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FGN'S N2.7TRN PROMISSORY NOTES TO ITS CREDITORS- IMPACT ON LIQUIDITY & INTEREST RATES

The Federal Government on July, 2017 approved to issue N2.7trn of promissory notes to offset its debt to local contractors. This payment will cover obligations dated as far back as 1994 and will be phased over a three-year period. The debt instrument is 11.25% of money supply and 12.43% of Nigeria's total debt stock as at December 31st, 2017. Once these instruments are issued, the impact on liquidity and other macroeconomic variables such as interest rates and the exchange rate will be profound.

Impact on Economic Variables

Money Supply & Inflation

Growth in money supply has been benign at an annualized rate of 0.42% (CBN's benchmark is 10.29%). This is expected to change once the promissory notes are discounted. Assuming at least 50% of the notes are discounted, this will be equivalent to at least two months of FAAC. The liquidity pressure will be significant and could exacerbate inflationary pressures through the demand pull effect. Inflation has been on a downward trend in the last 13 months to 14.33% (February inflation data). Whilst we are anticipating a further deceleration in March, once these notes are issued and discounted, we may see a reversal in trend. Also, there are questions to the authenticity of some of the debts, which may actually be political IOUs especially as the campaign season has started. Hence the payment of such political debts will result in increased money supply with no impact on productivity.

Nominal Interest Rates

The negative relationship between increased liquidity and nominal interest rates means that average NIBOR, which has ranged between 12% pa-14% pa is expected to trend downwards.

Exchange Rates

Also, exchange rate gains recorded in the forex market will come under pressure as the demand for forex by contractors/ manufacturers, to bring in new inventory, builds up.

Impact on Monetary Policy

The anticipated inflationary and likely exchange rate pressure may delay the start of an accommodative monetary policy or even trigger a further increase in rates by the hawks among the MPC.

The good news is that these funds can be channelled into productive activities which will boost aggregate output. This increase economic activity will taper the inflationary pressures that increased money supply will trigger.

THE IMPACT OF THE DELAYED BUDGET PASSING

Background

The National Assembly has announced that the 2018 national budget will be passed in May. This is contrary to an earlier announcement by the speaker of the house, Yakubu Dogara that the N8.6trn budget will be passed on April 24th.

According to reports, the date was postponed as NASS said some ministries were yet to defend their budget proposals.

This is not surprising news. The delay in the passage of the budget has almost become a norm in Nigeria.

In 2016, the NASS passed the budget in March. However, padding allegations by the President delayed the final sign off till May 6th.

In 2017, the Senate alleged that the Nigerian police had taken 18 files needed to fully assess the budget. In the end, NASS passed the N7.4trn budget on May 11th, and the Acting President, Yemi Osinbajo signed it into law on June 12th.

Every year since 2014, the national budget has been passed and signed into law around May/June.

Implications

Nevertheless, this delay in the budget would still have the following effects:

- Postpone the multiplier effect of government spending. Recurrent expenditure boosts injections, while capital spending reduces the country's infrastructure deficit. The latter will also support activity in the construction sector, which grew by 1% in 2017.
- The government will have less time to use these funds. This brings into question the issue of the absorptive capacity of the economy. Assuming the budget is passed and signed in May, the government will only have 7 months to spend what was initially meant for a 12-month budget calendar. However, as it has always done in the past, the government is likely to extend the timeline of the budget from December to Q1 of the next year. As at December 2017, the government had spent less than 50% of its 2017 capex budget and had announced that the remaining funds will be rolled over to 2018. The implementation of the 2017 budget will be extended May 31st, 2018.

- The delay will postpone the inflationary and exchange rate pressures that usually come with increased government spending. This is because more money in the system would translate into increased consumption and higher demand for forex. Dollar demand, as a result of the budget passage, is estimated to increase by $5bn in H2. This could also lead to a depletion of external reserves.

FGN AWARDS $2.8BN TO THE IMPLEMENTATION OF THE AKK GAS PIPELINE - IMPACT ON POWER

Background

Gas power plants contribute approximately 70% of Nigeria's total electricity on the national power grid. However, gas constraint remains a critical issue as it prevents power generation on a daily basis. Since the start of the year, gas constraints account for 74.25% (186,331MWH/H) of total constraints (250,967MWH/H) despite the underutilization of over 192 trillion standard cubic feet of gas reserves. This was primarily due to the GenCos defaulting on the terms of payment for gas, and not accepting the required volume of gas needed to generate more electricity.

In a bid to reduce the gas constraint in the national power grid, the Federal Government on the 13th of December 2017, awarded $2.8bn to the implementation of the Ajaokuta-Kaduna-Kano (AKK) Gas Pipeline and Stations. The 614km 40-inch gas pipeline is a 100% contractor-financing model awarded to the Oando Consortium.

This marks the beginning of the first phase of the gas master plan, Trans-Nigeria Gas Pipeline project, approved in 2016. The main aim by the FGN is to enable the industrialization of the Eastern and Northern parts of Nigeria.

Impact

The proposed gas pipeline will be supplied with quality gas sourced from various gas projects. It is expected to improve electricity distribution, jumpstart Nigeria's power industry, maximize gas utilization (domestic and export use), ensure long term energy security as the country's energy demand is growing rapidly, and reduce environmental hazards associated with gas flaring. In turn, this will boost industrialization thereby driving economic activity and spur growth at the retail level (Small & Medium Enterprises (SMEs & the labor market). In addition, steady gas supply will reduce the bottlenecking of stranded power to the DisCos which could increase GDP by approximately 2%.

However, the power situation could worsen as the total power sector indebtedness is now in excess of N1trn. Nigeria needs to attract more investment in its power sector. Recently, the World Bank endorsed an International Development Association credit of $486mn towards rehabilitating Nigeria's electricity transmission lines. Furthermore, the Nigerian Electricity Regulatory Commission (NERC) introduced Meter Asset Providers (MAPs) which are a set of operators that will help distribution companies provide electricity meters. The plan is expected to attract N200mn in investments.

Provided the funds are disbursed effectively, it would help solve the structural problems faced in the industry, curb the frequent shutdowns of power plants, and the high losses incurred at the distribution stage. This will ensure the provision of reliable and affordable electricity service.

IMPROVED WHEAT PRODUCTION: AN AID TO NIGERIA'S DIVERSIFICATION STRATEGY AND A SOLUTION TO NIGERIA'S IMPORT DEPENDENCE

Wheat farming has been the most complicated area of Nigerian agriculture for the last decade, owing to high temperatures unsuitable for the crop. As a result, Nigeria has depended on imported wheat to meet the growing demands of its large population. However, since the oil shock of 2015/2016, wheat farming is experiencing renewed interest from policy makers who see Nigeria's potential to be self-sufficient. There are still certain challenges yet to be addressed which pose a threat to the country's aim of diversifying revenue and reducing its growing dependence on imported wheat. These challenges include low wheat production, insecurity in Nigeria's wheat belt, a lack of mechanized and modernized farming techniques, and uncompetitive pricing. But if is able to improve its wheat output to a level of self sufficiency, Nigeria can achieve non-dependency on imported wheat and reduce its trade deficit by approximately 3.06%.

Understanding Nigeria's wheat market

Wheat is a cereal grain that is grown in almost every country in the world. It was first grown in Lebanon and Syria but spread across countries through trade, followed by improved science and technology. It is the third most grown cereal in the world with global wheat production at approximately 755mn tons ($159.3bn) in 2016/17.[1] Wheat production in the northern regions of Nigeria dates back centuries when it was grown on a modest scale.

