ANNEX 4 – FINANCIAL ASSESSMENT OF tcn

# Introduction

This Annex presents the financial assessment of TCN covering the recent past performance (2011 to 2013) and a “Minimum Funding” cash constrained operating budgets for TCN for 2014-15. The forecasts are prepared under the assumption that there will be no tariff increase in 2014-15 (i.e. MYTO II tariffs will apply throughout). TCN’s historical financial statements have not yet been audited and there is fundamental uncertainty regarding the reliability of these financial statements.

# Recent Performance

## Operational Performance

1. TCN’s key operational performance indicators over the last three years are indicated in and below.

Table : Operational Indicators 2011-13

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2011 | 2012 | 2013 |
| Peak generation (MW) | 4,089 | 4,518 | 4,458 |
| Average generation (MW) | 3,082 | 3,298 | 3,297 |
| Growth in peak generation | 7.5% | 10.5% | -1.3% |
| Energy wheeled (sent out by stations) (GWh) | 26,999 | 28,890 | 28,879 |
| Growth in energy sent out | 10.8% | 7.0% | 0.0% |
| Transmission losses (%) | 10.4% | 12.1% | 12.1% |
| Bulk supply to DisCos (GWh) | 24,205 | 25,385 | 25,373 |
| Number of staff at December 31 | 3,334 | 3,958 | 4,210 |
| Energy wheeled (GWh) per staff | 8.1 | 7.3 | 6.9 |

Figure : Operational Indicators 2011-13

1. Peak generation of around 4,500 MW in the last two years was more or less equal to the capacity of the transmission network to transmit the available generation to the distribution companies (DisCos).
2. Energy wheeled (sent out by stations) registered growth rates of 10.8% in 2011, 7.0% in 2012 and remained almost unchanged in 2013. Total wheeled energy in 2013 reached 28,879GWh. Performance in terms of transmission losses has deteriorated since 2011, increasing from 10.4% in 2011 to 12.1% in 2012/13. The high losses include non-technical losses attributable to illegal connections by some large industrial consumers. Inadequate maintenance of the transmission network over the years has resulted in high technical losses.
3. The number of staff employed by TCN increased from 3,334 in 2011 to around 4,210 by end 2013. The increase in staff numbers was far greater than the growth in wheeled energy and as a result the energy wheeled per staff declined from 8.1GWh in 2011 to 6.9GWh in 2013.

## Financial Performance

1. TCN is technically insolvent as the existing MYTO transmission tariffs and billing collections are inadequate for the company to finance its operations. The company is consistently unable to meet its obligations to suppliers/contractors in compliance with terms of contracts. TCN is fortunate that the company has FGN backing. The present financial situation of the company is not sustainable.
2. Non-collection of tariff charges is a significant recurring problem for TCN. The Interim Market Rules (pre-TEM) provides for collection of 70% for TSP and 60% for SO and MO. However, the overall average collection rate in 2013 was around 60%. Retail billing collections by DisCos have dropped to 45% in the last two months and this will impact on all the Market Participants and Service Providers, including TCN. Shows the monthly billing collection performance in 2013.

Figure : 2013 Monthly Billing Collection Performance

1. The company’s unpaid billing due from the market fund as at December 31, 2013 amounted to NGN50 billion (US$315 million), equivalent to 138% – or 16 months – of TCN of 2013 annual revenues.
2. below provides the key financial performance indicators over the past three years.

Table : Financial Indicators 2011-13

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2011 | 2012 | 2013 |
| Av tariff (NGN/MWh) | 1,331 | 1,445 | 1,490 |
| Av tariff (US$/MWh) | 8.73 | 9.25 | 9.57 |
| Av operating profit/(loss) (NGN/MWh) | 449 | (269) | (278) |
| Av operating profit/(loss) (US$/MWh) | 2.94 | (1.72) | (1.79) |
| Net profit/(loss) (NGN millions) | 10,968 | (6,718) | (7,005) |
| Net profit/(loss) (US$ millions) | 72 | (43) | (45) |
| Operating margin | 29.5% | -18.1% | -18.2% |
| Return on equity | 3.5% | -2.2% | -2.1% |
| Current ratio (times) |  | 4.5 | 2.9 |
| Debt/equity ratio |  | 9.0% | 11.2% |

