Research Update:

South Africa-Based Exxaro Resources 'zaA/zaA-1' National Scale Ratings Affirmed On Strong Financial Performance

September 13, 2022

PRIMARY CREDIT ANALYST

Munya Chawana
Johannesburg
2711-214-4814
munya.chawana@spglobal.com

SECONDARY CONTACT

Omega M Collocott
Johannesburg
+ 27 11 214 4854
omega.collocott@spglobal.com

Rating Action Overview

- We expect South Africa-based Exxaro Resources Ltd. to generate strong earnings in the near term, supported by strong pricing in the export coal market.
- At the same time, Exxaro is reducing expansionary capex in its core coal business as it transitions its operations toward a diversified mix of minerals and energy, and has begun divesting from smaller, higher-cost, and noncore coal assets.
- We estimate that the company will maintain debt to EBITDA below 1.0x and funds from operations (FFO) to debt above 70%, which we consider commensurate with the rating.
- We therefore affirmed our 'zaA/zaA-1' South Africa national scale ratings on Exxaro.

Rating Action Rationale

Strong pricing in the coal export market to support strong near-term earnings. We believe Exxaro's steady production output, combined with strong coal prices, will drive robust earnings and enable deleveraging in 2022. Realized export coal prices exceeded US$250 per ton during first-half 2022, compared with about US$100 per ton in the same period in 2021. The company's coal production volume increased 1% year on year to 21.7 million tons in first-half 2022, while coal production cost increased 4.7%. While logistical challenges continue to constrain sales volumes, we expect supportive coal prices and manageable production costs to lead to stronger EBITDA of South African rand (ZAR) 21 billion-ZAR23 billion in 2022, compared with ZAR20.4 billion in 2021. Beyond 2022, we expect realized export coal prices to soften, leading to annual EBITDA of ZAR10 billion-ZAR13 billion. This should result in Exxaro generating robust operating cash flows of above ZAR18 billion in 2022 and ZAR7 billion-ZAR11 billion in 2023 and 2024. This will be more than sufficient to cover annual capital expenditure (capex) of ZAR2.8 billion-ZAR4.3 billion, which we understand will mainly relate to sustaining capex.

We forecast debt to EBITDA and FFO to debt will improve to below 1x (previously 1.0x-2.0x) and close to 70% (previously 50%-60%), respectively, on average. At the same time, we anticipate that Exxaro's dividend distributions (ZAR4 billion-ZAR9 billion annually) will be higher than forecast (ZAR2.5 billion-ZAR3 billion), in line with the company's policy to pay out a percentage of core earnings and the pass-through of dividends from it 20% investment in Sishen Iron Ore Co. (SIOC). Higher dividend distribution, in our view, is also supported by expected high free operating cash flow of about ZAR15 billion in 2022 and ZAR4 billion-ZAR7 billion in 2023 and 2024. However, we anticipate negative discretionary cash flow could weigh on the company's credit metrics, especially in 2023 and 2024. We believe Exxaro will focus on its long-term strategic objectives, although these are not specifically incorporated into our base-case scenario. These objectives include driving decarbonization through divestment of noncore coal assets, starting production of manganese, copper, and bauxite (likely through acquisitions) and expanding its renewable energy generation capacity.

Exxaro's debt metrics over the coming three years should support credit quality. While not our base-case scenario, the rating could come under pressure if we expect Exxaro's FFO to debt will fall below 30% or we expect the company's liquidity position to weaken. This could result from Exxaro experiencing payment delays or nonpayment on sales to Eskom Holding SOC Ltd., lower-than-expected export market prices and volumes, or a large debt-funded acquisition. Notably, Eskom is also the off-taker of power from Exxaro's recently acquired renewables assets. 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 the company.

Company Description

Exxaro is primarily a South African-domiciled coal mining company. It generated ZAR32.7 billion in revenue in 2021 and expects to sell 43 million tons of coal in 2022, with 70% of sales by volume to South African energy utility Eskom, 10% to other domestic buyers, and 20% to export markets.

