GCR GLOBAL CREDIT RATING CO.
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Infrastructure Credit Guarantee Company Limited

Nigeria Financial Institution Analysis **July 2020**

Rating class	Rating scale	Rating	Rating outlook	Expiry date
Long-term	National	$AAA_{(NG)}$	Stable	June 2021

Financial data:

(USDm comparative)#

	31/12/18	31/12/19
NGN/USD (avg.)	305.6	306.4
NGN/USD (close)	306.5	306.5
Total assets	105.3	148.6
Core capital	57.8	61.1
Operating income	2.7	6.8
Profit after tax	0.7	3.4
Capital leverage	0.2x	0.4x
Market cap.*	n.a	
Market share*	n.a	

#Central Bank of Nigeria exchange rate

^Core equity + contingent capital

*Not applicable

Rating history:

Initial rating (July 2017)

Long-term: $AAA_{(NG)}$

Rating outlook: Stable

Last rating (July 2019)

Long-term: $AAA_{(NG)}$

Rating outlook: Stable

Related methodologies/research:

Global Master Criteria for Rating Banks and Other Financial Institutions, updated March 2017

InfraCredit Rating Reports (2017-19)

Glossary of Terms/ Ratios (February 2016)

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Summary rating rationale

- The rating of Infrastructure Credit Guarantee Company Limited (“InfraCredit” or “the Company”) reflects its operational uniqueness as a guarantee provider, strong ownership and management profile, demonstrated financial flexibility, strong liquidity position, and profitability track record so far.
- The Company’s capitalisation is considered satisfactory relative to its current operational scale. Strong internal capital generation lifted core capital by 5.8% to N18.7bn at FY19. InfraCredit’s leverage (core and contingent capital to issued guarantees) equated to 0.4x at FY19, well below the internally set cap of 7.5 times. The financial leverage of 24.6% at FY19 (FY18: 41.9%) is also considered moderate. Notwithstanding the strong capitalisation, management disclosed to Global Credit Rating Company Limited (“GCR”) that discussion for additional equity injection from another Development Finance Institution (“DFI”) of up to USD28m has reached an advanced stage, hoping to conclude the process before end-FY20.
- Asset quality (in terms of issued guarantees) is sound, with nil non-performing exposure recorded from inception to date. In spite of the current macro-economic challenges, management is highly optimistic that asset quality indicators will remain at strong levels over the short to medium term, given the quality of Issuers in its guarantee portfolio, the Company’s stringent underwriting criteria, as well as portfolio monitoring and management process.
- Liquidity risk is considered minimal, given the highly liquid nature of the balance sheet throughout the review period, with a sizeable 75.9% of the asset held in cash and risk-free tradeable instruments at FY19.
- Key performance metrics improved in FY19, reporting a pre-tax profit of N1.1bn (FY18: N171m), which measured well ahead of budget for the year. However, profitability remained largely driven by non-core revenue (investment income), which registered a 242% growth to N1.5bn. The core income (net guarantee fee income) recorded a less aggressive growth of 98.2% to N519m, bringing total operating income to N2.1bn (translating to a 152.1% year-on-year (“y/y”) increase). While operating expenses escalated by 61.9% (in line with budget), the outpacing income growth saw the cost to income ratio end down to 47.2% (FY18: 73.5%). Furthermore, performance as at 1Q FY20 reflects a significant growth in total income, although this was mainly supported by foreign exchange translation gains on financial assets (a function of the Naira devaluation during the period).

Factors that could trigger a rating action may include

Negative change: A negative rating action could follow decline in performance or unfavourable development in the operating environment which impacts negatively on the Company’ performance, downgrades in the ratings of any of the contingent capital providers and/or a significant rise in leverage beyond current position.

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Organisational profile

Corporate summary

InfraCredit was incorporated as a limited liability company on 20 October 2016, following a feasibility study (undertaken jointly by NSIA[1] and GuarantCo[2] in 2014) covering the prospects for establishing a Nigerian infrastructure credit enhancement facility with the specific objective of attracting the investment interest of a pool of long-term capital for credit worthy infrastructure projects. InfraCredit was afterward established under a collaboration arrangement between NSIA and GuarantCo, with the sole mandate of providing guarantees to enhance the credit quality of local currency debt instruments (mainly bonds) issued by entities (corporates and state governments) to finance eligible infrastructure projects in Nigeria. InfraCredit commenced operations in 2017 and has its operational office in Lagos.

