Credit Rating Report | Nigerian Corporate | June 2021*

Coleman Technical Industries Limited

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook/Watch
Coleman Technical Industries Limited	Long Term Issuer Short Term Issuer	National National	BBB-(NG) A3(NG)	Stable

Strengths

- Strong competitive position, underpinned by substantial production capacity.
- Well established brands, which has supported solid revenue progression and growth prospects.
- Well diversified funding sources and financial flexibility afforded by strong relationships with financial institutions.

Weaknesses

- Limited product diversification to a key segment.
- Earnings concentration to few large distributors.
- Weak leverage and credit protection metrics due to earnings margin pressure and rising debt.

Rating Rationale

Coleman Technical Industries Limited's ("Coleman" or "the Company") ratings reflect its relatively strong position within the Nigerian cables and wires manufacturing sector, underpinned by continuous capacity expansion which has facilitated stronger earnings growth. However, the ratings are constrained by the relatively high gearing, and ongoing requirement for funding to drive expansion.

Coleman's competitive advantages include its established operational track record and strong relationships with key vendors, albeit that concentration towards two major distributors who jointly account for about 35% of revenue is a rating constraint. On the back of ongoing investment in capex, Coleman has established itself as the dominant producer of aluminium and copper cables (installed capacity of c.100,000 tons per annum), with diverse product lines relative to other African peers. Thus, the Company has a c.10% market share in the Nigerian cables sector, with major competition being from imported finished products from Asia. GCR expects the successful completion of ongoing expansion projects to better position Coleman to compete favourably with imported products.

At the current rating level, GCR's view of management and governance remains neutral despite the dominance of the Board by the owning family (including the Chairman and CEO), given the presence of two independent directors.

Supporting the ratings, Coleman has maintained strong volumes-driven revenue progression over the review period, with 24.2% CAGR over the 5-years to FY20. Coleman is projecting an aggressive growth of about 3.5x in FY21, driven by the expected completion of the 11,000 tons/month (combined) backward integration project and the new fibre optic manufacturing plant, which are expected to help capture further high value demand opportunities in the power and

*The last rating announcement was in May 2021. Rating reports are updated at least once a year from the date of the last rating announcement.

telecommunications sectors in the medium term. GCR believes that even if these projects are not fully realised, the 70% leap in 1Q FY21 still provides a strong case for sustainable business growth for the full year and into FY22.

While EBITDA margins have been persistently impacted by volatile commodity prices, fluctuating between 16.8% and 33.6%, earnings are stronger than the level reported by the available comparable peers. GCR expects some margin enhancement to come from the introduction of higher margin products, greater economies of scale and cost savings upon the completion of the backward integration project.

Constraining the rating somewhat, Coleman has relied on debt to fund its expanding business. Debt rose to N13.8bn in FY20 and N14.9bn 1Q FY21, from N9bn in FY17. Exacerbated by the weakening in core earnings, net debt to EBITDA spiked to 532% at FY20 (FY19: 366%). The Company intends to raise an additional N30bn in FY21 to finance expansion and support working capital requirements, while refinancing short-term debt, resulting in projected gross debt more than doubling to N35.2bn at FY21. Assuming that strong earnings are maintained for the full year, GCR expects that the net debt to EBITDA will likely improve to a moderate range of 200%-250%. Discretionary cash flow coverage of debt and EBITDA coverage of net interests are weaker metrics, both trending well below the intermediate range. Looking ahead, GCR expects interest coverage to improve primarily underpinned by stronger earnings, but weak/negative cash flow coverage is likely to persist. Coleman's diversified funding sources, including nine banks and government concessional facilities (40% of total debt) and the longer tenured debt profile do mitigate financing risk somewhat.

The liquidity assessment is neutral to the ratings. While Coleman has arranged sufficient funding sources to cover its capex and working capital requirements, coverage is only around 1x. New debt funding is anticipated in the short term, but should it not materialise, capex spend will be curtailed accordingly. GCR takes cognisance of the strong lending relationships and the fact most of the short-term debt are revolving. There is an all-asset debenture on Coleman's factories, but these are mostly related to the short-term facilities which are generally below 30% of gross debt and around 20% of the total asset base.

