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# FDC ECONOMIC MONTHLY

## CBN'S NEW WINDOW FOR INVESTORS & EXPORTERS: WHAT IT MEANS AND IMPLICATIONS

### WHAT IT MEANS

The CBN's recently established a new forex window for investors and exporters, in a bid to deepen the forex market. Transactions at the window took effect on April 24 and transactions ranging from invisible transactions, bills for collection to any other trade-related payment obligations at the instance of the customer are permitted. However, airlines are excluded from this segment and will continue to obtain forex by the CBN at its Special Market Intervention Sales (SMIS).

### PRICE DISCOVERY

FMDQ Securities will carry out a price survey twice a day for price discovery and a new fix called the Nigerian Autonomous Foreign Exchange Market (NAFEX) will be published on the FMDQ website. However, this is not a 2-way quote, although the market is moving in that direction. Until there is a 2-way quote, the market will remain inefficient.

### IMPLICATIONS

This is a good initiative by the CBN as it boosts liquidity in the system. The new window also changes the market structure with investors and exporters also bringing in their dollars. Hence, the CBN is no longer the main supplier of forex. It is also expected to ease the process of fund repatriation for investors and serve as an incentive for foreign investors. There will be increased convergence in rates especially as the demand pressure at the parallel market eases.

INSIDE THIS ISSUE:

However, while the quantity supplied has increased, the initiative further segments the market, resulting in multiplicity of rates. Nonetheless, Nigeria is getting closer to a price discovery path.

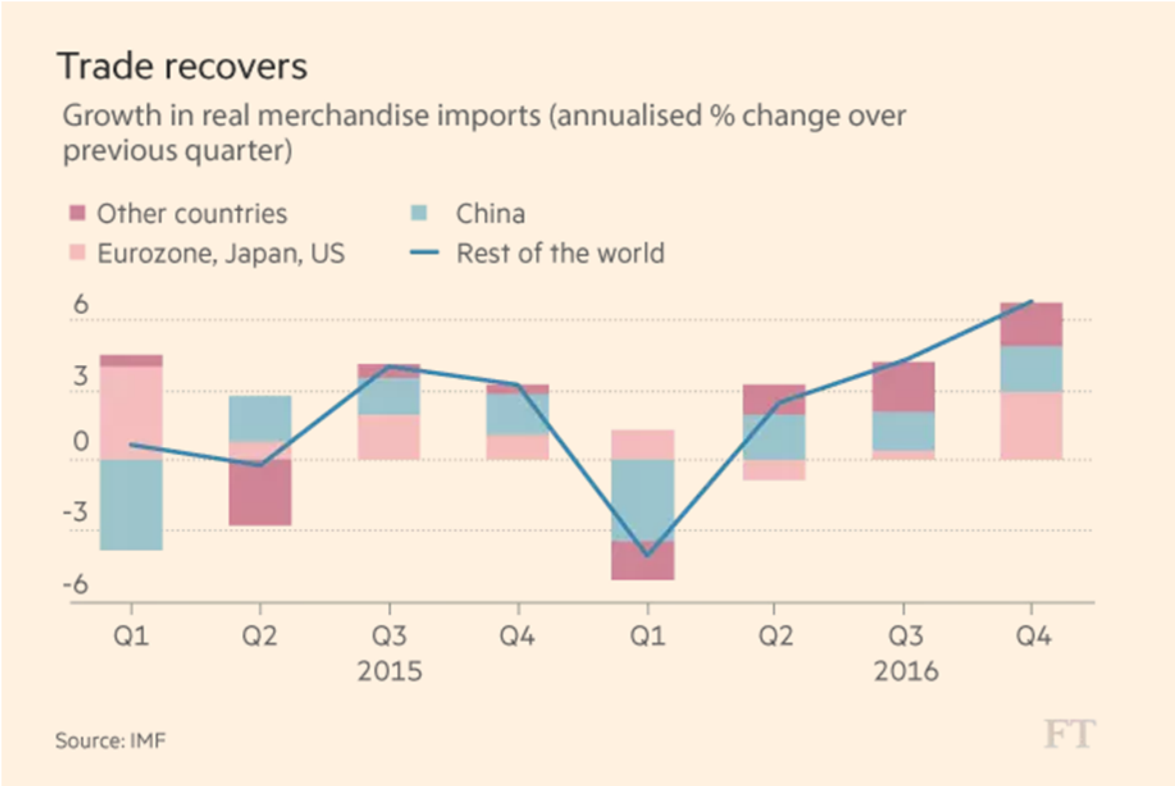
## GLOBAL PERSPECTIVE: AN UPSWING IN THE WORLD ECONOMY IS NOT SUSTAINED GROWTH CULLED FROM FT

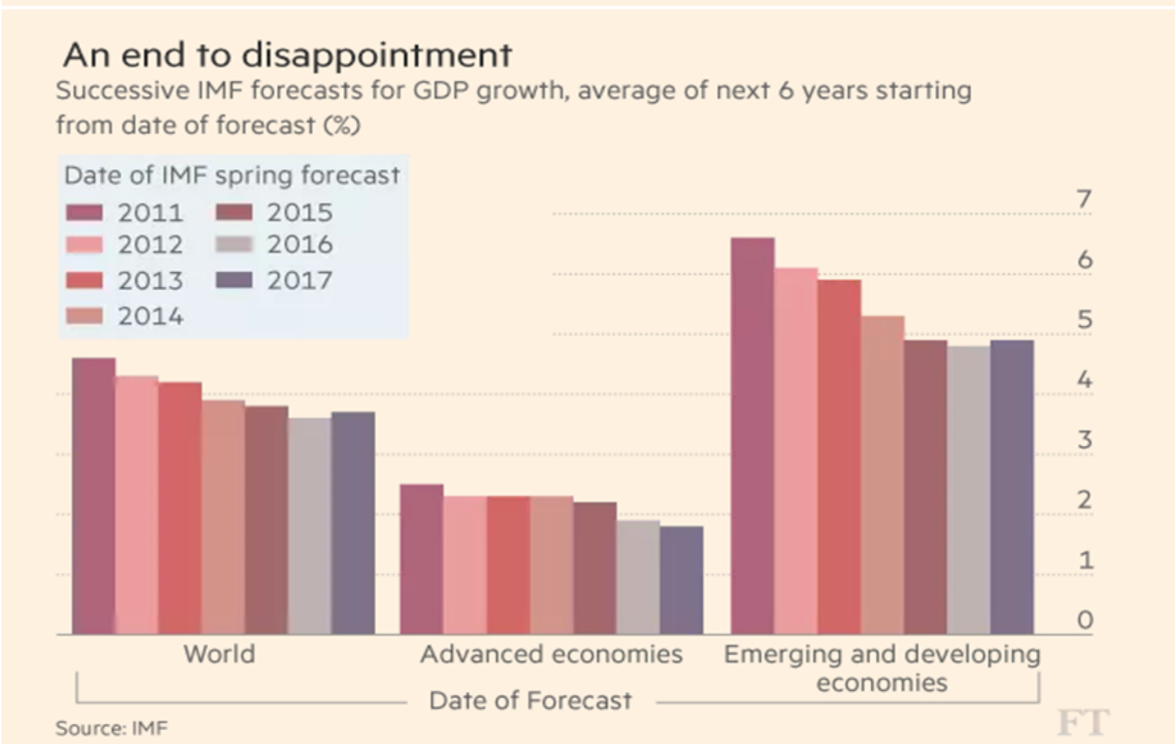
### THE QUESTION IS WHETHER POLITICS WILL GIVE THE NECESSARY SUPPORT TO LONG-TERM RECOVERY