With the construction of large-scale irrigation dams in the 1970s and growing local demand, production of wheat began on a commercial scale despite farmers being ill-equipped. However, due to the neglect of the agricultural sector, importation of agricultural produce was on the rise. Farmers were no longer encouraged to produce in commercial quantities as they did not have the necessary resources and government incentives. In 1976, Nigeria produced 18,000MT of wheat and imported 730,000MT at the cost of N97mn.[2] This was a major cause for concern as it was a drain on the country's forex revenues. The Federal Government, under the administration of General Ibrahim Babangida, sought to address the problem of wheat production.

In 1987, the importation of wheat was banned and the Accelerated Wheat Production Program (AWPP) was implemented to encourage local production. Farmers were provided inputs and necessary equipment at subsidized rates. Nigeria's wheat production rose from 50,000MT to 450,000MT within three years of the program. However, the program failed due to Nigerian wheat millers, who were reluctant to patronize locally produced wheat. The importation ban was lifted in 1990 and the program ended abruptly. This led to an 87% fall in production to 60,000MT in 1991.[3] Farmers switched to the production of other crops such as rice, maize and vegetables.

[1]The Economist Intelligence Unit. 2018. World commodity forecasts: food, feedstuffs and beverages.

[2]Index Mundi. 2017. Nigeria Wheat Production by Year. https://www.indexmundi.com/agriculture/?country=ng&commodity=wheat&graph=production

[3]Food and Agriculture Organization of the United Nations (FAOSTAT). 2016. TITLE OF PAGE OR PUBLICATION. http://www.fao.org/faostat/en/#data/

Today, food items made from wheat have gained popularity over traditional staples made from commodities such as maize and cassava. Nigeria is the second largest consumer of wheat in Sub-Saharan Africa - behind South Africa.[4] The government spends approximately $1.5bn (2016) on wheat imports alone, and with the growing demand for non-traditional foods such as pasta, increase in wheat imports will lead to an increase in Nigeria's import bill. While Nigeria produces approximately 60,000MT of wheat (2016) worth $12.66mn (only 0.004% of global production or 1.498bnMT), the demand is much higher at 4.63mn tons (2016/17). There is therefore a huge demand gap of 4.57mn tons, making Nigeria the least self-sufficient country in Africa when it comes to meeting its wheat demand.[5]

Challenges hindering wheat production in Nigeria

To address this significant gap, Nigeria plans to cut importation of wheat by 50% in 2018, creating an opportunity for Nigerian farmers. However, several challenges will need to be addressed if farmers are going to be successful.

One of the major challenges of low-wheat production in Nigeria is the type of wheat grown and its growing requirements. The unfavorable local climate requires expensive irrigation and makes Nigeria unsuitable to grow hard red winter wheat. This type of wheat is used for making bread and general purpose flour - mostly grown in the plains of the US and Canada. Instead, Nigeria grows hard wheat, which is bred for the tropical climate. It is heat tolerant and can be grown in many of the northern Nigerian states. However, hard wheat has lower gluten content than hard red winter wheat, making it ill-suited for bread; also, the particular variety available in Nigeria has a low yield.

[4]The Economist Intelligence Unit. 2018. World commodity forecasts: food, feedstuffs and beverages.

[5]The Economist Intelligence Unit. 2018. World Commodity Forecasts - Food, Feedstuffs & Beverages.

A second major challenge is the turmoil that faces Nigeria's wheat belt. Wheat is grown in the northeast region including Borno, Yobe and Jigawa states. Here the night temperatures range between 15-20 degrees Celsius (°C), which makes the land good for massive hard-wheat production. This is particularly true for Borno State which contributes approximately 30% of Nigeria's total wheat output and is the largest wheat producing state.[6] However, continued threats of Boko Haram and migrant herdsmen insurgencies in the area remain a major setback. The majority of wheat farmers have fled their farms and settled in camps as internally displaced persons living on donated food items. As a result, Borno State produces next to nothing. Allegedly, there are limited government funds to rehabilitate the massive destruction of farmlands and infrastructure.

The third challenge is the lack of mechanized and modern farming techniques. Wheat farming in Nigeria is predominantly carried out by small-scale farmers who have outdated skills and limited access to finance and technology. Inadequate funding for research, mechanized farming, modern lab equipment and an unavailability of high-quality inputs continue to reduce local production. According to the USDA, production costs for local wheat has doubled to approximately $420/ton due to high input costs such as quality seeds and fertilizers.[7] Good quality seeds, when available, are not enough for distribution to farmers. In addition, private seed companies are not interested in wheat seed production as they mostly produce cassava stalks or rice seeds. Available wheat seeds have been planted and replanted for over five years leading to a deterioration in crop quality. As a result, flour millers have shifted to partial substitution of wheat flour with cassava composite flour (spurred on as well by the government's initiative to promote cassava flour in bread). Farmers are also forced to abandon their plans of cultivating wheat farms.

[6]FAO. June 2017. Monthly News Report On Grains, http://www.fao.org/fileadmin/templates/est/COMM_MARKETS_MONITORING/Grains/Documents/MNR_June_2017.pdf
[7]USDA Foreign Agricultural Service. 2017. Nigeria Grain and Feed Annual Report. https://gain.fas.usda.gov/Recent%20GAIN%20Publications/Grain%20and%20Feed%20Annual_Lagos_Nigeria_4-6-2017.pdf

Solutions and consequences of improved wheat production in Nigeria

With the growing importance for Nigeria to reduce its dependence on oil and gas, and diversify into non-oil activities especially agriculture, the need for improved wheat production cannot be overemphasized. In order to ensure increased wheat production, the Wheat Farmers Association of Nigeria (WFAN) needs to be encouraged. This could be done through the government allocating adequate funding support for wheat development. The need for stable and consistent Federal Government agricultural policies, such as the Agriculture Transformation Agenda (ATA), to increase the production of wheat, and the Anchor Borrower Programme to encourage wheat farming become a necessity.

Nigeria has to invest in research into new and improved wheat farming techniques, wheat technology and modern agronomy practices in order to improve crop yield and expand wheat production.

Nigeria has to boost its food security. The government could introduce a bill which would make it compulsory for flour millers to buy locally produced wheat as a substitute for imported wheat. The security situation in the northern regions of the country also needs to be addressed. This will encourage the much needed private sector investment.

Furthermore, to reduce imports, Nigerian consumer price preference has to be satisfied. A minimum purchasing price, which is competitive against international prices, needs to be determined. This will ensure that local wheat produce stays cheaper in the Nigerian market.

Focusing on wheat farming will generate thousands of jobs and income for both farmers and millers. Agriculture's contribution to GDP began to decline from 60% in the early 1960s to approximately 49% in the 1970s and 25.08% in 2017.[8] However, with improved wheat production, and reduced reliance on oil, agriculture's contribution to GDP has the potential to grow further. Consequently, it will boost economic growth and foreign exchange inflows, as business activities will begin to expand and wheat produce is exported.

Focusing on wheat farming will generate thousands of jobs and income for both farmers and millers.

[8]National Bureau of Statistics. 2017. Nigerian Gross Domestic Product Report (Q4 & full year 2017). http://nigerianstat.gov.ng/elibrary?page=5&offset=40

Looking forward at Nigeria's wheat opportunity

Wheat is usually underestimated given that rice is the main food crop in Nigeria. However, the taste of the domestic market is changing and the importance of wheat has grown over the years. Although there are challenges hindering the production of wheat in Nigeria, It has become a profitable cash crop and the government needs to ensure that it is grown on a large scale. Nigeria needs to grow a great deal of its own wheat and take advantage of its available market. This will reduce its exposure to exogenous shocks from depending on other nations for its food supply. Nigeria needs to produce its own wheat and free itself from decades of dependence on imported wheat.