The company also holds 100% of Cennergi Proprietary Ltd., which has two windfarm projects running, generating about ZAR1.2 billion in revenue and 724 gigawatt-hoursh of power annually; and 20.6% of SIOC, which is 79.4% owned by JSE listed Kumba Iron Ore.

Our Base-Case Scenario

Assumptions

- Realized domestic and Eskom thermal coal selling prices of ZAR500-ZAR550 per ton on average over 2022-2024.
- Prices at Exxaro's Eskom tied-coal mine to remain above ZAR500 per ton on average.
- Realized export coal sale prices of $170 per ton in 2022 and $97 per ton in 2023.
- Overall, thermal coal sales to Eskom of 28 million tons per year (Mtpa)-30 Mtpa, domestic thermal and metallurgical sales of about 5 Mtpa, and export sales of 4 Mtpa-6 Mtpa from

2022-2024.

- Consumer price index inflation of 6.1% in 2022 and 5.0% in 2023 and 4.6% in 2024.
- Expected EBITDA contribution of 10% of overall EBITDA per year from Cennergi.
- Dividends from SIOC of ZAR2.5 billion-ZAR3.5 billion per year over 2022-2024. We include dividends received in our adjusted EBITDA calculation.
- Working capital outflow of about ZAR500 million per year.
- Capex in line with guidance, at about ZAR2.8 billion in 2022, increasing to about ZAR4.3 billion in 2023 due to mining fleet replacement then decreasing to ZAR3.2 billion in 2024.
- In line with guidance, a 2.5x-3.5x dividend cover on core coal earnings, with SIOC dividends passed through to shareholders.
- ZAR2.0 billion in share buybacks in each of 2022, 2023, and 2024.

Key metrics

Exxaro Resources Ltd.--Key Metrics*

	--Fiscal year ended Dec. 31, 2021--				
	2020a	**2021a**	**2022f**	**2023f**	**2024f**
(Mil. ZAR)					
Coal sales volume (mil. tons)	46.8	42.8	40-43	40-43	40-43
Revenue	28.9	32.3	40-43	30-33	28-31
EBITDA	10.7	20.4	21-23	12-14	8-10
Capital expenditure	2.8	2.2	2.8	4.3	3.2
Dividends	4.0	12.7	8-9	6-7	4-5
Debt	15.6	11.7	11.0-11.5	11.0-11.5	10.0-10.5
Debt to EBITDA (x)	1.4	0.6	0.5	0.8	1.0
FFO to debt (%)	52	152	105	50-60	81
DCF to debt (%)	9	12	36	(14)	(22)

*All figures adjusted by S&P Global Ratings. 2021 year-end debt of ZAR12.7 billion consists of gross financial debt of ZAR10.3 bilion with key adjustments being ZAR504 milion in operating leases, ZAR115 milion in postemployment obligations, and ZAR824 million of asset retirement obligations. a--Actual. f--Forecast. FFO--Funds from operations. FOCF--Free operating cash flow. DCF--Discretionary cash flow. ZAR--South African rand.

Liquidity

We assess Exxaro's liquidity as adequate. For the 12 months started July 1, 2022, the company's liquidity sources should exceed uses by more than 1.2x. Our adequate liquidity assessment is also supported by the company's generally prudent risk management, sound relationships with banks, and ample covenant headroom.

We estimate that principal liquidity sources over the 12 months from July 1, 2022, will include:

- Cash and cash equivalents of around ZAR12.2 billion.

- Committed undrawn bank lines maturing beyond 12 months of ZAR3.3 billion.
- Expected annual cash FFO, including forecast dividends from SIOC, of about ZAR13.8 billion.

For the same period, we estimate principal liquidity uses will include:

- ZAR803 million of debt maturities for next 12 months.
- Working capital outflows of around ZAR0.5 billion.
- Capex of about ZAR3.5 billion.
- Share repurchases of ZAR2.0 billion.
- Dividends exceeding ZAR7.5 billion.

