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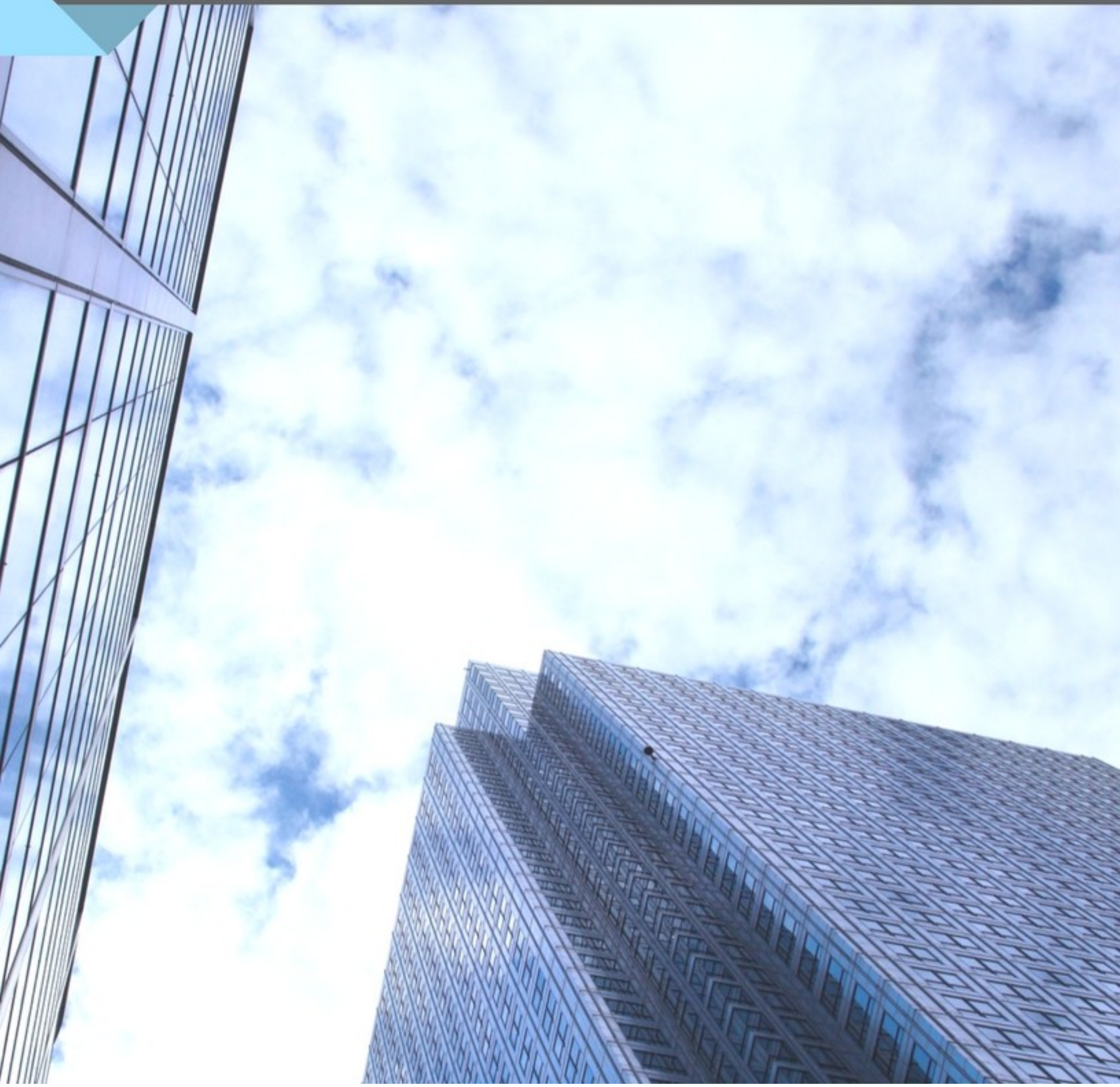
FDC MONTHLY ECONOMIC UPDATE



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In This Issue ...

The Nigerian Telecommunication Sector:
Challenges and Cautious Optimism

Background of the Telecom Sector

The Nigerian telecommunication sector is the largest segment of the Information and Communication sector. Nigeria has one of the largest telecom markets in Africa. The Nigerian Telecommunication sector has evolved over the years to an oligopolistic market structure (a small number of firms have the majority of market share). The sector includes a strong multinational presence. The leading players are MTN, a South African based multinational company with a market share of 37.21%, Airtel (an Indian based multinational telecommunication), Glo (a Nigerian multinational company) and 9mobile (formerly Etisalat). The sector over the years has contributed immensely to Nigeria's economy and the lives of Nigerians. The advancement of mobile phone usage from basic phone telephony to new enhanced services and the introduction of new technology within diverse sectors of the country have seen the sector grow massively. The sector has experienced rapid growth and helps in e.g. easier banking services (bank mobile apps) and access to e-learning platforms to Nigerians.

However, the Nigerian telecommunication sector saw stalled growth during the second half of 2016 leading to delays or deferrals of expansions and upgrades to networks and this trend has continued into Q2'17. The GDP Q2'17 result showed that the telecommunications sector contracted by 1.92%. The major challenges facing the sector are low consumer purchasing power, currency movements and the recent loss of global investors. The inaccessibility of the dollar in the economy resulted in weak macroeconomic conditions. Nigeria's weak macroeconomic conditions have led to weak labor market dynamics (high unemployment and underemployment), reduced disposable income and poor corporate performance. To ensure long-term growth and sustainability, the sector needs to focus on innovative business practices by investing their assets in more creative services that focus primarily on meeting consumer needs and establish a regulated minimum market price. These will create new streams of income for operators and mitigate the decline in their traditional revenues.

Prior to 2014, Nigeria was attractive to both local and foreign investors due to a stable currency and rise in oil prices. However, in 2016, there was a significant fall in oil prices which resulted in the shortage of dollars and depletion of external reserves, revenue shortfalls, high inflation and ultimately a recession. The naira's severe devaluation by 215% to $490/$ as at 30th December 2016, compared to $155.71/$ at the start of 2014 pushed up the costs of imported items such as RF Coverage Equipments (Node B) and Transmission Equipments (Optical Fibre) which stifled expansion plans of most network operators from expanding their service capacity. The sector has also been affected by a reduction in consumer demand due to lower disposable income in consumption.

Challenges in the Nigerian Telecommunication Sector

There has been a decline of GSM mobile subscribers as the market grapples with shifts in product options. Consumers are moving away from traditional cellular services to data bundle packs, which allows them to use Over the Top (OTT) services. Q4-2016 saw an increase in total GSM subscribers of 0.84% to 154 million (mn). However, subscribers dropped in Q1-2017 by 1.38% to 152mn; Q2-2017 results were worse, dropping 6.15% to 143mn.

Telecom operators and Internet service providers are currently at loggerheads to deliver data at relatively cheaper prices. The fierce price competition among telecom operators on their voice and internet data has led to the contraction in the sector revenue over time. Consumers benefit from temporary low prices only in the short run. The sector has also contended with OTT players that utilize technology to convey voice/video calls at a fraction of traditional voice call costs. While Nigeria's data bundle prices are the lowest in sub-Saharan Africa, they are priced below actual costs which can harm the sector and puts long-term customer benefits at risk. Smaller mobile network operators find it hard to survive in the market which leaves an industry dominated by few players. These few players will increase their market share and have the power to influence prices. Prices can more than double which can have a negative effect on the levels of consumption.

In recent years, Nigerian companies have had difficulties accessing foreign currency (FX) to finance their dollar/FX debt. The telecommunications sector was no exception. Etisalat Nigeria has been adversely affected by both a financial and management crisis. Etisalat obtained a $1.2 billion foreign-backed guarantee bond in 2013 to upgrade and expand its operations, but has been unable to meet its obligations since 2016. Etisalat's outstanding loan has adversely affected 13 Nigerian banks. Given the macroeconomic climate, it is expected that banks will record a substantial amount of non-performing loans (NPLs) due to the debt crisis. Such a scenario will adversely affect their profits (a 12% decline is expected in 2017) and their ability to meet their activities. There may be a decline in their equity instruments impeding their ability to absorb losses. Zenith Bank's exposure to the Etisalat loan, which accounted for N80bn of the total loan, was about 3.5% of Zenith's total loan book. The 2017 half year results of most banks have shown a substantial decline in their loans to customers in order to minimize and stabilize risk assets. First Bank has reduced its loans by 6% to 2 trillion (trn) in H1 2017. In a bid to prevent high NPLs in the future, banks are expected to further reduce their loans to retail clients and firms.

