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Bi-monthly Economic & Business Update

Deepening the Nigerian Capital Market – A Case for Exchange Traded Funds (ETFs)

While market volatility has made many investors nervous, there are a few investment vehicles that have continued to grow. Exchange Traded Funds (ETFs) are pooled investment vehicles with shares that can be purchased or sold on a stock exchange at a market-determined price. They offer investors access to the markets such as the Nigerian Stock Exchange (NSE), the Standard & Poor's 500 (S&P 500), the Financial Times Stock Exchange 100 Index (FTSE), and Johannesburg Stock Exchange (JSE) while offering diversification, access to non-traditional asset classes and hedging tools.[1]

Since the introduction of ETFs in 1993, they have gained widespread acceptance in most developed markets. Over the last 10 years, investors' demand for ETFs (both retail and institutional) has grown markedly, which in turn has led to a greater variety offered by ETF sponsors. Now there is one for almost every type of market index or financial benchmark in existence. As of September 2015, the ETF and exchange traded products industry managed 5,978 products, representing total assets of $2.8trn.[2]

The Way It Works

An ETF originates with a sponsor - either a company or financial institution - who determines the investment objective. The origi-

[1] Investment Company Institute, Investment Company Fact book 2015, page 58

[2] EY Global ETF Survey 2015 : ETFs a positive force for disruption

INSIDE THIS ISSUE:

nator is also referred to as an active participant (AP). The AP creates a basket of assets (e.g. equities, bonds, commodities, alternative assets, etc.) and in exchange for those assets receives creation units in the form of ETF shares.

Once the ETFs have been listed on the various exchanges, investors can then purchase and incorporate the securities into their respective portfolios. Institutional and retail investors can access ETFs in both the primary and secondary markets.

In the primary market, investors buy these securities directly from the company issuing them, while in the secondary market, investors trade securities among themselves. Investors can buy and sell these shares just like any other shares on an exchange with easily accessible prices. The company with the security being traded does not participate in the transaction. A company publicly sells securities for the first time on the primary capital market. In many cases, this takes the form of an initial public offering (IPO).

ETFs share risks common to other pooled investments such as mutual funds. An ETF is similar to a mutual fund as it offers investors a proportionate share in a pool of stocks, bonds, and other assets and is most commonly structured as an open-ended investment. A major difference is that investors trade ETF shares on the secondary market (stock exchange) through broker-dealers, just like other stocks. In contrast, mutual fund shares are not listed on stock exchanges. Instead, retail investors buy and sell mutual fund shares through a variety of distribution channels, including investment professionals—full-service brokers or independent financial planners.

Pricing also differs between mutual funds and ETFs. All orders of mutual funds placed during the day will receive the same price—the Net Asset Value (NAV) - while for ETFs, the price of a share is continuously determined on a stock exchange and can trade on any intra-day price. Hence the price an investor buys or sells may not be the same as the NAV.[3]

ETFs are subject to standard downside market risks as well as individual risks specific to the content of each ETF. To mitigate general downside risks, investors can hold Inverse ETFs. These pro-

[3] Investment Company Institute, Investment Company Fact book 2015, page 64

duce the opposite return of the underlying asset. For example, an investor who bought into an inverse crude oil ETF would have recorded gains in the period when global crude oil lost 65% of its value. By holding positions in inverse ETFs investors not only diversify, but can hedge against downside risks.

Even though rarely considered by the average investor, tracking error is a general risk that can have a potential impact on returns. As ETFs grow in complexity their tracking error (the difference between the returns of the index fund and the target index) grows.

While replicating the performance of an index may seem easy, there are a number of ways tracking errors creep into ETFs. The most common sources of tracking errors are high expense ratios and rebalancing of indexes. High expenses of an average fund are likely to reduce returns relative to those of the index being tracked. Rebalancing or Index reconstitution with the removal or addition of securities could also introduce tracking errors. When this occurs, fund managers have to make adjustments to their own fund composition. If this is not well monitored, it could lead to tracking errors.

To address this, investors are advised to understand what they are buying and make sure that the ETF index fund they are considering does a good job in tracking its index. Usually this information is provided by managers of the fund and in cases of IPO's, prospectuses usually contain the necessary information.

In summary, key benefits of ETFs include diversification, the ability to engage in intra day trading and a means to hedge other investments in a portfolio.

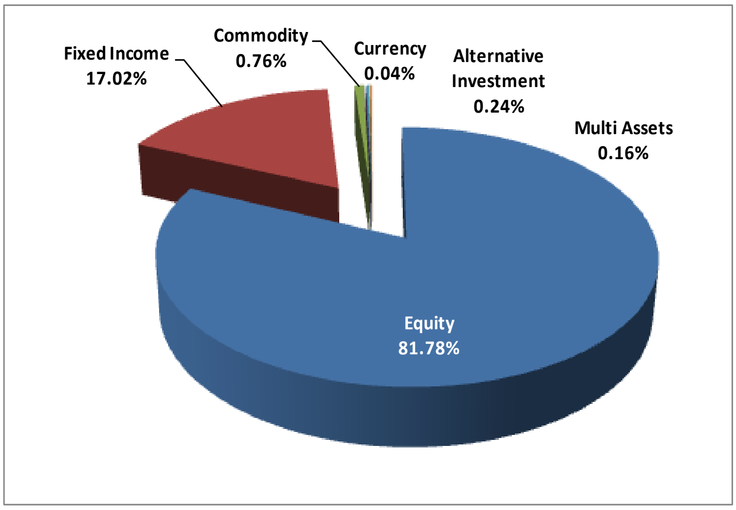
The Nigerian Opportunity

A survey by Investment Company Institute and ETFGI (an independent research and consultancy organization on the ETF and ETP Industry) showed that the US and Europe accounted for 89% of the global ETF market in 2014.[4] Africa and Asia Pacific accounted for $216bn of the market size. Within Africa, South Africa

[4] Investment Company Institute, Investment Company Fact book 2015, page 61

had the largest share of ETFs with 45 worth a combined total of $80.1bn (N15.88trn). Nigeria, on the other hand, only had seven valued at $22.6m (N4.5bn). However, with an 85% skew to equities, the Nigerian ETFs asset distribution closely aligned with the global average of 80%.

