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Bi-monthly Economic & Business Update

What is the meaning of an increasing misery index and how does it affect you?

Definition & Background

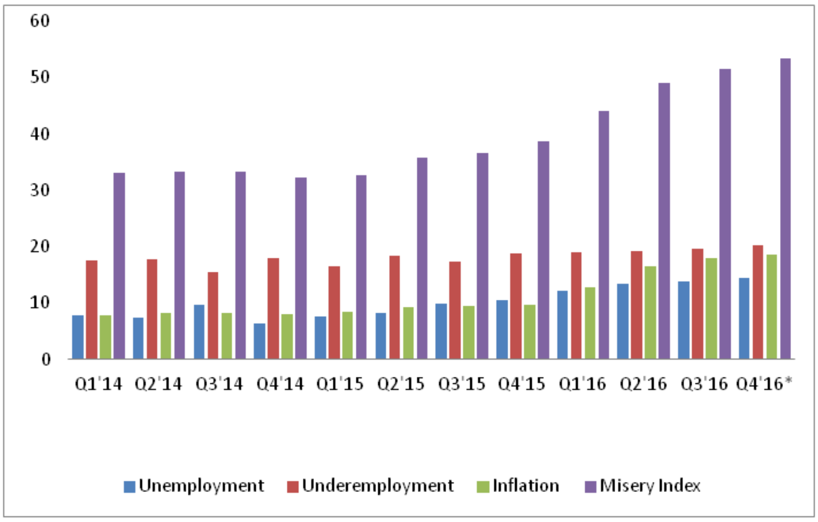
The misery index is an indicator that is used to determine how economically well off the citizens of a country are. It is the sum of the unemployment and underemployment rate and the inflation rate of the particular period.[1] These factors are important because they pose economic and social costs to the average income earner. An increase in the misery index is triggered by an increase in either variable, and signifies economic discomfort and negative consumer sentiment.

Using Q3'2016 unemployment and underemployment rate of 13.9% and 19.7% (the most recent published figures), and December's inflation of 18.55%, Nigeria's misery index is 52.15. Due to nationwide job cuts (in the banking and oil sector especially) unemployment is estimated to have risen to 14.5% in Q4'16. This will bring the misery index of the fourth quarter (2016) to a record high of 53.35. This is 21.05 points higher than Q4'14 figures.

INSIDE THIS ISSUE:

[1] Traditionally, misery index =unemployment rate + inflation rate. However, because Nigeria's unemployment figures do not paint a complete picture of the state of the labor market, the FDC think tank has added underemployment into its analysis

Chart 1: Misery Index



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Regional comparison

Leading the pack of high misery indexes in SSA is South Sudan, whose inflation rate of 457.20% in November 2016 has sent its misery index through the roof. Other countries with high misery index include Angola (67.92), Congo (57.3), Libya (46.9), Kenya (46.3). On the other hand, some countries such as Cameroon (4.55), Ivory Coast (5.1) and Uganda (9.5), still maintain low misery indexes. At 52.15, Nigeria's misery index is among SSA's top 10[3]

Implication & Outlook

Beyond the numbers, what is of most concern is the trend of Nigeria's misery index. The index has risen for the last six quarters. If this movement persists, consumers will be hit hard. They will face an even deeper dwindling in purchasing power, as their incomes can only buy less of their usual consumption basket. The poor will become poorer in real terms, and the middle class will thin out.

Additionally, climbing misery index implies declining economic activity and reduced consumption. This is because unemployed peo-

[2] NBS, FDC Think Tank

[3] Misery indexes of all stated countries are calculated using the most recently published figures

ple are underutilized and rising prices will discourage rational consumers from spending. This can cause or complicate an economic slowdown or contraction. There will also be increased debt, as the FG borrows money to increase social support schemes.

In the end, the citizens will be left with high uncertainty and low morale.

Furthermore, it is believed that consecutive rises in the misery index usually lead to a decline in the favourability ratings of the serving administration, and could result in a re-election loss for the incumbent. This was the case for U.S. President Ford and Jimmy carter, whose terms saw the misery index reach all-time highs. Likewise, Nigeria's 2015 elections reflected this hypothesis.

Angola and Venezuela Runaway Inflation and the Oil Curse

Natural resource curse hypothesis and empirical studies often characterize countries that fall prey to this state of inefficiency with deindustrialisation, bad growth prospects and currency disequilibrium. Our focus will rest mainly on the latter as forex market challenges and currency woes have contributed significantly to the astronomical hike in the price levels of net oil importers, Venezuela and Angola.

Venezuela and Angola are oil producing countries that pull their weights in their respective continents. Venezuela currently produces 2.02 million barrels per day, 14.85% higher than 1.72 million barrels per day that Angola produces. Oil revenue contributes about 45% to the GDP of Angola and about 95% to its total exports. The same trend is observed in Venezuela where oil production and activities contribute 50% and 95% to its GDP and exports respectively.

The oil booms in the past engineered the significant increase in the revenues of net oil exporting countries, with dramatic changes felt in countries like Nigeria, where oil revenues per capita in Nigeria increased from $33 in 1965 to $325 in 2000. With this oil windfall however came dramatic appreciations in the currencies of net oil exporters leading to the famous Dutch disease studies on the effects of oil bonanzas on currencies of countries especially but not exclusive to countries with under developed institutions.

What we observe however, is the Dutch disease in reverse as the entry of US shale producers into the oil market essentially introduced an oil glut into the market, forcing oil prices down to record lows of $28pb as at January 2016. Therefore the fundamentals in these countries that depend on oil earnings have weakened forcing a chain of events such as a depreciating currency and rising inflation. As stipulated above, the external balance of the countries of Venezuela and Angola as with many net oil importers, have been adversely affected due to the decline in oil prices in 2016. The weight of the depreciation of the Venezuelan Bolívar and Angola Kwanza increased inflationary pressure from imported inflation and as such inflation soared and kept rising in these countries. Angola now currently has an inflation rate of 41.95%

from 10.3% in 2015, while Venezuela's inflation rate is believed to be increasing at a rate of 130% monthly. This trend is not uncommon in other net oil exporting countries as we know that Nigeria's inflation rate has soared to 18.6% from the CBN's comfort level of 6-9% the previous year.

Political structure and tensions in Angola and Venezuela

Venezuela

President Nicolas Maduro has to contend with domestic rifts, political assassinations and his country's deteriorating relationship with the West, especially the United States. This is because of the socialist ideologies and policies that Maduro subscribes to, which the US views as a threat to its geopolitical stability. Maduro sustained the established policies of his predecessor Hugo Chavez in order to maintain his popularity with the population that idolised him, in spite of the country's current economic woes and political tensions.