THE ECONOMIC COST OF SOCIAL IN-SECURITY IN NIGERIA

Nigeria has been marred by social unrest, including Boko Haram terrorism[9] and herdsmen attacks[10] just to mention a few. As a result of this unrest, the country ranked 149th out of 163 countries on the Global Peace Index in 2017.[11] The impacts are broad: agricultural production has been devastated, public infrastructure such as schools, hospitals and bridges have suffered significant damage, and the loss of life and mass displacement of people are astounding. Yet, security spending in the 2018 budget is $1.58 billion, which translates to a paltry $8 per Nigerian.[12] Evidence from other economies such as Germany, Japan and Botswana, with relatively peaceful environments, suggests that this is low for a country of Nigeria's population. It is also low compared to the global average. Global total defense spending is expected to reach $1.76 trillion in 2018, translating to $220 per person.[13] Indeed, there is a need for more robust defense spending to improve the security condition of the country, which would in turn contain the economic costs of unrest and support economic activities.

[9]The name "Boko Haram" stems from a phrase that literally translates as 'Western education is forbidden'. The group became active in 2002. However, their insurgents began in Nigeria in July 2009. Since September 2010, Boko Haram has frequently organized violent attacks.

[10]The Herdsmen are largely nomads who go through towns with their cattle in search of pasture. They frequently trespass farmlands owned by locals in their host communities, destroying crops. Attempts by farmers to prevent herdsmen from entering their lands have been met with violent resistance that became rampant in 2016.

[11]Institute for Economics and peace. 2017. "2017 Global Peace Index", http://economicsandpeace.org/research/#measuring-peace

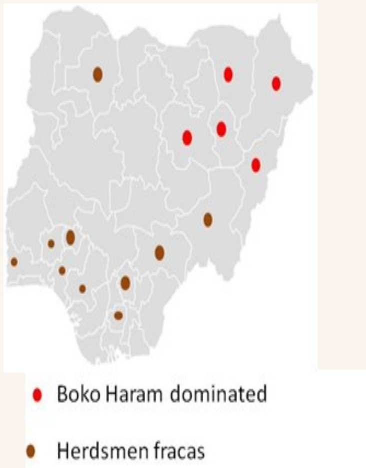
[12]Budget Office of the Federation. 2017. "2018 Budget Proposal", http://www.budgetoffice.gov.ng/index.php/2018-budget-proposal

[13]IHS Markit. December 18, 2017. "Global defense spending to hit post-cold war high in 2018", http://news.ihsmarkit.com/press-release/aerospace-defense-security/global-defense-spending-hit-post-cold-war-high-2018-janes-i

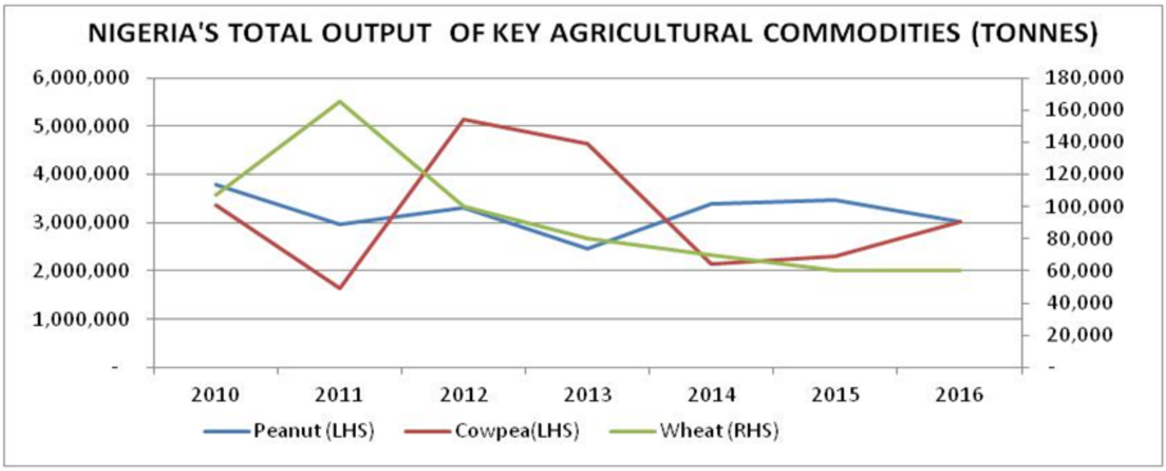
Cost of Insecurity to Nigerians and the Nigerian Economy

On the Global Terrorism Index Rankings in 2017, Nigeria ranked 1st in Africa and 3rd globally, largely due to the activities of Boko Haram and herdsmen attacks.[14] At least 15 out of Nigeria's 36 states are currently experiencing violence and upheaval from these two groups. Boko Haram operates predominantly in the north eastern part of the country (and is also active in Chad, Niger and northern Cameroon). The herdsmen predominately attack in the southern region of the country. These violent events exist alongside south-south clashes among rival cults and militant attacks targeted at crude oil facilities.

The 15 states highlighted in the map are mainly agrarian economies, representing approximately 47% of Nigeria's total land mass and 32.5% of its GDP.[15] Insecurity in these regions disrupts economic activity, particularly agricultural activities, and slows aggregate output growth in the economy. Meanwhile, Nigeria's Chief of Army Staff, Tukur Buratai, has estimated



that the economic impact of Boko Haram activities in the north east has cost the country N274.5bn ($9bn), with the loss of agricultural production put at N107bn ($3.5bn).[16] This loss to agricultural production might have explained the reason for the decline in Nigeria's total output of commodities such as cowpea, wheat and groundnut which are predominantly produced in the north east. As of 2016, the output levels of these key agricultural commodities were below 2010 levels.



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[14]Institute for Economics and peace, 2017. "Global Terrorism Index 2017", http://economicsandpeace.org/

[15]National Bureau of Statistics. 2010. "Annual abstract of statistics, 2010". www.nigerianstat.gov.ng/download/71

[16]First annual conference of the Guild of Corporate Online Publishers. 2017. "Counter- Insurgency and Role of the Nigerian Army in Creating Conducive Environment For Nigeria`s Economic Development". Guild of Corporate Online Publishers. http://gocop.com.ng

[17]Food and Agriculture Organization. 2018. "Crops". United Nations, http://www.fao.org/faostat/en/#data/QC

As for the impact of the herdsman attacks, there have been media reports that farms have been destroyed, crops have been lost and the incentive to plant again in these areas has declined. These effects could translate to deepening poverty and food insecurity. Insecurity results in damage to critical infrastructure such as schools, hospitals and bridges. Boko Haram has carried out suicide bombing attacks on schools, markets and car parks among other places.[18] While these attacks continue, more of Nigeria's infrastructure is poised for destruction.

Furthermore, insecurity has displaced about 1.96 million people resulting in extreme pressures on those who have been displaced and on the federal and state governments that must provide humanitarian assistance.[19] According to the Minister of State for Budget and National Planning, Zainab Ahmed, the federal government and the six north-east states spent $6.4bn on interventions and humanitarian service in 2016 and 2017.[20] This translates to an average of $3.2bn per annum. It also represents about 8% of combined spending by the federal and state governments in the country. Governments have also had to sustain this expenditure amid unemployment and other infrastructural challenges that require huge fiscal spending.