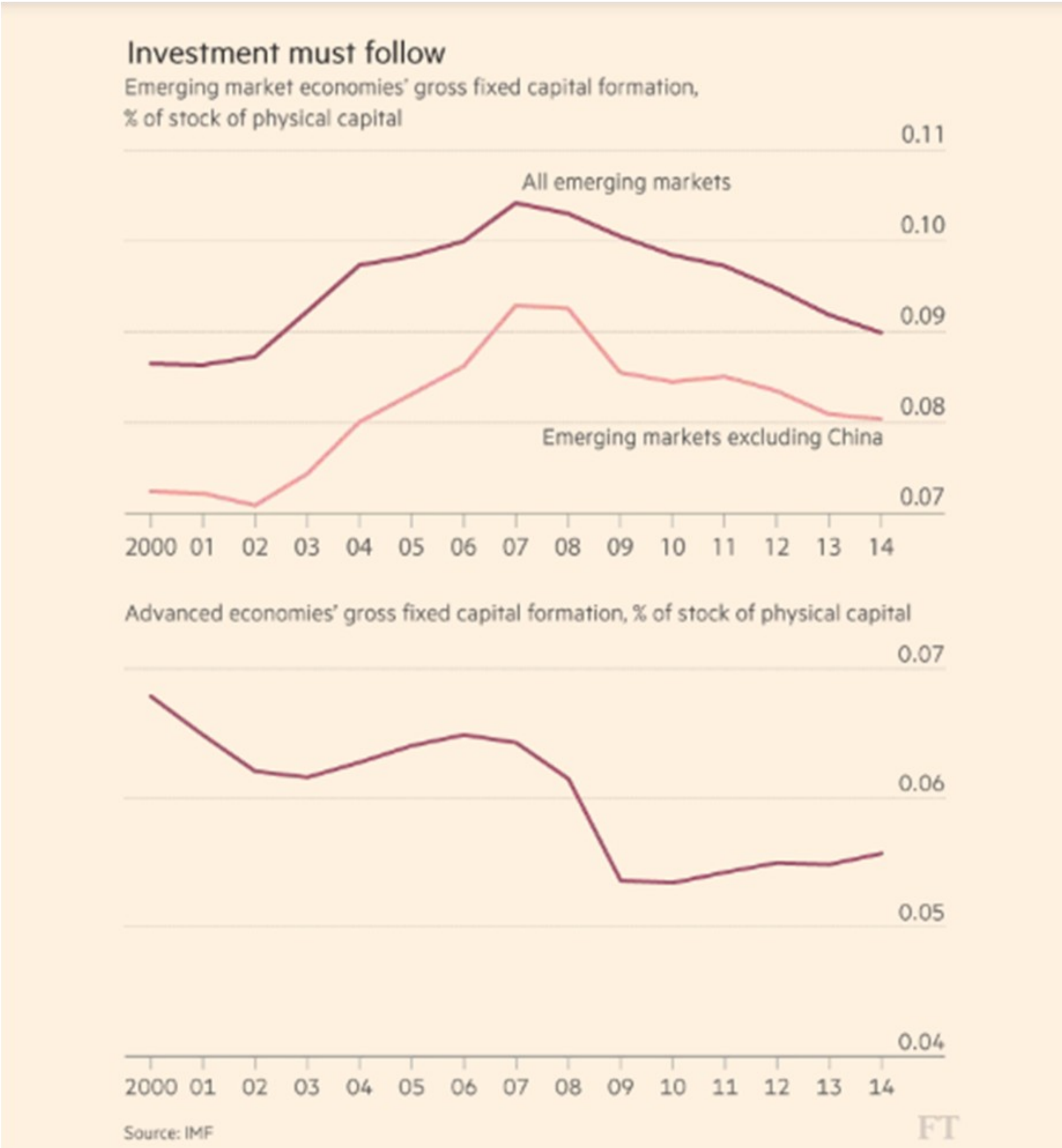
*Martin Wolf*

The world economy is improving. The question is how strong and long-lasting this improvement will be. The recovery could disappoint, last for a time or mark the beginning of a period of rapid and sustained growth. The last seems the least likely outcome. But failure is not predestined.

The International Monetary Fund's World Economic Outlook lays out the issues. It had expected the economy to improve and it may be doing so. Last year, the world economy grew 3.1 per cent (at purchasing power parity). The IMF now forecasts growth will be 3.5 per cent in 2017 and 3.6 per cent in 2018. These forecasts are more or less identical to those published last October. As the WEO notes, even global trade is strengthening. Yet this upswing has to be put in context: it comes after many years of downgrades to the forecasts. The future looks far worse than it did just a few years ago.


Trade recovers
Growth in real merchandise imports (annualised % change over previous quarter)
Other countries
China
Eurozone, Japan, US
Rest of the world
6
3
0
-3
-6
Q1
Q2
Q3
Q4
Q1
Q2
Q3
Q4
2015
2016
Source: IMF
FT


An end to disappointment
Successive IMF forecasts for GDP growth, average of next 6 years starting from date of forecast (%)
Date of IMF spring forecast
2011
2015
2012
2016
2013
2017
2014
7
6
5
4
3
2
1
0
World
Advanced economies
Emerging and developing economies
Date of Forecast
Source: IMF
FT




The most important reason for the recovery is that three successive shocks — the financial crisis of 2007-09, the eurozone crisis of 2009-13 and the commodity price falls of 2014-15 — are moving well into the past. Most affected economies are enjoying cyclical recoveries: indeed, all regions and most significant economies are forecast to enjoy some growth. As these shocks fade, confidence has returned. Financial crises, in particular, have long-lasting effects. But even these do not last forever. Strongly supportive monetary policies have also helped. We may at last be seeing the end of the post-crisis malaise.

In all, states the WEO, "barring unforeseen developments, continued recovery and gradual closing of output gaps are projected to keep growth modestly above potential in many advanced economies over the next few years". Among emerging economies, the turnround in commodity exporters has been particularly noteworthy.

## WHAT THEN MIGHT DETERMINE THE LENGTH AND STRENGTH OF THIS UPSWING?

A happy story would build on the notion of strengthening confidence and rising investment in high-income and emerging economies (with the notable exception of China, where the pace of investment needs to slacken). This would strengthen productivity growth, as newer and more efficient capital replaced the old and outmoded stock of today. With productive investment and potential growth rising, it would also become easier to grow out of debt.

That is a pleasing story. Alas, it is far from the only possibility. We can easily identify significant downside risks.

The first such set of risks is political. The backlash against an open world economy in the high-income countries is real and, in the case of the election of Donald Trump, already significant. Yet rising protectionism and a consequent slowdown in world trade are not the only dangers. An even bigger risk is a breakdown in co-operation and even open conflict among great powers.

The second set of risks is the new US policy agenda. Probably the biggest danger is that overambitious hopes for economic growth are taken to justify excessively expansionary fiscal policies and unduly lax monetary policy. In the short to medium run, that might generate a boom and even secure re-election for Mr Trump, as similar policies did for Richard Nixon in 1972. In the longer term this could be hugely destabilising.

A third set of risks, again closely linked to the agenda of the Republicans, is irresponsible financial deregulation. The short-term effects of taking the brakes off an unstable financial system might also be positive. The longer-term ones might include a more devastating crisis even than the one of a decade ago.

A fourth set of risks concerns the longer-term evolution of the Chinese economy. In the short term, the authorities have the ability to sustain growth in line with targets. But growth remains credit-dependent. In the longer term, they seem to have a choice between ever more debt or far slower growth. How the Chinese manage this remains vital for global economic prospects.

A fifth set of risks arises in the other emerging economies. In particular, the impact of the Trump administration might be highly destabilising, via rising interest rates and a rising US dollar.

A sixth set of risks is in Europe. As the WEO notes, in the eurozone's lagging economies, persistently poor economic performance might link up with financial sector weaknesses to depress demand — and so supply — permanently. The large European country most vulnerable to this malaise is Italy. But even France is not immune. Meanwhile, there is a risk that a hard or even chaotic Brexit will end up damaging the UK economy substantially.

Finally, there are political factors, apart from the ascendancy of a rightwing demagogue in the US. The rise of plebiscitary dictatorship in Hungary, Poland, Russia and Turkey does not bode well for their economies. Not dissimilar concerns arise in South Africa. Good policy depends on sensible policymakers. The supply of the latter cannot be taken for granted, especially now.

The biggest question then is whether politics will give the necessary support to economics. There is now a reasonable chance of a cyclical recovery. But turning that into something more durable will mean a delicate balancing act. Policymakers must support private and public investment, further innovation, maintain open and competitive economies and reduce regulation where it is excessive, while maintaining it where it is essential. Yet policymakers must also ensure that the benefits of growth are far more widely shared than before.

The upswing is an opportunity. If this is not exploited, it could prove just a temporary upward economic blip. But it could (and should) be more than that.

## GLOBAL PERSPECTIVE: TALKS HELP CRUDE AND PEACE FLOW IN THE NIGER DELTA CULLED FROM FT

### TENSIONS IN THE REGION EASE AFTER SHIFT IN GOVERNMENT POLICY

After more than a year on the run, former militant turned millionaire businessman TomPolo is in talks with government officials about a possible amnesty, his brother says, as part of a new strategy that local leaders say is contributing to peace and a recovery in crude production in the oil-rich Niger Delta.

Government "TomPolo" Ekpemupolo was a top commander in the insurgency that sabotaged Africa's biggest oil industry until he and other militants accepted a government amnesty in 2009. He was later awarded security contracts to guard the pipelines the militants had been blowing up.

But after President Muhammadu Buhari came to power nearly two years ago, the government cancelled contracts and issued a warrant for his arrest on money-laundering charges related to other government deals. TomPolo maintains his innocence.

As relations between the Delta and the federal government deteriorated, a new wave of attacks on infrastructure owned by majors including Shell and Chevron erupted. It remains unclear who is behind the attacks, but the arrest warrant fuelled tensions in an area already wary of Mr Buhari.

Nigeria's crude production fell last May to near 30-year lows, exacerbating the worst economic crisis in decades in the oil-dependent nation.

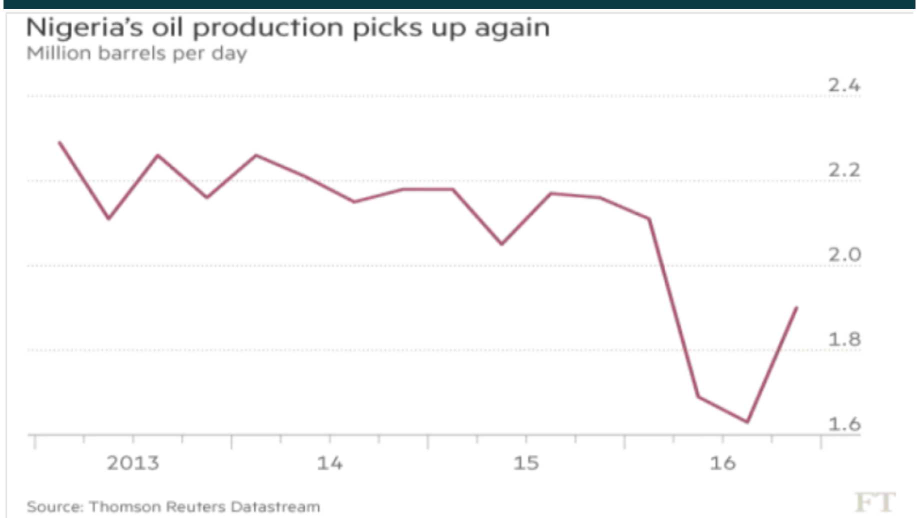
But in the past two months, calm has returned to the region following a noticeable shift in government policy.

