

CREDIT RATING ANNOUNCEMENT

GCR upgrades Coleman Technical Industries Limited's long-term rating to BBB_(NG); Outlook Positive.

Rating action

Lagos, 29 August 2024 - GCR Ratings (GCR) has upgraded the national scale long-term Issuer rating of Coleman Technical Industries Limited (Coleman or the company) to BBB_(NG) from BBB_(-NG) previously but affirmed the short-term Issuer rating at A3_(NG). The rating Outlook has been revised to Positive from Evolving.

Rated Entity	Rating class	Rating scale	Rating	Outlook
Coleman Technical Industries Limited	Long-term issuer	National	BBB _(NG)	Positive
	Short-term issuer	National	A3 _(NG)	

Rating rationale

The rating upgrade on Coleman is underpinned by the improvements in liquidity and earnings in the recent period, which have somewhat eased off the pressures on leverage despite a rise in debt level. This is facilitated by the increased operational scale attained over the past three years, following the completion of several manufacturing plants. The positive outlook is anchored on the potential for a further rating uplift in the near term, if robust liquidity is maintained, debt contained and expansion plans are completed timeously, translating to stronger cash generation.

Coleman's business profile is strong, given the significant and increasing market share across multiple product categories in the Nigerian wires and cables market. This market position is being driven by the ongoing expansion of production capability and higher diversification into specialised products to meet demands of customers in the power, oil and gas, telecommunications, and marine service sectors. The company expect to imminently complete the backward integration for the local smelting of copper rods which it hitherto imports. The initiative is aimed at satisfying all internal input requirements for copper rods, achieve some cost savings, and position Coleman as a major supplier to local and regional market participants.

Earnings remain a major positive rating factor, driven by the recent improvement in earnings margins, which we expect to be sustained over the outlook period. The margin enhancement was supported by greater contribution of higher margin products, as well as the cost saving benefits from internal power generation. However, revenue underperformed our expectations by 34%, primarily due to contract variations by a major customer during Q4 2023. Most of these orders have since been fulfilled, supporting an annualised 90% revenue growth to NGN51.5Bn (USD38.3m) as of 31 June 2024. We have adopted a cautionary stance to the revenue expectations for full year 2024 and assumed that the smelting plant would become operational and contribute to the income stream in H1 2025 (management estimates: Q4 2024). Accordingly, we expect revenue to rise to NGN106Bn in 2024, while the EBITDA margin would be sustained at the 27%-33% range as the company ramps up operational scale and sustain cost efficiencies.

The solid earnings growth and cash retention have supported a better leverage metrics. However, leverage assessment remains a negative rating factor because of the compression in net interest coverage and the persistent increase in debt, 50% of which matures within 12 months from 30 June 2024. Net debt to EBITDA improved to 2.2x in 2023 (2022: 5.3x) and to 1.1x in H1 2024; while operating cash flow coverage of debt registered at a lower 22.6% in H1 2024 (after an all-time high of 52% in 2023), due to increase in prepayments for inputs and the unwinding of creditors

and customer deposits. Although, interest coverage appeared strong at 14x in H1 2024 (2023: 3x; 2022: 5.4x), we believe that it would normalise to the 4x-5x range in full year 2024, as a higher proportion of the finance costs fall due in H2 2024. We expect debt to increase further to NGN70Bn in 2024 (H1 2024: NGN56.4Bn; 2023: NGN49.8Bn) to support ongoing capital investments and the resultant increase in working capital requirements. Despite this, we project net debt to EBITDA to remain modest below 2x and operating cash flow to debt at around 40%, driven by strong earnings and cash generation. We also take cognisance of Coleman's access to concessional loans from Development Finance Institutions (80% of debt as of 30 June 2024), as well as funding support from commercial banks and the commercial papers market.

The liquidity assessment is a strong positive rating factor, reflecting the substantial (eligible) committed credit facilities of over NGN80Bn held with five local lenders, which mitigates refinancing risks associated with the recent spike in short-term debt to NGN30Bn, from NGN13Bn in the comparable period in June 2023. Cash holding is also robust, registering at NGN17.7Bn as of 30 June 2024. We have also factored in GCR-estimated cumulative operating cash flows of NGN54Bn over the 18-month period to 31 December 2025, but this remains highly sensitive to potential working capital swings, that could arise from operationalising the new plants in the near term. Conversely, we expect less aggressive capital spending as the ongoing projects near completion, while also estimating moderate dividend payments based on the historical average payout ratio. Overall, liquidity sources versus uses coverage is estimated at 3.3x and 2.3x over the next six and 18-month period, respectively.

