



Credit Rating Announcement

GCR downgrades Daraju Industries Limited's national scale long term Issuer rating to BBB_(NG), with the Outlook accorded as Stable.

Rating Action

Lagos, 23 May 2022 - GCR Ratings ("GCR") has downgraded the national scale long term Issuer rating of Daraju Industries Limited to BBB_(NG) and affirmed the short term Issuer rating of A3_(NG), with the Outlook accorded as Stable.

| Rated Entity / Issue | Rating class | Rating scale | Rating | Outlook |
|---------------------------|-------------------|--------------|---------------------|---------|
| Daraju Industries Limited | Long Term Issuer | National | BBB _(NG) | Stable |
| | Short Term Issuer | | A3 _(NG) | -- |

Rating Rationale

The rating downgrade of Daraju Industries Limited ("Daraju" or "the Company") is attributable to the significant deterioration in the leverage metrics due to the sharp compression of EBITDA and high working capital pressures. GCR has factored in the stronger financial profile of the parent, Ashwah Holdings (Mauritius) Limited ("Ashwah Holdings" or "the Group") and taken cognisance of Daraju's recent deeper market penetration and the resultant solid revenue progression.

GCR has adopted a group approach to the ratings, incorporating the consolidated financial performance of Ashwah Holdings, which wholly owns Daraju and five other subsidiaries. This is because Daraju is a critical member of the Group, contributing 100% of group revenue. The Group also benefits from operational synergies from its members which underpins the stronger fundamentals.

Earnings came under severe pressure in FY21, resulting from input cost inflation, which were not fully passed on to consumers. Furthermore, Daraju was constrained from making a fully cost-reflective price adjustments during the year given its strategy to deepen market penetration amid tight competition. Thus, while strong volumes-driven revenue growth was reported during the year, input costs accounted for 85% of income (FY20: 78.7%), resulting in a steep decline of the EBITDA margin to 4.9% (FY20: 10.7%). Having implemented upward price adjustments for selected products during 1Q FY22, and with further repricing likely, management anticipates a recovery in the EBITDA margin to 9%-10% in FY22-23. As such, annualised top line growth of 45% in 1Q FY22 is expected to be sustained for the full year. GCR has also factored in the stronger earnings quality at Ashwah Holdings, as it has reported firmer EBITDA with greater stability. This is underpinned by the operational efficiencies afforded by the group members that provide backward integration for Daraju's operations.

The ratings are negatively impacted by the leverage and capital structure, given the deterioration in gearing metrics. Following the decline in core earnings and the increase in debt to N24.5bn at FY21 (FY20: N20bn), net debt to EBITDA spiked to 12.5x (FY20: 5.6x). Concurrently, the interest coverage narrowed to just 1x in FY21 from 1.9x in FY20 (FY19: 3.9x) on the back of the simultaneous increase in finance costs and decline in earnings. In addition, operating cash flow coverage of debt has remained negative since FY20, due to significant working capital absorptions attributable to higher inventory and debtor balances. However, GCR anticipates that net debt to EBITDA will materially improve to 4.6x in FY22 and further to 3.4x in FY23, underpinned by the expected ramp up in earnings, assuming debt is maintained at the current level. Conversely, interest coverage and operating cash flow ("OCF") coverage of debt will likely remain constrained over the outlook period, given the current debt quantum. The high proportion of short-term debt and the

foreign currency exposures also increase funding risk. Conversely, GCR has recognised the diversified funding base comprising 10 Nigerian commercial/merchant banks and more recently Bank of Industry. In addition, Ashwah Holdings reports more modest leverage, underpinned by its firmer earnings, suggesting additional support.

The liquidity assessment is a neutral rating factor, with the uses versus sources liquidity coverage estimated at 1.74x over the next 12 months. Although, cash in hand at 31 March 2022 was low and moderate operating cash flows are projected for FY22, liquidity is underpinned by the availability of unutilised committed facilities of N23.5bn. This ensures that there is sufficient resources to meet the short term debt of N16.5bn for FY22. Daraju completed substantial expansionary spend between FY18-20, as such, capex commitments for FY22 are low and primarily relate to replacement of existing assets. We expect that the management will maintain prudent treasury oversight such that the metric is not pressured by a further increase in short term debt, dividend payments and/or discretionary investment commitments.

Outlook Statement

The Stable Outlook reflects GCR's view that Daraju will sustain strong top line growth, improve margins, and return to profitability in FY22. We also expect that gross debt will be contained at the current level.

Rating Triggers

A rating upgrade is dependent on sustained improvement in earnings, coupled with better oversight of the working capital, which translates to stronger operating cash flows. A material reduction in debt leading to a meaningful improvement in the leverage metrics would also be positively viewed.

As the current ratings assumes a recovery in earnings from the lows in FY21, the ratings could be further downgraded: 1) if margins remain at the current weak levels, 2) if net debt to EBITDA remains above 6x; OCF coverage of debt remains negative or very low; interest coverage remains around 1x, 3) if higher refinancing risks and liquidity pressure become evident due to increase in short term debt and/or foreign currency exposure.

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 2022
 GCR Country Risk Scores, December 2021
 GCR Nigeria Corporate Sector Risk Scores, April 2022

Ratings History

Daraju Industries Limited

| Rating class | Review | Rating scale | Rating | Outlook | Date |
|-------------------|---------|--------------|----------------------|---------|------------|
| Long Term Issuer | Initial | National | BBB _(NG) | Stable | April 2021 |
| Short Term Issuer | Initial | National | A3 _(NG) | | |
| Long Term Issuer | Last | National | BBB _{-(NG)} | Stable | May 2022 |
| Short Term Issuer | Last | National | A3 _(NG) | -- | |

Risk Score Summary

| Rating Components & Factors | Risk scores |
|--------------------------------|---------------|
| Operating environment | 6.75 |
| Country risk score | 3.75 |
| Sector risk score | 3.00 |
| Business profile | 0.50 |
| Competitive position | 0.50 |
| Management and governance | 0.00 |
| Financial profile | (1.50) |
| Earnings performance | 0.50 |
| Leverage and Capital Structure | (2.00) |
| Liquidity | 0.00 |
| Comparative profile | 0.00 |
| Group support | 0.00 |
| Peer analysis | 0.00 |
| Total Score | 5.75 |

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. |
| 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. |
| 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. |
| 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. |
| 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. |
| 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 |

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 Daraju Industries Limited. 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.

Daraju Industries Limited 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 Daraju Industries Limited and other reliable third parties to accord the credit ratings included:

- 2020 audited annual financial statement, and prior four years annual financial statements;
- 2021 unaudited financial statements;
- management accounts for the period to 31 March 2022;
- 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.

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