Credit Rating Report | Nigerian Corporate | October 2021*

Ardova Plc

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook/Watch
Ardova Plc	Long Term Issuer	National	A-(NG)	Stable
	Short Term Issuer	National	A2(NG)	
N9bn Series 1 Senior Unsecured Bonds	Long Term Issue	National	A-(NG)	Stable

Strengths

- Strong market share, underpinned by extensive retail footprint and control over the value chain
- Robust revenue growth expected to be sustained through acquisition and capacity expansion
- Conservative leverage and access to diverse funding sources

Weaknesses

- Revenue concentration to PMS, with inherently weak margins
- Weak corporate governance structure up the parent level
- High working capital pressures leading to a compression of debt service metrics

Rating Rationale

The ratings of Ardova Plc ("Ardova" or "the Company") reflects its strong competitive position in the Nigerian oil and gas downstream sector, solid earnings performance through the cycle and moderately strong credit protection metrics and capital structure. These are balanced against the inherently high liquidity requirements in the sector, and GCR's concerns on the shareholding structure.

Ardova's strong business profile is underpinned by its integration along the value chain. Thus, while the Company's core operations consist of a network of over 450 retail outlets well spread across key cities in Nigeria, it benefits from backward integration through its parent, Prudent Energy and Services Limited ("Prudent" or "the Group"), which is able to import and store fuel, as well as managing the full logistics operation through in-house subsidiaries. The successful acquisition of Enyo Retail and Supply Limited ("Enyo"), with additional 93 retail outlets, should help capture stronger market share. Other key competitive advantages relate to the ongoing expansion of non- premium motor spirit ("PMS") product lines, including liquified petroleum gas, bitumen, and lubricants (through upgrade of lubes blending plant and exclusive distribution rights to Chevron and Shell lubes).

Although GCR has adopted a standalone credit analysis, we recognise Ardova's position as an important component of the Group (48% and 44% of consolidated revenue and EBITDA respectively in FY20). Accordingly, a slight negative adjustment has been applied to group support to account for the perceived higher risks within the Group's operations, compared to Ardova.

*The last rating announcement was communicated on 6 July 2021. Rating reports are updated at least once a year from the date of the last rating announcement.

GCR takes cognisance of the well constituted Board of directors (separate from the parent) with credible strategic goals, an experienced senior management team, and the public listing status of Ardova, albeit the weaker governance structure at the ultimate group level does constrain the ratings somewhat. Positive adjustment to this assessment is dependent on demonstrable stronger governance structure at the group level.

The robust earnings growth has been supportive to the ratings, underpinned by the strong revenue progression in PMS (due to higher volumes and price increase), which accounted for around 80% of FY20 revenue. While the other product lines are expected to expand over the medium term, earnings concentration to PMS will remain. As PMS pricing is closely regulated, the profit margin is narrow, with little headroom to manage earnings variability. Accordingly, earnings margins have been reported slightly below the peer average of 3.3%, due to the lesser contribution from lubes (compared to Total Nigeria Plc and Eterna Plc). While GCR expects some marginal enhancement, underpinned by the anticipated growth in other product lines, this margin will likely remain below 5% over the rating horizon, in line with industry norm.

Leverage and capital structure are deemed neutral to the ratings primarily due to the reduction in gross debt from N34.8bn at FY17 to N9bn at FY20. This has supported the substantial improvement in net debt to EBITDA to around 1.24x in FY20 (period average 3.66x). Although debt is expected to more than double to around N20bn in FY21-22, GCR anticipates that the metric would remain at the 1.8x-2.2x range on the back of an increase in absolute EBITDA. This is offset against the historically low interest coverage, albeit expected to widen slightly to the intermediate range of 5.5x-7.5x over the rating horizon due to the supportive interest rate environment. Operating cash flow coverage of debt is expected to contract slightly (but remain moderate) due to working capital pressures. GCR takes cognisance of Ardova's access to diverse funding sources and the low currency risks, but this weighs against the short maturity on all debt. The imminent bond issuance should help spread the maturity profile over the longer term.

