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North South Power Company Limited

Nigeria Corporate Analysis **December 2020**

Rating class	Rating scale	Rating	Rating Outlook	Expiry date
Long term	National	A-(NG)	Stable	October 2021
Short term	National	A2(NG)		

Financial data:

(USD'm comparative)^

	31/12/18	31/12/19
N/USD (avg.)	305.6	306.4
N/USD (close)	306.5	306.5
Total assets	265.7	327.7
Total debt	17.9	28.4
Total capital	27.1	50.9
Cash & equiv.	33.8	53.3
Turnover	123.3	126.6
EBITDA	92.4	86.4
NPAT	(17.7)	23.8
Op. cash flow	69.7	20.2
Market share:	8%*	
Market cap	n.a	

^Central Bank of Nigeria exchange rate
*Management estimate

Rating history:

Initial rating (August 2017)
Long term: BBB+(NG)
Short term: A2(NG)
Outlook: Stable

Last rating (December 2019)
Long term: A-(NG)
Short term: A2(NG)
Outlook: Stable

Rating methodologies/research
Global Master Criteria for rating Corporate entities (updated February, 2018)
NSP's rating reports (2017-19)
Glossary of terms/ratios, February 2018

GCR contact:
Primary Analyst:
Funmilayo Abdulrahman
Senior Credit Analyst
funmilayo@gcrratings.com

Committee Chairperson:
Dave King

Analyst location: Lagos, Nigeria
+23 41 462-2545

Website: http://www.globalratings.com.ng

Summary rating rationale

- The ratings reflect North South Power Company Limited's ("NSP" or "the Company") niche market position in a highly fragmented market, underpinned by its demonstrated ability to profitably manage and operate the 600-megawatt Shiroro Hydro Electric Power Plan, under a 30-year concession agreement with the Federal Government of Nigeria ("FGN").
- The power sector generally displays low economic cyclicality due to the crucial nature of the services being provided. Competition is considered relatively low, as the huge gap between demand and supply implies strong potential for capacity buildout. That said, the industry faces a range of challenges, primarily weak legacy collections, which have seen generation companies' earnings partly being subsidised by the government. As such, base operating cash flows remain volatile, with material non-performing debtor balances. While GCR has noted the increase in NSP cash reserves, this is underpinned by balances owed to government agencies, as management awaits outcomes on offsetting discussions. Ongoing interventions by government could see sustained improvement in cash generation going forward, although this depends on enabling infrastructure being put in place to improve collections across the value chain.
- Revenue maintained an upward trajectory prior to 1H FY20, with sustained offtake supporting a five-year CAGR of 34% to FY19. Although NSP is rolling out revenue diversification strategies these are likely going to materialise in strong growth over the medium to long-term.
- Earnings generating capacity is strong, supported by the relatively cost-effective hydro-electric power infrastructure. As such, notwithstanding observed volatility, the EBITDA margin is expected to trend well above domestic industry levels.
- NSP's leverage position is considered to be relatively conservative, with sufficient headroom to fund a sizeable capex backlog. Management plans to raise up to N5.5bn through bond issuance in the short term, normalised EBITDA would be able to cover total obligations by 75%-125%, while operating cash flow to debt coverage is expected to trend between 50%-100% over the outlook period.
- A relatively quick recovery in earnings by FY21 is expected to support reasonable liquidity coverage going forward. Risks to an otherwise sound liquidity profile could arise from sustained pressure on the cash conversion cycle, and/or high distributions during the capex upcycle.

Factors that could trigger a rating action may include

Positive change: Upward movement in the rating could follow sustained improvement in profitability and liquidity metrics on the back of timely completion of planned capacity expansion projects.

Negative change: Further escalation in debtors' absorptions that impair liquidity, profitability and/or debt serviceability could result in a negative rating action.

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Background, operation and recent developments[1]

NSP was established in 2012 to develop, own and operate power plants and other energy infrastructure systems, with special emphasis on renewable energy systems including hydro, electric, thermal, wind and solar power plant. NSP's strategic intent is to be the leading power generation company in Sub-Saharan Africa, focused on providing reliable and sustainable power. NSP holds has 30-year concession rights (executed in 2013) to operate the Shiroro Hydro Electric Power Plant on behalf of the Federal Government of Nigeria, through the Bureau of Public Enterprises ("BPE"). The plant comprises four units of 150MW generating capacity, totalling 600MW. The plant comprises four units of 150MW generating capacity, totalling 600MW. Per the agreement, NSP is expected to pay an annual concession fee, as well as royalties (of 5% of turnover) to the FGN.