Angola

Angola is a pseudo democracy which implies that on paper it exhibits all the characteristics of a democratic system but in reality the authoritarian government of Jose dos Santos does not allow opposition ideologies to sway the direction of his government. Under the reign of the dos Santos, multiple parties have emerged to which he controls and the constitution has been amended to keep the fate of presidency away from the public and for the party leader with the most seats in its national assembly. Dos Santos has revealed his intention to step down in 2018 and has tagged his daughter (Isabella) as his most suitable successor.

In comparison to these countries, Nigeria is an electoral democracy that is fairly neutral to geopolitical tensions between the West and socialist nations. Therefore the risk of coming to blows with the West and getting lack lustre or 'bad' deals so to speak is not an issue for the economy.

Monetary policy response

Monetary policy in Angola in the last year has strived to address the issue of rising inflation in the country. The Angolan monetary policy committee raised its benchmark interest rates three times in the first quarter of 2016 and has retained its high interest rate of 16% since then. The high interest environment is justified by the evolution of consumer prices, the kwanza and other key economic indicators. A high interest rate environment is to pacify investors who have endured large devaluations and a reduction in the value of their kwanza denominated investments due to a high inflation rate.

Venezuela is dealing with much harsher conditions as its hyperinflation has rendered some denominations of its currency obsolete. Basic goods such as sugar and bread have become inaccessible for most citizens and a handful of the population have fled the country for more conducive environments. The government recently introduced a new denomination of the Bolivar, 500 bolivars; 1,000, 2,000, 5,000, 10,000 and 20,000 are set to arrive to reduce the bucket loads of money that citizens would have to carry to buy goods for their most pressing needs. Data on the economic situation of the country have not been published since February 2016 and many are calling for a currency substitution rather than the printing of new money that is virtually made worthless due to hyperinflation.

Outlook and policy options

In the case of Angola, the new global oil environment that seeks to rebalance the oil market and restore prices from 2016 lows will help boost the fiscal and forex earnings by the Angolan government, as Angola has been able to maintain its oil production levels. It has trumped Nigeria to be the highest African oil producing nation. However, diversification is more of a long term policy option that needs to be considered in order to hedge the Angolan currency and economy as a whole against external shocks.

The Venezuelan case is a lot trickier due to the intricacies of the problems that the country is currently facing. The country's fiscal earnings will receive a boost from a higher price environment and as such the government will refrain from printing new ad hoc money to settle its fiscal requirements. However, as the currency has sunk to new lows, an independent central bank is very likely to be a welcomed step in the path to curtailing the enormous pressure on the Bolívar. This is because an independent Central Bank might opt for a currency board that ensures seigniorage revenue from exchanging bolivares for the foreign currency to which it enters this contract with at a fixed rate.


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Oil Prices average $55pb, 100% higher than January 2016, what does it mean for Nigeria?

Global oil prices (Brent) are currently at an average of $55pb, and have hovered around this level in the last one month. The last time oil prices were at this level (aside from December 2016) was July 2015. At $55pb, the price of the black gold is 100% higher than what it was in January 2016. This means that with respect to oil prices, Nigeria is technically 100% "richer". This is good news for a country that earns at least 60% of its government revenue and 79% of its export revenue from crude.

What does this mean for Nigeria?

At this price, it is 23.6% above the proposed budget price of $44.5pb. This means that the surplus of $10.5pb will accrue into the excess crude account. Monthly statutory allocations would increase, while we expect to see a narrowing of the fiscal deficit, ceteris paribus. On the external sector, we expect to see an accretion in the reserves level, implying that the CBN's ability to support the naira would heighten.

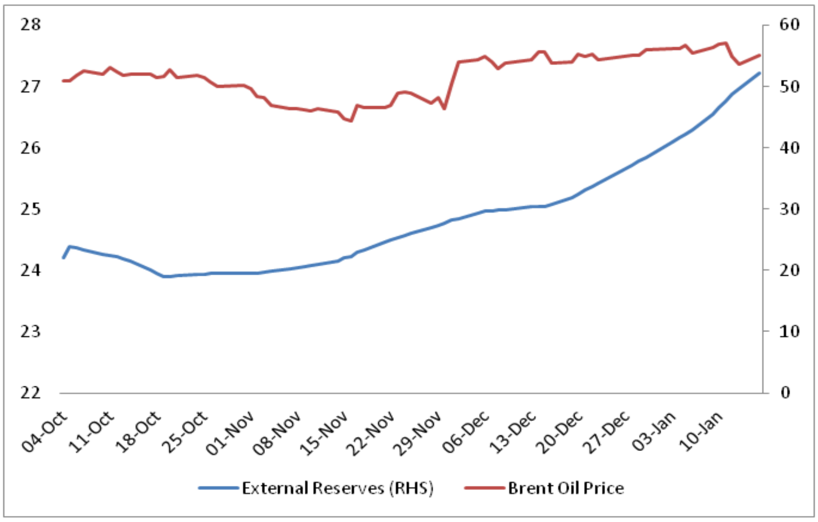
However, the fiscal and external buffers' dynamics are not just a function of oil prices but also of production levels. Nigeria is more production sensitive and in order to benefit from higher oil prices, it needs to ramp up its output level. Currently at 1.54mbpd[4], Nigeria's oil production is still a far cry from the budget benchmark of 2.2mbpd; a consequence of the intermittent attacks on pipelines.

As long as production remains below the proposed budget level, revenue projections will only be academic- good on paper. Also, external reserves accretion may begin to dwindle from the recent upward trend witnessed, especially if the frequently talked about international funds fall below expectations. The good news is that the government (Vice President) has begun discussions with Niger

[4] Source: OPEC's December 2016 Monthly Report

Delta stakeholders. Whether such discussions will pan out into anything of significance remains to be seen. If there is no cease- fire and attacks on pipelines reoccur, leading to disruptions in production, all bets are off.

Chart 2: Showing the relationship between external reserves and Brent Oil Price



[5]

Another implication of higher oil prices which many tend to forget or ignore is the impact on the petroleum pricing template. In May 2016, the average landing costs was N122.03/litre while total costs were N140.4/litre[6]. An exchange rate of N285/$ was used to derive the pump price range of N135-N145 per litre for petrol, effectively ending the payment of fuel subsidies; at that time, oil prices were trading at an average of $47.5pb.

Since then, Brent crude has increased by over 15.79%, while the IFEM rate has weakened to N305/$ (parallel market rate is almost at N500/$). The implication of this is that either (1) subsidies are reintroduced or (2) the petroleum pricing template is reviewed upwards (i.e. the pump price of petrol will increase). With a minimum wage of N18, 000 and a sharp drop in consumer disposable income, the second option would meet with some pushback from the unions.

