C & I Leasing Plc

Up to ₦10 Billion 7-year Series II Senior Fixed Rate Bond

Indicative Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

C&I Leasing Plc.

Up to ₦10 Billion 7-year Series II Senior Fixed Rate Bond due 2027

Indicative Rating Assigned*:

Bbb+

**The Issue rating is indicative and a final rating will be based on receipt of all duly executed contractual agreements.*

Outlook: Stable

Issue Date: December 2020

Expiry Date:
The rating of the Bond is subject to annual review throughout the tenure of the Bond

Previous Rating: None

Bond tenor: 7 years

Issuer Rating: Bbb

Industry: Finance & Leasing

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The Bond is adjudged to offer adequate safety of payment of interest and principal; however, changes in circumstances can adversely affect such issues more than those in the higher rated categories.

Rating Rationale

Agusto & Co has assigned an indicative rating of "**Bbb+**" to C&I Leasing Plc.'s ("C&I Leasing", "the Issuer") ₦10 billion Series II Fixed Rate Senior Secured Seven-Year Bond ("the Issue", "the Bond"). The Bond is secured by 15 marine vessels – 10 unencumbered vessels and 5 encumbered vessels ("the Security") – owned by the Issuer and jointly valued at ₦17.2 billion on the open market by Ubosi Eleh & Co. The rating is supported by a notching up of the Issuer's "Bbb" rating due to a 66% expected recovery rate from the enforcement of the Security under a forced sale ₦12.9 billion valuation and after the repayment of the balance due to the Series I bond and the encumbered vessels' creditor. In our view, the expected credit loss on the Issue is moderate in the event of default because of the marine vessels which provide credit enhancement for the Bond.

The Issue's proceeds will be utilised by the Sponsor to replace short-term funds. The Bond's interest shall be payable semi-annually, while the principal on the Bond will be repaid semi-annually on an amortized basis after an initial two-year moratorium period. A sinking fund is to be created in accordance with the trust deed and made available for principal redemption and coupon payments.

The Issuer has good asset quality underpinned by good capacity utilisation, with most vessels tied-up in long term contracts. C&I Leasing Plc also has good quality obligors (including international oil companies) with relatively low delinquent rates on receivables. The Issuer's good asset quality is also reflected in the relatively young average age of the marine vessels which enhances the Issuer's earning capacity while C&I Leasing's crew boats are versatile with utility in the general transportation of people and cargo. Nevertheless, we note that asset quality remains contingent on

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Related Document: Agusto & Co.'s 2020 C&I Leasing Plc.'s Entity Rating Report

a favourable oil and gas market. We however take comfort in the fact that the bulk of the Issuer's obligors are considered prime.

C&I Leasing's leverage is on the decline with a debt to equity ratio of 2.2 times as at 30 September 2020 (2019FYE: 3.1 times). With previous successful bond issuances, the Issuer's access to the debt capital market continues to improve. C&I Leasing also has a strong ability to refinance with undrawn committed local and foreign currency lines from banks in excess of ₦15 billion and $25 million respectively. As at 30 September 2020, the Issuer's coverage ratio (EBITDA/interest expense) stood at 2.6 times and has averaged 3.3 times over a 3-year period, indicating adequate ability to meet interest payments. We expect the Issuer's leverage ratio to remain below 4 times during the life of the Bond.

The Issuer's capitalisation is satisfactory, with a Basel II capital adequacy ratio of 26% as at September 2020, which is higher than the regulatory minimum of 12.5% prescribed for finance companies. The inclusion of the seven-year bond to replace short-term finance and still serve as Tier 2 equity will improve the Issuer's capital adequacy ratio. Improved capital will protect C&I Leasing against unexpected losses particularly given the unprecedented global and domestic economic uncertainties due to the COVID-19 pandemic.

The Issuer generated gross earnings of ₦22.3 billion in the nine months to 30 September 2020, lower than the ₦26.6 billion recorded in the corresponding period of 2019 due to challenges around the COVID-19 pandemic. The economic challenges faced by the Issuer's client base (mainly international oil companies) has resulted in fiercer negotiations around rates which has put greater pressure on the Issuer's profit margins. C&I Leasing's weak profitability also results from a high cost profile – typical to marine lease operators. Nevertheless, the Issuer recorded a profit before tax (PBT) of ₦460 million for the first nine months of 2020 translating to annualised ROA of 1.1% and ROE of 4.6%, lower than 2019's 1.9% and 8.6% respectively. We expect C&I Leasing's profitability to remain constrained in the short term. Notwithstanding, we note that the Issuer has been in existence for over 25 years and has an experienced and stable management team with a track record of weathering storms related to oil price shocks.

We expect that the Issuer will continue to fulfil its bond obligations despite the low economic activities given the resilience shown over the years. We hereby attach a **stable** outlook to the rating.

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The final rating will be assigned upon receipt of executed transaction documents. Any adverse change in contract terms or structure of the Security will affect the final Bond rating. The Bond rating may also change if the Issuer rating changes and/or if the estimated stressed value of the Security changes materially.