Chart 1 : Global ETFs by Asset Distribution



Source :

A breakdown of the Nigerian ETFs, their underlying assets and the

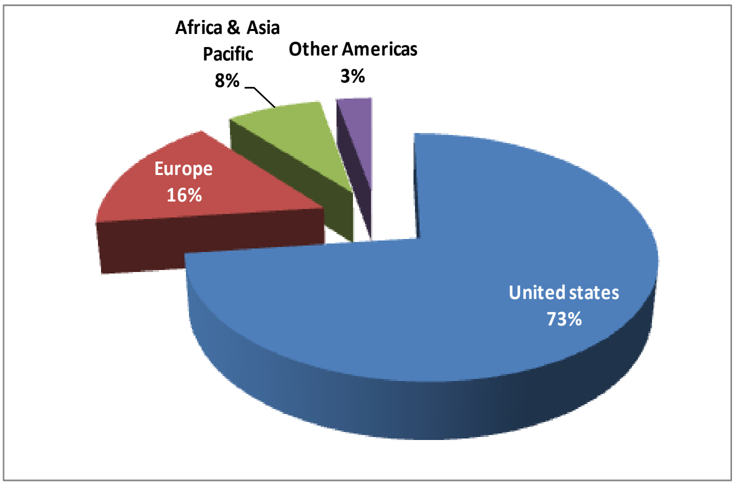
S/N	Name	Type	Listing Date	Index
1	NewGold ETF	Commodity	Dec-11	Gold Fix PM prices on LSE
2	Vetiva Griffin 30	Equity	Mar-14	Tracks NSE 30 Index
3	Lotus Halal Equity ETF	Equity (Sharia Compliant)	Nov-14	NSE Lotus Islamic Index
4	Stanbic IBTC	Equity	Dec-14	Tracking the NSE 30
5	Vetiva bank ETF	Equity	Oct-15	Tracks NSE Banking Index
6	Vetiva Industrials ETF	Equity	Oct-15	Tracks NSE Industrial Index
7	Vetiva Consumer Goods ETF	Equity	Oct-15	Tracks NSE Consumer Goods Index

indices they track is shown below:[5]

Each of these funds attempt to replicate the price and yield performance of their respective indices by holding a portfolio of securities on behalf of unit holders that substantially represents all of the component securities of the index.

[5] Global ETF Trends – The compelling growth story. A presentation at the NSE Investor forum 2015 page 10 (delivered by Lotus Capital)

Chart 2 : Total worldwide ETF assets : $2.7trn



Source : 2004 Investment Company Institute and ETFGI

A cursory look at the global structure of ETFs by assets type, size and growth rate further emphasizes the nascent stage of the Nigerian ETF industry. Its current size to total market capitalization (debt and equity market) of 0.03% (i.e. N4.5bn relative to the market capitalization size of N15.8trn) shows the industry's contribution to market size is lagging behind regional and global markets.

If our capital market is to play its role in acting as the major African financing hub for borrowers and investors, it surely has to offer more opportunities. While it has always offered basic financial and investment products and has promised to introduce variety and sophistication, it needs to introduce quality and diversified products to broaden our markets. As our markets remain dynamic and global investors' risk perception changes, markets will have to adapt and introduce financial products and services tailored to suit investors' objectives. It is against this background that we believe the ETF industry will gain traction and other exotic products will be gradually introduced.

The Securities and Exchange Commission (SEC) has recognized this opportunity and in 2015 drew up a 10-year Capital Market Master Plan. Among its objectives was the need to further broaden and deepen markets in order to remain competitive:

"[The SEC will] examine successful growth strategies in other jurisdictions and articulate a development strategy for the Nigerian capital market covering key areas such as investor protection and education, professionalism, product innovation and expansion of the role of the capital market economic development".[6]

This is a clear message and an invitation for institutions to invest in product development and innovation.

Since the release of this plan, the SEC has embarked on campaigns to educate investors, denouncing ponzi schemes and sham investment opportunities that promote quick access to dividend payments. These and other initiatives will help improve market confidence and transparency. Even though this has not directly impacted the growth of ETFs and other product initiatives, it would help in creating an enabling environment for their further market acceptance.

We do not expect to gain traction in the near term with product development and innovation as current investor sentiment is characterized by general uncertainty and caution as a result of the economic slowdown. However, as the SEC's plan gradually comes to fruition, we expect a shift in the regulatory environment. This will help produce opportunities that may encourage a growing number of firms to enter the ETF market. Furthermore, the desire of fund managers to differentiate their product offerings to address the needs of specific investor segments will ensure the rapid growth of the industry.

ETFs are on the path to a diversified market

The benefits of having diverse investment products like the ETF cannot be over emphasized. They are essential in markets with a significant low product to investor ratio such as ours. This gap is expected to be bridged over the coming years.

However, our regulators and fund managers have key roles to play in ensuring the right products are introduced to the market and that product proliferation does not lead to investor abuse.

[6] Securities & Exchange Commission, The Nigerian Capital Market Master Plan (2015-2025), 2015 Page 9

The Central Bank of Nigeria's (CBN) recent introduction of a flexible foreign exchange (forex) policy and the commencement of a futures forex market leads us to believe that the next wave of market driven changes will be in the capital markets. There are plans to introduce esoteric securities, including equity options and futures that would deepen the markets and give investors more confidence in products to meet their investment objectives.

We believe that before these products are introduced, other existing products, such as ETFs and mutual funds, will gain greater investor acceptance.

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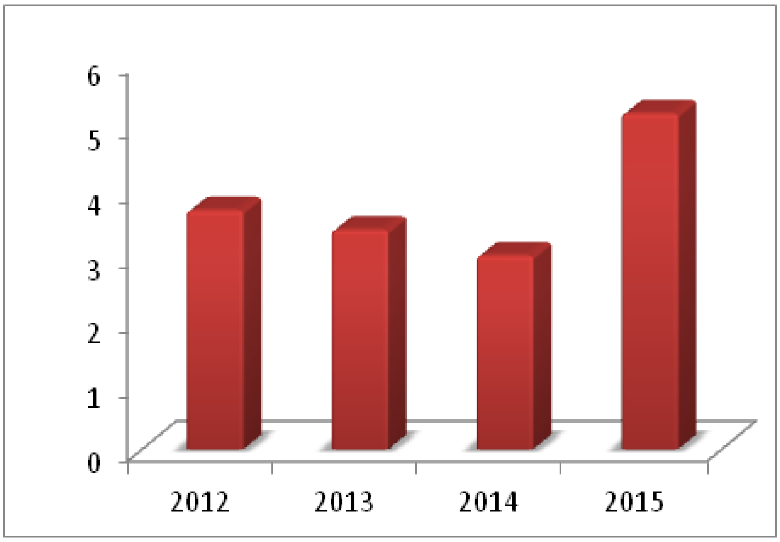
The Rising Trend of Non-Performing Loans in Nigeria

The decline in oil prices has led to a cycle of economic and social problems in Nigeria, affecting all sectors in one way or the other. The banking sector is not immune. The inability of businesses to access foreign exchange (forex), rising inflation, the shortages in premium motor spirit (PMS) leading to long fuel queues and power shortages have all affected the ability of businesses to meet up with their financial obligations to the banks.

The release of the 2015 results for public companies shows that a decline in corporate performance is the general trend. Most manufacturing companies who depend on imported raw materials have been unable to meet production and sales targets due to the high cost of forex. In a bid to manage the situation and maintain profits, businesses have adopted several measures to severely cut costs, such as reducing staff, delaying the payment of salaries, and increasing prices. Repayment of loans has also become a problem. As a result, there has been a rise in the incidence of non-performing loans (NPLs). In 2015 alone they rose by 73.3%.[7]

Chart 3 : Ratio of Nigeria's NPL's to Total Gross Loans over the Last Four Years



[7] World Bank. February 2016. "Bank nonperforming loans to total gross loans (%)". http://data.worldbank.org/indicator/FB.AST.NPER.ZS

Effect of Rising NPLs on the Economy

There are three major consequences that are likely with the rise of NPLs. First and foremost, the credit available to businesses and individuals is likely to reduce as banks will fear that obligations will not be met when due. With the cost of business on the rise and the resulting increase in the need for working capital, a reduction in banks' willingness to lend will significantly affect economic output and growth.

