GCR Nigeria Corporate Sector Risk Scores
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Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Corporate Entities, January 2022
Criteria for Rating Real Estate Investment Trusts and Other Commercial Property Companies, January 2022
GCR Rating Scales, Symbols & Definitions, May 2019
GCR’s Country Risk Score Report, December 2021
GCR’s Nigeria Corporate Sector Risk Scores Report, 1 April 2022

The GCR Nigerian Corporate Sector Risk Assessment

The corporate sector risk score is a combination of a) cyclicalilty b) country business environment and effectiveness 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 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 of the economy, 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. To find out more about GCR sector risk scores please visit our website: http://gcrratings.com/risk-scores/.

Summary of the changes since last review

The following risk scores have been updated since the last publication (1 April 2022)

- Inclusion of a risk score for Commercial Property, initial score of 2.00
Nigerian Corporate Sector Risk Scores

**Agriculture, Sector Risk Score 2.50 (Previously 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 chain at a concessionary interest rate.

The agricultural sector remains the mainstay of the Nigerian economy, with annual contribution of about 25% to national GDP and growth rate of 2.13% in 2021. The sector has evidenced strong resistance to the COVID-19 disruptions given its essential nature, with industry’s players demonstrating solid financial performance into 2022. GCR expects these trends to continue, supported by people’s needs for food, and government drive towards internal food sufficiency for its large population. Moreover, favourable agricultural commodity prices should further bolster cash flows for farmers and encourage development of the sector.

**Commercial Property, Sector Risk Score 2.50 (Initial Score)**

The Nigerian commercial property sector is reflective of below average cyclical as industry performance adjusts slowly to changes in the environment. The formal market is still at infancy, with only three trading REITs on the Nigerian Stock Exchange and total net assets value at N37.2bn (USD88.7m) at end-December 2021. This is small compared to the potential size of the market because of the relatively weaker yields (compared with other investment classes) and limited investor knowledge. Furthermore, Nigerian existing REITs are all closed ended, restricting additional investors into the existing REITs and constraining growth somewhat. The industry has very little exposure to changes in government or political interference, but the listed entities must comply with Companies and Allied Matters Act, 2014, Nigerian Exchange Limited listing requirements, and Securities and Exchange Commission listing rules. Nevertheless, there are several small property companies operating in Nigeria without a REIT structure but deriving earnings from rental income.

Similar to other markets, Nigerian real estate market has witnessed some setbacks since 2020 due to the COVID-19 crises and the resultant remote working. The position worsened in 2021, with higher vacancy rates and downward rental reviews to minimize level of vacancies. However, earnings have been resilient through multi-year rental agreements.

Looking ahead, the retail sub-sector remains resilient due to strong demand from consumers and the sector is less susceptible to disruption from online sales channels than other markets. As more companies resume work in physical offices, the demand for commercial office space is expected to increase, but the vacancy rate should remain under pressure. In a bid to strengthen future earnings and returns, industry players are increasing focus towards retail (shopping malls and parks), industrial-use properties and purpose-built student accommodations as these sub-sectors have proven economically resilient.
**Construction, Sector Risk Score 2.00 (Initial Score)**

GCR considers the Construction Sector to evidence high cyclicality as a result of its correlation to economic activity, government infrastructural spend and demand. Although the sector has low risk of substitution, the industry is characterised by complex nature of work undertaken, and relatively moderate to low margins. Accordingly, projects are susceptible to cost overruns, leading to low profitability and potential cash outflows. Furthermore, participants in the industry contend with bureaucratic red tape, changes in political ideology leading to delays, non-adherence to construction contract terms, and imported cost inflation. Because of unscrupulous contractors, there are persistent safety and environmental concerns within the building segment, leading to workplace injuries and the collapse of a number of buildings.

GCR views the Nigerian construction industry to have positive medium to long term prospects considering the government’s renewed focus on infrastructural development and the significant housing deficit of over 17 million housing units. This is evidenced by the sectorial real GDP annual growth rate of 3.09% in 2021. Although demand from the private sector is rising, government remains the major driver for construction services in the market, given the huge infrastructural gap across the country. Since 2021, industry performance has improved across board, with rise in revenue and profitability, with the large construction companies having captured most of the benefits, given their expertise, financial strength, and scale. Looking forward, industry players are expected to report improved top-lines, but threat of delays and cost overruns could constrain profitability.

**Education, Sector Risk Score 3.25 (Previously 3.25)**

The Nigerian private education sector reflects low cyclicality given the essential nature of educational services and their high priority in most household budgets, underpinning the relative stability of sectorial revenue and cash flows through economic cycles. This is evidenced by the low rate of attrition of students even during the COVID-19 pandemic, attributable to the generally low quality of education and limited capacity in government-owned schools. The score also reflects the supportive regulatory oversight and the moderately high industry profitability given the relatively low and predictable operating cost pattern. Although GCR expects that the demand for private education will maintain an upward trajectory, fee affordability is being threatened by the narrowing disposable income. This may result in reduced operating margins and greater debtors’ collection challenges.

