GCR Nigeria Corporate Sector Risk Scores
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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Corporate Entities, May 2019
Criteria for Rating Real Estate Investment Trusts and Other Commercial Property Companies, May 2019

The GCR Nigerian Corporate Sector Risk Assessment

The corporate sector risk score is a combination of a) cyclicality b) ease of doing business and c) sector specific dynamics scores and is intended to provide users with an overview of the major factors that impact GCR's assessment of the relative risk of each sector.

GCR utilises the sector risk score in conjunction with the country risk score, to determine the operating environment risk score for each individual sector within the Nigerian environment. The core of the GCR Ratings Framework is based on GCR's opinion that an entity's operating environment largely frames its creditworthiness. As a result, the operating environment analysis anchors the underlying risk score for the GCR ratings criteria. The following sector risk scores are intended to provide users with an overview of the major factors that impact GCR's assessment of the relative risk of each sector in the local economy. The following list is not a comprehensive list of all sectors, but largely covers GCR's Nigerian corporate rating universe. Additional sector risk scores will be introduced as necessary.

GCR will continue to monitor trends in the sectors contained in this publication and will update sector risk scores as the underlying factors shift.

Agriculture, Sector Risk Score 2.25

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 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 was not immune to the adverse effects of the pandemic, 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.

Fast Moving Consumer Goods ('FMCG'), Sector Risk Score 3.00

The essential and largely non-discretionary nature of the products manufactured and traded within the FMCG sector contributes to moderately low cyclicality. Products include foods and beverages, household products, body care, hygiene products, alcohol and tobacco, which benefit from relatively stable demand through economic cycles. Industry volumes are also buoyed by Nigeria's large population and expanding middle class, which underpins new demand. The income elasticity of demand is generally low (further contributing to sector stability), although consumers trade down from premium brands to affordable/value brands in times of economic troughs (as has been the case through the COVID-19 pandemic).

Industry profitability is considered to be moderate, given the large and rising number of competitors in all product segments. Moreover the industry remains vulnerable to global commodity price movements, foreign exchange volatility and high logistics costs, which cannot always be passed onto consumers. Changing consumer tastes, ever evolving product innovation and high product substitution risk necessitate continued high investment in products and marketing.

GCR expects the FMCG industry to remain resilient in 2021 as the category includes necessities even if the COVID-19 disruptions persist. Favourable demographics should continue to drive industry volumes, and ongoing government's restrictions on imported goods should reduce competition from imported substitutes. However, margin pressure is expected to persist, largely due to the continuous devaluation in Naira value, which has raised the prices of imported raw materials and capital expenditure.

Hospitality, Sector Risk Score 2.00

The Nigerian hospitality industry reflects above average cyclicality, due to the sensitivity of travel and tourism to local and global economic cycles and discretionary spending patterns. Overall, barriers to entry for the industry are low, with relatively few regulatory and compliance requirements. Hotels are especially susceptible to seasonality and exogenous shocks, but demand in the Nigerian hotel segment is buoyed by the country's strategic importance within the African continent, being a key regional destination for business and political travel. Although, mostly robust, profitability is sensitive to adverse changes in the operating environment due to the relatively high fixed cost base.

The hospitality industry's significant exposure to disruption, was highlighted by the COVID-19 pandemic and the almost complete cessation of global travel. This has resulted in occupancy levels plunging to unprecedented lows and almost all hospitality operators experiencing severe financial distress. Much uncertainty persists as the pandemic continues to prevent a recovery in travel and a rebound in economic activity. The risk score may be further marked down if fresh restrictions on movement are imposed for protracted periods. As profit levels are likely to remain around very low levels, the survival of hospitality providers will depend on them retaining good access to capital.

Logistics, Sector Risk Score 2.50

GCR's sector risk score for Logistics is reflective of the above average cyclicality and volatility presented by moderately low barriers to entry. Most significantly, industry risk is characterised by relatively low profit margins induced by intense competition and the additional costs incurred due to Nigeria's poor infrastructure and bad road network. Despite the challenges faced by the industry, there is low susceptibility to technology disruption.

Long term growth prospects appear positive due to infrastructural development in Railways and Airways, as well as improvement in transport networks within the African regions. Domestically, the move towards outsourcing the logistics and supply chain functions amongst the corporate sector, bodes positively for specialised logistics companies. Similarly, the rise in E-commerce has expanded the need for logistics to service the private sector.

