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CBN AMENDS DIVIDEND PAY-OUT POLICY FOR BANKS

Prior to this guideline, most banks adopted an aggressive dividend policy, partly to shore up their share price and secondly to splash cash to shareholders. Consequently, banks resorted to external funding sources to support their balance sheet, as against internal capital consolidation in the form of retained earnings.

In a bid to further comply with the Basel accords, the CBN in October 2014 issued a directive aimed at preventing a systemic failure and effectively pushing banks to enhance their capital buffers. This was in form of restricting deposit money banks (DMBs) and discount houses (DHs) with low capital base and high non-performing loans (NPLs) from paying out dividend. This order ensured banks provided adequate capital buffers and prevented them from paying out cash dividend out of their reserves.

On January 31, 2018, the CBN added another paragraph to its existing directive on dividend policy, allowing banks who maintained capital adequacy ratio (CAR) of at least 3% above minimum requirement, low composite risk rating (CRR) and NPLs between 5% and 10%, to retain a pay-out ceiling of 75%.

Before this new guideline, the CBN did not make adequate provision for banks with low CRR, but NPLs between 5% and 10%. Despite this policy relaxation, there has been a negative knee-Jerk reaction.

October 2014 Policy on Dividend Pay-out Ratio			
Capital Adequacy Ratio (CAR)	**Composite Risk Rating (CRR)**	**Non-performing Loans (NPLs)**	**Dividend Pay-out Ratio Ceiling**
Exceeds limit	High	>10%	0%
Within Limit	Above Average	5% - 10%	30%
Below limit	Low	≤5%	100%

Since the issuance of this directive, the banking sub-sector index, on the Nigerian Stock Exchange (NSE) lost about 4.03%. This is partly as a result of negative investor sentiment towards banking stocks, as investors expectations point towards reflecting the true value of these stocks. Hence, banks will have to boost their tier 1 capital, if they intend to embark on distribution of capital (i.e. issue dividend) as a way to signal financial strength, as well as comply with this new directive.

This affirms that the banking system remains fragile. The adoption of IFRS 9 from January 2018 will further exacerbate the financial woes of most banks going forward. The implementation of IFRS 9 changes the measurement of financial assets as well as provisions for loan losses (impairments). This will have an immediate impact on profitability and ultimately worsen most banks' CAR.

In effect, asset quality might improve considerably, while the cost of regulatory capital to cover risk weighted assets will remain high. This will further erode banks' economic profit, preventing banks from taking on more risk assets without raising additional capital. This becomes a vicious cycle – in a bid to protect depositors from growing NPLs, the CBN imposes strict regulations to serve as buffers, which reduces the risk appetite of banks. As a result, banks charge borrowers exorbitant rates to cover the cost of regulatory compliance. But sky high rates increase the risk of default, adversely affecting NPLs.

THE RETAIL REVOLUTION & THE PLACE OF THE CONSUMER

The next decade is expected to be the era of the consumer, with shoppers having varieties and more control than ever before. They will be presented with a growing array of products and services, often personalized to their specific needs and wants. Consumers will continue to demand price and quality transparency along with a wide range of convenient fulfillment options. Overall, the retail experience is poised to become more exciting, easy and convenient, depending on the consumer's ever-changing needs. The evolution in consumer demand, combined with transformative technological innovations, will continue to drive fundamental changes. The limitations of "retailer" and "manufacturer" will continue to distort, as companies evolve to meet their customers' needs. These factors will cause the Retail and Consumer Packaged Goods (CPG) landscape to change further in the next 10 years than it has in the past 40 years.

WHERE DOES THIS LEAVE THE RETAIL INDUSTRY?

The retail market has become complex as the marketplace has changed. It has polarized into 'global extremes', thus forcing retailers to re-strategize. Mega retailers dominate one end of the competitive spectrum and focused specialists, the other. Simultaneously, increasing customer diversity and individualism is creating significant demand complexity. Companies with no differentiation strategy are facing tremendous pressure; many have failed and others are still struggling to find the path back to consistent growth and success.

The rise of e-commerce is shaking some of the retail industry's biggest names, forcing many to re-tool their businesses for the digital age and weeding off weaker members of the herd. The Nigerian retail industry is not left out in this revolution, given the vast increase of stores and shopping malls in recent decades. The idea that the most successful businesses are those which simply deliver what people want is misplaced.

Technological innovations have put the world at the fingertips of consumers via their laptops, tablets and smart phones. Thus, prompting retailers to make dramatic changes to their business by closing high street stores and investing in websites and mobile applications.

Yet, despite this so-called revolution, there is no certainty on what the 'future retailer' will look like. The key success drivers over the next decade will be centered on building a deep understanding of and connection to the empowered consumer, promptly incorporating disruptive technologies, embracing transformative business models in both the offline and online space, and establishing key capabilities.

With this transformation, there will also be challenges to solve by pro-actively preparing organizations for change and implementing the required technologies to address issues related to store closures, employment (job loss/reskilling) and potential adverse environmental impacts.

SHIFTING THE INFRASTRUCTURE NEEDLE

One of the biggest constraints to competitiveness, economic growth and diversification in Nigeria is the crippling infrastructure deficit – estimated at about $300bn (N30trn) by the African Development Bank (AfDB). They estimate that the gross underinvestment in infrastructure over the years has left Nigeria with a core stock of infrastructure of just 20-25% of GDP – compared to 70% for more advanced middle-income countries of similar size. This has driven the cost of doing business up significantly and impaired both foreign and domestic investment. The cheapest alternative to public power supply is at least three times more expensive. Businesses simply need adequate transportation systems (roads, railways and ports) to receive supplies and access markets for their goods.

Nigeria spent N2.07trn (3% of GDP) on capital expenditure in 2017 and plans to spend N2.43trn (3.5% of GDP) in 2018. This pales in significance to China which spent an estimated 15% of its GDP per year on infrastructure between 1980 and 2005. Attempting to follow the Chinese model will amount to spending N10trn ($33bn) per annum on infrastructure – 16% higher than total expenditure proposed in the 2018 budget. This is simply not feasible given Nigeria's current revenue profile and the huge burden of recurrent expenditure – much of which already goes into debt servicing. Borrowing specifically to address the infrastructure gap would only push the debt-to-GDP and debt-to-exports ratios – 11.1% and 62.4% respectively – beyond sustainable levels.

Efficient Deployment of National Savings

In the last 10 years, with the exception of 2009, the Gross Domestic Savings rate has been consistently higher than the rate of capital formation. In 2014, the Gross Domestic Savings and Capital Formation rates were 21.7% and 15.8% respectively. Increased national savings and its efficient deployment to infrastructural development should be a national priority. Nigeria currently has about N6.5trn (9.5% of GDP) tied up in pension funds. This highlights the suboptimal deployment of national savings to investment.

External funding sources are crucial for the long-term as huge projects, especially transportation infrastructure, require funding beyond the capacity of the government given its competing priorities. Empirical evidence from across Africa shows that a stable multi-year funding mechanism free of annual fiscal constraints is imperative to galvanize diverse long-term funding sources like pensions, multilateral agencies and bond markets. Nigeria's case should hardly be any different. Bridging the infrastructure gap would require sourcing and efficiently allocating an estimated N4.57trn ($15bn) – 6.7% of GDP annually to key infrastructure projects (power and transportation).

Attracting private capital requires well articulated guidelines and an enabling environment that would create incentive for private investment – especially through Public Private Partnerships (PPPs). When well designed and implemented, PPPs have the ability to leverage public funding and harness private sector technology and innovation in public services.

This ensures efficiency and sustainability in addition to optimally allocating risk between the public and private partners on the basis of their capacity to manage it. Enhancing the investment climate and dismantling roadblocks to investor entry should be a major priority for the Nigerian government. Investor confidence in PPP arrangements would be given a huge boost by strengthening the legal and institutional framework to support healthy project preparation, tender processes and contract management.

So far, Nigeria has largely failed at meeting the needs of specific investors and projects already in progress, or on creating policy incentives that will spur new investments. For instance, the recent privatization of power assets is yet to have the desired effect as the government is still well invested in the transmission, supply of gas, and setting tariffs. This has left current investors gasping for breath and deterred further investment as the government's resolve to achieve the conditions necessary for long-term sustainability remains unclear – especially as regards to cost-reflective tariffs.