Table 1: Financial Data for C&I Leasing Group

	31 December 2019	31 December 2018
Total Assets	₦56.2 billion	₦52.6 billion
Gross Earnings	₦32.5 billion	₦28.2 billion
Pre-tax return on average assets	1.9%	3.2%
Pre-tax return on average equity	8.6%	14.7%

Source: C & I Leasing Plc

Figure 1: Strengths, Weaknesses and Challenges

Strengths

- Good asset quality
- Good brand in the leasing and logistics industries
- Stable and experienced management team
- Adequate capitalisation

Weaknesses

- Low profitability
- High cost profile - typical in the vessel leasing industry
- Risk Management practices can be improved upon.

Challenges

- Sustaining asset quality in the face of the weak macroeconomic climate
- Stemming decline in profitability due to the adverse business environment
- Vulnerability to the volatile oil & gas industry

This report should be read in conjunction with Agusto & Co's 2020 entity rating report for C&I Leasing Plc.

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ISSUER'S PROFILE

C&I Leasing Plc ("C&I Leasing", "the Issuer") is one of the largest leasing companies and personnel and logistics support providers in Nigeria. The Issuer provides services including fleet management, offshore marine support and personnel outsourcing. C&I Leasing commenced operations in 1991 and was listed on the Nigerian Stock Exchange in 1997. The C&I Leasing Group ("the Group") comprises C&I Leasing Plc and two subsidiaries: EPIC International FZE and Leasafric Ghana Limited. The Issuer owns a majority equity stake of 71% in Leasafric Ghana while EPIC International FZE is a wholly owned subsidiary.

C&I Leasing Plc

C&I Leasing's operations are structured along four key divisions:

- Fleet Management which provides fleet maintenance, car rental (under the Hertz franchise) and automobile finance leasing services.
- C&I Outsourcing which provides human resource consulting services including personnel outsourcing, personnel recruitment, training and manpower development.
- Citrack Telematics which provides asset monitoring solutions such as vessel and automobile tracking services.
- C&I Marine which leases offshore support vessels to exploration and production operators.

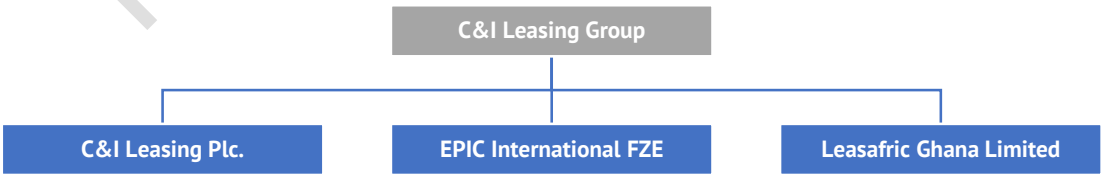
EPIC International FZE

EPIC International was incorporated in the United Arab Emirates (UAE) in 2011 to aid access to low cost borrowings for the acquisition of ships, ship components and automobiles. Operations at EPIC International commenced in 2014, with the acquisition of three vessels. EPIC International now procures vessels and other offshore support equipment on behalf of C&I Leasing for lease back to the Issuer to service marine support contracts.

Leasafric Ghana Limited

Leasafric Ghana commenced operations in 1994 and is licensed by the Bank of Ghana as a non-bank financial institution. Leasafric Ghana provides services similar to C&I Leasing such as fleet management, automobile tracking and personnel outsourcing. In 2019, Leasafric Ghana obtained a permit from the Ghanaian Petroleum Commission to participate in the country's oil & gas industry in collaboration with local partners. Leasafric Ghana aims to list on the Ghanaian Stock Exchange in the medium term.

Figure 2: C&I Leasing Group Structure



Source: Agusto & Co. Research

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THE ISSUE

C&I Leasing intends to issue a ₦10 billion, 7-year, Series II bond ("the Bond" or "the Issue"). The Bond is the second tranche under the Issuer's ₦20 billion bond issuance programme. The Issue is a Fixed Rate Secured Debt Instrument, with 15 marine vessels ("the Security") belonging to the Issuer provided as security for the Bond. The fifteen vessels will jointly secure the proposed Series II Bond and the balance of ₦4.84 billion on the existing Series I Issue due 2023.

Five of the fifteen marine vessels are currently encumbered to the tune of $2.92 million in favour of a third-party creditor, 'BV Scheepswerf Damen Gorinchem', a Netherland based ship and vessel repairs services provider. C&I Leasing has made the following covenants with regards to the encumbered vessels in the security pool:

- The Issuer undertakes to repay the third-party creditor by 31 August 2021.
- The Issuer covenants to procure the execution of a deed of release by the third-party creditor over the encumbered vessels within five (5) Business Days following the date of repayment to BV Scheepswerf Damen Gorinchem ('the release date')
- C&I Leasing will procure the registration and perfection of the deed of release in relation to the encumbered vessels in the relevant jurisdictions, and provide the Security Trustee with evidence of the registration and perfection of the deed of release within seven (7) Business Days from the release date
- Within three (3) Business Days of the Release Date, the Issuer intends to create in favour of the Security Trustee a first ranking priority fixed charge over its shares in the encumbered vessels by the execution of a security deed under the same terms and conditions as set forth in the Series II Security Deed.
- Within seven (7) Business Days from the execution of the security deed, the Issuer will perfect in the relevant jurisdictions a first ranking fixed charge over its shares in the encumbered vessels for the benefit of the Security Trustee in accordance with the terms of the Deed
- C&I Leasing will also procure the requisite approvals and registrations required under the applicable laws of any relevant jurisdiction.