Ownership structure

As at 31 December 2019, NSIA and Africa Finance Corporation ("AFC") held 52% and 48% of InfraCredit's ordinary and preference shares respectively, however the two institutions have equal voting rights (50% each) based on the shareholders' agreement.

InfraCredit was conceptualised to have a blend of Nigerian public or government institutions, international DFIs, and private institutional investor base. The subsisting Shareholders' Agreement limits public institution's stake (which was 100% at the time of commencement) to a maximum of 25% once new investors come on board and shareholder base is diversified. Per management, InfraCredit received expression of interest for equity investment from some corporates and has reached advanced stage for both equity and debt capital injection from two DFIs. These are expected to be concluded before the end of 2020.

Table 1: Envisioned ownership structure	%
Nigerian public or government institutions	20-25
International Financial Institutions	25-40
Private Institutional Investors	35-50

Source: InfraCredit

Operating environment

Economic overview

The Nigerian economy sustained growth momentum in 2019, with the gross domestic product ("GDP") expanding by 2.27% y/y, up from 1.91% registered in 2018. The recorded growth was largely underpinned by the curtailed pipeline vandalism, calmness in the oil-producing regions, and the relative stability in global crude oil prices and foreign exchange ("FX") market. While the oil sector registered a robust growth of 4.59% (2018: 0.97%), the non-oil sector improved slightly by 2.06% in 2019 relative to 2% recorded in 2018. However, the Nigerian economy is currently witnessing a sharp slowdown due to the coronavirus disease ("COVID-19"), which is being compounded by the contraction in crude oil demand and dwindling prices at the international market. In a bid to stimulate prices, the Organisation of Petroleum Exporting Countries (OPEC) and its allies in mid-April 2020 agreed to a global production cut of about 10 million barrels per day. This production cut, coupled with the gradual easing of lockdown across most countries resulted in an uptick in global crude oil prices, which hovered between USD30/barrel and USD40/barrel in June 2020.

The headline inflation rate increased to 12.56% in June 2020, for the tenth consecutive months owing to supply constraints, higher input costs and increased system liquidity. To curtail inflationary pressures, the CBN increased the cash reserve requirement ("CRR") by 500 basis points to 27.5% in January 2020, and has also recently released some policies to cushion the adverse impact of the COVID-19 pandemic on the economy. These measures include, among others, a reduction in interest rates on all CBN intervention facilities to 5% from 9% (for one year with effect from 01 March 2020), and the creation of N50bn targeted credit facility to households and SMEs negatively affected by the pandemic. However, the pressures of the current macroeconomic challenges have resulted in the depreciation of FX rate to N360/USD and N380/USD from N306.5/USD and N360/USD at the official window and Investors' & Exporters' window, respectively. Similarly, the external reserves declined to USD36.6bn at end-May 2020 from USD38.6bn as at 31 December 2019, with further contractions expected over the short term on account of the relatively low FX earnings. Given that the Nigerian economy is heavily dependent on the oil sector, which has overtime accounted for over 90% of foreign exchange earnings and over 60% of government budgetary revenues, the current dwindling global crude oil price remains a major concern.

In a bid to consolidate growth over the medium term, the Federal Government of Nigeria ("FGN") had maintained an expansionary policy, with a budget of N10.59tn for 2020 fiscal year (2019: N8.92tn). The estimate was based on an oil benchmark of USD57/barrel, a daily production output of 2.18mbpd, new value added tax rate of 7.5% (from 5% previously), *inter alia*. In light of the current

[1] An entity established by an act of the National Assembly in May 2011, with mandates to build a saving base for Nigerians, enhance the development of Nigeria's infrastructure, and provide stabilisation support in times of economic stress.

[2] A supranational organisation established in 2006 as part of the Private Infrastructure Development Group, sponsored by five G12 governments.

macroeconomic challenges, the FGN reviewed the oil benchmark downwards to USD28/barrel, daily production output to 1.8mbpd, while also indicating external borrowing plans to cushion the economic impact of the pandemic. GCR however, expects the continuing slowdown in economic activities to have significant implications for budget implementation and its already elevated credit risk profile.