Outlook Statement

The Stable Outlook is predicated on GCR's expectation that Coleman will sustain a strong earnings trajectory on the back of an expanding production capacity and improved cost efficiencies. Accordingly, we expect leverage metrics to remain moderate, even with the planned increase in debt.

Rating Triggers

Positive rating action could result from the successful and timeous completion of the ongoing projects which translates to meaningful earnings growth and net cash flows. A successful debt issue which helps to refinance existing obligations, and further stretch the debt maturity profile would also be positively viewed. Conversely, the ratings could come under pressure if further earnings pressure manifests, resulting in further deterioration in credit protection metrics, higher leverage metrics and/or weaker liquidity assessment.

Analytical Contacts

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Ratings History

Coleman Technical Industries Limited					
Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long Term Issuer	Initial/new	National	BBB-(NG)	Stable	May 2021
Short Term Issuer		National	A3(NG)		

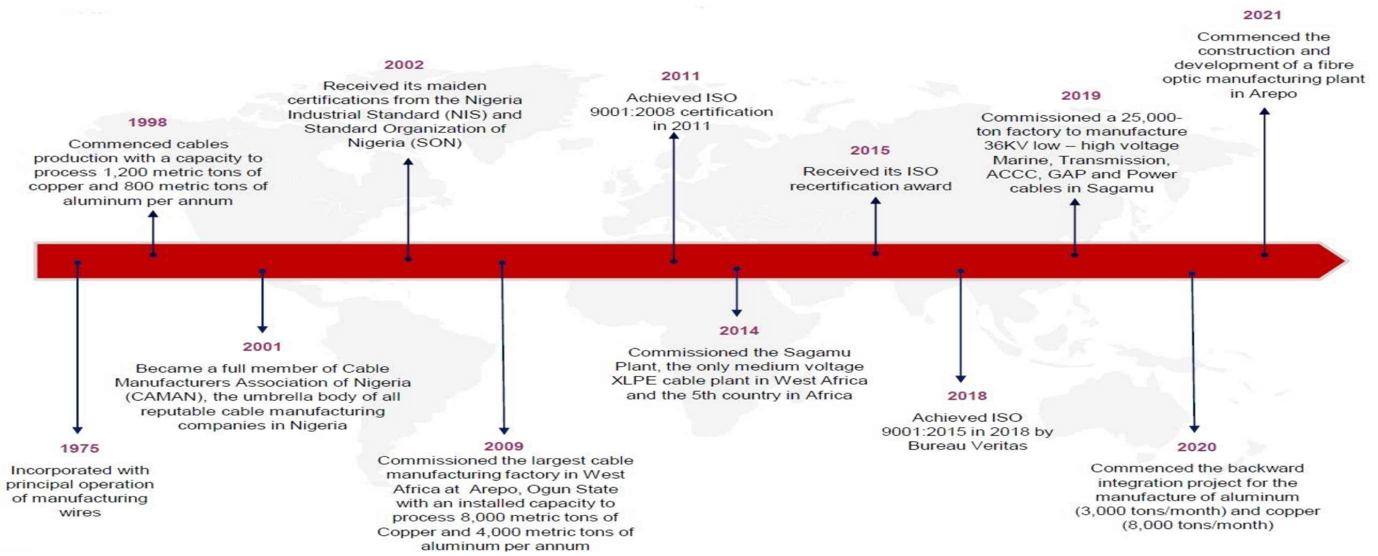
Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Corporate Entities, May 2019
GCR Rating Scales, Symbols and Definitions, May 2019
GCR's Nigeria Country Risk Scores, February 2021
GCR's Nigeria Corporate Sector Risk Scores, February 2021

Analytical Entity: Coleman Technical Industries Limited

Coleman was incorporated in 1975 with the primary object of manufacturing cables and wires. As depicted in Figure 1, operations commenced in 1998 and the Company has evolved through continuous capacity expansion and increase in product portfolio to attain a dominant market position, with management indicating 45% and 20% shares in house cables and power cables segments, respectively. Expanding further, Coleman is undertaking a backward integration project (to produce additional 3,000 tons/month in aluminium and 8,000 tons/month in copper) and constructing a fibre optic manufacturing plant (in partnership with a leading international manufacturer), both expected to be completed in 2H FY21. These projects are poised to positioning Coleman to meet the high demand potential from the power transmission and telecommunication sectors. Given that Coleman neither has subsidiaries nor is a member of any group, GCR's analytical approach is a standalone analysis for the credit risk assessment.