[5] Source: Bloomberg; CBN
[6] Source: PPPRA

Outlook

Oil prices are an external factor and being a price taker, Nigeria has no control over the global oil market dynamics. The consensus view puts the 2017 forecast within a range of $50-55pb. This is subject to the strict adherence of oil producers to the output cut deal. However, US oil producers are increasing production levels (almost 9mbpd). With a break even cost that has dropped from $79pb in 2014 to $48pb in[7] 2016, it is becoming increasingly cheaper for shale producers to boost production; a factor that could depress prices below projected levels in 2017.

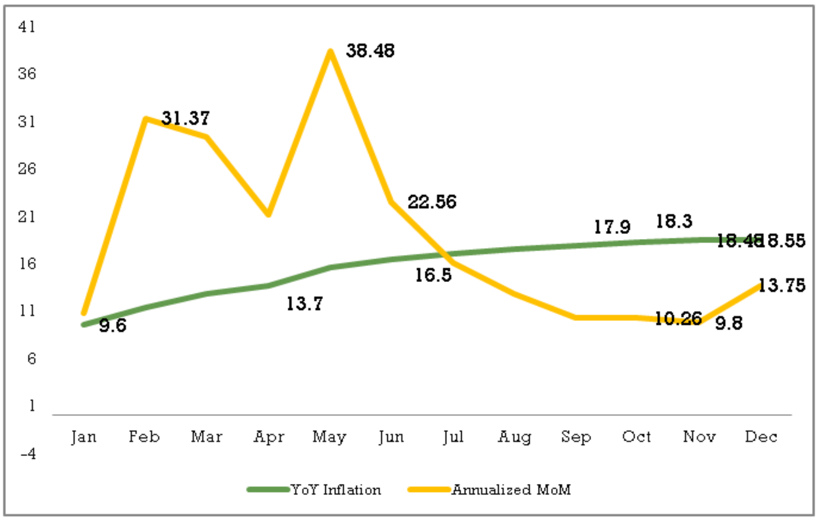
To benefit from higher oil prices, the Nigerian government needs to resolve the militancy issue in the Niger Delta in order to boost production. The policymakers in the meantime would have to resolve the problem of higher landing costs and develop an efficient petroleum pricing template that is reflective of market and economic realities.

[7] Source: IHS Market

Inflation dynamics leave some puzzled as headline rate climbs to 18.55%

Headline inflation has defied analyst consensus creeping to another 11-year- high. At this inflation rate, Nigeria is the 6th highest inflation economy in SSA. Last week, Angola, another oil producer announced an inflation rate of 41.95%. Structural and cost push factors have generally stoked inflationary pressure in most oil producing nations. Venezuela is now potentially the country with the highest inflation rate in the world. In 2015, inflation in Venezuela was 122%.

Chart 3: Nigeria's Inflation

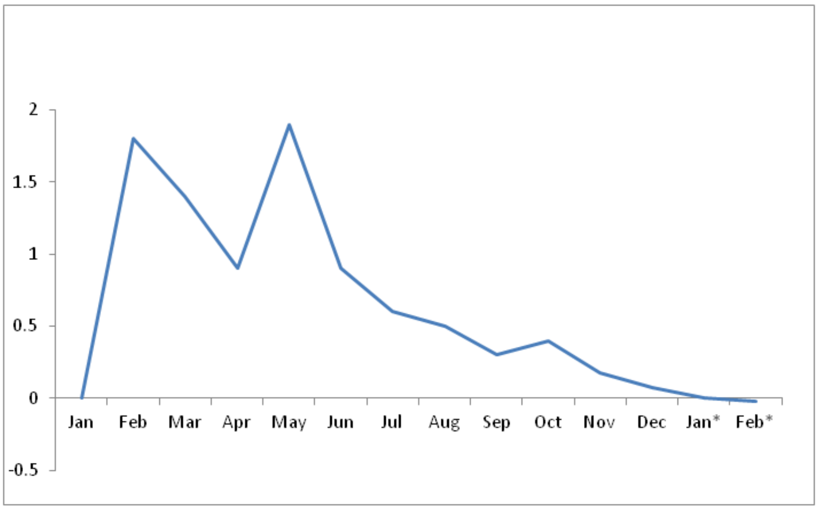


[8]

Inflation is defined as the persistent increase in the prices over a period. A decline in inflation rate does not necessarily mean a reduction in prices; rather it only illustrates a slowing down in the pace of rising prices. An analysis of headline inflation in 2016 shows this declining trend in price movements. Therefore a point of inflection (where the inflation trajectory changes) is likely to manifest in the nearest future.

[8] Source : NBS, FDC Think Tank

Chart 4: Difference



Further decomposition of inflation statistics reveals a decline in core inflation. Inspite of the declining impact of base year effects, food inflation rose predominantly due to price increases in bread and cereals, meat, fish and oil and fats. One of the factors responsible for this menace can be attributed to the increasing prices of diesel and alternative power for processing and logistics. The difference between the NBS and FDC statistics is marginal at 0.25%. Therefore it is safe to say that we are beginning to see a reduction in the rate of change of prices even though inflation increased.

NBS December Consumer Price Breakdown

The food basket increased to 17.39% from 17.2%. However, a 0.1% decline was recorded in the non-food basket to 18.1% from 18.2% in the previous month. Movements in the food basket were attributed to price increases from major food groups such as bread and cereals, meat, fish and oil and fats. Surprisingly, the core basket declined for the first time in 15 months. This is in spite of the uptick in transport costs (air, road and sea) and energy costs.

Although urban inflation increased marginally to 20.12% in December from 20.1%, rural inflation on the other hand declined to 17.2% from 18.33% in the previous month. This reinforces the impact of higher logistics costs on inflation as urban inflation is typically rural inflation plus transportation costs.

New oil price environment

Oil prices are trending upwards due to efforts across OPEC and non-OPEC members to cut production levels to rebalance the market. In previous analysis, this has been cited as a win scenario for Nigeria especially in its quest to curtail rising inflation. This is because higher oil prices, conditioned on the frequency of militant activity in the Niger Delta, means higher fiscal and forex revenue, which in turn facilitates a recovery in struggling output levels.

However, what we can observe of recent is higher costs of production on the part of oil importers. Landing costs of PMS stands at N165/ltr according to NNPC reports and are expected to rise given higher oil prices. Therefore, what we see is a surge in the average price of petroleum products. The government has resumed its role in bearing the burden of higher energy costs via subsidies. In fact reports show that the NNPC recorded losses of N121bn in November 2016. This is not sustainable in the medium to long-run however, because it comes at an opportunity cost to more productive spending, which will elevate output levels. In addition it also prolongs the inevitable, which is a re-evaluation of the petrol price ceiling.

