



CARDINALSTONE

TRANSCORP POWER PLC INITIATION OF COVERAGE

Turn on the lights

March 2024



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TRANSCORP POWER PLC

Turn on the Lights

BLOOMBERG: TRANSPOWER

BUY

Target Price: N323.64

CardinalStone Research
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We initiate coverage on Transcorp Power Plc (TPP) with a 12-month Target Price (TP) and projected market capitalisation of N323.64 and N2.4 trillion, respectively. Our TP implies a price return of 22.6% and a BUY recommendation on the stock. Our outlook on the stock is premised on projected improvements in return metrics and is consistent with the following:

- ◆ The company currently accounts for 7.0% of Nigeria's installed grid capacity but generates 10.0% of the country's power needs, with its leadership position in the West African Power Pool (WAPP) and planned strategic alliances with DISCOs, eligible customers, and state governments leaving legroom for output growth in the near term.
- ◆ The material export component of revenue is likely to continue providing some important hedge against the negative impact of Naira devaluation on costs linked to energy and equipment maintenance.
- ◆ The company's average dividend payout ratio of c.75.0% over the last five years is materially higher than the mean of 48.0% for EMEA peers ex GEREGU over the same period. Our expectations for operating cash flow and dividend paid CAGRs of 17.4% and 26.1%, respectively, between FY'24 and FY'28, are likely to keep investors mostly interested in the stock in the near to medium term.
- ◆ Our projection for a relatively low mean financial leverage of 328.6% over our forecast horizon (vs 487.3% in the last five years) and robust cash position make the ticker suitable for investors looking to outperform in a macroeconomic environment characterised by hawkish monetary policy and rising interest rates.
- ◆ The government's plan to clear legacy debt owed to power sector players bodes well for receivables management and the overall cash flow position of the company.
- ◆ The company's involvement in the black starting of the entire grid upon collapses may have conferred a level of systemic importance that may be critical to its outlook.

Valuation: We deployed a discounted cash flow (DCF) methodology to arrive at our TP. The DCF methodology resulted in a 12-month equity value of N2.4 trillion for TPP and a TP of N323.64/share. The assumptions underlying our DCF include a beta of 0.62 (using beta conversion with GEREGU as the listed peer), a terminal growth of 5.0%, a cost of equity of 24.2%, and an effective interest rate on debt of 11.5%.

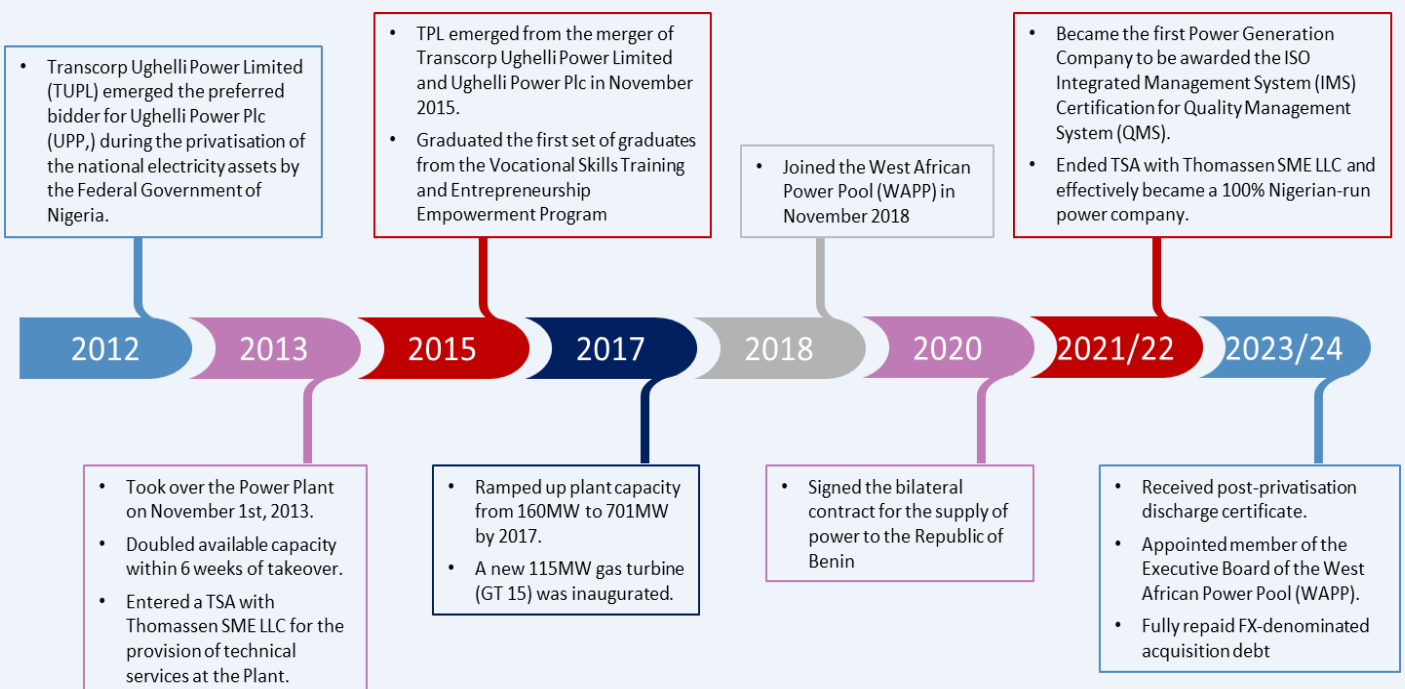
Risks to expectations: In this report, we have identified the following broad categories of risks, namely: 1) risk of Naira devaluation, 2) risk of competition, 3) risk of unfavourable changes in interest rates, and 4) risk of higher trade receivables balances.



Introduction

ABOUT TRANSCORP POWER PLC

Figure 1: History and Key Milestones



Source: Company presentation, CardinalStone Research.

Figure 2: Board of Directors

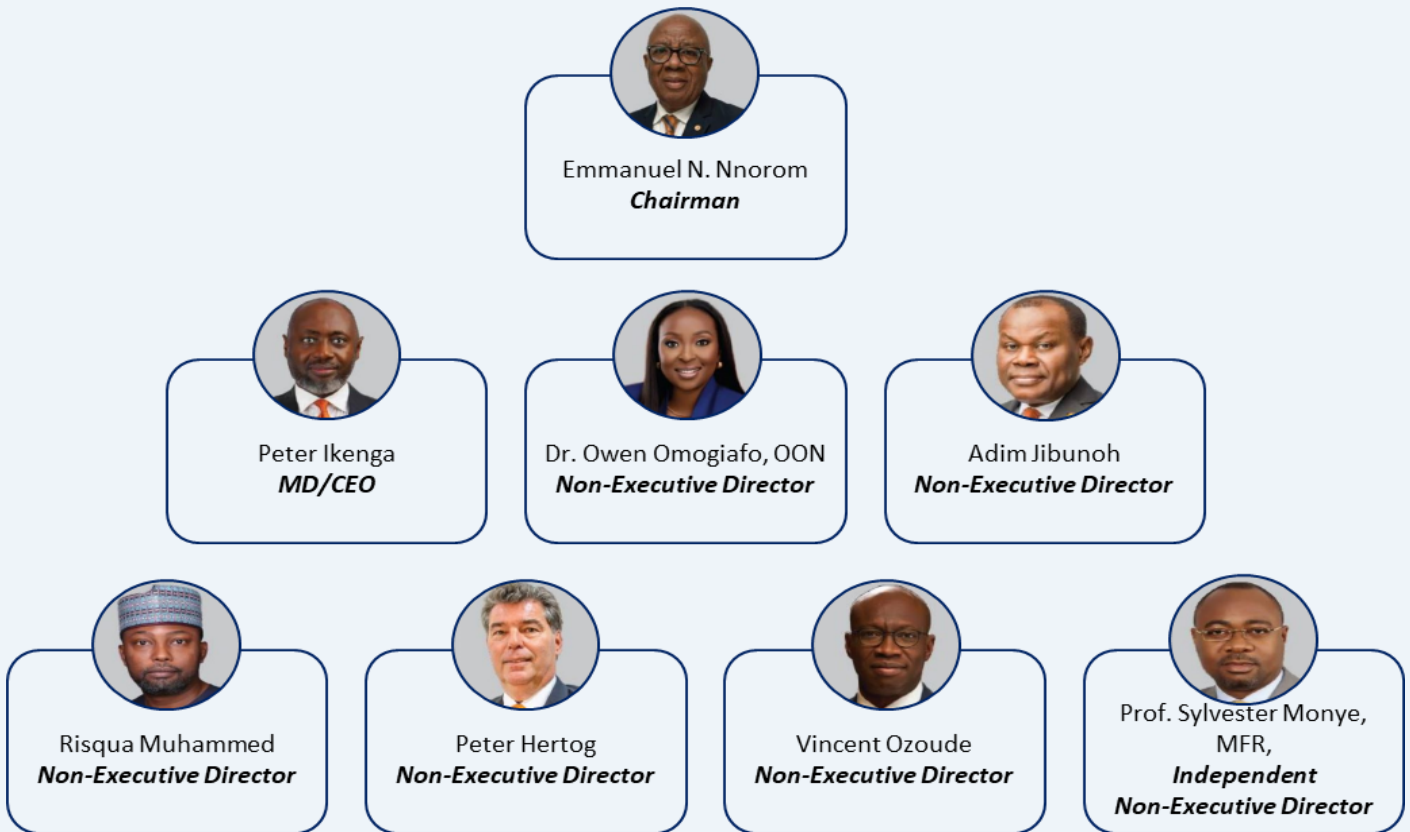
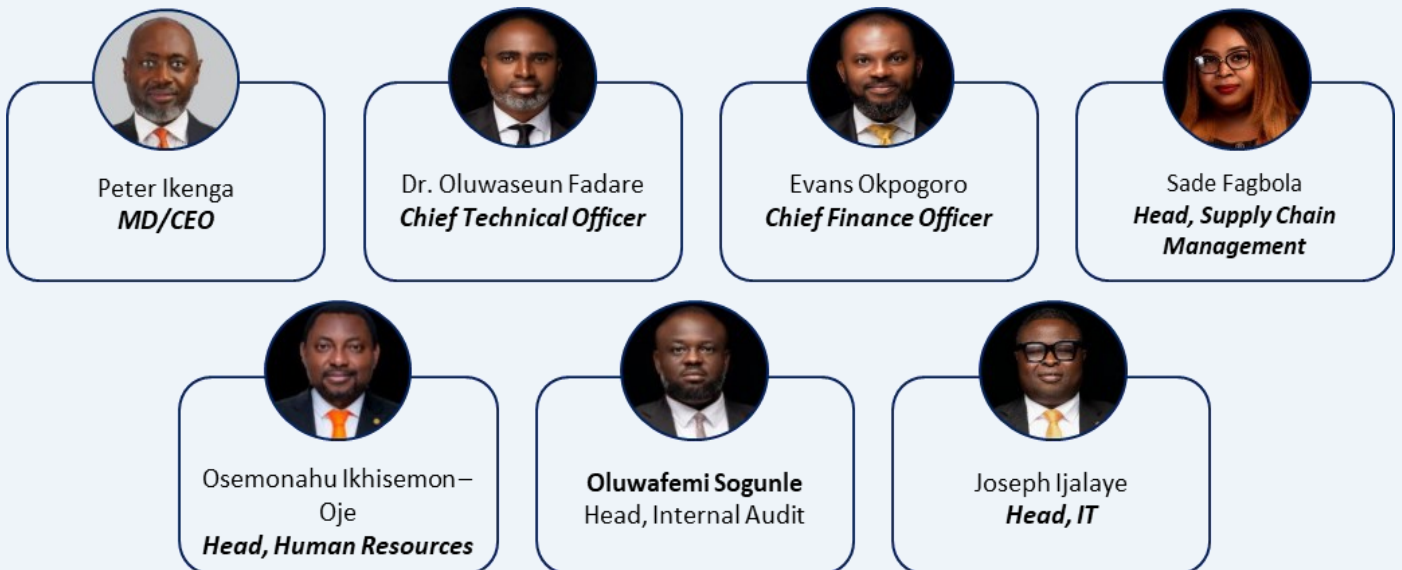