The foregoing is balanced against the low barriers to entry as the industry is highly fragmented with thousands of individual players, despite the relatively long time required to construct standard educational infrastructure, build reputation, and attain meaningful scale. While environmental impact risk is low, the severity of reputational damage is high. Furthermore, given that most Nigerian educational institutions are privately held and mostly family owned, weak management and governance structures could also threaten succession and/or smooth operation, although the industry-wide impact will remain insignificant. We expect an increase in the adoption of technological solutions to further enhance on-site learning experience and continue to support distance learning services.

**Fast Moving Consumer Goods (‘FMCG’), Sector Risk Score 3.00 (Previously 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 food and beverages, household products, body care, hygiene products, alcohol, and tobacco, which all 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).

The industry has demonstrated strong resilience through the COVID-19 pandemic with stable demand but 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. Looking-forward, 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 heighten due to a significant cost inflation pressure. The recent surge in energy cost following the hike in prices of fuel to power manufacturing plants, will increase both raw input prices and manufacturing costs, whilst the continuous depreciation of the Naira, has resulted in higher prices for imported raw materials and capital equipment. GCR will continue to monitor these trends to assess their impact on the sector’s credit quality.

Hospitality, Sector Risk Score 2.00 (Previously 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 to demand and income, as was evidenced through the COVID-19 pandemic, with almost complete cessation of global travel, leading to many hotels having to close.

Although Nigeria does not have a large tourism market, 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. As such, the sector is now witnessing recovery, following relaxation of the various restrictions on sectorial business activities, as well as local and global travel. This has resulted in increase in occupancy levels. In addition, demand for conferencing and functions is also picking up, with social events nearing pre-COVID levels. Accordingly, GCR expects the industry to report a recovery in earnings during 2022, which should increase cash flows and credit strength from the weaknesses evidenced over the past two years. Barring any further outbreaks, the risk score may be reviewed upward later in the year.

Logistics, Sector Risk Score 2.50 (Previously 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 due to its highly fragmented nature with significant number of small-sized players. Most significantly, industry risk is characterised by relatively low profit margins, constrained by intense competition and the additional costs incurred due to Nigeria’s poor infrastructure and bad road network.

This notwithstanding, the sector demonstrated strong resilience to the COVID-19 disruptions, recording volume growth in 2020 and 2021, as many segments of the industry are classified as essential services or support essential services. Demand remained robust in port operations, rail, trucking, passenger transport, and freight services, although air transport operators suffered some setbacks due to the restrictions on international travel. The emergence of small-scale logistics businesses that focus on on-demand deliveries, driven by technology, has also created opportunities for new entrants to the sector, at a much lower start-up cost.

Long term growth prospects appear positive due to infrastructural development in rail and air connections, as well as improvement in transport networks within the African region. Domestically, the continued trend by many large
corporates to outsource their logistics and supply chain functions, bodes positively for specialised logistics companies, whilst the growth in E-commerce has expanded the need for logistics to service the private sector.

Non-discretionary Retail, Sector Risk Score 3.0 (Previously 3.0)

The Nigerian non-discretionary retail sector score of 3.0 is reflective of the below average cyclicality and steady cash flows, underpinned by the constant need for and high demand of the products sold, even in times of economic downturn. This has been evidenced through the COVID-19 economic disruptions.

Nigerian retail continues to be dominated by informal channels, but modern retail is growing rapidly as the benefits of shopping in supermarkets and convenient stores have become increasingly apparent to consumers. Nevertheless, the number of modern retailers relative to the Nigerian population remains low, even by the standards of other emerging economies. Non-discretionary retailers tend to be susceptible to high levels of competition because of the relatively low barriers to entry and limited regulatory control, but this is considered less of a risk in Nigeria due to the underdevelopment of the sector. However, managing the supply chain remains a major challenge for local players as the availability of products is often disrupted by import constraints and the inability to access foreign currency, as well as domestic production and logistics challenges.

The growing population, young demographic, increasing urbanisation, and rising middle class provide substantial scope for sectorial growth. Thus, margins are expected to remain resilient although, even amidst the rising inflationary pressures.

Oil and Gas – Downstream, Sector Risk Score 2.75 (Previously 2.75)

The oil and gas downstream sector score evidences 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 subsidised and regulated. Thus, the refined product marketers do not stand to benefit from the very high price for PMS on the international markets and may see profitability reduce due to consumers reducing volumes. 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.

Industry dynamics are expected to improve when the Dangote Refinery becomes operational in 2023 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.