[18]Human right watch, 2015. https://www.hrw.org/report/2016/04/11/they-set-classrooms-fire/attacks-education-northeast-nigeria

[19]Internal displacement monitoring centre. 2017. Norwegian Refugee Council, http://internal-displacement.org/countries/nigeria

[20]Office of the Coordination of Humanitarian Affairs, 2018. "2018 Humanitarian Response Plan Launch". United Nations, https://reliefweb.int/node/2433214

The way forward – lessons from peers and developed economies

Given these huge economic costs of insecurity, the Nigerian defense sector is likely being underfunded. This is reflected in low staff strength, weak surveillance system, and a paucity of arms and ammunitions. According to the Institute for Economics and Peace, Nigeria had a relatively small military and private security sector in 2016. The organization noted that there are 219 police officers for every 100,000 Nigerians, significantly below both the global median of 300, and the sub-Saharan Africa average of 268.[21] Similarly, Boko Haram especially has been alleged to possess more sophisticated arms than the Nigerian military. Indeed, the paltry $8 per capita spending on defense has made containing insecurity operations more difficult.[22]

By comparison, Germany, with a population of 83 million people, spent an equivalent of $44bn on its defense sector in 2017, amounting to a per capita amount of $530. As of 2017, the country was ranked the world's 16th most peaceful country on the Global Peace Index.[23] In Asia, Japan - a country with population of about 127 million - expects to spend $46.5bn on defense in 2018.[24] This translates to $366 per head. The country is ranked as the world's 10th most peaceful country on the Global Peace Index, compared to Nigeria's ranking of 149th. On the Global Terrorism Index, the country is ranked 54th, better than Nigeria's 3rd position.

Within the continent, Botswana, Africa's most peaceful country, appropriates the second largest share of its total spending to defense. In 2018, the country is projected to spend P2.78 billion pulas ($294mn) on defense.[25] Given a population of about 2.25 million people, the country would spend approximately $130 per capita on security.

[21]International Police Science Organization. 2016. "World Internal & Security Police Index (WISPI)". Institute for Economics and Peace. http://www.ipsa-police.org/ProjectInfoDetails/world-internal-security-and-police-index#

[22]Al Jazeera. February 17, 2014. "Boko Haram 'stronger than Nigerian army'". Al Jazeera Media Network. https://www.aljazeera.com/news/africa/2014/02/boko-haram-stronger-than-nigerian-army-2014217194247251822.html

[23]Institute for Economics and Peace. 2017. http://economicsandpeace.org/

[24]Ministry of Defense. 2017. "Defense Programs and Budget of Japan Overview of FY2018". Government of Japan. http://www.mod.go.jp/e/d_budget/

[25]Bank of Botswana. 2018. "2018 budget speech". Pp. 16

Also noteworthy, Botswana's police ranked the best in Africa on the World Internal and Security Police Index, while Nigeria's police ranked the worst.[26]

Nigeria needs increased defense spending (albeit with a close monitoring on spending to avoid mismanagement) to enhance the country's arms and ammunitions, increase its number of armed personnel and train them efficiently. Higher recurrent spending in form of improved salaries may also boost motivation and improve performance amongst security personnel. Together, both a stronger arsenal and motivated defense personnel could do a lot more to contain insecurity. However, should the government decide to sustain its relatively low defense spending in the country, the impact of the defense sector to combat insecurity is poised to be limited and the continued negative impacts on the economy, infrastructure and Nigeria's population are set to persist.

[26]International Police Science Organization. 2016. Ibid. http://www.ipsa-police.org/ProjectInfoDetails/world-internal-security-and-police-index#

Nigeria hopes high tariffs will make it grow more rice. Farmers and millers are happy. So are smugglers

GROW YOUR RICE AND EAT IT

STANDING ankle-deep in water between neatly spaced rice plants, an instructor shows a group of about 100 farmers in Kebbi, a state in north-west Nigeria, how to apply herbicide. The training session, arranged by TGI Group, a Nigerian conglomerate that runs a large rice mill nearby, has an enthusiastic audience. Hussein Ahmed, a farmer, says the yield from his small field has increased by about 50% since he started using chemicals and carefully spacing the seedlings. Another farmer boasts of marrying a second wife thanks to the extra money he is earning from growing rice.

[27] https://www.economist.com/news/middle-east-and-africa/21738920-farmers-and-millers-are-happy-so-are-smugglers-nigeria-hopes-high-tariffs-will

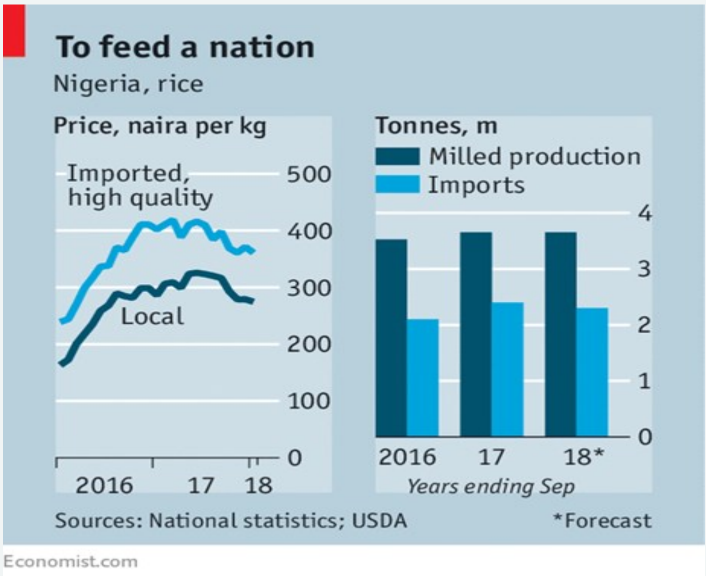
Across the region the grain is cooked with tomatoes and mounds of chili to make jollof, a dish that is almost always eye-wateringly spicy, no matter how mild the cook insists it is. Jollof is not just the cause of many arguments in the region—Ghanaians and Nigerians each insist theirs tastes better. Its main ingredients have also become symbols of how Nigeria is trying to diversify an economy that exports crude oil and imports almost everything else.

Muhammadu Buhari, who was inaugurated as president in May 2015 in the midst of an economic shock caused by low oil prices, turned to autarky. His central bank stopped providing foreign exchange to importers bringing in 41 categories of goods, including rice, toothpicks and incense. The government increased customs duties on rice from 10% to 60% in October 2016 to encourage farmers to plant more.

Such tariffs have certainly spurred investment in farms and in milling plants such as the one run by TGI in Kebbi. The mill can already produce 120,000 tonnes of rice a year, yet the company is planning to add another 100,000-tonne production line and open two more mills in other states in the next five years. Aliko Dangote, Africa's richest man, says he will invest in six new factories that will produce 1m tonnes of rice a year.

To feed these mills, Nigeria will have to increase its rice yield, which is among the lowest in the world. Farmers in Thailand harvest three crops a year, compared with one or sometimes two in Nigeria. Outgrower schemes, in which firms such as TGI provide training, fertiliser and other chemicals on credit that is repaid after harvest, can help. But extending them to all 1.4m rice farmers in the country would be a huge task.

The central bank has done its bit by doling out some 55bn naira ($153m) in loans to 250,000 farmers (most of whom grow rice). Architecture graduates and civil servants have cashed in on the boom and taken up farming. Central-bank officials are happy to talk about how much money it has lent, but they do not mention how much money is being paid back. Nigeria's anti-corruption body recently said that



it had recovered 300m naira stolen from the farm-loan scheme in two states.

The bigger problem, however, is that local rice is still not competitive with Asian imports. Farouk Gumel of TGI says that in January he was selling 50kg bags at his factory gate for 14,000 naira each (traders then add on the cost of the long journey to cities in the south). Smuggled rice, on the other hand, was being sold in urban markets for 12,500 naira a bag. Thanks to increased production and perhaps smuggling, rice prices are lower now than they were a year ago, though they are still 68% higher than they were two years ago.

