



## **MERISTEM EQUITY RESEARCH REPORT**

### **ENERGY COMPANY NIGERIA LIMITED (ENCON)**

### **PRIVATE PLACEMENT OF 3,333,333,334 Ordinary Shares of 50k @ N18/Share**

### **PLACEMENT'S DIGEST**

**Report Date: May 16, 2008.**

### **EXECUTIVE SUMMARY & INVESTMENT RATIONALE**

- Energy Company Nigeria Limited (ENCON) is a wholly owned flagship of Negris Group, an integrated, indigenous energy solutions provider with specialities in comprehensive power/engineering services to the oil and gas, general energy and industrial sectors of the Nigerian economy. Negris' distinctive expertise includes design, detailed engineering, procurement/supply and construction/installation, operation and maintenance of gas turbines and reciprocating engines for power generation applications.
- ENCON's core competencies range from provision of electricity, steam and refrigeration, development of independent power plants as well as sales and support of turbines and reciprocating engines. The company was licensed by the Federal Government of Nigeria to generate, transmit and supply electricity across the country to industrial/corporate and public sector consumers. The company provides these services via its portfolio of power plants operated as independent power producers (IPP) exploiting different project financing schemes such as Build-Own-Operate (BOO), Build-Own-Operate and Transfer (BOOT), Build-Own-Transfer (BOT) and Acquire and Operates (A & O).

- Premised on its commitments to its key strategic intents; viz strengthening its funding capacities for effective and efficient operations as well as **growing and controlling** its share in the budding independent energy producers market via cost leadership, ENCON is making recourse to the primary market for ~~₦~~60bn equity financing.
- Key risks attached to the company's lofty plans and forecasts are **operational risks as the** power industry in Nigeria is faced with significant challenges arising from unreliable supply of gas, which is instrumental to the generation of electricity. Meanwhile, it is hoped that the Federal Government will remain committed to its lead role in guaranteeing a reliable supply of gas and water by channeling substantial funding towards securing these resources to support private investment in power generation. As a proactive measure to cushion this potent risk, ENCON builds plants that use dual fuel gas engines i.e plants with engines that can operate using gas or liquefied products. In addition, a recent publication in the Weekend **Financial Standards** of Friday-Sunday, May 16-18, 2008 reveals that the Federal Government has approved ~~₦~~410 per standard cubic feet of gas as the new penalty fee for flaring of associated gas (AG) by oil firms operating in Nigeria. This shows about 4,000% increase from the former penalty and it is an indication of strict compliance with the domestic gas supply obligation of oil firms.
- **Political risk also exists as** the operations of Independent Power Providers could be adversely affected by the uncertainties that characterise Nigeria's political environment. A cushion for this is the recent policy reforms in the power industry which is expected to be sustained by successive regimes as the sector occupies a prime place in the next developmental stage of the country. There is also **competitive risk** consequent on the deregulation of the power sector; the company is prone to face stiff competition as more IPPs are licensed to operate due to the sector's attractiveness to sophisticated investors. However, this risk is mitigated by the huge supply gap between electricity generation and consumption. Similarly, high capital intensity of the project also limits barrier to entry and largely mitigates competitive risk. **ENCON enjoys a first mover advantage to position itself as industry leader.**

- We recommend the **PLACEMENT** for **medium to long term investment horizons** given the nature of the company's operations which require huge capital outlay (a **'star' business**) and high gestation period for investment maturity. Forecasted distributable earnings show its suitability for value investors with high appetite and strong bias for growth rather than instant capital appreciation.