Rather than vowing to crush the militancy, Mr Buhari's administration has been talking to Delta leaders.

Vice-president Yemi Osinbajo, standing in for Mr Buhari during his recent 50-day medical leave abroad, has made six visits to the region, where he sat with traditional chiefs and local politicians. He listened and promised action on a number of issues, some linked to disputes involving TomPolo.

And the diplomatic blitz appears to be working — there has been no incident of militancy-related sabotage for three months.

Chart 1 : Nigeria's  oil production picks up again




"In a situation of conflict, consultations matter a lot. It's really important to hear the people," said George Ekpemupolo, a government official and TomPolo's half-brother. Mr Ekpemupolo said he has represented TomPolo in closed door discussions with the vice-president.

"He's a messiah here," Mr Ekpemupolo said of his half-brother. TomPolo, 45, built mansions and doted on his family, but he also built roads and health clinics, filling a gap that neither the government nor oil companies had addressed.

"There is relative peace partly because of the closed-door discussions [of the] vice-president and TomPolo's kinsmen," said Sheriff Mulade, who runs a local non-governmental organisation and is from Kokodiagbene, which is near Chevron's Escravos terminal and the Shell-operated Forcados pipeline.

Whether an official deal, which locals hope would include a public pledge by the government to drop the arrest warrant against TomPolo, will be announced is unclear.

Mr Buhari, a former general and a Muslim from the north of the country, has in the past professed his disdain for the Delta elites, who he sees as complicit in the looting of the nation's wealth.


But the tone of his government began to change in January as the economic crisis deepened.

"There is no time to waste," tweeted Mr Osinbajo during one of his recent trips to the region. "We must all recommit to working together to make the Niger Delta a vibrant and dynamic economic zone," reflecting the attitude of compromise now prevailing in the region on which Nigeria relies for 90 per cent of its foreign earnings.

Gail Anderson, lead Nigeria analyst at Wood Mackenzie, said that production is still impaired by non-militancy related issues, such as crude theft. Wood Mac estimates that output has risen to 1.7m bpd, up from 1.5m bpd last May, when the militant attacks were at their peak. But that is below the government's claim that oil production has recovered to 2m bpd.

Still, Ms Anderson said the situation is "far more positive". "The government seems to be investing a lot of effort to keep people on side, and it seems to be working," she added.

Moses Taiga, a leader from another oil-producing area in the Delta state, said his people have decided to "give the government the benefit of the doubt".

The subtext of such statements, say observers, is that angry youth have been told to hold fire and cease attacks on pipelines and other infrastructure.

Three oil industry insiders in Nigeria said that the unofficial truce will not be enough for Shell to begin repairing Forcados, which can ship more than 200,000 bpd. It is the only major pipeline attacked by suspected militants last year that remains offline.

Meanwhile, a Nigerian oil company that normally ships its oil through the Forcados system has been taking its crude out of the creeks by barge, according to Mercuria, the commodities trading house that is barging the oil.

A Shell spokesman said the company is "committed to getting the pipeline back on stream and we acknowledge the efforts of the federal government in creating an enabling environment".

Mr Ekpemupolo agrees. Of the vice-president's pledges, he concludes on a positive note: "What he's saying is in line with 50 per cent of what we're asking for, so we need to work with him." Additional reporting by Anjli Raval.

# GLOBAL PERSPECTIVE: THE HISTORY OF GROWTH SHOULD BE ALL ABOUT RECESSIONS CULLED FROM THE ECONOMIST

## FASTER GROWTH IS NOT DUE TO BIGGER BOOMS, BUT TO LESS SHRINKING


"Throughout history, poverty is the normal condition of man," wrote Robert Heinlein, a science-fiction writer. Until the 18th century, global GDP per person was stuck between $725 and $1,100, around the same income level as the World Bank's current poverty line of $1.90 a day. But global income levels per person have since accelerated, from around $1,100 in 1800 to $3,600 in 1950, and over $10,000 today.

Economists have long tried to explain this sudden surge in output. Most theories have focused on the factors driving long-term economic growth such as the quantity and productivity of labour and capital. But a new paper* takes a different tack: faster growth is not due to bigger booms, but to less shrinking in recessions. Stephen Broadberry of Oxford University and John Wallis of the University of Maryland have taken data for 18 countries in Europe and the New World, some from as far back as the 13th century. To their surprise, they found that growth during years of economic expansion has fallen in the recent era—from 3.88% between 1820 and 1870 to 3.06% since 1950—even though average growth across all years in those two periods increased from 1.4% to 2.55%.

Instead, shorter and shallower slumps led to rising long-term growth. Output fell in a third of years between 1820 and 1870 but in only 12% of those since 1950. The rate of decline per recession year has fallen too, from 3% to 1.2%.

So why have these "growth reversals" decreased in length and depth? In another paper** Messrs Broadberry and Wallis find that conventional explanations—such as demographic change or a sectoral shift from volatile agriculture to the more stable services sector—do not fully explain the shift.

More important is the rise of the rule of law, enabling disputes to be settled by impartial courts. Before the modern era, elites would fight between themselves for the spoils of growth and send the economy back to square one through wars, corruption and the like. Respect for courts to resolve disputes prevents this from happening. With populist politicians challenging the authority of judges once again across the world, that is food for thought.

* "Growing, Shrinking and Long Run Economic Performance: Historical Perspectives on Economic Development" by S. Broadberry and J. Wallis

** "Shrink Theory: The Nature of Long Run and Short Run Economic Performance"

This article appeared in the Finance and economics section of the print edition under the headline "Shrink wrap"

## THE ROLE OF THE PRIVATE SECTOR IN STIMULATING ECONOMIC GROWTH

Agriculture was the mainstay of the Nigerian economy, at least with respect to output, prior to the rebasing exercise in 2014. Approximately 70% of the population was dependent on agriculture and contributed about 40% to gross domestic product (GDP). Since the rebasing, the change in GDP structure showed a shift in the Nigerian economy from being production intensive to more of services. Using the most recent data, the economy is structured in the ratio of 54: 46 in favor of services, while agriculture and industries account for the latter figure. Oil on the other hand has remained the bane of Nigeria's fiscal and forex revenue although its contribution to GDP output has remained below 9%. Nigeria's overdependence on oil receipts left it exposed to the commodity shock that started in 2014. From a commodity shock, it translated to an exchange rate crisis (over 90% of Nigeria's forex is from oil). Being a highly import dependent country, the weakness in the currency resulted in a full blown economic crisis (present day reality). While we all know the what and why of the recession story, more importantly is how does Nigeria navigates through the murky waters and returns to the hay days of a 7% growth? One of the options touted around is the need for increased investment especially from the private sector.

Over the years, countries especially developing economies have witnessed a gradual increase in private sector investment. With the increased pace of globalization and technological development, the role of private sector has intensified. This is because governments of nations have identified the benefits of private investment and public-private partnerships (PPP) which include but are not limited to market discipline and efficiency (e.g in the telecoms and power sectors in Nigeria), an economic strategy for boosting GDP growth, job and income creation, efficient resource allocation, provision of infrastructure and social benefits. The private sector also plays an important role in key sectoral developments such as infrastructure development (an economic strategy for most if not all countries), education and health sectors. Hence it is safe to say there cannot be growth without some level of private sector investment involved. According to Bayraktar (2003), investment is the result and cause of economic growth. Private sector investment is seen as the engine of growth while the public sector provides an enabling environment such as infrastructural development.

## CASE STUDIES

### Japan

The Japanese economy is a good example of an economy with an investment led growth story. Domestic investment in industries and infrastructure were the bane of the Japanese government's strategy in boosting its output and economic growth. In the early 90s, Japan was poised to overthrow the US to become the largest economy globally. Gross fixed capital formation in the private sector was as high as 21% of GDP in Japan in 1996.[1] GDP growth rate was approximately 4% in that year.[2]

### China

Private sector investment in China accounts for 60% of the country's total fixed asset investment.[3] A total of $3.62trn was recorded as private investment in China in the first two months of 2017.[4] Private sector investment is projected to increase to 10% in 2017 from 3.2% in 2016.[5] This is after an annual average growth rate of 30% in the last 10 years.

The role of private sector investment and its efficient utilization also vary from region to region, nation to nation and depends on several factors: macro-economic policies, economic incentives, well defined property rights, as sound judicial system, sound financial system, policy certainty and clarity, etc.[6] it can be funded either through domestic or international financing.