The second likely consequence of an uptick in NPLs is a weak cash flow position for the banks, creating illiquidity and affecting the ability of the banks to pay depositors. Depositors in the banks may be unable to receive returns and in worst case scenarios, the depositors could lose their assets completely. To curb the effect of these losses, the banks may charge higher interest rates on loans and provide lower deposit interest rates. This will discourage savings and stifle economic growth.

The third likely consequence is the issue of lost opportunity. Funds that would have been used for other projects that might have been more profitable or at least practical, were either used for failed projects or will now be unavailable due to greater lending restrictions.

NPL Hedging Strategies

In an effort to try to reduce these impacts, banks can adopt strategies to either minimize or hedge against the effects of the NPLs. These can be divided into proactive and reactive approaches.

Proactive Approaches

In-depth Customer Knowledge

This approach focuses on having a broad knowledge of the borrower. This involves not just an understanding of the business of the borrower, but that of the borrower's industry in general. It includes researching other players in the industry, regulatory constraints, the macroeconomic environment and how it affects the business.

Strong Corporate Governance

The importance of strong corporate governance in the banking and financial sectors cannot be overemphasized. This ensures that adequate supervision is in place when granting credit to customers. A strong corporate governance structure ensures that the bank undertakes due diligence before new credit is released. Though steps taken should not be unnecessarily bureaucratic, they should ensure that all relevant areas including risk management, securitization, and legal procedures are fully covered and well documented.

High Quality Securitization

There is need to ensure that the credit is not just collateralized but that the collaterals provided are sufficient and cover the credit to be availed. This gives banks a cushion in the event the borrower is unable to repay the loan. In addition, there should be sophisticated analytical techniques for proper management of the collateral so as to reduce the incidence of unexpected loss of value on the asset.

Database Integration

Database information should be readily available to significant business units and triggers should be set in place to alert the units in instances of a potential default risks.

Legal Cover

Financial institutions should also ensure that they properly manage their litigation processes and are covered in all legal areas. This ensures that, if the need arises, they have a good chance to recover all or most of their funds. In cases where debtors are unable to pay down debts, they take advantage of loopholes in credit agreements signed to avoid meeting their obligations. It is thus necessary for financial institutions to have strong legal backing on every step of the credit process.

Reactive Approaches

Default Warning Signals

A major cause of the rise of NPLs is the issue of default recognition. Often, in a bid to manoeuvre the regulatory implications of NPLs in the books, default loans are left to linger for a long period of time before necessary and effective measures are put in place to recover funds. NPLs should be recognised early enough to make way for possible solutions to curb their effects.

Debt Sale and Loan Restructure Mechanisms

Recognising a default account on time makes it possible for businesses to be given the option of restructuring their loan if the account is still viable. This way, debtors are given the chance to repay their loans before more vigorous collection methods are adopted. Loan restructuring gives debtors the opportunity to pay back the loan over a longer period of time.

Retain More

It is important for banks to retain more of their earnings when faced with a high occurrence of NPLs. This will help boost the capital adequacy ratio of the bank, keeping the balance sheet in a strong position.

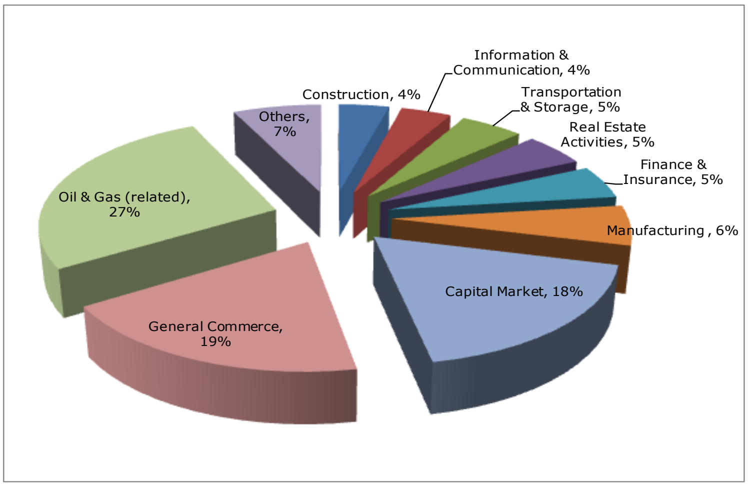
Government Intervention in Managing NPL's

The intervention of the government is a common mechanism to manage NPLs. Due to the critical nature of the functions of the bank in ensuring economic growth, the intervention of the government to a degree is important.

In 2010, the Federal Government of Nigeria established AMCON (Asset Management Corporation of Nigeria), for the sole purpose of managing the NPLs of Nigerian banks. These NPLs, also called Eligible Bank Assets (EBAs) were bought by AMCON from 22 Nigerian banks and cut across various sectors with significant exposure to the oil and gas sector.[8] Though AMCON has experienced difficulty in recovering these loans, they are in a much better position to recover these loans due to their capacity as a government parastatal and their level of specialisation in such matters.

Sector	Percentage of AMCON Portfolio
Oil and Gas	27.23%
General Commerce	18.49%
Capital Market	17.93%
Manufacturing	6.24%
Finance and Insurance	5.47%

Chart 4 : Sectorial Distribution of EBAs



The banks are in for a bumpy ride

The increase in NPLs may not end soon as the economy is still in a very uncertain state. However, there is bound to be some level of adjustment as businesses will strive to align with the new economic direction. This, coupled with the strategies above, if adopted by the financial services sector, will likely give rise to proper management of credit by banks in the medium to long term.

[8] http://www.amcon.com.ng/About-our-work.aspx

Global Perspective – IMF forecasts Nigeria will fall into recession as the country's economic woes deepen - Culled from the FT

Nigeria will slide into recession this year for the first time in more than two decades as Africa's largest economy grapples with a deepening economic crisis, the International Monetary Fund said.

The IMF forecast on Tuesday that the economy will contract by 1.8 per cent in 2016, slashing an estimate in April of 2.3 per cent growth for the year.

Low oil prices have plunged Nigeria, which is the continent's top crude producer, into its worst crisis for years as it struggles with a foreign currency shortage, rising inflation and falling state revenue.

The economic woes deepened in 2015 after the central bank imposed currency restrictions in an attempt to protect falling foreign reserves, further slowing the economy and scaring off investors. A spate of recent militant attacks in the oil-rich Delta has exacerbated the government's problems, reducing oil output at the worst possible time.

