FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms NamPower at 'BB'; Outlook Negative

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Fitch Ratings - London - 09 Feb 2022: Fitch Ratings has affirmed Namibia Power Corporation (Proprietary) Limited's (NamPower) Long-Term Issuer Default Rating (IDR) at 'BB' with a Negative Outlook. A full list of rating actions is below.

NamPower's rating is constrained by the Namibian sovereign (BB/Negative) under Fitch's Government-Related Entities (GRE) Rating Criteria and Parent and Subsidiary Linkage (PSL) Rating Criteria. NamPower's Standalone Credit Profile (SCP) is 'bbb-', reflecting the company's monopolistic position in transmission and energy trading in Namibia and strong financial profile.

KEY RATING DRIVERS

Strong GRE Links: Fitch assesses the government's ownership and control of the company as 'Strong' under its GRE Criteria. This is due to the government's full ownership of the company through The Ministry of Mines and Energy and Ministry of Public Enterprises. The track record and expectations of support is 'Strong', with the most significant elements of support including government-guaranteed debt (about 5.1% of total debt at FY21 (ending June 2021)) and historical government grants for infrastructure and fuel.

Fitch deems the socio-political and financial implications of a default by NamPower as 'Strong', given the essential character of electricity supply and significant development needs for electricity infrastructure.

'bbb-' SCP: NamPower has a strong capital structure, driven by over NAD9 billion of liquid investments (over 75% with short-term maturities) compared with NAD761 million debt at FY21 and Fitch expected negative free cash flow (FCF) of an average NAD1.7 billion over the next four years. This enables NamPower to maintain a net cash position throughout the rating horizon, which is consistent with the current SCP.

Reliance on Imported Energy: Fitch expects NamPower to remain reliant on imported electricity, with a gradual reduction over the medium term and more significant reduction from 2025 with the expected increase from new generation capacity. The level of energy imports was about 66% in FY21, slightly higher than in FY20. About half of imports are from Eskom with the remaining from Zimbabwe Power Company, Zambia Electricity Supply Corporation (ZESCO) and Southern African Power Pool (SAPP).

Near-term Profitability Dependent on Ruacana: Ruacana hydro power plant represents about 37% of installed capacity available to NamPower (including imports) and its production varies depending upon the flow of river Kunene. This variation in production has a direct impact on NamPower's total cost of electricity supply.

Annual production from Ruacana can vary from a low of 900 GWh to around 1,500 GWh and we estimate that a 1 GWh variation in Ruacana production leads to on average NAD1 million variation in profits for NamPower. While NamPower is regulated under a cost-reflective framework, NamPower's strategic intent is to keep tariff increases inflation linked, which can result in a lag in cost recovery and consequently variation in profitability.

Capex Drives Negative FCF: NamPower is undertaking five power generation projects and 11 transmission projects aimed at reducing its reliance on imported electricity. These projects will increase capex to about NAD1.5 billion in FY22 and NAD3 billion in FY23 and FY24, from less than NAD500 million average over the last four years. The majority of this will be funded through NamPower's substantial cash and liquid assets. The projects will also increase operating costs in the medium term by about NAD300 million on average.

Gradual MSB Impact: The MSB model came into effect in Namibia in September 2019. Fitch does not expect the MSB model to negatively affect NamPower's SCP. The modified single buyer (MSB) model allows independent power producers to generate and sell electricity output directly to regional electricity distributors, large industrial and mining companies, including municipalities, compared with the single buyer model where electricity output could only be sold to NamPower.

These agreements are initially limited to 30% of customers' energy consumption. NamPower retains its monopolistic transmission position through the unbundling of the tariff structure, including reliability charge, and remains the supplier of last resort. Forecast capacity under MSB to come online by FY23 is estimated around 100 MW, but this could vary due to project uncertainties and readiness.

DERIVATION SUMMARY

NamPower's ratings are the same as Namibia Water Corporation's (NamWater; BB/Negative). The IDRs are constrained by the Namibian sovereign (BB/Negative) in accordance with Fitch's GRE and PSL Criteria. Their SCPs of 'bbb-' benefit from monopoly positions and strong financial profiles.