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[1] Source: World Bank

[2] Source: Trading economics

[3] Source: South China Morning Post

[4] Source: China's National Bureau of Statistics

[5] Source: South China Morning Post

[6] Source: Journal of Economic Cooperation 24, 1 (2003), 63- 110- The Role of private Sector Investment in the Economic Performance of OIC Member Countries

## PRIVATE SECTOR INVESTMENT IN NIGERIA

Due to Nigeria's huge dependence on oil following the oil boom era of the 1970s, the economy has been more of a public sector led government. Between 1986 and 2014, private sector investment in Nigeria started growing as market forces started playing a more prominent role. Efforts to privatize the public sector led to the reformation of key sectors such as the telecoms sector in Nigeria, the power sector (although still saddled with funding constraints). It also opened Nigeria to more foreign trade activities, resulting in an influx of gross fixed investments that reached a peak of $85.7bn in 2014.[7] Nonetheless, growth of private sector investment in Nigeria has been constrained by a difficult business operating environment (169th out of 190 countries in the ease of doing report for 2016); more recently by weak confidence in the policy implementation and the general economic environment, and a distorted foreign exchange market.

## WHAT NIGERIA NEEDS TO DO

There is empirical evidence to show that investment plays an important role in a nation's economic growth.[8] The Nigerian government needs to emphasize the need for private sector investment by increasing the PPP in key capital projects such as the railway projects, privatization of government owned refineries, airport concessioning, etc. For example, the railway concessions with GE (Lagos-Kano and Port Harcourt- Maiduguri). These will free up some cash for the government that has a fiscal deficit treading close to the 3% of GDP threshold.

[7] Source: EIU March 2017 Report

[8] Baghebo and Edoumiekumo (2012)


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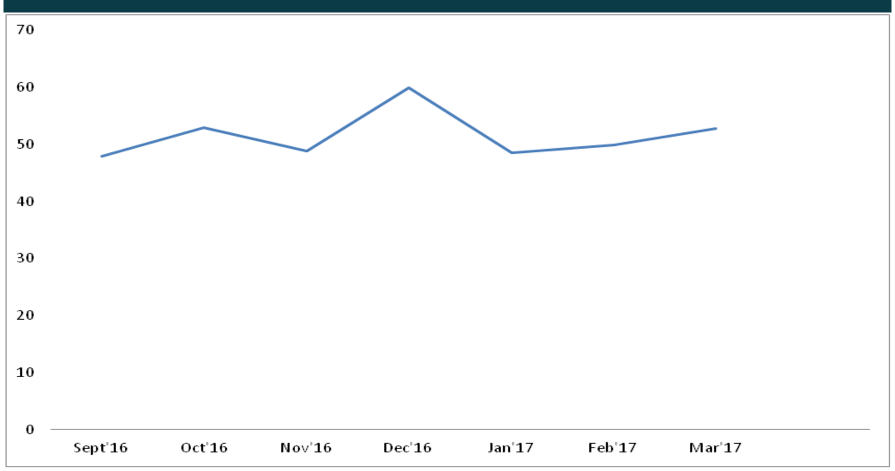
## MACROECONOMICS INDICATORS

### PURCHASING MANAGERS INDEX (PMI)

The purchasing managers index (PMI) computed by the FBN Quest increased to 52.8 in March relative to 50 in February. This highlights the impact of the CBN's intervention in the forex market and the slight respite in the energy market (improved power supply and lower diesel prices) in March. However, economic fundamentals remain weak with a volatile oil price environment and high financing costs in the domestic market. Therefore the future of the manufacturing sector is still on the path to recovery. The IBTC PMI recorded the highest reading in March, rising to a 15-month high of 53 from 52.2 recorded in the previous month.

The CBN's PMI also recorded improvement although the manufacturing sector still remained in a contractionary state. The CBN PMI increased to 47.7 from 44.6 in the previous month. Thirteen out of the sixteen sub-sectors contracted while sub-sectors such as food, beverage and tobacco, clothing and appliances and components expanded in the review period.

Chart 2: PMI




[9]

### Outlook

The PMI results highlight an improvement in the producers' expectations of a recovery in the manufacturing industry, following the

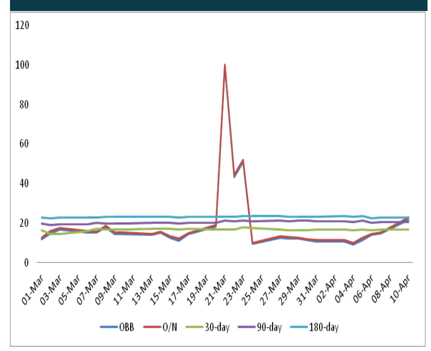
[9] Source: FBN, CBN, FDC Think Tank

increased pace of forex interventions by the CBN. Financing costs remain a problem for manufacturers, therefore gains in this sector are likely to be capped.

## MONEY MARKET

The opening liquidity position in the money market was significantly lower in March at N51.2bn long relative to February's position of N303.4bn long. The money market averaged N27.74bn short in March which is relatively higher than February's average of N74.88bn short. In April, the market opened N88.69bn long and has averaged N23.06bn long (April 3-10). Once again, a significant portion of liquidity in the money market is predominantly being mopped up by the CBN's interventionist policies which has summed up to almost $3bn YTD. The frequency of OMO auctions in the review period was also high.

Chart 3: Inter-bank Rates (%pa)



[10]

Short term interbank rates (OBB, ON and 30-days) averaged 19.37% in March, 22.3% in Feb and 14.91% between April 3 to 10. A negative relationship exists between the liquidity position in markets and interest rates and as such explains why on average rates were higher in February compared to March. The OBB and O/N rates peaked to as high as 100% p.a. and 100.08% p.a. respectively in March, as a result of investors and consumers funding their accounts to participate in the CBN's forex contracts. At the end of March, the closing rate for 91-day, 182-day and 364-day T/bills were 13.35%, 17.2% and 18.69% p.a. respectively at the primary market auction relative to closing rates of 13.65%, 17.2% and 18.5% pa in February.

## Outlook

As long as the CBN sustains its sale of forex in the markets, the mopping up effect through funding for dollars will keep interest rates elevated. However, a counteracting factor will be the maturity of OMO auctions in the review period which will pump naira back into the system thereby capping further increases in interest rates.

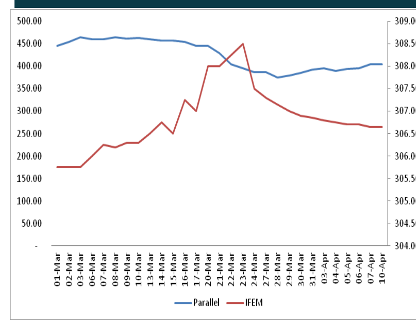
[10] Source: CBN, FMDQOTC, FDC Think Tank

## FOREX MARKET

### Exchange Rate

The exchange rate remains a major topic of discussion when assessing the fundamentals of the Nigerian economy. However, a common misconception is to equate currency recovery with economic recovery. The forex market structure remains inefficient with the effective PPP value of the naira at N325, yet the interbank market still trades at N306/$. The parallel market closed March at N392/$ relative to February's closing rate of N445/$, highlighting the positive effects of the CBN's interventionist stance in the FX market. The market remains positive about the CBN's policy as the naira has further appreciated to N390/$ as of April 24th. However, appreciation gains remain capped by two main factors one of which is the lingering uncertainty in the market about the sustainability of the current FX market policies. The other is the manifestation of the cobweb theory where the market keeps moving in a cobweb pattern until it reaches its point of equilibrium. At the interbank market, the exchange rate depreciated marginally by 0.28% to N306.85/$ in March and is currently trading at N306.45/$ as at April 24th.

Chart 4: Exchange Rate (N/$)




[11]

### *Outlook*

In the short term, the naira is expected to remain around the N400-N410/$ band in the forex market in spite of the CBN's intervention. This is because uncertainty in the market persists. Fundamentals are improving, i.e higher oil prices and relative peace in the Niger Delta, hence the accretion in the external reserves will help boost the CBN's ability to continue its intervention.

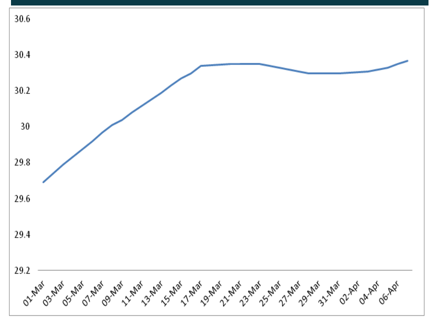
However, on the global front, the US seems to be on a tightening cycle in that at least two fed rate hikes are expected. This effectively strengthens the dollar and attracts increased dollar investments. Hence expect stronger dollar-naira parity as the months roll on.

[11] Source: FDC Think Tank

## External Reserves

The 90-day moving average of Nigeria's gross external reserves increased by 2.19% ($650m) to $30.3 billion in March relative to $29.65 billion in February. As of April 7th the gross reserves level stood at $30.37 billion. This brings the reserves import and payment cover to 7.2 months. The CBN is building its reserves base despite the current wave of forex injections in the market mainly due to improvements in oil prices and production.

Chart 5: External Reserves ($bn)



[12]

### *Outlook*

We expect external reserves accretion to continue with higher oil receipts. Also, the mandate by the presidency to the ministry of finance and CBN to expediently secure a proposed $4.5bn from China will go a long way in providing funds for the proposed 2017 budget. Other sources consist of the outstanding balance from the $1bn AfDB loan and an additional $500m from the Global Medium Term Note program.