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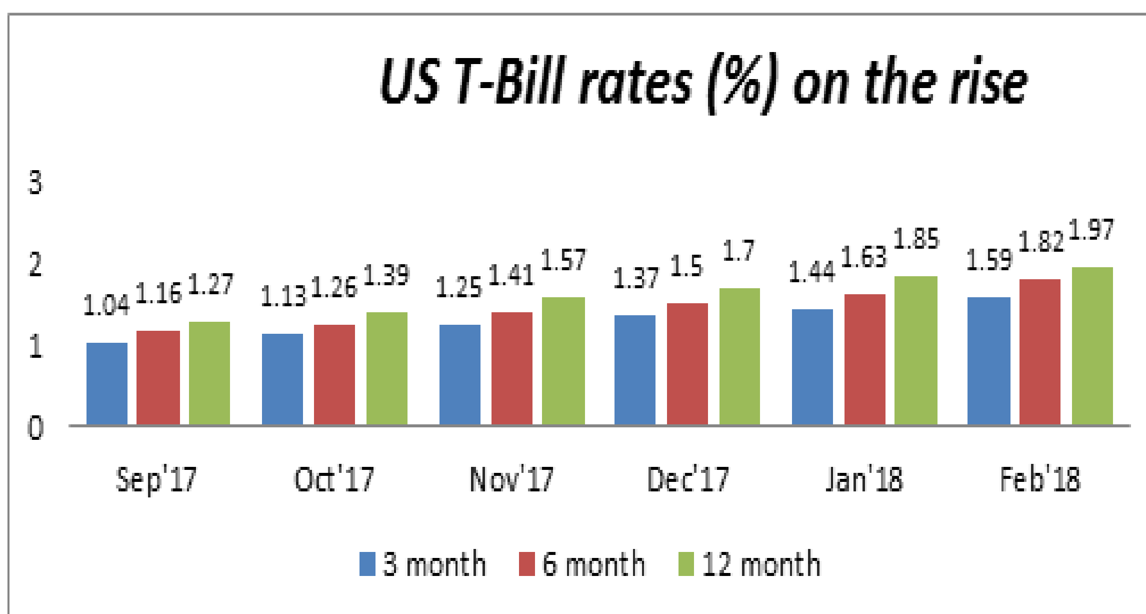
WEAKER DOLLAR, HIGHER US INTEREST RATES, A DILEMMA FOR A CENTRAL BANK WITH NO QUORUM

Who needs an MPC after 19 months of status quo? The MPC is like the boy who cried 'Wolf!', till he lost credibility in the sight of his neighbours. Who will come to its aid now?

Nigeria has stayed without an active Monetary Policy Committee (MPC) so far in 2018. A political stalemate between the Executive and National Assembly has caused a delay in the latter's confirmation of Buhari's nominees. In such a situation, the central bank ought to establish a quorum, which is a temporary board containing at least 6 members. However, the apex bank has not been able to do so as only four out of 12 members are still seating.

The absence of an acting MPC has raised concerns over the effects of a pause in economic and monetary policy making. This is especially worrying given the recent developments in the US money and forex market.

The US dollar has lost 12% in value since November 2017, falling to the lowest level since 2014. Additionally, the Federal Reserve, led by Jerome Powell, has signalled a continuation in its contractionary policy. Analysts predict at least three hikes this year, bringing the Fed rate to 2.00-2.25% by December from the current 1.25%-1.5%. 91-day T-bill rates have also increased by 0.22% YTD, and are expected to continue on this upward trend. These have been driven by heightened worries over runaway inflation, prompting investors to sell dollars and US T bills. Additionally, comments from the Treasury Secretary indicated that the US could adopt a devaluation to support its trade balance.



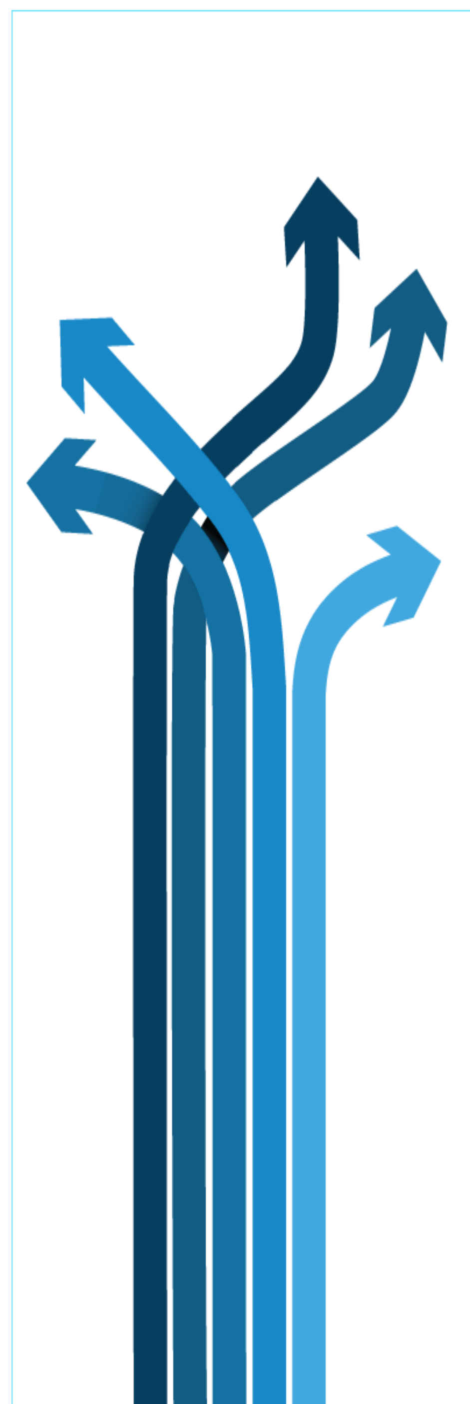
These developments have implications for Nigeria, as they increase the competitiveness for the US market. First, weaker dollar will make US goods cheaper, and could lead to an increase in demand for US exports. Higher interest rates are also positive for hot money traders, who might find the US money less risky, and more attractive for investments. These could lead to capital flight[1], which will put pressure on the external reserves and exchange rate.

The response of the CBN in such moments would be a tightening of monetary policy rates, to keep domestic yields high and attractive. However, given the lack of a quorum, or confirmation of new members, the CBN is unable to response with the required policy.

What are the alternatives?

Without a quorum, the CBN's hands may be tied with respect to traditional monetary policy measures. However there are still options open to the CBN, one of which is forward guidance. Forward guidance is the term used by central banks to communicate their future monetary policy decisions. It is used mostly to instil calm in the wake of market uncertainty. The Central Bank of Nigeria has come forward to say it will adopt this unconventional method of implementing monetary policy, which is not uncommon. Global monetary authorities that have used this concept in the past to implement policy decisions include the Federal Open Market Committee of the US (2013). In the same year, the Bank of England and the European Central Bank also adopted the use of forward guidance to address monetary policy decisions.

The CBN's decision to proceed with forward guidance in a period of no MPC quorum will help ensure confidence in the policy decision process of the Central Bank. It also provides a clear communication of future decisions that will be taken and hence the markets, investors are duly informed. It portrays the fact that there is still some guidance in place even if there is no committee.



[1]Capital flight occurs when significant assets or funds flow rapidly out of the county, triggered by political, or economic events.

BLOCKCHAIN: RETHINKING BANKING AND BUSINESS

In today's world, disruption is the constant over-arching theme. Technology is constantly changing the way we do things. The recent rise – and fall – in crypto-currencies caught the majority of people off guard. Many still dismiss them as fool's gold, and lacking in most of the fundamental properties of a proper currency (medium of exchange, store of value and a unit of account). Bitcoin is perhaps the most popular of the lot. It is now even traded on a futures exchange. Where many saw a bubble, others saw opportunity for a quick buck. The value of bitcoin skyrocketed by over 2000% in the space of a year to $20,000 per coin – astronomical by any standard – but has fallen to under $9,000 as at the 9th of February. Whether bitcoin or any of the countless other crypto-currencies will be worth upwards of $50,000 per coin, as predicted by some analysts, or that it will one day replace fiat-currency, is something that is still the subject of frenzied debates. However, the real treasure is blockchain – the underlying technology on which bitcoin and the entire crypto currency universe is based.

What is blockchain?

Purportedly the brainchild of a person or group of persons known as Satoshi Nakamoto, blockchain, also known as distributed ledger technology (DLT), is a digital platform and database that allows digital information to be distributed but not copied. Originally created to authenticate bitcoin transactions, it was designed as a way to centralize record-keeping without needing third-party authorization – like a bank or a regulator. It enables users to record, track, and validate peer-to-peer transactions. Confirmation of records is done by multiple users with access to the data. It keeps a permanent record of all transactions, keeps users information anonymous while all activity is secure and unchangeable. But beyond recording financial transactions, it can be used to record practically everything of value.

Decentralization – the masterstroke

This single advancement in technology has the potential to revolutionize our world and the way we do business in ways so profound it would have been considered unfathomable just a few years ago. Perhaps the most crucial area where the blockchain technology comes into play is in guaranteeing the legitimacy of a transaction by documenting it on a main register as well as on a connected distributed system of registers, all connected through a secure validation mechanism.