1. Transmission tariffs were applied in accordance with MYTO II tariffs pre-determined by NERC for the period June 2012 to May 2017. Although the revenue requirements of TCN are mostly of a fixed nature, the transmission tariff determined by NERC is based on the volume of bulk supply to distribution companies. This means that TCN carries an element of generation risk. The company is financially exposed due to non-availability of expected generation capacity. The average transmission tariff increased by 11.9% compared with domestic inflation of 21.7% during the last two years to end 2013.
2. TCN made pre-tax losses of FGN13.7 billion (US$88 million) in 2012/13 with negative operative margin of around 18%, based on unaudited financial statements. The company had a low debt/equity ratio of 11% as at December 31, 2013.

# Financial Outlook 2014/15

1. The financial outlook over the next few years will largely depend on the availability of generation capacity (and thus wheeled energy), refurbishment of existing the transmission network in the short-term, expansion of the transmission network in the medium-term, efficiency improvements in terms of transmission losses and operating expenses, financing costs of planned investments and tariff levels in particular.

## Conclusions

1. The collected cash revenue is inadequate for TCN to embark on the required program of transformation. For the remainder of 2014 and into 2015, TCN will continue to operate under severe cash constraints if the existing MYTO II tariffs regime applied and tariffs are not revised upwards. The main takeaway is that existing tariff levels and cash collections on billed revenues are much too low to fund the operational and capital expenditures necessary for TCN to adequately perform its functions. Until the situation turns around, a minimum funding regime and strict austerity will have to be implemented.
2. TCN will make an application to NERC for higher tariffs to reflect changes since 2012. These include:

* Poor billing collections (MYTO II assumes 100% collections)
* Much higher annual network maintenance & operating requirements for proper operations
* Depreciation on assets in service and returns on capital employed:
* Planned heavy network investments (US$7.7 billion) to 2018
* Anticipated transfer of NIPP assets (US$2.0 billion) in 2014
* Transfer of transmission assets (US$467 million) recorded in PHCN books
* Transfer of transmission assets ($147 million ) recorded in PMU books

1. In view of the uncertainties concerning the outcome of the forthcoming tariff negotiations, the Minimum Funding financial projections of TCN presented in this Annex are limited to 2014-15.

## Tariffs

1. MYTO II tariffs, which were pre-determined by NERC for 2012-17, are shown in below. Tariffs are revised every June 1 and the percentages changes shown are implemented as per MYTO rules. Tariffs were reduced by 6.5% effective June 2013 and are expected to be reduced by 1.6% in June 2014 and revised upwards by 9.3% & 11.7% in June 2015 & 2016 respectively.

Table : MYTO II Tariffs 2012-16

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | MYTO II Tariffs | | | | |
|  | June 2102 | June 2103 | June 2104 | June 2105 | June 2106 |
| TSP wheeling charges | 1,216 | 1,137 | 1,119 | 1,224 | 1,367 |
| SO services | 195 | 182 | 179 | 196 | 219 |
| MO services | 51 | 48 | 47 | 52 | 58 |
| TCN charges | 1,462 | 1,367 | 1,346 | 1,472 | 1,643 |
| Ancilliary charges | 21 | 19 | 19 | 21 | 23 |
| NERC fees | 38 | 36 | 35 | 38 | 43 |
| Transmission tariff | 1,521 | 1,422 | 1,400 | 1,531 | 1,709 |
| Change in tariff |  | -6.5% | -1.6% | 9.3% | 11.7% |

1. The above tariffs have been assumed in the projected financial outcomes presented in this Annex.

## Key Performance Indicators 2014-15

1. Table 4 below provides a summary of energy wheeled, revenues, operating costs, capital investments funded from internally generated revenues (IGR) and cash flows under the Minimum Funding projections for 2014-15 together with estimated actuals for 2013.