## COMMODITIES MARKET - EXPORTS

## Oil Prices

Chart 6: Brent Crude ($/pb)

[13]

Brent crude averaged $52.54pb in March, 6.17% lower than February's average of $56pb. So far in April prices have averaged $54.81pb, with Brent trading at $56.04pb as at April 11th. The decline recorded in March is attributed to high stock build in the US as part of the US shale producers' agenda to flood the market with oil and capture gains from a relatively high price environment. The re-opening of the Keystone XL refinery construction, which was shut down by the previous administration on environmental and civic grounds, is underway. The EIA's latest report shows that US production averaged 16.4mbpd in the week ending March 31st. Baker Hughes also reported 839 operational rigs as of

[12] Source: CBN, FDC Think Tank
[13] Source: Bloomberg, FDC Think Tank

April 7th compared to 754 in February.

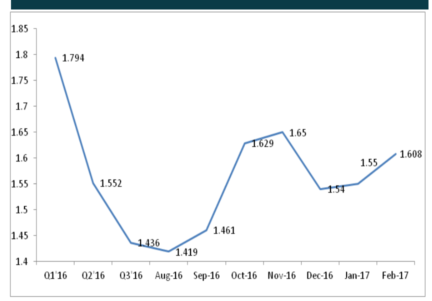
However, oil prices have begun to rally as it is expected that the rate of US stock build will decelerate in the coming days. This will lend support to prices in the market with the API predicting a stock draw of 1.8mbp in the coming week.

***Outlook***

It is expected that oil prices will rally as OPEC is making hard negotiations for its upcoming meeting in May to decide on strategies to lead it towards its goal of rebalancing the market. There is the threat of an increase in US shale which will curb price gains.

## Oil Production

Chart 7: Oil Production (mbpd))



[14]

According to the OPEC monthly report, production in Nigeria improved to 1.608mbpd in February from 1.55mbpd in January. This is attributed to the calm in the Niger Delta following series of engagements between the FGN and the Niger Delta representatives. However there were force majeures which are planned disruptions and these are likely to lead to a fall in output levels in the month of March.

***Outlook***

The Shell Nigeria Bonga deep water oil field which was closed for 30-day maintenance is expected to reopen in April and as such we expect production to increase. Hence, production from the re-opening of the field coupled with the relative calm in the Niger Delta will have a positive impact on production levels. A higher oil price with improved production levels is good news for federal and state finances.

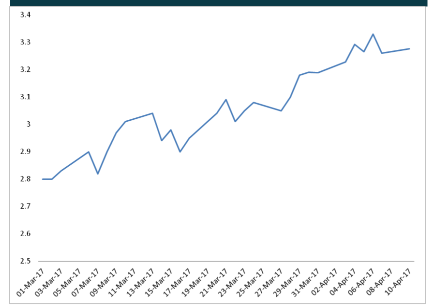
## Liquefied Natural Gas LNG

In the review period, the average price of natural gas recovered slightly to \$2.99mmbtu, 3.10% higher than \$2.90mmbtu in Feb-

[14] Source: OPEC, FDC Think Tank

ruary. So far in April, natural gas is trading higher at $3.262mmbtu as of April 11th. The market traded relatively bullish despite warmer weather conditions in the US. According to the latest EIA report, U.S natural gas inventories in storage is 2,051bcf, 17.2% lower than the 5 year average of 2,478bcf.

Chart 8: Natural Gas ($/mmbtu)



[15]

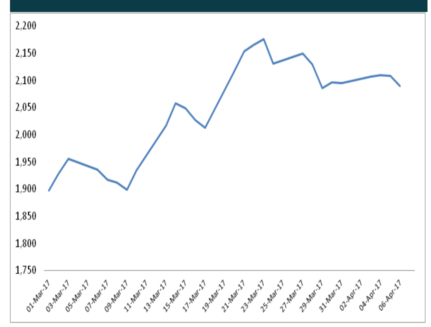
***Outlook***

Warmer weather conditions are expected in the coming months as the spring and summer months roll on. Therefore, the demand for gas is expected to slide giving rise to lower prices in the natural gas market.

## Cocoa

The average price of cocoa increased slightly in March by 1.6% to $2,036/mt from $2,004/mt in February. Cocoa traded as high as $2,176/mt on the 23rd of March due to dry weather conditions in the world's largest producer of cocoa, Ivory Coast. Currently, cocoa prices are trading lower at $1,988/mt as at April 11th, highlighting that gains have been capped due to weak fundamentals. The cocoa market is heavily oversupplied with no corresponding demand, which is putting pressure on prices.

Chart 9: Cocoa



[16]

***Outlook***

In the short run cocoa prices should maintain the upward trend for the duration of the dry season in Ivory Coast. However, as we see in the beginning of April, these gains are likely to be capped as the glut crisis still exists.

## IMPORTS

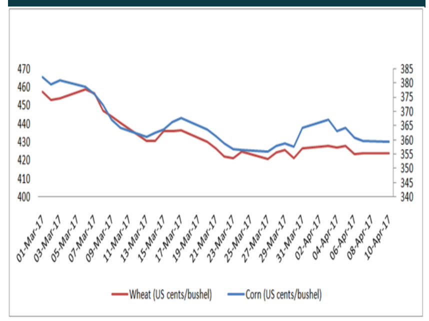
## Wheat

Average wheat prices in March were lower by 2.68% to $4.36/

[15] Source: Bloomberg, FDC Think Tank
[16] Source: Bloomberg, FDC Think Tank

bushel from $4.48/bushel in February. As at April 11th wheat was trading at $4.3/bushel. The wheat market traded bearish in the review period due to negative sentiment as a result of ample supply. Wheat hovered around its lowest level since early February due to favorable weather conditions in the U.S. further supporting the bearish tone in the market. USDA report released showed a 21% YoY increase in all wheat stock to 1.66 billion bushels, prompting the selloff of long positions by investors.

Chart 10: Grains




[17]

## Corn

In March, average corn futures also contracted by 1.88% to $3.66/bushel from $3.73/bushel in February. As at April 11th, corn futures traded at $3.69/bushel. Corn stocks also increased according to the USDA report although less than the wheat stock build. Corn stocks totaled 8.62 bushels, 10% higher YoY.

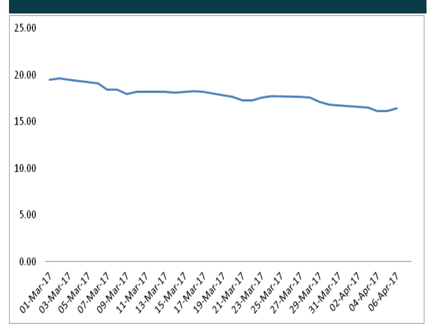
### *Outlook*

Grain prices are will be subject to weather conditions this month. Analysts also expect ample supply in the grains market which will sustain the bearish tone.

## Sugar

In March, average sugar prices decreased by 11.4% to $0.1806/pound from $0.2038/pound in February. This is mainly due to amply supply from India and Brazil with little corresponding demand from mills and skockists. Currently, sugar prices are trading at $0.1608 as at April 11th showing the persistence of the bearish undertone in the market.

Chart 11: Sugar




[18]

### *Outlook*

Analysts fear that sugar gains predicted at the start of the year may not actualize due to the persistent bearish trend recorded in the market. However, a price rally might be on the horizon as the summer wedding season in India approaches, forcing an increase

[17] Source: Bloomberg, FDC Think Tank
[18] Source: Bloomberg, FDC Think Tank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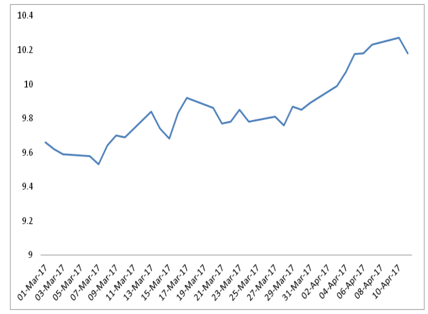
in the demand for sugar.

## Rice

The average price of rough rice increased by 2.38% to $9.750/cwt from $9.523/cwt in February. Currently, prices are trading higher at $10.22/cw. Iran's state grains buyer, Government trading Corporation (GTC), purchased about 400,000 tonnes of rice from Thailand. This has been flagged by analysts as a sign of change in the country post sanctions and will feed into demand for rough rice which will in turn trickle down into prices.

Chart 12: Rice ($/cwt)



[19]

### *Outlook*

EU farm commissioner proposes support for rice growers in the region. The EU's self sufficiency in rice is about 70%. Hence further support could increase the supply of rice in the market and weigh on prices.

[19] Source: EIU, Bloomberg, FDC Think Tank

# Who We Are

Avant-garde Academia Limited

Avant-garde Academia Limited (AAL) is an education advisory and counseling service organization that was incorporated in July of 2013. AAL was incorporated as an educational aggregator in grooming candidates to be potential global citizens who will reinvest their acquired skills in Nigeria in future. It is positioned to provide support, assistance and guidance to potential candidates and entrants to Ivy League, Elite and premium academic institutions in America. Our target market comprises parents of children in identified elite Nigerian secondary schools and/or top executives in the business community, who have a strong need for our services.

The market also extends to Nigerians resident in Diaspora, and expatriates resident in Nigeria. In Partnership with Ascent Education Advisors, a reputable Education Advisory Services firm, we have designed a range of admissions solutions to cater for children in different stages of secondary school education.

