GCR RATINGS

Private Credit Rating Report | Nigerian Corporate Analysis | October 2021*

Babban Gona Farmer Services Nigeria Limited

Rated Entity	Rating class	Rating scale	Rating	Outlook
Babban Gona Farmer Services Nigeria Limited	Long Term Issuer	National	BBB-(NG)	Stable
	Short Term Issuer	National	A3(NG)	

Strengths

- Strong competitive position, underpinned by the strong social impact of its business model
- Sound revenue trajectory and expected ramp up in earnings.
- Well diversified funding sources and significant access to concessional funding.

Weaknesses

- Earnings concentration to a single product
- Rising debt level and weak debt service metrics

Rating Rationale

The ratings of Babban Gona Farmer Services Nigeria Limited ("Babban Gona" or "the Company") balance its strong environmental, social and governance ("ESG") impact on its host communities and strong liquidity coverage against fast rising debt amid persistently negative operating cash flows (due to huge inventory requirement as it scales operations), which has translated to weak leverage and cash flow metrics.

Babban Gona's ratings are supported by the strong competitive position, which reflects the underlying positive environmental and social impact/mandate that the Company fulfils through its smallholder farmer partnership ("SHP") model, which has helped to network cumulative c.250,000 farmers across Nigeria. Services provided to farmers include training, supply of inputs, financial credit, harvest advance loans, storage, and marketing services, which has helped the beneficiaries to achieve significantly higher yield per hectare and net income than the national average. The model has also underpinned ongoing financial support to Babban Gona from reputable global and local partners including, Bill & Mellinda Gates Foundation, KfW, Rippleworks, USAID, Nigeria Sovereign Investment Authority ("NSIA"), and the Central Bank of Nigeria.

Earnings have reported a sound positive trajectory with a 70% 5-year CAGR to FY20. While revenue growth has been slow in recent years due to a fall in price of maize, 1Q FY21 results have shown substantial annualised growth (2.4x), reflecting the doubling of both SHPs engaged (to c.40,000) and hectares cultivated (c.33ha) in 2020. That said, GCR expects the strong growth to be sustained for the full year, with subsequent growth to be contingent on an increase in SHPs and hectares grown. The earnings assessment is constrained by the concentration of earnings toward maize, with contributions from rice and other business lines expected to remain relatively small over the medium term.

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

EBITDA margins have been variable over the cycle, bottoming out in FY19 due to the high sensitivity to volatile commodity prices. While some variability is still expected over the rating horizon, GCR expects the margins to be generally good and to remain above the historical average. Furthermore, GCR expects that Babban Gona will continue to benefit from grant incomes which are targeted towards offsetting rising direct operational expenses.

Leverage and cash flow is the weakest rating factor, due to the persistent rise in gross debt from N3.2bn in FY17 to N13.5bn in FY20. Necessitated business expansion, debt is expected to rise further to N40.7bn in FY21 and furthermore to N65bn in FY22. However, supported by strong cash holding, net debt to EBITDA has remained moderate (between 1.4x and 2.3x) in most years, barring FY19. GCR expects this to trend around the higher range of 3x-3.5x in FY21-22 if earnings targets are met. Operating cash flows coverage is particularly very weak due to negative net funds flow since FY17 and likely to persist over the medium term as a consequence of high pressures from the substantial inventory holding requirement (in line with business growth) and harvest advance loans granted to farmers. However, GCR takes cognisance of Babban Gona's access to a diverse pool of international and local funding, with most facilities obtained on concessional terms. Although 34% of debt is USD denominated, these are hedged through a back-to-back ("B2B") debt arrangement, with USD fund inflows lodged in a foreign currency ("FCY") fixed deposit account with local banks who in turn advance Naira debt to Babban Gona.

