and success factors, key risks
- Barriers to entry
- Sensitivity to economic cycles
- Regulatory issues

### 4. AGENCY(IES)’S CREDIT ANALYSIS

Once the due diligence visit and the gathering of all the required information has been completed it’s over to the CRA internal processes and the utility will need to wait for the result (i.e. the assigned credit rating) to be advised to them.

The following schema provides a detaild overview of the process steps at the CRA from the rating agency perspective (note this is baed on Fitch’s information, but should not deviate much for S&P and/or Moody’s either):
Naturally, it takes the CRAs some time to work their way through the information they have gathered and to take their final rating decision.

Timing-wise expect this to be anything between 1 to 3 months and it is likely that the CRA will require occasional clarification of the materials that have been given to them.
From an utility perspective it may be useful to have a decicate project team established that is familiar with the overall process and have been involve then rating discussion with CRA since its inception. Typically the Finance functions at the utility would lend itself to this task, given that they are familiar with the financial information submitted to the CRA.

From an utility perspective it may be worth considering to establish a project team of subject matter experts that are familiar with the above questions/areas and can co-ordinate internal activities around the overall rating process.

Of course, this comes at a cost to the utility, but the potential benefit of having such a dedicate team may reflect positively on the final result – i.e the credit rating and hence, maybe a worth-while investment from the utility perspective. Furthermore, if the utility was to choose a monitored/surveillance credit rating, then the re-occuring nature (at least once a year) for updated information by the CRAs may warrant having such a dedicate team.

In time to come, such team can form the internal basis and point-of-contact for investors into the utility, i.e. an ‘Investor Relationship’ department.

**VII TACTICAL CONSIDERATIONS & CONCLUSION**

Just as there is no black and white, there is no clear favourite when it comes to selecting the best CRA for the purposes of this project. However, the following tactical questions, in combination with the detailed information provided in the previous sections will enable the utility firms to make an informed decision:

1. **TACTICAL CONSIDERATIONS**

   Depending on the ultimate objective of the utility firm it may choose a different type of rating as well as select a specific credit rating agency to achieve this goal.

   a) **Credit worthiness assessment**

      If the utility is plaining undertaking a one-off exercise to get an independent assessment of it’s current point-in-time credit worthiness, then is should aim for a credit assessment. Fitch states that if a utility was to choose Credit assessment first and then eventually would decide to go for the full public (or indeed private) rating, the cost for the Credit assessment could be taken into account and the agency would only need to be reimbursed for difference of cost between public rating and Credit assessment.

   b) **Publicly rated entity**

      If the utility’s objective is to get eventually publicly rated and hence access to cheaper funding and the international capial markets, then the consultant recommends the utility to consider aiming for a point-in-time credit assessment first, eventually followed by additional CRA engagement and analysis that would lead to a full-scale public rating. The agencies have confirmed that many corporate entities in a similar situation to the SAPP
utilities go this route, i.e. get their overall credit worthiness assessed first and then decided separately whether or not they wish to pursue with a full-scale public rating.

c) Privately rated entity

If the utility’s objective is to get rated, but the rating to remain in the private domain with only disclosure to selected contacts, then the consultant suggests considering a private rating as opposed to a full-scale public rating. The analytical process for the private rating would be the same as for the b), however, the rating may be slightly cheaper as it will not be disclosed, hence saves some cost in publishing it and maintaining it on the utility’s website. There are, however, limitations regarding the usage and usefulness of such private rating and hence the consultant considers this to be the least attractive option for the utility.

d) Availability of a Sovereign rating

According to Bloomberg (as of 10 August 2010) the foreign currency long-term debt ratings for the four respective sovereigns are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Fitch</th>
<th>Standard &amp; Poor’s</th>
<th>Moody’s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Botswana</td>
<td>Not rated</td>
<td>A2</td>
<td>A-</td>
</tr>
<tr>
<td>Lesotho</td>
<td>BB-</td>
<td>Not rated</td>
<td>Not rated</td>
</tr>
<tr>
<td>Mosambique</td>
<td>B</td>
<td>Not rated</td>
<td>B+</td>
</tr>
<tr>
<td>Zambia</td>
<td>Currently not rated, but there are suggestions it will become rated in 2010 (please see attached article from ‘The Post Newspapers Zambia, dated 22 Jan 2010.)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The utility should consider in its decisions-making process whether the absence of a sovereign rating may potentially restrict its ability to gain an entity rating.

Whilst S&P have indicated in some of the communication that they are only able to rate utilities in countries that carry a sovereign rating (with a few exceptions, see above), Moody’s answer is currently not providing information about this particular item.

This contrasts to the information given by Fitch which suggest that it would consider rating utilities in countries that currently do not have a sovereign rating on the basis that the agency may be able to produce and use a so called “shadow rating” for the sovereign in lieu of a public or private rating. Fitch indicated that if for instance the shadow rating for Botswana was say ‘AA’ then they would probably be able to rate the Botswana Power Corporation at a similar level, up to ‘AA’. This is of course subject to further detailed analysis of the regulatory environment and the availability (or indeed absence) of an explicit or implicit government guarantee for Botswana Power Corporation.
In conclusion, with a view to the Sovereign rating, where such rating is readily available, the utility firm may go with the credit rating agency that can provide the cheapest analysis. However, for utilities where the sovereign is currently unrated, the consultant suggest to consult Fitch Ratings, given that the absence of a sovereign rating does not appear to represent a major hurdle for the agency.

e) Cost and Benefits

Benefits of the rating assignment are largely access to cheaper funding for the utility and easier access to the international capital market.

The costs depend largely on the chosen agency as well as the type of rating (Credit Assessment, Private rating or Public rating) that has been selected. Given that there are virtually no object differences in the investors perception of the credit rating chosen (i.e. Moody’s, S&P or Fitch), the consultant suggests to select the agency that can provide the most competitive offer.