**OUR STRATEGIC PARTNER – ASCENT EDUCATION ADVISORS**

**A reputable education advisory service firm, the lead consultant Ms. Peggy Hanefors has over 10 years experience in admissions; including a position as the Assistant Director of International and Transfer Admissions at the University of Pennsylvania. She was first reader and evaluator of about 3,000 applications for students from across the globe.**

## What We Offer

- Information and advice about the American University System and its application process.
- Evaluation of student's record prior to application.
- Assistance in selecting curriculum and summer activities that will match the student's desired course of study and also highlight his/her personality and interests.
- Development of personal application timeline, that includes standardized testing, college visits, application deadlines, etc.
- Help in selecting teachers for recommendations
- Guidance in presenting extracurricular record
- Guidance in putting together an overall great college application that highlights the unique attributes of the applicant
  - Essay topic brainstorming
  - Editing
  - Proof-reading
- Guidance in choosing the most suitable college among acceptances.
- Interview preparation

## Our Packages

**Package 1: 8th to 10th Grade (Final 3-5 Years)**

This package is a program designed for candidates from as early at the 8th grade (Junior Secondary School - JSS 2) of high school. This is a full package with the benefits of all the services we offer in addition to education and assistance with entire college admission process, including an unlimited number of applications.

**Package 2: 11th and 12th Grade (Final 1-2 Years)**

This package is similar to Package 1 but is designed for students in the final two years of high school.

**Package 3: (Per Application)**

Unlike packages 1 and 2, package 3 only provides unlimited assistance with applications to pre-determined universities.

We host a Parents Admission Support Forum in Lagos bi-annually with the aim of giving parents the information they need to ensure their child(ren)/wards gain admission into reputable universities in United States of America.

To attend one of our events, kindly contact or visit us at
**9a Idejo Street, Victoria Island Lagos.**

For more information about Avant- Garde Academia Limited please go to our website: www.avant-gardeacademia.com
For enquiries or consultation E-mail us: info @avant-gardeacademia.com Or call Chinyere Ubani 08039238138 | Tope Vincent 08034017603

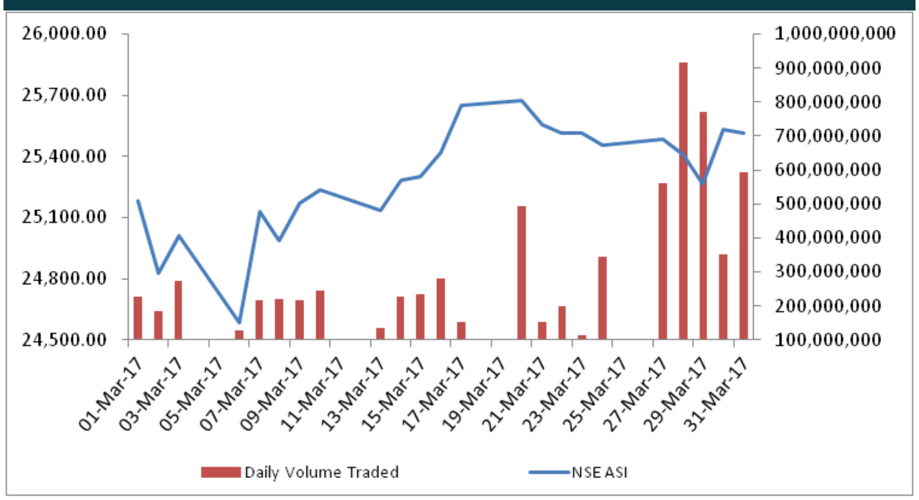
## STOCK MARKET UPDATE

The Nigerian equities market had its first positive month-on-month performance in the year as the NSE ASI gained 0.74% in the month of March, to close at 25,516.34 from the 25,329.08 points recorded in the previous month. The increase on the index may be attributable to investors 'cherry picking' value stocks with attractive entry prices.

The liquidity weighted SFNG Blue Chip 30 Index increased by 1.30% in the month of March, from the 4.14% loss recorded in February 2017.

Activity on the bourse was slightly positive resulting in 12 days of gains and 11 days of losses. Daily changes, representing volatility on the ASI, ranged between -1.72% and 2.23% in the month.

Chart 13: NSE ASI March 2017



[20]

There was a spike in market activity for the month as turnover increased by 284.62% to N142.52bn from the N37.06bn reported in the month of February. The massive spike was driven predominantly by the N90.29bn acquisition of Exxon Mobil's shares in MOBIL Oil Nigeria by NIPCO Limited, which was executed in the month being reviewed. Average daily turnover for the review month also increased to N6.20bn, 74.65% above the year's daily average of N3.55bn.

Investor sentiment, as reflected by market breadth, was positive

[20] NSE, FSDH, FDC Think Tank

at 1.12x, as 38 stocks advanced against 34 stocks that declined while 105 stocks remained unchanged.

NESTLE 31.58%, AIRSERVICE 23.61%, UNILEVER 20.77%, BETAGLAS 15.70% and UBA 15.40%, were the best performing stocks for the month.

| Top 5 Gainers | | | | |
|---|---|---|---|---|
| Company | Mar-17 | Feb-17 | % Change | Absolute Change |
| Nestle Nigeria Plc | 750.00 | 570.00 | 31.58% | 180.00 |
| Airline Services & Logistics Plc | 3.56 | 2.88 | 23.61% | 0.68 |
| Unilever Nigeria Plc | 35.00 | 28.98 | 20.77% | 6.02 |
| Beta Glass Co. Plc | 44.28 | 38.27 | 15.70% | 6.01 |
| UBA Plc | 5.77 | 5.00 | 15.40% | 0.77 |

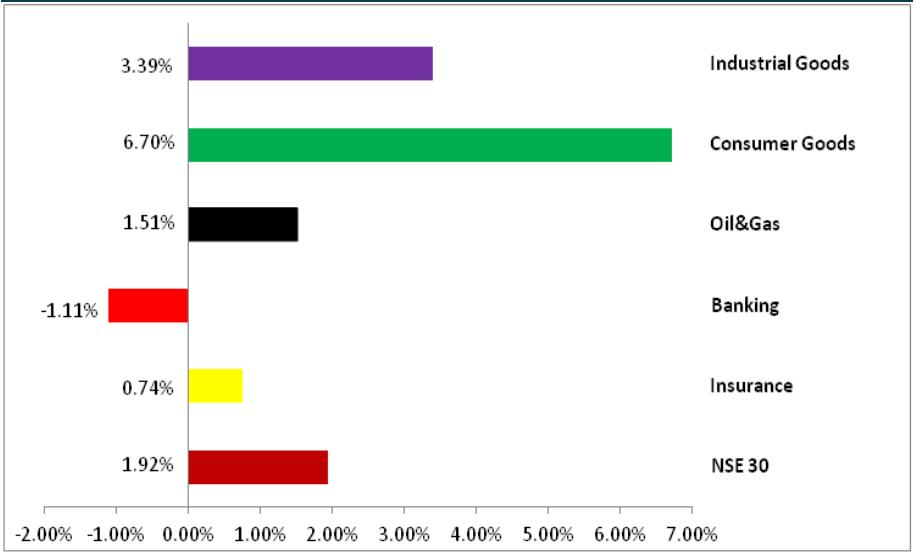
Top price losers for the month were LIVESTOCK (23.38%), UCAP (20.40%), UNITYBNK (18.99%), ARBICO (17.27%) and 7UP (17%).

| Top 5 Losers | | | | |
|---|---|---|---|---|
| Company | Mar-17 | Feb-17 | % Change | Absolute Change |
| Livestock Feeds Plc | 0.59 | 0.77 | -23.38% | -0.18 |
| UBA Capital Plc | 2.81 | 3.53 | -20.40% | -0.72 |
| Unity Bank Plc | 0.64 | 0.79 | -18.99% | -0.15 |
| Arbico Plc | 4.79 | 5.79 | -17.27% | -1.00 |
| 7-Up Bottling Co. Plc | 83.00 | 100.00 | -17.00% | -17.00 |

Performance across the NSE sub-indices was largely positive as all sectors closed higher, save for the banking index, which closed lower in the month being reviewed. The consumer goods index reversed some of last month's losses as it gained 6.70%, as investors took advantage of sector's stocks trading below their intrinsic levels.

In spite of the positive FY 2016 results of banking stocks, the sector emerged a lone loser in the month of March, declining by 1.11%. This decline may be attributable to the profit taking activities in some of the bank's stocks as well as the mark down of GUARANTY, ahead of its dividend payment.

Chart 14 : Sectors in March 2017




[21]

## GLOBAL MARKET REVIEW

As anticipated, the US Fed raised its benchmark interest rate by 25bps thereby bringing it to a target range of 0.75% - 1.00%. This is coming on the back of the last FOMC meeting held in December 2016, where Fed Chair, Janet Yellen, indicated the possibility of three rate hikes in 2017.