Figure 3: Management Team

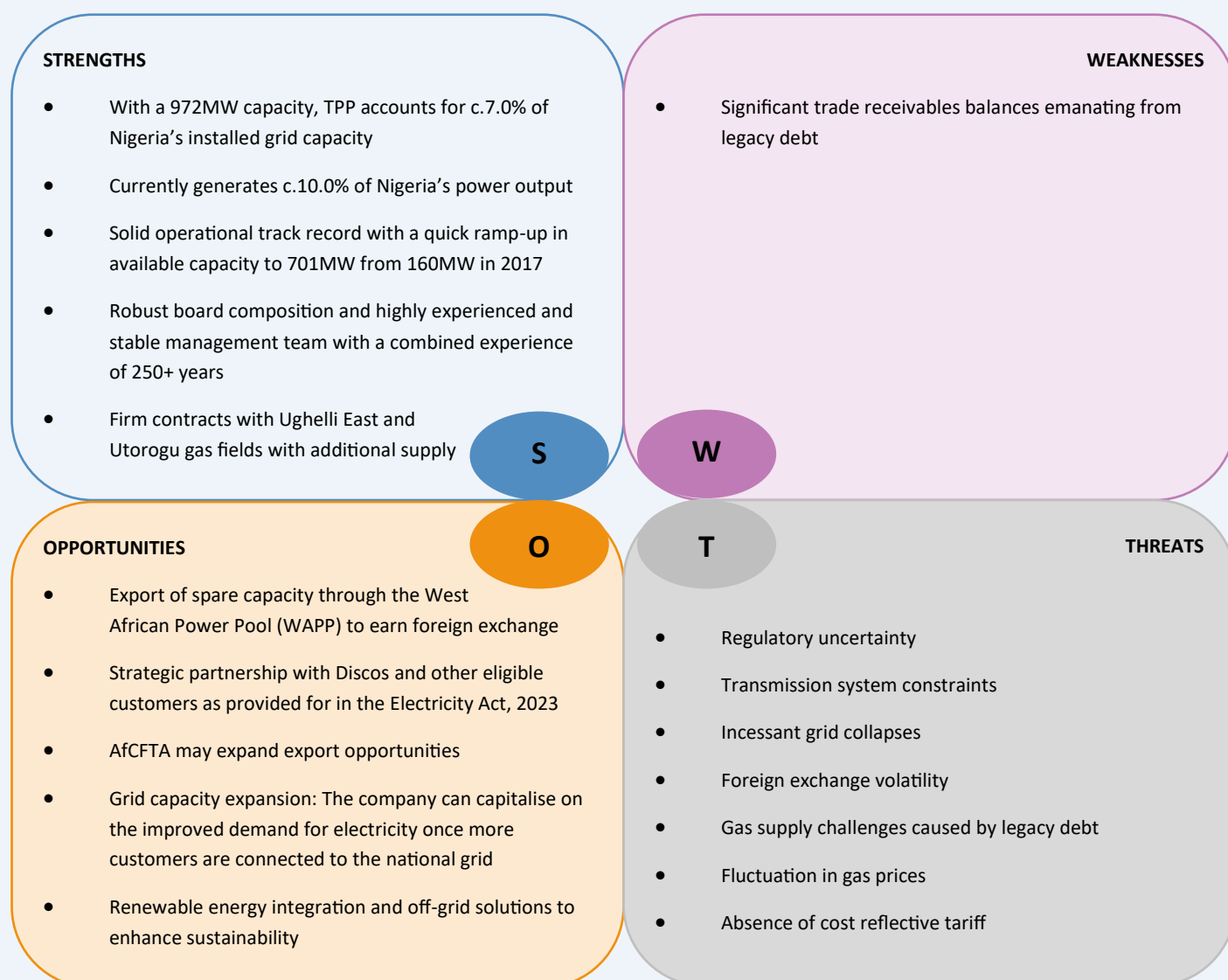


Source: Company presentation, CardinalStone Research

Figure 4: Shareholding Structure

Shareholders	Number of shares	Proportion (%)
Transnational Corporation Plc	3,867,409,318	51.6%
RichPoint Limited	2,495,397,959	33.3%
Woodrock Energy Resources Limited	560,506,826	7.4%
Seaforce Investments Limited	270,090,268	3.6%
Thomassen Holding Limited	192,898,378	2.6%
HH Capital Limited	49,880,886	0.7%
Mr. Emmanuel Nnorom	17,349,873	0.2%
Dr. Owen D. Omogiafo, OON	17,349,873	0.2%
Mr. Christopher Ezeafulukwe	10,843,671	0.1%
PSL Engineering and Control Limited	9,298,011	0.1%
Mr. Samuel Nwanze	8,674,937	0.1%
United Capital Trustees Limited	300,000	0.0%
Total	7,500,000,000	100.0%

Figure 5: SWOT Analysis



Source: Company presentation, CardinalStone Research



Sector Overview

REFORMS BRIGHTEN SECTOR OUTLOOK

Passage of Electricity Act drives renewed hope in power sector

The Nigerian power sector reform reached new heights with the accenting of the amended Electricity Bill in February 2023. With the new Electricity Act, efforts to decentralise the Nigerian electricity supply industry finally yielded results, as constitutional barriers over authority to legislate on power-related issues were finally resolved, and incentives to encourage renewable energy sources were simultaneously introduced. The provisions now allow states to generate, transmit, and distribute electricity within their respective domains.

There is also leeway for state-licensed private sector investors (companies and individuals)¹ to support state-focused electricity markets by engendering greater competition, efficiency, and transparency. That said, states are required to first enact their electricity market laws before they or private sector investors can participate in the generation, transmission, and distribution of electricity. The Nigerian Electricity Regulatory Commission (NERC) also remains the apex regulator in the industry, retaining powers to licence and regulate players in the generation, transmission, system operation, distribution, supply, and trading segments of the electricity market. The regulator also has the power to delegate regulatory authorities to state regulators and sanction licensees in deserving circumstances.

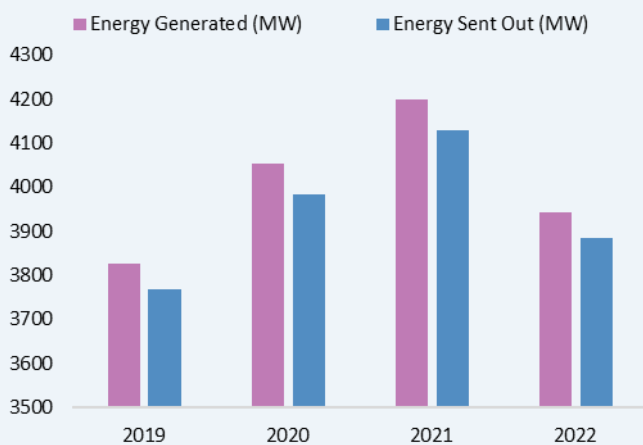
¹However, private individuals are allowed to construct, own, or operate an undertaking for the purpose of generating or distributing electricity even without a license, provided generation does not exceed 1MW or distribution does not exceed 100KW.

