GCR RATINGS

CREDIT RATING ANNOUNCEMENT

GCR affirms Axxela Limited's national scale long-term and short-term Issuer ratings of A-$_{(NG)}$ / A2$_{(NG)}$ respectively, Outlook revised to Stable

Rating action

Lagos, 21 August 2023 – GCR Ratings (GCR) has affirmed the national scale long-term and short-term Issuer ratings of A-$_{(NG)}$ and A2$_{(NG)}$, respectively assigned to Axxela Limited. Concurrently, GCR has affirmed the national scale long-term Issue rating of A-$_{(NG)(EL)}$ accorded to Axxela Funding 1 Plc's NGN11.5Bn Series 1 Senior Secured Bonds. The Outlook on the ratings has been revised to Stable.

Rated entity/issue	Rating class	Rating scale	Rating	Outlook/Watch
Axxela Limited	Long-term Issuer	National	A-$_{(NG)}$	Stable Outlook
	Short-term Issuer	National	A2$_{(NG)}$	
NGN11.5Bn Series 1 Senior Secured Bonds	Long-term Issue	National	A-$_{(NG)(EL)}$*	Stable Outlook

*The Senior Secured Bonds rating is based on an estimate of the expected loss in the event of an issuer default and is a function of the estimated probability of default of the issuer and the potential losses that may be incurred. As such, this rating carries an "(EL)" suffix. The expected loss rating assigned to the Bonds issued therefore differs from the long-term senior unsecured credit rating of the Issuer.

Rating rationale

The ratings affirmation of Axxela Limited (Axxela or the group) reflects its sustained earnings progression and robust cash flows, underpinned by consistent business expansion, with good liquidity. However, the ratings are constrained by higher debt position, which has weakened leverage metrics.

Axxela's strong competitive positioning is a rating strength underpinned by its consistent capacity expansion and widening geographical coverage. The group's long-term agreements with suppliers and customers have bolstered earnings stability, enhancing Axxela's competitive position. The group continued to grow its regional businesses, supplying gas to Togo through the West African Gas Pipeline, and is making inroads into Benin Republic and Ghana in the near to medium term. Furthermore, Axxela has leveraged on its large gas grid to diversify its earnings, providing gas-to-power solution through the establishment of captive power plants for its customers. In addition, Axxela, in joint venture with NNPC Gas Marketing Limited (NGML) is developing new gas distribution businesses which should boost future revenue. However, the overdependence on its sole supplier (NGML) remains a downside risk. Axxela has onboarded three alternative gas suppliers to cushion any gas supply disruptions, but these extendible contracts are usually for shorter periods and the gas supply volume is comparably small.

Axxela reported a modest growth in revenue for 2022 despite the lingering supply disruptions experienced since H1 2022. Revenue rose by 13% to register at NGN120Bn ($284M) for the full year 2022, slightly missing our target of 15% growth. The growth was underpinned by higher gas supply to its local and regional customers.

However, revenue growth slowed during 5M 2023, mirroring the H1 2022 performance with a marginal annualised growth of 3% (H1 2022: 1%), attributable to lower consumption caused by supply disruptions and election activities within the first quarter. EBITDA margin remained within strong level but has declined in recent period due to the low margin sales to the Togo market. Nevertheless, stronger revenue growth is anticipated for the full year 2023 and 2024 on the back of higher gas sales volumes. In addition, we expect Axxela to benefit from the recent foreign exchange liberalisation as invoices are denominated in USD, boosting revenue on the back of the exchange rate differential. EBITDA margin should remain strong around 18% by 2023, supported by the established stringent cost control.

The ratings are constrained by the relatively weak leverage and capital structure attributable to rising debt utilisation amid constrained earnings. Gross debt almost doubled to NGN70Bn in May 2023, from NGN39Bn in December 2021 (December 2022: NGN67Bn) due to additional loan obtained to fund expansion projects. The elevated debt combined with moderated earnings saw net debt to EBITDA ratio weakened to 2.9x in May 2023 (2022: 2.3x, 2021: 1.6x). Similarly, operating cash flow (OCF) coverage of debt weakened to a negative position in May 2023, from 38% in 2021 attributable to high receivables. Furthermore, EBITDA coverage of net interest also reduced slightly in May 2023 to 5x, from 6x in 2022 due to constrained earnings. Axxela anticipates a further rise in debt to NGN82bn and NGN93Bn by 2023 and 2024 respectively given its ongoing capacity expansion. However, leverage metrics are expected to improve as earnings targets are met. We note the relatively high foreign currency exposure in respect of its convertible shareholder loan, but this is hedged with a non-deliverable forward contract.

Axxela's liquidity assessment is slightly positive, supported by robust cash holdings, anticipated improvement in operating cash flow and availability of several committed facilities from financial institutions. Most of these facilities have been provided specifically for capacity expansion projects, with around 33% of the total disbursed as of June 2023. Furthermore, the group has NGN4.2Bn deposited as of December 2022 for foreign currency allocation to support its import procurement costs once allocated. Aside the expected capital spending, liquidity uses include a small short-term debt repayments and dividend payments. Accordingly, the liquidity sources versus uses coverage is estimated at 1.7x over the seven months to December 2023 and 1.2x over the 19 months to December 2024. In addition, refinancing risk is minimal as debt maturity profile largely weighs above the 12-month period.