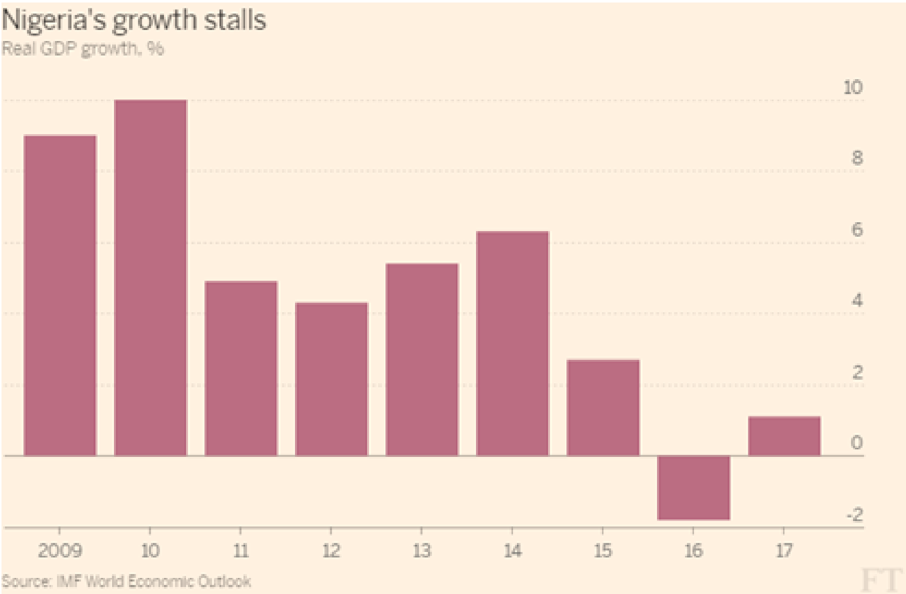
The IMF said "economic activity is now projected to contract as the economy adjusts to foreign currency shortages as a result of lower oil receipts, low power generation, and weak investor confidence".

The economy shrank by 0.36 per cent in the first three months of the year. The IMF also sharply cut its growth forecast for 2017, from 3.5 per cent to 1.1 per cent.

Nigeria — Africa's most populous nation — was one of world's fastest growing economies during the oil boom and it was attracting increasing levels of interest from investors keen to tap into the potential of its young, fast growing population.

But now its economic travails are helping drag down forecasts for sub-Saharan Africa, with the IMF estimating that the region will grow at 1.6 per cent this year.

Amid pressure to allow the naira to depreciate, the central bank did remove a currency peg in June that had worsened dollar shortages. But liquidity remains thin and some analysts say the bank is still intervening too much in the foreign exchange market.



Inflation accelerated to 16.5 per cent in June, the highest level in more than a decade.

President Muhammadu Buhari's government — which depends on oil for about 70 per cent of revenue — has pledged to revive the economy with a record budget that is heavy on infrastructure spending. But last week Udoma Udo Udoma, the budget minister, said first quarter revenues had come in just over half the target, and Nigeria has yet to secure funding to plug a $11bn budget deficit.

Still, Razia Khan, chief Africa economist at Standard Chartered, said economic conditions could improve in the second half of the year. "It is still early days for the new foreign exchange regime and implementation of the budget", she said, calling it a "bit of a stretch" to say a contraction for the year was guaranteed.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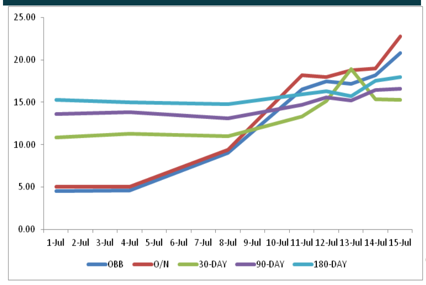
Macroeconomics Indicators

Money Market

The opening liquidity position in the money markets for the first half of July was much lower than that of the corresponding period in June. Markets opened on the 1st of July with a liquidity position of N267.1bn long. This is a 35.3% decline from June's level of N412.54bn. There was a steady decline in liquidity within the period under review to a slow as N41bn before a gradual pickup to N137.3bn on July 15th. Average liquidity position stood at N153.7bn, 61.9% lower than the corresponding period in June of N403.8bn long. The decline was due to forex funding and frequent interventions by the CBN in the money market via OMO and Treasury bills. 5-Year, 10-Year and 20-Year FGN bonds worth N120bn were auctioned towards the end of the first half of July, contributing to the mop up of liquidity in the money market.

Short-term interbank rates (OBB, O/N, 30-Day) averaged 13.7% p.a. between July 1st to 15th, 780bps higher than the corresponding period in June with an average of 5.9%. This corresponds with the decline in liquidity. As at July 15th, the OBB and O/N rates were at 20.83% p.a. and 22.75% p.a. respectively. These rates are 1,641bps and 1,779bps higher compared to the first half of June. The yields on Treasury bills have also moved in tandem with liquidity in the market, with 91-day T/bills at 14.6567% and 364-day at 19.7211% compared to 10.2502% and 17.6371% in the previous month.

Chart 5: NIBOR % p.a.



[9]

Outlook

The Monetary Policy Committee is scheduled to meet on the 25th – 26th of July and is facing a dilemma of curbing rising inflation or stimulating growth. In a period of contracting economic activities, the conventional logic is to pursue growth. In addition, inflationary pressures have been supply shock driven; hence a further tightening in interest rates may not have the desired effect on inflation. We expect money market indicators to move in tandem with the direction of monetary policy and liquidity.

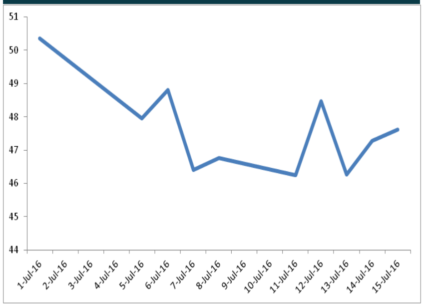
[9] CBN, FDC Think Tank

Oil Market

Oil Prices

Global oil prices (Brent crude) averaged $47.61pb in the first half of July. This is 5.7% below the average price of $50.5pb in the corresponding period in June. Global uncertainty following the Brexit vote in late June, coupled with supply recovery in countries such as Nigeria, Canada and Libya are having a downward pressure on prices. Data from the Energy Information Administration (EIA) indicates a decline in global demand forecast for 2016 by 10,000 bpd to 1.44million bpd. However, this is a very modest revision compared to the supply glut of over 1.1mbpd.

Chart 6: Brent Crude Oil ($/b)



[10]

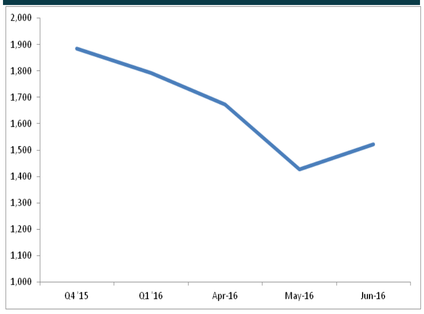
Outlook

A continued decline in prices is expected, given the ongoing increase in global supply. Iran has reached pre-sanction levels of production and shows no signs of slowing down production. The downgrade of global growth to 3.2% by the International Monetary Fund (IMF) in the first half of July would reinforce negative sentiment that global oil demand will decrease and in turn make oil prices bearish.