Global influence gives a company easy access to revenue. Raising capital in international markets helps to grow the business, meet daily obligations and minimize cost. It strengthens the business through exposure to new relationships. It diversifies business risks across a broader customer base. The recent exit of one of the major foreign investors from the telecom sector raised concerns about the reluctance of other investors entering into the mar-

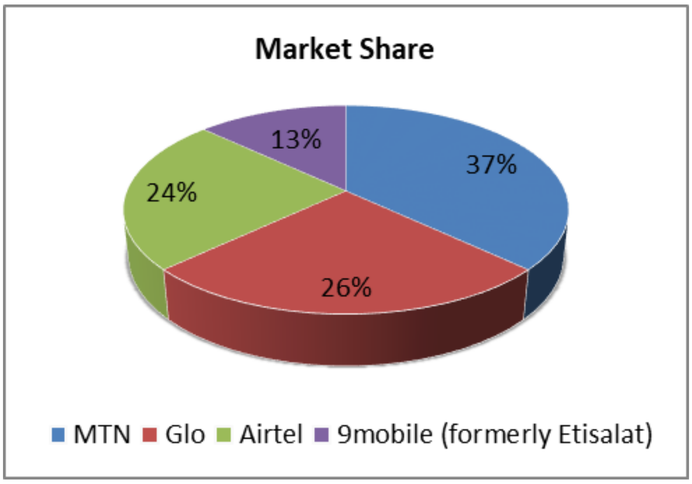
Solutions to the Challenges in the Nigerian Telecommunication Sector

To ensure sustainable growth, the sector is in need of reform. Previous changes (e.g. the Nigerian Communications Act 2003) are outdated as they focus on how voice calls are regulated and not on matters that relate to the new technological era. The focus today should cover competition in the sector, the market and other services the telecom sector is linked closely to such as finance, technology and media services. The current government has shown its commitments in creating an enabling environment for the private sector to contribute innovative solutions to allow consumers to benefit from Information Communication Technology (ICT) advancements. This will in turn bring about efficiency and productivity in the telecom sector and eventually enhance economic growth.

To solve the issue of artificial low prices, a regulated minimum price level has to be put in place by the government and regulators. Big and small telecom operators can compete on the quality of the network and customer services they provide. The sector's regulator, the Nigerian Communications Commission (NCC), should ensure that the quality of service provided by telecom operators are enhanced through an emphasis on the strength of their signals and the quality of their data services. Customers can also play a part in regulating prices by valuing and promoting services that offer the best customer experience and not those that offer only the cheapest price.

Since the exit of Etisalat's major investors, there have been recent reports that three telecommunication giants, Orange (French telecom group), Britain's Vodafone Group and India's Bharti Airtel,[1] are in the race to take up the investment opportunity and buy 45% of Etisalat's stake. Such a move will inevitably boost the telecom sector as it will attract improved technology into the country to drive better quality service.

Although the telecommunication industry has gone through turmoil, it can bounce back from its recent challenges and boost economic growth. With the sixth consecutive decline (0.3%) in year on year inflation to 16.05% and the simultaneous appreciation of the naira, the sector will see a steady growth in its activities. To drive economic growth, it needs to establish new reforms and review existing policies and regulatory actions to monitor the health of the sector. To ensure long-term growth and sustainability there is a need to improve on general business processes/practices to create new revenue streams, recreate existing products, diversify into new areas for which the resources and capabilities are available and establish a minimum market price. This will result in increased investors' confidence and will enable operators to serve multinationals including Small and Medium-sized Enterprises (SMEs) that are dependent on their internet services (better quality service). The sector needs to be considered important to Nigeria's economic development as it provides the infrastructural backbone for new digital economy that drives socio-economic development across all sectors in the economy (e-commerce, Mobile banking). Investments in operating telecom infrastructure are essential for economic growth as proper infrastructure leads to efficient operations of the sectors involved in the economy. The government therefore needs to pay a significant role in the sector as it has with developing policies to diversify the economy from



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[1] Reuters, "Former Etisalat Nigeria, 9mobile, appoints Citi, Standard Bank to find new investors". 2017
[2] Source: NCC, FDC Think Thank

Institutional Quality and Structural Reform

"Africa does not need strong men,

it needs strong institutions"... President Barack Obama.

Introduction

Policy mismanagement will continue to weigh heavily on the economic outlook of Sub-Saharan Africa (SSA) economies, according to the Economic Intelligence Unit (EIU), especially in regional heavyweights – Nigeria and South Africa. For commodity exporters like Nigeria, the persistent oversupply of crude oil at a global level has lowered the prospects for trade-led (commodity) growth. On this backdrop, accelerating the pace of structural reforms to diversify the economic base and improve competitiveness has become crucial – more so in an era of lower revenues and a global shift to more renewable forms of energy.

The EIU goes further to say that policy agenda will continue to be destabilized by political friction between reformists pushing for liberalization, and protectionists that favor a more traditional state-led approach to development. The protectionist argument in Nigeria has thrived on the continued use of three crucial subsidies: exchange rate, electricity and premium motor spirit – which have mostly encouraged consumption, rent-seeking and crony-capitalism.

For Nigeria, the imperative to reform stems from the suboptimal developmental outcomes that have been witnessed even when its economic growth numbers averaged about 7% between 2009 and 2014. The reformists argue that the traditional state-led approach has been constrained by an unhealthy dependence on natural wealth (oil exports), inefficient factor pricing and a rent-seeking imperfect market structure which have engendered a dysfunctional reward system.

Typically, the economic reform process should typically begin with the liberalization of markets, opening businesses to competition and unlocking value from the demolition of existing structures. For Nigeria, this process has been long and tedious, and looks set to remain that way, not due to a lack of effort from a policy standpoint but because of weak institutional quality which will continue to undermine structural reform.

The Evidence

The 2016 edition of the World Bank's annual Country Policy and Institutional Assessment (CPIA) Africa analysis showed that, on average, the quality of policies and institutions declined in the face of challenging economic conditions. The CPIA is an index that assesses the progress of SSA countries with regards to the quality of policies and institutions. The trend was also observed to be particularly pronounced in the region's commodity exporters and fragile states.

The CPIA is based on 16 development indicators that cut across four broad categories: economic management, structural policies, policies for social inclusion and equity, and public sector management and institutions. Countries are rated on a scale of 1 (low) to 6 (high) for each indicator. The overall CPIA score reflects the average of the four areas of the CPIA.

Nigeria scored 3.3 – compared to 3.4 in 2015. It scored highest in economic management and lowest in Public Sector Management and Institutions. Deeper scrutiny of the scores reveals it had its lowest scores in Property rights and Rule-based Governance (2.5) and the Quality of Public Administration. Both subcategories underline the urgent need to strengthen institutions

Country Policy and Institutional Assessment 2016

Indicator	Nigeria	SSA IDA Average
Economic Management	**3.5**	**3.2**
Monetary and Exchange Rate Policy	3.0	3.3
Fiscal Policy	3.0	3.0
Debt Policy	4.5	3.2
Structural Policies	**3.3**	**3.2**
Trade	3.5	3.6
Financial Sector	3.0	2.8
Business Regulatory Environment	3.5	3.1
Policies for Social Inclusion and Equity	**3.5**	**3.2**
Gender Equality	3.0	3.2
Equity of Public Resource Use	3.5	3.3
Building Human Resources	3.5	3.6
Social Protection and Labor	4.0	3.0
Policies and Institutions for Environmental Sustainability	3.5	3.2
Public Sector Management and Institutions	**2.8**	**3.0**
Property Rights and Rule-Based Governance	2.5	2.8
Quality of Budgetary and Financial Management	3.0	3.1
Efficiency of Revenue Mobilization	3.0	3.4
Quality of Public Administration	2.5	2.9
Transparency, Accountability, and Corruption in the Public Sector	3.0	2.7
Overall CPIA Score	**3.3**	**3.1**

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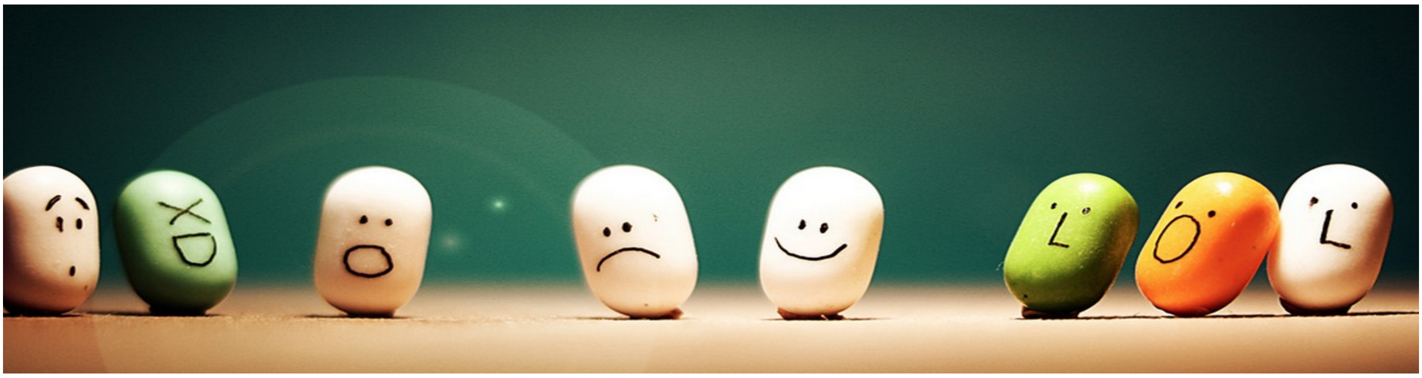
[3] Source: World Bank



But what are Institutions; Why and How do they Matter?