The ratings are somewhat constrained by the liquidity assessment, with sources versus uses of cash calculated to register around 1.34x over the next 12 to 18 months. Liquidity is underpinned by cash holdings of around N2.4bn at FY20 and N6.8bn committed facilities, as well as anticipated strong cash flows. This will be augmented by the anticipated bond issue which will be utilised to settle the Enyo acquisition cost and other capex requirements.

Outlook Statement

The Stable Outlook reflects GCR's expectation that sound earnings will be sustained over the rating horizon, which should cushion the impact of the anticipated increase in debt on leverage metrics. We also envisage that the intermediate liquidity assessment will continue to be supported by good operating cash flows and the Company's strong relationships with lenders.

Rating Triggers

Positive rating action is only likely over the medium term, contingent upon achieving consistently stronger earnings and cash flows above the industry average. This should allow Ardova the resources to fund a larger portion of its operations internally, thus reducing reliance on debt.

The ratings could be downgraded if 1) there is material and sustained earnings shock which impacts on profitability and substantially impacts the debt service metrics 2) Ardova is unable to raise sufficient funding to meet short term maturities and capex commitments 3) liquidity coverage falls below 1.25x due to higher recourse to short term debt or cost overrun on expansion projects.

Given that the indicative rating is intrinsically linked to the Issuer's long-term rating, any change to the corporate rating assigned to Ardova will directly affect the Bond rating.

Analytical Contacts

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Ratings History

Ardova Plc

Rating class	Review	Rating scale	Rating	Outlook	Date
Long Term Issuer	Initial	National	A-(NG)	Stable	June 2016
Short Term Issuer	Initial	National	A1-(NG)		
Long Term Issue	Initial	National	A-(NG)	Stable	December 2016
Long Term Issuer	Last	National	A-(NG)	Stable	December 2020
Short Term Issuer	Last	National	A2(NG)		
Long Term Issue	Last	National	A-(NG)	Stable	December 2020

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, October 2021
GCR's Nigeria Corporate Sector Risk Scores, August 2021

Analytical Entity: Ardova Plc

Incorporated as British Petroleum Nigeria ("BP") in 1964, Ardova (formerly Forte Oil Plc) evolved into a leading integrated energy company engaged in refined petroleum marketing, upstream oilfield services and power generation. In 1978, BP sold 40% of its shares to Nigerians[2], and Ardova was converted to a public company. The Federal Government of Nigeria ("FGN") acquired BP's residual 60% stake through the Nigerian National Petroleum Corporation ("NNPC") in 1979, while the entity was renamed African Petroleum Plc ("AP"). Ardova's ownership profile underwent further changes between 2000 and 2007. In December 2010, AP rebranded, changing its name to Forte Oil Plc. In 2019, Prudent Energy acquired a 74% stake in Forte Oil Plc through Ignite Investments and Commodities Limited, an investing arm of the ultimate parent, Prudent, with a consequent change of name to Ardova Plc. Prudent (established in 2014) is a leading energy and commodities trading company with substantial downstream oil storage facilities (combined 64,000CBM storage terminals in Nigeria) and 3 Marine Vessels (combined tonnage of 85,000DWT). Service offerings include marine logistics services, oil sector consulting and petroleum marketing. Prudent enjoys technical support and supply chain access through strategic partnerships with international commodities trading firms such as British Petroleum and Glencore Energy UK Ltd, and an affiliation with NNPC.

Operating Environment

The operating environment assessment is constrained by the strict price regulation and the attendant impact on the oil and gas downstream sector profitability, albeit the prospect for full deregulation should bode well for the industry.

Country risk

Ardova's country risk score reflects its 100% Nigerian exposure, with no 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

[2] In compliance with the Nigerian Enterprises Promotion Decree of 1977

October 2021, available for download at https://gcrratings.com/wp-content/uploads/2021/10/202110-Country-Risk-publication_FINAL.pdf.

