

BAUCHI STATE

₦15 Billion 15.5% Seven-Year Fixed Rate Series 1 Bond Due 2021

2017 Bond Rating Review Report

 **Agusto&Co.**

Research, Credit Ratings, Credit Risk Management

Bauchi State Government of Nigeria

₦15,000,000,000 15.5% Fixed Rate Series 1 Bond Due 2021

Issue Rating:

Bbb+

Satisfactory quality debt Issue with moderate credit risk; satisfactory capacity to pay coupon and principal on local currency debt in a timely manner.

Outlook: Stable

Issue Date: December 2017

Expiry Date: 30 September 2018

The rating is valid throughout the life of the instrument but will be subject to annual monitoring and review.

Previous Issue rating: Bbb+

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RATING RATIONALE

Agusto & Co. hereby affirms the “Bbb+” rating assigned to the Bauchi State Government’s ₦15 Billion 15.5% Fixed Rate Series 1 Bond Due 2021 (“the Issue” or “the Bond”), which was issued in December 2014. The assigned rating reflects the fact that the Issue is supported by the execution of an Irrevocable Standing Payment Order (ISPO) mandating monthly withdrawals of ₦305.6 million from the State’s share of statutory allocation (SA) into a sinking fund account (SFA). The SFA, which is being managed by a joint team of experienced trustees, is exclusively set aside to meet the payment of the Issue’s coupon and principal, which are both payable semi-annually over the duration of the Bond. The Issue rating is also supported by the fact that the balance in the SFA as at 30 September 2017, in addition to the remaining monthly ISPO contributions will be sufficient to cover the Bond’s outstanding obligations 1.04 times over the life of the Issue.

Similar to most states of the Federation, Bauchi State Government derives the bulk of its earnings from centrally collected revenue, which is distributed among the three tiers of government by the Federal Government of Nigeria (FGN). Due to the relative rally in crude oil prices as well as the ramp-up in production, Bauchi State’s share of statutory allocation is expected to rise by 24% to about ₦37.4 billion in period ended 31 December 2017 (2016: ₦30.2 billion). As a result, share of statutory allocation will account for a high 70% of the State’s total revenue in 2017 (2016: 67%), with value added tax (VAT) and internally generated revenue (IGR) representing 21% and 9% respectively during the same period.

Agusto & Co. estimates that Bauchi State’s total annual ISPO deductions in favour of the ₦15 billion Bond as a percentage of SA will improve to 11% by the end of 2017 (2016: 15%). We consider this ratio to be satisfactory and better than the majority of states in the country. From December 2014 when the Bond was issued up to 30 September 2017, Bauchi had met the Issue’s obligations totalling ₦8.97 billion as and when due. Agusto & Co. anticipates this prompt settlement to continue, as the ISPO is expected to remain in force.

ADEQUACY OF SINKING FUND

In December 2014, Bauchi State Government issued a ₦15 Billion 15.5% Fixed Rate Seven-Year Series 1 Bond, which was fully supported by the issuance of an Irrevocable Standing Payment Order (ISPO). The ISPO authorises the Accountant-General of the Federation to deduct, on a monthly basis, the sum of ₦305.6 million from the State's statutory allocation into a sinking fund account (SFA) which was solely created for servicing the Bond's obligations (i.e., coupon payments and principal repayments). Both coupon payments and principal repayments are made semi-annually over the duration of the Issue in line with the Bond's amortisation schedule. The SFA is jointly managed by five trustees – ARM Trustees Limited, STL Trustees Limited, United Capital Trustees Limited, Union Trustees Limited and FBN Trustees Limited.

As at 30 September 2017, total contributions (ISPO & investment income) into the SFA amounted to ₦10.26 billion. This sum was sufficient to cover total payments due to Bondholders (₦8.97 billion) and bond related expenses (₦0.16 billion), leaving a balance of ₦1.14 billion as at the same date. Based on our estimate, the SFA balance (as at 30 September 2017) plus the remaining 51 monthly ISPO deductions amounting to a total of ₦16.73 billion will be sufficient to cover the outstanding bond (coupon and principal) obligations 1.04 times. In our view, this reflects adequacy of the funds in the SFA to meet the Bond's obligations as and when due.

Table 1: Sinking Fund Schedule as at 30 September 2017

Description	₦'000
Total ISPO contributions	10,087,090
Investment income	174,914
Payment to Bondholders (coupon & principal)	(8,965,597)
Bond expenses	(156,648)
Balance as at 30 September 2017	1,139,759
Outstanding ISPO contributions till maturity (51 months ISPO)	15,589,138
Total contributions till maturity	16,728,897
Bond obligations (coupon & principal) till maturity	16,138,074
Sinking Fund Adequacy Coverage ratio	1.04 times

UTILIZATION OF BOND PROCEEDS

The net proceeds of the ₦15 billion Bond were utilised as follows: refinancing of commercial bank loans (50%); completion of Sir. Abubakar Tafawa Balewa International Airport (40%); and the part-financing of Bauchi State Specialist Hospital (10%).