### **PURPOSE OF THE PLACEMENT:**

ENCON is motivated to source for long term equity capital primarily by the need to grow its business by building funding capacity for proposed power projects. Other key strategic reasons for this option are: gaining competitive cost advantage to effectively compete with other formidable players such as **Shell, Chevron** in the emerging power industry; enjoying economies of scale through expansion of the capacity of its existing plant projects and construction of mega power plants. Another motivation is the need to position the company which also implies a shift in strategy from building captive power plants to developing medium to large power plants for national grid supply. This change in strategy is to stimulate a number of benefits or concessions that are provided by government to supplier of power to the grid, e.g. gas price concession. The grid is also expected to provide greater opportunities for capacity growth and increased market share. **The company has identified a number of power projects to which the net proceeds of the placement will be channelled with a view to achieving its key strategic objectives in the medium to long term horizons. These are:**

- Expansion of Ikorodu Power Plant from 10MW to 150MW using 4 x 35MW gas turbines **(representing 27.72% of the placement proceeds translating to ₦16.38bn; US\$140mn).**
- Construction of 100MW (3 x 35MW) gas turbine Independent Power Project for Lekki **(representing 23.76% of placement proceeds equal to ₦14.04bn; US\$120mn)**
- Development of captive power projects for identified large consumers of electricity, oil and gas freezone **(representing 13.86% of placement proceeds, valuing ₦8.19bn; US\$70mn).**
- Expansion of Ewekoro Power Projects from 12.50MW to 45MW using 5 x 8.5MW dual fuel gas engines. **(representing 9.90% of placement proceeds, ₦5.85bn; US\$50mn)**

- Refinancing of Unilever Independent Power Project (**representing 1.19% of placement proceeds, ₦702 mn; US\$6mn**)
- Refinancing of term loan facility for Ikorodu Power Plant Phase 1 (**representing 0.99% of placement proceeds, ₦585mn; US\$5mn**)

**IMPORTANT INFORMATION:** 10 percent of the shares offering by placement will preferentially be allotted to staff of the Negris Group while 30% is reserved for High Networth Individuals (HNIs) and Institutional Investors who apply for preferential allotment within the first week of the placement. This implies that **ONLY 2billion shares**, representing 60% will readily be available to all other categories of investors.

## **NIGERIAN ENERGY SECTOR CRISIS: THE IMPERATIVE FOR IPP**

- In spite of its promising economic outlook, power supply has been an endemic predicament in Nigeria. Electricity supply has been perennially unreliable. **With a population estimate of over 150 million** and an electricity output of less than 3,000 MW, Nigeria ranks amongst the countries with the lowest electricity per capita in the world. This is manifested in all indices of growth without any solution at sight from the Government.
- Infrastructural deficit remains one of the most severe banes of development in the Nigerian economy today, especially the fragility of the nation's energy sector. As acute shortage of power supply continues to **manifest** in industrial/manufacturing capacity underutilization, governmental initiatives at stemming the ugly trend have always underscored the indispensability of private sector collaborative effort at bolstering energy supply in Nigeria.
- There are consensus of opinions amongst industrialists, technocrats and governments at all levels that a public-private partnership (PPP) approach is inevitable for provision of a long-term solution to the protracted energy sector crisis. Hence, the giant stride by the Federal Government to embark on deregulation policy with a view to integrating private sector collaborative efforts.

## **ABOUT ENERGY COMPANY NIGERIA (ENCON):**

- Energy Company Nigeria Limited (**ENCON**) was incorporated in 1999, but commenced trading in 2005, as a private limited liability Company. It is a wholly owned subsidiary of

**Negris Holdings Limited.** The Company in 1999/2000 was one of the first few companies that secured license from the Ministry of Power and Steel to operate as an IPP and has since then been positioning itself as a leading total Energy Solutions Provider in Nigeria, West Africa, and beyond.

- **The Company** has strategically positioned itself to explore the immense opportunities in independent power generation in Nigeria. ENCON has a rich blend of portfolio of independent power projects ranging from **Ikorodu Industrial Power Project (150MW gas turbine multi-faceted independent power plant for on-grid power supply)**, **Ewekoro Power Limited (12.5MW gas-fired reciprocating independent power plant providing electricity to Lafarge Cement WAPCO Nigeria Plc's factory at Ewekoro, Ogun State)**, **Unipower Agbara Limited (6MW gas-fired captive power plant for Unilever Plc's factory in Agbara, Ogun State)**, **Ilupeju Power Limited (1.2MW gas-fired reciprocating independent power plant providing electricity to Academy Press Plc, Ilupeju, Lagos State)**.
- For obvious strategic sentiments, ENCON selected Ikorodu IPP to provide flexibility for grid and off grid connections as the market for sale of electricity to industrial high load consumers continues to expand in an emerging economy like Nigeria.