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%).

Exxaro's debt covenant ratios exclude project finance debt that was consolidated following the acquisition of Cennergi because it is limited recourse funding with no additional security from Exxaro.

Environmental, Social, And Governance

ESG credit indicators: E-4, S-4, G-2

Environmental factors are a negative consideration in our credit rating analysis of Exxaro. We see the company as more exposed to climate transition risks than peers given its high exposure to thermal coal mining. We believe this is balanced by long-term off-taker contracts with Eskom, under which Exxaro supplies coal to Eskom's more recently built coal plants. These are key contributors to the country's base load energy supply, which reduces Exxaro's exposure to the acceleration in the energy transition away from coal. Also, Exxaro is transitioning its exposure toward the low-carbon economy with investments in renewable energy generation projects and associated minerals. Social factors are also a negative consideration. Similar to other miners operating in developing economies, we believe underlying social tensions and inequalities in South Africa translate into weaker operating and investment conditions, which affects operating efficiency.

Ratings Score Snapshot

Issuer Credit Rating	zaA/zaA-1
Business risk:	Weak
Country risk	Moderately high
Industry risk	Moderately high
Competitive position	Weak
Financial risk:	Significant

Issuer Credit Rating	**zaA/zaA-1**
Cash flow/leverage	Significant
Anchor	bb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	b+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

Ratings Affirmed	
Exxaro Resources Ltd.	
Issuer Credit Rating	zaA/--/zaA-1

Regulatory Disclosures

Exxaro Resources Ltd.

- Primary Credit Analyst: Munya Chawana, Associate
- Rating Committee Chairperson: G. Andrew Stillman
- Date initial rating assigned: March 12, 2014
- Date of previous review: June 14, 2021

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.

S&P Global Ratings' regulatory disclosures (PCRs) are published as of a point-in-time, which is current as of the date a Credit Rating Action was last published. S&P Global Ratings updates the PCR for a given Credit Rating to include any changes to PCR disclosures only when a subsequent Credit Rating Action is published. Thus, disclosure information in this PCR may not reflect changes to data within PCR disclosures that can occur over time subsequent to the publication of a PCR but that are not otherwise associated with a Credit Rating Action.

Note that there may be instances where the PCR reflects an updated Ratings Model version in business use as of the date of the last Credit Rating Action although use of the updated Ratings Model was deemed unnecessary to produce that Credit Rating Action. For example, this may occur in the case of event-driven reviews where the event being assessed is considered to be not relevant to running the updated Ratings Model version. Note also that, in accordance with applicable regulatory requirements, S&P Global Ratings evaluates the impact of material changes to Ratings Models and, where appropriate, issues revised Credit Ratings where necessitated by the updated Ratings Model.

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.
- 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 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.
- Economies of scale: This is the cost advantage that arises with increased size or output of a product.
- Efficiency gains: Cost improvements.
- ESG credit factors: Those environmental, social, and governance (ESG) factors that can materially influence the creditworthiness of a rated entity or issue and for which we have sufficient visibility and certainty to include in our credit rating analysis. These credit factors can have a negative or positive impact on creditworthiness, depending on whether they represent a risk or an opportunity.
- ESG credit indicator: An ESG credit indicator is an alphanumeric representation of the qualitive assessment of ESG factors' impact on creditworthiness produced as part of the ratings process. Our ESG credit indicators provide additional disclosure by reflecting our opinion of how material the influence of ESG factors is on the various analytical components in our rating analysis through an alphanumerical 1-5 scale. ESG credit indicators are applied after the ratings have been determined.

- 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.
- Government-related entity: An entity that could, under stress, benefit from extraordinary government support in order to meet its financial obligations; or conversely an entity controlled by a government that could be subject to negative extraordinary government intervention if the government is under stress.
- 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.
- Issue credit rating: This is a forward-looking opinion about the creditworthiness of an obligor with respect to a specific class of financial obligations or a specific financial program.
- 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).
- 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.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

Copyright © 2022 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.