A major milestone towards growth and expansion of its generation capacity was the execution of the 25-year concession agreement on the 30MW Gurara hydro power plant in May 2020. The project is to be handled by North South Gurara Energy Company Limited, a wholly owned subsidiary of NSP, incorporated in 2018 mainly for the project. Management intends to operationalise the plant by fourth quarter of 2021.

Other projects in progress include the launch of the 15MW Pre-Phase 1 solar pilot project, a project being handled by Shiroro Solar Generating Company Limited (another wholly owned subsidiary of NSP), acquisition of a distribution company for vertical business integration purposes, as well as planned expansion of existing capacity of each unit of the Shiroro hydro plant (to about 165MW each). The Company's two-year capex pipeline is expected to cost approximately N7.5bn, of which over 70% will be debt funded.

Shareholding and corporate governance

NSP's corporate governance structure complies with the provisions of Companies and Allied Matter Act ("CAMA") 2004. As at 31 December 2019, the board of directors ("Board") comprised ten members, made up of one executive director and nine non-executive directors (including the Chairman and an independent director). Overall, the Board comprises professionals with extensive experience in different fields, and some holding directorships in other companies.

Table 1: Shareholding structure as at FY19	% Holding
CEC Africa Hydro Investments Limited	25.6
Urban Shelter Limited	23.6
BP Investments Limited	20.0
Niger State Development Company Limited	10.0
Transatlantic Invt. and Dev. Co. LLC	5.3
Pan-African Global Infrastructure Co. Ltd.	5.3
Roads Nigeria Limited	3.7
Opec Investment Inc	3.7
Puma Engineering Limited	1.5
Olocorp Nigeria Limited	1.5
Total	**100.0**

The shareholding structure remains unchanged from that of the previous year. Table 1 provides a breakdown of the shareholders and their percentage holding as at FY19.

Operating environment

Economic overview

The Nigerian economy registered an annual real GDP growth of 2.3% in 2019 (2018: 1.9%), underpinned by relative stability within the oil producing areas and the foreign exchange market, reduced farmer/herder clashes, favourable climatic conditions and increased monitoring of land borders. However, the GDP contracted by 6.1% year-on-year in 2Q 2020, reflecting the adverse impact of the disruptions caused by the COVID-19 pandemic and the substantial decline in global demand for oil. The latter saw oil prices fall below USD20/barrel in mid-April 2020 (before rising to c.USD44/barrel in July 2020), against an average of USD64/barrel in 2019. Overall, while Nigeria reports the highest absolute nominal GDP in Africa, per 2019 estimates, GDP per capita remains below the average reported by comparable African sovereigns.

The inflation rate registered at 12.56% in June 2020, rising amidst the prevailing macroeconomic challenges. The CBN has reduced the monetary policy rate to 12.5%, and implemented policy measures to cushion the economy from short-term exogenous shocks, including a reduction in interest rates on all CBN intervention facilities from 9% to 5%. While the CBN has increased focus on maintaining relative foreign exchange market stability, reserves remain under pressure, declining from USD43bn in January 2019 to a low of USD35.8bn at end-July 2020. As the oil sector accounts for at least 90% of foreign exchange inflows and over 60% of government budgetary revenues, constrained crude oil prices represent increased fiscal risk, albeit this is counterbalanced by Nigeria's relatively well controlled sovereign debt levels.

Industry overview

The power industry is considered to have low cyclicality due to the essential, non-discretionary nature of its offering, as well as the high (capital and statutory) entry barriers, which typically limit market participants to state owned-entities and authorised independent players. The Nigerian value chain has been segregated into generation, transmission and distribution. Nigeria's generation and distribution are fully privatised. Transmission assets are FGN owned and managed via the Transmission Company of Nigeria ("TCN"), while the generation and distribution subsectors are fully privatised. The national grid relies on 28 mostly gas (67%) and hydro-powered plants, with total installed capacity of approximately 12,210MW.