The concept itself encapsulates diverse elements. It refers to the formal and informal rules of behavior, methods of enforcing these rules, arrangements for conflict resolution, penalties for violating these rules, and organizations facilitating market transactions. They are simply systems of man-made rules that shape human interaction. In practice, the quality of institutions is often measured by the absence of corruption as well as bureaucratic efficiency, protection of property rights and the rule of law. The United Nations posits that institutions are most crucial to economic growth and development primarily because they create or eliminate incentives for businesses and individuals to engage in economic activity.

The important role played by institutions in facilitating economic activity is summed up by the World Trade Organization as follows:

* They decrease information asymmetries as they channel information about market conditions, goods and participants;

* They reduce risk as they define and enforce property rights and contracts, determining who gets what and when;

* They restrict the actions of politicians and interest groups, making them accountable to citizens

Strong institutions require that strong rule of law, high transparency and accountability in the public sector and an independent judiciary, be at the center of governance structures.

Verdict

Strong institutions ensure that the focus is on the process rather than the outcome. Economic agents are driven by incentive. The stronger the institutions, the stronger the incentive. In the absence of strong institutions, the best policies and leadership simply CANNOT drive economic development.

Reforms are underway in Nigeria to dismantle the imperfect market structure that is characterized by subsidies and has fueled rent-seeking behavior. The transition from slow to accelerated reform is only possible when the process is underpinned by strong institutions.

Structural reform that would alter the incentive system away from the status quo, and towards production, requires strengthening the institutional framework of governance to drive competitiveness and diversification. Institutions do not just matter. They matter the most.

Will OPEC Extend Oil Production Cut Deal At Next Meeting?

Two months before the next regular OPEC and Non-OPEC meeting in Vienna on November 30, 2017, the parties are already maneuvering to make their cases for what should happen. Already, OPEC and Non-OPEC oil ministers are discussing whether to extend the production cut deal past March 2018.

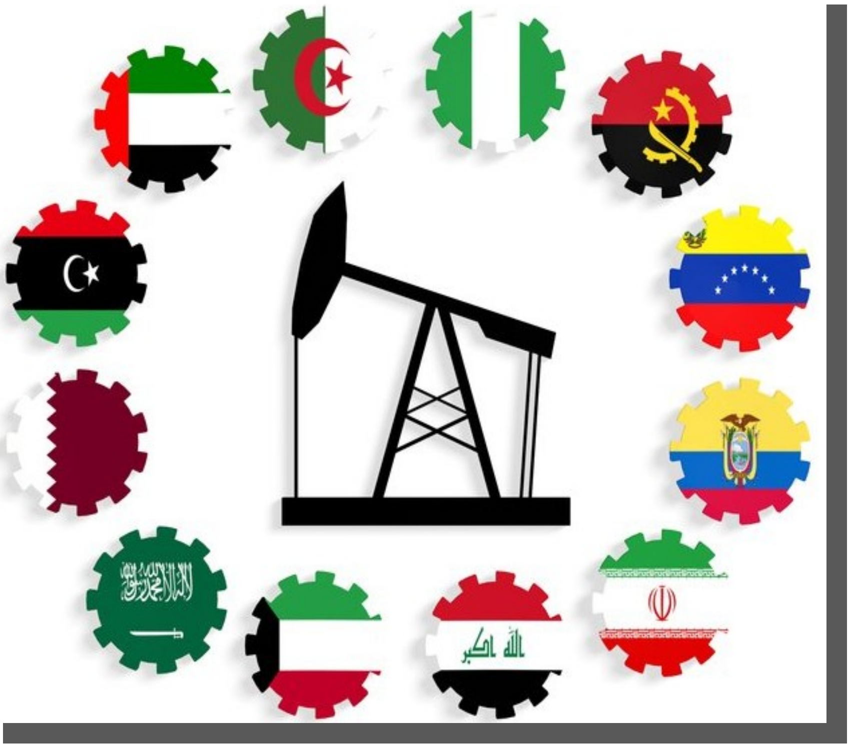
On September 5, Russian oil minister Alexander Novak said Russia would consider supporting an extension of the deal past March if data shows that the oil glut has not abated. This reflects a shift from July, when Novak said he did not see a need to extend cuts. Russia and Saudi Arabia recently reaffirmed their commitment to shared goals in the energy industry with a visit to the Kingdom by Russian Foreign Minister Sergei Lavrov.

Saudi oil minister Khalid al-Falih also traveled to Venezuela to meet with the embattled President Maduro. There the Venezuelan President affirmed his support for extending the production cuts beyond March 2018. This is not surprising given the fact that Venezuela's oil production has remained below its quota for several months, and there is no indication Venezuela has the ability to increase production anytime soon. According to S&P Global Platts, Venezuelan production declined even further in August, from 1.91 million bpd to 1.90 million bpd.

Venezuela's early commitment to extending the production cuts is not surprising given the country's economic woes and the financial problems of its national oil company, PDVSA. However, Venezuela's strong commitment could help influence other South American oil producers to commit to continue the production cuts.

In July, Ecuador, made headlines by stating it planned to unilaterally raise production. Though Ecuador later toned down its statements, the country has continued to exceed its quota. Venezuela, despite its economic and political chaos, is still the most prominent South American oil producer and could pressure Ecuador to adhere to its quota and support an extension of the cuts.

In truth, none of these early commitments are surprising. All eyes should be on Libya and Nigeria, the two OPEC countries that were exempt from the production cuts. Libya's oil production has not been steady. The government closed a pipeline from the Sharara oil field after militants took it over in mid-August. However, on September 6 the two sides reached an agreement and oil began flowing again. The Sharara oil field was taken over by militants in mid-August. When this happened, the Libyan government turned off the pipeline carrying oil from that field and cut off production.



Nigeria's oil minister, Emmanuel Kachikwu, stated that Nigeria cannot join the production cuts at least until after March 2018, because it needs additional "recovery time" from the outages caused by other militants in that country. This could present a problem at the next OPEC meeting, because non-OPEC participants have long seen the exemptions given to OPEC members Libya and Nigeria as unfair.

In the next two months traders should keep an eye on the statements coming from OPEC and non-OPEC oil producers. Statements affirming commitment to the deal from countries like Saudi Arabia, Iran, Iraq, and Ecuador should move oil higher.

A positive statement from Nigeria or Libya regarding any intention to participate in the deal should also cause oil prices to move higher. On the other hand, negative statements from Libya, Nigeria or Kazakhstan that undermine support for the deal could move oil prices lower.

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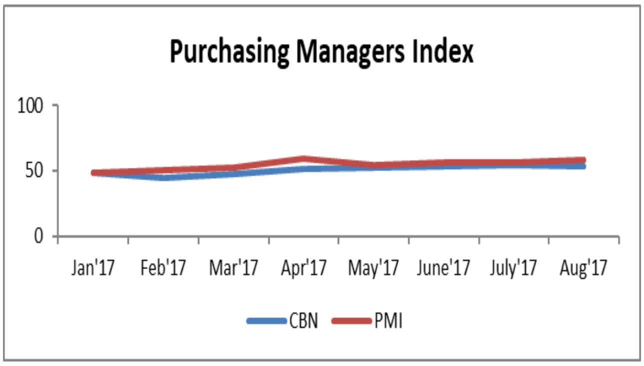
Purchasing Managers Index (PMI)

FBN's PMI reading rose to 58.5 points in August from 56.3 points in July. According to the FBN report, output, employment, new orders and suppliers' delivery time all expanded while stocks of purchases declined marginally in the review period. However, all five sub-indices remained in the positive territory. The improved access to foreign exchange (FX) through CBN's sustained FX interventions and improved utilization of local input substitutes by manufacturers led to the continuous expansion in the manufacturing sector. On the other hand, the CBN's PMI declined marginally to 53.6 points from 54.1 points in July. In the review period, raw materials, inventories and suppliers' delivery time grew at a faster rate while production, new orders and employment levels grew at a slower rate.



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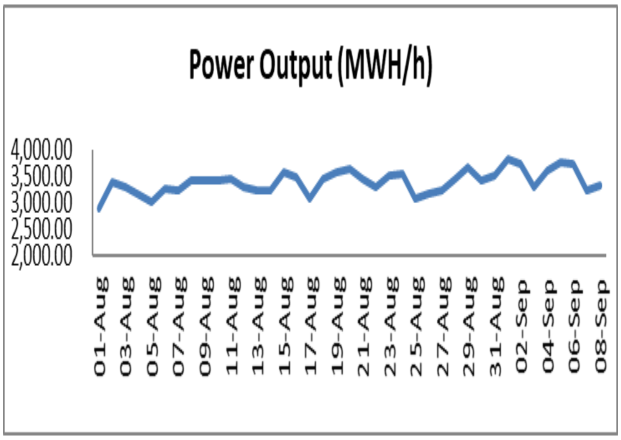
Outlook

We expect the manufacturing sector to remain in the positive territory with PMI readings for the coming month above 50, indicating an expansion.