The ratings are bolstered by the strong liquidity coverage with uses versus sources of 2.6x over the short term, underpinned by substantial cash holding of N11.9bn and undrawn committed facilities of N11.6bn (from FCMB and European Development Finance Institution) compared to moderate debt redemption and low capex commitments related to construction of additional storage facilities. However, a negative adjustment has been made to the overall score to reflect the expected negative operating cash flows over the medium term. GCR takes cognisance of the significant headroom against financial covenant thresholds.

Outlook Statement

The Stable Outlook is underpinned by GCR's expectation that the strong revenue progression will be sustained over the medium term. GCR also anticipates that the positive ESG impact will continue over the medium term, facilitating strong support from international and local counterparties.

Rating Triggers

Positive rating action is contingent on demonstrated stability in earnings over the medium term, better management of cash flows that results in lesser recourse to debt funding and a moderation in the leverage metrics to around the 1.5x-2x range.

Inability to convert debt funded inventories to cash in a timely manner could threaten leverage and liquidity, and result in a ratings downgrade. In addition, significant underperformance in earnings and/or material elevation in debt beyond expected levels could further weaken the debt service metrics and trigger a negative rating action.

Private rating usage

Recipients of this rating notification are to note that the rating accorded is private. A private rating is by nature confidential, but GCR may agree that the Rated Entity distributes the rating confirmation letter to (prospective) investors and other relevant counterparties, but only to the extent that such parties agree to confidentiality with the Rated Entity and agree that the credit rating action is private and only intended to be used in a closed circle of known parties. GCR requires Rated Entities to disclose the counterparties to whom it intends to distribute the letter prior to such distribution.

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Ratings History

Babban Gona Farmer Services Nigeria Limited					
Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long Term Issuer	Initial/last	National	BBB-(NG)	Stable	July 2021
Short Term Issuer		National	A3(NG)		

Related Criteria and Research

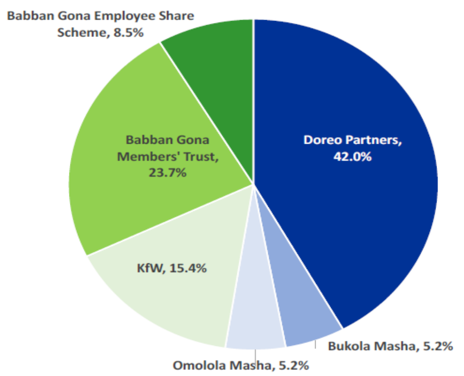
Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Corporate Entities, May 2019
GCR Rating Scales, Symbols and Definitions, May 2019
GCR's Nigeria Country Risk Scores, February 2021
GCR's Nigeria Corporate Sector Risk Scores, February 2021

Analytical Entity: Babban Gona Farmer Services Nigeria Limited

Babban Gona is established in 2012 as an integrated agricultural franchise business, which is co-owned by its farmer members. The agricultural franchise model was developed in partnership with reputable individuals and organisations including His Highness Muhammad Sanusi II, DFiD, AGRA, BMGF, Skoll, GIZ, USAID and the Rockefeller Foundation. The franchise model involves aggregation of maize through smallholder farmers (across multiple local communities in Nigeria), to whom Babban Gona provides training, financing, harvesting, storage, marketing, and distribution services. The Company intends to scale its impact to one million farmers by 2025.

The majority shares in Babban Gona are held by Bukola Masha and Omolola Masha (who hold the Managing Director and Deputy Managing Director position respectively). Other key shareholders include KfW, smallholder members[2] and employees, through an employee trust scheme. The details of the respective shareholding are detailed in Figure 1.

Figure 1: Shareholding structure



Operating Environment

The operating environment assessment reflects Babban Gona's full exposure to Nigeria and relatively weak agricultural sector fundamentals.