Figure 1: Coleman's corporate evolution



Source: Coleman Technical Industries Limited

Operating Environment

The operating environment assessment weighs the strong longer-term sectorial growth prospects against constrained economic trajectory, weak industry fundamentals and negative outlook on the Nigerian primary manufacturing sector.

Country risk

The country risk score of "3.75" assigned to Coleman mirrors its 100% Nigerian exposure, with no material geographical earnings diversification expected over the outlook period. Nigeria's country risk score balances its strong economic base, supported by significant natural resources and large population, against low wealth levels, moderately weak institutional scores and currently restrained economic growth. Details of the discrete country risk scores are outlined in GCR's Country Risk Score report published in February 2021, available for download at https://gcrratings.com/wp-content/uploads/2019/08/20210330-Country-Risk-publication_FINAL.pdf

Sector risk

The primary manufacturing sector risk score of "1.75" reflects the generally low barriers to entry as evidenced by the fragmented industry space and intense competitive landscape. Most segments within this bucket also require relatively low start-up capital, contributing to the low entry barriers. Pricing pressure is also exacerbated by lower cost imported products and smuggled items. While the Government has introduced legislation and tariffs to promote local content, enforcement often falls short, with Nigerian manufacturers still having to contend with cheaper imported products. Nevertheless, the huge demand-supply gap portends strong opportunities for growth in the long term. The sector score also depicts the above average sensitivity to economic growth to sustain demand, but this is somewhat balanced against the necessity for consistently high government spending on infrastructural development. Environmental impact risks are high due to the generally heavy carbon footprints, however, ongoing efforts by industry players to upgrade to more environmentally friendly technologies are noted.

Aside from competitive pressures, industry profitability is negatively impacted by elevated production costs due to the infrastructure deficit in areas such as electricity generation, transportation, as well as bottlenecks in the supply chain management due to port congestion. The reliance on raw material imports also adds foreign exchange risk, higher working capital and financing costs.

GCR expects some contraction in sectorial performance in the short term due to the impact of the COVID-19 pandemic on the economy and consumer income levels. Thus, the already low profit level is expected to deteriorate even further owing to pricing pressure and imported inflation on inputs. However, over the longer term, the disruption to imports could provide the local manufacturing industry an opportunity to increase its market share.

Business Profile

Coleman's dominant market position driven by continuous expansion of production capacity and the robust pipeline of potential manufacturing contracts, is counterbalanced by significant earnings concentration.

Competitive position

Coleman's key competitive advantage lies in its leading role in the Nigerian cables and wires manufacturing industry, underpinned by ongoing investment in capacity expansion and technologies that continue to drive meaningful upscaling and gain efficiency relative to peers. With an installed capacity of 60,000 tons per annum ("tpa") for copper and 40,000tpa for aluminium, Coleman is acclaimed to have c.80% of installed capacity in the country. A key challenge is the dominance of imported cables and wires into the country. However, the government's local content policy and foreign exchange restrictions for imported finished cables offer some support for Coleman's business case and the wider industry.

Coleman has a large clientele and a bunch of reputable vendors, which help to strengthen its sales volume. However, GCR negatively views concentration of earnings to two mega distributors, who jointly contribute about 35% of revenue in FY20, with the products' geographic distribution also highly skewed to the South-West (over 85%). Nevertheless, GCR expects the ongoing investments in technological upgrades, current certifications (such as ISO 9001: 2015), and expansionary projects to continue to favourably position Coleman to attract high profile industrial clientele and partnerships, and further entrench its market position.