Power Sector

The average on-grid power output from the national grid in August was 3,352.97MWh/h, 0.08% higher than July's average output of 3,350.45MWh/h. Despite this marginal improvement, the sector lost approximately N38.32bn. The sector was hampered by high frequency constraints and gas constraints in major power stations. The power sector load summary from the 13th to 20th of August showed an average of 1,000MW being rejected daily by Power Distribution Companies (Discos) and a total of 8,391.05MW rejected within eight days. The Transmission Company of Nigeria (TNC) as at September 7th revealed that Nigeria was only able to generate 3,264MWh/h despite an increase in national demand to 19,100MWh/h, due to the TNC transmitting below its current capability of 7,000MWh/h. Transmission remains the weakest link in the power value chain



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[4] Source: FBN, CBN, FDC Think Tank
[5] Nigerian Electricity Supply Industry

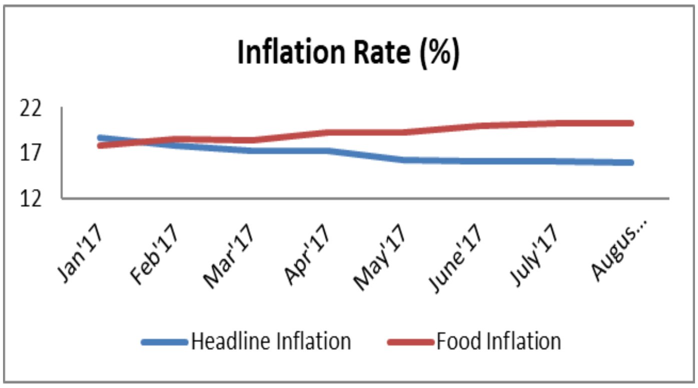
in Nigeria as power cannot be distributed to specific geographical locations due to the technical difficulties TNC faces. As at September 15th, average on-grid power output declined sharply by 41.3% to 2,310MWh/h. This was due to a sharp fall in system frequency from 50.36Hz to 48.50Hz - Lagos, Osogbo, Kainji, Jebba and Shiroro lost supply. Egbin ST6 and Sapele I were also out of service. in Nigeria as power cannot be distributed to specific geographical locations due to the technical difficulties TNC faces.

Outlook

We expect stable power generation in the month of September. However, we expect a decrease in power supply from the month of October. This is mainly attributable to the start of the dry season and further rejection of generated energy from power plants by Discos in Nigeria. However, the relative peace in the Niger Delta will help to drive hydro power.

INFLATION RATE

Headline inflation eased marginally to 16.01% in August, declining for the seventh consecutive month in 2017. This implies that base year effects are waning. However, the core inflation rate moved in the opposite direction with headline inflation, increasing by 0.1% to 12.3% in August. The contributions with the highest increases were pharmaceutical products and maintenance, clothing materials, furniture and furnishings, non-durable household goods, books and stationary, shoes and other footwear, motorcycles, and passenger transport by air. The upward trend in the food basket was bucked as food inflation declined marginally to 20.25% from 20.28% year-on-year in the month of July. Although there was a decline in food inflation, it is still above 20%, due to poor weather conditions in specific northern states reducing agricultural produce. Highest increases recorded in price level of the food basket included meat, fish, bread and cereals, vegetables, coffee, tea and cocoa, and milk, cheese and egg. Meanwhile, imported food inflation rose marginally to 14.42% from 14.11% in July, which could be linked to the currency volatility in the exchange rate market



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Outlook

In the coming months, we expect further weakness in the influence of base year effect on inflation. The harvest season is fast approaching and as such, food prices are expected to ease as a result of seasonality.

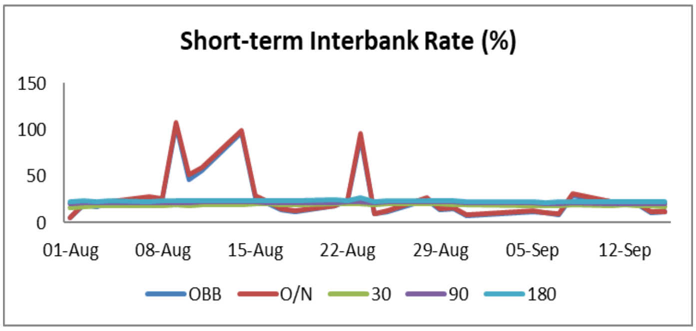
[6] Source: NSE, FDC Think Tank

MONEY MARKET

Markets opened at N215.44bn long in August relative to July's opening position of N130.69bn long. Average liquidity in August was N107.96bn short relative to the average opening position in July of N89.65bn long. Reduced liquidity in the money market is attributable to a rise in OMO sales that amounted to a total of N974bn (N779bn in July) and a fall in FAAC disbursements to N467.9bn from N652bn in July. Average NIBOR (OBB, O/ N and 30-day) was 27.48% pa in August, compared to 17.68% in July. The OBB and O/N rates were as high as 105% pa and 107.75% pa respectively as at the 9th of August. However, the rates fell significantly to 7.33% pa and 8.42% pa respectively as at August 31st.

As at the 8th of September, the average liquidity in the system was N59.24bn long and the OBB and O/N rates as at the 15th of September were higher at 11.33% pa and 12.17% pa respectively.

In the secondary market, average yields on Treasury Bills ranged between 16.93% - 17.77% for the 91 to 364 day bills as at the 15th of September. Lending rates have remained flat at an average of 25%.



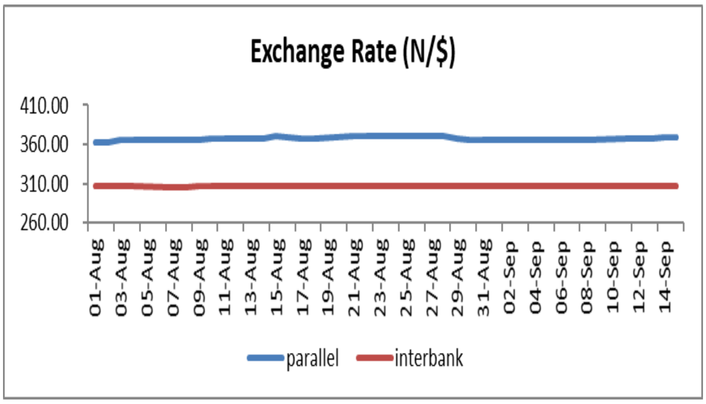
Outlook

Interest rates movement are a function of market liquidity. We expect the volatility in the interbank rates to remain in September, driven by CBN OMO and forex sales mopping up naira liquidity in the banking system. The Monetary Policy Committee (MPC) meeting is set to hold September 25-26. If the CBN maintains status quo (MPC rates of 14%), we do not expect to see any changes to short-term interest rates and the level of liquidity in the market. However, there is increased pressure on the CBN to reduce the MPR due to positive GDP growth by 0.55% in Q2'17, decline in headline inflation rate to 16.05% and the election cycle around the corner. If this happens, we expect short-term interest rates to decline and market liquidity to increase.

FOREX MARKET

Exchange Rate

The Naira depreciated to N370/$ mid August in the parallel market as robust demand from users such as hajj pilgrimage and school fees weighed on the naira. The exchange rate however strengthened to N365/$ as at August 31st, the same level it closed at in July. The interbank market rate depreciated slightly by 0.08% to close at N306.35/$, compared to July's close of N306.10/$. The spread between the parallel and interbank market rates has narrowed to N58.65 from N58.9



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

[8] Source: FDC Think Tank

in the previous month. The IEFX rate appreciated by 2.23% to close at N359.67/$, compared to last month's close of N367.88/$. An average turnover of $3.86bn was traded at the IEFX window in August month, higher than the average of $2.26bn in July. The IATA rate was adjusted twice from N306/$ to N325/$ and then to N359/$ early September.

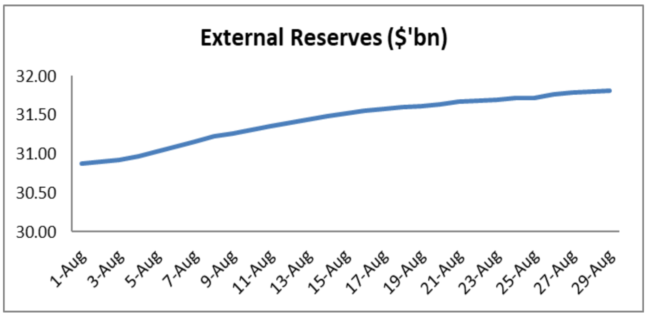
As at September 15th, the naira depreciated by 0.54% in the parallel market to N369/$. The inter-bank market rate moved in the same direction with the parallel rate, depreciating marginally by 0.03% to close at N306.45/$.