While recent reforms have driven some improvements in the sector, there are still significant structural challenges. These include illiquidity, shortage of skilled labour, poor gas infrastructure and low supply to power plants, vandalism, mismanagement, inadequate and obsolete infrastructure as well as policy ambivalence, all of which has contributed to high technical, commercial, and credit

[1] See previous report for detailed background.

losses. Nigeria's 11 Electricity Distribution Companies ("DisCos"), which are tasked with collections for the entire sector, have struggled to remit revenue to producers, compounding operational challenges. While government has provided operational, governance and financial interventions *via* the Power Sector Recovery Programme, which has injected about N1.3tn through the payment assurance guarantee ("PAG")[2] into the sector since 2017. This, however, does not address the legacy receivables or offset the tariff shortfall, which was estimated at N1.63trn between 2015 and 2019.

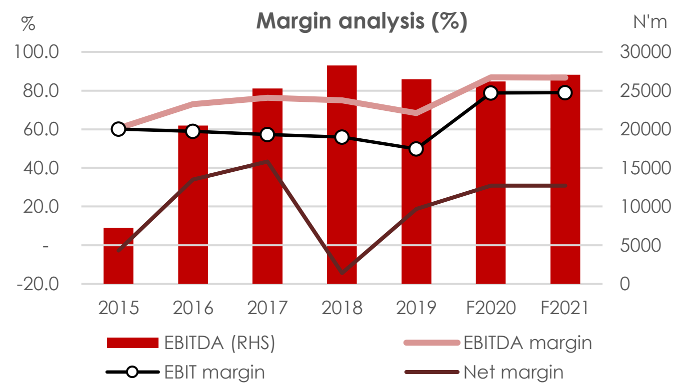
Reduced economic productivity in the wake of COVID-19 restrictions also reduced electricity demand from industrial and commercial customers. Although demand from residential customers increased during the period, tariffs from this segment is usually lower and sometimes even below the average cost of supply, thus constraining performance across the sector for the first half of 2020. In this regard, service-based tariffs introduced in September 2020 will be used to reduce the debt owed by the DisCos to state-owned entity Nigerian Bulk Electricity Trading ("NBET"), thereby improving liquidity along the value chain. DisCos will also have to make full remittances to market operators, repay CBN loans, and pay a stipulated percentage of NBET's monthly invoices. Looking ahead, the recent agreement between the FGN and Siemens for the rehabilitation, upgrade and expansion of infrastructure also bode well for the industry.

Financial performance

A financial synopsis including the unaudited six months results to June 2020 is reflected at the end of this report, and commentary follows hereafter. NSP's financial statements comply with International Financial Reporting Standards ("IFRS") as well as the requirements of CAMA and Financial Reporting Council of Nigeria. KPMG Professional Services issued unqualified opinions for each of the five years of audited financial statements.

NSP historically achieved sound growth on the back of bulk purchase agreement with NBET. The company achieved a five-year CAGR of 34% to FY19, but revenue fell sharply YoY due to decline in its electricity generation in 1H FY20. In addition, the overhaul of one of the units at Shiroro was disrupted by the Covid-19 lockdown, and this may limit capacity for the rest of the year. While fairly quick top line recovery is expected in FY21, revenue progression is expected to remain moderate in line with inflationary trend.

NSP's underlying gross margin continues to trend above global industry averages of 40-60%, on the back of the relatively low cost of hydro-electric power generation in Nigeria. The cost structure continues to filter through to the EBITDA margin, which registers comfortably above levels achieved by domestic thermal powered plants despite recent decline. After accounting for amortisation of the concession, the underlying EBIT is expected to remain strong over the rating horizon.



Though moderated from FY18 position, impairment remain high (FY19: N8.3bn; FY18: N20.2bn) reflecting pressure from poor control of collections along the power generation value chain. Adjusted for these write-downs, gross and EBITDA margins would register at a lower 65% and 50% in FY19 respectively (FY18: 33% and 21%), emphasizing the risk to earnings of the poor debtors' turnover. The attendant volatility in post-tax profitability is also of concern, as it implies high recapitalisation levels to fund capex (or to maintain financial flexibility).