The database is not stored in a single location – It is hosted by millions of computers concurrently and stays accessible to anyone on the internet. This means records stay public, can be easily verified, and no centralized version of this information exists for any hacker to corrupt.

What can blockchain do for business?

At the moment, the financial industry, and banking in particular, has the biggest potential for disruption by blockchain technology. Its proponents are of the opinion that current banking processes are expensive and time-consuming and blockchain technology presents a much more secure and convenient alternative. From all kinds of payments, settlements, trade finance and even compliance, the underlying features of blockchain technology seems almost tailor-made for banking and it is garnering increasing support from major players in the global financial services industry.

According to PWC, as of 2014, over 45% of financial intermediaries worldwide suffered from some form of economic crime yearly[2].

Blockchain's ability to create shared digital databases of entries that are incorruptible would drastically eliminate the potential for cyber attacks against many banking systems – currently built on centralized databases. The current system is highly vulnerable as a single breach of the system by hackers gives them full access.

[2]Source: https://www.pwc.com/gx/en/financial-services/publications/assets/pwc-gecs-2014-threats-to-the-financial-services-sector.pdf

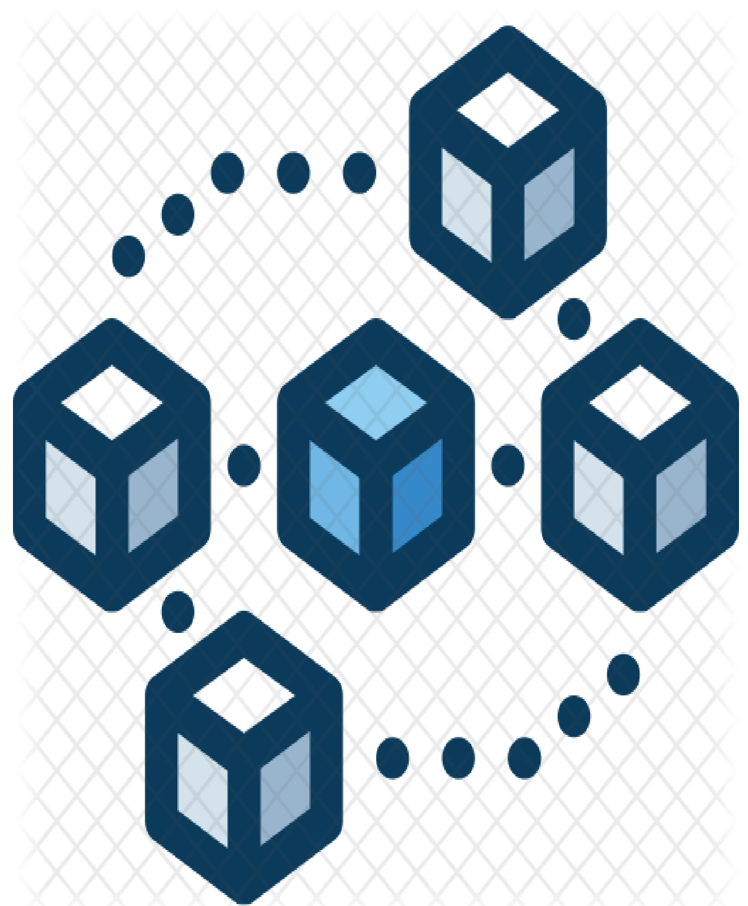
Another big win would be in the area of remittances as it would drastically cut down the time taken to complete a transaction. Nigeria received an estimated $22bn in diaspora remittances in 2017 while spending $2bn (9%) in remittance fees. The standard transaction time is typically two business days. Blockchain technology has the ability to not only increase the speed and efficiency of sending and receiving money, it also drastically lowers transaction costs. An example would be Thailand, through Siam Commercial Bank, and Japan's SBI Remit, which have mutually adopted the first blockchain-powered instant remittance service as a way to create another means of payment between the two countries. A transaction that would typically take two business days to complete is now being done in an estimated time of less than five seconds.

Another major area that DLT could give banking a significant upgrade – in terms of cost and efficiency – is in trade finance. It has the potential to fine-tune the cross-border trade finance process through the use of smart contracts. Blockchain can store any kind of digital information – including computer code which could be programmed to generate contracts or carry out transactions once a given set of conditions are met. It will allow companies to track orders and automatically activate payments on specific events – for example, delivery being recorded could be programmed to trigger an invoice notification. It would lower the costs and complexity of the current process and may also mean that a far wider range of potential users could now access trade finance services.

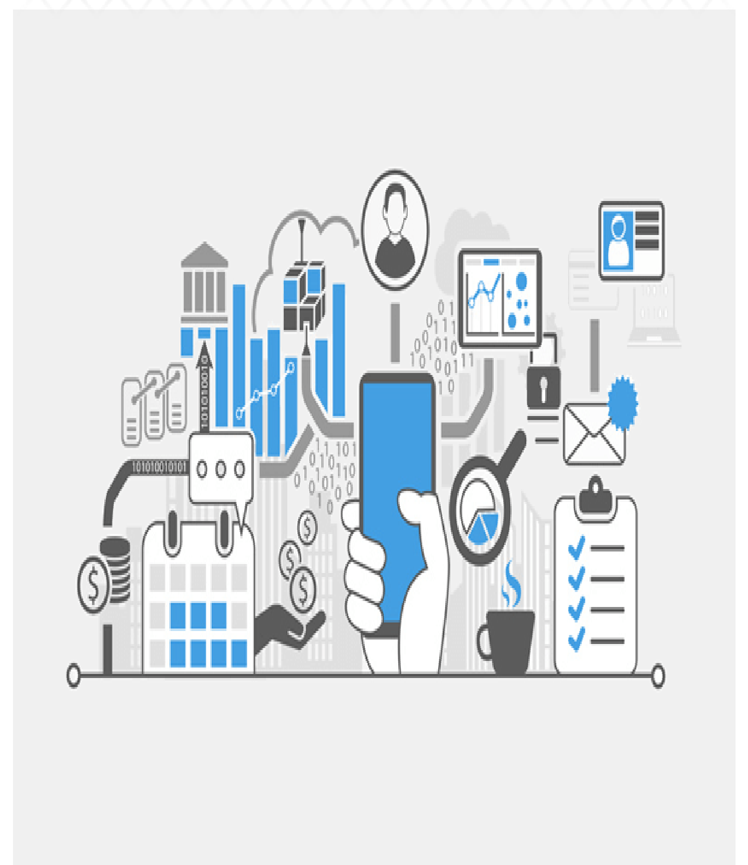
Other areas of increased efficiency and cost-cutting would be in meeting the standard Know Your Customer (KYC) regulations. A survey by Thomson Reuters estimated that financial institutions spend over $400mn annually on KYC requirements. Blockchain would simply allow the independent verification of one client by one organisation to be accessed by others, saving time and cutting costs significantly.

Possible Implications for Nigeria

Since blockchain makes record-keeping more efficient, a blockchain of property titles would go a very long way in drastically curbing cases of fraud in the sale of properties in Nigeria. The idea is already being experimented with in a few advanced countries like Sweden and Georgia.



In this and other developing parts of the world, the use of blockchain technology could also facilitate financial inclusion: increasing the share of the population with access to financial products. Nigeria is still well short of the Central Bank of Nigeria's (CBN) target of 80% by 2020. Two years to the deadline, only 41.6% has been achieved. The adoption of blockchain technology would enable banks bridge this gap by circumventing legacy infrastructure – and the attendant costs – especially in the rural communities. This would allow Nigeria's informal economy go mainstream, giving them access to services like credit and insurance, allowing them expand their business and maximize potential – by so doing, stimulating the wider economy.



It is still early days yet the impact has already been profound while the possibilities appear limitless. The blockchain disruption may be the biggest yet and business may never be the same.

THE FORCES OF 5G – THE NEXT GENERATION OF WIRELESS TECHNOLOGY IS READY FOR TAKE-OFF

NORTH KOREAN athletes will not be the only unusual participants at the winter Olympics in Pyeongchang in South Korea, which begin on February 9th. Anyone can take part, at least virtually. Many contestants will be watched by 360-degree video cameras, able to stream footage via a wireless network. At certain venues around the country sports fans will be able to don virtual-reality, head-mounted displays to get right into the action. Flying alongside a ski jumper, for instance, will offer an adrenalin rush without any risk of a hard landing.

These virtual experiences will be offered by KT, South Korea's largest telecoms firm. They are meant to showcase the latest generation of wireless technology, known as "5G". But just as ski jumpers never know exactly how far they will leap after leaving the ramp, it is unclear where 5G will land.