Outlook

At the parallel market, we expect that strong demand pressure will weigh on the naira as manufacturers have begun opening letters of credit in preparation for the festive period. However, this is conditioned on the CBN's frequency of FX market injections. We expect the CBN to continue to intervene aggressively in the market.

External Reserves

The bullish global oil market and stable production levels contributed to the upward trend in the gross external reserves level. Nigeria's gross external reserves increased by 3.14% ($970mn) to $31.81bn from July's level of $30.84bn. The gross external reserves import and payment cover is now at 8.81 months, compared to July's level of 6.89 months.



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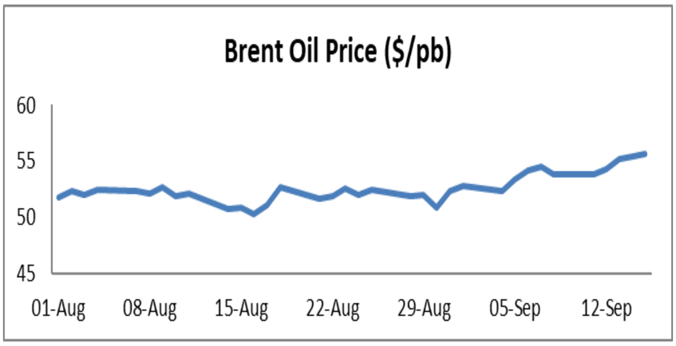
Outlook

Accretion in the external reserves level depends largely on stable oil production in Nigeria and the global oil market. We expect external reserves to increase in the month of September. However, due to OPEC's production cap on Nigeria's output at 1.8mbpd, production is expected to remain flat in the coming months which could affect Nigeria's external reserves negatively. In addition, if the demand for dollars picks up and the CBN intensifies its intervention, this may slow down the pace of accretion.

[9] Source: CBN, FDC Think Tank

OIL PRICES

Oil prices in August were volatile. The shutdown of 20%-25% of refining activities in Texas due to the effect of Tropical Storm Harvey, the slowdown in Chinese refining activities and the rise in U.S output weighed down on prices. In a bid to curb global oil glut, OPEC and non-OPEC members decided at a 2-day meeting held in Abu Dhabi in early August to rein in on non-compliant oil producers. Expectations of lower OPEC output and global supply, after large oil companies curtailed production in the Gulf of Mexico ahead of Hurricane Harvey, caused prices to increase in the first week of August. The shutdown of three oilfields in Libya due to pipeline blockades by Libyan militants in late August also bolstered prices. Despite global demand and supply fluctuations, average price of Brent crude was $51.87pb, 5.51% higher than July's average of $49.16pb. From September 1st, oil prices have been on the increase. However, on September 8th prices took a downward plunge by 1.03% to $53.78pb. This was driven mainly by the aftermath of Hurricane Irma, which reduced demand for energy that just begun to recover from Tropical Storm Harvey and the likelihood of China reducing the capacity of its teapot refineries. The market has recovered from the aftermath of Hurricane Irma as prices increased by 3.42% to close at $55.62pb as at September 15th. This was mainly due to expectations of a possible extension of OPEC's output cut deal and reports of lower global crude oil stock.



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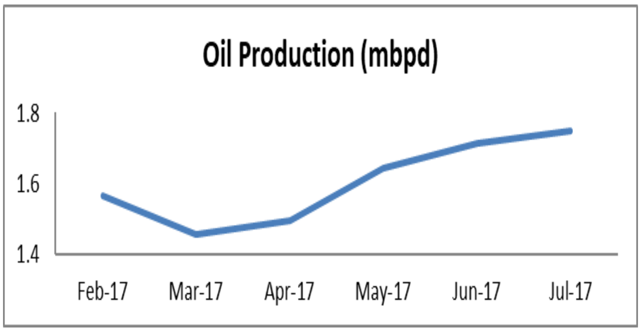
Outlook

With a compliance level of 89% in the month of August, oil prices are likely to remain bullish. This is due to expectations of deeper oil production cuts. Saudi Arabia has pledged to deepen its crude supply cuts by 10% in September to comply with OPEC'S output deal.

Oil Production

The recently released OPEC report showed an increase in oil production in Nigeria by 1.98% to 1.75mbpd in July from 1.74mbpd the previous month. The relative stability in the Niger Delta helped drive the output rise.



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Outlook

Oil production is expected to remain flat around current levels of 1.75 - 1.8mbpd in the coming months due to the OPEC production cap on Nigeria's output. Nigeria was invited to attend the September 22 meeting. The likely outcome is that the cap on Nigeria's production will be maintained.

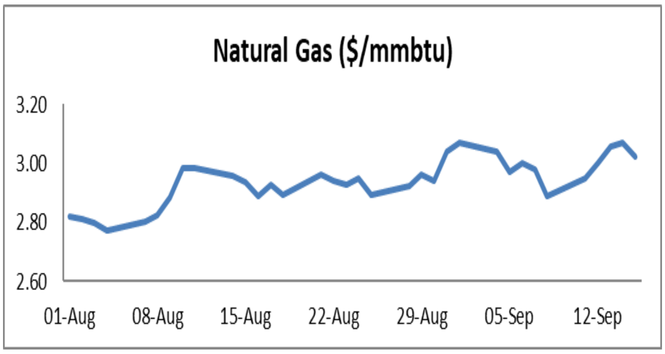
[10] Source: Bloomberg, FDC Think Tank

[11] Source: OPEC, FDC Think Tank

Natural Gas

Natural Gas prices averaged $2.91/MMBtu in August, 1.70% lower than July's average of $2.96/MMBtu. Prices fell to the lowest since Aug 9th at $2.82/MMBtu before closing at $3.04/MMBtu. Damage from the Tropical Storm Harvey disrupted gas production in the U.S golf coast. However, production losses were more than offset by reductions in demand due to cooler temperatures and power outages. Consumption in August is projected to be 12% lower than that of August 2016.

From September 1st to September 15th, Natural gas prices were volatile. The average price of the commodity within the review period was $3.00/MMBtu. The volatility in prices was primarily due to an increase in domestic LNG supply by 65 billion cubic feet which led to a fall in prices, and unplanned power outages in the U.K which bolstered prices.



[12]

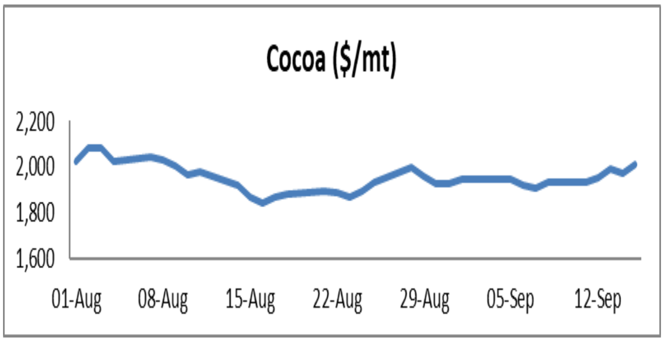
Outlook

We expect the market to remain oversupplied as the American Shale gas is set to kick off. With Hurricane Irma in sight, some parts of the US will experience cooler temperatures. These will dampen demand and keep gas prices below $3.00/MMBtu.

Cocoa

Average cocoa prices increased by 1.12% to $1,951/mt in August compared to $1,930/mt in July. However, cocoa prices closed lower for the 4th consecutive month in August due to robust supplies from the top 2 producers - Ivory Coast and Ghana. The increase in average prices was mainly due to technical buying driven by expectations of smaller crops in West Africa and stronger British pound.

Cocoa prices fell significantly on September 7th from $1,946/mt to $1906/mt – a 2.10% decrease. This was driven by increased global supply as Ivory Coast recorded its highest cocoa output of 2mn tons, expectations of a robust cocoa harvest in Nigeria and dampened demand. So far in September, cocoa prices are trading at an average of $1,950/mt (September 1st to September 15th).



[13]

Outlook

Cocoa prices are expected to remain soft as demand continues to fall.

[12] Source: Bloomberg, FDC Think Tank

[13] Source: Bloomberg, FDC Think Tank

Wheat

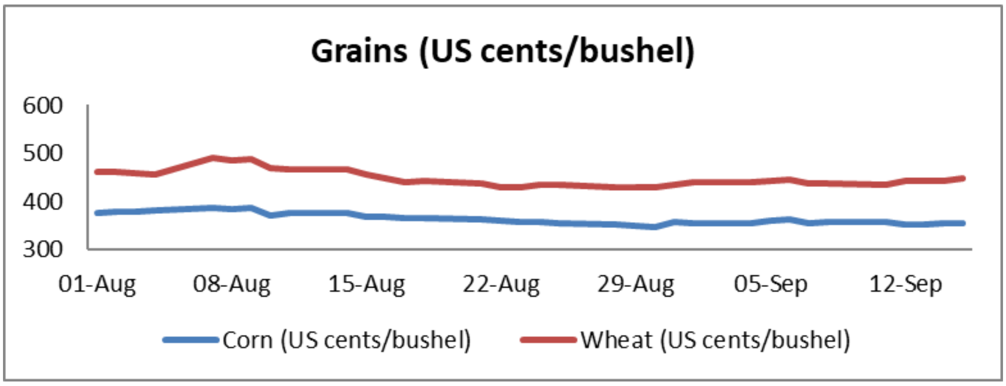
Wheat prices closed at $4.34/bushel, 8.43% lower than $4.75/bushel in July. Average wheat prices also fell by 11.95% to $4.51/bushel from $5.12/bushel. Wheat harvesting in major exporting countries, favourable weather conditions in the U.S growing regions and thinning demand for U.S wheat led to the bearish prices. Prices rose in early August due to expectations of a fall in U.S wheat supplies. However, the price increase was outweighed by robust global supply.