Sector risk

The oil and gas downstream sector score evidences below-average cyclicality and low product substitution risk. Nevertheless, these strengths are offset somewhat by the low barriers to entry, thin margins, as well as regulatory and environmental tussles. Currently, the industry's main product, Petroleum Motor Spirit (PMS), is solely imported by the government, and its price is regulated, thus impacting earnings margin for the refined product marketers. Although the non-PMS fuels segment is driven by market forces, heightened pricing competition among over 3,000 marketers has constrained the ability to pass on additional cost to consumers. For GCR to review the sector risk score upwards government interference across the sector's value chain would need to be more limited, allowing prices to be determined by market dynamics, rather than the government's manner of fixing prices.

Industry dynamics are expected to change when Dangote Refinery becomes operational in the near future and is able to fully meet local PMS demand. This will reverse the decades-old system of exporting crude oil and importing about 90% of local demand for the refined petroleum products. The refinery is expected to help curtail costs in the industry and thus improve margins, while also promoting freer market dynamics. Localised refining capacity should also help ease the USD demand pressure on downstream players and associated working capital requirements, as well as boosting the nation's foreign reserve.

Business Profile

Competitive position

GCR anticipates that Ardova's leading market share and control over the value chain will be further complemented by the robust pipeline of product innovation, but revenue concentration to a single product will remain a constraint over the rating horizon.

Ardova's strong business profile is underpinned by its integration along the value chain. Thus, while the Company's core operations consist of a network of over 450 retail outlets, spread across key cities in Nigeria, it benefits from backward integration through its parent, which is able to import and store fuel, as well as managing the full logistics operation through in-house subsidiaries. The successful acquisition of Enyo Retail and Supply Limited ("Enyo"), with additional 93 retail outlets, should help capture stronger market share. Other key competitive advantages relate to the ongoing expansion of non-PMS product lines, including liquified petroleum gas, bitumen, and lubricants (through upgrade of lubes blending plant and exclusive distribution rights to Chevron and Shell lubes).

Table 1: Peer analysis | NGX-Listed major oil marketers | 2020 (N'm)

	Ardova	Total	11 Plc	Conoil	Eterna	MRS Oil
Revenue	181,939	204,721	165,496	117,471	58,716	41,981
EBITDA	5,283	10,231	1,995	3,533	2,680	-900
Depreciation	-1,480	-6,537	-5,123	-969	-1,095	-1,492
EBIT	3,804	3,695	-3,128	2,564	1,585	-2,392
Net finance charge	-1,232	-2,668	-246	-683	-987	-1,081
NPBT	2,905	2,909	5,702	2,145	548	-2,652
OCF	2,670	41,889	17,764	9,295	-58	3,946
Gross debt	8,957	33,627	5,296	190	12,713	2,065
Cash	2,404	31,014	10,582	5,895	2,056	4,462
Net debt	6,553	2,613	n.a	n.a	10,656	n.a
Ratios (%)						
Revenue growth	3.1	-29.9	-13.7	-15.9	-74.4	-36.0
EBITDA margin	2.9	5.0	1.2	3.0	4.6	neg
EBITDA: net interest	4.3	3.8	8.1	5.2	2.7	neg
OCF: debt	29.8	124.6	335.4	4,899	neg	191.1
Net debt: EBITDA	124.0	25.5	n.a	n.a	397.6	n.a
Retail outlet count	450+	575+	250+	395+	72+	113+

In FY20, Ardova was the largest marketer per volume and revenue of PMS traded (from a second position in FY19). The Company has also maintained a second position in the higher margin lubes segment, with revenue nearly equating the combined sales by Conoil, Eterna and MRS Oil, but still far below the market leader, Total Plc, with c.50% market share. The distributive capacity is further enhanced by the recent acquisition of Axle and Cartage, resulting in total fleet of around 1,600 trucks for distribution nationwide.