Table 1: Manufacturing Sector Comparative Financial Data- 2019 (USD'm)^	Coleman	East African Cables
Revenue	37.7	15.5
Gross profit	9.9	4.9
EBITDA	**8.9**	**(1.8)**
Depreciation	(2.4)	(2.6)
EBIT	6.5	(4.4)
Net interest expenses	(4.4)	(2.7)
NPBT	2.2	6.5
OCF	**4.6**	**0.9**
Gross debt	33.3	35.6#
Cash	0.9	1.7
Net debt	32.5	33.9
Ratios (%)		
Revenue growth	34.5	(2.8)
Gross margin	26.3	31.8
EBITDA margin	23.5	neg
EBITDA: net interest (x)	2.0	neg
OCF: Gross debt	13.8	2.4
Net debt: EBITDA	366.2	neg

^Based on CBN exchange rates
#Estimated for 2019; only an abridged version of the audited financial statements is publicly available.

Coleman also demonstrates stronger top line progression, better earnings, and net operating cash flows relative to its comparable peer, per Table 1. However, East African Cables (Kenya) is more diversified geographically, with distributive footprints in Uganda, Rwanda, Burundi, South Sudan, and Eastern DRC.

Management and governance

At the current rating level, and given the presence of two independent directors, GCR's view of management and governance remains neutral despite the dominance of the Board by the owning family (including the Chairman and CEO). This notwithstanding, should any material corporate governance concerns arise, GCR will make negative adjustments to the assessment.

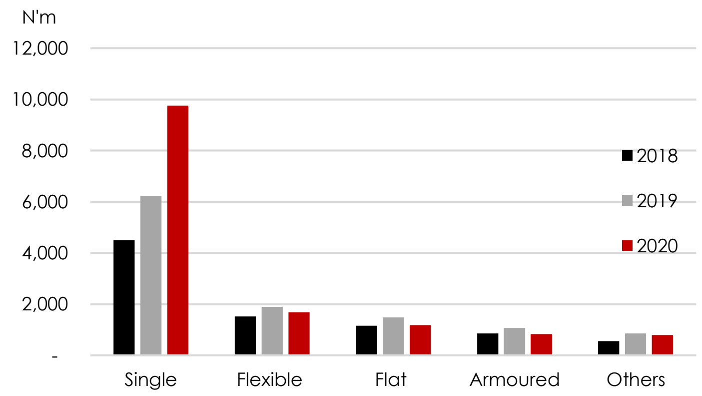
Financial Profile

Coleman's financial profile balances its sound revenue trajectory, well-diversified funding base and moderate liquidity coverage against persistent earnings pressure, limited product diversification and weak credit protection metrics.

Earnings

Supporting the ratings, Coleman has maintained strong volumes-driven revenue progression over the review period, with 24.2% CAGR over the 5-years to FY20. Although Coleman has about 30 products based on varying specifications (classified under five main categories), ultimate product diversification is limited, with the Single Cable product category accounting for 69% of the top line in FY20 (FY19: 54%) and is expected to remain the key growth segment over the outlook period.

Figure 2: Coleman's product mix (2018-20)



Coleman is projecting an aggressive growth of about 3.5x in FY21, driven by the expected completion of the 11,000 tons/month (combined) backward integration project and the new fibre optic manufacturing plant, which are expected to help capture further high value demand opportunities in the power and telecommunications sectors in the medium term. GCR believes that even if these projects are not fully realised as planned (either due to delays in fund raising, cost overrun, supply chain disruption or other exogenous factors) the 70% leap in 1Q FY21 still provides a strong case for sustainable business growth for the full year and into FY22.

Figure 3: Revenue progression

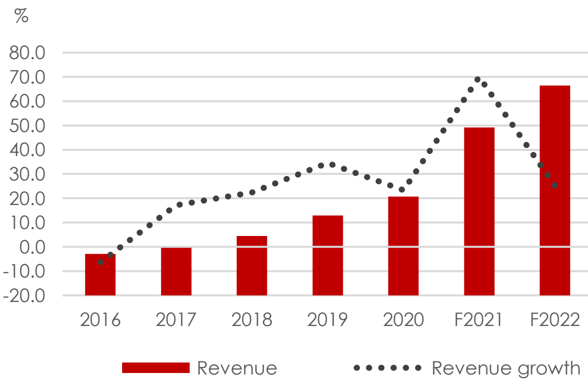
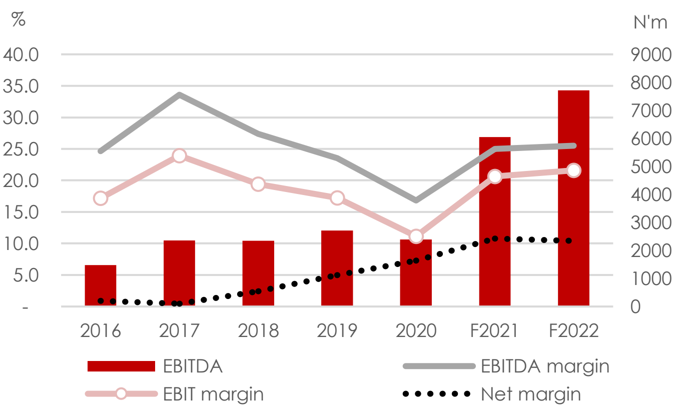