Wheat prices for the month of September have been bullish due to increased demand from Asian mills and supply concerns in the U.S growing regions. However, on the 7th and 8th of September, wheat prices fell despite adverse weather conditions in the U.S growing regions. Wheat is currently trading at $4.49/bushel (September 15) and at an average of $4.41/bushel (September 1st to September 15th).

Corn

Corn prices averaged $3.67/bushel in August, compared to $3.786/bushel in July. Prices on August 28th were up from more than 7 months low due to a weak U.S and concerns of dry weather curbing production in the US Midwest. However, expectations of an oversupplied global market due are weighing down prices. This is despite the decline in crop condition ratings by the USDA and limited rainfall which threatened corn plants during their yield-setting pollination phase.

Corn prices have enjoyed a bullish trend in September due to heavy rainfall across Southern China, slashing supply in the market and increasing demand in the spot market. However prices fell on the 12th and 13th of September due to ample supply in the global market. Corn prices are currently $3.55/bushel (September 15) and average $3.56/bushel (September 1st to September



[14]

Outlook

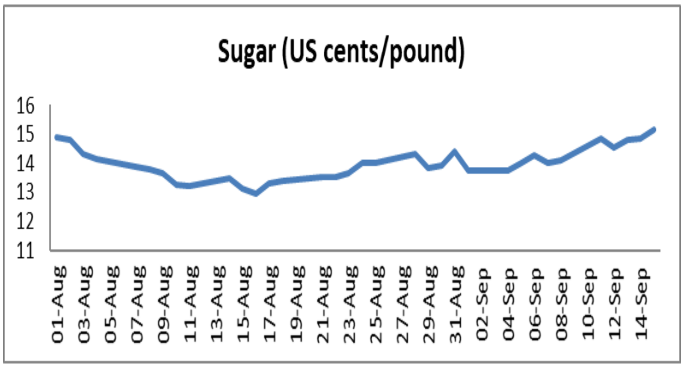
We expect grain prices to remain bearish in the short-term due to an increase in global forecast by the USDA for wheat production by 15mn tons and corn production to 14.1bn bushels for 2017/18 season. Ample wheat and corn supplies in Australia and Europe will offset the effects of unfavourable weather in the US.

[14] Source: Bloomberg, FDC Think Tank

Sugar

Sugar prices have maintained their bearish trend this month, averaging $0.1380/pound in August, compared to $0.1412/pound in July. Prices were dampened by import bans from India.

Sugar prices maintained a bullish trend in the month of September. This was due to expectations of Hurricane Irma causing havoc for Florida's sugar industries just weeks before harvest of its sugar cane plants, weak E.U. sugar inventory and increased global demand.



[15]

Outlook

Sugar prices will remain bullish in the next month on increased festive demand in India and a supply crunch due to damage of sugarcane crops by Hurricane Irma. However, the global sugar output for 2017/18 has been raised by 1.59mn tons to 7.14mn tons which could affect sugar prices negatively.

[15] Source: Bloomberg, FDC Think Tank

STOCK MARKET

The Nigerian Stock Exchange (NSE) performance for the month of August showed a bearish overall market sentiment with a negative market breadth of 0.78, as prices of 39 stocks increased, while 50 declined. This shows a relapse compared to the bullish market sentiment of 1.67 in July, where 60 stocks gained against losses recorded in 36 stocks.

On September 13, the stock market maintained its bearish market sentiments with a market breadth of 0.61, as 27 stocks increased while 44 declined.

This made the market close on a negative with market capitalisation declining marginally (by 0.89%) from N12.35trn to N12.24trn (though it reached a peak of N13.17trn on the 11th of August). NSE All Share Index (ASI) was 0.95% lower at 35,504.62 points during the period with a daily ASI volatility between -6.9% and 0% during the month. The Year to Date (YTD) return on the index declined to 32.11% from 33.38% recorded in the month of July.

NSE ASI on September 13 closed at 35,464.34, declining 0.11%, with market capitalisation declining marginally by 0.16% to N12.22trn against the previous month.

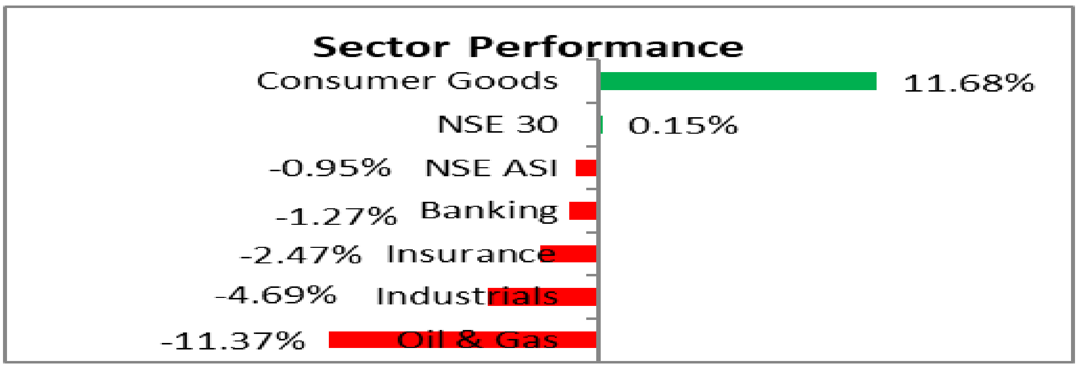
All sectors in the month of August closed on a negative with the exception of the consumer goods sector, which grew by 11.68%. The NSE 30, which is a key driver of the NSE ASI grew marginally by 0.15%, but the decline recorded in other sectors especially the oil and gas sector (-11.37%) consequently led to the marginal decline of the NSE ASI.

Decline in market performance was due to profit taking activities of investors in stocks that recorded significant share price gains, especially the Bellwether stocks.

The main drivers of the consumer goods sector were NASCON Allied Industries (24.76%), Dangote Flour (22.6%), Nestle (21.55%), Guinness Nigeria (16.06%), Dangote Sugar (12.8%) and Nigerian Breweries (7.8%). These stocks posted impressive half year results, and contributed 27.11% to market capitalisation for the month under review.

The oil and gas decline was due to huge losses recorded by major players in the sector; 11's (formerly Mobil Oil) stock price lost 34.74% as NIPCO announced its intention to acquire additional shares in 11 with minority shareholders selling their stocks; Conoil also declined, as it paid out a substantial part of FY' 2016 profit as dividend; Oando has been on the downward trend due to internal conflict among shareholders. This showed a massive movement out of the sector during the month as most of the oil and gas bellwether stocks failed to impress traders and investors, dragging down the stock index.

The decline recorded by the banking, insurance and industrial sectors was due to investors and traders' profit taking activities, following the release of most companies' half year results and interim dividend.



The consumer goods sector dominated the top gainers with NASCON Allied Industries, Dangote Flour, Nestle and PZ gaining 24.76%, 22.61%, 21.55%, and 18.70% respectively; C&I Leasing recorded the most gain of 33.33%. Also the PE ratio shows investors are optimistic about the growth potential of Nestle and PZ; so we expect more activities on these stocks.

Top Gainers

Symbol	Jul '17 Price (N)	Aug '17 Price (N)	Change	% Change
CILEASING	0.75	1	0.25	33.33%
NASCON	10.42	13	2.58	24.76%
DANGFLOUR	5.22	6.4	1.18	22.61%
NESTLE	1003.7	1220	216.30	21.55%
PZ	23	27.3	4.30	18.70%
Top Losers				

Top Losers

Symbol	Jul '17 Price (N)	Aug '17 Price (N)	Change	% Change
MORISON	1.3	0.82	- 0.48	-36.92%
11 (MOBIL)	253	165.11	- 87.89	-34.74%
NEM	1.34	1	- 0.34	-25.37%
CONOIL	36.4	27.7	- 8.70	-23.90%

While the losers chart for the month of August was dominated by the oil and gas sector with 11 Plc (Mobil), Conoil and Forte oil stocks losing by 34.74%, 23.90%, and 20.58% respectively. Morison and NEM Insurance declined by 36.92% and 25.37% respectively. With the exception of Morison that recorded a half year loss, other losers' PE ratios signify the likelihood of stock movement in the coming weeks.