On paper, the new technology should go far. The International Telecommunication Union (ITU), a UN body which helps develop technical standards, has agreed on an ambitious set of requirements for the technology. It should offer download speeds of at least 20 gigabits per second, response times or "latency" of less than 1 millisecond and the ability to connect at least 1m devices in one square kilometre. So 5G networks are supposed to be able to transfer a full-length, high-resolution film in two seconds, respond to requests in less than a hundredth of the time it takes to blink an eye and effortlessly serve cities that are densely packed with connected humans and devices.

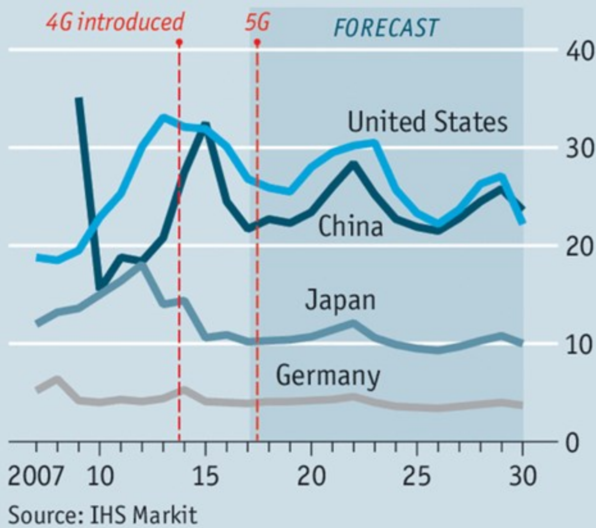
When 5G is properly rolled out, wireless bandwidth may seem infinite, says Alex Choi, until recently the chief technology officer of SK Telecom, South Korea's second biggest carrier, who is now at Deutsche Telekom, a German operator. That will enable all kinds of data-ravenous services, which SK is testing at its "5G Playground" near Seoul. One such is a virtual-reality offering that allows people to beam themselves into shared digital spaces such as a virtual sports stadium.

Another piece of 5G ingenuity is on view at Ericsson, a maker of network equipment. In what was once a factory building next to its headquarters near Stockholm, it is demonstrating "network slicing", a technique to create bespoke networks. The antennae on display are able to create separate wireless networks, to serve anything from smartphones and wireless sensors to industrial robots and self-driving cars. "Each set of devices will get exactly the connectivity they need," says Nishant Batra, who runs wireless-network products at the Swedish firm.

This versatility, along with the ITU requirements, could make 5G the connective tissue for the internet of things (IoT), as connected devices are collectively called, says Pierre Ferragu of Bernstein Research. Networks based on it could connect and control robots, medical devices, industrial equipment and agricultural machinery. They could also enable "edge computing", the idea that more and more number-crunching will not happen in centralised data centres but at the fringe of networks.

The telecoms industry has a lot riding on 5G. Mature network-equipment makers such as Ericsson and Nokia want it to revive demand for their wares, which has declined markedly since investment in 4G peaked a couple of years ago. Makers of radio chips, such as Qualcomm, are keen too. Countries are also boosters of 5G. Having lagged in the previous wireless generation, Asian countries want to lead the way on the next one. Using the Olympic Games to showcase and launch 5G is not unique to South Korea. Japan will do so in 2020, when Tokyo hosts the summer Olympics and NTT DoCoMo, the country's largest operator, wants to start offering 5G services commercially. In China the government, operators and local equipment makers such as Huawei and ZTE are about to launch big 5G trials.

In America, where competition between AT&T, Sprint, T-Mobile and Verizon has already speeded 5G development, industrial policy may further accelerate its roll-out: a leaked memo written for the White House by an official of the National Security Council went so far as to call for a nationalised 5G network. Such a project, it argued, would allow America "to leap ahead of global competitors and provide the American people with a secure and reliable infrastructure". The memo was dismissed, but the idea could crop up again.



Economist.com

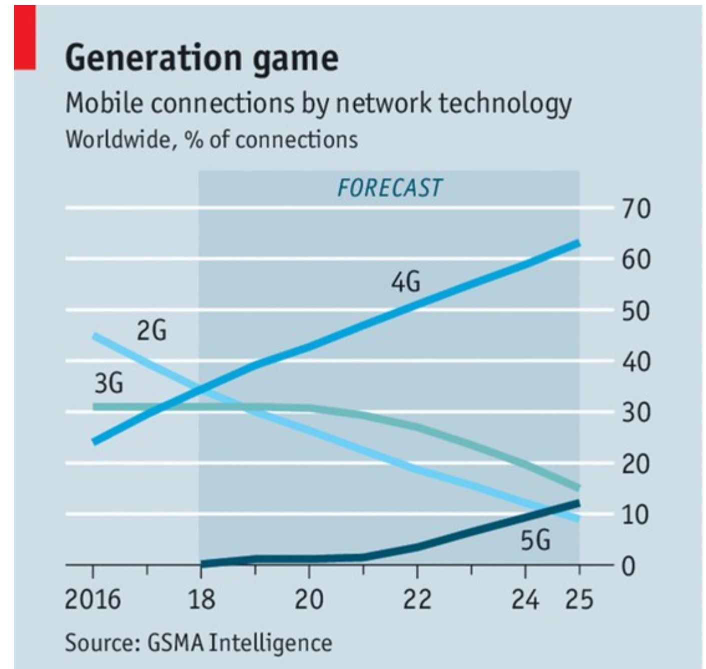
In spite of all this backing for 5G, hurdles exist. One of these is radio spectrum, which is increasingly saturated in the lower frequency bands usually used by mobile networks. Free spectrum abounds in the higher bands—in particular where the length of radio waves is counted in millimetres. But the higher the frequency, the more difficult things get, explains Stéphane Téral of IHS Markit, a research firm. Millimetre waves provide a lot of bandwidth, but even foliage can block them. They either need direct line-of-sight to work or must be bounced around obstacles, which requires lots of computing power.

Hardware is another headwind. Some equipment vendors have been touting their wares as "5G-ready", needing only software upgrades to work with the new standards. In fact, even if equipment is easily upgradeable, most operators will have to rejig their networks. High-frequency radio waves do not travel far, so firms have to erect more base stations (computers that power a network's antennae). As for mobile devices, big changes must be made for these to be able to use millimetre waves; with current technology, the computing power to process the signals would drain batteries in a twinkling.

But the biggest brake on 5G will be economic. When the GSMA, an industry group, last year asked 750 telecoms bosses about the main risk to delivering 5G, over half cited the "lack of a clear business case". Some of this pessimism is tactical: if operators were more enthusiastic, equipment vendors would raise their prices. But as things stand, 5G is unlikely to be a big moneymaker, says Chetan Sharma, a telecoms consultant.

That is because, although people want more bandwidth, they are often not willing to pay for it—an attitude even the fanciest virtual-reality offerings may not shift. Revenue per gigabyte of data has already plunged by over 50% between 2012 and 2015, estimates Mr Sharma. Costs per gigabyte have not gone down nearly as much and building 5G will not be cheap. Because of the higher frequencies, 5G will require more antennae, base stations and fibre-optic cables to connect them. And before firms can take full advantage of "network slicing", for instance, they have to upgrade the computers at the core of their networks. "We will have to work harder to give 5G a push," admits Lauri Oksanen, who oversees network research at Nokia, a Finnish equipment maker.

Operators are unlikely to ramp up their 5G investments quickly, predicts Bengt Nordstrom of Northstream, a telecoms consultancy. Instead, he says, they will roll it out gradually where the numbers add up. Some will first use the technology to provide superfast "fixed" wireless links (ie, between two stationary antennae), which is less tricky to do. Both AT&T and Verizon have said they will start offering such a service in America this year. Other carriers may use 5G to get more out of the spectrum they own. Others will weave 5G networks to serve densely populated cities, most probably in Asia. And some will launch private systems, for instance to provide connectivity in mines and ports.



In other words, 5G's trajectory is likely to differ from that of a ski jumper: it may fly low for years before it takes off. If this is the case, it would develop much like 3G, a mobile technology introduced in the early 2000s. It disappointed until it found a "killer application" with the smartphone late in the decade. And it was only with 4G that mobile networks lived up to the promises made of 3G, such as being able to watch video streams (see chart). "The odd-numbered generations do not seem to do too well," quips Dean Bubley, a telecoms expert. "We may have to wait for 6G to get what 5G promises."