Inflation across Sub-Saharan Africa

Inflationary movements in sub-Saharan Africa were relatively mixed amongst Nigeria's counterparts. Countries such as Angola, Botswana, Rwanda, Senegal and Tanzania recorded price increases. This comes in contrast to declines in inflation recorded in Ghana, Ethiopia, Kenya, Zambia and Ivory Coast, with the latter entering a state of deflation with an inflation rate of -0.2%. Key decisions are to be made this month in some of these countries as their individual monetary policy committees are to meet to deliberate on the direction of monetary policy.

Country	December 2016	November 2016
Angola	41.95%	41.15%
Botswana	3%	2.9%
Ethiopia	6.7%	7%
Ghana	15.4%	15.5%
Ivory Coast	-0.2%	0.4%
Kenya	6.35%	6.68%
Namibia	7.3%	7.3%
Rwanda	11%	9.1%
Senegal	2.1%	0.2%
Zambia	7.5%	8.8%
Nigeria	18.55%	18.48%

Outlook

Although price movements still maintain an upward trajectory, we are optimistic of a possible reversal in this direction in the near future. This is attributed once again to waning base year effects that cannot be ignored. This is also due to reduced spending power as consumers recover from expenses from the festive season and school fees requirements. However, consumers have to be weary of rising energy prices especially now when the frequency of blackouts has increased.

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Business Regulation as a Catalyst of Economic Performance & Profitability

At a period when Nigeria desperately needs investment to stimulate the economy and reduce the impact of dwindling oil revenues, government agencies are implementing heavy-handed regulations that negatively impact the private sector. The major victims of these excessive regulations are multinationals. The regulatory penalties that have been imposed include excessive fines, multiple taxation as well as abrupt bans and property seizures. Justifications range from corporate xenophobia to the government's need for additional sources of funding. Yet a hawkish business environment rife with excessive and unnecessary business regulations does not bode well for businesses and the economy.

Business regulation and its effects

Even through a business world without regulation would result in absolute chaos, regulations could be used in such a way that it impedes economic progress. Regulations have to be properly formulated and implemented so that they do not stifle growth. The World Bank's 2010 publication, "Business Regulation and Economic Performance" provides a strong foundation to understand the impact of regulations on businesses and the broader economy[9]. Firms' decisions concerning investment, innovation and job creation reflect a combination of macroeconomic incentives and barriers[10]. A hyper-regulatory environment reduces a firm's ability to make profit and reinvest in new and progressive ideas. Additionally, regulation imposes economic costs on firms as productive resources are being used for regulatory compliance rather than production of goods and services.[11] Regulation also impacts the dynamic of output and productivity by changing the incentives for process and product innovation, capital accumulation and job creation. In essence, excessive regulation can discourage existing firms from investing more in capital, technology or even hiring

[9] World Bank, 2010 "Business Regulation and Economic Performance", Norman Loayza and Luis Serven

[10] World Bank, 2010 "Business Regulation and Economic Performance", Norman Loayza and Luis Serven

[11] Ibid

new workers. A corollary effect of business regulation is the informality that can arise in the economy when businesses perceive the costs of belonging to the economy's legal and regulatory framework as exceeding the benefits. In such a situation, firms bypass regulations all together especially when a government's monitoring and enforcement capacity is weak.[12] Informality is a problem as it underscores misallocation of resources and inefficient utilization of government services, which could jeopardize a country's growth and poverty-alleviation prospects.[13]

As business regulation affects business performance, the overall impact of regulations is reflected on the aggregate economy. The growth in aggregate output and employment is driven by a firm's decision regarding job creation and capital accumulation in an economy.[14] Microeconomic efficiency and company-level performance underlie aggregate economic performance in terms of productivity, growth and volatility.[15] Consequently, businesses' ability to adjust the deployment and utilization of productive factors in the face of disturbances shapes the resilience of the economy to exogenous shocks and determines the consequences of instability.[16] An economy with companies that are making good returns, which are also reinvested or redeployed efficiently, can better survive commodity price shocks.

There are two major ways through which regulation can have a negative impact on growth. The first is by impeding the reallocation of resources (or orienting it toward inefficient uses).[17] In such a situation, regulation could have a macroeconomic impact by exacerbating recessionary periods and reducing trend growth.[18] When companies use resources that could be utilized in further production for paying up excessive regulatory costs, profits are affected thereby reducing firms' ability to investment more in an economy. The second way is the efficiency cost of evading regulation. When firms decide to work outside the regulatory framework and become informal. In such an instance, the firm loses the advantages associated with legality, such as police and judicial protection, access to formal credit institutions and participation in

[12] Ibid
[13] Ibid
[14] Ibid
[15] Ibid
[16] Ibid
[17] Ibid
[18] Ibid

international markets.[19] By trying to escape the government's control, many informal firms become sub-optimally small, use illegal procurement and distribution channels, and constantly divert resources to mask their activities or bribe officials.[20] This stifles growth and development. A good example was the underground dollar market that sprang up when the Department of State Security (DSS) operatives arrested some forex dealers for selling dollars above the CBN limit.

Though business regulations can be constraining, they can still be effectively utilized in most economies. A few points were highlighted if countries wanted to benefit from business regulations. The World Bank stated intricate regulation and its arbitrary enforcement among key obstacles to growth in many developing countries. Furthermore, better governance was identified as a factor that could mitigate and even eliminate the impact of regulation on growth.

Regulations in Nigeria at a critical time

Even though business regulations are aimed at reining the excesses of companies, recent regulatory responses can be seen as combative. At a time when foreign direct investment (FDI) is at a record low and growth is negative, giving harsh sanctions to businesses that are pivotal to the revival of the Nigerian economy can in some way be seen as economic suicide. Though some of these sanctions are justifiable, others seemed a bit draconian. Recent regulatory actions across companies in various sectors include:

- N2bn fine on Standard Chartered Bank for forex transactions
- N3.2bn fine on selected banks for TSA deadline remittance delay
- Sanction of Stanbic IBTC by the FRC over irregularities in financial reporting
- Initial fine of N1.04trn on MTN for failure to disconnect improperly registered lines. Fine was later reduced to N330bn

[19] Ibid
[20] Ibid

- N1bn NAFDAC fine on Guinness
- SEC sanctions on Cadbury and UACN over late filing of accounts
- Multiple taxation and charges in the aviation sector
- Ban on 9 banks by the CBN from forex transactions
- Arrest of bureau de change operations by the Department of State Security (DSS)

Besides the companies that have had to grapple with the consequences of these fines, the Nigerian economy has also suffered. The various sanctions meted out to banks by the CBN with respect to forex market transactions has led to the unprecedented depreciation of the naira, which is close to the 500 threshold at the parallel market. Furthermore, the actions by the regulatory body have sent several messages, mostly negative, to the international investment community. The effects and unintended consequences of the regulatory tyranny include signaling issues, limited infrastructural development, repatriation of capital, capped technology gains from innovation, reduced FDI and stunted growth prospects.