OUTLOOK

The overall market sentiment for the month of August was bearish, but we expect the news of Nigeria's exit from recession to boost market confidence and encourage investment towards the end of the month. Though increasing speculative activities and major trade unions' strike action might unsettle the market, leading to some level of volatility in the market. The MPC is scheduled to meet on September 25/26 and we expect the committee to either hold rates or adopt a more accommodative stance. The hawks in the committee are more likely to have their way – maintain status quo. This is likely to have no impact on the general level of interest rates in the market as the MPC decision has already been factored into market expectations.

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

CORPORATE FOCUS :

JULIUS BERGER

Analyst's note

Industry leader in a contracting economy with huge staff and administrative expenses and foreign exchange losses

Julius Berger Nigeria is the leader in the construction industry with a market capitalization of over N45 billion (bn) and a history of delivering superior value to clients both in the design and construction of private and public projects. Owing to the economic woes and the spending constraint of its main client – the Nigerian government – the company recorded below par performance in FY'2016 due to high foreign exchange losses and operating inefficiencies.

The H1'2017 result shows a better performance with a year-on-year (YOY) growth of 47.36% from N47.3bn to N69.7bn in revenue; Q2' 2017 shows a YOY growth of 86% from N19.13bn to N35.57bn in revenue. This was mainly due to the gradual recovery of the economy and the introduction of the Investors and Exporters Foreign Exchange (IEFX) window. Net income for H1' 2017 was negative at 0.36bn (a 368% YOY decline) during the period, mainly due to foreign exchange losses and high administration expenses.

In the second quarter of 2017, Julius Berger Nigeria announced its intention to diversify its investment portfolio through a strategic partnership with Petralon Energy Limited for the acquisition and development of oil fields in Nigeria.

(Note that we did not consider the implication of this partnership in our valuation as the expected period of impact is outside the scope of our forecast)

Analyst Recommendation: Sell

Market Capitalization: N47.51bn

Recommendation Period: 180 days

Current Price: N30.87

Industry: Construction

Target Price: N28.65

ECONOMIC RECOVERY RESTRAINED BY ELECTION PREPARATIONS AND SLOW BUDGET IMPLEMENTATION

The growth in revenue could be a sign that the economy is gradually approaching a recovery while the government rolls out more capital projects during the period under review. The government also introduced the IEFX window, facilitating the inflow of foreign exchange and investment. The group's four-year compound annual growth rate (CAGR) declined by 10%, implying that the industry is yet to return to its glory days. The main focus of the present administration has been on foreign exchange stabilization by promoting import substitution and foreign investment (both foreign direct investment [FDI] and foreign portfolio investment [FPI]). The federal government's 2017 budget, which includes the year's infrastructure spending, was only signed in June 2017. It is yet to be fully implemented due to a lack of synergy between the executive and legislative arms of government in the allocation of projects and payments. We believe 2018 will be a flat year for the construction sector as political parties prepare for the elections. The election year (2019) will see further shrinkage in infrastructural spending owing to a probable delay in signing the national budget coupled with election activities. Accordingly, we believe that Julius Berger is overvalued, and recommend a SELL as we do not see any positive leads that would support or boost its share price in the near to medium term.

INDUSTRY AND COMPANY OVERVIEW

FIRST VERTICAL INTEGRATION, THEN CONGLOMERATE EXPANSION... MORE THAN A CONSTRUCTION COMPANY

Julius Berger is currently the largest construction company by market capitalization on the Nigerian Stock Exchange (NSE), with a value of N45bn. Upon creating a niche segment by delivering superior value on highly technical projects, Julius Berger has been a key strategic partner to the Nigerian government since the construction of the Eko Bridge in 1965, its pioneer project. Other notable works include Akwa Ibom Stadium, Lekki-Ikoyi Bridge and Central Bank of Nigeria's offices in Abuja and Lagos among other commendable projects. Before listing on the NSE in 1991, Julius Berger was owned by Bilfinger Berger, a German construction firm which maintains a 16.5% ownership of the company as of the end of H1' 2017.

With government contracts accounting for more than 50% of earnings over the years, Julius Berger has been exposed to the cyclical trends of the economy. Management has made a deliberate effort to diversify its investment portfolio and exposure, through the acquisition of supporting segments and other interests outside its value chain. Due to its extensive investment in state-of-the-art technology and methodologies, Julius Berger developed expertise in delivering integrated solutions that span from planning, design, engineering, and construction to maintenance services. However, the construction segment still accounts for more than 90% of the group's earnings

FEW PLAYERS IN A HIGH POTENTIAL INDUSTRY

Though a lower proportion of the Nigerian budget is earmarked for infrastructural development as compared to recurrent spending, the presence of very few players has made the sector attractive to Julius Berger. In addition, the sector is strengthened by a high rate of urbanization and the emergence of the upper middleclass. Julius Berger plays in the premium segment of the construction sector, where the barrier to entry is high due to the required level of investment in fixed assets and the high maintenance cost of those assets. The sector is highly influenced by the cyclical nature of the economy. This niche consists of clients with specialized technical needs and the affluent, seeking quality in terms of value, durability and creativity. Client needs vary from the construction of dams, stadiums, essential bridges, roads, buildings, for residential and commercial purposes, and facility services.

There are very few competitors that can effectively compete with Julius Berger in Nigeria, due to the sophistication of private and public project needs of its clients. Most competitors are foreign construction companies in partnership with local players. The competitors include China Civil Engineering Construction Corporation (CCECC), Reynolds Construction Company (RCC), Arab Contractors, Setraco Nigeria Limited, and Dantata & Sowoe Construction Company Nigeria Limited, which are all private companies and not listed on the Nigerian Stock Exchange (NSE). CCECC, a Chinese state-owned company, has access to financing from China at single digit rates. This gives CCECC better working capital flow and finance cost savings as compared to Julius Berger. To add to this, the renewed partnership between the Nigerian and Chinese governments, especially in the rail segment, could be a penetration strategy by CCECC to establish its foothold in the construction industry

Julius Berger has a narrow customer base and a high exposure (*to revenue generation*). Julius Berger's premiums make up for the narrow customer base, but the market and concentration risks have left them at risk to the volatile performance of its major client, the Nigerian government, which accounts for more than 50% of its earnings.

Another feature of the upscale construction sector is the prevalence of both high receivables and payables. Construction companies receive advances on payments prior to the commencement of work from clients and then accrue income as work is completed. This has made cash management cumbersome leading to high financing costs, and in extreme cases, illiquidity and bankruptcy. This has been a major constraint for Julius Berger, as delay in the release of funds by the government has increased its short term borrowings and consequently finance cost.

Income statement for Julius Berger Plc					
N'000	**2012**	**2013**	**2014**	**2015**	**2016**
Revenue	201,565,276	212,737,291	196,808,632	133,807,574	138,993,752
Cost of sales	(156,726,348)	(161,134,675)	(146,313,712)	(100,473,106)	(84,767,291)
Gross Profit	**44,838,928**	**51,602,616**	**50,494,920**	**33,334,468**	**54,226,461**
Marketing and distribution expenses	(153,661)	(111,209)	(116,879)	(75,140)	(53,327)
Administrative expenses	(31,704,992)	(32,624,772)	(32,885,108)	(21,445,734)	(37,380,880)
Operating Profit	**12,980,275**	**18,866,635**	**17,492,933**	**11,813,594**	**16,792,254**
Investment income	838,767	19,949	405,811	139,763	284,681
Other gains and losses	1,232,358	295,816	(170,361)	695,388	1,443,523
Finance cost	(2,709,908)	(2,961,864)	(4,593,487)	(6,148,772)	(5,784,246)
Foreign exchange acquisition loss					(14,234,241)
Profit Before Tax	**12,341,492**	**16,220,536**	**13,134,896**	**6,499,973**	**(1,498,029)**
Income tax expense	(4,328,798)	(8,367,196)	(4,894,917)	(4,059,833)	(2,318,763)
Profit After Tax	**8,012,694**	**7,853,340**	**8,239,979**	**2,440,140**	**(3,816,792)**