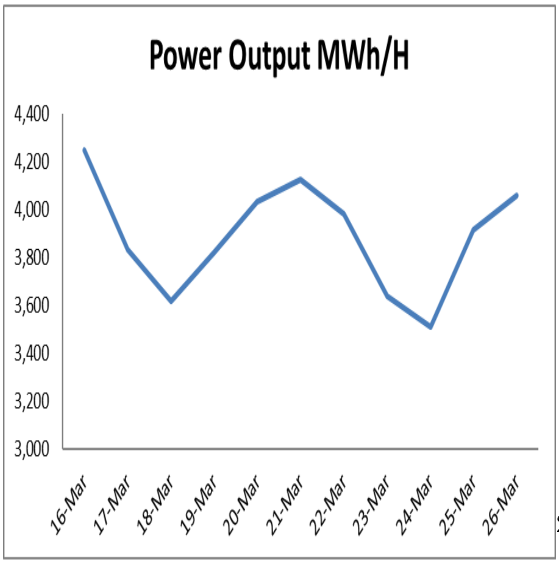
The government says its policies are working and that Nigeria will no longer need to import rice by the end of the year. But its numbers do not add up. It says that rice production has doubled since 2015 (and will increase by 50% again this year), but there are scant data to support such ambitious claims. Nigerians eat 5.3m-7m tonnes of rice a year. Imports account for 2m-3m tonnes, a figure that has barely budged in recent years (see chart). Nigeria's information minister, Lai Mohammed, points to statistics from Thailand showing that its exports to Nigeria have slumped by 97% in two years. But Thailand's exports to Benin, have doubled to 1.8m tons a year, the equivalent of 160kg per Beninese. The country's tariff of 12%, and its poorly policed border with Nigeria are probably the main reason for its booming demand.

Nigeria's import restrictions benefit farmers and millers and seem to be encouraging more planting. But until yields improve and the costs of producing Nigerian rice fall, the country's consumers will have more reason to thank smugglers for keeping their plates filled with jollof.

MACROECONOMIC INDICATORS

POWER SECTOR

The average on grid power output was 3,889MWh/h for the period March 16th - March 26th. This represents a marginal decline of 0.03% compared to the corresponding period in February but 5.24% lower than the average on grid power of 4,104MWh/h in the first half of the month. The decline recorded was as a result of the gas supply constraint, which left about 2000MW capacity idle in 12 power plants. Also, the Shiroro Hydro plant failed to generate power due to turbine flooding on March 21st.



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Outlook

The country generates the bulk of its electricity from gas fired power plants, while hydro-power plants generate only about 30% of the total power output.[29] As the rainy season slowly picks up, we expect an increase in hydro generated power, which should mitigate the deficiency in gas supply. We expect on-grid power output to increase in the coming period. The approved $486m by the World Bank to improve electricity in Nigeria has a long term benefit of boosting the power sector if the fund is well invested and bottlenecks are avoided.

MONEY MARKET

The average opening position was N187.88bn long for the period (March 16th – March 27th) compared to N243.52bn long for the period (February 16th to February 28th). This was 34.24% lower than the average opening position of N285.70bn recorded in the first half of March.

The total OMO sale of N691.51bn was issued while a sum of N162.82bn matured. The total OMO sales recorded during the period was 62.05% higher than the total OMO sales issued in the corresponding period in February but 16.31% lower than what was issued in the first half of the month.

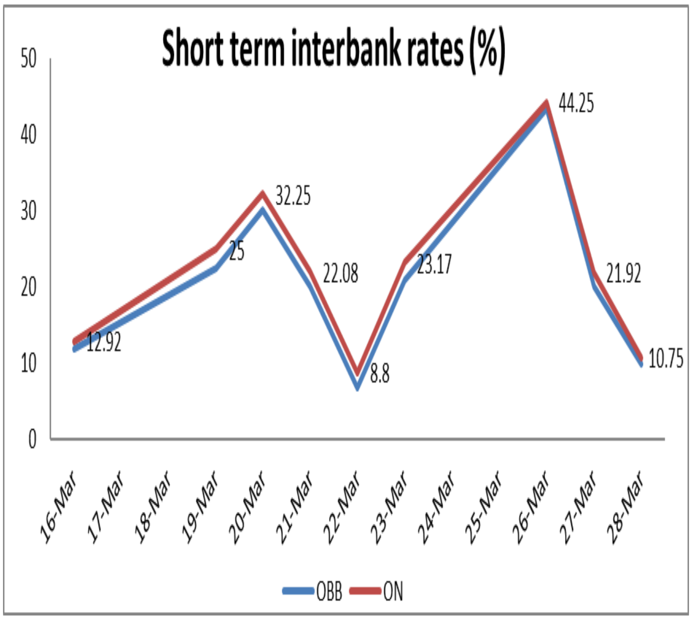
T/bill yields maintained a downward trend to close at 13.15% for the 364-day tenor, while the yield on the 91-day tenor increased slightly by 170bps to 11.95%. Nevertheless, the yield

[28]Source: FGN

[29]Punch

on the 182–day tenor was maintained at 13% pa.

The average NIBOR (OBB/ON) for the period March 16th – March 28th was 21.47% compared to 12.97% in the corresponding period in February. During the review period, OBB & ON reached a low of 6.83% pa and 8.8% pa respectively on March 22nd before retreating to a high of 43.33% pa and 44.25% pa on March 26th respectively.



Outlook

With the receipt of inflows from FAAC disbursement which amounts to N685.15bn, we expect interbank interest rates to decline. However, this tends to be temporary as rates would likely increase with the sale of secondary Treasury Bills by the CBN and forex Retail auction. The MPC meeting is proposed to hold next week and decisions are likely to tilt towards an accommodative stance. This would likely cause rates to decline.

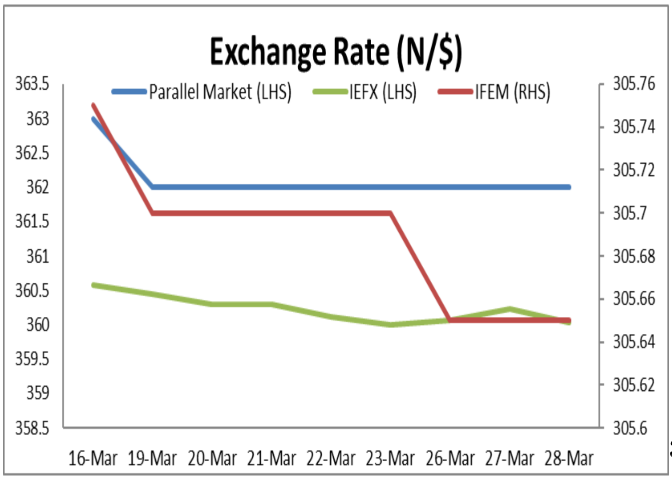
FOREX MARKET

Exchange Rate

At the parallel market, the naira depreciated by 0.28% to N362/$ on March 19th from N363/$ on March 16th and traded flat at this rate till March 28th.

The naira maintained a downward trend at the IEFX window to close at N360.03/$ on March 28th from N360.57/$ on March 16th. The total turnover at the IEFX window was $2.15bn during the review period compared to $2.73bn in the first half of the month.

The IFEM rate traded within the band of N305.65/$ and N305.75.