Country risk

Babban Gona's country risk score reflects 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 Nigerian agriculture sector risk score reflects its inherently highly cyclical nature, with agro-industrial corporates' earnings and cash generation fluctuating widely due to exogenous factors including climatic conditions and commodity price volatility. Locally, the sector has been adversely affected by the protracted security issues, in particular

[2] Through an equity injection by Bill and Melinda Gates Foundation to purchase ownership for the smallholder farmers

the Boko Haram insurgency in the North-Eastern region and farmers-herders clashes across many states. Nevertheless, the national government has been increasing support to the agricultural sector through various incentives to promote sustainability and ensure food sufficiency for the country. Moreover, encouraging local production of a wider range of agricultural produce is considered critical in extracting the full economic benefits from agriculture, including significant job creation. One of these initiatives is the Central Bank of Nigeria's Anchor Borrowers' Programme, through which the federal government provides funds to businesses across the agricultural value chains at a concessionary interest rate.

Despite being treated as an essential sector and exempted from the various restrictions induced by the COVID-19 pandemic, the sector is not immune to the adverse effects of the pandemic and has been impacted by disruptions to supply chains and falling consumer demand. While GCR expects the sector to witness moderate growth in 2021, this is likely to be tempered by the ongoing internal security issues and COVID-19 related challenges.

Business Profile

The strong business profile is underpinned by positive ESG considerations, strong counterparties, and control over the value chain

Competitive position

Babban Gona's ratings are supported by the strong competitive position, which reflects the underlying positive environmental and social impact/mandate that the Company fulfils through its SHP model, which has helped to network cumulative c.250,000 farmers across Nigeria, with 190,000 acres of cultivated land to date and over 60,000MT smallholder grain storage capacity (which is managed through a Warehouse Receipt System[3]). The Company also utilises on-field technological solutions to improve field monitoring operations, analysis of optimal plant populations, rates of germination and testing for plant nutrient deficiencies, which has helped it to garner farming efficiencies resulting in significantly higher yield per hectare and net income for its SHPs than the national average.

Babban Gona is one of the largest maize aggregators in Nigeria and Sub-Saharan Africa ("SSA"), with operations spanning a broad spectrum of the value chain. Compared to other players who focus on a few aspects of the value chain, Babban Gona is involved in providing agricultural inputs, financing, training, warehousing, and distribution of farm outputs. The Company has developed a strong reputation which has helped it to attract partnerships with strong financial counterparties including Bill & Mellinda Gates Foundation, Nigerian Sovereign Investment Authority, Central Bank of Nigeria[4], KfW, Rockefeller Foundation, USAID, and European Development Finance Institution. Although, strong growth opportunities exist for maize production, being an important grain in the continent as staple foods and animal feeds (specifically poultry), earnings are concentrated to this product, with rice production accounting for less than 5% of revenue during FY20 (but projected to steadily increase to 10-15% over the medium term). In line with the market dynamics for maize, given its high demand and liquidity relative to comparable products, it will likely remain Babban Gona's dominant revenue contributor, similar to AFEX Commodities Exchange with 74% contribution from maize, with the balance split between seven other commodities including soybeans, paddy rice, sorghum, ginger, cocoa, sesame, and cashew.

Management and governance

GCR's assessment of Babban Gona's management and governance is neutral to the ratings.

Financial Profile

Earnings

GCR anticipates sound earnings over the medium term on the back of strong activity progression, with less volatile margins underpinned by commodity price insurance and supportive grant incomes.

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[3] A technological platform that helps to provide real time monitoring, storage, and measurement of grains to minimise wastages