OUTLOOK ON BOND REPAYMENT

The Nigeria's economy rebounded from recession in the second quarter of 2017, with a revised real GDP growth rate of 0.72% followed up by a further improvement in growth rate to 1.4%¹ in the third quarter of the same year. The economy recovery, which was driven largely by oil sector contribution following the relative rally in oil prices, has boosted the fortunes of the three tiers of government. From a low of ₦5.18 trillion generated in 2016, the centrally collected revenue of government has been projected to close at ₦6.13 trillion² in 2017.

Agusto & Co. estimates Bauchi State's total revenue to grow by 19% to ₦53.6 billion in 2017 with centrally collected revenue contributing about 70% of the total. In the same vein, ISPO deductions as a percentage of the State's statutory allocation is expected to improve appreciably to an estimated 11% in 2017 (2016: 15%). We anticipate that the Issuer should continue to meet the obligations on the Bond since the ISPO is expected to remain in force.

In addition, we estimate that the total SFA balance of ₦16.73 billion upon maturity of the Issue will be sufficient to fully meet the Bond's outstanding obligations projected at ₦16.14 billion, thereby representing a satisfactory adequacy ratio of 1.04 times.

Based on the above, Agusto & Co. attaches a **stable** outlook to the Bauchi State Government's ₦15 Billion 15.5% Series 1 Fixed Rate Bond Due 2021.

Bauchi State's Total SA & ISPO as a % of SA (2015 – 2017e)

Description	2017e ³ ₦'bn	2016 ₦'bn	2015 ₦'bn
Total FAAC Distributed (Statutory allocation, VAT & others) to the tiers of Government	6,125.63	5,177.11	6,064.25
Total share of FAAC to State Governments	1,924.73	1,641.92	2,007.90
Share of Statutory Allocation (SA) to Bauchi State Government	32.26	24.38	33.67
Share of VAT & other income to Bauchi State Government	<u>16.35</u>	<u>15.35</u>	<u>14.14</u>
Total FAAC to Bauchi State Government	48.61	39.73	47.81
Total first line deductions (ISPO, external debts & others) of Bauchi State Government	10.56	7.31	6.60
Total deductions as a % of Bauchi State Government's FAAC	22%	18%	14%
Total ISPO deductions for Bauchi State Government's Bond	3.67	3.67	4.37
Total ISPO deductions as a % of Bauchi State Government's SA	11%	15%	13%

¹ National Bureau of Statistics

² Federal Ministry of Finance, Agusto & Co. Research.

³ The 2017 estimates are based on actual FAAC figures for the State between Jan. 2017 and Oct. 2017

FINANCIAL SUMMARY

REVENUE & SPENDING										
	2017e		2016e		2015		2014		2013	
REVENUE	₦'mns	%	₦'mns	%	₦'mns	%	₦'mns	%	₦'mns	%
Tax revenue										
Personal Income Tax	4,726.6	9%	4,611.3	10%	5,123.7	9%	4,321.0	6%	2,782.9	4%
Share of VAT collected centrally	11,257.5	21%	9,505.7	21%	9,206.9	17%	11,510.9	17%	8,071.2	12%
Share of other revenues collected centrally (Stat. Allocation)	37,351.4	70%	30,225.7	67%	38,604.8	71%	53,099.2	76%	57,013.8	83%
Property tax										
Other taxes	-		-		-		-		223.9	0%
	<u>53,335.5</u>	<u>100%</u>	<u>44,342.7</u>	<u>98%</u>	<u>52,935.5</u>	<u>98%</u>	<u>68,931.1</u>	<u>99%</u>	<u>68,091.7</u>	<u>99%</u>
Non-tax revenue										
Asset sales										
Investment income	-		534.8	1%	688.6	1%	242.6	0%	713.1	1%
Other	253.2	0%	253.2	1%	468.1	1%	290.8	0%	216.9	0%
	<u>253.2</u>	<u>0%</u>	<u>788.0</u>	<u>2%</u>	<u>1,156.7</u>	<u>2%</u>	<u>533.4</u>	<u>1%</u>	<u>930.0</u>	<u>1%</u>
TOTAL REVENUE	53,588.7	100%	45,130.7	100%	54,092.1	100%	69,464.5	100%	69,021.7	100%
Of which internally generated revenue (IGR) is	4,979.8	9%	5,399.3	12%	6,280.4	12%	4,854.3	7%	3,936.7	6%
Grants							1,174.0		6,261.7	
TOTAL REVENUE & GRANTS	53,588.7		45,130.7		54,092.1		70,638.4		75,283.4	
SPENDING										
Transfers (including pension costs)	5,172.2	8%	5,444.4	8%	6,222.2	9%	7,095.9	9%	5,763.8	8%
Interest payments	7,900.6	12%	8,391.8	13%	9,479.4	14%	5,378.3	7%	2,229.9	3%
MDA spending	52,599.8	80%	50,764.9	79%	53,662.0	77%	67,964.1	84%	60,981.5	88%
TOTAL SPENDING	65,672.6	100%	64,601.1	100%	69,363.5	100%	80,438.4	100%	68,975.2	100%
Personnel costs	28,838.1	44%	28,134.7	44%	29,615.5	43%	23,225.7	29%	22,505.3	33%
Purchase of goods & services	13,747.6	21%	13,092.9	20%	14,963.4	22%	28,060.1	35%	27,620.7	40%
Capital expenditure	10,014.1	15%	9,537.2	15%	9,083.1	13%	16,678.3	21%	10,855.4	16%
TOTAL MDA SPENDING	52,599.8	80%	50,764.9	79%	53,662.0	77%	67,964.1	84%	60,981.5	88%
BUDGET BALANCE	(12,083.9)		(19,470.4)		(15,271.4)		(9,800.0)		6,308.3	
NOMINAL GDP	883,543.2		882,660.5		881,778.7		860,271.9		815,423.6	
BUDGET BALANCE AS % OF GDP	-1.4%		-2.2%		-1.7%		-1.1%		0.8%	
Surplus of prior years	25,245.2		25,245.2		7,011.5		3,412.1		25,245.2	
Domestic borrowing (net)	(3,586.0)		(3,586.0)		7,948.4		1,644.2		(5,717.6)	
External borrowing (net)	363.8		363.8		199.0		987.9		363.8	
Other										
TOTAL FINANCING	22,022.9		22,022.9		15,158.9		6,044.2		19,891.3	
Foreign Loans- New Borrowings	443.3		443.3		642.6		1,293.6		443.3	
Repayment during the year	79.6		79.6		443.7		305.7		79.6	
Foreign loan balance	18,444.3		18,080.6		17,716.8		11,279.3		10,830.9	
Domestic- New Loans	-		-		17,651.1		11,129.6		-	
Loan due (repaid) within the year	3,586.0		3,586.0		9,702.7		9,485.5		5,717.6	
Domestic loan balance	52,480.7		56,066.7		59,652.7		27,999.8		9,071.1	