Oil Production

Nigeria's oil production level recovered in the month of June from May's record decline. Production stood at 1,523mbpd, which is 97,000bpd higher than May production levels of 1,426mbpd according to the OPEC monthly oil market report. June's production figure is 30.8% below the 2015 budget benchmark of 2.2mbpd and 15.4% below Nigeria's OPEC quota of 1.8mbpd. Pipeline vandalism in the Niger Delta still persists with recent attacks recorded in the outskirts of Warri, Delta state. The destruction of these oil infrastructures also extended to Ogun state in the South West region of the country.

Chart 7: Oil Production (mbpd)



[11]

[10] Bloomberg
[11] OPEC Monthly Report

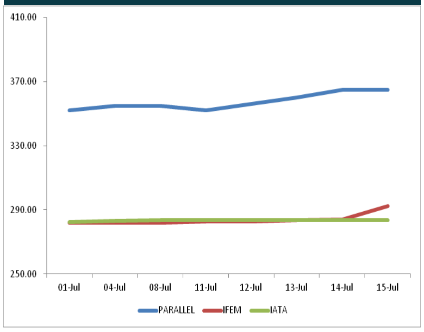
Outlook

The challenges in the Niger Delta remain a major cause for concern. The pipeline vandalism has reduced Nigeria's oil production significantly, thereby crippling funding of the government's fiscal plans and denting the dollar cash flow. If this continues it could lead to a reversal of key policies implemented.

Forex Market

The naira has weakened in all market segments as illiquidity concerns mount up and demand pressures increase. This in turn is orchestrating a further divergence in forex market rates in the economy. The parallel market lost 3.56% to close at N352/$ on July 2015 while the IFEM rate depreciated to N292.35/$ by July 15th from N283.13/$ on July 1st. The IATA rate of exchange also weakened to N283.5/$ as at July 15th, a 0.35% decline from N282.5/$ as at July 1st. There is still significant intervention in the market by the CBN following the implementation of the flexible exchange rate system.

Chart 8: Forex (N/$)



[12]

Outlook

Investors are still adopting a wait and see approach about the sustainability of the flexible exchange rate system. Illiquidity concerns alongside summer demand would continue to put pressure on the naira. Nonetheless, as the naira moves towards N300-N310 level, and market rates converge, this would attract the CBN and sellers to offer more dollars.

External Reserves

Gross external reserves declined by 0.17% to $26.34bn as at July 15th from $26.39bn at the start of the month. Year to date, the reserves level has depleted by 9.11% ($2.59bn).

[12] CBN, FDC Think Tank

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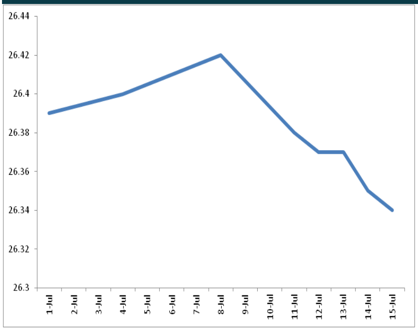
Chart 9: External Reserves($ 'bn)



[13]

The reserves level still includes the 90-day forward transaction of $3.48bn and Letters of Credit in arrears. Therefore net reserves are approximately $20.85bn, with an import cover of 3.37months.

Outlook

The outlook of the external reserves is subject to a recovery in oil proceeds. In addition, the CBN's frequent intervention in the forex market to meet demand would continue to deplete the reserves level.

[13] CBN, FDC Think Tank

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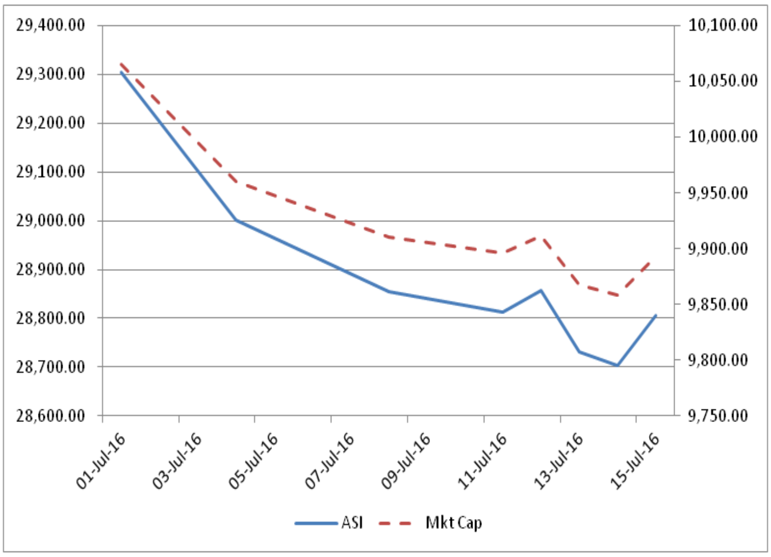
Stock Market Update

In the face of a worsening risk environment, the Central Bank of Nigeria (CBN) stepped up on its regulatory function and invoked a partial dissolution of the board of Skye Bank Plc (a systematically important bank) on grounds of gross mismanagement. This action came at a time when both local and foreign investors were questioning the health of the listed banks following a series of downgrades by international rating agencies.

The International Monetary Fund's (IMF) also revised its outlook on the Nigerian economy for 2016 from moderate growth to a contraction increasing investor fears

The Nigerian Stock Exchange (NSE) All Share Index (ASI closed at 28,805.45 down 2.68% from 29,597.79 at the end of last month. Market capitalization also decreased by 2.68% in the first two weeks of July from N10.17trillion to N9.89trillion. Year to date (YTD) return of the market however remained in positive territory of 0.57%.

Chart 10 : NSE Performance



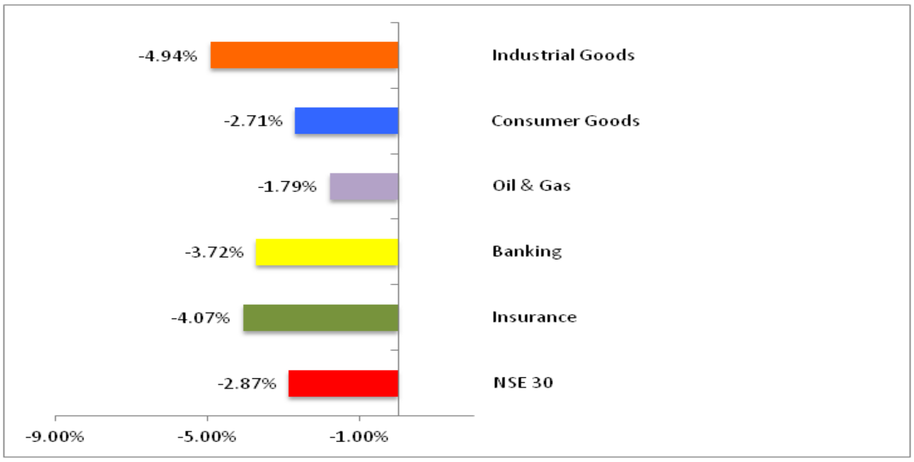
[14]

All sectors recorded negative performance during the period under review. The performance of the industrial goods sector had the worst performance (-4.94%) following profit warnings by Larfarge

[14] NSE, FDC Think Tank

Africa, which shed 9.40% during the period under review. Drop in the share price of AXA Mansard and NEM Insurance also saw the insurance sector shed 4.07% in the first two weeks of July. The banking sector and the consumer goods sector lost 3.72% and 2.71% respectively whilst the oil and gas sector recorded the a loss of 1.79% as the positive performance of Oando and Conoi managed to mitigate the effect of drop in the share prices of MRS and Forte Oil Plc.