The Nigerian Stock Exchange ("NSE") All-Share Index ("ASI") sustained a negative trend in 2020, contracting by 5.9% as at end-May 2020. The bearish stock market performance was largely driven by the challenges in the macroeconomic landscape, underwhelming trends in foreign portfolio investments as well as profit takings.

Regulation

InfraCredit's business does not fall within the oversight of existing financial services regulators in Nigeria (ie, CBN and Securities and Exchange Commission). Thus, the Company is currently self-regulated.

Strategy and operations

InfraCredit's primary focus over the last three years of operation has been towards capital mobilisation for infrastructure projects by providing innovative credit enhancements, risk sharing and partnership opportunities across projects life cycle.

Major milestones achieved in FY19 includes, new guarantees issued and additional subordinated capital during the period. Also, to deepen its guarantee capacity, particularly with respect to new products launch include, the Company established; (i) Annuity PPP, (ii) Contingent Refinancing Guarantee and (iii) Blended Finance. The Annuity PPP was established to aid penetration into the subnational market in relation to infrastructural developments. The product allows for project financing for up to 20-years, with the support of the "Primary ISPO" (i.e. Irrevocable Standing Payment Order) of the state. A pilot project was signed with one the states during FY19. On the other hand, the Contingent Refinancing Guarantee, was launched to enable InfraCredit provide takeout refinancing guarantees to green field projects (i.e. early stage projects) on conditional basis (these includes predictability of cashflows, strong off-take and takeout for early stage investors and so on). Two mandates were signed in this respect during FY19. Finally, for the blended finance strategy, the Company approached a DFI to explore the possibility of providing guarantee for their loan beneficiaries to enable them enjoy blended rates (i.e access lower rates from the DFI, in addition to funds from the open market). InfraCredit received an approval in FY19 to pilot up to N10bn line of credit.

The Company undertook the maiden transaction (GEL Utility Limited) under a risk sharing arrangement with the USAID in FY19. The transaction involves 50:50 risk sharing ratio between InfraCredit and USAID. InfraCredit is seeking to explore similar arrangement with other DFIs going forward.

While the Company had initially planned to grow significantly in FY20, the current macro-economic challenges had prompted management for a more cautious growth to reflect the nascent nature of the guarantee market in Nigeria. Also, the Company is set to explore the private-corporate market, such as FMDQ's Private Companies' Bonds, as well as commercial paper issuance, with the maiden programme registered recently in this respect. InfraCredit is currently intensifying focus on deployment of information technology across its processes to improve time to market.

The ongoing business growth and expansion plan necessitated an increase in staff strength to 22 in December FY19 from 13 the previous year, with the likelihood of further increase in the current year. Nevertheless, only core operations are performed by the Company while non-core functions are outsourced to reputable organisations.

InfraCredit's operational structure remained unchanged during the review period. The Company is structured along five core departments, namely: Origination and Structuring, Risk Management, Legal, Human Resources and Admin, and Financial Control, with the respective departmental head reporting to the Chief Executive Officer ("CEO").

Corporate governance structure

InfraCredit's governance structure is in line with international best practices. The shareholders agreement prescribes a ten-member board, with one third or at least two members (whichever is higher) being independent non-executive directors. As at 31 December 2019, the board comprised seven members, made up of an executive and six non-executive directors (including two independent non-executive director). However, management has informed GCR that the independent non-executive director resigned in FY20 due to a new opportunity. As such, the Company is in the process of replacing the independent member. The board performs its oversights function through four standing committees, namely: Risk and Capital Committee, Finance and Audit Committee, New Business and Credit Committee, and Remuneration and Nomination Committee.

Overall board composition is considered satisfactory in terms of members experience and expertise in the business and other fields. Also, majority of the non-executive directors are senior executives of the institution they represent.

Funding profile

Likelihood of support
Given InfraCredit's private corporate status, financial support is limited to its shareholders and contingent capital providers.