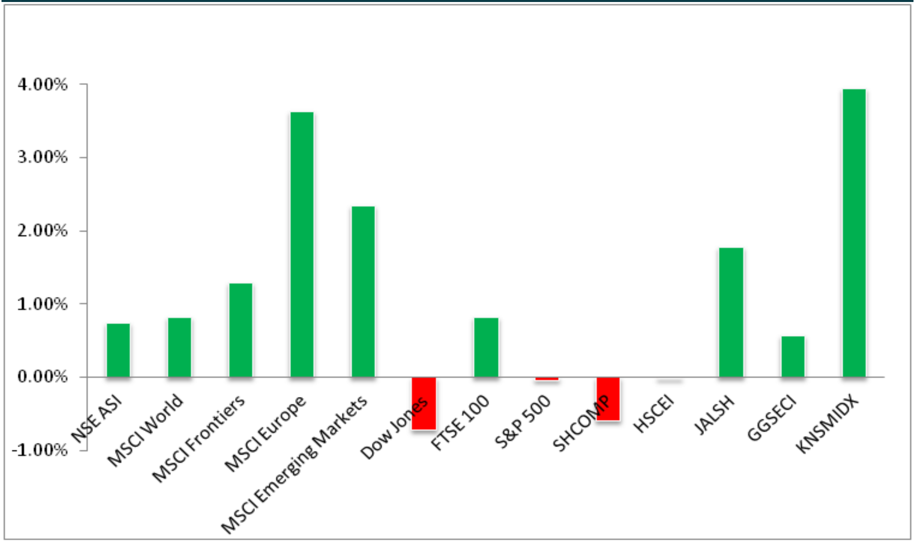
Most global equities had a bullish outing in the month of March, except for the Dow Jones Industrial Average index (DJIA), which lost 0.72% as investors begin to fear that President Trump's agenda on tax reform, regulatory relief and infrastructure spending may be delayed, watered down or even derailed.

The SHCOMP index declined by 0.59%, in spite of the news that China's manufacturing sector, measured by the purchasing managers' index (PMI), expanded at the fastest pace in nearly five years in March.

Sentiments in the sub Saharan African region closed positive in the month. The JALSH, KNSMIDX and GGSECI advanced by 1.78%, 3.94% and 0.57% respectively, moving in tandem with the NSE ASI.

[21] NSE, FDC Think Tank

Chart 15 : Global Indices March 2017




[22]

## OUTLOOK

As the FY 2016 earnings season winds down, we believe market performance will be driven by developments in the economy. With the recent improvement observed on key macroeconomic variables, we expect that investors will want to see the impact on Q1'17 earnings to help them reorganize their investment strategies for the rest of the year.

On the global front, the US Fed raised its benchmark interest rate by 25bps – benchmark rate now between 0.75% and 1% – while investors anticipate the possibility of at least two further rate hikes before the end of the year.

This has extensive implications for frontier and emerging markets with volatile currencies as the decision will likely strengthen the greenback with global fund managers rushing for safer investments. This will result in funds outflow.

[22] NSE, Bloomberg, MSCI, FDC Think Tank

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| Financial Modeling | July 17 - 21 |

### GENERAL MANAGEMENT

| | |
|---|---|
| Managing Compliance and Legal Risk | May 22 - 24 |
| Stepping up to Management | June 29 - 30 |
| Managing People for Strategic Advantage | July 10 - 12 |


### MARKETING AND SALES MANAGEMENT

| | |
|---|---|
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| Strategic Account Management | July 11 – 13 |
| Digital Marketing | July 24 – 25 |
| Outstanding Customer Relationship | August 29 – 30 |


### OPERATIONS & MANAGEMENT INFORMATION SYSTEMS

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|---|---|
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| **Smart Business Decisions:** The power of data analysis | May 22 - 26 |
| Developing Analytical Competencies for Managing Operations | July 3 – 7 |

### PERSONAL LEADERSHIP & HUMAN RESOURCES MANAGEMENT

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| Legal Issues in HRM | April 19 - 27 |
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| Advanced HRM | April 7 - May 12 |
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| Refining Your Interpersonal Skills | October 23 – 25 |

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|---|---|
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| Mastering Competitive Strategy and Blue Ocean Strategy | May 15 - 18 |
| Leading a Sustainable Business | June 1 – 2 |
| Driving Strategic Innovation and Business Development | July 3 - 5 |
| Executing Sustainable Strategy | October 9 – 10 |

## GENERAL INFO

**PROGRAMME VENUE:**
Km 22, Lekki-Epe Expressway, Ajah, Lagos

**TIME:**
9.00 a.m. - 5.00 p.m.

**PRIOR REGISTRATION** is mandatory to secure a place on the seminar.

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|---|---|
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## CORPORATE FOCUS: FLOUR MILLS

**Analyst Recommendation:** BUY

**Recommendation Period:** 365 days

**Industry:** Food, Beverage & Tobacco

**Market Capitalization:** N45.9 billion

**Current Price:** N18.00

**Target Price:** N24.61

The Nigerian food and FMCG sector in general has been hit by lower sales and declining margins due to weaker consumer purchasing power and increasing input costs. Despite these challenges, some companies have been able to position themselves in order to grow sales. Flour Mills recorded a 47.9% increase in revenues as of the 9th month of 2016 (9M 2016). This increase was driven by price increases and volume growth, especially in the food segment. Though the result shows a decline in earnings, if an adjustment is made to the comparative 9M 2015 period, by excluding the gain on disposal of investment of N23.7bn, then Flour Mills was more profitable based on recurring items.

Flour Mills has been affected forex shortages that most manufacturing companies have been facing. The company's 9M 2016 showed a 48% increase in material costs mainly due to forex pressures. The company also highlighted increased power costs as a major cost driver. However, if the recent positive developments in the Nigerian economy are sustained, the company may benefit even further from increased consumption and a better forex policy.

Flour Mills' decision to restructure its balance sheet will help reduce its interest expense, thus enhancing its profitability and margins. A major factor that will make the company grow more is its capacity expansion and diversification moves. Given these factors, we place a BUY rating on Flour Mills of Nigeria PLC.

### INDUSTRY AND COMPANY OVERVIEW

The Nigerian flour milling industry is an intensely competitive industry with pricing wars generated by market players that seek to gain or retain market share. Given the projected population growth in the country, the Nigerian flour millers have been investing heavily in capacity expansion. The industry size is estimated at $2 billion with an annual growth rate of 3.5%.[23] Leading players in the Nigerian flour industry include Flour Mills, Dangote Flour Mills, Honeywell and Olam International.

Flour Mills Nigeria was incorporated in Nigeria as a private limited liability company on 29 September, 1960 and became a public liability company in November, 1978. The ownership structure can classified under two segments: Excelsior Shipping Company Limited (52.18%) and other individuals and institutional investors (47.82%). The company is mainly engaged in

- flour milling
- production of pasta, noodles, edible oil and refined sugar
- production of livestock feeds
- farming and other agro-allied activities
- distribution and sale of fertilizer
- manufacturing and marketing of laminated, woven polypropylene sacks and flexible packaging materials
- operation of terminals a and B at the Apapa Port
- customs clearing and forwarding agents, shipping agents and logistics

The food segment comprises over 70% of the company's revenue base. The food segment consists of the company's marquee products such as milling and sales of flour and rice and production and sales of pasta, snacks, sugar and noodles. Other revenue segments include agro-allied, packaging, port operations & logistics and real estate & others. The company's growth can be seen through the increases of its total assets and revenue during the years. Between 2012 and 2016, revenue and total assets has increased by 7.3% and 10.5%, respectively. A snapshot of Flour Mill's latest annual financials is shown below.

[23] Femi Adekoya, https://guardian.ng/business-services/business/olam-targets-1-billion-share-of-nigerias-flour-milling-market/, 12 January 2016

The company's expansion is expected to foster its position as one of the leading food companies in Nigeria. The increased focus on its strength, the food segment, which saw its revenue rise significantly in 9M 2016 will be a key driver to its future growth plans. Finally, the improvement in operational efficiency as evidenced in its cost optimization strategies will help boost its earnings.

## Income Statement for Flour Mills of Nigeria Plc FY March

| N'000 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| Revenue | 258,268,251 | 301,941,329 | 325,790,187 | 308,756,526 | 342,586,459 |
| Cost of Sales | (218,559,730) | (263,931,207) | (288,485,692) | (273,389,567) | (304,961,737) |
| **Gross Profit** | **39,708,521** | **38,010,122** | **37,304,495** | **35,366,959** | **37,624,722** |
| Other gain and losses (Other income) | 2,596,509 | 5,407,308 | 3,873,953 | (685,050) | (7,720,517) |
| Selling and distribution expenses | (7,513,409) | (10,066,912) | (6,081,666) | (4,184,382) | (5,003,801) |
| Administration expenses | (14,000,952) | (15,204,512) | (15,721,482) | (20,281,760) | (15,848,261) |
| **Operating Profit** | **20,790,669** | **18,146,006** | **19,375,300** | **10,215,767** | **9,052,143** |
| Investment Income | 2,372,931 | 5,464,686 | 5,027,713 | 2,303,588 | 1,103,475 |
| Finance costs | (8,493,212) | (11,407,268) | (16,101,379) | (18,703,526) | (22,397,762) |
| Share of loss in associate company | (2,867,227) | (1,037,993) | (73,651) | (381,012) | - |
| Gain on disposal of investment in associate | - | - | - | 14,289,953 | 23,731,422 |
| **Profit Before Tax** | **11,803,161** | **11,165,431** | **8,227,983** | **7,724,770** | **11,489,278** |
| Income tax credit/(expense) | (4,041,532) | (3,438,760) | (2,860,108) | 738,292 | 2,931,006 |
| **Profit After Tax** | **7,761,629** | **7,726,671** | **5,367,875** | **8,463,062** | **14,420,284** |
| Profit from discontinued operations | | | | 11,280 | - |
| Profit for the year | 7,761,629 | 7,726,671 | 5,367,875 | 8,474,342 | 14,420,284 |