The Series II Bond when issued, will be a direct, unconditional, senior and secured obligation of the Issuer and shall rank pari passu without preference, with other outstanding senior secured obligations of the Issuer – except for obligations binding by the law.

SECURITY

The ten unencumbered marine vessels were valued at ₦11.7 billion by Messrs Ubosi Eleh & Co. ("the Valuer") in September 2020. The five encumbered marine vessels were valued at ₦5.5 billion by the Valuer on the same date. These assets jointly secure the sum of the proposed ₦10 billion, 7-year, Series II Bond and the ₦4.84 billion balance of the existing 5-year ₦7 billion Series I, 16.54% Fixed Rate Senior Secured Bond due 2023 – indicating a 1.72x cover.

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We note that the Series I Trust Deed permits the use of its collateral for any other series under the debt issuance programme. By September 2021, it is expected that the encumbrances on the five marine vessels will have been expunged following the repayment of the outstanding balance of the $2.92million loan due to BV Scheepswerf Damen Gorinchem'. C&I Leasing covenants that for as long as any portion of the Bond remains outstanding, there will be no charge, mortgage, lien, pledge or other interest upon the Security, without the prior written consent of the Trustees.

Table 2: Ten Unencumbered Marine Vessels

Marine Vessels	Builders	Year Built	Market Value
Tug Boat M.V. "Charis"	Celtug Service Shipyard, Malaysia	2010	1,013,357,000
Tug Boat M.V. "Eliezer"	Celtug Service Shipyard, Malaysia	2010	1,013,200,000
Crew Boat M.V. "Ephrahim	Celtug Service Shipyard, Malaysia	2010	1,014,050,000
Crew Boat M.V. "Deborah"	Veecraft Marine, South Africa	2011	1,040,149,000
Crew Boat M.V. "Perez"	Veecraft Marine, South Africa	2010	1,014,400,000
Crew Boat M.V. "Ahuva"	Veecraft Marine, South Africa	2011	1,008,600,000
Patrol Boat M.V. " Sakak Defender	Damen Shipyards Group, Netherlands	2013	1,290,900,000
Patrol Boat M.V. "Sur Defender"	Damen Shipyards Group, Netherlands	2013	1,279,000,000
Crew Boat M.V. "Magen Defender"	Veecraft Marine, South Africa	2013	1,486,000,000
Crew Boat M.V. "Masud Defender"	Veecraft Marine, South Africa	2013	1,492,000,000
			11,651,656,000

Table 3: Five Encumbered Marine Vessels

Marine Vessels	Builders	Year Built	Market Value
Patrol Boat M.V. "Helam"	St Kitts & Nevis, Damen	2015	1,342,045,750
Patrol Boat M.V. "Helez"	St Kitts & Nevis, Damen	2015	1,341,445,750
Patrol Boat M.V. "Eran"	St Kitts & Nevis, Damen	2015	1,341,559,750
Patrol Boat M.V. "Eluzai"	St Kitts & Nevis, Damen	2015	1,341,772,750
Patrol Boat M.V. "Rhib" (This is small vessel attached the other four vessels)	Marine Specialized Technology Limited, United Kingdom	2015	182,430,000
			5,549,254,000

Analysis of the Bond's Security

Ten Unencumbered Marine Vessels

We view positively the fact that the unencumbered security pool constitutes a relatively modern and diverse fleet of medium-sized and smaller marine vessels that benefit from stronger market demand given the greater versatility and functionality than bigger vessels. Crew boats are versatile with utility in the general transportation of people and cargo. Tug boats are essential in the berthing operations of ships while patrol boats aid surveillance at sea. We also note that the unencumbered security pool's vessels have an average age of 9 years, which we view favourably given the estimated useful life of 25-30 years for such vessels.

The marine vessels were valued using the depreciated replacement cost (DRC) method by Messrs. Ubosi Eleh & Co. This method equates the open market value of an asset to the estimated total cost of the items as new at the date of valuation less an allowance for depreciation to account for age, wear and tear and obsolescence.

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We have applied an additional haircut of 25% on the market value of ₦11.65 billion for the ten marine vessels. These ten vessels were previously (during the Series I Bond issuance) valued at ₦9.7 billion in December 2017 by the aforementioned valuers with a forced sale value of ₦7.3 billion, which translated to a 25% drop under more difficult market conditions. Moreover, Industry operators opine that as a result of the COVID-19 pandemic, there has been a lull in the vessel market. Our 25% haircut on the estimated open market value for the ten marine vessels is additionally justified by the facts that:

- Vessel values usually erode with time and use.
- In marine asset liquidations, realized value may be significantly below fair market value, especially during weaker macroeconomic and industry conditions, and vessel foreclosures may take a significant amount of time, given Nigeria's slow judicial system.

