FitchRatings

Fitch Affirms NamPower at 'BB+'; Outlook Stable

Fitch Ratings - London - 30 November 2018: Fitch Ratings has affirmed Namibia Power Corporation (Pty) Ltd's (NamPower) Long-Term Issuer Default Rating (IDR) at 'BB+' and Short-Term IDR at 'B'. Fitch has also affirmed NamPower's National Long-Term Rating at 'AA+(zaf)' and Short-Term Rating at 'F1+(zaf)'. The Outlooks on the Long-Term ratings are Stable.

The ratings of NamPower reflect its standalone credit profile (SCP) of its monopolistic position in energy trading and transmission in Namibia, with a cost-reflective tariff framework and strong financial profile. However, the rating is capped by that of the group's Namibian sovereign shareholder (BB+/Stable). We expect capex to lead to negative free cash flow (FCF) for the financial year ending June 2019 (FY19), which will largely be funded from existing cash resources.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Namibia Power Corporation (Proprietary) Limited	Natl LT AA+(zaf) Affirmed		AA+(zaf)
	Natl ST F1+(zaf) Affirmed		F1+(zaf)
	LT IDR BB+ Affirmed		BB+
	ST IDR B Affirmed		B

KEY RATING DRIVERS

Strong Shareholder Links: NamPower is rated under Fitch's Government-Related Entities Rating (GRE) criteria and its rating is capped by Namibia's. The ratings for NamPower are driven by its SCP of 'BBB-', which is stronger than the sovereign's, but are capped by the sovereign's ratings, given its strong links with the government.

SCP Assessment Improves: NamPower's SCP assessment has been revised higher to 'BBB-' from our previous assessment of 'BB' category, on confirmation (including importantly clarity on timing, scale and funding) of the utility's investment decision on power generation. The limited visibility on NamPower's investment decision previously led to a lower assessment of the group's SCP.

Final Investment Decision on Generation: Fitch understands from management that NamPower has committed to three renewable power generation projects to reduce its reliance on imported energy. Once completed this will improve its generation capacity to 500 megawatt (MW) by end-FY 22/23 from 400MW FYE17. The three renewables projects will be funded by cash resources and cash-flow from operations, and will comprise solar photovoltaics, wind power and biomass.

Reliant on Imported Electricity: Fitch expects NamPower to remain reliant on imported electricity as opposed to its own generation for the next four years. The level of energy imports marginally declined in FY17 to 57% from 63% in FY16, as the hydro power plant produced about 200 gigawatt hours (GWh) more electricity in FY17 compared to FY16.

NamPower optimises its electricity supply mix between its own generation, independent power producers (IPPs) and imported electricity. The energy trading department manages the imported electricity through power purchase agreements (PPAs) and the Southern African Power Pool (SAPP) day ahead market. Fitch expects NamPower to remain dependent on its trading partners to meet its current electricity demands, especially the day ahead market. NamPower has long-term contracts with Eskom Holdings SOC Ltd (Eskom; Long-Term Local-Currency IDR BB-/Negative), Zimbabwe Power Company (ZPC), and Zambia Electricity Supply Corporation (ZESCO).

Growth in IPPs: IPPs contributed about 40 GWh to Namibia generation in FY17. Fitch expects 14 IPPs to be online by end-2019 with an installed capacity of 70MW. The development of IPPs originated from the government's initiative, Interim Renewable Energy Feed-in Tariff (REFIT), which planned to develop 14 IPPs, each with a 5MW capacity. In addition, 57MW of solar photovoltaics capacity is planned to be added to generation by end-March 2019.

State Boost to Own Generation: The Namibian government aims to reduce reliance on imported electricity by improving local electricity generation. In October 2018, the Minister of Mines and Energy announced new renewable generation projects in Namibia for a combined generation capacity of 220MW. NamPower is expected to build, own and operate assets with about 150 MW capacity and the remaining 70 MW is expected to be provided by IPPs. These initiatives could improve Namibia's generation to about 800MW (including NamPower's and IPPs' capacities) in the next six to eight years, although the exact timing and form of these further projects is yet to be determined. The government is also committed to the Paris climate accord to obtain 70% of its electricity requirements from renewable sources by 2030.