In Nigeria, there are three key players in the power sector value chain. They include the 26 power generating companies (GENCOs), the 11 electricity distribution companies (DISCOs), and the Transmission Company of Nigeria (TCN), which the federal government manages.

Generation capacity continues to lag 2021 highs

The average available generation capacity was 2.5% lower YoY in 2023, following a steeper contraction in 2022 (-14.0% YoY to 5254.03 MW). The drags to generation capacity have largely reflected issues around gas constraints, routine maintenance, and technical mechanical faults. In particular, the legacy lack of liquidity and payment assurance (especially for gas suppliers) was a major bane to generation and the capacity to carry out routine maintenance of machines, with the latter cascading to unscheduled outages. However, aided by the escrow arrangement aimed at improving the visibility of collection, power distribution companies have been recording notable improvements in revenue collection. The average load factor² also improved to 93.2% in 2023 (vs 86.1% in 2022), indicating an increase in load factor offtake by distribution companies and explaining the corresponding increase in revenue.

Figure 6: Energy generated has moderated from 2021 levels

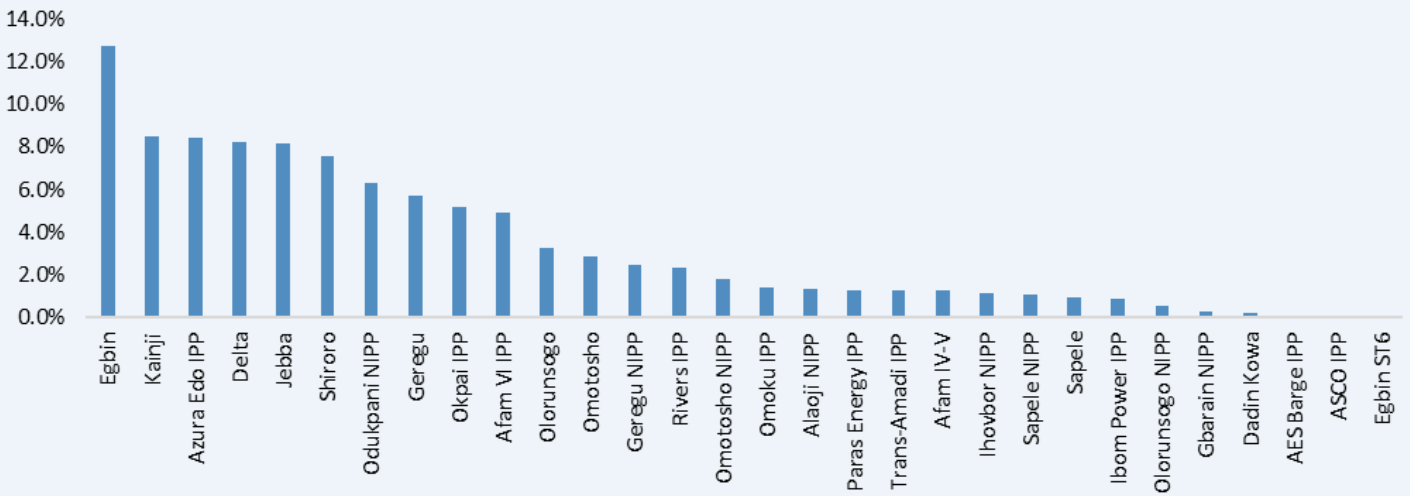


Source: NERC, CardinalStone Research

The competitive landscape in the generation sub-segment

In terms of market share by electricity output, Egbin GENCO boasts the largest market share in the energy generation space. The Egbin plant is closely trailed by Kainji, Aura Edo IPP, and Delta GENCOs in terms of share of the market. Nigeria's listed companies, GEREGU and TPP, have plants that are mostly gas powered and are respectively located in the North Central (14.5% of the total population) and South-South (14.3% of the total population) geopolitical zones of the country.

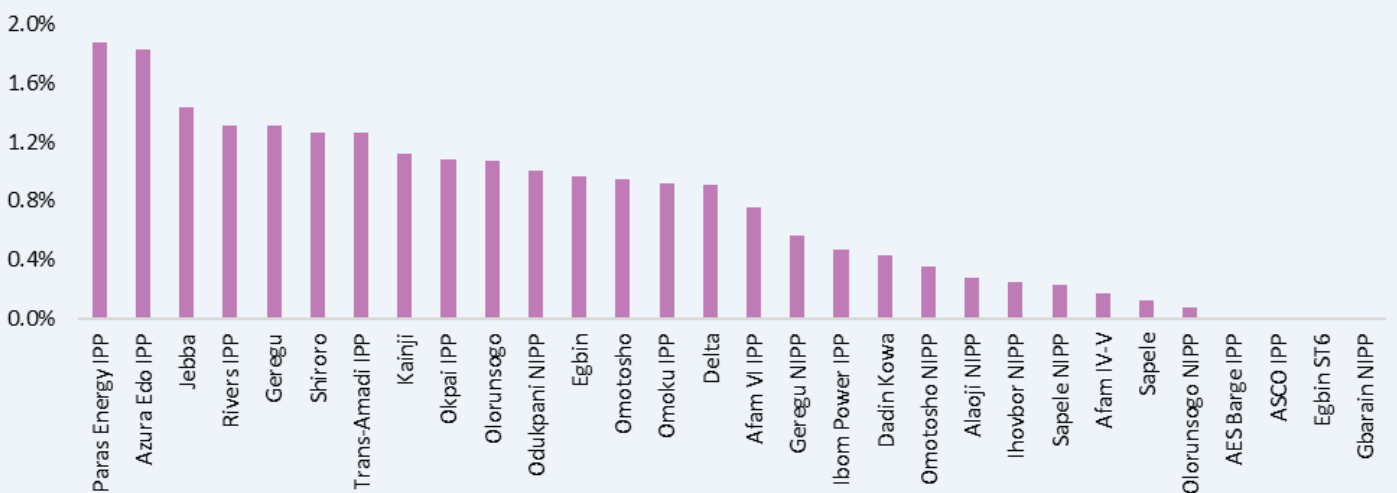
Figure 7: Average share of generated output by GENCOs (2019 to 2022)



Source: NERC, CardinalStone Research

As a proxy gauge of efficiency in the power generation sub-segment, we adopted the percentage of electricity output per capacity across the space (using 2019 to 2022 data provided by NERC). The results revealed Paras Energy IPP and Azura Edo IPP as clear industry leaders using this metric. These GENCOs were closely followed by Jebba, Rivers IPP, Geregu, and Shiroro on the basis of this assessment. We, however, note that the relatively low electricity output per capacity for some younger plants may be the consequence of the ramping-up process. For such companies, the low ratios may even be an indication of the vast potential that could be tapped in the medium to long term. Such potentials are even likely to attract strategic investors looking to unlock alpha in the energy generation market, especially given the recent regulatory incentives.

Figure 8: Percentage of electricity output per capacity (2019 to 2022)



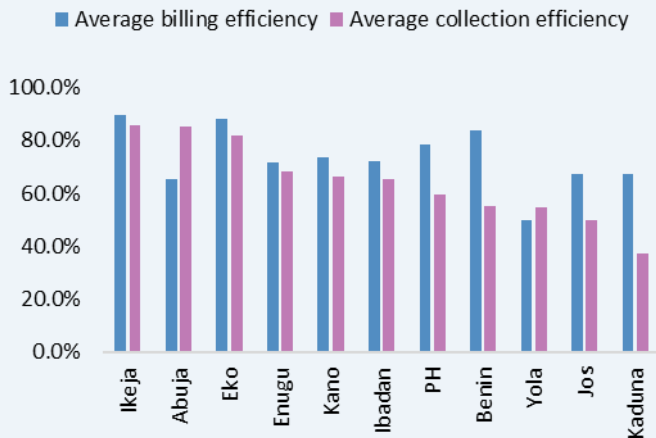
Source: NERC, CardinalStone Research

DISCOs continue the revenue ramp-up, but more needs to be done

In line with the aforementioned, DISCOs improved revenue collection by 55.1% to N841.8 billion between 2020 and 2022, with corresponding collection efficiency improving from 66.5% in 2020 to 71.0% in 2022. As of Q3'23, collection efficiency had improved to 76.6% - suggesting further possibilities of improvements in liquidity for the entire power value chain. The improvement notwithstanding, the figures show that for every N100.00 worth of energy billed, N23.40 is not collected (vs c.N29.00 in 2022). The drags to collection efficiency continued to reflect legacy issues such as 1). A lack of willingness to pay when due on the part of consumers, 2). Dissatisfaction with DISCOs' services; 3). Inadequate customer metering; 4). Energy theft, and 5). Technical losses.

Abuja and Eko DISCOs continue to lead the pack in terms of billing efficiency with 81.4% and 84.3%, respectively, in Q3'23. This performance closely mirrors the high metering rates of the companies. Ikeja DISCO also boasts a high billing efficiency that can be explained by its superior metering rate as well.