Please note that as opposed to usually project tender processes and subsequent procurement, the oligopolistic pool of available international credit rating is limited to those three. Hence, there is no need to tender the rating assignment with the rating agencies (in fact this is what the consultant has done in preparation for this procurement report in form of gathering the CRAs’ quotes.)

The only other factor that may be worth considering for SAPP as project sponsor is whether the CRAs are able to offer a ‘volume discount’ or similar if more than utility where to choose engaging the CRAs. Fitch has indicated that they would be able to reduce the travel costs, if any, if the utilities would be looked at at the same time. None of the other agencies has suggest such reduction of costs.

2. CONCLUSION

- All three rating agencies are comparable in terms of the ratings type they provide.
- The consultant is of the view that there is not much benefit in becoming publicly rated by more than one credit rating agency. From an investor’s perspective, it is more of interest whether a utility is publicly rated and not whether it has got more than one public ratings. You may wish to – via SAPP – confirm this view with NamPower and ESKOM to determine why those utilities chose to become rated by more than one agency. In fact, investors may find it confusing in case a utility is ‘split-rated’, i.e. has got a rating from one CRA that differs from the rating from another CRA.
- They differ, however, in terms of pricing as well as the sovereign rating requirement.
- Key question each utility needs to ask themselves is whether they feel they are already to go the full road down to a public credit rating. If not, then the consultant suggest as a a first step the Credit Assessment avenue.
• If this is successful and the outcome of the analysis reflective to the utility’s own view/expectations with regards to its crediworthiness, then as a second step it may consider becoming publicly rated.

• Utilities need to be aware that whilst there are benefits of having a public rating, this will also incur annual costs in order to keep & maintain this rating. If the utility would opt for public rating(s) they would need to include this into their medium and long-term financial planning as a recurring cost.

• This direct cost may also increase indirect cost – which are not easily to determine – as this will require the utility to improve it’s MI systems and have a dedicated team (or some staff seconded to this project) that builds the communication bridge between utility and CRA.

• Some agencies appear to have better grasp of the regional market, most notably Fitch Ratings as they are familiar with the SAPP as well as the African subcontinent. (see appendix ‘FITCH on SAPP’) and a local office in Johannesburg.

• Two members of the SAPP, NamPower and ESKOM are already rated. As previously suggested, the consultant recommends contacting those utilities via the SAPP in order to understand which materials have been passed on to the Credit rating agencies as part of the due diligence and the subsequent rating analysis.

• SAPP should consider whether it would be a feasible approach to co-ordinate the communication with the agencies in order to reduce the overall costs involved for the individual utilities (i.e. come to some kind of ‘volume discount arrangement’).
VIII ANNEXES

1. RATING METHODOLOGIES

1.1. Rating criteria: Fitch Ratings

1.1.1. Corporate Rating Methodology, published 24 November 2009
1.1.2. Credit Rating Guidelines for Regulated Utility Companies, 31 July 2007
1.1.3. Rating EMEA Utilities – Sector credit factors, 14 May 2010
1.1.4. The Rating Process, July 2006
1.1.5. Definitions of Ratings and Other Forms of Opinion, July 2010
1.1.6. Inside the Ratings: What Credit Ratings Mean, August 2007
1.1.7. Rating example reports provided by the CRA:
   a) Namibia Power Corporation (Proprietary) Limited – Credit Update, 29 April 2010
   b) Eskom Holdings Limited – Credit Update, 5 May 2010

1.2. Rating criteria: Standard & Poor’s

1.2.1. 2008 Corporate Criteria: Analytical Methodology, 15 April 2008
1.2.2. Enhanced Methodology and Assumptions for Rating Government-Related Entities, 29 June 2009
1.2.3. Credit Ratings – Government Related Entities, July 2007
1.2.4. Rating example reports provided by the CRA:
   a) Carmel S.A. – Credit Estimate (i.e. Credit assessment), 6 August 2008
   b) Botswana (Republic of), Sovereign rating report, 11 March 2010
   c) Mozambique (Republic of), Sovereign rating report, 22 January 2010

2. FEE QUOTATIONS AND RATING FEE SCHEDULES

2.1. Fee quote: Fitch Ratings

2.1.1. Fitch Proposal Public Utilities BLMZ 20 07 2010
2.1.2. Fitch Power Utilities Quote 27 – 07 –2010

2.2. Fee quote: Standard & Poor’s

2.2.1. S&P Email (containing information on Credit assessments, Corporate ratings and Fees)
2.3. Fee Quote: Moody’s

2.3.1. MOODYS 2010.07 PIP General ECFG Euro 2010 UK
2.3.2. MOODYS CFG Questionaire
2.3.3. MOODYS Corporate Presentation

3. MINI-PRESENTATION ON CREDIT RATING AGENCIES

Although BCP, EDM and LEC participated in the utility credit rating workshop in Gaborone in February 2010 and have been provided with the full and comprehensive workshop materials, we include the mini-presentation that was given to ZESCO later in 2010. The consultant feels that this is succinct but sufficiently information and could be used by all utilities involved to prime their management for this exercise and in preparation of any due diligence.

The consultant suggest that participants from each utility that attended the utility credit rating workshop may be able to use this brief presentation to share the knowledge wrt credit ratings internally and to brief senior management as well colleagues that are likely to be involved in the CRA’s due diligence exercise. This can help to increase the understand the purpose and ultimately get the internal ‘buy-in’ at the firm for this project.

4. OTHER SUPPORTING MATERIALS

4.1.1. The Post Newspapers Article “Zambia to get sovereign credit rating by June”, dated 22 Jan 2010
4.1.2. Fitch on SAPP