[4] Through the Anchor Borrowers Programme

Figure 2: Revenue progression

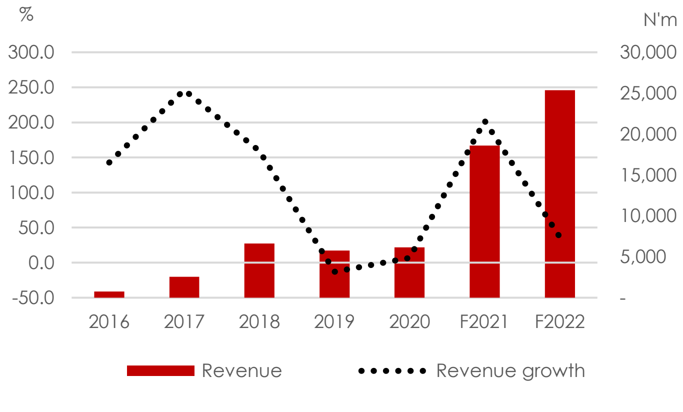
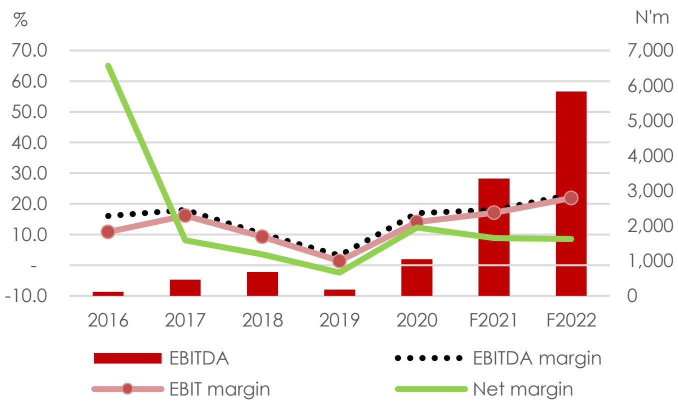


Figure 3: Margins trend



Sound earnings growth was reported between FY16-18, but this slowed in FY19 and FY20 due to a fall in price of maize. The key revenue drivers for any given year include the current market price of maize, area of land cultivated, and the number of active farmers engaged during the penultimate farming season. That said, 1Q FY21 results have shown substantial annualised growth (2.4x), reflecting the doubling of both SHPs engaged (to c.40,000) and hectares cultivated (to c.33ha) in 2020. As such, GCR expects strong growth to be sustained for the full year, with subsequent growth to be contingent on an increase in SHPs and hectares grown. The earnings assessment is constrained by the concentration of earnings toward maize, with contributions from rice and other business lines expected to remain relatively small over the medium term.

EBITDA margins have been volatile over the cycle, bottoming out in FY19 due to the high sensitivity to the unstable commodity prices. To mitigate this, the Company has procured a commodity price insurance with three Nigerian insurers, while grant incomes will be used to offset rising direct operational expenses. Consequently, EBITDA has been significantly boosted in FY20, registering at a high of N1bn (at 16.9% margin), compared to a cumulative of N1.4bn in FY16-19 (average margin: 11.9%). We expect the ongoing margin protecting initiatives to be sustained and support better earnings over the rating horizon.

Figure 4: Activity progression

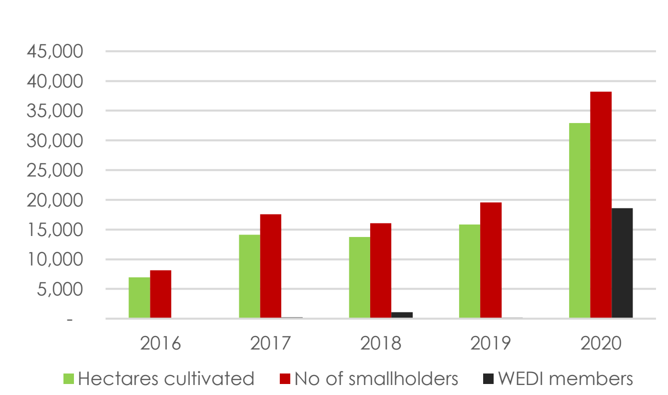
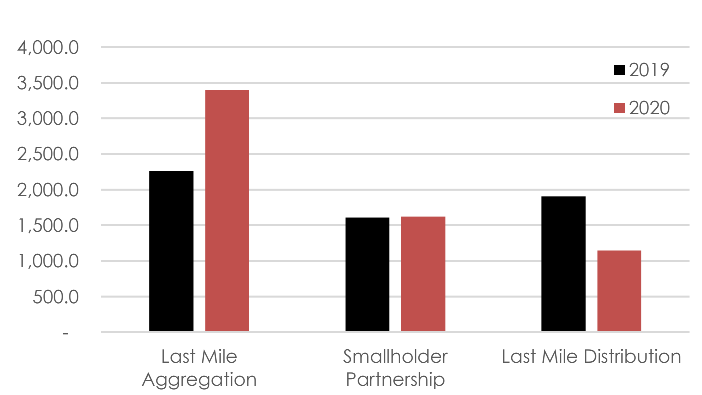