Figure 9: Average billing and collection efficiencies across DISCOs



Source: NERC, CardinalStone Research

*PH is Port Harcourt

Figure 10: Electricity supply (GW/h)

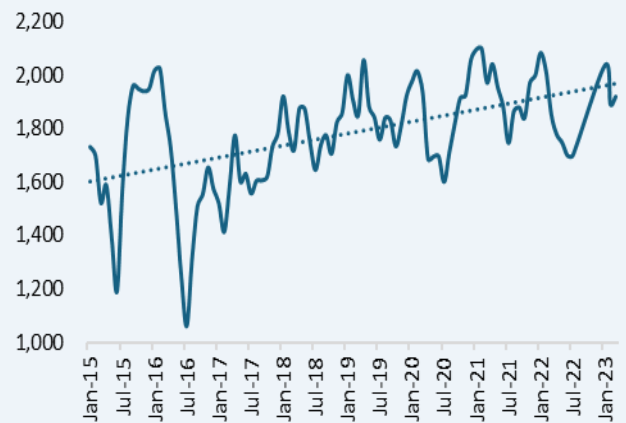
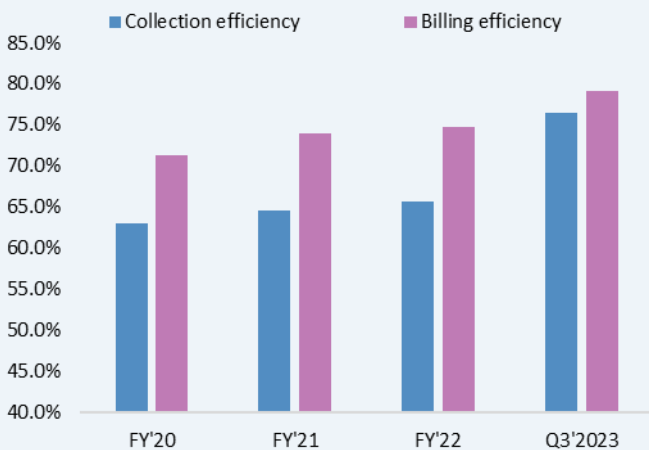
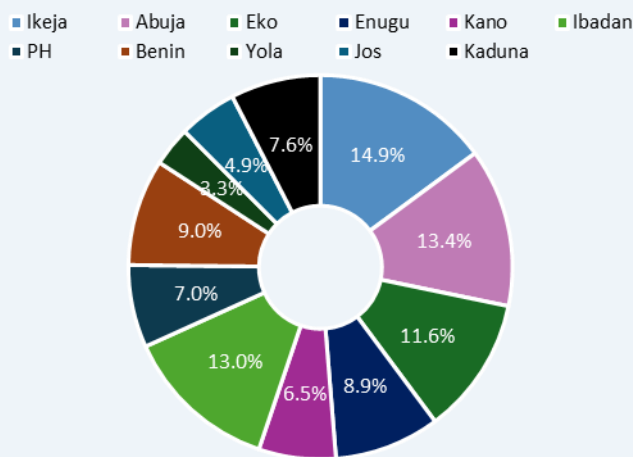


Figure 11: Collection and billing efficiencies have materially improved



Source: NERC, CardinalStone Research

Figure 12: Distribution of overall energy received by DISCOs (2020 to 2022)



Transmission: The battle to contain incidences of grid collapses goes on

Aided by Transmission Service Provider and System Operator licenses, TCN has the responsibility of maintaining transmission infrastructure, system stability, and load balance and dispatch. The TCN aims to make the grid achieve the desired state by tracking the following performance indicators: 1) Transmission loss factor³; 2). Stability of grid frequency⁴; 3). Voltage fluctuation⁵; and 4). Incidence of system collapse⁶.

In 2022 and 9M'23, data suggests that the grid was operating close to extreme stress frequencies, leading to significant disruptions. Hence, the number of grid collapses doubled YoY to 4 in 2022 and a further two collapses in 9M'23. Each time there is a grid collapse, there is the need to black start the system to get power up and running across the country. In recent years, this black-start function has been carried out by TPP (historically part of its ancillary services) at little or no cost to NERC or other players in the power value chain. This 'corporate social responsibility' highlights the systemic importance of the company within the Nigerian power ecosystem.

To contain incidences of grid collapses, NERC is embarking on strict monitoring of GENCOs to ensure compliance with System Operator (SO) directives to generators on the free governor and frequency control modes. The institution is also trying to drive the enforcement of under frequency load shedding scheme, instituted to provide extra security in the event of grid collapses.

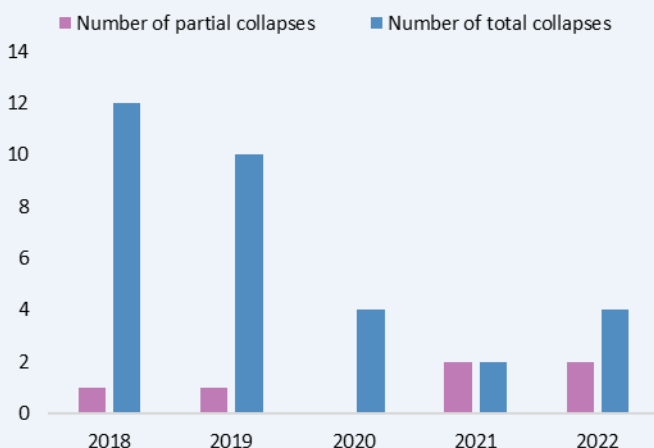
³Proportion of energy lost during transfer of power from GENCOs to DISCOs.

⁴The grid code specifies that system frequency is supposed to be between 49.75Hz and 50.25Hz (allowance of +/- 0.5%) normally or between 48.75Hz and 51.25Hz (allowance of +/- 2.5%) under extreme circumstances.

⁵To guarantee high-quality power, the Grid Code specifies a nominal system voltage of 330kV with a tolerance range of +/- 5% (313.5kV to 346.5kV).

⁶System/grid collapses (partial of full) are usually the result of material deviations from stability ranges in voltage and frequency.

Figure 13: Historical records of grid collapses



Source: NERC, CardinalStone Research



Financial Analysis

POWERED BY CAPACITY & FAVOURABLE PRICES

TPP grew revenue at a CAGR of 25.2% between FY'19 and FY'23, aided by improvement in capacity utilisation (+11ppts to 77.7% between FY'20 and FY'23), c.16.2% increase in generated capacity paid to 358 MW in the last four years, and positive translation effect of naira depreciation (mean annual weakness of 23.0% since FY'20) on tariff rates on capacity and energy. Riding on the mentioned drivers, revenue from energy delivered and revenue from capacity charge grew at CAGRs of 27.4% and 21.4%, respectively. Capacity charges, in this context, refer to revenue earned from providing capacity or the ability to generate electricity, regardless of whether that capacity is utilised or not. These charges are often the result of long-term contractual contracts with electricity purchasers and are usually in the form of fixed charges. The energy revenue component refers to revenue earned from the actual energy supplied to customers.

Further decomposition of revenue revealed that the exportation of power generated accounted for 16.1% of revenue in FY'23, compared to 3.3% in FY'20. The FX inflows from this strategic exportation partially helped the company offset some of the negative impact of the naira devaluation across some other lines of the financial statements (e.g. the company's debt had a very high FX component until FY'23). The company's primary export market is the Republic of Benin, and it is pushing to expand into other West African territories

Figure 14: Ramp-up in capacity utilisation and increases in energy tariff rates were key to revenue traction

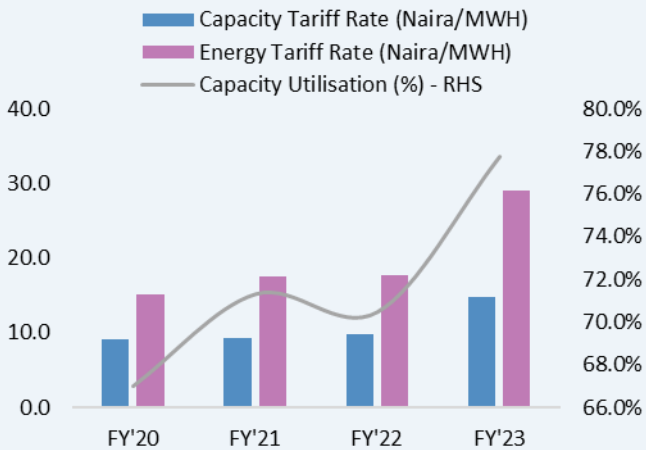
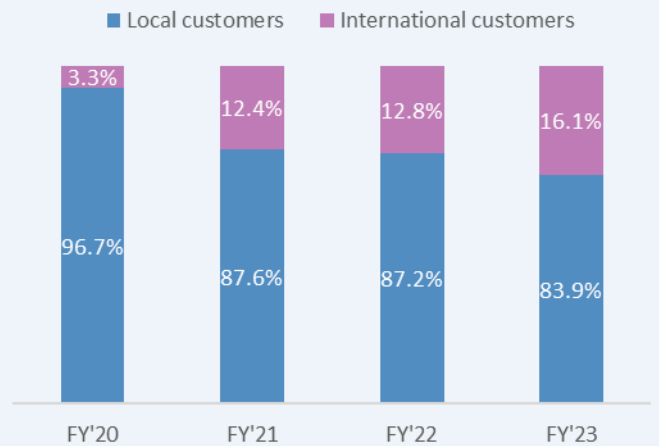