30

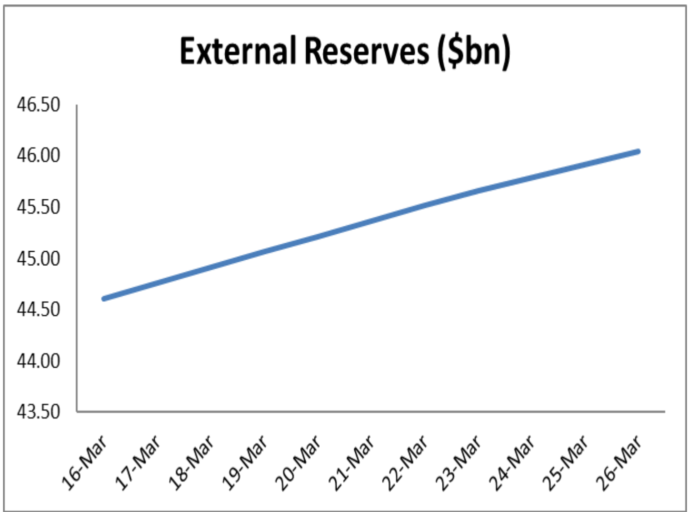
[24]Source: FMDQ, CBN, FDC Think Tank

Outlook

We expect increased demand pressures on forex in response to the receipt of FAAC disbursement for March and an approval of the 2018 budget in April. Hence, the naira is likely to depreciate further in April. However, with the CBN's intervention to mop up liquidity, naira would likely trade between N362/$ - N363/$

EXTERNAL RESERVES

External reserves maintained an upward trend during the period March 16th – March 26th. It increased by 3.23% to $46.04bn on March 26th from $44.60bn on March 16th, supported by increased proceeds from oil.



[31]

Outlook

With strict adherence to the OPEC quota system, we expect oil prices to remain around current levels. Currently forex demand pressures are subdued and are likely to remain so pending the disbursement of budget funds and the resurgence of any other factors that could trigger demand pressure.

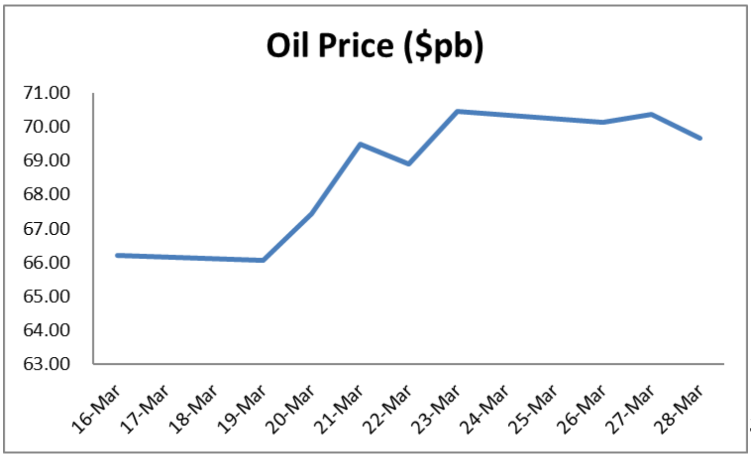
COMMODITIES MARKET - EXPORTS

Oil Prices

Oil prices increased by 5.21% to close at $69.66pb on March 28th from $66.21pb on March 16th. Average price for the period was $68.74pb compared to $66.09pb in the corresponding period in February. Year to date, the price of Brent has averaged $67.14pb.

During the review period, oil prices reached a 2-month high of $70pb before retreating to $69.66pb on March 28th. This increase in oil prices was driven by strict adherence to OPEC's production quota system, sharp decline in Venezuela's oil output as a result of its political and economic crisis as well as a decline in Iraq's oil exports.

[31]Source: CBN



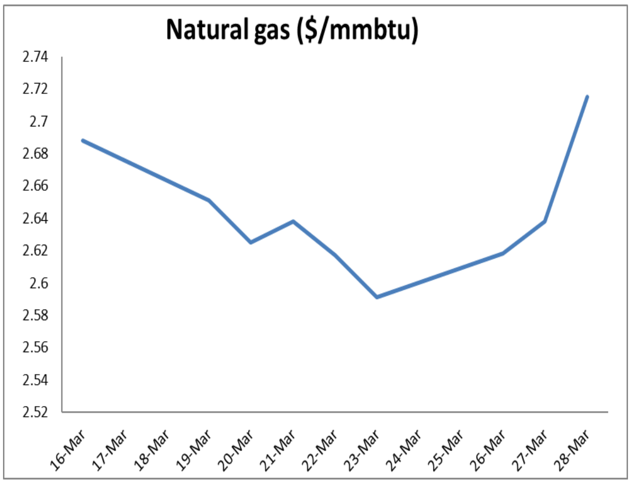
[32]

Outlook

Oil prices are likely to remain within the band of $65pb to $70pb due to strong market fundamentals. The risks to this outlook remain rising shale oil production and US crude inventories.

Natural Gas

Natural gas increased by 1.00% during the review period to close at $2.715/mmbtu on March 28th. The average price for the period was $2.64/mmbtu compared to $2.74/mmbtu recorded in the first half of the month. This was due to a decline in demand as Brazil cut its gas importation by 75%, owing to increased production.



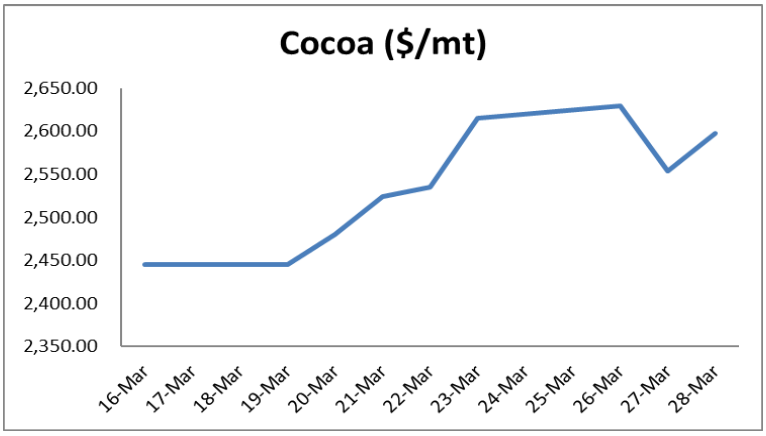
[33]

Outlook

We expect the price of natural gas to increase further due to higher global demand for gas and a reduction in EU output.

Cocoa

Cocoa price closed the month of March 6.22% higher at $2,597/mt on March 28th from $2,445/mt on March 16th. Prices increased during the period before declining on March 27th.



[32]Source: Bloomberg
[33]Source: Bloomberg

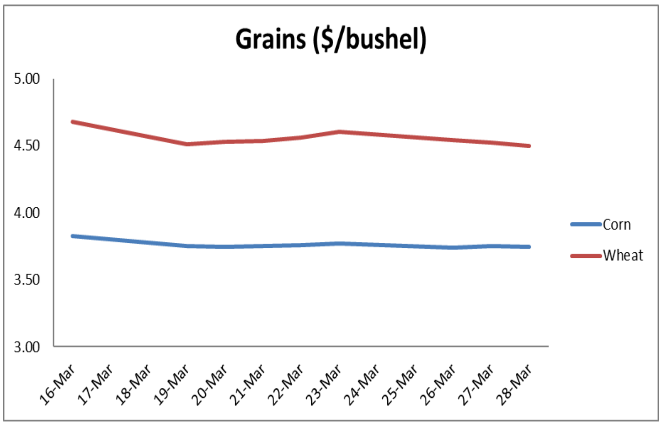
Outlook

Land for rubber plantations attract a higher price compared to the land used for cocoa cultivation. Hence land owners are leasing more land for the production of rubber. The will ultimately reduce the land available for the production cocoa and the supply. The anticipated decline in supply will push up the price of cocoa.

IMPORTS

Wheat

Wheat prices trended downwards during the review period to close at $4.50/bushel on March 28thowing to improved weather conditions in U.S planting regions.