Figure 4: Margin analysis



Gross margin has persistently declined since FY17 and has shed about 17 percentage points over the four years to FY20. This is attributable to volatility in commodity prices and adverse movements in foreign exchange, resulting in elevation of the cost of imported inputs. This has reflected in the EBITDA margins, fluctuating between 16.8% and 33.6% over the review period and has now shrunk to about half of the FY17 level. However, earnings are stronger than the level reported by the available comparable peers. On the back of tighter cost controls, 1Q FY21 results have already shown significant improvement relative to the same period in FY20 and expected to be sustained for the full year and FY22. Overall, GCR expects some margin enhancement to come from the introduction of higher margin products, greater economies of scale and cost savings upon the completion of the backward integration project.

Leverage and cash flow

Leverage and cash flow assessment is considered a negative rating factor. Debt has consistently increased from around N9bn in FY17 to N14.9bn in 1Q FY21 (FY20: N13.8bn) as Coleman has utilised debt funding to support ongoing business expansion and the resultant spike in working capital requirement. Exacerbated by the weakening in core earnings, net debt to EBITDA spiked to 532% at FY20 (FY19: 366%). The Company intends to raise an additional N30bn in FY21 to finance expansion and support working capital requirements while refinancing short-term debt, resulting in projected gross debt more than doubling to N35.2bn at FY21. Looking ahead, meaningful moderation in net debt to EBITDA (to around the intermediate range of 200%-250%) is contingent upon achieving anticipated strong earnings, specifically as efficiency benefits begin to accrue from internalising some key aspects of the supply chain. However, any material deviation from earnings target (due to higher commodity prices, adverse foreign exchange movements or other exogenous factors) could result in a more temperate improvement in the earnings based gearing metrics.

Discretionary cash flow coverage of debt and EBITDA coverage of net interests are particularly weaker metrics, both trending well below the intermediate range over the review period. Although the interest coverage of 5.2x achieved in FY20 was one-off on the back of the lower finance cost (due to concessional facilities drawn and the currently lower interest rate), the metric is now expected to be sustained at around 4.0x to 5.0x in FY21 (and slightly lower in FY22) due to the anticipated widening of earnings and the ongoing utilisation of lower interest debt. Applying a further -10% stress to EBITDA, the ratio would range between 3.5x-4.7x, which is considered weak within the high cyclicality band, albeit still well above the pre-FY20 levels.

Given the rapid volumes growth, working capital pressures have been elevated, mainly due to large inventory holdings. Specifically, in FY20, substantial absorption emanated from huge stock-up of raw materials to mitigate shortage triggered by COVID-related global supply chain disruptions. Over the medium term, we expect further pressures from inventory requirements (in line with expected growth) and the unwinding of payables to suppliers. Given the large capex roll out expected between FY21 to FY23, discretionary cash flows will likely remain insufficient to cover expansion funding requirements, translating to weak/negative coverage of debt, but this will be augmented by debt proceeds.