Outlook statement

The Positive Outlook is anchored on the anticipated completion of the smelting plant and other key capital projects within the next 6 to 9 months. This could translate to stronger earnings performance in line with projections and underpin robust internal cash generation, less recourse to debt funding and sustained liquidity strength. Furthermore, timely completion and optimum operationalisation of the ongoing projects could further bolster Coleman's market position, supporting a rating uplift.

Rating triggers

A rating upgrade could be driven by an overall improvement in the financial profile, especially if earnings perform in tandem with expectations, and net debt to EBITDA remains below 2x, interest coverage strengthens above 5x and operating cash flow to debt is sustained above 40%. The ratings could also improve if liquidity coverage is sustained above 2x over a 12-to-18-month period, and if Coleman demonstrably increases market shares across multiple product categories.

On the other hand, a rating downgrade could follow a material escalation in debt without a corresponding increase in earnings and cash flows. The ratings would be lowered if interest coverage remains below 5x and operating cash flow to debt falls below 17.5% and net debt to EBITDA weakens above 3x. Refinancing and repayment risks could become elevated from a greater recourse to short-term debt, especially commercial papers, placing further strain on liquidity and triggering a downgrade.

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2024
Criteria for Rating Corporate Entities, May 2024
GCR Ratings Scales, Symbols & Definitions, May 2023
GCR Country Risk Scores, July 2024
GCR Nigeria Corporate Sector Risk Scores, June 2024

Ratings history

Coleman Technical Industries Limited

Rating class	Review	Rating scale	Rating	Outlook	Date
Long term issuer	Initial	National	BBB _(NG)	Stable	May 2021
Short term issuer	Initial	National	A3 _(NG)		May 2021
Long term issuer	Last	National	BBB _(NG)	Evolving	July 2023
Short term issuer	Last	National	A3 _(NG)		July 2023

Risk score summary

Rating Components & Factors	Risk scores
Operating environment	5.25
Country risk	3.50
Sector risk	1.75
Business profile	0.75
Competitive position	0.75
Sustainability	0.00
Financial profile	0.75
Earnings performance	0.75
Leverage and capital structure	(0.75)
Liquidity	0.75
Comparative profile	0.00
Group support	0.00
Peer analysis	0.00
Total score	6.75

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.
Commercial Paper	Commercial paper is a negotiable instrument with a maturity of less than one year.
Credit	A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company
Creditor	A credit provider that is owed debt obligations by a debtor.
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.
Dividend	The portion of a company's after-tax earnings that is distributed to shareholders.
Downgrade	The rating has been lowered on its specific scale.
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.
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.
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.
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.
Recourse	A source of help in a difficult situation.
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.
Repayment	Payment made to honour obligations in regard to a credit agreement in the following credited order: 1.) Satisfy the due or unpaid interest charges; 2.) Satisfy the due or unpaid fees or charges; and 3.) To reduce the amount of the principal debt.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term	Current; ordinarily less than one year.
Upgrade	The rating has been raised on its specific scale.
Working Capital	Working capital usually refers to the resources that a company uses to finance day-to-day operations. Changes in working capital are assessed to explain movements in debt and cash balances.

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.

Subsequent to an appeal by the rated entity, the rating was revised as reflected in the announcement.

The credit rating has been disclosed to the rated entity.

The rating above was solicited by the rated entity.

The rated entity participated in the rating process via in person interaction and/or via online virtual interaction and/or via electronic and/or verbal communication and correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from the rated entity and other reliable third parties to accord the credit ratings included:

- 2023 audited annual financial statement, and prior four years annual audited financial statements;
- Unaudited management accounts for the six-months period ended 30 June 2024;
- Industry comparative data and regulatory framework and a breakdown of facilities available and related counterparties
- Details of Unutilised Committed Facilities and
- Information specific to the rated entity and/or industry.
- Exchange rate source: Central Bank of Nigeria | Jan-Jun 2024 average rate of NGN1,345.24/ 1USD.

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