[34]

Corn

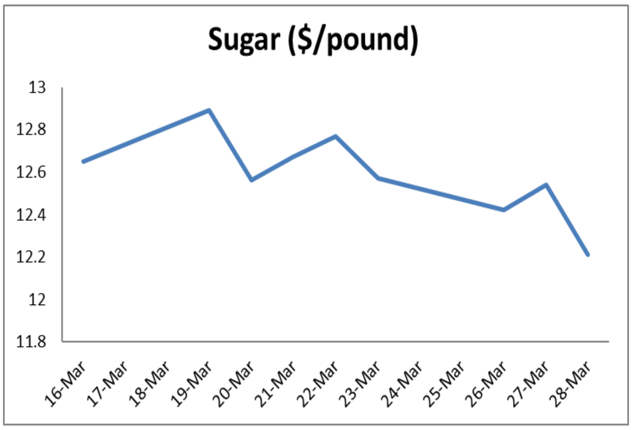
Corn prices declined 2.35% to close at $3.74/ bushel on March 28th from $3.83/bushel on March 16th consequent upon strong Ukrainian output.

Grains- Outlook

According to the National Weather Service, widespread showers are expected in parts of south western Kansas and the Oklahoma. This may boost crops that are emerging from over-wintering.

Sugar

Sugar prices declined by 3.48% to close at $0.1221/ pound on March 28th from $0.1265/pound on March 16th, owing to a decrease in demand as firms (Nestle) respond to the target set by the Public Health England to reduce sugar in chocolate by 20% in 2020 with 5% cut in the first 12 months.



[35]

Outlook

As the UK government begin its Sugary drinks levy in April, we expect chocolate and confectionary firms to adhere strictly to the target thereby reducing the demand for sugar further. The price is expected to ease as demand drops.

[34] Bloomberg.

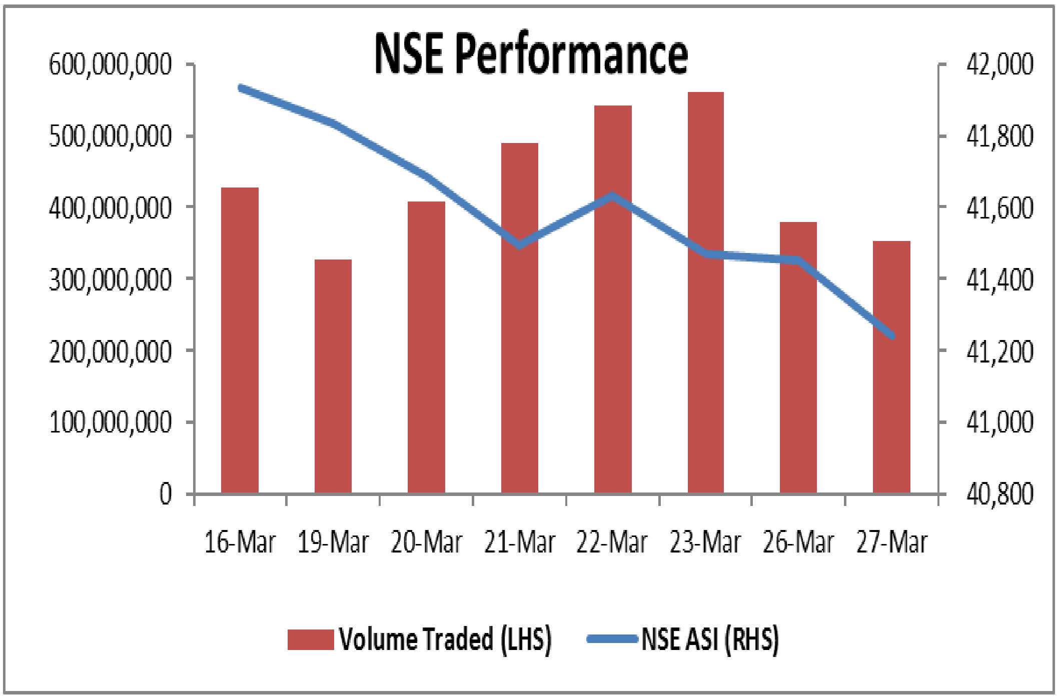
[35] Bloomberg.

STOCK MARKET UPDATE

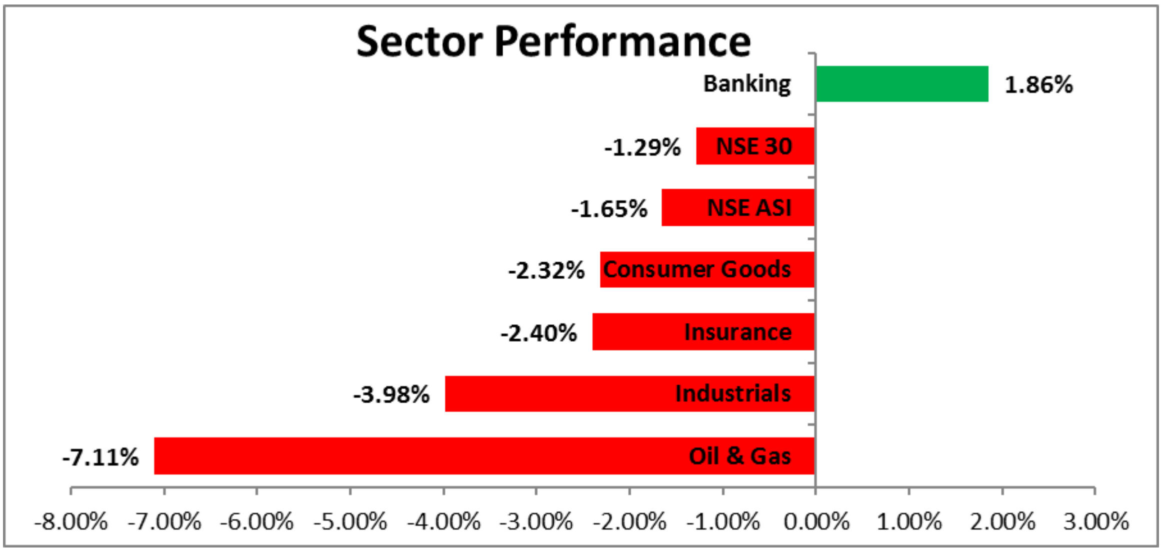
The Nigerian stock market maintained its bearish performance into the second half of March 2018 (up to March 27) despite the pickup in crude oil prices. The NSE ASI lost 1.65% to close at 41,243.24 points on March 27, 2018. However, Brent oil prices surged 5.89% during the same period to close at $70.11pb. This affirms that the stock market might be heading for a market correction.

Like the NSE ASI, market capitalization slipped 0.51% to N14.9trn during the period. The market was particularly dragged down by large cap stocks, as investors were largely unimpressed by company results and corporate actions released so far.

The stock market is currently trading at a price to earnings (P/E) ratio of 11.15x, a marginal decline over mid March, which closed at 11.94x. In addition, market breadth remained negative at 0.75x, as 41 stocks gained, 75 remained flat and 55 declined. However, this is a marginal improvement over the first half of March of 0.63x.



Trading activities on the stock market slowed further in the second half of March. Average volume declined by 18.35% to 436 million units, with average turnover moving in the same direction, losing 25.53% compared to the first half of March. Financial services stocks maintained dominance over trading volumes, accounting for 76.15% of trading activities during the second half of the month.



With the exception of the banking sub sector index, all indices recorded a contraction during the review period. In a twist of events, the banking and oil & gas indices reversed positions in the second half of March. The banking sector, which was the biggest loser in the first half of March, reversed some of its losses to outperform its peers in the second half of March. It recorded a gain of 1.86% during the period. Sequel to the sharp sell-offs of banking stocks, new investors took positions in some undervalued banking stocks with little downside risks.