Among its international peer group, which includes Eskom Holdings SOC Ltd (Eskom, B/Stable), PGE Polska Grupa (BBB+/Stable) and Saudi Electricity Company (A/Stable), NamPower's financial profile is the strongest in terms of funds from operations (FFO) net leverage. NamPower's net cash position is due mainly to cash generated from operations supported by cost-reflective tariffs, on average, and a large cash buffer due to historical delays in capex for new generation capacity. However, NamPower has a weaker business profile due to smaller scale, weaker market trends, volatile profitability and significant reliance on load factors at Ruacana and imported electricity.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- National energy demand to increase at around 2% CAGR between FY22-FY25

- MSB sales all behind the meter contributing low single digits percentage of total demand

- Average system loss factor of around 8% and distribution loss factor of around 12%

- Revenue to increase by 5.2% on average between FY22-FY25

- Average Ruacana load factor of 30%

- Imports around 64% of total demand on average

- Average EBITDA margin of 7.5%

- Increase in capex to over NAD2.5 billion per year over FY22-FY25

- Net working capital outflow of approximately NAD200 million per year over FY22-FY25

- No dividend distribution during FY22-FY25

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Positive rating action on Namibia's sovereign ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Negative rating action on Namibia's sovereign ratings.

Namibia sovereign rating sensitivities (15 July 2021)

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Public Finances: Failure to achieve clear progress towards stabilising government debt-to-GDP in the medium term or a faster near-term increase in government debt/GDP than our current projections;

- Macroeconomic Performance, Policies and Prospects: Prolonged economic growth weakness post-pandemic and/or further downward revision to trend growth;

- External Finances: Increased external vulnerabilities for example from significant widening of the current account deficit or a sustained decline in international reserves

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Public Finances: Credible fiscal plans and evidence of stronger ability to implement fiscal reforms sufficient to stabilise the government debt/GDP trajectory in the medium term;

- Macroeconomic Performance, Policies and Prospects: Stronger medium-term growth, for example resulting from improved prospects for the mining sector.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: As at end-December 2021, NamPower had Fitch-defined cash and cash equivalents of approximately NAD3.4 billion and around NAD7.1 billion in liquid assets. This compares favourably with short-term debt of NAD214 million and Fitch's expectation of FCF of negative NAD462 million at end June 2022.

ISSUER PROFILE

NamPower is a wholly state owned, vertically integrated power utility in Namibia. The company's core business is generation, energy trading and transmission. Nampower owns and operates hydro, coal and diesel generation plants with a combined installed capacity of 489 MW and is reliant on energy imports within the SAPP, and especially Eskom, in order to meet its domestic demand.

ESG CONSIDERATIONS

Fitch does not assign an ESG credit relevance score to NamPower as the rating is equalised with that of the Namibian sovereign.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

NamPower's rating is driven by the Namibia sovereign, in line with Fitch's PSL and GRE criteria.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	PRIOR ⬍

Namibia Power Corporation (Proprietary) Limited	LT IDR BB Rating Outlook Negative Affirmed	BB Rating Outlook Negative
	ST IDR B Affirmed	B
	Natl LT AAA(zaf) Rating Outlook Stable Affirmed	AAA(zaf) Rat Outlook Stable
	Natl ST F1+(zaf) Affirmed	F1+(zaf)

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Raman Singla
Director
Primary Rating Analyst
+44 20 3530 1728
raman.singla@fitchratings.com
Fitch Ratings Ltd
30 North Colonnade, Canary Wharf London E14 5GN

Carlos Baeta
Senior Analyst
Secondary Rating Analyst

+44 20 3530 2616
carlos.baeta@fitchratings.com

Antonio Totaro
Senior Director
Committee Chairperson
+39 02 879087 297
antonio.totaro@fitchratings.com

MEDIA CONTACTS

Tahmina Pinnington-Mannan
London
+44 20 3530 1128
tahmina.p-mannan@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 15 Oct 2021)

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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