Thus, our estimated forced sale value for the ten vessels is ₦8.74 billion, which equates to a 39% recovery rate after we deduct the ₦4.84 billion balance on the Series I Bond. We believe that until year 2023, the Series 1 bondholders will have a higher priority charge over the ten marine vessels in terms of default than the Series II bondholders.

Five Encumbered Marine Vessels

Our 25% haircut on the open market value of ₦5.5 billion for the five encumbered marine vessels gives an estimated forced sale value of ₦4.16 billion, which increases the 39% recovery rate by 27% (totalling 66%), after we deduct the repayment to the third-party creditor.

However, we note that the effective addition of these vessels to the security pool is contingent on a successful Series II Bond issuance. We also note that contrary to the Series I Bond issuance, the Series II Bond has no underwriters to assure the success of the Issue. We attribute this absence of underwriting to the high level of liquidity in the capital market in 2020 which the Issuer is banking on to achieve a successful issuance.

PURPOSE OF THE ISSUE

C&I Leasing plans to use the proceeds of the proposed Series II Bond to replace short term debt. The Issuer expects this to significantly reduce interest expense, which constitutes the largest portion of C&I Leasing's direct costs. Thus, after deduction of the Issue costs – estimated at ₦229.3 million and representing 2.3% of the expected gross issue proceeds – the net proceeds amounting to ₦9.8 billion will be used to repay existing short-term loans.

Table 4: Use of Proceeds

Purpose	Percentage (% of Proceeds)	Amount
Repayment of existing short-term loans	97.707%	9,770,700,000
Issue Expense	2.293%	229,300,000
Total	**100%**	**10,000,000,000**

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REPAYMENT

C&I Leasing plans to repay the Bond from its operating cash flows. Interest shall be payable semi-annually beginning from six months from the Bond's date of allotment. While, the principal on the Bond will be repaid semi-annually on an amortised basis following an initial two-year moratorium. A sinking fund will be created in accordance with the trust deed and made available for principal redemption and coupon payments. Monthly payments shall be made from the cash flow of the Issuer, including all other monies (if any) due and payable by the Issuer in respect of the Bond into the Sinking Fund as set out in the Series Trust Deed.

PARTIES TO THE ISSUE

Issuing Houses

Cordros Capital Limited

Cordros Capital Limited ("Cordros") is the lead issuing house to the Issue. Cordros is licensed as a Broker/ Dealer, Issuing House and Fund/Portfolio Manager by the Securities & Exchange Commission (SEC).

The joint issuing houses (all SEC registered operators) include:

- Coronation Merchant Bank Limited
- FCMB Capital Markets Limited
- FSDH Capital Limited
- Planet Capital Limited
- Financial Derivatives Company Limited

Trustees

UTL Trust Management Services Limited (UTL)

UTL is the Security trustee and a joint trustee to the Issue. The company, which has acted as sole and joint trustees to numerous issuances in Nigeria, is licensed by SEC to provide trusteeship and portfolio management services.

Other joint trustees to the Issue include:

- GTL Trustees Limited,
- STL Trustees Limited
- Cordros Trustees Limited

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Table 5: Other Parties to the Issue

Role	Companies
Registrars	• Cordros Registrars Limited
Solicitor to the offer	• G. Elias & Co Solicitors
Solicitor to the Issuer	• Adroit Lex & Co
Reporting Accountant	• SIAO Partners
Auditors to the Issuer	• PKF Professional Services
Receiving Bank	• Stanbic IBTC Bank Limited • First City Monument Bank
Stockbrokers	• Cordros Securities Limited • Apel Assets Limited • Mega Equities Limited • Bestworth Assets & Trust Limited

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THE NIGERIAN LEASING INDUSTRY

Data from the Equipment Leasing Association of Nigeria (ELAN) indicates a 14% growth in lease volumes in 2019, with outstanding lease volume increasing to ₦1.91 trillion from ₦1.68 trillion in 2018[1]. The increased demand for leasing services was attributable to the rising cost of assets and greater lease awareness[2]. Leasing remains a veritable means of equipment financing particularly in difficult macroeconomic environments where many consumers are not able to 'self-finance' the purchase of a required asset.

The Nigeria leasing industry comprises banks, independent leasing companies, captive leasing operators and informal players. The industry is highly fragmented but only structured leasing operators such as C&I Leasing Plc are registered with the Central Bank of Nigeria under the Banks and Other Financial Institutions Act. While commercial banks mainly offer consumer and corporate (asset) finance leases, independent operators such as C&I Leasing Plc and Aquila Leasing Limited generally offer both operating leases and finance leases and also related services such as fleet management, vehicle tracking and personnel outsourcing. The captive operators are finance units of manufacturers such as Mantrac, who offer leases on the companies' own products.