Table 2: Peers Product Mix Comparative | 2020

	Ardova		Total		Conoil		Eterna		MRS Oil	
	N'bn	%	N'bn	%	N'bn	%	N'bn	%	N'bn	%
Petroleum & allied products	165.0	90.7	157.1	76.7	109.6	93.3	51.3	87.3	38.2	90.9
Lubes	17.0	9.3	47.7	23.3	7.9	6.7	7.5	12.7	3.8	9.1

Management and governance

GCR takes cognisance of the well constituted Board of directors (separate from the parent) with credible strategic goals, experienced management team, and the public listing status of Ardova, albeit the weaker governance structure at the ultimate group level does constrain the ratings somewhat. Positive adjustment to this assessment is dependent on demonstrable stronger governance structure at the group level.

Financial Profile

Earnings

Revenue progression is generally sound, but industry earnings margins remain inherently weak. However, the anticipated full deregulation of the downstream oil and gas sector and ongoing diversification into margin-enhancing products, should bode positively for stronger earnings over the medium to long term.

Figure 1: Revenue progression

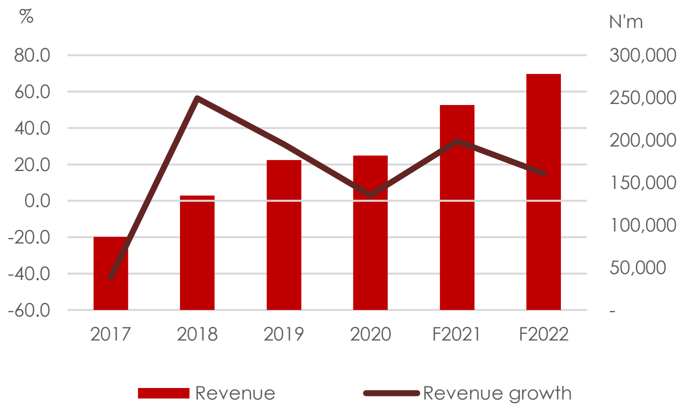
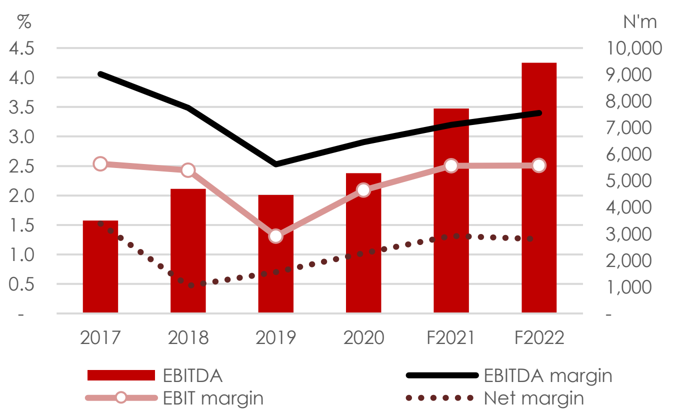


Figure 2: Margins trend



Ardova has maintained a strong revenue progression post divestment of the power business, underpinned by higher volume and price increase of PMS, barring FY20 when growth was constrained by the impact of COVID-induced disruptions to fuels consumption. 1Q FY21 performance also underperformed expectations and reported a 19% y/y decline relative to 1Q FY20, due to industry-wide supply shortages from NNPC, the sole importer of PMS. Nevertheless, GCR expects the full year revenue growth to be around 30% on the back of anticipated stronger PMS consumption for the second half. Future growth should be supported by the ongoing expansion of Ardova's retail footprint (including, through the proposed acquisition of Enyo), which will complement the expansion of the Company's branded lubes blending capacity, exclusive distribution rights to Shell's lubes, and the additional stream from Bitumen production and sales. As such, the contribution of PMS should gradually taper, but given the huge demand, it is expected to remain the dominant business. In addition, we recognize the likelihood that the anticipated full deregulation of the downstream oil and gas sector could materialise over the rating horizon, resulting in the potential for higher pump price for PMS, hence, higher revenue.