Funding composition
InfraCredit's balance sheet is currently funded through core equity, subordinated debt, and contingent capital. The funding base continued to grow year-on-year, displaying an improved N41.9bn at FY19 (FY18: N30.5bn). This is in addition to a callable capital of up to USD25m (equivalent of N9bn) from GurantCo. The following paragraphs provides more details on each of the funding component.

Capitalisation and leverage
Capitalisation is considered satisfactory relative to the Company's current operational scale. Total core capital increased by 5.8% to N18.7bn at FY19, underpinned by sound internally generated capital during the year. InfraCredit's core capital comprised USD25m paid-up equity contribution from NSIA and US25m in redeemable and irredeemable preference share investment by AFC. While the Company does not have any externally imposed capital adequacy, it is expected to maintain an appropriate level of qualifying capital to cater for its guarantee. As such, the assessment of capital risk measured by total guarantee to qualifying capital (including the contingent capital) equates to 0.4times at FY19, well below the internally set limit of 7.5times. Furthermore, core capital to total on and off-balance sheet assets is considered satisfactory at 24.3% (FY18: 41.9%).

Cognisance is taken of management's continuous effort to attain the envisioned capital structure of USD100m in core capital (currently USD50m) and a combination of subordinated and contingent capital[3] of equivalent amount. Management disclosed to GCR that it has reached an advanced stage for additional equity injection of up to USD28m from a DFIs, hoping to conclude the process before the end of FY20.

Subordinated debt
To strengthen its balance sheet and boost liquidity InfraCredit obtained unsecured subordinated long-term loan (tier 2 capital) of N12.8bn (USD35m) from KfW Development Bank in 2018 and additional N9.6bn (USD26m) in 2019. The tenor of the loan is ten years at simple interest rates of 6% and 5.25% respectively.

Contingent capital
InfraCredit signed a Callable Capital Funding Facility Agreement with GuarantCo in December 2016. The Callable Capital is a 15-year unconditional and irrevocable obligation of GuarantCo and can be called on demand by the Company to replenish the Company's Core Capital if at any time the Company determines that as a result of actual or expected credit losses on its guaranteed portfolio, its Core Capital will become impaired by 80%. The Callable Capital is a revolving facility, subject to a cumulative outstanding limit of USD 50 million Naira equivalent of which USD25 million is available based on the terms of the agreement. The Callable capital agreement became effective on 12 December 2017.

Risk management

Strategic overview
InfraCredit has in place a stringent risk management policy, which guides the management and monitoring of credit risk exposures arising from the guarantee portfolios, as well as the perceived market, liquidity and operational risks exposures.

Asset composition
Total assets (on balance sheet) grew 41.1% to N45.5bn at FY19, fuelled by cash inflow from the subordinated debt and growth in guarantee assets. InfraCredit's assets are mainly held in foreign denominated bank placements and investment securities (particularly FGN and corporate Eurobonds). Thus, credit and currency risk exposure is considered well mitigated.

Guarantee liability
Total guarantee liabilities increased by 215% to N31.5bn at FY19 (FY18: N10bn), driven by two additional transactions finalised during the year. In addition to the 10-year N10bn bond guarantee issued to Viathan Funding Plc in FY17, InfraCredit issued unconditional and irrevocable guarantees in respect of 15-year N8.5 billion bond issued by North South Power Company Limited ("NSP") and 10-year N13 billion bonds issued by GEL Utility Limited ("GELUL") in FY19. NSP is a private electricity supplier in Nigeria, with total generating capacity of up to 600MW. On the other hand, GELUL is a private power developer and operator with 84MW of gas-fired off-grid power plants. Both NSP and GELUL are currently rated A-(NG) and BBB(NG) respectively by GCR. The credit exposure is contingent on the guarantees being called due to inability of the obligors to pay the principal and interest due to investors in the bonds.

Management planned to grow the guarantee liability by about N60bn in FY20, albeit with current economic realities things may get slower, as some of

[3] A 15 year unconditional and irrevocable obligation of highly rated international DFIs. Structurally, this is an unfunded second loss component of the capital structure, callable on demand by InfraCredit to replenish the core capital any time it falls below 20% (ie, it is impaired by up to 80%).

the transaction in the pipeline are being revisited and re-evaluated.