However, over the short term GCR expects industry profitability to be negatively impacted by the reduction in the volume of goods across the country caused by the covid-19 pandemic. Accordingly, GCR anticipates higher gearing levels (in respect of the fleet lease arrangements that are common to the industry) as a result of reduced cash flows, which could severely impact undercapitalised players. However, even capitalised and well-managed businesses will need to focus on cash management.

Oil and Gas – Downstream, Sector Risk Score 2.75

The oil and gas downstream sector score evidences the below average cyclicality and low product substitution risk. Nevertheless, these strengths are offset somewhat by the low barriers to entry, thin margins, as well as regulatory and environmental tussles. Currently, the industry's main product, Petroleum Motor Spirit (PMS), is solely imported by the government, and its price is regulated, thus impacting earnings margin for the refined product marketers. Although the non-PMS fuels segment is driven by market forces, heightened pricing competition among over 3,000 marketers has constrained the ability to pass on additional cost to consumers. For GCR to review the sector risk score upwards government interference across the sector's value chain would need to be more limited, allowing prices to be determined by market dynamics, rather than the government's manner of fixing prices.

Industry dynamics are expected to change when Dangote Refinery becomes operational in the near future and is able to fully meet local PMS demand. This will reverse the decades-old system of exporting crude oil and importing about 90% of local demand for the refined petroleum products. The refinery is expected to help curtail costs in the industry and thus improve margins, while also promoting freer market dynamics. Localised refining capacity should also help ease the USD demand pressure on downstream players and associated working capital requirements, as well as boosting the nation's foreign reserve.

Oil and Gas (Upstream), Sector Risk Score 1.25

GCR's sector risk score for the oil and gas upstream sector reflects the high cyclicality of the industry, due to wide fluctuation in demand and international prices. However, some support is derived from high barriers to entry, low risk of substitution and slow adoption of technological changes domestically. The volatility was evidenced by the poor performance of the sector over the past 12 months, following the steep fall in the international crude oil prices induced by the weak demand because of the COVID-19 crisis, as well as the trade war between Russia and Saudi Arabia. Internally, regulatory uncertainties, particularly relating to the ongoing debate on the Petroleum Industry Bill which seeks to establish the legal and regulatory framework, institutions, and regulatory authorities for the sector remain a key challenge; as does the political interference that is often associated with contract awards. Pipeline vandalism and social unrest within the oil producing Niger-Delta region have also not be resolved. Such concerns are likely to remain a constraint on the Nigerian upstream sector in 2021, even if the global oil market recovers somewhat.

Crude oil still remains one of the most important fuel sources globally, and GCR considers the rising economic activities to support industry demand and profitability. However, the growth in shale oil production in the United States (Nigeria's major market) will continue to put a cap on prices, while over the long term the rising profile of renewable energy will continue to adversely impact the global demand for crude oil.

Pharmaceuticals, Sector Risk Score 3.25

The Nigerian pharmaceutical sector benefits from low economic cyclicality, underpinned by the essential nature of medicines. Nevertheless, given its dependency on imported raw materials, the sector remains susceptible to global shocks, as experienced by the shortage of key inputs through the COVID-19 pandemic because of disruptions to the supply chain and shortage of foreign currency. Local manufacturers are also faced with substantial competitive pressures from foreign suppliers, albeit this is partly mitigated through government's support for local players through higher import tariffs on imported finished medicines, and concessional loans to support expansion.

Profit levels are moderate and are upheld by a fairly stable regulatory environment and technologically driven efficiencies, which continues to support earnings growth and stable cash flows. Whilst current levels of local production are low relative to demand, this is being addressed by ongoing expansion across the industry, as well as partnerships with international pharmaceutical manufacturers. This should support growth over the next 12 months, albeit pressures from imported inflation and value chain disruptions will likely continue to constrain industry performance.

Power - Generation, Sector Risk Score 3.25

The Nigerian power generation sector's low cyclicality is reflective of the essential nature of the services, and the very substantial latent demand for power in the country. Industry players are somewhat insulated by relatively high barriers to entry due to the substantial regulatory requirements associated with power generation and transmission. In addition, the high capital costs of establishment provide another barrier to entry, although funding for such projects is generally available.