Figure 5: Segment mix



GCR believes that the Company will continue to grow its customer base through the various programmes, including the Last Mile Distribution programme, "LMD" (which serves as the wholesale and retail channel), the Last Mile Aggregators programme, "LMA" (which focusses on bulk sales to industrial off takers including Nestle, Grand Cereals, New Hope and Olam Nigeria), and SHPs from which Babban Gona derives revenue from services rendered (inputs, training, financing, storage, and sales).

While revenue is fairly distributed among the three schemes, LMA will likely be the key growth driver over the medium term as the Company increases its production and aggregation capacity to serve a wider range of bulk off-takers, while SHPs are also expected to deliver robust growth as area of land cultivated and farmer engagements increase.

Leverage and cash flow

Leverage profile is constrained by anticipated sharp rise in debt and gearing metrics and weak debt service metrics, balanced against diversified funding sources and well spread debt maturities.

Figure 6: Debt and gearing

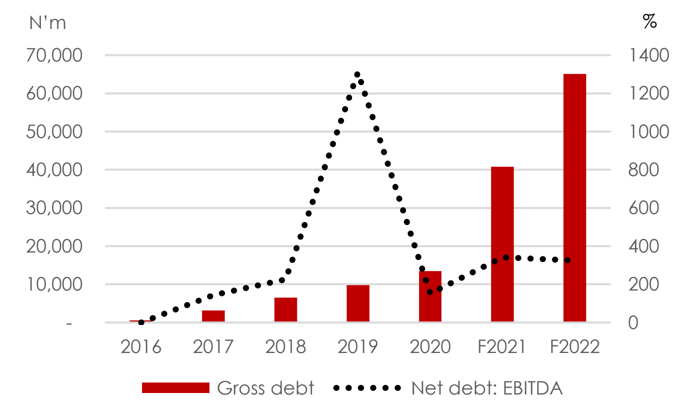
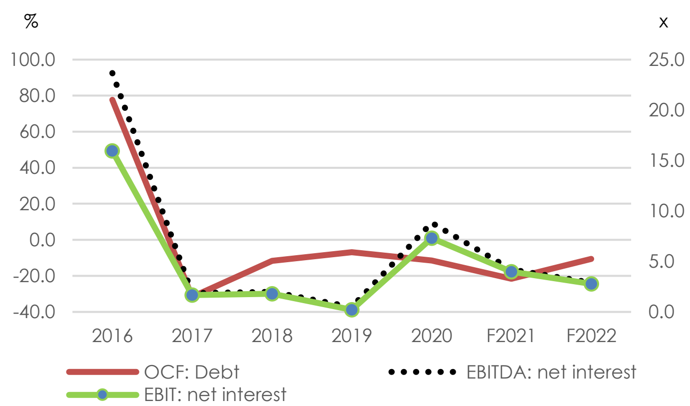


Figure 7: Credit protection metrics



Leverage and cash flow is the weakest rating factor, due to the persistent rise in gross debt from N3.2bn at FY17 to N13.5bn at FY20. However, supported by strong cash holding, net debt to EBITDA has remained moderate (between 1.4x and 2.3x) over the cycle, barring FY19 when it spiked to 13.1x due to a combination of weaker earnings and rise in debt. Necessitated by business expansion, debt is expected to rise further to N40.7bn in FY21 and furthermore to N65bn at FY22. Accordingly, GCR expects the leverage metrics to trend around a higher range of 3x-3.5x in FY21-22, if earnings targets are met.