Some independent leasing operators are positioned in niche markets in the leasing industry. For instance, C&I Leasing Plc is prominent in the marine support & logistics segment. Supported by the Oil & Gas Local Content Act, leasing institutions such as C&I Leasing Plc drive activities in Nigeria's domestic marine vessels segment. Revenues of marine lease operators are significantly dependent on exploration and production activities in the Nigerian oil & gas sector. Thus, gluts in the global oil markets or declines in the volume of crude oil produced in Nigeria significantly impact the revenues of marine vessel lease operators.

Finance leases remain the predominant type of leases in Nigeria, accounting for 70% of lease transactions while operating lease transactions accounted for 30%[3]. Leasing typically finances a higher percentage of the value of assets than bank loans. The bulk of leased assets are vehicles including trucks for haulage and buses for inter-state commercial transportation. Financing specialised assets – particularly in the health sector – is an emerging product line in the industry[4]. In our view, the volume of operating leases is understated due to inadequate regulatory oversight, with the operations of firms that render only operating lease services not regulated by the Central Bank of Nigeria (CBN).

However, funding remains critical to the development of the industry as most operators rely on more expensive short-term funding sources (such as bank borrowings), instead of medium to long-term funding which is more suitable for equipment/machinery financing. Lessors' inability to fund big ticket lease assets is one of the reasons for the relative underdevelopment of the Nigerian leasing industry. Furthermore, the lack of a standardised lease structuring system and asset repossession difficulties have eroded investor confidence. The industry is also quite susceptible to macroeconomic headwinds such as rising inflation and declining consumer purchasing power which impacts negatively on lessors, manifesting in higher cost profiles and default rates.

[1] *https://elannigeria.org/blog/elan-adovocates-leasing-for-re-inflating-the-economiy-in-covid-19/*
[2] *https://elannigeria.org/blog/elan-adovocates-leasing-for-re-inflating-the-economiy-in-covid-19/*
[3] *http://elannigeria.org/2018-outlook-things-are-looking-up-2/*
[4] *http://elannigeria.org/2018-outlook-things-are-looking-up-2/*

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The COVID-19 pandemic and the containment efforts have negatively impacted the finances of businesses and consumers. ELAN[5] admits that in this COVID era, many operators have experienced delayed rental payments due to clients experiencing slow business activities which has in turn affected the cashflow of leasing firms. There has also been a contraction in the demand for non-essential items while operators have grappled with inflationary and devaluation pressures that have made costs and assets prices to spike. In our view, ability to obtain low-cost long-term funds and leverage technology are key success factors in this harsh business climate. Industry experts have suggested that lessors should benefit from intervention funds facilitated by agencies such as the Central Bank of Nigeria (CBN) and the Bank of Industry (BOI). However, in our opinion, the underlying structural bottlenecks that stymie the leasing industry such as asset abuse and asset repossession difficulties remain sizeable challenges that will not be resolved by cheaper funding.

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[5] *https://elannigeria.org/blog/covid-19-navigating-the-terrain/*

ANALYSTS' COMMENTS

The rating assigned to the Issue reflects the performance and support of the C&I Leasing Group. The analysis in this report therefore includes an assessment of the Issuer, its 71% owned Leasafric Ghana and the core operations of its wholly owned subsidiary – EPIC international FZE.

ISSUER'S FINANCIAL CONDITION

Marine operating lease assets continues to account for the largest share of total assets

As at 31 December 2019, C&I Leasing's total assets stood at ₦56.2 billion, representing a 7% growth from the prior year. Operating lease assets valued at ₦31 billion and comprising mainly marine vessels and autos & trucks accounted for the largest share of total assets at 54%. The Issuer's marine vessels are mainly provided to major exploration and production (E&P) companies including Nigeria LNG Limited (NLNG), Shell Petroleum Development Company of Nigeria (SPDC) and Mobil, under long-term contracts. C&I Leasing's autos & trucks lease clients include companies in the FMCG, banking, transportation and hospitality industries. The vehicles in the auto and truck fleet also have multi-year contracts with an average length of 4 years. This covers the automobiles' useful life, a deliberate matching strategy that we view positively. Unaudited accounts as at 30 September 2020 indicates no significant change in asset structure with marine vessels and autos & trucks constituting the largest share of total assets at 55%.