Table 5: Income statement (N'm)	FY17	FY18	FY19	1H FY20
Revenue	*33,131*	*37,674*	*38,790*	*17,345*
Gross Profit	28,678	32,726	33,576	14,727
EBITDA	**25,285**	**28,233**	**26,481**	**12,251**
Depreciation*	(6,293)	(7,153)	(7,153)	(3,952)
Op. Profit	**18,992**	**21,080**	**19,328**	**8,299**
Net interest	(1,599)	(762)	830	(1,960)
Forex loss	(430)	(849)	(1,192)	(750)
Impairment charge	(7,555)	(20,157)	(8,254)	(3,633)
NPAT	**9,408**	**(688)**	**10,712**	**1,956**
Key ratios (%)				
Revenue growth	18.2	13.7	3.0	(10.6)
Gross margin	86.6	86.9	86.6	84.9
EBITDA margin	76.3	74.9	68.3	70.6
EBIT margin	57.3	56.0	49.8	47.8

*Includes amortisation of concession.

Cash flow, Leverage and Capital Structure

Although underlying cash generation is strong, this has historically been constrained by the aforementioned pressure on the working capital cycle. While FGN interventions resulted in a receipt of over N10bn by NSP in 1H FY20 in respect of outstanding debtors for FY19, the proportion of non-performing debtors remains high, while the average collection period spiked to approximately 2 years at 1H FY20. In GCR's view, the withholding of BPE payments (FY18-19: N14.5bn in concession fees and N2.8bn in royalties) to fund working capital is not sustainable. Stripped of the withheld balances, operating cash flows would have historically been much more volatile.

[2] PAG is one of the financial interventions of the government which guarantees generating companies a minimum of 80% payment of invoices for electricity taken up by NBET (excluding Deemed capacity) commencing from January 2017

Table x: Trading asset profile (N'bn)	FY18	FY19	1H FY20
Inventories	1,125	1,146	1,336
Trade receivables	19,920	29,862	33,191
Other	10,576	16,644	22,285
Total trading assets	**31,621**	**47,651**	**56,811**
Less: Creditors	(4,817)	(3,146)	(34,074)
Other	(25,888)	(34,883)	(6,703)
Net working capital	**915**	**9,623**	**16,033**
Debtors' profile			
Non-performing (%)	43.9	23.7	76.8
Provisions (% of total)	106.2	27.6	10.9
OCF progression (N'bn)			
OCF	21,315	6,189	11,625
Normalised OCF excl. withheld BPE balances	14,065	(11,311)	(5,875)

Capex has been very low levels over the period under review, implying high recapitalisation requirements in the medium term. Specifically, capex stood at N1.5bn in FY19, and related to upgrade of one of Shiroro's units. NSP projects capex of c.N7.5bn in the 18 months to the end of 2021, this is to be funded largely through debt.

As with the FGN remittances, NSP has withheld dividends to shore up liquidity. It still owes shareholders FY17-19 distributions, and projects moderate payout over the next 24months. This bodes positively in view of planned capex and shareholders' limited ability to fund the rising capital investment requirements over the rating horizon in GCR's view.

Table x: Debt profile (N'm)	FY18	FY19	1H FY20
Short term debt	2,906	1,482	1,482
Long term debt	2,571	7,213	4,678
Gross debt	**5,477**	**8,695**	**6,160**
Cash excl. withheld BPE balances	3,109	(1,159)	4,785
Adj. Net debt	**2,368**	**9,854**	**1,375**
EBITDA	28,233	26,481	12,251
Gross finance charge	1,052	1,032	2,491
Adj. OCF*	14,065	(11,311)	(5,875)
Key ratios			
Total debt: equity (%)	66.0	55.8	30.8
Total debt: adj. EBITDA (x)	67.8	47.7	71.5
Adj. net debt: EBITDA	8.3	37.2	11.2
Adj. OCF: debt (%)	256.8	Neg.	Neg.
EBITDA: total interest (x)	7.7	17.7	3.5

*Adjusted OCF is calculated by deducting withheld concession fees/royalties from working capital, and has also been normalised by stripping clawed back debtor balances at 1H FY20

Following repayment of the two bank loans, interest bearing debt registered at N8.7bn at FY19 (1H FY20: N6.2bn), representing the balance on the N8.5bn Series 1 secured notes issued by subsidiary NSP-SPV Powercorp Plc. The maturity profile of the bond is considered positive given its long tenor of 15 years, and amortised semi-annually at a fixed coupon of 15.6%. NSP plans to raise up to N5.5bn from secured notes in the short-term. The proceeds will be used mostly to fund the solar pilot project's initial phase (N3.6bn).