Axxela, through its special purpose vehicle (Axxela Funding 1 Plc) raised NGN11.5Bn in Series 1 Senior Secured Bonds from the Nigerian debt capital market in May 2020, under its N50bn Bond Issuance Programme. The Series 1 Bonds are direct, irrevocable and senior secured obligations of the Issuer, Axxela Funding 1 Plc, and at all times rank *pari passu* and without any preference among themselves. The bonds mature in 2027 and have a coupon rate of 14.3%.

Pursuant to the Series 1 Trust Deed, security is primarily created over trade receivables due from take or pay contracts, held in trust under an existing Security Deed, in addition to the assets pledged by the Sponsor. However, the existing receivables are not sold off to any entity, neither will the receipts on future receivables be ring-fenced for the payment of the bond obligations. As such, GCR considers the trade receivables as part of the working capital available for day-to-day operations of the Obligors, which have been factored into the long-term corporate ratings accorded to the Sponsor. Thus, recoveries would be in line with the corporate recovery prospects in a default scenario. As such, the Bonds bear the same default risk as its Sponsor.

GCR has reviewed the Trustee's report dated 3 August 2023, regarding the Series 1 Bonds performance and noted that Axxela has complied with the transaction terms and conditions in respect of the coupon payments and principal repayments. The total interest paid as of May 2023 amounted to NGN4.9Bn being six semi-annual payments while the principal repayments totaled NGN1.7Bn being two semi-annual repayments after the expiration of the moratorium.

Outlook statement

The revised Stable Outlook reflects our opinion that Axxela will continue to garner scale that supports sustained earnings and cash flows even during the ongoing capacity expansion. This should improve financial profile over the rating horizon with less recourse to debt.

Rating triggers

A rating upgrade is dependent on the timely completion of the projected capacity expansion which supports sustained robust earnings and cash flow in line with or above budget. This should support strong improvement in the leverage metrics, with net debt to EBITDA contained around 2x and OCF coverage of debt recovering to 30%.

Conversely, the rating may come under pressure from delays in project rollout and/or adverse exogenous factors, which constrain sales volume, leading to operational or earnings underperformance. Also, higher than anticipated increase in gross debt which further weakens leverage metrics and places some pressure on liquidity as well as any change in the convertibility clause on the shareholder loan will be negatively viewed. Greater earnings contribution from higher risk countries could moderate the rating if not offset by clear diversification benefits.

Analytical contacts

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Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Corporate Entities, January 2022
GCR Ratings Scales, Symbols & Definitions, May 2023
GCR Country Risk Scores, August 2023
GCR Nigeria Corporate Sector Risk Scores, April 2023

Ratings history

Axxela Limited					
Rating class	Review	Rating	Rating	Outlook	Date
Long-term Issuer	Initial	National	BBB+(NG)	Stable	September 2018
Short-term Issuer	Initial	National	A2(NG)		
NGN11.5Bn Series 1 Senior Secured Bonds	Initial	National	BBB+(NG)	Stable	December 2020
Long-term Issuer	Last	National	A-(NG)	Positive	August 2022
Short-term Issuer	Last	National	A2(NG)		August 2022
NGN11.5Bn Series 1 Senior Secured Bonds	Last	National	A-(NG)(EL)	Positive	August 2022

Risk score summary

Rating Components & Factors	Score
Operating environment	**6.25**
Country risk score	3.50
Sector risk score	2.75
Business profile	**0.75**
Competitive position	0.75
Management and governance	0.00
Financial profile	**0.25**
Earnings	0.50
Leverage & cash flow	(0.50)
Liquidity	0.25
Comparative profile	**0.00**
External support	0.00
Peer comparison	0.00
Total Risk Score	**7.25**

Glossary

Affirmation	See GCR Rating Scales, Symbols and Definitions.
Bond	A long term debt instrument issued by either a company, institution or the government to raise funds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Forward Contract	A forward contract, colloquially known as a forward, is an agreement to buy or sell a commodity, security or financial instrument at a specified future date at a predetermined price.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Joint Venture	A project or other business activity in which two persons or companies partner together to conduct the project.
Leverage	With regard to 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.
Moratorium	A period of time in which an activity is suspended until such time as a change in circumstances permits its removal. For example, a borrower can declare a moratorium on the repayments of the principal, and sometimes the interest, on a loan.
Offset	A right (Right of Offset) to set liabilities against assets in any dispute over claims.
Pari Passu	Side by side; at the same rate or on an equal footing. Securities issued with a pari passu clause have rights and privileges that are equivalent to those of existing securities of the same class.
Rating Horizon	The rating outlook period
Recourse	A source of help in a difficult situation.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Senior	A security that has a higher repayment priority than junior securities.
Upgrade	The rating has been raised on its specific scale.

Salient points of accorded rating

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 Axxela 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.

Axxela Limited participated in the rating process via telephonic management meetings, 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 Axxela Limited and other reliable third parties to accord the credit ratings included:

- 2022 audited annual financial statement, and prior four years annual financial statements;
- Five-month unaudited financial statement to 31 May 2023;
- Internal and/or external management reports;
- Industry comparative data and regulatory framework and a breakdown of facilities available and related counterparties;
- Information specific to the rated entity and/or industry was also received; and
- Trustees' report and transaction account bank statements dated June and August 2023.
- Exchange rate is sourced from Central Bank of Nigeria | Exchange Rate (cbn.gov.ng)

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