KEY RATIOS	2017e	2016e	2015	2014	2013
Revenue					
IGR as % of GDP	1%	1%	1%	1%	1%
Tax revenue as % of GDP	6%	5%	6%	8%	11%
Total revenue as % of GDP	6%	5%	6%	8%	11%
IGR as % of total revenue & grants	9%	12%	12%	7%	5%
Tax revenue as % of IGR	95%	85%	82%	89%	71%
Growth in tax revenue	60%	12%	-23%	1%	43%
Spending					
Spending as % of GDP	6%	6%	6%	8%	7%
Non-discretionary spending as % of tax revenue	79%	95%	86%	52%	45%
Capital expenditure as % of total spending	15%	15%	13%	21%	16%
Payroll as % of revenue	54%	62%	55%	33%	33%
Other overheads as a % of revenue	26%	29%	28%	40%	40%
Leverage					
Budget balance (₦' mns)	(12,083.89)	(19,470.39)	(15,271.44)	(9,799.95)	6,308.28
Debt as % of nominal GDP	8%	8%	9%	5%	2%
Interest payments as % of total revenue	15%	19%	18%	8%	3%
Principal due as % of Revenue	13%	16%	14%	42%	29%
Financial flexibility					
Discretionary revenue** as % of total revenue	22%	7%	16%	49%	56%
Debt as % of Free cash flow***	61%	235%	88%	12%	52%
Share of savings in "excess crude account" (₦' mns)					
Non-discretionary Spending** as % of total spending	64%	65%	65%	44%	44%
Outstanding Debt/Revenue*	13%	16%	14%	57%	29%
* Annualized					
** Non-discretionary spending is made up of statutory transfers, interest payments and personnel costs					
** Discretionary revenue is total revenue minus non-discretionary spending					
*** Annualized free cash flow is defined as revenue minus non-discretionary spending					

RATING DEFINITIONS

Aaa	Highest quality debt issue with minimal credit risk; strongest capacity to pay coupon and principal on local currency debt in a timely manner.
Aa	High quality debt issue with very low credit risk; very strong capacity to pay coupon and principal on local currency debt in a timely manner.
A	Good quality debt issue with low to moderate credit risk; strong capacity to pay coupon and principal on local currency debt in a timely manner.
Bbb	Satisfactory quality with moderate credit risk; adequate capacity to pay coupon and principal on local currency debt in a timely manner.
Bb	Below average quality with moderate to high credit risk; speculative capacity to pay coupon and principal on local currency debt in a timely manner.
B	Weak quality with high credit risk; speculative capacity to pay coupon and principal on local currency debt in a timely manner.
C	Very weak capacity to pay coupon and principal. Debt instrument with very high credit risk.
D	In default.

Rating Category Modifiers

A "+" (plus) or "-" (minus) sign may be assigned to ratings from 'Aa' to 'C' to reflect comparative position within the rating category. Therefore, a rating with + (plus) attached to it is a notch higher than a rating without the + (plus) sign and two notches higher than a rating with the - (minus) sign.

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