Table 3: Projected earnings mix	2020(A)		F2021*		F2022*	
	Revenue	% contr.	Revenue	% contr.	Revenue	% contr.
PMS	144,697,000,000	80.1	175,356,000,000	72.6	192,892,000,000	69.4
AGO	15,073,920,075	8.3	20,545,698,420	8.5	22,600,268,262	8.1
ATK	3,317,409,904	1.8	8,391,600,000	3.5	9,230,760,000	3.3
LPG sale	208,273,781	0.1	-	-	11,575,725,000	4.2
FO lubes	15,856,610,911	8.8	18,440,278,304	7.6	20,284,306,135	7.3
TX lubes	1,280,178,360	0.7	1,222,914,000	0.5	1,345,205,400	0.5
SHELL lubes	-	-	4,293,432,000	1.8	5,366,790,000	1.9
Bitumen	-	-	9,000,000,000	3.7	9,900,000,000	3.6
Haulage & transport	274,211,000	0.2	4,181,568,421	1.7	4,599,725,263	1.7
Total	180,707,604,031	100	241,431,491,145	100	277,794,780,060	100

*Company forecast

Given the high concentration to PMS (80% in FY20), with pricing closely regulated, Ardova's profit margins are weighed down by the PMS business, with little headroom to manage earnings variability. Accordingly, earnings margins have been reported slightly below the peer average of 3.3%, due to the lesser contribution from lubes which reports better margins (compared to Total Nigeria Plc and Eterna Plc). While GCR expects some marginal enhancement, underpinned by the anticipated growth in other product lines, this margin will likely remain below 5% over the rating horizon, in line with industry norm. Over the long term, we expect significant ramp up in profitability post full deregulation.

Leverage and cash flow

Ardova is conservatively geared, reporting modest debt service metrics. Financial flexibility is also underpinned by the access to diverse funding source, including the local debt capital market.

Figure 3: Gearing

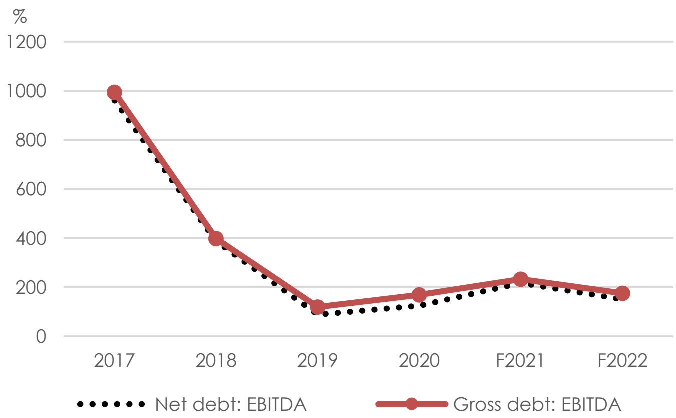
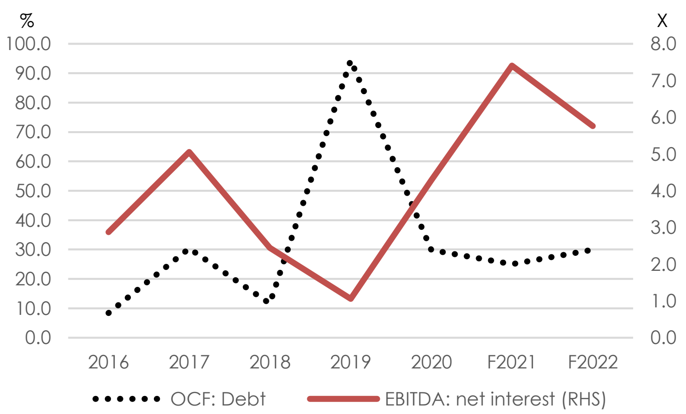


Figure 4: Debt service metrics



Leverage and capital structure are deemed neutral to the ratings primarily due to the reduction in gross debt from N34.8bn at FY17 to N9bn at FY20. This has supported the substantial improvement in net debt to EBITDA to around 1.24x in FY20 (period average 3.66x). Although debt is expected to more than doubled to around N20bn in FY21-22 due to the planned bond issuance, GCR anticipates that the metric would remain at the 1.8x-2.2x range on the back of an increase in absolute EBITDA.