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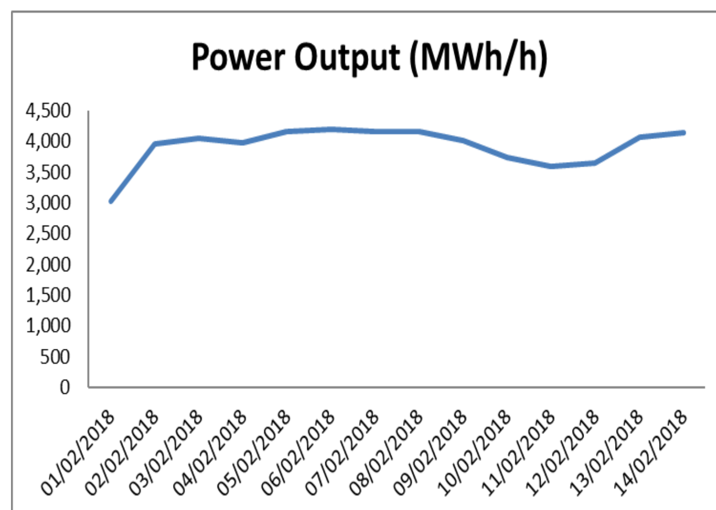
POWER SECTOR

Power output on February 14th was 4,138MWh/h, increasing by 36.88% from 3,023MWh/h on February 1st. Average power output from the national grid was 3,918MWh/h between February 1st – February 14th. Increased output was largely due to reduced gas constraints.



[3]

Outlook

As the raining season approaches, national hydroelectric power output is likely to increase further.

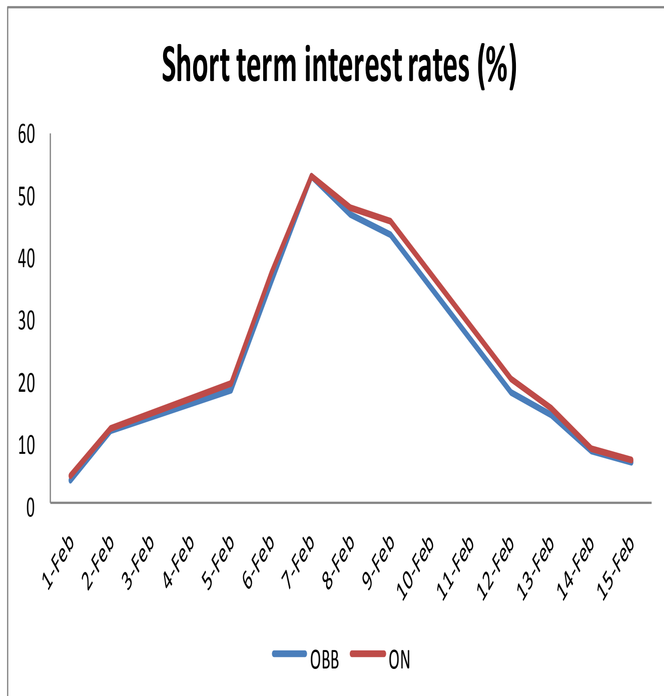
MONEY MARKET

Average opening position of the interbank market was N111.02bn long between February 1st -15th compared to N284.08bn long in the corresponding period in January. The DMO issued a sum of N176bn in T/bills in the first auction of February compared to the first auction in January of N161.55bn . The stop rates for the 182 and 364 - day tenors were unchanged at 13.65% pa and 13.7% pa while the 91-day tenor declined further to 11.95% pa from the last auction conducted in January.

In the secondary market, T/bills yields for the 182-day tenor remained unchanged while it declined for the 91-day and 364-day tenors during the review period. The 91-day, 182-day and 364-day closed at 12.38%, 14.58% and 13.55% from 13.12%, 13.42% and 13.75% on February 1st respectively.

Average NIBOR (OBB, O/N) was 24.17% pa during the review period, compared to 11.05% pa in the corresponding period in January. Short term interest rates reached a high of over 50%, due to reduced market liquidity before retreating to close at 6.80% on February 15th (average OBB/ON). The total OMO sales in the first half of February was N249.5bn compared to N344.48bn sold in the corresponding period in January.

[3]Source: FGN



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Outlook

With the February FAAC disbursements expected in the next few days, short term interbank rates are expected to drop due to increased liquidity. However, the next DMO auction scheduled for February 21st and an anticipated withdrawal by the CBN via OMO auctions should help keep interest rates at an average of 6-10%. Additionally, treasury bills rate are likely to continue to decline as consumers switch appetite to other asset classes.

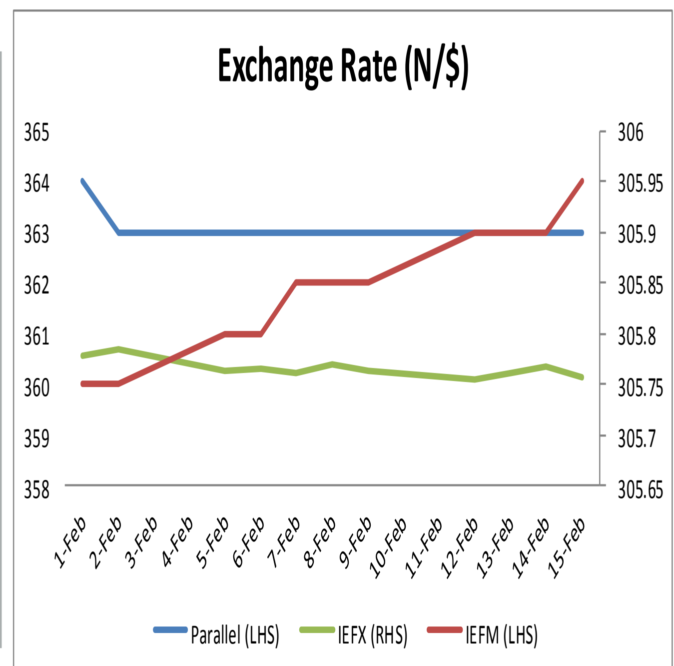
FOREX MARKET

Exchange Rate

The naira appreciated marginally by 0.27% at the parallel market to close at N363/$ between February 1st –February 15th. The IEFX rate appreciated marginally by 0.12% to N360.13/$ from N360.57. Total turnover during the review period at the IEFX window was $2.01bn compared to $2.14bn in the corresponding period in January. Year to date, a total of $8.04bn has been sold as at February 15th. The IFEM rate traded within a tight band of N305.8/$ and N305.9/$.

Outlook

The naira has remained relatively stable over the past few weeks following regular CBN foreign exchange auctions. However, increased liquidity in the money market following the DMO's next auction and the February FAAC allocation would boost forex demand in the coming weeks. We expect CBN's regular intervention to taper the increased demand and sustain stability in the market.



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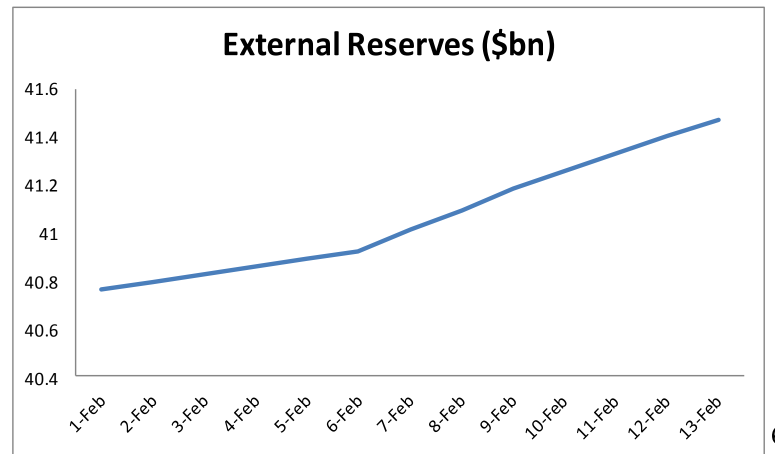
[4]Source: FMDQ

[5]Source: FMDQ, CBN, FDC Think Tank

EXTERNAL RESERVES

External reserves hit $41.47bn as at February 13th, a 3-year high. This represents a YTD increase of 6.58%. This positive trend continues to be supported by strong oil and Eurobond proceeds.



[6]

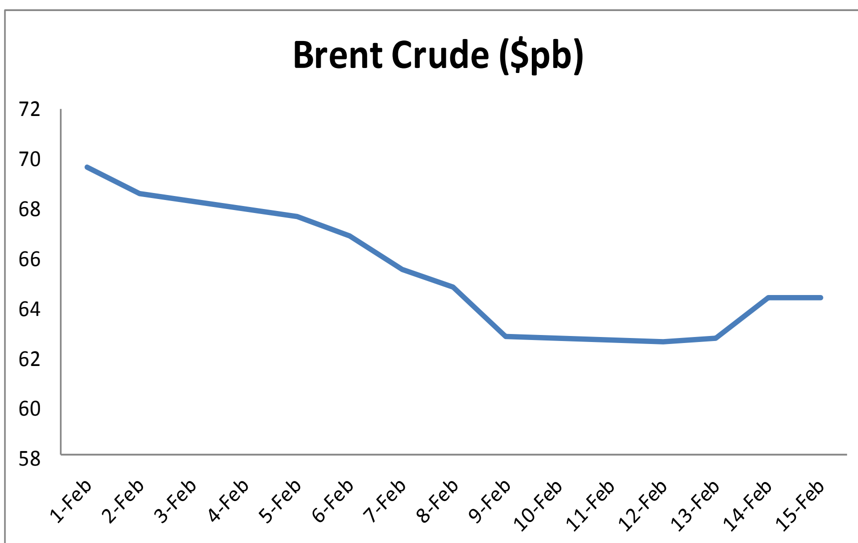
Outlook

The accretion in external reserves is expected to continue in the second half of February. Risks to this outlook include a reversal in the oil price rally, a fall in domestic oil production and heightened forex demand pressure.