Figure 15: Breakdown of revenue by regional segment



Source: Company Financials, CardinalStone Research

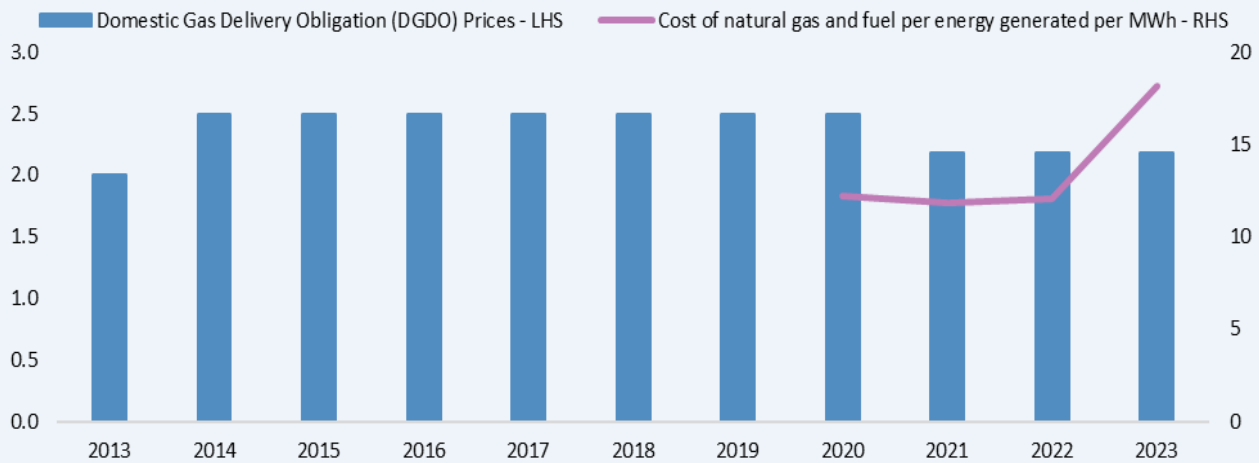
The knock-on effect of robust sales and cost efficiency boosted core profits

Over the last five years, TPP grew EBITDA and EBIT by CAGRs of 33.9% and 36.1%, respectively (vs 15.3% and 20.3%, apiece, for GEREGU). This improvement in core profit principally reflected the mentioned support from favourable changes in the drivers of top-line and relatively benign cost environment in at least three of the last five years. To the latter, we note the relative stability in the cost of natural gas and fuel (c.91.0% of the cost of goods sold since FY'20) per energy generated per MWh in FY'20, FY'21, and FY'22. This cost stability was despite the notable increase in production in the period, evidenced by the 5.6% average growth in energy generated per MWh in FY'20, FY'21, and FY'22. Importantly, we note the drop in the cost of natural gas and fuel occasioned by the federal government's decision to reduce the price of gas to power plants from \$2.50/standard cubic feet to \$2.18/standard cubic feet in FY'21.

In addition to the impact of the government's initiative, TPP signed a Gas Supply and Aggregation Agreement in FY'22 that improved the supply of gas (c.124 MMSCF per day) and reduced the impact of supply volatility on cost.

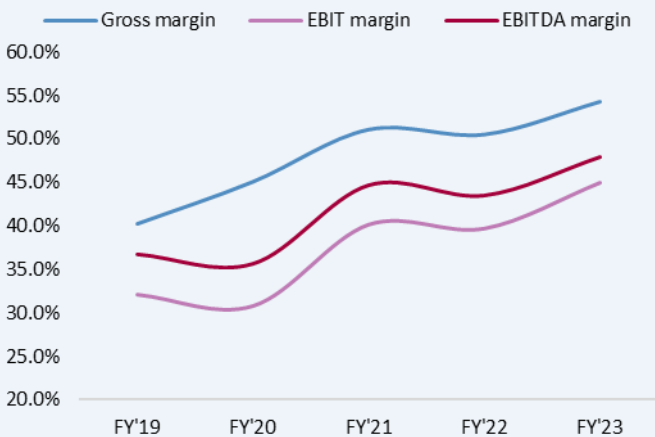
That said, in FY'23, the lagged impact of naira depreciation on gas prices pressured TPP's energy cost. Specifically, the devaluation bloated gas payment in Naira terms even though the government retained its fixed price of \$2.18/standard cubic feet. The passthrough of this surge in gas payment in Naira terms was, however, masked by the knock-on effect of robust top-line growth, with export sales and the positive translation effect of naira depreciation on tariff rates on capacity and energy generated proving supportive. Consequently, TPP reported a 6.8ppts expansion in EBITDA margin to 43.5% between FY'19 and FY'22 and a further 4.5ppts increase to 48.0% in FY'23.

Figure 16: Domestic gas pricing/standard cubic feet (\$) has been mostly favourable



Source: SEPLAT, TPP, CardinalStone Research

Figure 17: The trajectories of core margins have been positive despite Naira devaluation



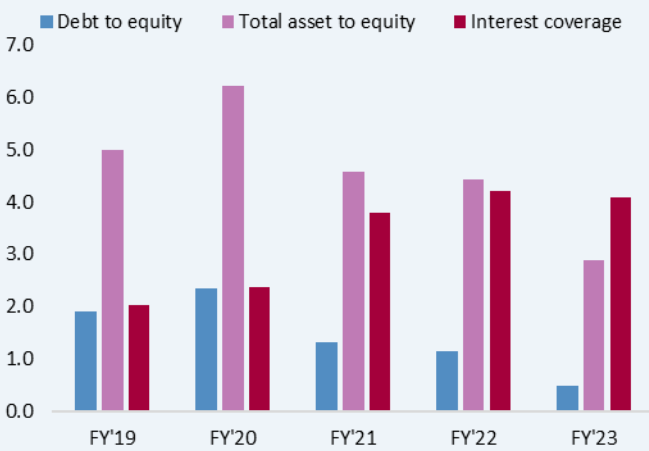
Source: SEPLAT, TPP, CardinalStone Research

TPP reduces leverage ratios in response to high debt FX exposures.

In recent years, the negative impact of the Naira devaluation on TPP's dollar exposure created interest expense concerns, with the 77.3% surge in FY'23 to N15.1 billion particularly notable. Breakdowns from TPP's financials suggest that the finance cost pressures primarily stemmed from foreign exchange losses on financial activities, which moved from N4.1 billion in FY'22 to N8.4 billion in FY'23. For context, the company had secured a \$215 million acquisition loan from a consortium of bankers (UBA, AFC, Fidelity and FCMB) in August 2013, which was deployed to the 100.0% acquisition of Ughelli Power Plc. The repayment of the balance of the facility was due in December 2021 but was restructured to a maturity timeline of 2023 at a floating interest rate of 90 days LIBOR + 8.5%. According to management, this facility was completely paid off in FY'23 in line with the contract to create legroom for temperance in interest expense increases – primarily a consequence of the Naira devaluation and rising interest rate.

Consistent with the company's position on its balance sheet restructuring, TPP's FY'23 debt-to-equity ratio improved from a five-year high of 2.3 times in FY'20 to a low of 0.5 times in FY'23. Similar improvements were evident in the company's total asset-to-equity ratio, with reliance on equity for asset financing now materially higher in line with plans to reduce risk from high leverage, particularly given the volatile interest rate environment in Nigeria. Interestingly, TPP's interest coverage remained very decent in FY'23 (-10bps to 4.1 times compared to an average of 2.2 times between FY'19 and FY'20) despite the surge in finance costs. In our view, this improvement in interest coverage ratio primarily reflected the positive passthrough from strong capacity utilisation and favourable pricing.

Figure 18: Leverage ratios have significantly improved

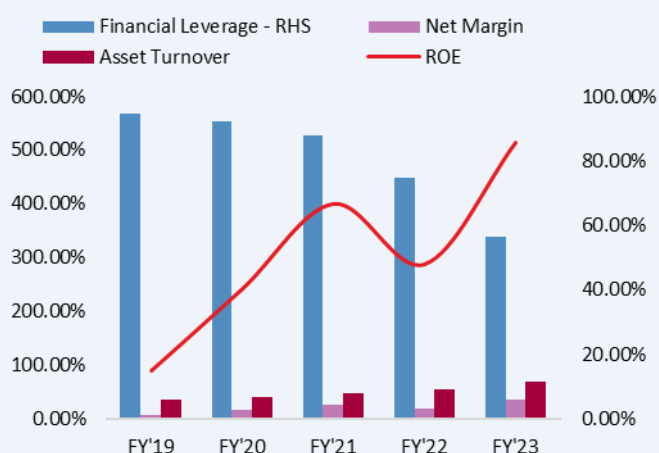


Source: Company Financials, CardinalStone Research

DuPont Analysis suggests asset turnover as a critical driver of ROE.

Between FY'19 and FY'23, TPP grew return to equity shareholders (ROE) from 14.9% to 85.8%. This growth in the profitability metric was primarily occasioned by greater efficiency in the use of assets in the production process, manifested in the 34.8ppts surge in asset turnover to 70.5%. In addition, ROE gains expectedly reflected the notable increases in net income margins in the review period. Importantly, the strategic decision to completely repay dollar-denominated debt lowered the risk associated with the company's ROE, which is now more supported by efficiency in the sweating of assets owned and the capacity to make more profits from each unit of power sold.

Figure 19: TPP materially derisked ROE in the review period



Source: Company Financials, CardinalStone Research

Improved working capital management bloated operating cash flow

Elsewhere, cash generated from the company's operations accelerated at a CAGR of 57.2% between FY'19 and FY'23 to N38.9 billion, supported by a robust increase in operating profits and improved working capital efficiency (CAGR of 60.2% for net working capital). In particular, the gains from the management of trade and other payables were notable.

Further aided by the moderation in CAPEX in FY'23 from the highs of FY'21, the company closed 2023 with a strong net cash balance of N6.4 billion. For context, this net cash balance position is higher than the total dividend paid in each of FY'18, FY'19, FY'20, and FY'23.

In passing, we also note the company's mean dividend payout of 75.0% since FY'19, which compares favourably to the 48.0% payout for EMEA peers even though it is slightly below the recent average for GEREGU.