Table : Energy, Revenues & Cash Flows 2013-15

|  |  |  |  |
| --- | --- | --- | --- |
|  | Est Actual | Minimum Funding | |
|  |  | MYTO II Tariffs | |
|  | 2013 | 2014 | 2015 |
| Energy |  |  |  |
| Transmission losses | 12.1% | 10.0% | 9.5% |
| Bulk supply to DisCos (GWh) | 25,373 | 31,895 | 33,172 |
| Growth in bulk supply | 0.0% | 22.7% | 3.4% |
| Tariffs (excl Ancilliary & NERC charges) |  |  |  |
| Date of tariff increase | June 1 | June 1 | June 1 |
| Tariff increase | -6.5% | -1.6% | 9.3% |
| Average tariff after increase (NGN/MWh) | 1,367 | 1,346 | 1,472 |
| Average tariff in year (NGN/MWh) | 1,432 | 1,355 | 1,419 |
| All figures in NGN billions |  |  |  |
| Wheeling revenue: |  |  |  |
| Billed | 36.3 | 43.2 | 47.1 |
| Collected | 22.1 | 21.6 | 34.8 |
| % collected/billed | 61% | 51% | 75% |
| Operating costs | 24.8 | 27.2 | 30.6 |
| Capital expenditure from IGR | 2.1 | 0.9 | 4.0 |
| Incr/(decr) in inventory | (4.5) | (1.4) | 0.0 |
|  |  |  |  |
| Net cash inflow/(outflow) | 1.1 | (6.7) | 0.2 |
| Cash balance at Dec 31: | 0 | 0 | 0 |
| As forecast | 8.4 | 1.7 | 1.9 |
| Minimum required |  | 1.7 | 1.9 |
| Cash surplus/(shortfall) |  | 0.0 | 0.0 |

1. The following observations can be made concerning the figures shown in the foregoing table:

* Energy wheeled is forecast on the basis of constrained gas supply. The increase in bulk supply to DisCos is projected to increase by 22.7% in 2014 and by 3.4% in 2015. The increases are due to a combination of additional generation capacities coming online and reduction in transmission losses. The energy losses are projected to decline by 2% in 2014 by targeting non-technical losses (i.e. theft by some major industrial consumers) and investments in the refurbishment of the network, a modest reduction of 0.5% is assumed in 2015.
* MYTO II tariffs are revised every June 1 and the percentage changes shown are implemented as per MYTO order. It should be noted that tariffs were reduced by 6.5% effective June 1, 2013 and are expected to be reduced by 1.6% effective June 1, 2014. MYTO II tariffs are expected to be revised upwards by 9.3% effective June 1, 2015.
* Billing collection rates are assumed under all scenarios at 45% from January to July 2014, 60% from August to December 2014 and 75% in 2015. The 45% figure represents the fact that retail billing collections by DisCos have dropped to 45% in the last two months and this will impact on all the Market Participants and Service Providers, including TCN. Non-collection of tariff charges is a persistent problem for TCN. The Interim Market Rules (pre-TEM), which provide for collection of 70% for TSP and 60% for SO and MO effective November 2013, have not been followed to date. The overall average collection rate in 2013 was around 61%
* TCN’s collected revenue varies directly with the amount of energy wheeled, whereas TCN’s costs are nearly 100% fixed. Under the existing tariff levels and collection rates, the energy wheeled would need to be more than double the current amount to generate enough cash for proper funding of the business. below provides a sensitivity showing the change in cash flows for changes to the amount of wheeled energy.

1. Operating costs and investments funded from internally generated revenues (IGR) have had to be scaled back significantly to levels that are affordable in terms of forecast cash inflows under the Minimum Funding budgets. Required minimum cash balances are maintained in 2014-15.
2. TCN will have to operate under a tight financial regime or risk defaulting on cash obligations. Net cash outflows of NGN6,704 million in 2014 are forecast under the Minimum Funding budgets (MYTO II tariffs) and the cash balance by December 2014 declines to NGN1,731 million, which is equal to the minimum requirement.

## Sensitivities to Minimum Funding Budgets

1. The Minimum Funding cash flows presented above were subjected to several key sensitivity tests and the results of these sensitivities are presented in below.

Table : Cash Flow Impacts of Key Sensitivities 2014-15



1. Changes in assumptions relating to wheeled energy, transmission losses and collection rates have significant impacts on the financial outcomes for TCN. This is clearly illustrated in the results indicated in the above table.

## TCN Unaudited Draft Financial Statements 2012-13

1. The unaudited draft financial statements of TCN for 2012 and 2013 are presented in the following pages.