COMMODITIES MARKET - EXPORTS

Oil Prices

Oil prices closed at $69.65pb at the start of the review period after hitting a peak of $71pb in January. However, the rally was shortlived as crude prices started trending lower to a 1-month low of $62.59 in the early days of February before recovering to close at $64.33pb on February 15th. The bearish sentiment is supported by increasing U.S. Shale production and a weak dollar. The average price during the period was $69.65pb. This is 48.19% above the 2018 budget's benchmark of $47pb and 28.98% above 2017's average price of $54pb.



[7]

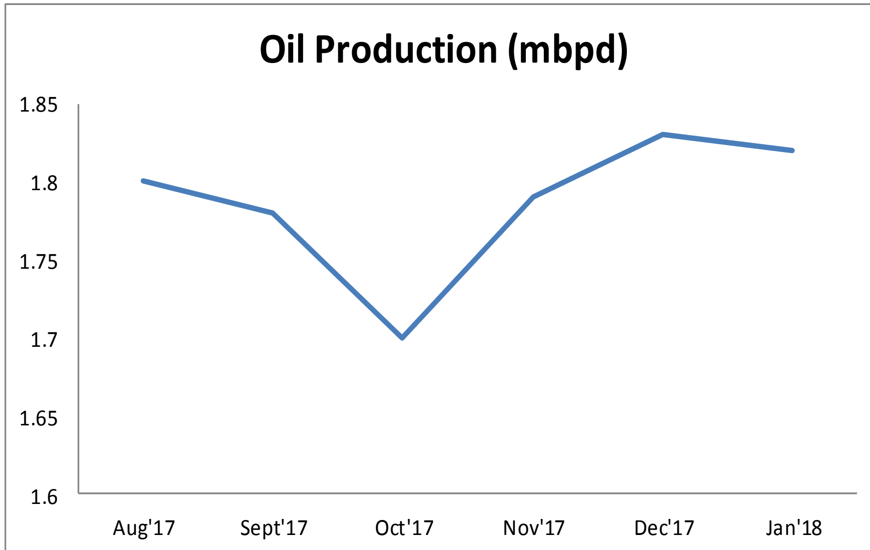
Outlook

Oil prices are expected to remain volatile as U.S. shale production continues to increase and OPEC member countries remain committed to production cuts.

[6]Source: CBN
[7]Source: Bloomberg

Oil Production

Nigeria's oil production declined marginally by 0.55% from 1.83mbpd in December to 1.82mbpd in January. Production remains higher than the OPEC cap of 1.8mbpd.



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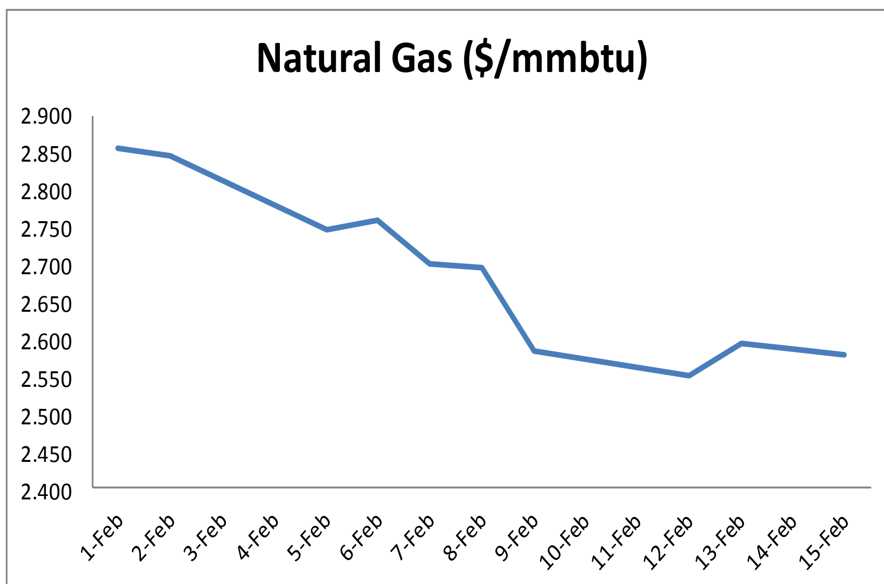
Outlook

Oil production is largely dependent on favourable government negotiations with the Niger Delta avengers. We expect production to remain positive in February barring any agitations in the oil producing regions.

Natural Gas

Natural gas declined by 9.66% during the review period to close at $2.580/mmbtu on February 15th amidst expectations of increased production by Saudi Arabia.



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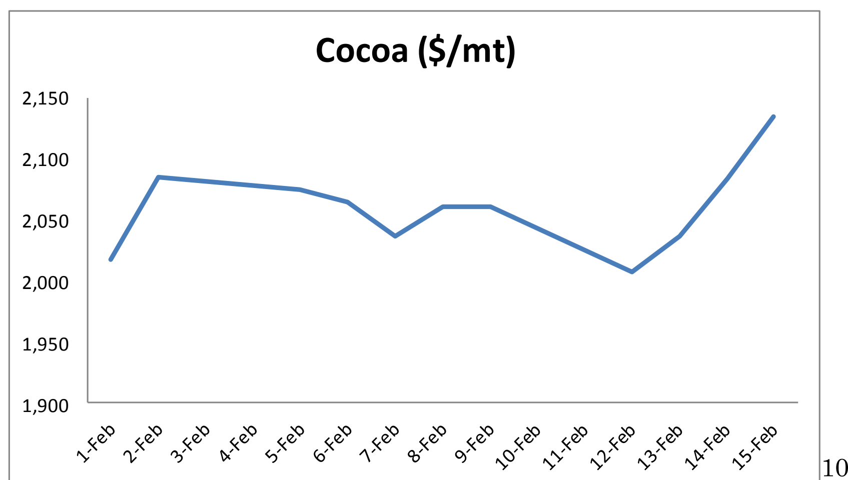
Outlook

Gas prices are expected to post gains in coming weeks as colder weather drives up demand for heating.

[8]Source: OPEC
[9]Source: Bloomberg

Cocoa

Cocoa prices advanced 5.8% to $2,134/mt on February 15th, from $2,017/mt on February 1st. The uptick in cocoa prices is due to increased seasonal demand.



[10]

Outlook

Despite rising global demand, we expect cocoa prices to fall in the coming months as seasonal demand wears off.

IMPORTS

Wheat

Wheat prices gained 5.31% to close at $4.75/bushel despite increasing Russian output.

Corn

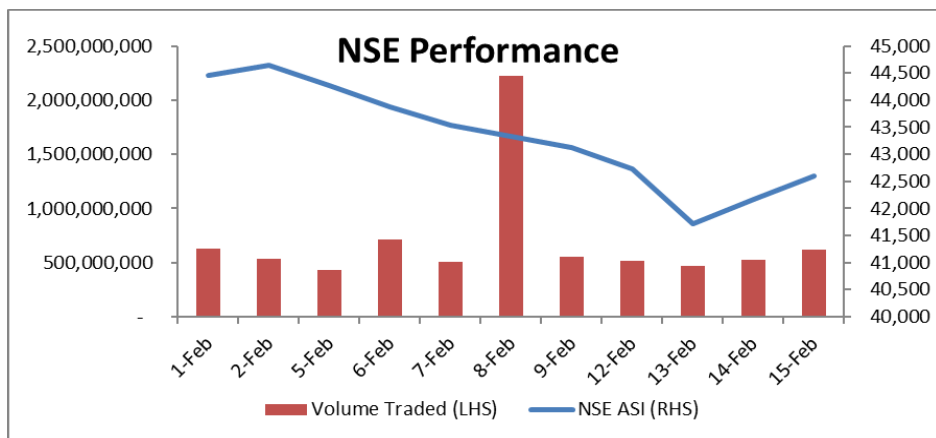
Corn prices declined by 3.87% to $3.78/bushel from $3.62/bushel during the review period. This was driven by improving U.S weather conditions.