Operating cash flow coverage of debt has been volatile due to working capital pressures related to increase in inventory holding (in line with volumes growth) and large cash outflows to settle creditors. In FY20, the coverage contracted to 30%, compared to 94.5% in FY19 (review average: 36%) due to substantial increase in advance payment to suppliers (N12.7bn). However, this was cushioned by the inventory accruals related to liabilities accrued pending the receipt of invoice on products purchased. Going forward, we anticipate that inventory requirement will persist in line with business expansion, with some pressure also expected from debtors (albeit lesser than FY20 as FGN promissory notes receivables are realised). Overall, we expect the coverage to remain suppressed at the current level.

Interest coverage has been historically low, having hovered at an average of 3.1x over the review period. This has improved slightly to 4.3x in FY20 because of lower finance cost (given the significant reduction in debt) and increase in the quantum of earnings. Given the plan to raise bonds at currently favourable interest rates and the plan to renegotiate/refinance existing bank loans, we project that EBITDA coverage of interest will trend around 5.5x to 7.5x in FY21-22.

GCR takes cognisance of Ardova's access to diverse funding sources and the low currency risks, but this weighs against the short maturity on all debt. The imminent bond issuance should help spread the maturity profile over the longer term.

Liquidity

Liquidity is constrained by high capex commitment and imminent debt redemption

The ratings are somewhat constrained by the liquidity assessment, with sources versus uses of cash calculated to register around 1.34x over the next 12 to 18 months. Liquidity is underpinned by cash holdings of around N2.4bn at FY20 and N6.8bn committed facilities, as well as anticipated strong cash flows of N4.8bn. This will be augmented by the anticipated bond issue which will be utilised to settle the short term redemption of c.N9bn, the Enyo acquisition cost and other capex requirements (estimated at around N15bn).

Comparative Profile

Group support

Although GCR has adopted a standalone credit analysis, we recognise Ardova's position as an important component of the Group (48% and 44% of consolidated revenue and EBITDA respectively in FY20). Accordingly, a slight negative adjustment has been applied to group support to account for the perceived higher risks within the Group's operations, compared to Ardova.

Rating Adjustment Factors

Structural adjustments

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

Instrument ratings

The N9bn Series 1 Bonds constitute senior, direct, unconditional, and unsecured obligations of Ardova. The Bonds were issued in December 2016, with coupon rate of 17.50%, and legal maturity in December 2021. Being senior unsecured debt, the Bonds rank *pari passu* with all other senior unsecured creditors of Ardova. As such, the Bonds bear the same national scale long term rating as that accorded to the Issuer. Accordingly, any change in the Issuer's long-term rating would impact the Bond rating. Furthermore, GCR has reviewed the Bond Performance Report dated June 30, 2021, jointly issued by ARM Trustees Limited, FBNQuest Trustees Limited, UTL Trust Management Limited, United Capital Trustees Limited and Vetiva Trustees Limited ("the Joint Trustees"). The Joint Trustees indicated that coupon and principal repayment have been made on the respective payment dates, with the total outstanding principal of N1.5bn. The next/final coupon payment date is December 2021. The Joint Trustees did not report ant breach of negative pledges or covenants by the Issuer.

Risk Score Summary

Rating Components and Factors	Risk scores
Operating environment	**6.50**
Country risk score	3.75
Sector risk score	2.75
Business profile	**0.75**
Competitive position	1.00
Management and governance	(0.25)

Financial profile	**0.00**
Earnings profile	0.50
Leverage & cash flow	0.00
Liquidity	(0.50)
Comparative profile	**(0.25)**
Group support	(0.25)
Peer comparison	0.00
Total Risk Score	**7.00**

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 rating has been disclosed to Ardova Plc. The rating above was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating.

Ardova Plc participated in the rating process via telephonic management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from Ardova Plc 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 period to 31 March 2021;
- Internal and/or external management reports;
- 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.
- Trustees Report on the N9bn Series 1 Senior Unsecured Bonds, dated 30 June 2021