While cash has risen materially in recent years, this is partly supported by BPE payment delays in the hope to offset agreements with the agencies. As GCR views these balances as restricted, the assessment of NSP's funding flexibility is primarily based on gross leverage metrics. NSP's leverage is low, with adjusted debt to EBITDA registering at an annualised 25% at 1H FY20 (FY19: 41%). This, in GCR's view, implies reasonable headroom to absorb more debt to fund the sizeable capex backlog. Adjusted for projected commitments, leverage is expected to remain in the low-moderate range of 75%-125% (assuming earnings revert to FY19 levels over the rating horizon). Normalised operating cash flow coverage of NSP's projected debt and capital commitments remains strong, and is expected to range between 50%-100% over the rating horizon.

Although reasonable, debt service is prone to volatility in the Company's earnings. In this regard, NSP will be expected to achieve a recovery in its gross interest cover to at least 5.0x (1H FY20: 3.5x annualised) to avoid undue pressure on its funding profile.

Liquidity coverage is expected to be reasonable despite the lack of secured/committed facilities. Cash generation is expected to support 12 months' liquidity coverage is of 2.17times and could improve to 2.47 times if the planned bond issue is successful. Risks to the liquidity assessment include volatility in NSP's cash generating capabilities, as well as high dividend flows over the rating horizon.

Table x: Liquidity profile (N'm) Sources	18months to FY21	FY22
Adjusted operating cash flow	22,946	22,180
Cash excl. withheld BPE balances	16,341	25,032
Facilities – committed	-	-
Facilities - non-committed	-	
Total sources	**39,287**	**47,212**
Uses		
Debt redemption	1,482	1,482
Capex	574	4,910
Other investments	6,380	
Dividends	9,674	9,481
Other uses	-	-
Total uses	**18,110**	**22,253**
Sources to uses -12 months (x)	2.17	2.97
Sources to uses - 18 months	1.52	2.04

North South Power Company Limited

(Naira in Millions except as Noted)

31 December Statement of Comprehensive Income	2015	2016	2017	2018	2019	1H 2020
Turnover	11,990	28,038	33,131	37,674	38,790	17,345
EBITDA	**7,254**	**20,472**	**25,285**	**28,233**	**26,481**	**12,251**
Depreciation	(46)	(3,956)	(6,293)	(7,153)	(7,153)	(3,952)
Operating income	**7,208**	**16,516**	**18,992**	**21,080**	**19,328**	**8,299**
Net finance charges	(2,100)	(2,069)	(1,599)	762)	830	(1,960)
Exchange loss	(3,043)	(4,000)	(430)	(849)	(1,192)	(750)
Impairment charge	(2,415)	(4,486)	(7,555)	(20,157)	(8,254)	(3,633)
NPBT	**(349)**	**13,747**	**9,408**	**(688)**	**10,712**	**1,956**
Taxation paid	15	3,576	4,937	(4,731)	(3,418)	0
Profit from continuing operations	**(335)**	**17,322**	**14,345**	**(5,420)**	**7,295**	**1,956**

Statement of cash flows						
Cash generated by operations	**8,429**	**21,924**	**26,472**	**30,013**	**27,240**	**7,593**
Utilised to increase working capital	(2,478)	(16,847)	(18,936)	(7,729)	(21,742)	4,733
Finance charges/interest paid	(1,736)	(1,686)	(1,689)	(968)	1,009	(741)
Taxation paid	0	0	0	0	(318)	0
Cash flow from operations	**4,216**	**3,392**	**5,847**	**21,315**	**6,189**	**11,625**
Maintenance capex‡	(29)	(1)	(49)	(506)	(126)	(120)
Discretionary cash flow from operations	**4,187**	**3,391**	**5,799**	**20,809**	**6,063**	**11,505**
Dividends paid	0	0	(4,877)	(7,390)	(1,832)	0
Retained cash flow	**4,187**	**3,391**	**922**	**13,420**	**4,231**	**10,928**
Net expansionary capex	(4,851)	(807)	(420)	(817)	(1,480)	(578)
Investments and other	0	0	0	0	0	0
Proceeds on sale of assets/investments	0	3,680	4	4(	0	0
Shares issued	0	0	0	0	0	0
Borrowings: increase/(decrease)	(451)	(3,247)	(2,948)	(3,186)	3,230	(4,821)
Cash movement: increase/(decrease)	**(1,115)**	**3,017**	**(2,443)**	**9,422**	**5,980**	**6,106**