## Balance Sheet for Flour Mills of Nigeria Plc FY March

| N'000 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| Property, Plant and Equipment | 112,194,408 | 144,346,381 | 169,287,517 | 208,940,475 | 213,561,751 |
| Intangible assets | 520,868 | 672,908 | 554,905 | 496,248 | 735,330 |
| Goodwill | 583,728 | 4,148,022 | 4,148,022 | 4,148,022 | 4,148,022 |
| Investment properties | - | - | - | - | 49,704 |
| Investment in subsidiaries | - | - | - | - | - |
| Investment in associates | 1,391,674 | 2,058,203 | 7,790,094 | - | - |
| Other financial assets/investments | 414,198 | 24,948 | 135,456 | 114,716 | 45,696 |
| Deferred charges/Deferred tax assets | - | 311,072 | - | 411,431 | 66,022 |
| Long-term loans receivable | 18,578,584 | 19,717,445 | 11,457,561 | 3,904,188 | - |
| Biological assets | - | | 609,112 | 58,509 | 352,020 |
| Deposit for shares | 2,194,171 | - | - | - | - |
| Other long term assets | | | 1,734,837 | 1,583,075 | 1,703,939 |
| **Non-current assets** | **135,877,631** | **171,278,979** | **195,717,504** | **219,656,664** | **220,662,484** |
| Inventories | 50,277,454 | 64,366,539 | 63,683,942 | 68,426,003 | 58,698,768 |
| Biological assets | - | 696 | 144,885 | 399,081 | 182,613 |
| Trade and other receivables | 17,425,462 | 19,467,295 | 15,478,510 | 15,373,448 | 18,966,168 |
| Prepayments, Other assets | 1,402,967 | 1,710,231 | 4,004,007 | 3,060,090 | 13,625,250 |
| Non-current assets held for sale | - | - | - | 3,514,035 | - |
| Due from related companies | 1,355,402 | 1,585,988 | 3,331,669 | 1,699,790 | |
| Cash and bank balances | 26,239,138 | 21,837,482 | 16,825,163 | 31,131,719 | 33,213,043 |
| **Current assets** | **96,700,423** | **108,968,231** | **103,468,176** | **123,604,166** | **124,685,842** |
| **Total Assets** | **232,578,054** | **280,247,210** | **299,185,680** | **343,260,830** | **345,348,326** |

Source : Flour Mills Nigeria Plc Annual Reports


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## SKILLED MANAGEMENT TAKING ADVANTAGE OF GROWTH OPPORTUNITIES IN THE FOOD INDUSTRY

The series of acquisitions and capacity enhancement projects undertaken by the Flour Mills management team underscores the company's intention to continue as a major player in Nigeria's food segment. The company's management team has also shown its ability to enhance shareholder value through strategic goals to streamline operations, reduce administrative costs and improve operating efficiency. Management's decision to defer its proposed N40 bn right issues was due to the bearish sentiment in the equities market. The company will undertake the rights issue through a shelf programme in three tranches. The company's decision to raise funds via rights issue is aimed at restructuring its balance sheet, using proceeds to reduce its debt burden and replenish working capital.

Flour Mills' board of directors is led by Mr. John Coumantaros who has been with Flour Mills since 1984 and has been a director since 1993. He also serves as the chairman of the Nigerian Bag Manufacturing Company PLC and Northern Nigeria Flour Mills PLC, and sits on the board of the United Cement Company of Nigeria Ltd as a non-executive director. The veteran businessman is an alumnus of Yale University where he graduated with a BA in History. John Coumantaros took over from Mr. George Coumantaros, the founder of the company. George Coumantaros led the company through its operational inception in 1962 when it produced 600 metric tons per day to its current milling capacity of over 8,000 metric tons per day.

Other key members of the Flour Mills' management team include Paul Gbadebo and Mark Coakley. Mr. Paul Gbededo has been the Chief Executive Officer and Group Managing Director at Flour Mills of Nigeria Plc since April 2013. He previously served as Director of Golden Fertilizer & Golden Rice Company. Mr. Gbededo is a Loughborough alumnus with a graduate degree in Plastics and Polymer engineering technology.

Another key management staff is Mark Coakley who serves as the Managing Director, Food Division, at Flour Mills of Nigeria PLC. He has international experience with PepsiCo, and worked at Brim Brother Ltd, the Smiths Snack Food Company and Nestle before joining FMN in December 2015. He is a University College Dublin alumnus with a BComm in Marketing and a Master of Business Studies in international Marketing.

***Bulls Say:***

- Wide product range ensures sustainability of revenue profile
- Solid brand value given Flour Mill's recognition as a leader in the consumer goods segment
- Highly skilled workforce with adept technical and marketing skills
- Dominance in the Nigerian flour mill industry
- Investments in backward integration positions the company to benefit from cheaper raw materials and reduced production costs
- Favorable government policies towards firms invested across Nigeria's agricultural value chains

***Bears Say:***

- Intense competition from recognized brands such as Dangote Flour Mills Plc, Honeywell Flour Mills Plc and Olam International
- High leverage and rising finance costs threaten earnings growth
- Forex shortages could result in higher operating cost of imported raw materials, thereby curtailing profitability
- Persistent macroeconomic headwinds has affected consumer demand for goods
- Poor infrastructure increases operating costs

## RISKS AND OUTLOOK: WEAK MACROECONOMIC FUNDAMENTALS CONSTRAINS GROWTH POTENTIAL

The major risks that could limit Flour Mills from achieving its strategic goals include market risks, high leverage, project completion and security challenges. Forex risk is a key risk the company faces as evidenced by the spike in input costs due to forex shortage. Furthermore, the company is exposed to commodity price risks as it needs to purchase specific quantities and qualities of raw materials to meet its milling requirements. These raw materials include wheat, rice and cassava flour.

The company has implemented various strategies to control market risks. Flour Mills' controls interest rate risks by negotiating long term loan facilities and obtaining subsidized government loans. Also, the company is controlling its exchange rate risks through its backward integration of agro allied products in order to reduce dependencies on imported raw materials. Flour Mills' debt burden is also a key risk. However, Flour Mills has effective capital risk management and liquidity risk management frameworks in place to manage its debt and capital structure. The three-year plan to raise N40 billion equity capital will help deleverage its balance sheet, thereby reducing interest expenses.

Project completion is another risk if the expansion projects for which the loans were secured are not completed. With Flour Mills' excellent execution record, as witnessed in the completion of its sugar milling, flour milling and other key projects, the likelihood of an abandoned project is significantly reduced. Despite the gravity of the risks facing Flour Mills, the solid risk management in place, alongside its backward integration agricultural projects and its productive use of debt to fund expansion and growth shows that it is a company with a viable investment plan. As such, it is a company with prospects to enhance shareholder value.

## APPENDIX - VALUATION

We derived our valuation for Flour Mills of Nigeria Plc by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate for Flour Mills is N24.61, which is a 36.7% upside on the price of its share as of April 19th 2017. The discount rate - weighted average cost of capital (WACC) - of 13.0% is derived using a 15.78% risk free rate (yield on 10 year FGN bond initiated on Mar 2017), a beta of 0.8877, an after-tax cost of debt of 8.3%, and a market risk premium of 6.0%. The calculated long term cash flow growth rate to perpetuity is 5.0%.

Taking into account Flour Mills' latest financial performance, cost structure, its product mix, expansion projects and the prevailing macroeconomic conditions, we forecast a five-year revenue compound annual growth rate of 7.3%.

## FLOUR MILLS NIGERIA PLC VALUATION USING DISCOUNTED CASH FLOW (DCF)

**DCF Valuation**

| N'000 | 2017E | 2018E | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|
| EBIT | 25,907,734 | 29,345,090 | 32,165,657 | 34,452,787 | 39,533,569 |
| Less: Taxes | (6,476,934) | (7,336,273) | (8,041,414) | (8,613,197) | (9,883,392) |
| EBIAT | 19,430,801 | 22,008,818 | 24,124,243 | 25,839,590 | 29,650,177 |
| | | | | | |
| Plus: Depreciation & Amortization Expense | 43,843,713 | 50,594,119 | 56,983,588 | 63,053,910 | 72,217,838 |
| Less: CAPEX | (60,858,248) | (68,625,567) | (75,853,132) | (82,700,671) | (91,073,150) |
| Change in working capital (+/- Decrease/Increas | 29,358,574 | 12,552,998 | 7,616,536 | 8,391,441 | 7,210,037 |
| **Free Cash Flow (FCF)** | 31,774,839 | 16,530,367 | 12,871,235 | 14,584,270 | 18,004,902 |
| WACC | 13.0% | 13.0% | 13.0% | 13.0% | 13.0% |
| Present Value (PV) of FCF | 28,115,763 | 12,942,421 | 8,917,021 | 8,940,273 | 9,766,149 |
| | | | | | |
| | | | | | |
| Terminal value @ perpetual growth rate (2020) | **2017** | **2018** | **2019** | **2020** | **2021** |
| Terminal value as of 2020 | | | | | 235,892,070 |
| Present value of terminal value | 127,951,666 | | | | |
| | | | | | |
| **DCF Calculation** | **Valuation** | | | | |
| PV of explicit period | 68,681,628 | | | | |
| PV of terminal value | 127,951,666 | | | | |
| Enterprise Value | 196,633,294 | | | | |
| + Cash | 33,213,043 | | | | |
| - Borrowings | (165,253,161) | | | | |
| Equity Value | 64,593,176 | | | | |
| Share price | 24.61 | | | | |
| | | | | | |
| *Shares outstanding ('000)* | 2,624,253 | | | | |