Figure 3: Breakdown of Total Assets as at 2019FY

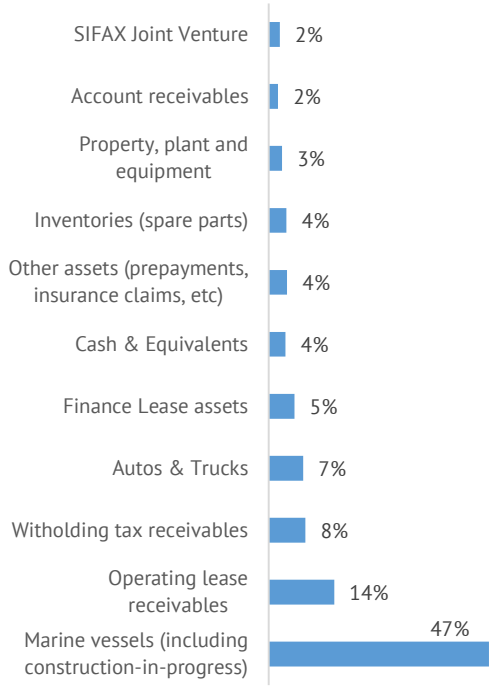
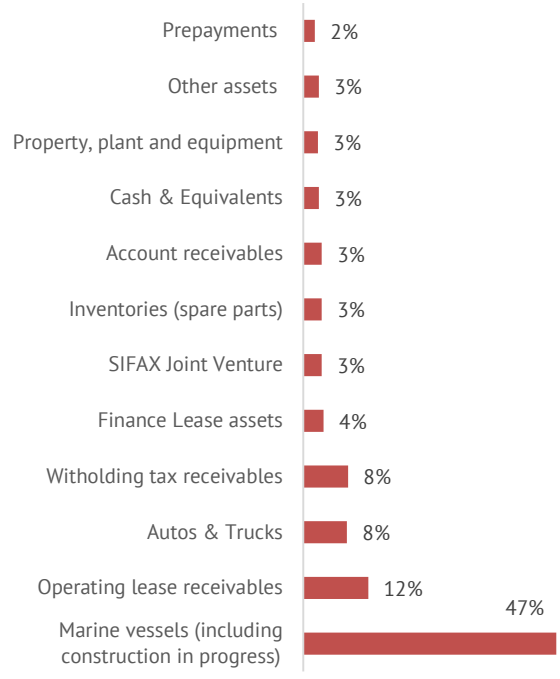


Figure 4: Breakdown of Total Assets as at Sep 2020



Source: C&I Leasing Plc.

Operating lease receivables – largely from the marine vessels lease portfolio – accounted for 12% of total assets, the second largest asset class. C&I Leasing offers a 90-day credit period particularly to international oil companies (IOCs) in the marine vessel lease space. However, the bearish trend in the global crude oil market in the latter part of year 2019 and in 2020, which has been exacerbated by the outbreak of COVID-19 has led oil majors to push for lower rates across board from service providers including the Issuer. Local oil companies such as COOEC-Dangote and NPDC which comprise 43% of total receivables have delayed payments beyond the 90-day credit limit to up to 122 days.

Past due receivables from marine support services stood at ₦75.3 million as at the 2019 FYE, accounting for 1% of total marine lease receivables. A further breakdown and ageing analysis of the operating marine lease portfolio reveals that only ₦6 million worth of delinquent receivables were in arrears for over 12 months as at the 2019 FYE. However, as at 30 September 2020, the '3-6 months' past due marine lease receivables stood at ₦903 million, accounting for 14% of total marine lease receivables and reflective of the slowdown in the economy. C&I Leasing's management expects these receivables to be paid by January 2021.

Given the bearish trend in the international crude oil market amid the COVID-19 pandemic, we expect a slight increase in the level of non-performing receivables in the short term. However, we take comfort in the fact that the obligors of operating lease receivables are largely IOCs in long-term contracts with the Issuer. In our view, the dominance of marine operating leases in the lease portfolio and tilt to oil servicing contracts will continue to make C&I Leasing susceptible to events in the global oil & gas sector.

We have also noted delinquencies in the Issuer's fleet management division as at the 2019 FYE and September 2020. Of total invoices of ₦451 million for fleet leases (mainly operating fleet management leases) as at the 2019 FYE, ₦113 million were delinquent, translating to a non-performing lease ratio of 24%. Subsequent to year end, past due operating lease receivables for fleet management rose to ₦206 million of a total of ₦483 million, signifying further deterioration to 43% as at September 2020. With the re-opening of airports and gradual lifting of lockdown restrictions, we anticipate lower impairments in fleet management receivables.

Overall, we consider C&I Leasing's asset quality to be good primarily due to the quality of marine lease assets. The marine vessels are versatile and of a relatively young age (an average of 9 years which is favourable in comparison to the estimated useful lives of 25-30 years). Capacity utilisation has also been high, at up to 92% during bullish periods in the oil & gas sector and currently at about 76%, which is adequate in our view. Vehicles for fleet leases are also tied up in multiyear contracts with reputable obligors.

Capital to remain adequate for current business risks

C&I Leasing's capital adequacy ratio (in line with Basel II) stood at 20% as at the 2019 FYE and 26% based on unaudited September 2020 accounts, above the minimum 12.5% regulatory requirement for finance companies operating in Nigeria, signifying adequate capitalisation. The Issuer's capital includes the ₦2 billion five-year unsecured variable coupon convertible note issued to a private equity firm – Abraaj Advisers Nigeria Limited – in 2009. With a conversion of the loan notes to shares, there will be a significant concentration in ownership

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with Abraaj Advisers Nigeria Limited's equity stake rising up to 50%. With this shareholding structure, Abraaj Advisers Nigeria Limited will be able to exert significant influence over the Issuer's board of directors and strategic direction which may cause conflicts with existing shareholders. We also believe that recapitalisation exercises going forward might become difficult given the significant shareholding by a private equity firm whose preference is to exit.