Statement of financial position						
Ordinary shareholders interest	9,645	28,267	34,019	8,300	15,595	19,985
Outside shareholders interest	0	0	0	0	0	0
Total shareholders' interest	**9,645**	**28,267**	**34,019**	**8,300**	**15,595**	**19,985**
Current debt	2,908	2,912	2,903	2,906	1,482	0
Non-current debt	9,489	8,966	5,958	2,571	7,213	6,160
Total interest-bearing debt	**12,397**	**11,877**	**8,861**	**5,477**	**8,695**	**6,160**
Interest-free liabilities	24,498	46,868	57,349	67,660	76,155	91,464
Total liabilities	**46,541**	**87,013**	**100,229**	**81,436**	**100,445**	**117,610**
Property, Plant and Equipment~	29,595	47,484	46,264	45,794	45,248	52,180
Investments and other non-current assets	6	3,591	13,269	4,021	7,546	8,618
Cash and cash equivalent	127	4,199	1,758	10,359	16,341	22,285
Other current assets	16,812	31,739	38,939	21,261	31,310	34,526
Total assets	**46,541**	**87,013**	**100,229**	**81,436**	**100,445**	**117,610**

Ratios						
Cash flow:						
Operating cash flow : total debt (%)	34.0	28.6	66.0	389.2	71.2	377.4
Discretionary cash flow : net debt (%)	33.8	28.6	65.4	n.a	n.a	n.a
Profitability:						
Turnover growth (%)	16.0	133.9	18.2	13.7	3.0	(10.6)
Gross margin (%)	79.3	81.6	86.6	86.9	86.6	84.9
EBITDA : revenues (%)	60.5	73.0	76.3	74.9	68.3	70.6
Operating profit margin (%)	60.1	58.9	57.3	56.0	49.8	47.8
EBITDA : average total assets (%)	15.5	31.7	27.9	33.3	34.1	27.3
Return on equity (%)	neg	91.4	46.1	neg	61.1	22.0
Coverage:						
EBITDA : net interest (x)	3.5	9.9	15.8	37.1	n.a	6.2
Operating income : net interest (x)	3.4	8.0	11.9	27.7	(23.3)	4.2
Activity and liquidity:						
Trading assets turnover (x)	1.2	1.5	1.2	1.7	1.8	1.1
Ave. Days receivable outstanding (days)	282.2	267.7	375.7	279.0	234.2	663.4
Current ratio (:1)	2.2	4.0	2.0	1.0	1.3	1.4
Capitalisation:						
Net debt : equity (%)	127.2	27.2	20.9	n.a	n.a	n.a
Total debt : equity (%)	128.5	42.0	26.0	66.0	55.8	30.8
Total debt : EBITDA (%)	170.9	58.0	35.0	19.4	32.8	25.1
Net debt : EBITDA (%)	169.1	37.5	28.1	n.a	n.a	n.a

‡ Depreciation used as a proxy for maintenance capex expenditure
*Unaudited numbers as at 1H FY20
^Includes non-cash sums for present value of concession fees payable
~The bulk of PPE comprises intangible assets, representing initial and future concession fees

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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; c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the ratings expire will expire in October 2021.

North South Power Company Limited participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit ratings have been disclosed to North South Power Limited with no contestation of the ratings

The information received from NSP to accord the credit rating included;
- 2019 audited annual financial statements (plus four years of comparative numbers),
- Unaudited management accounts as at 1H FY20
- Industry comparative data and regulatory framework
- a breakdown of facilities available and related counterparties.
- information specific to the rated entity and/or industry was also received.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.