Imagine the effect the penalty on MTN will have on the investment community. MTN, Nigeria's leading telecommunication provider, has expended over $12bn on technological and infrastructural investments across the country. The company's tax payments amounts to over $435m and it has a staff base of over 2,000 people. It has also invested over N10bn in philanthropy through the MTN Foundation. The company's contribution to the transformation of Nigeria's economy is immeasurable, and therefore it is imperative that MTN be encouraged to invest even further in the Nigerian economy. Paying off the fine will have an effect on the company's profit margins, thereby limiting its ability to invest in infrastructure and growth.

With the Nigerian economy in serious need of an elixir, investors need to feel secure. A harsh regulatory environment does not encourage investments to view Nigeria as a viable investment destination. The World Bank publication mentions the payoff between streamlining regulation and strengthening governance. In weak government environment such as Nigeria's, it is necessary to reduce regulation. And with the government's goal of increasing its revenue tax base, a more favorable regulatory environment will lead to more formal businesses that fall under the tax net. The resilience of the Nigerian economy to the oil and supply shocks that it is facing may lie in regulators and firms having a more collaborative environment.

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Financial Times, London.

Macroeconomic Indicators

Money Market

The money markets opened with a liquidity position of N235.73bn long for the month of January compared to N104.11bn in December. Markets opening position averaged N103.26bn from the 3rd to 16th January, 47.9% lower than the N198.39bn long position for the corresponding period in December.

Short-term interbank rates (OBB, O/N, 30-Day) have averaged 12.06% per annum (pa) from the 3rd to the 16th of January, 281bps higher than December's average of 9.25% pa. As at January 16th, short-term interbank rates, OBB and O/N rates were 10.67% pa and 11.75% pa respectively. Rates reached a 5-week high of 15% during the review period, as a result of an OMO auction of N223bn. This is because interest rates move in tandem with liquidity in the market. Despite economic projections, yield rates have remained sticky. As of January 4th, yields stood at 14.5% and 22.96% for 91-day and 364-day T/bills at the primary market, this is flat, compared to the corresponding period in December.

Chart 5: Inter-bank Interest Rates (%)

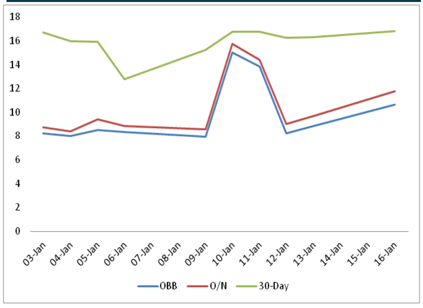

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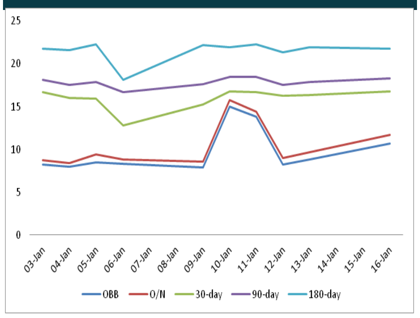
Chart 6: NIBOR % p.a.



21i

Outlook

We do not expect the Monetary Policy Committee to make any significant adjustments to rates in its meeting this month. Thus, interest rates are projected to remain within the band of 7% - 12% for the rest of January.

Yet, due to the rising government-debt burden, the CBN might intervene in the market to push down T/Bills rate. They could adopt signalling methods towards the end of Q1.

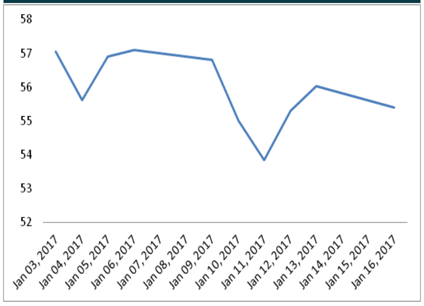
Oil Market

Oil Prices

Brent crude prices averaged $55.9pb between the 3rd and 16th of January. This is a 2.95% increase from December's average of

[21] CBN, FDC Think Tank

Chart 7: Brent Crude ($pb)



[22]

$54.3pb. Prices have stayed above $50pb throughout 2017, and closed the period at $55.4pb on January 16th. Current prices are 86.5% higher than a year ago of $29.7pb on January 15th; this is approximately 100% lower than 2016's lowest price level of $27.72pb on January 21. This means higher dollar inflows for government coffers. Initial optimism about OPEC production cut has waned. The market is now sceptic as to how much excess supply can be soaked up by the production cut.

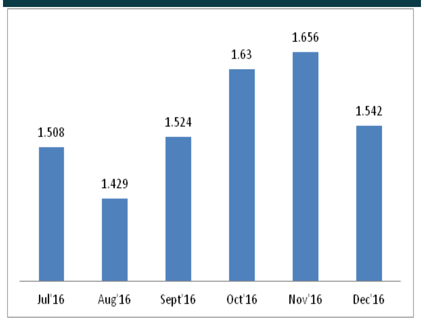
Outlook

Prices are projected to remain above $55pb in coming weeks.

OPEC is expected to comply with the production cut deal, in an effort to bring back market equilibrium, where prices are reflective of an approximately equal supply and demand.

However, a further rise in oil prices is expected to be capped by U.S. production outlook. Shale producers are expected to ramp up production to gain from higher prices and lower costs. Driven by improved technology, the break-even cost of shale production has fallen by 39.2% since 2014. February shale output is expected to edge up by 40,750bpd to 4.75mbpd, reversing a 3-month decline in production. Total U.S. oil production (shale & non-shale) could increase by at least to 500,000mbpd in 2017, dampening the effects of OPEC's planned 1.8mbpd cut.

Chart 8: Oil Production (mbpd)



[23]

Oil Production

Production levels plunged in the month of December mainly due to maintenance issues on Erha field and a strike by Exxon Mobil's port workers. Output levels fell by 113,500 bpd to 1.542 mbpd.

Outlook

January's oil production is likely to be marginally constrained by a widespread industrial action by Nigerian Union of Petroleum and Natural Gas Workers (NUPENG) against recent mass firings. We expect production to recover to 1.6-1.65mbpd in January.