Cost reduction measures will sustain profits at breakeven levels

The Issuer recorded gross earnings of ₦32.5 billion in 2019, representing a 15% growth from prior year with revenues largely driven by a favourable crude oil market in the earlier part of the year and improved fleet management operating lease income. However, the contraction in the oil & gas market, the impact of the COVID-19 pandemic on economic activities and the slow recovery of Nigerian and Ghanaian economies have significantly constrained revenues in 2020 to ₦22.3 billion in the nine months to September (September 2019: ₦26.6 billion). Earnings for the first three quarters of 2020 were majorly from the marine vessel lease division given that the Issuer ties its vessels to long-term marine contracts.

Notwithstanding, C&I Leasing's gross margin ratio (which indicates the revenue the Issuer retains after incurring core costs[6]) improved slightly to 36% in September 2020 from 34% in the 2019 FY, due to lower direct operating costs (such as travelling expenses) achieved by cost savings from the COVID-19 pandemic. In 2019, the Issuer had incurred one-off expenditure for the hire of substitute vessels to temporarily stand in for some of C&I Leasing's vessels which were scheduled for mandatory maintenance and dry docking.

The Issuer recorded a cost to income ratio (CIR - measured as operating expenses to net earnings ratio) of 92% in the first nine months to September 2020, due to lower earnings. C&I Leasing's CIR was 88% in 2019. Thus, C&I Leasing's profitability was low during period ended 30 September 2020 with annualised return on average equity (ROE) at 4.6% (2019 FY: 8.6%) and annualised return on average assets (ROA) of 1.1% (2019 FY: 1.9%). We expect C&I Leasing's 2020 and 2021 earnings to be under pressure because of spending cuts by oil and gas producers in response to lower oil prices and demand. Nevertheless, the Issuer is undertaking cost cutting initiatives including renegotiating vendor contract terms and interest rates on bank loans to improve profitability.

Leverage is declining with the use of cheaper long-term funds increasing

The Issuer recorded a debt to equity ratio of 3.1 times as at 31 December 2019 compared to 2.8 times as at the end of 2018. During the financial year ended 31 December 2019, C&I Leasing's total borrowings increased by 11% to ₦37 billion driven largely by new short-term commercial notes to augment working capital. However, as at 30 September 2020, the Issuer's total borrowings had declined to ₦33.4 billion as C&I Leasing paid down on some expensive bank borrowings. Thus, the Issuer recorded a debt to equity ratio of 2.2x as at 30 September 2020, lower than our benchmark of 4x for marine vessel leasing operators. The Issuer also has

[6] Core costs include direct operating costs and interest expense.

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a strong ability to refinance with undrawn committed local and foreign currency lines from banks in excess of ₦15 billion and $25 million respectively as at 30 September 2020.

As at the 2019 FYE, the Issuer's interest coverage ratio (EBITDA/interest expense) stood at 2.6 times but has averaged 3.3 times over the last three years, indicating sufficient ability to meet interest payments. We expect C&I Leasing's leverage to remain moderate over the seven-year tenor of the Bond, with the interest coverage ratio remaining within the range of 2-4 times.

OUTLOOK

The oil & gas servicing industry was particularly hard hit by the challenges related to the COVID-19 pandemic. Thus, the decline in oil prices and the COVID-19 pandemic pose downside risks to C&I Leasing's asset performance in the short term – particularly for marine leases which account for the bulk of the Issuer's portfolio. In addition, demand for fleet management/car rental and outsourcing services is not expected to return to pre-COVID-19 levels until mid-2021, as activities in the Nigerian economy remain subdued with the recent civil unrest and COVID-19 threat still lurking. Nonetheless, C&I Leasing has a proven track record of remaining resilient during turbulent times, which is partly due to an experienced and stable management team and improved track in accessing Nigeria's debt market.

Therefore, we expect the profitability of C&I Leasing's core business lines to decline substantially in 2020 as the Issuer awaits economic recovery across the globe and an attendant uptick in the oil & gas market. We expect capital and leverage to remain adequate, supported by a recent injection of equity via a rights issue and a successful launch of the proposed Series II Bond. C&I Leasing's leverage and capital positions will also become well-defined with the conversion of the Abraaj Advisers Nigeria Limited's shares to equity by the 2020 FYE. Nevertheless, there will be a significant concentration in the Issuer's ownership structure.

We believe the Issuer's ability to meet obligations on the Bond is adequate. The Bond is secured by fifteen marine vessels with a charge to be created in favour of the Security Trustee – UTL Trust Management Services Limited – for the benefit of the bondholders. The marine vessels were valued at a total of ₦17.2 billion by Ubosi Eleh & Co. in September 2020 and our forced sale estimate indicates a 66% recovery rate for these vessels which is moderate in our opinion. We hereby attach a **stable** outlook to the rating. Our outlook is based on our expectation that the Issuer will continue to fulfil its bond obligations despite the decline in economic activities given its track record of resilience.