[10]Source: Bloomerang

In a shocking turn of events, the Nigerian stock market reversed some of its gains in January, losing N607bn in the first 15 days of February. The NSE ASI lost 3.92% to close at 42,604.4 points in mid-February. This decline could point towards an impending market correction which some analysts believe is long overdue.

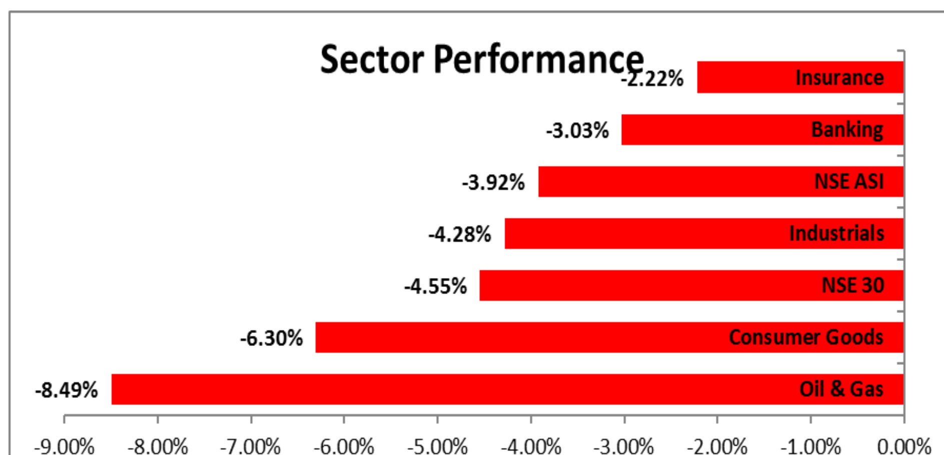
On the back of this decline in NSE ASI, market capitalization dipped 3.82% to N15.29trn during the period. This slump in performance can be partly attributed to the fall in crude oil prices. Brent oil prices peaked $70.53pb in January, but closed the first half of February at $64.33pb, losing 8.79%.

The stock market is currently trading at a price to earnings (P/E) ratio of 13.99x, a dip compared to its close of 14.02x in January. In addition, market breadth was negative at 0.32x, as 23 stocks gained, 77 remained flat and 71 declined, a relapse compared to the previous period's market breadth of 3.6x.



[11]

Trading activities on the bourse slowed in the first half of February. Average volume declined by 29% to 701 million units, with average turnover moving in the same direction, declining by 99.48% to N4.65bn. Financial services sub sector continues to dominate market volumes, accounting for 85% of total volume transaction during the period.



[12]

[11] Source: NSE
[12] Source: NSE

In an unexpected twist of events, all market indices declined during the period under review. The oil and gas sector was the biggest loser, losing 8.49% of its value by mid-February. This decline can be partly attributed to the losses recorded by most downstream oil players and to a larger extent profit taking activities of investors before the release of full year corporate results. Insurance sector lost the least, recording a marginal loss of 2.22%, as investors somewhat consider these stocks to be undervalued.

Top gainers had a blend of financial services and manufacturing companies. Linkage Assurance (27.5%) and Unity Bank (15.5%) were among the financial services gainers. While Beta Glass (15.7%), PZ Cussons (11.6%) and GSK Nigeria (11.6%) also featured among the advancers.

Top Gainers

Symbol	Feb 15'18 Price	Jan 31'18 Price	Change	% Change	PE Ratio
LINKAGE ASS PLC	0.88	0.69	0.19	27.54%	2.96
BETA GLASS CO PLC.	72.1	62.35	9.75	15.64%	11.47
UNITY BANK PLC	1.71	1.52	0.19	12.50%	1.42
P Z CUSSONS NIG PLC	25	22.4	2.6	11.61%	24.9
GSK NIG PLC	21.2	19	2.2	11.58%	49.01

The new par value rule continued to weigh in on the bourse, as all stocks in the top losers were priced below 50 kobo. The insurance sector dominated the losers' chart, with Consolidated Hallmark insurance (-42%) and UNIC (-26.1%) losing a substantial part of their value. First Aluminium (28.9%), Japaul Oil & Maritime Services (28%) and Multiverse (25%) also featured among the laggards.

Top Losers

Symbol	Feb 15'18 Price	Jan 31'18 Price	Change	% Change	PE Ratio
CONSOLIDATED HALLMARK INS PLC	0.29	0.5	-0.21	-42.00%	8.41
FIRST ALUMINIUM NIG PLC	0.37	0.52	-0.15	-28.85%	3.92
JAPAUL OIL & MARITIME SVCS PLC	0.36	0.5	-0.14	-28.00%	-
UNIC DIVERSIFIED HOLDINGS PLC.	0.34	0.46	-0.12	-26.09%	-
MULTIVERSE PLC	0.36	0.48	-0.12	-25.00%	-

Outlook

Price correction will continue in the short-term to reflect the true price of stocks. But strong full-year corporate earnings could turnaround market performance, giving the bourse the much need boost to return to a bullish territory.

Who We Are

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

Analyst Recommendation: *SELL*

Market Capitalization: *N70 billion*

Recommendation Period: *365 days*

Current Price: *N70*

Industry: *Agriculture*

Target Price: *N56.14*

ANALYST'S NOTE

Presco Plc recorded a 43% surge in revenue in its nine-month, 2017 (9M'17) statement. It's bottom line for the period declined by 21% as a result of increases in production and finance costs. Q3'17 also showed a N280mn loss on revaluation of its biological assets – 106% decline – compared to N4.4bn in Q3'16. FY'16 ended with a revaluation gain – approximately N24.9bn - a feat that boosted profit after tax (PAT) during that period.

The quarterly evaluation of Presco Plc also establishes deterioration in performance. According to results released so far, Q1'17 remained the best performing quarter. The remarkable performance in Q1'17 can be attributed, in part, to the foreign exchange crisis which favored the company. The exchange rate during the quarter was beneficial to Presco, as the company's products were benchmarked against export prices in dollar terms. However, the subsequent introduction of the Investor and Exporter Foreign Exchange (IEFX) window in April 2017, and the gradual restoration and stabilization of the foreign exchange market adversely affected Presco's top line. A quarterly assessment showed that Q2'17 revenue dropped by 21% to N5.7bn and Q3'17 revenue earnings by 28% to N4.1bn. Over the same quarters, PAT declined by 57% and 112%, with a loss after tax of N200mn in Q3'17.

The agricultural sector has been one of the main beneficiaries of the government's intervention programs. These have been in form of access to credit and some level of protection by regulatory agencies. For instance, the CBN's ban of 41 items (including palm oil products) from accessing foreign exchange at the official market, proved to be a major support to agricultural firms like Presco. Imported palm oil products became relatively expensive and thus unattractive. Nonetheless, the possibility of a policy somersault cannot be totally ruled out, considering the numerous policy turnarounds by the regulatory agencies.

In spite of the current favorable polices, finance costs and volatility in the valuation of biological assets remain key constraints for Presco Plc. As a result, we place a **SELL** rating on the company's stock.

INDUSTRY AND COMPANY OVERVIEW

As a sequel to the oil supply glut and subsequent collapse in crude oil prices in 2014, the Nigerian government identified agriculture as one of the 'low hanging fruits' poised to kick start growth through export revenue diversification and self sufficiency. Oil palm has been of those commodities key to the agricultural sector, partly due to the series of by-products obtained from the milling and processing value chain and the export potential of a mature oil palm industry. However, the gestation period has been a key factor that has encumbered investment in the industry, as only investors willing to take a long position considered oil palm investment. The major players in the market include: Presco, Okomu, PZ Wilmar and DUFIL. Of the lot, only Presco does not play in the oil palm retail space. However, in the medium term, only Okomu poses a major threat to Presco, as it has successfully diversified into the rubber plantation and retail oil palm value chains. But Presco currently focuses on industrial firms that use oil palm and by-products in large quantities.

Furthermore, the oil palm business is a scale enterprise; players in the sector cater to the industrial needs of a variety of customers such as consumer goods, cosmetics and pharmaceutical companies. Oil palm is also a major retail commodity used to garnish meals and a good source of essential vitamins. Key Nigerian companies that use oil palm as inputs include Nestle, Cadbury, Indomie (owned by Dufil) and Unilever.

Presco is an agro-industrial company incorporated in 1991 as Presco Industrial Limited. In 2002, the company listed on the Nigerian Stock Exchange (NSE) as Presco Plc. It is currently the largest agricultural company on the stock exchange with a market capitalization of approximately N70bn. The company primarily engages in the cultivation and processing of oil palm and palm kernel. The company keyed into the import substitution drive of the government to consolidate its position in the oil palm sector and maintain its market dominance.