#### **FUTURE STRATEGIC PLANS:**

- As part of its medium to long term strategic initiatives, the company has already secured power generation licence from the National Electricity Regulation Commission (NERC) and a transmission pact has been signed with the Transmission Company of Nigeria.
- ENCON is set to embark on Ikorodu Industrial Power Phase 2, a simple cycle and gas turbine driven 140MW power project which is designed to provide electricity to the national grid as well as the fast growing industrial consumers in the vicinity. The Company also intends to convert the plant to a combined cycle power plant with a view to increasing output and energy efficiency.

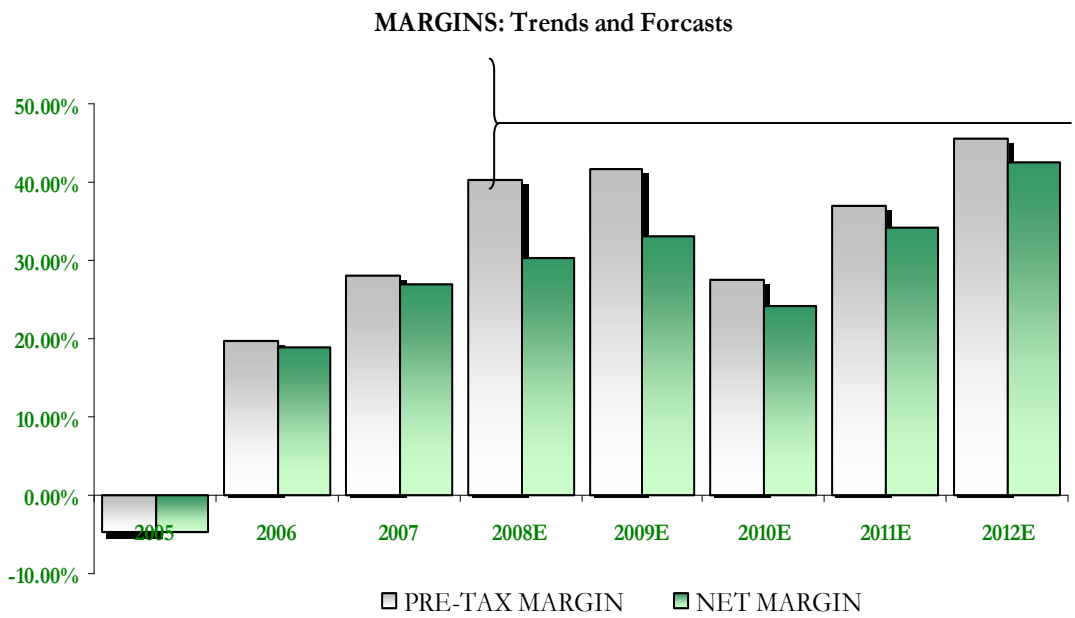
- The company is also bidding to execute additional captive power projects for one of its existing clients-Lafarge Cement WAPCO Plc. This project is expected to cover the construction of a 45MW gas-driven reciprocating engine plant for Ewekoro Cement Factory; 20MW additional capacity for the existing plant owned by ENCON which supplies power to Ewekoro Cement Factory; and a 45MW gas driven reciprocating engine plant for the cement factory at Sagamu, Ogun State.
- A 100MW (3 x 35MW gas turbine) Lekki Power Project is also at the conception stage. This will supply electricity to another high profile clientele group - NICON/CHEVRON Estates, Palm Spring Estate among others. The company intends to interconnect the plant to the national grid by taking advantage of open access structure of the system and leveraging on capacity growth in the future.
- ENCON has also won a bid to set up 140MW (4 x35MW gas turbine) IPP for the Nigerian Ports Authority (NPA), Onne, Rivers State as a base load facility to meet NPA's power requirement at Onne Oil and Gas Free Zone and other associated operations.
- There are also a number of small captive projects for industrial and commercial consumers who desire dedicated power supply on an outsourced arrangement. These projects are at various stages of development. ENCON projects a conservative minimum combined capacity of 50MW in the next three years for this class of consumers.
- The company has also committed significant resources towards Research and Development, with the primary aim of diversifying Power generation (i.e. using Renewable Energy technologies) which are more efficient, more environmental friendly and cheaper than current power generation.