Balance sheet for Julius Berger Plc					
N'000	**2012**	**2013**	**2014**	**2015**	**2016**
Property, plant and equipment	57,079,027	67,995,915	68,369,671	58,376,513	49,712,834
Goodwill	4,634,422	4,842,708	4,606,412	5,041,184	8,348,748
Other intangible assets	127,935	118,297	77,402	32,712	2,766
Investment property		780,177	2,648,412	2,546,436	2,444,460
Trade and other receivables	1,706,067	1,469,591	2,334,764	844,122	569,619
Tax receivable	25,957,783	31,075,595	35,060,509	21,039,915	26,026,032
Deferred tax assets	3,017,036	7,468,271	8,041,407	10,087,301	5,453,858
Other financial assets	4,125,734				
Non-Current Assets	**96,648,004**	**113,750,554**	**121,138,577**	**97,968,183**	**92,558,317**
Inventories	10,710,071	11,432,482	12,111,830	11,110,116	11,699,526
Amounts due from customers and other contracts	5,544,984	20,898,658	29,122,120	27,228,427	33,082,455
Trade and other receivables	41,582,008	52,245,757	63,425,208	88,634,246	108,291,146
Tax receivable	13,089,156	7,430,849	5,575,112	5,292,205	1,417,845
Cash and cash equivalents	10,731,468	20,475,649	23,473,159	13,360,038	10,584,522
Assets classified as held for sale	728,473	1,027,308	1,199,775	1,493,055	1,545,121
Current Assets	**82,386,160**	**113,510,703**	**134,907,204**	**147,118,087**	**166,620,615**
Total Assets	**179,034,164**	**227,261,257**	**256,045,781**	**245,086,270**	**259,178,932**
Share capital	600,000	600,000	660,000	660,000	660,000
Share premium	425,440	425,440	425,440	425,440	425,440
Foreign currency translation reserve	222,992	687,896	919,411	419,755	7,119,062
Retained earnings	13,774,577	18,863,052	23,420,332	22,729,580	17,065,287
Equity Attributable to Owners of the Company	**15,023,009**	**20,576,388**	**25,425,183**	**24,234,775**	**25,269,789**
Non-Controlling Interest	121,171	458,040	670,660	57,180	46,526
Total Equity	**15,144,180**	**21,034,428**	**26,095,843**	**24,291,955**	**25,316,315**
Borrowings	-	6,435,141	3,201,710	-	-
Retirement benefit liabilities	1,656,643	2,033,004	1,996,506	1,853,781	2,463,491
Deferred tax liabilities	5,666,877	12,336,676	13,220,121	12,989,322	9,185,562
Amount due to customers under contracts	87,755,151	80,214,852	93,690,330	106,971,355	119,098,895
Provisions			2,135,994	404,308	454,232
Non-Current Liabilites	**95,078,671**	**101,019,673**	**114,244,661**	**122,218,766**	**131,202,180**
Amount due to customers under contracts	18,863,122	46,472,088	35,188,722	32,912,602	24,009,265
Trade and other payables	33,121,063	34,016,585	42,138,848	34,596,825	44,015,318
Borrowings	8,208,260	19,279,413	34,809,060	24,807,936	33,172,798
Current tax payable	3,551,109	5,314,810	3,473,353	6,106,748	1,423,923
Retirement benefit liabilities	4,667,759	124,260	95,294	151,438	39,133
Provisions	400,000				
Current Liabilites	**68,811,313**	**105,207,156**	**115,705,277**	**98,575,549**	**102,660,437**
Total Liabilites	**163,889,984**	**206,226,829**	**229,949,938**	**220,794,315**	**233,862,617**
Total Equity and Liabilites	**179,034,164**	**227,261,257**	**256,045,781**	**245,086,270**	**259,178,932**

A LEADING COMPANY RUN BY SEASONED PROFESSIONALS

Julius Berger's management team is led by Mr. Wolfgang Goetsch, an Austrian national who joined the group in 1991. Before his appointment as Managing Director in 2016, he served on various Board positions within Julius Berger group since 2007. He is well acquainted with construction in the Nigerian economic space having worked in various capacities within the group for about a decade. He is a member of the Nigerian Society of Engineers and the Council for the Regulation of Engineering in Nigeria. He is also a member of the Board of Julius Berger Investment Limited and the 2nd Niger Bridge Development Company.

The Board of Julius Berger is led by Mr. Mutiu Olaniyi Sunmonu, CON, formally a Managing Director of the Shell Petroleum Development Company (SPDC) from 2004 to 2015. He is a Fellow of the Nigeria Society of Engineers (FNSE) and also serves as Executive Consultant to Pan Ocean and Newcross EP, providing leadership across the operations, regulatory compliance and external relationship management, thereby establishing his wealth of experience in high value projects and leadership.

Considering the network and experience of the current chairman, Mr. Mutiu Olaniyi Sunmonu, CON, in the oil and gas sector with a career spanning over 36 years in Nigeria, United Kingdom and Netherlands, Julius Berger might successfully diversify into the oil and gas sector. Also, the current partnership with Petralon energy, an upstream energy company, where Mr. Mutiu also serves as chairman, has the potential of creating a synergy for the two parties. However, the relevance of oil in the international market has continued to be threatened with oil prices tumbling as a result of the emergence of more sustainable energy sources.

Also in June 2017, the group announced the appointment of two non-Executive Directors, Mrs. Belinda Joke Disu and Mrs. Gladys Talabi. Mrs. Disu is an Executive Director of Nigeria's indigenous telecommunications network provider, Globacom Limited and an Executive Director of Cobble-Stone Properties and Estates Limited. Mrs. Talabi, also an Executive Director of Globacom Limited, handles Legal Services/Security in the company; she has 39 years of experience in legal agreements. This could be key as Julius Berger aims at diversifying vertically and across national borders. These appointments reflect the change in ownership structure of the group, with Bilfinger SE gradually reducing its stake in Julius Berger group from 39.9% in 2012 to 16.5% in 2016 while Goldstone Estate Limited built up its stake over the same period to 19.9%.

The Board of Julius Berger consists of other seasoned professional (locals and expatriates) with extensive experience in construction and a good knowledge of the Nigerian operating environment.

Management is driving revenue… though at what cost?

Owing to the fact that construction and related services are highly dependent on economic cycles, Julius Berger made some drastic decisions during periods of economic woes, such as downsizing, reducing capital expenditure and accessing funds only based on needs, i.e. using short term borrowing as opposed to long term loans. This strategy did not improve performance, as staff, administrative and financing costs skyrocketed during the period leading to unimpressive results in FY'2016. These decisions point to the need for management to revisit its working capital administration in both the short-term and long-term, especially the staffing costs which increased by 26%, though the group reduced its workforce by 16% and finance costs which have grown due to the increase of the group's operating cycle (with receivables being the main driver).

The Bulls and Bears Say:

Bulls:

- Reputable company with a proven track record in the construction sector
- The wide infrastructure gap in the Nigerian economic space shows an opportunity for growth
- Impending move to further diversify its portfolio and reduce its concentration of risk
- Introduction of the IEFX window will ease the foreign exchange risk

Bears:

- High financing costs are a threat to profitability
- Skepticism about the ability of the government to sustain the foreign exchange intervention
- Government delay in the implementation and release of funds for capital projects
- Growing size of the government's recurrent expenditure, which takes precedence over capital spending
- High dependence on government patronage, and exposure to economic volatility
- High operating costs eroding impact of revenue drive

Risks and Outlook:

Foresee economic recovery but little prospects for the construction sector

Facing significant market and concentration risk Julius Berger will be under immense pressure to further improve operating efficiencies. As political parties make preparations for the 2019 Presidential elections in Nigeria, we believe there will be considerable pressure on the earnings of Julius Berger as infrastructure projects are postponed or deferred indefinitely. Another risk is the emergence of other foreign-affiliated construction companies like Arab Contractors and CCECC in the infrastructure projects space. Their arrival can erode the large market share that Julius Berger currently enjoys.

Though these risks pose immense challenges on the company's outlook, Julius Berger has devised a practical risk management structure. The company manages foreign exchange exposures by utilizing forward foreign exchange contracts. The company's foreign debt is repayable on demand with its carrying amount reflecting the fair value and exposure to interest risk as of the reporting date.

Market risk is currently managed through forward funding, where achievable, in order to hedge against market volatility, especially foreign exchange price movement. The group aims at minimizing concentration risk through continuous diversification of its investment portfolio.

Nevertheless, the persistent macroeconomic headwinds still pose a huge challenge. The decline in demand for construction services, increasing interest rates and high forex charges threaten the company's ability to improve shareholder value. Thus, Julius Berger is a company with the paradox of good opportunities but little upside and we must recommend a SELL.

Our valuation of Julius Berger

Using Discounted Cash flow (DCF) methodology, we estimated a stock price of N30.78, which is a 10% downside on the current price of stock of N34.20 as at August 31, 2017. With a discount rate (Weighted Average Cost of Capital (WACC)) of 16.8% derived using a 16.80% risk free rate (FGN 5-year Bond as at August 2017), a Beta of 0.9503, after cost of debt of 12.2%, and a market risk premium of 6.4%. The long term cash flow growth rate to perpetuity calculated is 5.7%

Taking into account both leading and lagging indicators and the H1' 2017 performance, we forecast a revenue 3-year Compound Annual Growth Rate (CAGR) of -9.62%

DCF Valuation for Julius Berger Plc		
N'000	**2017E**	**2018E**
EBIT	11,009,139	7,463,557
Less: Taxes	(3,302,742)	(2,239,067)
EBIAT	7,706,397	5,224,490
Plus: depreciation expense	8,783,086	7,867,786
Less: CAPEX	(488,200)	(2,842,981)
Less: Change in working capital	11,411,082	(8,262,933)
Free Cash Flow (FCF)	27,412,365	1,986,362
WACC	16.8%	16.8%
Present value (PV) of FCF	20,084,533	1,245,751
Terminal value @ perpetual growth rate (2019)	**2017**	**2018**
Terminal value as of 2019		
Present value of terminal value	35,626,033	
DCF Calculation	Valuation	
PV of explicit period	24,781,740	
PV of terminal value	35,626,033	
Enterprise Value	60,407,773	