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.

Oil and Gas (Upstream), Sector Risk Score 1.75 (Previously 1.25)

GCR’s sector risk score for the oil and gas upstream sector reflects the high cyclicality of the industry, due to wide fluctuations 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. Despite the enactment of the Petroleum Industry Act (PIA) 2021, which seeks to provide legal, governance, regulatory and fiscal frameworks, the industry still faces structural challenges and regulatory uncertainties as the Act is yet to take full effect to overhaul the sector. Pipeline vandalism and social unrest within the oil producing Niger-Delta region have also not been resolved. Such concerns are likely to remain a constraint on the Nigerian upstream sector in 2022.

From a weak position over the last two years, the industry is rebounding on the back of a steep rise in crude oil prices on the international market. As long as the Russia/Ukraine conflict persists, and the sanctions on Russian oil (the third largest oil producer) and related businesses remains in place, the industry expects the oil price to remain above USD100/barrel, well above the levels evidenced over the past two years.

Nigeria’s non-export production volumes (which are not subject to OPEC quotas) should also increase substantially when Dangote Refinery becomes fully operational. Nevertheless, the ability to overhaul the sector, promote conducive operating environment for the international oil companies, and scale up production to meet target demand are critical success factors going forward.

Crude oil remains one of the most important fuel sources globally, and notwithstanding global efforts to develop green energy technologies, is likely to remain key to meeting the world economies energy requirements for the foreseeable future.

Pharmaceuticals, Sector Risk Score 3.25 (Previously 3.25)

The Nigerian pharmaceutical sector benefits from low economic cyclical, 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 continue 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 constrain industry performance.

Power - Generation, Sector Risk Score 3.25 (Previously 3.25)

The Nigerian power generation sector’s low cyclical 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 additional 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 (Previously 1.75)**

The primary manufacturing sector risk score reflects the high cyclicality of the industry balanced against the relatively
high barrier to entry due to the substantial capital investment required for manufacturing plants. The sector
encompasses a broad range of unrelated activities including, but not limited to the extraction and processing of wood,
steel, paper, glass, paints, chemicals, and cement manufacturing. Market demand is highly sensitive to economic
growth, or the lack thereof, as well as government spending patterns. Environmental impact risks are high due to the
generally heavy carbon footprints, however, ongoing efforts by some industry players to upgrade to more
environmentally friendly technologies are noted.

To spur diversification of the Nigerian economy the Government has introduced legislation and tariffs to promote local
Nevertheless, enforcement often falls short and manufacturing profitability continues to be constrained by pricing
pressure due to cheaper imported products and smuggled items. In addition, production costs in Nigeria are elevated
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, adversely impacting industry performance. GCR remains concerned
that the heightened inflationary pressures, due to rising commodity and energy cost may further weaken future
profitability.

Over the long term, manufacturing performance is expected to remain constrained, but more supportive Government
policies and improvements to infrastructure could allow local players to increase market share. Furthermore, the huge
demand-supply gap for the sectorial products portends strong opportunities for growth.

**Property Development, Sector Risk Score 1.75 (Previously 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, with low levels of profitability and risk of large losses.
GCR expects the challenging operating environment and the declining consumer disposable income to continue to constrain home purchases. Accordingly, industry earnings are likely to remain under pressure over the short to medium term. This will also impact inability to generate sufficient cash flows and service debt obligations. Nevertheless, the sector has a strong long-term prospect considering the significant housing deficit (with over 17 million, based on industry source) and the Federal Government of Nigeria's renewed focus on supporting new residential projects that target low to medium income families.

Secondary Manufacturing, Sector Risk Score 2.00 (Previously 2.00)

GCR’s sector risk score for secondary manufacturing reflects the industry's above average cyclicality due to the sensitivities to changes in the economic environment and discretionary spending patterns of customers. Much of Nigeria’s productive capacity in manufacturing has been lost over recent years, due to the high cost of production and rising level of cheap imports. Factors such as unstable electricity generation and high alternative energy costs, the reliance on imported raw materials, port congestion, and general supply chain management have all contributed to ongoing margin pressure. However, the Government of Nigeria has implemented far reaching regulations to ban the import of many secondary items, or to add substantial high import tariffs to encourage import substitution. These measures have encouraged increased investment in secondary manufacturing, and supported improved profitability for local manufacturers, in line with efforts to diversify the country’s economy.

The wide demand-supply gap portends strong opportunities for growth in the long term and government’s renewed focus on infrastructural development should help in providing a conducive operating environment to thrive. Accordingly, GCR anticipates sustained improvement in revenue as these regulations and other supporting policies to protect local industries are implemented and enforced, but the rising cost inflation remains downside risk that could offset these benefits.

Telecommunication, Sector Risk Score 3.50 (Previously 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 2022, 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
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