## **ENCON: FINANCIAL PERFORMANCE APPRAISAL**

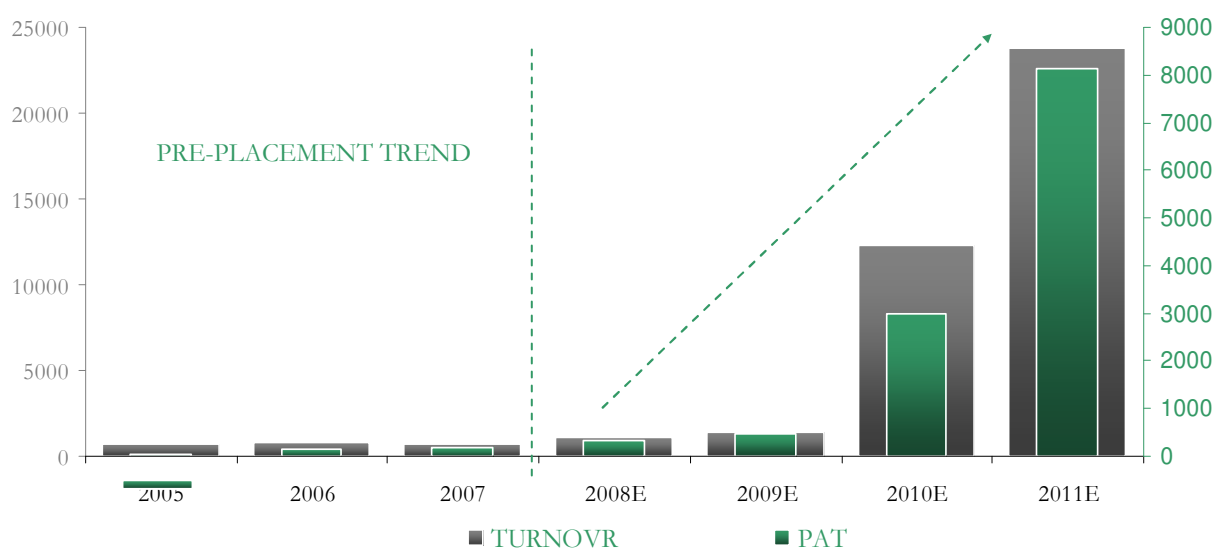
- In terms of profitability, **ENCON's** performance over the years has been commendable. Since it commenced operation in 2005, the company's gross margin has averaged 87.30% while its net profit margin has increased substantially from a loss position of -40.0% in its first year of operation. Although turnover rose marginally by 10% between 2005 and 2007,

having cut its huge administrative expenses by over 50%, the company's gross margin stood at about 26.9% in 2007.

- Apparently due to the peculiar nature of its line of business with high level of requisite cash injections, ENCON has maintained a sufficiently liquid position over the last 3 years. The company's current ratio rose from 0.14 in 2005 to 1.22 in 2007 thus recording a sharp increase of 771.4%. It currently stands at 1.08 meaning that its readily realizable assets cover over 100 percent of its short term liabilities.
- ENCON has exhibited a strong long term liquidity status as revealed by consistent fall in its Debt ratio and Debt to Equity ratio from 0.98 x and 26.28 x respectively in 2005 to 0.28 x and 2.52 x respectively in 2007. This is attributable to year-on-year strengthening of its capital structure through equity financing. Also, the company has demonstrated continuous improvement in operational efficiency over the years as earnings before interest and tax (EBIT) readily covers its interest obligations. Its Times interest earned moved from 0.77 in 2005 to 2.52.
- In addition, over the past three years, the company's shareholders fund leapfrogged to N2.65bn in 2008 from N75.5m in 2005.