OUTLOOK

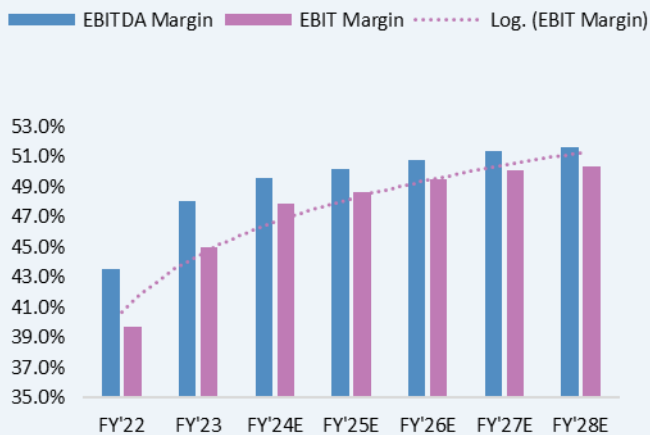
Regulatory support, capacity optimisation, and fair tariffs are positive for TPP's outlook

We expect TPP to grow operating profits at a five-year CAGR of 45.4% between FY'23 and FY'27 (vs 25.2% between FY'19 and FY'23). Precisely, we see operating profit reaching N308.0 billion in FY'27 compared to the N61.7 billion reported in FY'23. This sanguine position reflects the expected improvement in capacity utilisation to 85.0% in FY'27 (vs 77.7% in FY'23), a projected surge in tariff rates on capacity and energy, and a continued favourable domestic gas pricing environment.

The view on greater capacity utilisation is primarily hinged on plans to leverage state partnerships on the eligible customer policy of the new electricity reforms and enter into a strategic partnership with AEDC (a pilot program to try bilateral agreements with discos) and, eventually, EKEDC and IKDC. Our view on increased capacity utilisation is also consistent with the company's strategic position as a member of the Executive Board of the West African Power Pool (WAPP), which it can leverage to expand revenue from exports to West African markets.

The prognosis for an improvement in tariff rates on capacity and energy is consistent with ongoing Naira depreciation at the official window relative to 2023 levels. The expected positive passthrough is in line with management information, which revealed that charges for capacity and energy rates are adjusted for weaknesses in the domestic currency and changes in capacity size. Elsewhere, the gas pricing environment is likely to remain relatively stable in the near to medium term, at least in dollar terms. According to SEPLAT, a key player in the domestic gas supply market, the Domestic Gas Delivery Obligation (DGDO) pricing is expected to end in 2025 at the latest.

Figure 20: We expect operating profit margin to improve to 50.3% by FY'28

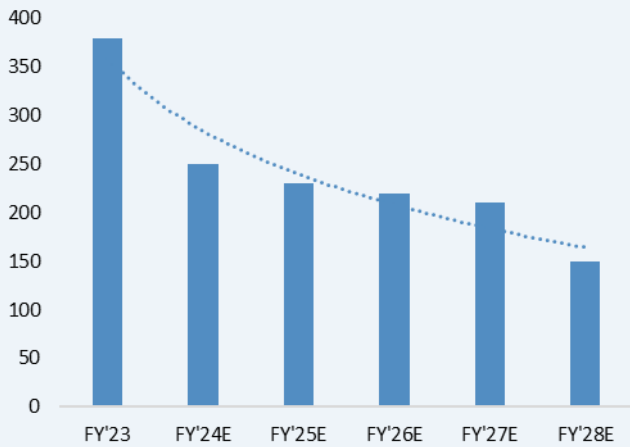


Source: Company Financials, CardinalStone Research

The government's commitment to clearing electricity backlogs bodes well for the cash flow outlook

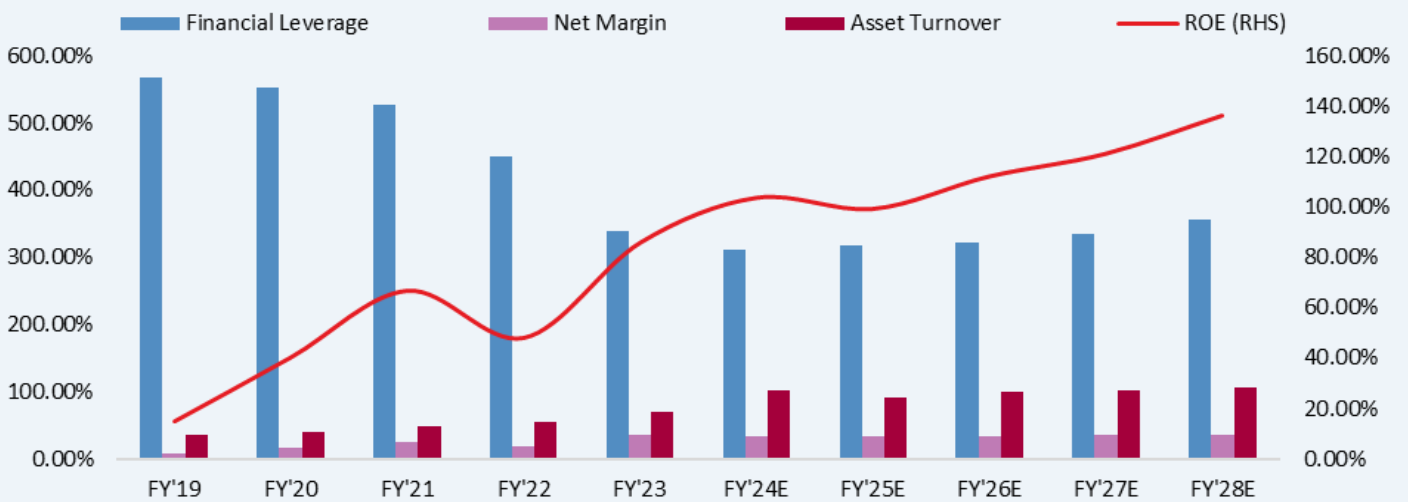
In our view, TPP is expected to record an improvement in cash flow over the next five years, with CFO to EBIT ratio set to expand from 62.9% in FY'23 to 108.0% in FY'28. In particular, we see latitude for a spike to 110.0% in FY'24, owing to notable improvements in DISCO cash collection and billing efficiencies as well as material progress in metering initiatives, before normalising to a conservative mean of 80.9% between FY'25 and FY'27. Our forecast also assumes improvements in the receivables position on the back of recent progress by the government to clear linked liabilities to DISCOs and a possible reversal in the slowdown in payment from NBET in some quarters of 2023. Aided by the above assumptions, we forecast the company's receivable days to reach 150 by FY'28 vs 379 in FY'23. We also see latitude for material improvements in ending cash balances for the business on the back of the mentioned and relatively contained CAPEX spending (intensity of c.3.7% over our forecast horizon vs 5.3% in the last five years). Even though management has not disclosed plans for any notable acquisition of PPE in the near to medium term, our CAPEX expectation is linked to projected asset maintenance activities, with most equipment usually shipped abroad to the original equipment manufacturers for servicing.

Figure 21: Receivable days to improve over the forecast horizon



Source: Company Financials, CardinalStone Research

Figure 22: ROE may remain relatively derisked across our forecast horizon



Source: Company Financials, CardinalStone Research

Valuation

Discounted cash flow valuation

We value TPP using a discounted cash flow (DCF) valuation methodology. Our DCF assumes a weighted cost of capital (WACC) of 18.87%, based on projected Naira free cash flows. This WACC reflects a cost of equity of 24.2% and an effective interest rate on debt of 11.5%. Similarly, our terminal value assumes a perpetuity growth of 5.0% in Naira cash flows. After discounting the terminal value and projected free cash flows by our WACC, we arrived at enterprise and equity values of N1.91 trillion and N1.95 trillion, respectively, with the higher equity value underscored by the company's net cash position of N43.0 billion. The equity value suggests a 12-month DCF TP of N323.64/share, given shares outstanding of 7.5 billion and the other valuation parameters stated below.

Figure 23: Discounted cashflow main assumptions

Assumptions	
Equity beta	0.62
Risk free rate	14.5%
Equity risk premium	15.57%
Cost of equity	24.20%
Cost of Debt	11.50%
Marginal tax rate	30.00%
After tax cost of debt	8.05%
WACC	18.87%

Figure 24: Discounted cashflow main assumptions

In N'million	2024E	2025E	2026E	2027E	2028E
EBIT	141,860.68	180,864.90	248,311.88	307,973.01	379,055.08
Cash Taxes	(42,558.20)	(54,259.47)	(74,493.56)	(92,391.90)	(113,716.52)
NOPAT	99,302.48	126,605.43	173,818.31	215,581.11	265,338.56
Depreciation	5039.00	5731.15	6665.76	7809.73	9210.83
Capex	(5,113.17)	(11,029.84)	(13,842.85)	(18,692.27)	(22,879.47)
Changes in NWC	50,880.34	19,835.73	19,962.06	23,930.33	136,196.45
Unlevered FCFF	150,108.65	141,142.48	186,603.29	228,628.90	387,866.37
Discounted Free Cashflow	130,212.80	102,955.45	114,504.81	118,018.04	168,731.78
Perpetual Growth Rate	5.0%				
Terminal Value	2,935,399.32				
Present Value of FCF	1,911,396.55				
Net Debt/(cash)	(42,951.60)				
Fair Value of Equity	1,954,348.16				
12-Month Equity Value	2,427,316.60				
12-Month TP	323.64				