Operating cash flows coverage is particularly very weak, due to negative net funds flow since FY17, which is likely to persist over the medium term on the back of high pressures from substantial inventory holding requirement (in line with business growth) and harvest advance loans granted to farmers. EBITDA coverage of interest has also been low and variable reflective of the weak and volatile earnings. While this has widened to 8.8x in 2020, we expect it to moderate to around 4x-5x in FY21-22 on the back of significant increase in finance costs in line with the planned increase in debt.

GCR takes cognisance of Babban Gona's access to a diverse pool of international and local funding, including charity organisations, development finance institutions, and the federal government, with most facilities obtained on concessional terms. Although 34% of debt is USD denominated, these are hedged through the B2B debt arrangement, with USD fund inflows lodged in a FCY fixed deposit account with local banks, who in turn advance Naira debt to Babban Gona. The B2B facilities are backed by letters of set-off and liens on Babban Gona's fixed deposits. While short term maturities are moderately high (36% at FY20), the Company intends to mitigate refinancing risk through the issuance of long-term bond.

Table 1: Breakdown of debt facilities

Lender	Ranking	FY20 (N'm)	Maturity	Currency
FCMB	Sub-ord	1,687.5	Jan-22	NGN
Skoll	Sub-ord	501.3	Apr-21	USD
Global Innovation Foundation	Sub-ord	554.0	Apr-21	USD
KIVA	Senior	278.6	Jul-21	NGN
Netri.	Senior	96.6	Jun-21	USD
Whole Planet Foundation	Sub-ord	302.5	Oct-22	NGN
Mulago	Sub-ord	256.1	2022/23	USD
FMO	Senior	799.5	Apr-21	USD
BOI	Senior	672.6	Sep-21	NGN
NSIA	Senior	1,418.7	Apr-23	USD
British American Tobacco Found.	Sub-ord	10.0	Jun-21	USD
FCMB- Anchor Borrowers Prog.	Sub-ord	3,682.7	Jan-21	NGN
Zenith- CBN MAS	Senior	1,999.9	2023	NGN
Rippleworks	Sub-ord	1,143.3	Nov-23	USD
Natalie Wenger		3.5	2021	NGN
Otunba Tunwase Foundation		41.8	2021	NGN
Total		13,448.6		

Liquidity

Strong liquidity assessment is underpinned by expected substantial cash resources amid low capex requirement and debt redemption

The ratings are bolstered by the strong liquidity coverage with uses versus sources of 2.6x over the short term, underpinned by substantial cash holding of N11.9bn and undrawn committed facilities of N11.6bn (from FCMB and European Development Finance Institution), compared to moderate debt redemption and low capex commitments relating to construction of additional storage facilities. However, a negative adjustment has been made to the overall score to reflect the expected negative operating cash flows over the medium term. Loan terms are favourable and financial covenants are moderate, with significant headroom against financial covenant thresholds. There exists a lien on the fixed deposit of USD23.8m held with local banks but only to the extent of the outstanding amount on the Naira facility advanced to Babban Gona. Most of these facilities are revolving.

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	**6.00**
Country risk score	3.75
Sector risk score	2.25
Business profile	**1.00**
Competitive position	1.00
Management and governance	0.00
Financial profile	**(1.00)**
Earnings profile	0.25
Leverage & cash flow	(2.25)
Liquidity	1.00
Comparative profile	
Group support	0.00
Peer comparison	0.00
Total Risk Score	**6.00**

Glossary

Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
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.
Issuer Ratings	See GCR Rating Scales, Symbols and Definitions.
Issuer	The party indebted or the person making repayments for its borrowings.
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.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Rating Horizon	The rating outlook period
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Refinancing	The issue of new debt to replace maturing debt. New debt may be provided by existing or new lenders, with a new set of terms in place.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.

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 Babban Gona Farmer Services Nigeria 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.

Babban Gona Farmer Services Nigeria 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 Babban Gona Farmer Services Nigeria 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 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.