Figure 5: Leverage

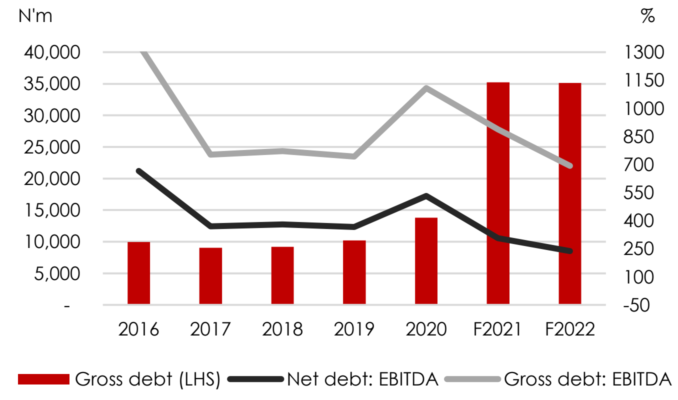
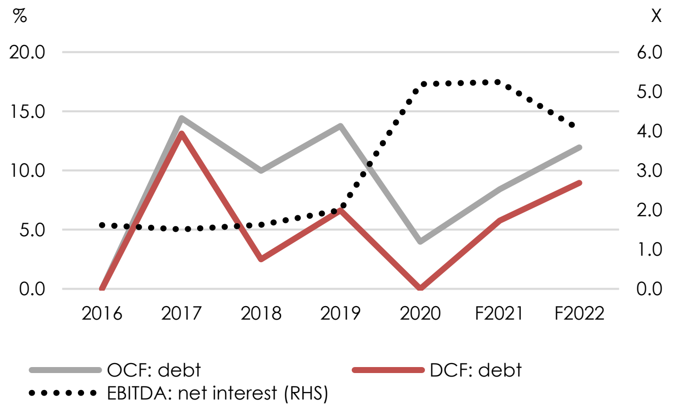


Figure 6: Credit protection metrics



Coleman's diversified funding sources, including nine banks and government concessional facilities (40% of total debt) and the longer tenured debt profile do mitigate refinancing risk somewhat. Specifically, short term debt has remained very moderate, averaging 20% between 2017 to 2020 (FY20: 37%), and is expected to remain below 30% in 2021. By 2022, we anticipate that most of the short-term debt would be entirely refinanced with longer term facilities. There is substantial foreign exchange exposure on the import finance facilities, with 41% USD-denominated debt, but these will be fully refinanced with local currency debt imminently.

Liquidity

The liquidity assessment is neutral to the ratings. While Coleman has arranged sufficient funding sources to cover its capex and working capital requirements, coverage is only around 1x. New debt funding is anticipated in the short term, but should it not materialise, capex spend will be curtailed accordingly. GCR takes cognisance of the Company's strong relationships with financial institutions and the fact that most of the short-term debt are revolving. There is an all-asset debenture on Coleman's factories, but these are mostly related to the short-term facilities which are generally below 30% of gross debt and around 20% of the total asset base. An uplift to the liquidity score is contingent upon sustained coverage trending between the 1.5x to 2x range or above. This could emanate from successful and substantially subscribed fund raising, which translates to refinancing of short-term obligations, with capex remaining as the major liquidity uses over the outlook period.

Comparative Profile

Peer analysis and group support

The peer analysis is neutral to the ratings. Group support is not applicable to the ratings.

Rating Adjustment Factors

Structural adjustments

No structural adjustments have been made to the anchor credit evaluator in arriving at the final ratings.

Instrument ratings

No adjustments for instrument ratings are applicable.

Risk Score Summary

Rating Components and Factors	Risk scores
Operating environment	**5.50**
Country risk score	3.75
Sector risk score	1.75
Business profile	**0.50**
Competitive position	0.50
Management and governance	0.00
Financial profile	**0.00**
Earnings profile	0.75
Leverage & cash flow	(0.75)
Liquidity	0.00
Comparative profile	**0.00**
Group support	0.00
Peer comparison	0.00
Total Risk Score	**6.00**

Glossary

Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with because of holding the security or asset. For a company, its exposure may relate to a product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Issuer	The party indebted or the person making repayments for its borrowings.
Leverage	Regarding corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.
Short Term	Current; ordinarily less than one year.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to Coleman Technical Industries Limited. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

Coleman Technical Industries Limited participated in the rating process via site visit as well as other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from Coleman Technical Industries Limited and other reliable third parties to accord the credit ratings included:

- 2020 audited annual financial statement, and prior four years annual financial statements;
- unaudited management accounts for the first quarter ended 31 March 2021;
- Industry comparative data and a breakdown of facilities available and related counterparties; and
- Information specific to the rated entity and/or industry was also received;