22 Bloomberg, FDC Think Tank

23 OPEC

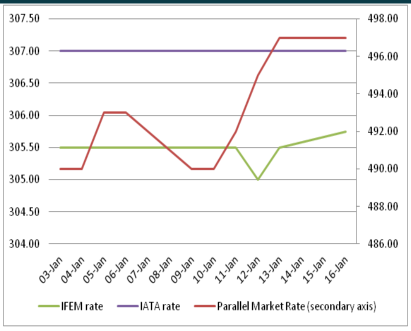
Meanwhile, the resumption of FG payments of cash stipends to ex-militants might encourage Niger-Delta Avengers to throw in the towel. A cease fire deal might be reached in the medium term. Although the budget 2017's assumption of 2.2mbpd seems far-fetched, production may average at 1.9-2mbpd in 2017.

Forex Market

Exchange Rate

At the parallel market, the naira depreciated to a closing rate of N497/$ on January 16th from N490/$ on January 3rd. The parallel market averaged N492.7/$ from the 3rd to the 16th of the month, a 1.42% depreciation from December's average of N485/$. The major driver of the depreciation was the reduction in forex supply, as the CBN suspended dollar sales to the BDC during the festive period. This combined with increased forex demand for dollars (e.g. for international education fees) weighed negatively on the naira. The IFEM and IATA rates stayed relatively flat, closing at N305.75/$ and N307/$ respectively. As instructed by the CBN, BDCs have started publishing their weekly official rates on their websites, creating yet another forex rate, as the quoted rates are most likely going to vary from over-the-counter rates.

Chart 9: Exchange Rate (N/$)



[24]

Outlook

CBN has resumed supply of forex to BDCs. This improved liquidity will lead to an appreciation of the naira at the black market. Yet, the question of sustainability lingers, as the CBN is still the primary supplier of forex.

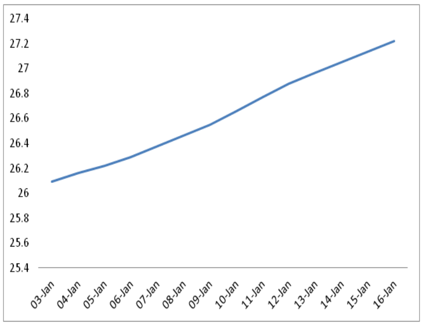
The parallel market rate is projected to break the N500/$ ceiling, depreciating further to N520/$ in 2017. Pending market reformation and increased dollar flows, this rate will recover sharply to N425-450/$ by year-end. The interbank is expected to close the year at N350-380$, bringing down the spread between the rates by up to 60%.

[24] CBN, FDC Think Tank

External Reserves

External reserves are currently at an 8-month high of $27.22bn on January 16th, a 4.3% ($1.13bn) gain from the opening level of $26.09bn on January 3rd. The level of net reserves is significantly lower than published reports. The external reserves level is 5.91% lower than 2016's peak of $28.93bn and 30.74% below 2015's peak of $34.51bn.

Chart 10: External Reserves($ 'bn)



[25]

Outlook

External reserves have been on the increase since October 21st. This trend is expected towards the end of January as forex inflows gradually gain momentum. Risks to this include stalled or disappointing borrowing plans and further disruptions to Nigeria's oil production.

[25] FDC Think Tank, CBN

Stock Market Update

Following a positive December 2016 run, the Nigerian equities market commenced the New Year on a negative note, losing 2.13% in the first week of 2017. Since then, movement on the NSE ASI has oscillated between 26,212pts and 26,616pts, as investor uncertainty heightened due to bargain hunting and profit taking activities. The index has lost 0.91% in the first 10 trading days of the New Year to close at 26,373.83 as at January 16th. Market capitalization also reported the same loss of 0.91%, (N83.63bn), to close at N9.07trn. The year- to- date return on the index is -1.86%.

Market breadth was negative at 0.58x as 26 stocks gained against 45 that declined; 110 stocks recorded no change in their share price. The average value of stocks traded on the exchange within the review period was N1.73bn. The most active stocks by value traded include Nigerian Breweries 22.83%, Unity Kapital 13.71%, GTB 8.86%, Zenith Bank 6.35% and Forte Oil 4.31%. The best performing stocks were Diamond Bank (32.22%), UBA Capital (19.57%), Access Bank (18.59%), FCMB Group (14.55%) and UBA (12.36%).

Top 5 Gainers

Company	Jan 3'17 (N)	Jan 16'17 (N)	% Change	Absolute Change (N)
Diamond Bank	0.9	1.19	32.22	0.29
UBA Capital	2.81	3.36	19.57	0.55
Access Bank	5.81	6.89	18.59	1.08
FCMB group	1.1	1.26	14.55	0.16
UBA	4.45	5	12.36	0.55[26]

The top laggards included CUTIX Plc -21.69%, N.E.M Insurance Co -19.05%, 7-UP -17.05%, Caverton -16.67% and Guinness -15.73%.

[26] NSE, FDC Think Tank,

Top 5 Losers

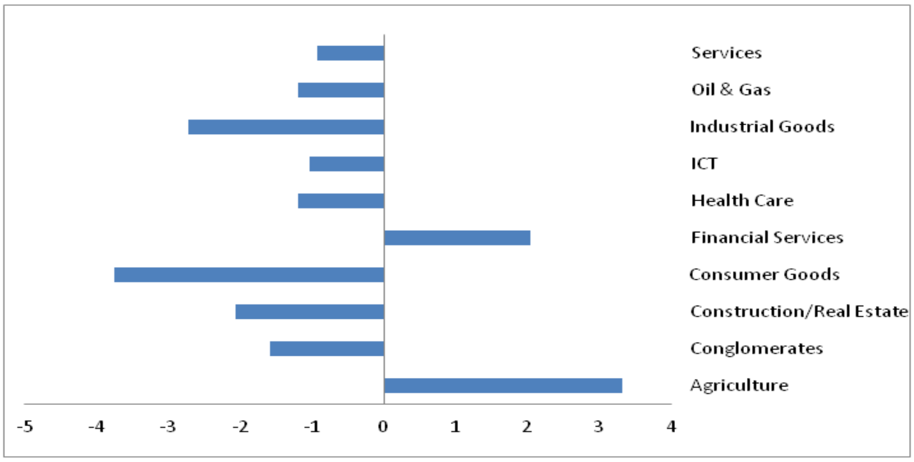
Company	Jan 3'17 (N)	Jan 16'17 (N)	% Change	Absolute Change (N)
CUTIX Plc	1.89	1.48	-21.69	-0.41
N.E.M. Insurance c	1.05	0.85	-19.05	-0.2
7-UP Bottling co.	129	107	-17.05	-22
Caverton	0.9	0.75	-16.67	-0.15
Guinness	83.05	69.99	-15.73	-13.06

[27]

Sector Performance

All sectors recorded negative performance during the period under review except the Agriculture and Financial Services sectors. The Consumer Goods sector had the worst performance with an average loss of 3.76% while gains in Okomu Oil and Presco, bolstered the Agriculture sector to post returns of 3.31%. Gains by some Tier Two banks also pushed the Financial Services sectors upwards to record gains of 2.04% in the first two weeks of January. The banking subsector gained 6.72% as investors continue to take positions in anticipation of capital gains and year-end dividends.