Shortage of Electricity Mitigated: Fitch does not expect NamPower to face an electricity shortage by 2022 when the five-year supply agreement with Eskom expires at end-March 2022. In addition, NamPower could negotiate an extension to the supply agreement or source the deficit in the SAPP day ahead market. Fitch estimates about 800GWh could have been sourced by NamPower in the SAPP day ahead market for FY18, compared with about 135GWh in FY17.

Eskom is expected to supply a significant portion of Namibia's electricity requirement up to 2022. In FY17 Eskom supplied almost half of Namibia's energy requirement of about 4,600 GWh. Fitch forecasts electricity volume sales to have grown for FY18 despite lower peak demand in FY17 of 661 megawatts (MW) compared with 667MW in FY16. If, however, the government introduces the Modified Single Buyer Market Model (MSB), NamPower's electricity sales would be impacted and could decline as early as FY19.

Modified Single Buyer Market Model: Fitch does not currently expect the introduction of MSB to negatively affect NamPower's rating, although our view may change as further details emerge. The government and the Electricity Control Board (ECB, which is NamPower's regulator) aim to liberalise the supply of electricity in Namibia. MSB will allow IPPs to generate and sell electricity output directly to regional electricity distributors, large industrial and mining companies, including municipalities, compared with the current single buyer model where electricity output can only be sold to NamPower. These agreements are expected to be limited to about 20% of customers energy consumption. Nevertheless NamPower is expected to retain its monopoly transmission position and remain the supplier of last resort.

DERIVATION SUMMARY

NamPower's ratings are the same as Namibia Water Corporation's (NamWater; BB+/Stable). The SCP drives the ratings for NamPower, which are capped by the sovereign. The rating of Telecom Namibia Ltd (TN; BB/Stable) is driven by the support it receives from the government but it is notched lower than that of NamPower under our GRE criteria, due to TN's weaker links.

NamPower's financial profile is the strongest in terms of FFO adjusted net leverage in the regional peer sector group, which includes Eskom and Saudi Electricity Company (A/Stable) mainly due to cash generated by operations supported by cost-reflective tariffs and delays in capex for new generation capacity. This is balanced against a business profile with weaker market trends, volatility of cash flows and reliance on imported electricity.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
- Energy sales including MSB to fall on average about 3% per year for 2019 to 2021
- Tariff increases of about 5% for FY18
- Cash tax of about NAD650 million in FY18
- NAD5.5 billion of liquid investments (treated as readily available cash) to be used to fund capex

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
- An upgrade of Namibia's sovereign ratings or revision of the sovereign Outlook to Positive. The rating impact of any improvement in the SCP would be limited by the sovereign ratings.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- A downgrade of Namibia's sovereign ratings or revision of the sovereign Outlook to Negative
- A significant change in the market trends, for example, introduction of MSB reducing NamPower's cash generation, or increased capex funding leading to weaker credit metrics such as FFO adjusted net leverage above 3.5x on a sustained basis, which would be negative for the SCP.

Sovereign Rating Sensitivities
For the sovereign rating of Namibia, Fitch outlined the following sensitives in its Rating Action Commentary dated 13 August 2018.

Future developments that could result in positive rating action include
- The government debt-to-GDP ratio firmly placed on a downward trajectory
- Marked improvement in the current account balance consistent with a stabilisation of external-debt-to GDP ratios
- Stronger medium-term growth resulting from better prospects for the mining sector or implementation of structural reforms

Future developments that could result in negative rating action include:
- Deterioration in debt dynamics beyond our current forecasts

- Wider-than-expected external deficits or emergence of external funding pressures
- Lower-than-forecast economic growth, for example due to an aggravation of policy uncertainty or weaker mining activity

LIQUIDITY AND DEBT STRUCTURE

Robust Liquidity: NamPower had NAD421 million of cash at FYE17, supported by a liquid investment portfolio of about NAD5.8 billion. This can be accessed at short notice to bolster its liquidity position and investment needs. This compares with NAD230 million of short-term debt and Fitch's estimate of positive FCF for FY18.

Additional information is available on www.fitchratings.com

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Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (/site/re/10023785)
Sector Navigators (pub. 23 Mar 2018) (/site/re/10023790)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018) (/site/re/10024585)
National Scale Ratings Criteria (pub. 18 Jul 2018) (/site/re/10038626)
Government-Related Entities Rating Criteria (pub. 25 Oct 2018) (/site/re/10047173)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (/site/dodd-frank-disclosure/10053788)
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