Source: CardinalStone Research

Key comparable metrics --TPP and peers

Profitability ratios

Figure 25: LTM Gross Margins

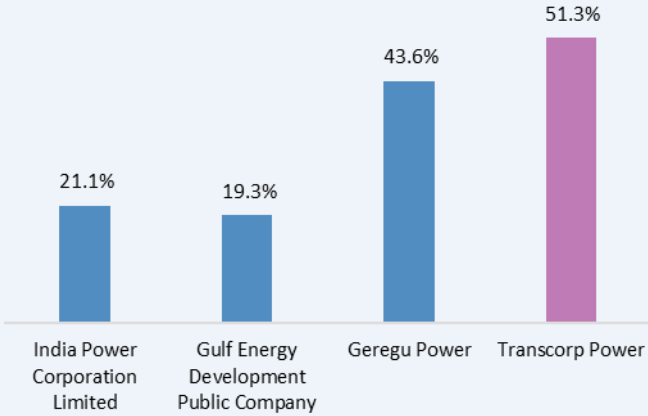


Figure 26: LTM EBITDA Margins

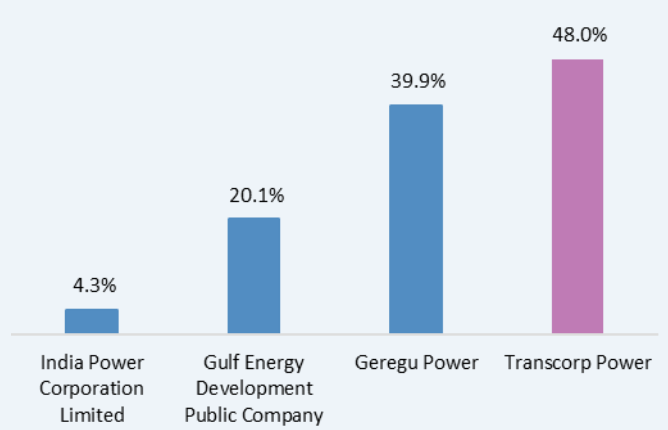


Figure 27: LTM EBIT Margins

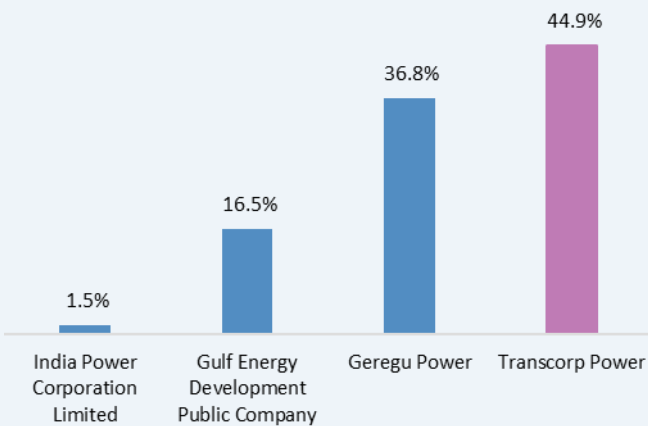
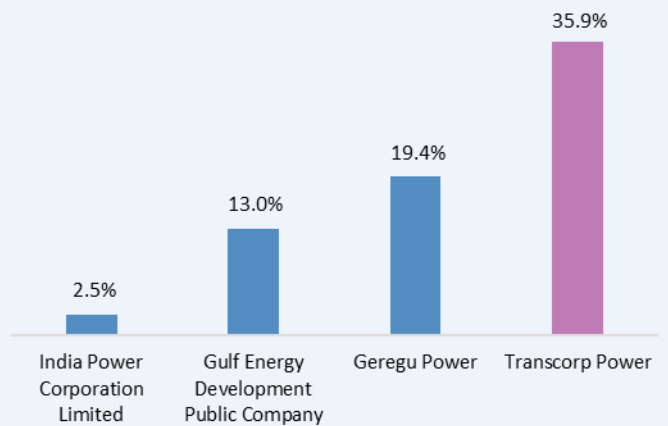


Figure 28: LTM Net Income Margins



Liquidity ratios

Figure 29: Cash conversion cycle (days)

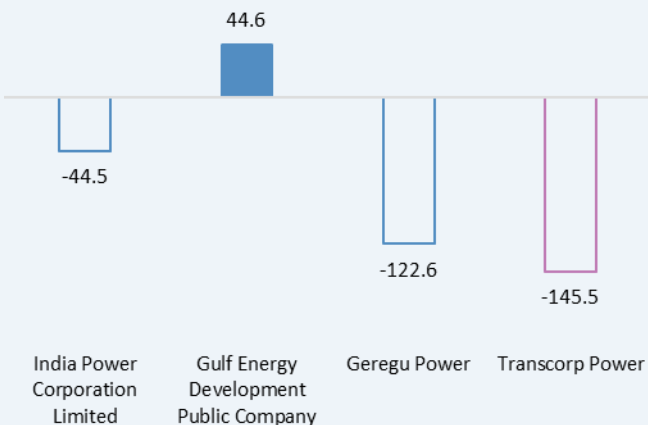
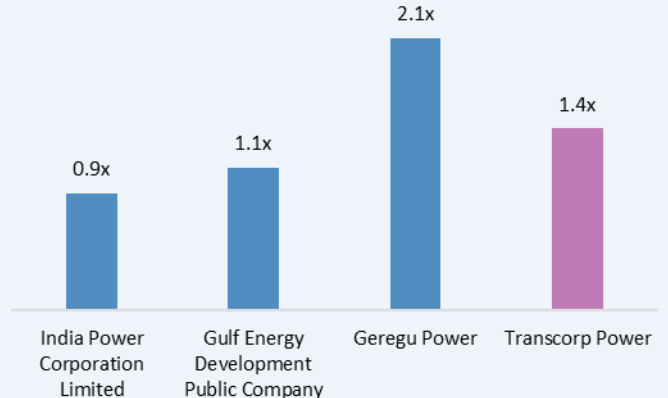


Figure 30: Current Ratio



Source: Capital IQ, Company Financials, CardinalStone Research

Leverage ratios

Figure 31: Total Debt to Capital

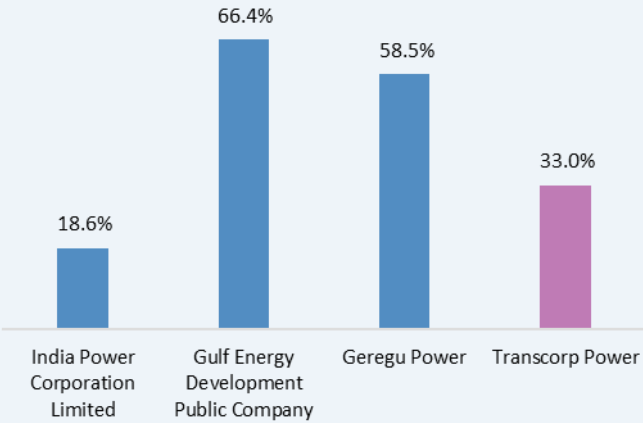


Figure 32: Total Debt to Equity

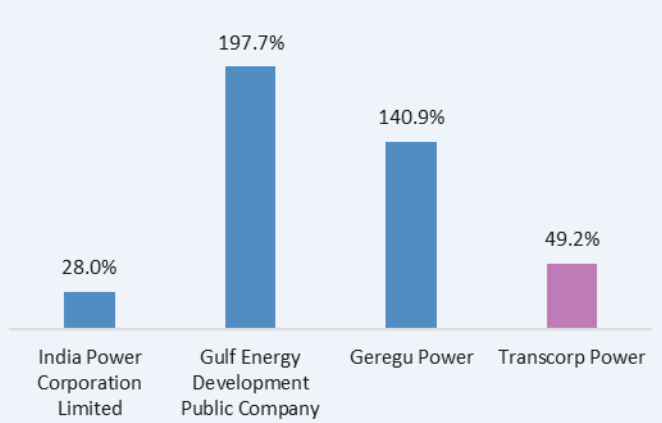


Figure 33: Total Debt to EBITDA

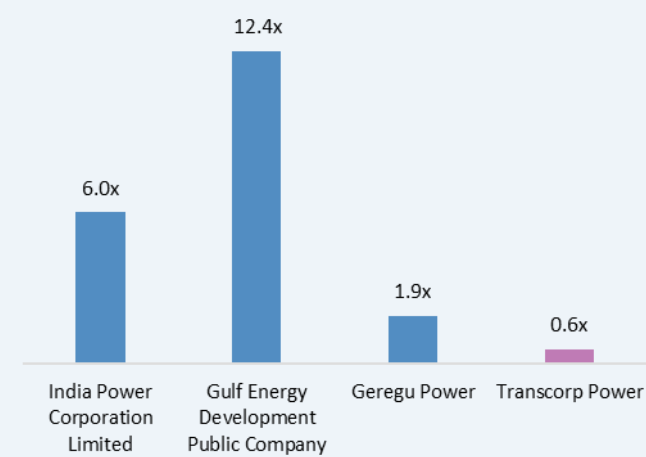
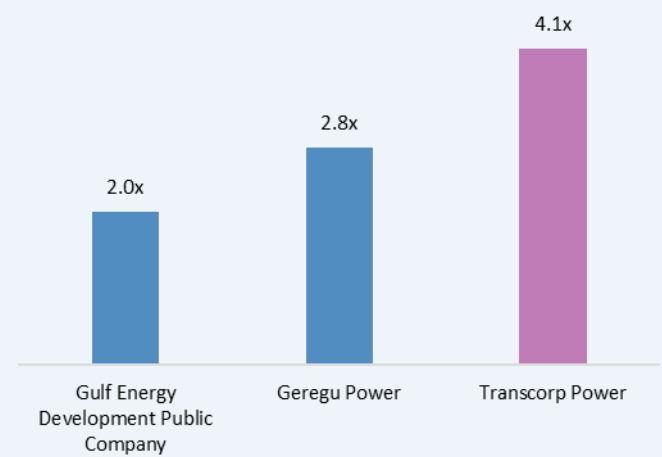