Chart 11 : Bi-Monthly Sectoral Performance



[15]

The financial services sector dominated activities on the exchange during the period under review accounting for 49.26% of the total value traded. The consumer goods sector accounted for 23.61% whilst industrial goods, oil & gas and conglomerates sector accounted for 16.21%, 5.39% and 1.87% respectively. Total value of stocks traded within the period was 19.48bn while market breadth declined to 0.27x as 59 stocks declined against 16 stocks that advanced. 117 stocks remained unchanged during the period under review.

The best performing stocks include Conoil 9.18%, UBA Capital 7.26%, Oando 5.85%, GREIF Nigeria 4.98% and Red Start Express 4.88%.

[15] NSE, FDC Think Tank

GAINERS			
COMPANY	15-Jul	30-Jun	% Change
Conoil Plc	25.22	23.10	9.18%
UBA Capital Plc	2.66	2.48	7.26%
Oando Plc	6.88	6.50	5.85%
Greif Nigeria Plc	9.69	9.23	4.98%
Red Star Express Plc	4.51	4.30	4.88%

Top losers during the period were; Fortis MFB -49.90%, Skye Bank -42.31%, Trans-Nationwide Express -24.63%, NPF MFB -22.31%, Glaxo-Smithkline Consumer -7.92%.

LOSERS			
COMPANY	15-Jul	30-Jun	% Change
Fortis Microfinance Bank Plc	2.58	5.15	-49.90%
Skye Bank Plc	0.60	1.04	-42.31%
Trans-Nationwide Express Plc.	1.01	1.34	-24.63%
NPF Microfinance Bank Plc	0.94	1.21	-22.31%
Glaxo Smithkline Consumer Nig. Plc.	18.05	23.02	-21.59%

Corporate Disclosures

Oando released its much-anticipated full year 2015 result and although the company reported a loss during the period, its revenue grew by 73.81% from the same period in 2014. Loss for year came to N49.67bn, a 65.89% improvement from its FY 2014 results. The group also released Q1 2016 immediately afterwards which saw the company return to profit after years of reporting losses. However, in a dramatic twist, the Oando group issued a profit warning just as investors were assessing the auditor's fears on the company as a going concern.

United Capital Plc also released its H1 2016 results, which was stellar by any standard. Gross earnings grew by 32.90% from N2.75bn to N3.66bn. In a bid to improve bottom-line, the company managed to cut expenses by 4.8%. Profit for the period also grew by 154.93% buoyed by gains from extraordinary operations.

Half-year results of Nigerian Breweries Plc showed a drop of 2.36% in revenue. Finance costs also increased sharply by over 150% worsening an already poor top-line. The rise in finance costs was attributed to foreign exchange losses. Profit after tax came to N19.07bn, down 11.23% from N21.48 recorded in the same period last year.

Unilever's half year results was a sharp contrast to Nigerian Breweries. Revenue growth came to 12.2% even as the company cut its finance cost by 55.86% and managed to report profit of N52.20mn from a loss position of N504.87mn last year.

Larfarge Africa issued profit warning on its expected Q2 results. The company cited shortages in gas supply as well as the Naira devaluation against USD, which would result in unrealised exchange loss. It however stated that unrealized exchange rate loss would have no immediate impact on cash flow and remained positive that the various initiatives, which have been put in place by management, will improve the future performance of company.

Outlook

We expect the market to be bearish in last two weeks of July. Foreign investors may remain on the sidelines until the half-year results are released before cherry picking stocks with good fundamentals.

Sell pressure is expected to persist as unimpressive results are released creating attractive entry prices for speculators. Timing the market has never been an effective strategy. Therefore, Investors are advised to identify their expected return, pick and entry price and take position(s) in stocks after necessary due diligence.

Corporate Focus- Transcorp Nigeria Plc

Sector: Conglomerate

Ticker Symbols: NSE: TRANSCORP BLOOMBERG: TRANSCOR:NL REUTERS: TRANSCO:LG FT: TRANSCORP:LAG

Shares Outstanding: 40.65b TP Downside: 3.1% Target Price: N1.56 Market Cap: N59.76b 2015 Annual Dividend: NIL 2015 Annual Dividend Yield: 2.53 Price: N1.61

TRANSCORP NIGERIA PLC: Currency alignment necessary measure but mixed for Transcorp Nigeria Plc

Analysts Recommendation: HOLD

Recommendation Period: 6 months

Analysts Note

Transcorp's Q1 2016 result shows a fair performance given the condition of the Nigerian economy throughout most of 2015-. Compared to Q1 2015, revenue was up by 33.2% from N9.9 billion to N13.19 billion. The increase was fueled by occupancy increases in its hospitality business unit and growth in its power sector operations. However, both profit before and after tax were down, as high operational costs ate into profit margins. As a result, profit before tax dropped by 33% from N2.57 billion to N1.72 billion and profit after tax dropped by 45.2% from N2.19billion to N1.2 billion. The profit margin also dropped from 57.1% in Q1'15 to 44.8% in Q1'16. Natural gas and fuel costs were key drivers of this drop. Costs in this areas increased by 134.6% from N2.12billion to N4.98bn.

Notwithstanding Transcorp's fair performance, several factors that could alter the company's earnings and profitability level. The continued low oil price has translated to low dollar revenues for Nigeria and has forced an economic reform. These include partial deregulation of the downstream sector, hike in electricity tariff by 54% and exchange rate adjustment from pegged exchange rate to a floating exchange rate. These three factors have curtailed the purchasing power of the average Nigerian. Thus, consumer resistance has kicked-in by way of lifestyle adjustment to the new reality.

We expect revenue and profitability to rise in the second half of 2016 as the economy goes through a recovery phase, engineered by countercyclical spending to the tune of N6.06billion and an accommodative monetary policy stance. Accordingly, we place a HOLD rating on Transcorp. This is a downgrade from our last BUY rating on the company's stock.

Profile

Transcorp was incorporated in November 2004 as a private limited liability company. In December 2006, it was listed on the Nigerian Stock Exchange (NSE). Its diversified business units include power, hospitality, agriculture and oil and gas, of which the hospitality arm of the business represents 34.3% of the group's earnings. The company has collaborated with strategic companies and state governments such as Hilton, Benue State Government and the Nigeria Bottling Company to provide products that meet consumers' needs.