Liquidity position
InfraCredit consistently maintained a highly liquid balance sheet throughout the review period, with a sizeable 75.9% of the asset held in cash and risk-free tradeable instruments at FY19.

Asset quality
Asset quality is considered sound, as the portfolio comprised reputable corporates with good financial standing and all in the power sector (which is crucial to the economy). However, InfraCredit made a loss provision of N21.1m in FY19 (in line with IFRS 9 accounting standard), representing about 0.8% of the gross on balance sheet guarantee liabilities. Also, the guarantee portfolio is adequately secured with not less than 1.25 times of total guarantee obligation by each of the Issuers. Going forward, in spite of current macro-economic challenges, management remain confident that asset quality indicators will remain at strong levels over the short to medium term, given its stringent underwriting criteria, as well as portfolio monitoring and management process.

Financial performance
Overall profitability improved significantly in FY19, largely supported by the robust funding base and yields on the funds.

InfraCredit's net guarantee fee income grew by 98.2% in FY19 to N519m, on the back of increase in business volume. Net interest income rose significantly by 242.2% to N1.5bn, driven by increase in funds inflows. However, other operating income declined by 79% as foreign exchange gains were marginal during the year. Nevertheless, total operating income closed at a new high of N2.1bn, representing 152.1% increase from the previous year.

Table 2: Selected financial indicators (N'm)	Actual FY18	Actual FY19	Actual* 1Q FY20
Income statement			
Net guarantee fee income	261.9	519.0	180.9
Net interest income	448.3	1,534.3	305.0
Other income	113.4	23.1	923.5
Total operating income	**823.6**	**2,076.4**	**1,409.4**
Impairment charge	(47.4)	(44.1)	-
Operating expenditure	(605.1)	(979.6)	(286.1)
Profit before tax	**171.1**	**1,052.7**	**1,123.3**
Tax expense/ (credit)	37.7	(18.2)	-
Net profit after tax	**208.8**	**1,034.5**	**1,123.3**
Selected balance sheet indicators			
Core equity	17,704.5	18,739.1	19,862.4
Total guarantee (on and off b/sheet)	10,000.0	31,500.0	31,500.0
Subordinated debt	12,813.7	23,170.4	24,093.1
Total assets	32,273.7	45,548.9	47,558.4
Selected ratios (%)			
ROE	1.2	5.5	5.7
Cost to income ratio	73.5	47.2	20.3

Source: InfraCredit AFS

While management had forecast an aggressive growth in transaction volume for FY20, the current economic realities have necessitated a more cautious approach to growth. However, performance for the first quarter of 2020 displayed a sharp increase in total income, mainly supported by foreign exchange gain of N923m. Given that InfraCredit's capital is largely FCY-denominated and held them in same denomination, foreign exchange gains were recorded on account of the recent Naira devaluation. Consequently, pre-tax profit amounted to N1.1bn, which is already ahead of the FY19 full year performance.

Table 3: Actual Vs. Budget (N'm)	Budget FY20	1Q FY20
Income statement		
Net guarantee fees	1,059.3	180.9
Net interest income	1,549.9	305.0
Other operating income	0.00	**923.5**
Total income	**2,609.2**	**1,409.4**
Impairment charge	(86.3)	-
Operating expenditure	(1,659.6)	(286.1)
Profit/ (loss) before tax	**863.3**	**1,123.3**

Source: InfraCredit

Based on the 1Q FY20 results and despite the macro economic challenges and uncertainties, management believes performance in FY20 will supersede that of FY19 and GCR is also of the opinion that it is possible, especially if gains in FX are not reversed by year-end, which is very unlikely.

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SALIENT FEATURES OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for 12 months, or as indicated by the applicable credit rating document.

The rating was solicited by, or on behalf of Infrastructure Credit Guarantee Company Limited, and therefore, GCR has been compensated for the provision of the rating.

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

The credit rating above was disclosed to and contested by Infrastructure Credit Guarantee Company Limited and was amended following the provision of further material information by the entity.

The information received from Infrastructure Credit Guarantee Company Limited and other reliable third parties to accord the credit rating included the audited financial statements for the past two years, up to 31 December 2019. In addition, other information specific to the rated entity was also received.