## TREND/FORECAST IN TOP AND BOTTOM LINES



## APPENDICES:

### Forecasts:

← 31 December →

	2008 N'm	2009 N'm	2010 N'm	2011 N'm	2012 N'm
Gross Revenues	1,085	1,399	12,283	23,756	24,350
Operating Expenses	(473)	(609)	(7,130)	(11,608)	(9,922)
EBITDA	612	790	5,153	12,148	14,428
Depreciation	(174)	(208)	(1,789)	(3,369)	(3,369)
Profit Before Taxation	438	582	3,364	8,779	11,059
Estimated Taxation	(108)	(118)	(382)	(660)	(677)
Profit after Taxation	330	464	2,982	8,119	10,382
Appropriation					
Dividends	(188)	(275)	(1,747)	(3,440)	(4,556)
Retained Earnings	142	189	1,235	4,679	5,826

Source: Company's Placement Memorandum

The Company will commission its proposed power plants with ratings and annual sales as follows:

Location of Plant	Start Date	Plant Capacity (kW)	Availability (Hours)	Availability (%)
Ewekoro (1)	Existing	12,500	7,884	90%
Ikorodu (1)	June 2008	9,000	8,260	94%
Agbara	June 2008	6,000	8,410	96%
Ilupeju	June 2008	1,320	8,700	99%
Lekki	June 2010	125,000	7,884	90%
Ikorodu (2)	June 2010	140,000	7,884	90%
Shagamu	June 2010	70,000	8,300	95%
Onne	June 2010	68,000	7,884	90%
Ewekoro (2)	June 2010	32,000	7,884	90%

Source: Company's Placement Memorandum

The analysis of revenues:

	← 31 December →				
	2008	2009	2010	2011	2012
	₦'million	₦'million	₦'million	₦'million	₦'million
Ewekoro (1)	645	661	678	695	712
Ikorodu (1)	262	430	440	451	463
Agbara	143	252	258	265	271
Ilupeju	35	56	58	60	62
Lekki	-	-	3,130	6,417	6,577
Ikorodu (2)	-	-	3,060	6,273	6,430
Shagamu	-	-	1,930	3,956	4,055
Onne	-	-	1,677	3,437	3,523
Ewekoro (2)	-	-	1,052	2,202	2,257
<b>Total</b>	<b>1,085</b>	<b>1,399</b>	<b>12,283</b>	<b>23,756</b>	<b>24,350</b>

Source: Company's Placement Memorandum

## THREE-YEAR HISTORICAL FINANCIAL SUMMARY

### ADJUSTED BALANCE SHEETS

	31 December					
	← 2005 GROUP ₦'000	COMPANY ₦'000	2006 GROUP ₦'000	COMPANY ₦'000	2007 GROUP ₦'000	COMPANY ₦'000
<b>ASSETS</b>						
Fixed Assets	2,017,220	87,367	2,222,867	440,377	2,517,004	885,034
Investments	1,982,370	1,994,870	2,629	2,629	611,533	2,175,180
<b>Current Assets</b>						
Stocks	66,359	-	66,359	-	66,359	-
Debtors	221,309	73,198	210,489	94,824	190,652	52,094
Prepayments						
Amounts due from						
Associated coys	3,827	3,827	43,518	14,379	81,607	95,173
Cash and Bank	36,921	31,377	89,024	38,295	241,924	152,295
<b>Total Assets</b>	<b>4,328,006</b>	<b>2,190,639</b>	<b>2,634,886</b>	<b>590,504</b>	<b>3,709,079</b>	<b>3,359,776</b>
Less: Amounts falling due within one year						
Trade & other	(2,267,672)	(8,416)	(169,533)	(18,517)	(116,409)	(17,435)
Creditors						
Due to related	-	-	-	-	(26,497)	(26,497)
Companies						
Borrowings	-	-	(23,460)	-	(317,156)	(288,674)
Taxation	(392)	-	(8,071)	-	(16,156)	(4,496)
<b>Current Liabilities</b>	<b>(2,268,064)</b>	<b>(8,416)</b>	<b>(201,064)</b>	<b>(18,517)</b>	<b>(476,218)</b>	<b>(337,102)</b>
<b>Net Current Assets</b>	<b>(1,939,648)</b>	<b>99,986</b>	<b>208,326</b>	<b>128,981</b>	<b>104,324</b>	<b>(37,540)</b>
Less: Amounts falling due within one year						
Borrowings	(1,984,442)	(1,984,442)	(2,174,069)	(367,908)	(578,045)	(578,045)
<b>Net Assets</b>	<b>75,500</b>	<b>197,781</b>	<b>259,753</b>	<b>204,079</b>	<b>2,654,816</b>	<b>2,444,629</b>
<b>CAPITAL &amp; RESERVES</b>						
Share Capital	26,000	26,000	51,000	51,000	2,499,958	2,499,958
Deposit for	297,791	297,791	272,562	272,562	-	-
Shares						
Profit & Loss Account	(248,291)	(126,010)	(63,809)	(119,483)	154,858	(55,329)
<b>Shareholders' Fund</b>	<b>75,500</b>	<b>197,781</b>	<b>259,753</b>	<b>204,079</b>	<b>2,654,816</b>	<b>2,444,629</b>