Figure 34: Interest coverage



Other ratios

Figure 35: Return on Equity

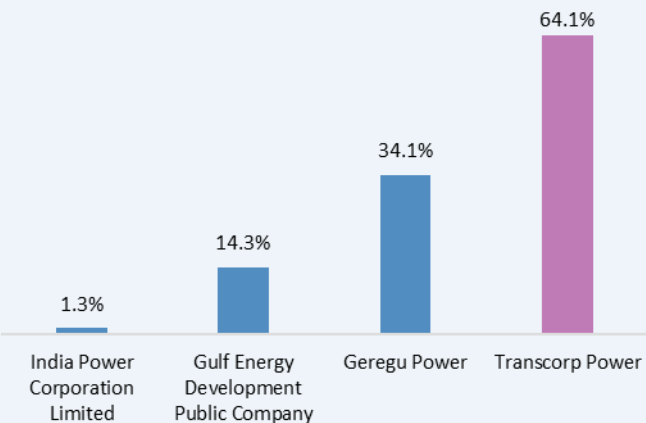
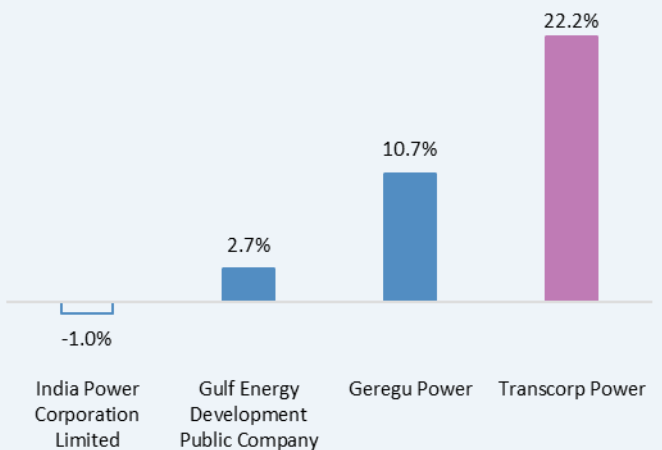


Figure 36: Return on Assets



Source: Capital IQ, Company Financials, CardinalStone Research

Risk to Expectations

Risk of Naira Devaluation

This risk can result from unexpected Naira depreciation or scarcity of required foreign exchange. The devaluation challenge is compounded by insufficient hedging instruments, with most NDFs, which are settled in local currencies, leaving the FX sourcing challenge squarely on the shoulders of the company. Even though TPP has resolved/paid off all its foreign currency debt, whose impact on interest expense dragged earnings in the past, most of its maintenance CAPEX still requires foreign exchange transactions. In particular, important plant parts are usually shipped abroad to the original equipment manufacturers for periodic servicing that requires foreign exchange. In addition to this, gas, the company's major raw material, is priced in US dollars even though payment is made in Naira. These exposures suggest that unexpected Naira weaknesses may negatively impact TPP's earnings. However, the company's growing exportation is likely to continue to generate much-needed foreign currencies that can act as a hedge to Naira devaluation concerns.

Risk of Competition

The newly signed Electricity Act looks to engender competition in the system that may lead to a proliferation of power-generating companies across the country. In particular, states, institutions, and individuals are now permitted to join the electricity value chain as the government takes bold steps to address lingering issues in the sector. In our view, this policy twist increases the risk of market share loss for existing players in the energy generation space (including TPP) and could potentially cap the scope for increases in tariff for capacity charges and energy generated as competition for a share of the consumers' wallet intensifies. That said, TPP's decision to proactively partner with state governments is likely to mitigate this loss, with non-state actors only allowed to participate in the value chain after obtaining licenses from the respective states.

Risk of unfavourable changes in interest rates

Our DCF 12-month TP is materially sensitive to changes in the risk-free rate and terminal growth rates. The former is a function of the broad yield environment, which is currently very hawkish as the apex bank looks to rein in stubbornly elevated inflation and address the currency crisis. Specifically, unfavourable movements in interest rates may increase the cost of equity and the WACC rate for discounting future cash flows. Higher interest rates could also translate to surges in interest expense and drags in earnings. Nevertheless, the company's proactive decision to offset all its foreign currency debt, which was mostly held at floating rates, has reduced its exposures on this front.

Risk of higher trade receivables balances

A few quarters of FY'23 saw renewed increases in trade receivables occasioned by a moderation in DISCO's collection efficiency. Even though metering is markedly improving, DISCOs' revenue collection efficiency may be negatively affected by weaker consumer discretionary incomes— occasioned by historically high inflation and a plunging currency. To put it simply, the cost of living crisis may make it difficult for a number of Nigerian households to pay for the electricity consumed, which may cascade into higher receivables across the value chain. Higher receivables could, in turn, negatively affect the company's cash flow and overall valuation.

Figure 37: TPP Summary of Financials and Forecasts

Income Statement (N'000)					Cash Flow Statement (N'000)				
	2022A	2023A	2024E	2025E		2022A	2023A	2024E	2025E
Revenue	90,349,386	137,379,894	296,347,958	371,927,547	Cash flow from operating activities	21,418,802	38,845,521	143,151,742	149,308,159
COGS	(48,147,009)	(66,939,902)	(135,431,017)	(168,855,106)	o/w Depreciation & amortization	3,472,313	4,198,092	5,039,004	5,731,146
Gross profit	42,202,377	70,439,992	160,916,941	203,072,441	o/w Changes in working capital	(15,158,160)	(20,704,364)	37,980,288	16,607,153
Other Income	189,109	593,485	800,139	1,004,204	Cash flow from investing activities	(3,749,156)	(2,561,121)	(8,066,357)	(10,123,574)
OPEX	(6,521,875)	(9,289,245)	(19,856,402)	(23,211,741)	o/w Capital expenditure	(4,326,546)	(5,113,171)	(11,029,837)	(13,842,849)
EBIT	35,869,611	61,744,232	141,860,679	180,864,904	as % of sales	4.8%	3.7%	3.7%	3.7%
Net Interest	(7,250,634)	(12,460,948)	(2,766,585)	(1,214,754)	Cash flow from financing activities	(23,714,585)	(32,617,273)	(73,546,480)	(103,880,302)
PBT	28,618,977	49,283,284	139,094,094	179,650,150	o/w Dividends paid	(12,950,053)	(2,322,472)	(63,287,813)	(94,316,329)
Tax	(11,335,571)	0	(41,728,228)	(53,895,045)	o/w Debt issued/(repaid)	(6,923,825)	(17,167,626)	(10,258,667)	(9,563,973)
PAT	17,283,406	49,283,284	97,365,866	125,755,105	Opening Cash and cash equivalents	8,746,571	2,701,632	6,368,759	67,907,664
EPS	218.36	6.57	12.98	16.77	Net change in cash	(6,044,939)	3,667,127	61,538,905	35,304,283
DPS (NGN)	216.88	3.13	8.44	12.58	Closing Cash and cash equivalents	2,701,632	6,368,759	67,907,664	103,211,947
Payout ratio	99.3%	47.6%	65.0%	75.0%					
Shares outstanding (m)	79	7,500	7,500	7,500					
Balance Sheet (N'000)					Ratio Analysis				
	2022A	2023A	2024E	2025E		2022A	2023A	2024E	2025E
Cash and cash equivalents	2,701,632	6,368,758	67,907,664	103,211,947	Gross Margin	46.7%	51.3%	54.3%	54.6%
Accounts receivable	94,558,786	142,569,673	202,423,469	234,365,304	EBIT Margin	39.7%	44.9%	47.9%	48.6%
Inventories	4,314,347	1,762,693	3,566,233	4,446,372	PBT Margin	31.7%	35.9%	46.9%	48.3%
Current assets	101,574,765	150,701,124	273,897,367	342,023,623	Net Profit Margin	19.1%	35.9%	32.9%	33.8%
PP&E	54,702,572	58,768,976	64,759,809	72,871,512	ROE	48.0%	85.8%	103.6%	99.2%
Intangible assets	9,701,191	9,701,191	9,701,191	9,701,191	ROA	10.3%	22.2%	27.8%	29.5%
Investment	2,208,918	2,373,892	2,373,892	2,373,892	ROIC	11.9%	23.3%	23.7%	24.7%
Total assets	168,187,446	221,545,183	350,732,259	426,970,218	ROCE	23.7%	42.1%	66.2%	72.2%
Short-term borrowings	13,104,504	2,682,082	2,361,234	2,033,205	OPEX/Sales	7.2%	6.8%	6.7%	6.2%
Payables	76,306,380	97,909,961	197,547,585	246,976,712	Net debt/Equity (x)	1.1	0.4	-0.3	-0.5
Other short-term liabilities	5,789,349	3,810,930	3,810,930	3,810,930	Net debt/EBIT (x)	1.1	0.5	-0.2	-0.4
Current liabilities	95,200,233	104,402,973	203,719,748	252,820,847	Sales/Assets (x)	0.5	0.6	0.8	0.9
Long-term debt	29,967,161	35,174,034	30,966,283	26,664,368	Assets/Equity (x)	4.4	2.9	3.2	3.0
Other long-term liabilities	5,056,075	5,056,075	5,056,075	5,056,075	Interest cover (x)	4.2	4.1	25.6	37.8
Total liabilities	130,223,469	144,633,082	239,742,106	284,541,290	Tax Rate	39.6%	0.0%	30.0%	30.0%
Share Capital	40,108	3,749,850	3,749,850	3,749,850					
Share premium	34,967,736	44,385,169	44,385,169	44,385,169					
Retained earnings	2,956,131	28,777,080	62,855,133	94,293,909					
Total liabilities & equity	168,187,446	221,545,183	350,732,259	426,970,218					
BVPS	479.65	10.25	14.80	18.99					
Net debt/(cash)	40,370,033	31,487,358	(34,580,148)	(74,514,374)					

Source: Company financials, CardinalStone Research estimates.

Note: NGN in thousands (except per-share data). The fiscal year ends in December. o/w - out of which

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