BUSINESS SEGMENTS	OVERVIEW
Power	Transcorp Ughelli Power Limited (TUPL) is a subsidiary of Transnational Corporation of Nigeria Plc (Transcorp). On August 21, 2013, TUPL made full payment of $300 million to the Bureau of Public Enterprises, representing 100% of TUPL's bid price for the plant. Transcorp Power operates the Ughelli Power Plant, which has an installed capacity of 900MW. TUPL has increased the available capacity at Ughelli Power Plant from 160 MW (November 2013) to 634 MW (December 2015). TUPL's medium term plan is to increase generating capacity at the plant to over 2,500 MW by 2018.
Oil and Gas	Transcorp Energy Limited is a fully owned subsidiary established in 2008 to spearhead Transcorp's push into the energy sector as well as its focus on upstream petroleum development. Transcorp has signed a production sharing contract with the Nigerian National Petroleum Corporation for the development of its oil block OPL 281. OPL 281 is located in Delta State, Nigeria.
Agriculture	Teragro Commodities Limited is the agribusiness subsidiary of Transnational Corporation of Nigeria Plc. Incorporated in 2008, the company is the operator of the 26,500 metric ton capacity Teragro Benfruit Plant in Benue State, Nigeria's first-of-its-kind juice concentrate plant. The company's strategic partnership with Coca Cola has seen sales growth in 2015 rise by 528%. Margins and portability remain weak due to the high cost of orange inputs resulting from activities of intermediaries and generally low fruit yield. As such the Group agro-allied arm recorded a loss of N247.6million
Hospitality	Transcorp Hotels Plc aims to build Africa's choice hospitality assets, starting from Nigeria but building a strong footprint in high population cities across the West African region.

Transcorp's objective to create long-term shareholder returns and social-economic impact, has seen its revenue grow exponentially by 24% between 2010 and 2015. During this same period, current and non-current assets grew by a CAGR of 38% and 24% respectively.

In Millions of NGN except Per Share 12 Months Ending	FY 2011 12/31/2011	FY 2012 12/31/2012	FY 2013 12/31/2013	FY 2014 12/31/2014	FY 2015 12/31/2015	CAGR %
Non-Current Assets	51,472.27	74,942.30	122,211.61	134,742.94	152,124.32	24%
Current Assets	9,999.81	24,615.36	27,252.80	36,012.43	50,759.63	38%
Total Non-Current Liabilities	10,117.06	18,864.68	47,050.82	48,732.33	72,346.94	48%
Total Current Liabilities	10,396.29	16,596.35	15,737.08	32,268.18	43,031.78	33%
Net Assets	40,958.74	64,096.64	86,676.51	89,754.85	87,505.23	16%
CAPITAL AND RESERVES						
Share Capital	12,907.00	12,907.00	19,360.50	19,360.50	19,360.50	8%
Share Premium	27,071.66	27,071.66	7,213.37	7,213.37	7,213.37	-23%
Other Reserves	(11,218.97)	1,879.73	31,703.97	30,208.01	28,138.36	-220%
Non-Controlling Interest	12,199.05	22,238.25	28,450.24	33,248.56	33,726.38	23%
Total Equity	40,958.74	64,096.64	86,728.08	90,030.43	88,438.60	17%
COMPREHENSIVE INCOME						
Revenue	13,901.45	13,244.85	18,825.28	41,338.14	40,753.51	24%
Profit Before Tax	4,605.93	3,948.22	9,032.15	7,731.60	3,319.53	-6%
Taxation	1,255.70	(1,420.47)	(2,074.25)	(4,427.34)	(1,287.97)	-201%
Profit After Tax	5,861.62	2,527.75	6,957.90	3,304.26	2,031.56	-19%
Source: Bloomberg, Company Data & FDC Think Tank						

Management

Transcorp Plc has a strong management team led by Tony O. Elumelu (Chairman) and Emmanuel N. Nnorom (CEO). They joined the board in 2011 and 2014 respectively. Mr Elumelu is an economist, investor, and philanthropist. In his early career, he made a name for himself by turning the nearly bankrupt Standard Trust Bank into a top-five player in Nigeria. In 2005, he led the largest merger in the banking sector in sub-Saharan Africa, acquiring United Bank for Africa (UBA), which he presently chairs. He also chairs Heirs Holdings and is the founder of the Tony Elumelu Foundation. His investments are informed by his philosophy of Africapitalism.

Emmanuel N. Nnorom (CEO) is a qualified chartered accountant with over three decades of professional experience in the corporate and financial sectors. Prior to joining Transcorp, he was President/ Chief Operating Officer of Heirs Holdings Group. He also served as CEO of UBA Africa, overseeing its operations outside Nigeria and executing corporate strategy in 18 African countries. Other senior roles within UBA included Group COO, followed by his appointment as UBA's Group CFO, with responsibility for Finance and Risk. He is an alumnus of Oxford University's Templeton College, and a prize winner and Fellow of the Institute of Chartered Accountants of Nigeria.

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For more information:

Henry Onukwuba
honukwuba@lbs.edu.ng
0708 007 0548/ 0701 990 0759

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For executives with existing and expanding business in Africa

This programme aims to deepen participants' knowledge of doing business in Africa and take advantage of the limitless opportunities the continent offers.

September 19, 2016 | **Duration: 4 Months**

For more information:

Bridget Chukwumah
bchukwumah@lbs.edu.ng
0701 990 0759/ 0708 007 0552

Application Deadline: September 5, 2016

Advanced Management Programme

For general managers and directors reporting to CEOs

This programme is designed to help experienced senior managers refine their management and leadership skills needed for continued career advancement.

March 14, 2016 | **Duration: 5 Months**

For more information:

Bridget Chukwumah
bchukwumah@lbs.edu.ng
0701 990 0759/ 0802 478 2466

Application Deadline: February 29, 2016

Senior Management Programme

For regional managers, unit heads and assistant general managers

This programme is designed for functional managers to enhance their strategic thinking capabilities and build their personal and leadership skills.

1st run: **February 15, 2016**
2nd run: **April 18, 2016** | **Duration: 6 Months**

For more information:

Henry Etok
hetok@lbs.edu.ng
0708 007 0551 / 0708 007 0552

Application Deadline: February 1, 2016
April 4, 2016

Management Acceleration Programme

For high-potential young professionals

This programme is focused on providing the skillset required to accelerate the positive impact young professionals can have on their organisation.

May 11, 2016 | **Duration: 4 Months**

For more information:

Olasunkanmi Adenuga
oadenuga@lbs.edu.ng
0802 478 2466 / 0701 990 0759

Application Deadline: April 27, 2016

Owner Manager Programme

For founders and business owners

This programme is designed to position your company for improved performance and consistent growth by mastering what it takes to build a successful and sustainable business.