Source: Company's Placement Memorandum

## Adjusted Profit and Loss Accounts

	NOTES	2005 GROUP N'000	COMPANY N'000	2006 GROUP N'000	COMPANY N'000	2007 GROUP N'000	COMPANY N'000
<b>ASSETS</b>							
Fixed Assets	1	2,017,220	87,367	2,222,867	440,377	2,517,004	885,034
Investments	2	1,982,370	1,994,870	2,629	2,629	611,533	2,175,180
<b>Current Assets</b>							
Stocks		66,359	-	66,359	-	66,359	-
Debtors	3	221,309	73,198	210,489	94,824	190,652	52,094
Prepayments							
Amounts due from							
Associated coys	4	3,827	3,827	43,518	14,379	81,607	95,173
Cash and Bank	5	36,921	31,377	89,024	38,295	241,924	152,295
Total Assets		4,328,006	2,190,639	2,634,886	590,504	3,709,079	3,359,776
Less: Amounts falling due within one year							
Trade & other	6	(2,267,672)	(8,416)	(169,533)	(18,517)	(116,409)	(17,435)
Creditors							
Due to related		-	-	-	-	(26,497)	(26,497)
Companies							
Borrowings	7	-	-	(23,460)	-	(317,156)	(288,674)
Taxation		(392)	-	(8,071)	-	(16,156)	(4,496)
<b>Current Liabilities</b>		<b>(2,268,064)</b>	<b>(8,416)</b>	<b>(201,064)</b>	<b>(18,517)</b>	<b>(476,218)</b>	<b>(337,102)</b>
<b>Net Current Assets</b>		<b>(1,939,648)</b>	<b>99,986</b>	<b>208,326</b>	<b>128,981</b>	<b>104,324</b>	<b>(37,540)</b>
Less: Amounts falling due within one year							
Borrowings		(1,984,442)	(1,984,442)	(2,174,069)	(367,908)	(578,045)	(578,045)
<b>Net Assets</b>		<b>75,500</b>	<b>197,781</b>	<b>259,753</b>	<b>204,079</b>	<b>2,654,816</b>	<b>2,444,629</b>
<b>CAPITAL &amp; RESERVES</b>							
Share Capital	8	26,000	26,000	51,000	51,000	2,499,958	2,499,958
Deposit for	9	297,791	297,791	272,562	272,562	-	-
Shares							
Profit & Loss Account		(248,291)	(126,010)	(63,809)	(119,483)	154,858	(55,329)
<b>Shareholders' Fund</b>		<b>75,500</b>	<b>197,781</b>	<b>259,753</b>	<b>204,079</b>	<b>2,654,816</b>	<b>2,444,629</b>

Source: Company's Placement Memorandum

### DISCLOSURE:

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