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FINANCIAL SUMMARY

C & I LEASING PLC						
Statement of Financial Position as at December	**2019**		**2018**		**2017**	
Assets	₦'000		₦'000		₦'000	
Liquid Assets	1,995,094	4%	1,712,543	3%	1,266,016	3%
Total Loans - Net	15,685	0%	16,574	0%	47,366	0%
Investment in Finance Lease	3,090,821	5%	1,999,330	4%	1,515,030	3%
Assets Under Operating Lease	30,556,351	54%	30,686,724	58%	27,167,387	60%
Total Other Assets	17,641,167	31%	15,739,607	30%	13,332,395	30%
Joint Ventures	1,334,226	2%	781,260	1%	52,634	0%
Property, plant & equipment (for own use)	1,579,191	3%	1,631,281	3%	1,584,522	4%
Goodwill & other intangible assets	23,190	0%	45,169	0%	15,955	0%
Total Assets	**56,235,725**	**100%**	**52,612,488**	**100%**	**44,981,305**	**100%**
Capital & Liabilities						
Total Shareholders' Funds	11,778,173	21%	11,827,604	22%	9,100,691	20%
Total Borrowings	36,980,144	66%	33,436,202	64%	28,918,233	64%
Total Other Liabilities	7,477,408	13%	7,348,682	14%	6,962,381	15%
Total Capital & Liabilities	**56,235,725**	**100%**	**52,612,488**	**100%**	**44,981,305**	**100%**

Statement of Comprehensive Income as at December	**2019**	**2018**	**2017**
	₦'000	₦'000	₦'000
Operating Lease	20,466,757	16,866,009	11,464,403
Finance Lease	1,863,993	2,518,970	2,508,548
Interest Earned on Loans & Advances	202,274	140,433	60,285
Core Income	**22,533,024**	**19,525,412**	**14,033,236**
Direct Costs	(10,615,783)	(8,672,739)	(4,861,802)
Interest Expense	(5,742,408)	(4,672,638)	(3,500,610)
Loan Loss Expense	(74,801)	(6,483)	(235,325)
Net Income	**6,100,032**	**6,173,552**	**5,435,499**
Net Outsourcing Income	1,001,254	792,563	704,657
Other Income	1,425,507	1,548,546	1,591,763
Total Operating Expenses	**(7,514,132)**	**(6,974,426)**	**(6,454,553)**
Profit (Loss) Before Taxation	**1,012,661**	**1,540,235**	**1,277,366**
Tax (Expense) Benefit	(73,239)	(342,470)	(162,783)
Profit (Loss) After Taxation	**939,422**	**1,197,765**	**1,114,583**
Gross Earnings	**32,492,296**	**28,181,994**	**21,855,227**

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FINANCIAL SUMMARY (CONT.D)

C & I LEASING PLC			
Key Ratios	**2019**	**2018**	**2017**
Profitability Ratios			
Lease Gross Margin	33.9%	38.6%	48.6%
Loan loss expense/Interest income	0.3%	0.0%	1.7%
Operating expenses/operating income	88.1%	81.9%	83.5%
Return on average assets (pre-tax)	1.9%	3.2%	3.1%
Return on average equity (pre-tax)	8.6%	14.7%	14.9%
Capital Adequacy & Leverage			
Debt/Equity	3.1	2.8	3.2
Adjusted Capital/Risk Weighted Assets	20%	18%	14%
Cash Flow Interest Cover (EBITDA/Interest Expense)	2.6	2.7	4.7
PBT/PBIT (3-year Avg)	22%	26%	24%
Staff Information			
Average number of employees	537	516	553
Staff cost per employee (N'000)	3,133.9	2,787.7	2,219.2
Net earnings per staff (N'000)	15,878.6	16,501.3	13,981.8
Staff cost/Net earnings	20%	17%	16%
Staff costs/Operating expenses	22%	21%	19%

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RATING DEFINITIONS

Aaa	This is the highest rating category. The Bond is adjudged to offer highest safety of payment of interest and principal.
Aa	The Bond is adjudged to offer high safety of payment of interest and principal.
A	The Bond is adjudged to offer adequate safety of payment of interest and principal; however, changes in circumstances can adversely affect such issues more than those in the higher rated categories.
Bbb	The Bond is adjudged to offer sufficient safety of payment of interest and principal for the present; however, changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal than for bonds in higher rated categories.
Bb	The Bonds is adjudged to carry inadequate safety of payment of interest and principal; while they are less susceptible to default than other speculative grade bonds in the immediate future, the uncertainties that the issuer faces could lead to inadequate capacity to make interest and principal payments.
B	The Bond is adjudged to have greater susceptibility to default; while currently interest and principal payments are met, adverse business or economic conditions would lead to lack of ability or willingness to pay interest or principal.
C	The Bond is adjudged to have factors present that make them vulnerable to default; payment of interest and principal is possible only if favourable circumstances continue.
D	The Bond is in default and in arrears of interest or principal payments or are expected to default on maturity.

Rating Category Modifiers

A "+" (plus) or "-" (minus) sign may be assigned to ratings from 'Aa' to 'C' to reflect comparative position within the rating category. Therefore, a rating with + (plus) attached to it is a notch higher than a rating without the + (plus) sign and two notches higher than a rating with the - (minus) sign.

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