March 7, 2016 | **Duration: 6 Months**

For more information:

Ebun Emelogu
eejirinde-emelogu@lbs.edu.ng
0708 007 0552 / 0708 007 0551

Application Deadline: February 22, 2016

Agribusiness Management Programme

For agric sector managers and value chain players

This is an innovative and stimulating learning experience that integrates classroom and action learning in providing the specific business skills required for the agricultural sector.

April 11, 2016 | **Duration: 6 Months**

For more information:

Ope Oteri
ooteri@lbs.edu.ng
070 800 0553 / 070 800 0548

Application Deadline: March 28, 2016

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Lagos Business School is ranked with the world's top business schools in open enrolment executive education (2007-2015) and custom executive education (2015).

Financial Times, London.

In sum, Transcorp's executive management team comprises of individuals that possess the requisite experience to steer the company towards attaining its value proposition and improving operational efficiency, enhancing its competitive position and having a huge developmental impact in Nigeria.

What the Bulls and Bears Say

The Bulls Say:

- Transcorp's diversified revenue stream, which cuts across various sectors such as hospitality, agro-business and energy, reduces volatility that could arise from macro-economic conditions.
- Strategic alliances with strong international organizations such as Hilton and Coca-Cola ensure enhanced standards in its hospitality business and capacity utilization/marginal contribution of its agriculture venture.
- Huge demographic opportunities in Nigeria which serve as a market for its product and services.
- Transcorp is consistently delivering on expectations to increase the installed capacity of its main power asset, with Ughelli Power's capacity reaching 634 MW in 2015.
- The January-February electricity tariff increase of 54% is likely to be the main driver of Transcorp's results in 2016 – we expect an additional N9.8billion of revenue.

The Bears Say:

- The current economic climate and outlook will generally weigh most on the hospitality business and the business at large in terms of occupancy levels, finance costs and profit margins:
  - Exchange rate conundrum
  - Slow GDP growth
  - Insecurity in the northern region of the country

- Creeping inflation

- Frequent interruptions of gas supply to the power station will affect Ughelli's power generation capacity.
- The Multi Year Tariff Order for electricity tariff is not cost reflective as most of the National Electricity Regulatory Commission's allowable revenue variables (exchange rate, inflation, gas cost etc.) are not in tandem with current macroeconomic landscape thus affecting the company's profitability.
- High debt exposure (gearing ratio 72%) puts the company in a precarious position in terms of flexibility to raise capital in a period of business downturn, though the gearing ratio cap of 75% set by the Group has not been exceeded.
- Naira depreciation by 42% to N282 might stagnate the occupancy level of hospitality arm, as hospitality business is elastic.

Investment Thesis

FDC places a HOLD recommendation on Transcorp Nigeria Plc stock based on a detailed analysis of the company's intrinsic valuation, dampened consumer demand, deteriorating macroeconomic conditions and improving earnings prospects. This is a downward review on the previous BUY rating at the price of N2.62 that we placed on our last Transcorp equity report in December 22, 2015. The company's share price eventually declined from N1.77 in December to 98 kobo in February 15, 2016 and its YTD low of 96 kobo in April 15, 2016. The 58.3% appreciation of Transcorp's stock in the last eight weeks is due to the positive sentiments about the Central Bank of Nigeria's new exchange rate policy and the euphoria over the re-ignition of foreign portfolio investor participation in Nigeria's equities market.

Transcorp has continued to show a brave heart in developing its OML 28 oil field despite industry hitches of low oil prices and investment cut backs in the sector. For the next two years, the oil and gas business unit will continue to be a cost center, but the diversification to the sector is definitely a positive. The Group's financial health is relatively solid though the 'gearing ratio' (high debt exposure) has spiked to 72% (2015) from 50% in 2014 and 39% in 2013. This is close to the Group's threshold of 75% and is likely to have implications on shareholders' value in the interim. Another concern is the effect of the recent policies implemented (currency adjustment, fuel subsidy removal, increase in electricity tariff, the fuel price adjustment) and the ability of Transcorp to transfer the cost-push and imported inflation to its consumers. In addition, disruption in gas supply to its power station in Delta will hinder power capacity generation.

We believe that Transcorp's impressive business portfolio will ensure stable cash flow to weather business challenges. However, the macroeconomic conditions could impede the ability to grow its revenues and profitability. Thus, we believe Transcorp Nigeria is appropriately valued and therefore do not foresee a significant upside or downside in its share price.

Transcorp Plc Valuation using DCF/FCFE

Our intrinsic value for Transcorp Plc was arrived at by using a Discounted Cash Flow (DCF) valuation method. Key assumptions include:

1. The DCF valuation method is based on a three year projected financial statement.
2. We assumed a terminal growth rate of 6.5% in estimating the company's future cash flows.
3. A cost of equity of 20.26% (capital asset pricing model), a beta of 1.55[14], a risk free rate of 12.51% (the rate for a 3-year FGN bond maturing in 2018), an after-tax cost of debt of 8.83%, and a market risk premium of 5%.
4. The valuation took into consideration the near term outlook such as the company's growth and profitability, the growth prospects of the agriculture and energy sectors, the value creation from strategic alliances, hospitality business expansion

[16] Financial Times data

plans, general global and domestic oil and gas industry trends and the prevailing macroeconomic conditions.

5. We forecast a three-year revenue growth CAGR of 12.8%.
6. The target price of Transcorp Plc is N1.56, which is at 0.01% premium to the current price of N1.52 as at June 17, 2016.

As such, we recommend a HOLD on the stock for a period of 12 months.

3 Year Free CashFlow to Equity Projections			
TRANSCORP NIG. PLC	2016 N'mn	2017 N'mn	2018 N'mn
Turnover/ Revenue	47,030	56,544	67,445
EBITDA	23,666	27,396	34,138
EBIT	15,035	21,117	26,786
Less: Cash Taxes @ 22%	10,347	12,440	14,838
Tax-effected EBIT (NOPAT)	4,689	8,678	11,948
Plus: Depreciation & Amortization	8,630	6,278	7,352
Less: Capital Expenditures	(3,059)	(2,687)	(7,389)
Less: Change in Net Working Capital	(6,740)	(2,583)	(9,852)
Unlevered Free CashFlow	3,520	9,686	2,059
WACC @13.9%	13.99%		
NPV of Unlevered Free Cash Flow	11,932		

PERPETUITY GROWTH RATE	Undiscounted	Discounted	EBITDA Multiple
Perpetuity Growth Rate @6.5%	169,839	114,659	4.98
Discounted Cash Flow			126,591
Equity Value			63,229
Implied Price Per Share			1.56

Risk

The new exchange rate regime has economic upsides for the most part, though it has a downside risk to the power sector as natural gas is priced in dollars. This could result in a lower gross margin since power business unit contributes 65.5% to revenue. Furthermore, economic woes might see consumers' product preference shift. Thus Transcorp may be unable to turn the loss arm of the Group (Agro-allied: N247.6million) to profitability sooner than anticipated. Finally, the Niger Delta Avenger's incessant gas pipeline vandalism will impede on Transcorp's power generation ability with direct effect on attributable revenue.

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