Chart 11 : Sector Performance (Jan 3-16, 2017)



[28]

[27] NSE, FDC Think Tank,
[28] NSE, FDC Think Tank,

Outlook

We expect increased volatility on the exchange in the second half of the month as both investors and speculators take position(s) in anticipation of full year 2016 results. Despite weak macro economic data released during the period, market activities may remain upbeat as the allure of short term capital gains continues to attract individual investors.

Equity Report: Okomu Oil Palm Company Plc

Analyst Recommendation: BUY

Recommendation Period: 365 days

Industry: Agriculture

Market Capitalization: N38.3bn

Current Price: N44.27

Target Price: N49.12

The Nigerian stock market, which lost 6.17% in 2016, has already declined by 2.32% year to date (YTD). Investors remain cautious about investing in the Nigerian Stock Exchange (NSE). The economy is still in recession, so investment activities continue to decrease as fewer stocks show growth potential. One sector that is growing is the agricultural sector. Recent results show that two agricultural companies listed on the NSE – Presco and Okomu – posted outstanding Q3'2016 results. Okomu, in particular, has seen growth in both its oil palm and rubber segments.

In analyzing Okomu's performance and forecasting an outlook, several factors were considered:

- Increased product demand;
- Production expansion;
- Impact of foreign exchange (forex) restrictions; and
- Expensive crude palm oil (CPO) import substitutes.

The company's 9M'16 shows an impressive performance in comparison to leading companies across all sectors that are reporting record losses. Okomu's revenue increased by 40.7% and its net income increased by 89.4% in 9M'16. It is a good investment for those seeking a company with solid fundamentals and sustainable growth prospects. Accordingly, we place a BUY rating on Okomu Oil Palm Company PLC.

Naira depreciation and forex restrictions buoys Okomu

The Central Bank of Nigeria (CBN) restricted the purchase of forex for crude palm oil imports from the interbank market. This decision has led palm oil importers to rely on the parallel market for forex. This situation, coupled with the sharp depreciation of the naira, has made imported CPO very expensive compared to locally produced CPO. Prior to these events, imported CPO was cheaper than local CPO even with the 35% tariff imposed on foreign CPO. This was because of the high cost of producing palm oil in Nigeria due to production bottlenecks. Nigeria's local palm oil pricing is now competitive as manufacturers have increased their demand. The increased demand can be seen in the revenue growth of both Okomu and Presco.

Industry and company overview

The Nigerian palm oil industry has declined through the years. A dearth of improved seedlings and the failure of previous government policies led to shrinkage. As a result, the palm oil produced by local producers has not been sufficient to meet the demand. Oil palm consumption is growing at a compounded annual growth rate (CAGR) of 2.8% while local palm oil production is growing at 1.2%, leaving a supply gap estimated at 1.7m metric tonnes (MT) per year. This supply shortage led to increased importation, a cheaper option than sourcing local product. Resolving the supply gap requires significantly more investment than is currently available.

The two major palm oil producers are Presco and Okomu. Both companies are listed on the NSE. In addition other players such as PZ Wilmar and DUFIL Prima Foods have made significant investments in the palm oil sector. This has increased the competitive landscape though Okomu and Presco are still the most recognized brands in crude oil production in Nigeria. It is estimated that the output from these increased investments in palm oil production could reduce the supply deficit by at least 60%, though it may take as much as five years for the yields of these oil palm plantations to be realized.[29] The oil palm gestation period is between three and five years.

[29] Femi Adekoya. 2016. Nigeria's path to revamping the oil sector. http://guardian.ng/business-services/industry/nigerias-path-to-revamping-oil-palm-sector/

Okomu's principal activities are the cultivation of oil palm, processing of fresh fruit bunches into crude palm oil for resale, rubber plantation and processing rubber lumps to rubber cake for export. The rubber business segment comprises about 20% of Okomu's total revenue. An examination of the company's performance and financial position between 2012 and 2015 shows a decrease in revenue and assets. The latest unaudited financials indicate that the company is positioned for an impressive increase in revenue and profitability. Furthermore, increased investment is expected to increase the company's asset base in the long term. The company acquired 11,400 hectares of land in Edo State. As a result, Okomu's total land holdings exceed 27,000 hectares. Okomu intends to use at least 10,000 hectares of the additional purchased land for oil palm cultivation. Additionally, Okomu has an oil mill capacity of 60 tonnes per hour, which is a huge improvement from its previous capacity of 30 tonnes per hour. This places Okomu as having one of the largest palm oil production capacities in Africa. These investments show that the company is positioning itself to be a leader in Nigeria's oil palm industry.

Income Statement for Okomu Plc (FY Dec 2015)

N'000	2012	2013	2014	2015
Revenue	10,146,164	8,860,425	8,655,718	9,738,015
Other work performed by the entity capitalised	498,254	152	656,858	1,448,193
Changes in inventories of the finshed goods and WIF	(84,378)	(289,244)	100,328	(41,170)
Raw materials and consumables used	(1,879,578)	(1,589,087)	(2,071,942)	(1,803,659)
Other external charges	(1,875,688)	(2,063,217)	(2,244,939)	(2,885,254)
Employee expenses	(834,616)	(774,433)	(899,865)	(728,909)
Depreciation of PPE	(525,386)	(706,541)	(734,977)	(916,786)
Depreciation of bearer biological assets	-	-	(223,500)	(228,288)
Other expenses	(1,605,102)	(1,956,344)	(1,477,914)	(1,490,374)
Other income	516,765	1,120,206	192,070	186,413
Profit from continuing operations	4,356,435	2,601,917	1,951,837	3,278,181
Finance income	170,075	102,295	85,701	43,111
Gain on diisposal of assets	17,903	22,896	8,534	6,534
Finance costs	(197,747)	(33,553)	(141,576)	(429,181)
Profit before tax	4,346,666	2,693,555	1,904,496	2,898,645
Companies income tax charge	(547,865)	(324,381)	(344,541)	(267,500)
Deferred tax charge	(208,038)	(277,000)	(230,000)	-
Profit after tax	**3,590,763**	**2,092,174**	**1,329,955**	**2,631,145**