Presco owns and operates four major oil palm plantations – Obaretin, Sakponba and Ologbo, which are located in Edo state, while the fourth, Cowan is situated in Delta state. They have a combined capacity of about 20,000 hectares of which 12,500 are mature. Apart from the existing plantations and its drive to expand its production capacity, Presco acquired a total area of about 11,500 ha at Ologbo and Sakponba to develop additional oil palm and rubber plantations.

Presco Plc's parent company, Siat SA, owns about 60% of the total issued share capital. Siat SA is a Belgian agro-industrial group specializing in the establishment and management of oil palm, rubber plantations and processing. Over the years, the parent has extended technical support to Presco, with its pool of agro-economists and actuarial experts. This has helped Presco remain innovative and competitive in a highly consolidated market. However, the recent setback in the management of production and operating expenses show that the parent still has an uphill task to ensure Presco remains one of the leading oil palm companies in Nigeria and beyond.

Income Statement for Presco Plc (FY Dec 2016)

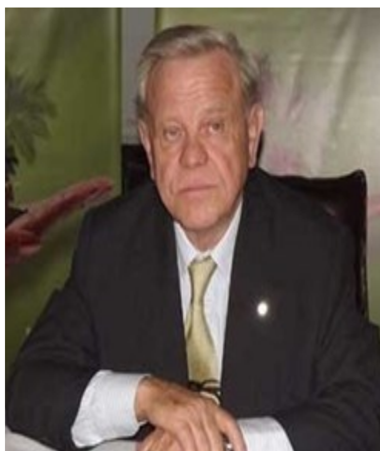
N'000	2013	2014	2015	2016
Revenue	8,485,144	9,137,704	10,448,353	15,716,198
Cost of sales	(3,869,321)	(3,199,422)	(3,813,137)	(4,404,785)
Gross profit	4,615,823	5,938,282	6,635,216	11,311,413
Gain/(loss) on biological assets revaluation	(223,045)	5,772,898	1,062,230	24,879,287
Distribution expenses	(159,927)	(169,110)	(198,608)	(223,945)
Selling, general & administrative expenses	(1,550,368)	(3,300,732)	(2,940,936)	(4,378,794)
Other operating income	41,933	22,004	364,639	323,146
Operating profit	2,724,416	8,263,342	4,922,541	31,911,107
Net finance cost	(390,444)	(362,562)	(707,800)	(684,655)
Exchange gains/(losses)				
Profit before tax	2,333,972	7,900,780	4,214,741	31,226,452
Income tax expense	(996,768)	(2,706,736)	(1,721,146)	(9,490,987)
Profit for the year	**1,337,204**	**5,194,044**	**2,493,595**	**21,735,465**

Balance Sheet for Presco Plc (FY Dec 2016)				
N'000	**2013**	**2014**	**2015**	**2016**
Intangible assets	303,296	147,933	183,581	192,566
Biological assets	17,503,858	34,343,913	29,291,216	44,920,219
Property, plant & equipment	10,686,754	10,946,470	19,990,011	22,444,657
Other non current assets	110	110	110	110
Non-current assets	28,494,018	45,438,426	49,464,918	67,557,552
Inventories	2,126,962	1,363,929	1,105,632	1,420,597
Trade and other receivables	1,914,507	1,768,774	2,777,782	1,095,901
Other current assets (includes bio as	-	1,184,273	1,252,376	10,502,660
Cash and cash equivalent	127,812	63,088	877,291	2,585,128
Current assets	4,169,281	4,380,064	6,013,081	15,604,286
Total assets	**32,663,299**	**49,818,490**	**55,477,999**	**83,161,838**
Share capital	500,000	500,000	500,000	500,000
Share premium	1,173,528	1,173,528	1,173,528	1,173,528
Retained earnings	15,708,541	27,342,427	29,622,561	50,358,026
Other reserves	-	43,000	58,724	87,448
Equity attributable to equity holders	17,382,069	29,058,955	31,354,813	52,119,002
Non controlling interests	-	-	-	-
Total equity	17,382,069	29,058,955	31,354,813	52,119,002
Provisions	730	-	-	-
Provisions for employee benefits	334,270	234,897	271,481	313,445
Financial Liabilities	4,151,080	3,415,994	4,787,517	4,781,433
Deferred tax liabilities	6,395,924	12,589,436	12,638,125	20,340,405
Non-current liabilities	10,882,004	16,240,327	17,697,123	25,435,283
Financial liabilities	702,943	687,031	2,069,896	1,917,514
Trade and other payables	3,391,864	3,397,025	3,356,707	1,699,761
Current tax liabilities	97,444	399,453	905,058	1,792,041
Other Current liabilites	206,975	35,700	94,401	198,235
Current liabilities	4,399,226	4,519,209	6,426,062	5,607,551
Total liabilities	15,281,230	20,759,536	24,123,185	31,042,834
Total equity and liabilities	**32,663,299**	**49,818,491**	**55,477,998**	**83,161,836**

MANAGEMENT

Felix Onwuchekwa Nwabuko

Managing Director



Mr Pierre Vandebeeck

Chairman

Presco's management team is led by Felix Onwuchekwa Nwabuko, a chartered accountant with extensive cross-border experience in project management and consulting. He became the Managing Director of Presco in 2015, having also served in various leadership roles within the group. He was part of the team responsible for the successful listing on the NSE. He is accompanied by a team of versatile and experienced executives, who have built a company with strong fundamentals. However, Presco needs to strive in its cost control drive. This will position the company for a possible change in both foreign exchange and import policies. In so doing, Presco will remain competitive both in the local and international markets.

Presco's board is led by Mr Pierre Vandebeeck, a Belgian, who has been instrumental to Presco's successes so far. He was made the Chairman of Presco in January 2010. He was also the pioneer Managing Director of Presco, building the agro-processing company from infancy to date. He has been responsible for the oil palm plantations setup in Nigeria. He remains an invaluable asset to the company and has proven to be the vital link between Presco and Siat S.A.

THE BULLS SAY

* Industry leader in oil palm sector
* Alignment between Presco Plc and parent company
* Gradual restoration of consumer confidence as Nigerian economy recovers
* Favorable government policies
* Diversification into rubber production

THE BEARS SAY

* Declining commodity prices
* Rising production and finance costs
* Highly dependent on one commodity
* Highly dependent on government protection to thrive
* Competitive rivalry among the leading players

Risks and Outlook

Although Presco Plc will be a viable investment in the long term, the company's dependence on government protection in terms of levies and subsidies has posed a substantial risk to the continued success of the oil palm processing company. A policy reversal will prove to be quite detrimental to the competitiveness of Presco, eventually hurting market share and earnings.

Even with the foreign exchange restriction on imported oil palm, the anticipated glut in supply due to favorable weather conditions will lead to a slide in global market price. This might further encourage importation and constrain earnings.

There is also the risk of reduced earnings due to the competitive rivalry among the top players, like Presco, PZ Wilmar and Okomu, as most players have continued to expand capacity to gain market share. This may result in a price war, especially when total capacity exceeds market demand.

APPENDIX - Our valuation of Presco Plc

Using Discounted Cash Flow (DCF) methodology, we estimated a stock price of N56.14, which is a 19.8% downside on the current price of N70 as at February 22 2018. The discount rate (Weighted Average Cost of Capital (WACC)) of 15.2% was derived using a 14.79% risk free rate (FGN 5-year Bond as at November 2017), a Beta of 0.2044, after tax cost of debt of 7.9%, and a market risk premium of 6.34%. The long term cash flow growth rate to perpetuity calculated is 6.4%.

Based on our analysis above, we place a **SELL** rating on the stock.

DCF Valuation			
N'000	**2017E**	**2018E**	**2019E**
EBIT	10,548,213	8,676,442	8,552,246
Less: Taxes	(3,206,030)	(2,637,123)	(2,599,375)
EBIAT	7,342,183	6,039,319	5,952,871
Plus: D&A Expense	2,590,649	2,754,274	2,988,159
Less: CAPEX	(5,346,383)	(3,843,510)	(2,953,462)
Less: Change in working capital	(369,700)	(158,224)	196,391
Free Cash Flow (FCF)	4,216,749	4,791,860	6,183,959
WACC	15.2%	15.2%	15.2%
Present Value (PV) of FCF	3,661,721	3,613,425	4,049,385
	2017	**2018**	**2019**
Terminal value			75,131,897
Present value of terminal value	49,197,929		
DCF Calculation	**Valuation**		
PV of explicit period	11,324,531		
PV of terminal value	49,197,929		
Enterprise Value	60,522,459		
+ Cash	2,318,501		
- Borrowings	(6,698,947)		
Equity Value	56,142,013		
Share price	**56.14**		

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