While the industry appears to report sound profit margins, trending between 65% and 80% on the back of the relatively low operating cost base, it has been severely hampered by cash flow constraints due to very high receivables. These outstanding receivables have arisen from power sales to the grid through the Nigerian Bulk Electricity Trading Company. The Eligible Customers Policy (instituted by the Nigerian Electricity Regulatory Commission in 2017) provides power generation companies the opportunity to sell directly to eligible end users, thereby partly mitigating the collection problems arising from the Distribution Companies ("Discos") who are the collection agents in the power value chain. Following litigation in respect of the application of this Policy, further regulatory guidelines have been issued to provide further clarity, creating opportunities for collaboration between Discos and generating companies within specified distribution networks. Although, a number of off-grid, small scale power generating models are currently being deployed as alternatives to the traditional power supply system, the industry-wide impact of such projects is not expected to be material over the short term. In addition, the Federal Government is considering significant investments (and partnerships with global industry leaders) in developing the grid system as a complement to the various off-grid models.

Over the rating horizon, GCR does not expect any improvement to the sector score until there are meaningful reforms at the distribution end of the market, which translates to more accurate metering, improved collections, and liquidity.

Primary Manufacturing, Sector Risk Score 1.75

The primary manufacturing sector risk score reflects the generally low barriers to entry as evidenced by the fragmented industry space and intense competitive landscape. Most segments within this bucket also require relatively low start-up capital, contributing to the low entry barriers. Pricing pressure is also exacerbated by lower cost imported products and smuggled items. While the Government has introduced legislation and tariffs to promote local content, enforcement often falls short, with Nigerian manufacturers still having to contend with cheaper imported products. Nevertheless, the huge demand-supply gap portends strong opportunities for growth in the long term. The sector score also depicts the above average sensitivity to economic growth to sustain demand, but this is somewhat balanced against the necessity for consistently high government spending on infrastructural development. Environmental impact risks are high due to the generally heavy carbon foot prints, however, ongoing efforts by industry players to upgrade to more environmentally friendly technologies are noted.

Aside from competitive pressures, industry profitability is negatively impacted by elevated production costs due to the infrastructure deficit in areas such as electricity generation, transportation, as well as bottlenecks in the supply chain management due to port congestion. The reliance on raw material imports also adds foreign exchange risk, higher working capital and financing costs.

GCR expects some contraction in sectorial performance in the short term due to the impact of the COVID-19 pandemic on the economy and consumer income levels. Thus, the already low profit level is expected to deteriorate even further owing to pricing pressure and imported inflation on inputs. However, over the longer term, the disruption to imports could provide the local manufacturing industry an opportunity to increase its market share.

Real Estate/Property Development, Sector Risk Score 1.75

GCR considers the Real Estate Development Sector to evidence high cyclicality as a result of its correlation to economic activity and consumer demand. In Nigeria, the industry is particularly hampered by affordability issues, given the weak per capita income, large informal economy and the limited availability of private mortgage finance in the economy. Furthermore, participants in the real estate industry also contend with bureaucratic red tape, imported cost inflation and intense competition given the fragmented nature of the business. This has given rise to constant cash flow challenges for industry players, resulting in a high cost of funding for developers. Accordingly, the industry has been highly vulnerable since the economic challenges of the 2015/2016 recession, with low levels of profitability and risk of large losses.

GCR expects the current economic slowdown, induced by the COVID-19 pandemic and weak oil price, to further constrain home purchases, given the job losses and redundancy of staff across sectors and associated deterioration in consumer disposable income. Accordingly, earnings over the short to medium term are likely to remain under pressure. This will also likely impact inability to service their debt obligations. Nevertheless, the sector has positive medium to long term prospects considering the significant housing deficit (17 million) and the Federal Government of Nigeria's renewed focus on infrastructural development.

Telecommunication, Sector Risk Score 3.50

GCR considers the Nigerian Telecommunication sector to exhibit low cyclicality, given the very strong demand for connectivity across all segments of the populations. However, legislation and the application of regulations do add uncertainty to the industry, having caused some significant disruptions over recent years, as well as financial uncertainty due to large fines.

The industry is oligopolistic in nature, the three large players control around 94% and are highly profitable. Nevertheless, the presence of many over-the-top players and e-services demands ongoing innovation as the usage of telecommunications services and sources of income are constantly shifting. Currency risk is high, as companies need to maintain high quality, modern infrastructure that is typically incurred in or indexed to the USD and cannot be hedged out.

GCR expects the telecommunications sector to remain resilient in 2021, with strong profitability and margins. Favourable demographics, strong subscriber base and rising technological advancement should continue to underpin strong prospects for the industry. Moreover, the COVID-19 pandemic has highlighted the need and benefits of strong telecommunications capabilities.

Figure 1: GCR Nigeria Sector Risk Ranking