Balance Sheet for Okomu Plc (FY Dec 2015)				
N'000	**2012**	**2013**	**2014**	**2015**
Property, Plant & Equipment	4,325,947	6,507,126	10,255,455	9,848,681
Biological Assets	21,008,866	19,692,910	5,111,060	7,395,989
Non-current assets	25,334,813	26,200,036	15,366,515	17,244,670
Inventories	973,615	1,319,903	1,415,552	1,490,595
Trade and other receivables	154,277	133,971	105,304	62,856
Intercompany receivables	112,163	136,810	-	-
Other receivables	557,292	1,077,483	626,875	296,592
Cash and bank balance	3,922,513	1,182,444	358,082	958,473
Current assets	5,719,860	3,850,611	2,505,813	2,808,516
Total assets	**31,054,673**	**30,050,647**	**17,872,328**	**20,053,186**
Share capital	238,478	476,956	476,956	476,956
Share premium	1,867,095	1,867,095	1,867,095	1,867,095
Revenue reserves	23,425,178	20,273,107	7,260,471	9,719,648
Equity attributable to equity holders of the company	**25,530,751**	**22,617,158**	**9,604,522**	**12,063,699**
Deferred tax liabilities	2,899,348	2,924,091	1,704,811	1,733,273
Post-employment benefits obligations	617,158	659,999	496,256	352,650
Non-current financial liabilities	-	1,266,667	1,477,305	3,386,168
Non-current liabilities	3,516,506	4,850,757	3,678,372	5,472,091
Trade payables	299,827	415,242	772,216	888,636
Other current payables	94,461	179,784	97,585	120,423
Current provisions and accruals	113,981	148,555	359,328	483,085
Other current financial liabilities	123,257	400,000	2,285,898	340,417
Current tax payable	1,261,376	1,302,970	1,003,014	611,862
Retirement benefit obligations	51,049	72,716	-	-
Dividend payable	63,465	63,465	63,465	63,465
Intercompany payables	-	-	7,928	9,508
Current liabilities	2,007,416	2,582,732	4,589,434	2,517,396
Total liabilities	5,523,922	7,433,489	8,267,806	7,989,487
Total equity and liabilities	**31,054,673**	**30,050,647**	**17,872,328**	**20,053,186**

Okomu's management capable of capitalizing on potential growth opportunities

Okomu Oil Palm Company Plc is led by a talented and highly experienced team that is driving the company towards sustained profitability and growth. Mr. G Oyebode is the Chairman of Okomu. He is an accomplished lawyer who is also on the board of MTN Nigeria. The Managing Director is Dr GD Hefer. Dr Hefer has a PhD in Agricultural Science and has held the position of Lecturer/Research Fellow at the University of Natal. He has also held director positions at Tongaat Cotton Limited and Noordelike Sentrale Katoen. Under his visionary leadership, Okomu has expanded its plantation size and oil mill capacity in order to grow its revenue and production capacity.

Bulls Say:

- Recognizable brand in the Nigerian oil palm sector
- Increasing demand for crude palm oil and its derivative products
- Favorable government policies towards the agricultural sector
- Okomu's rubber business provides diversification benefits
- Experienced and talented management
- Purchase of additional land for cultivation expands potential revenue base

Bears Say:

- Intense competition from leading players including Presco and imported substitutes
- Change in government policies could affect the competitiveness of companies in the agricultural sector, particularly the palm oil sector
- Persistent macroeconomic headwinds could curb demand for palm oil products

Risks and outlook: Strong potentials with potential policy risks

Okomu faces currency risks, interest rate risks and possible changes in government policy. The company buys and imports some of the raw materials used for production, and the payments are made in euros or US dollars, while it makes local payments and collects receipts in naira. The company's approach to managing the risk is to hold foreign currency bank accounts which act as a natural hedge for such transactions. Another risk is an increase in interest rates, which arises from trade finance for financing its transactions. The company manages this risk through negotiations with banks.

Any change in government policy towards agriculture and forex restrictions could affect Okomu's earning potential. Leading players in the manufacturing sector are pressuring the government to remove the tariff on imported palm oil as there remains an inadequate palm oil supply to meet demand. According to these manufacturers, unavailability of palm oil has led to the closure of some manufacturing plants. If the government accedes to these demands, this could change the competitive landscape in the palm oil industry and hurt Okomu's earning prospects. Though the argument for a better import policy for palm oil is tenable, the government's commitment to protecting the agricultural industry and ensuring backward integration of the palm oil industry will forestall any possible change in policy. Hence, a policy change is a lower risk at least in the near term.

APPENDIX - Valuation

We derived our valuation for Okomu Oil Palm Plc by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate for Okomu is N49.12, which is a 10.96% upside on the price of its share as of January 17th 2017. The discount rate (weighted average cost of capital (WACC)) of 14.8% is derived using a 13.25% risk free rate, a beta of 0.5555, an after-tax cost of debt of 7.4%, and a market risk premium of 6.9%. The calculated long term cash flow growth rate to perpetuity is 5.5%.

Taking into account Okomu's latest financial results, its product segments, the prevailing macroeconomic conditions and an impressive Q3 2016 result, we forecast a five-year revenue compound annual growth rate of 13.1%.

Okomu Oil Palm Plc valuation using discounted cash flow (DCF)

DCF Valuation					
N'000	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
EBIT	5,249,351	5,288,412	6,177,124	6,714,731	6,992,032
Less: Taxes	(681,976)	(692,172)	(808,491)	(878,855)	(915,150)
EBIAT	4,567,375	4,596,240	5,368,633	5,835,876	6,076,883
Plus: D&A Expense	1,259,544	1,582,373	1,758,290	1,863,191	1,916,453
Less: CAPEX	(900,000)	(945,000)	(992,250)	(1,041,863)	(1,093,956)
Less: Change in working capital	(450,000)	(472,500)	(496,125)	(520,931)	(546,978)
Free Cash Flow (FCF)	4,476,919	4,761,113	5,638,548	6,136,274	6,352,402
WACC	14.8%	14.8%	14.8%	14.8%	14.8%
Present Value (PV) of FCF	3,397,194	3,147,170	3,246,755	3,077,921	2,775,628
	2016	**2017**	**2018**	**2019**	**2020**
Terminal value					72,087,666
Present value of terminal value	31,498,090				
DCF Calculation	**Valuation**				
PV of explicit period	15,644,666				
PV of terminal value	31,498,090				
Enterprise Value	47,142,757				
+ Cash	958,473				
- Borrowings	(1,241,286)				
Equity Value	46,859,944				
Share price	49.12				