Conversely, oil and gas index, the best performing index in the first half of March, plunged. The index lost 7.11% in the second half of March in spite of the pickup in Brent oil prices of 5.89%.

Healthcare stocks led the gainers' chart, as Glaxo Smithkiline and Fidson recorded appreciations of 47.14% and 14.29% respectively. Fidelity (11.69%), Eterna (10.53%) and Transnational Corporation of Nigeria (10.06%) also featured among the advancers.

Top Gainers

Symbol	Mar 27'18 Price	Mar 16'18 Price	Change	% Change	PE Ratio
GLAXO SMITHKLINE CONS NIG.	30.90	21.00	9.90	47.14%	15.54
FIDSON HEALTHCARE PLC	6.00	5.25	0.75	14.29%	9.33
FIDELITY BANK PLC	2.58	2.31	0.27	11.69%	4.84
ETERNA PLC.	6.30	5.70	0.60	10.53%	4.51
TRANSNATIONAL CORP. OF NIG.	1.86	1.69	0.17	10.06%	-

The par value rule maintained its overwhelming effect on the laggards, as all stocks in the top losers' chart were priced below 50 kobo. FTN Cocoa Processors sustained its downward trend, losing 28.57% of its value. However, insurance stocks dominated the losers' chart, as Niger Insurance (-19.05%), African Alliance Insurance (18.52%) and Mutual Benefits Assurance (15.91%) all lost a substantial part of their value. Tantalizers also featured among the decliners.

Top Losers

Symbol	Mar 27'18 Price	Mar 16'18 Price	Change	% Change	PE Ratio
FTN COCOA PROCESSORS PLC	0.20	0.28	- 0.08	-28.57%	-
NIGER INSURANCE CO. PLC.	0.34	0.42	- 0.08	-19.05%	3.13
AFRICAN ALLIANCE INS. COMPANY	0.22	0.27	- 0.05	-18.52%	-
MUTUAL BENEFITS ASSURANCE	0.37	0.44	- 0.07	-15.91%	-
TANTALIZERS PLC	0.37	0.44	- 0.07	-15.91%	-

OUTLOOK

Choppy stock trading will persist in the short-term, as profit taking activities will undermine the performance of stocks with attractive yields and robust earnings. However, investors will maintain positions in stocks with strong fundamentals, as more corporate earnings are released.

EQUITY REPORT - OKOMU OIL PALM NIGERIA PLC

ANALYST'S NOTE

The Nigerian government has identified agriculture as a means of export revenue diversification since the plunge in crude oil prices in 2014. As a result, the agricultural sector has been one of the main beneficiaries of the government's intervention programs (access to credit and level of protection by regulatory agencies). An example is the Central Bank of Nigeria's (CBN) ban of 41 items (including palm oil products) from accessing foreign exchange on the official market. This was a major support to agricultural firms like Okomu Oil Palm Nigeria Plc (Okomu). Imported palm oil products became relatively expensive and thus unattractive. (The possibility of a change in policy cannot be totally ruled out, considering the numerous policy turnarounds by the regulatory agencies).

Analyst Recommendation: *HOLD*

Market Capitalization: *N68.68 billion*

Recommendation Period: *3 Months*

Current Price: *N72.00*

Industry: *Agriculture*

Target Price: *N73.34*

Furthermore, agriculture is increasingly becoming attractive to investors in Nigeria's capital market as the sector continues to grow. The two agricultural companies listed on the Nigeria Stock Exchange (NSE) – Presco and Okomu – recorded year to date (YTD) returns of 5.84% and 6.38%, respectively. Okomu grew in both its palm oil and rubber segments. Its palm oil segment posted revenue of N14.37bn in 9M'17, a 51.6% increase compared to N9.48bn recorded in 9M'16. Its rubber segment recorded a 54.73% increase in sales in 9M'17(N2.21bn), representing 13% of top-line earnings.

In determining Okomu's intrinsic valuation, we considered current financial performance, growth prospects, expansion plans, competitive positioning and macroeconomic fundamentals. We believe that Okomu's current price is hovering around its intrinsic valuation. Accordingly, we place a HOLD rating on the company's stock.

Double digit top-line growth in Q3'17 offset by weak gross margin and tax

Okomu posted sales of N4.11bn in Q3'17, 22.1% higher than sales of N3.37bn recorded in Q3'16. Similarly, profit before tax (PBT) increased by 13.5% to N1.44bn in Q3'17 from N1.20bn in Q3'16. Growth in PBT was relatively slow due to a 1,093 basis point (bps) decline in gross margins to 71.02% and the rise in operation expenses by 11.33% to N1.62bn in Q3'17.

Profit after tax (PAT) declined by 73% to N158.93mn in Q3'17 from N580.53mn in Q3'16. This decline was driven primarily by a 3,672 bps expansion in the effective tax rate from 51.61% in Q3'16 to 88.33% in Q3'17.

9M'17 earnings growth driven by a fall in finance costs

Okomu reported revenue of N16.59bn in 9M'17 (a 52% increase) compared to N10.91bn recorded in 9M'16. Although its gross margin contracted by 342bps and operating expenses rose by 13.04% to N4.88bn in 9M'17, these changes were not enough to offset its strong sales growth. In the same vein, Okomu posted PBT of N9.23bn, 79.5% higher compared to N5.34bn recorded in 9M'16. PAT grew by 53.13% to N6.39bn in 9M'17 due to a 76.03% fall in net finance costs.

Decline in quarter-on-quarter earnings driven by seasonality

Okomu posted revenue of N4.11bn in Q3'17, which represents a 38% decline of N6.58bn from Q2'17. This decline was driven primarily by seasonality as Q3 is usually a weak quarter for oil palm companies. A positive net finance cost of N64.84mn in Q3'17 from N105.96mn recorded in Q2'17, and a 20% decline in operating expenses was not sufficient enough to offset the sales decline in the period.

Furthermore, PBT declined by 69.16% to N4.42bn in Q3'17 from N1.36bn in Q2'17 while PAT fell by 94.98% to N158.93mn in Q3'17 from N3.17bn in Q2'17. These results were due to a 60% increase in tax rate.

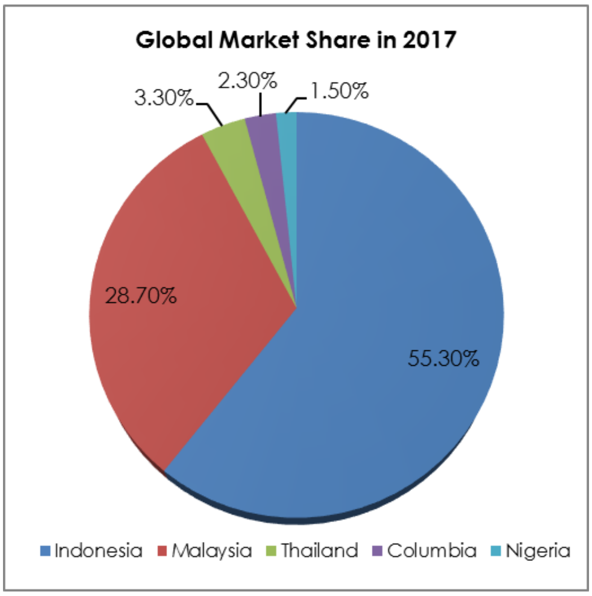
The Nigerian palm oil industry has been underperforming over the years due to the lack of improved seedlings, outdated and inefficient machinery, poor milling infrastructure, failure of previous government policies and inaccessibility of land. The industry is highly fragmented and dominated by small-holder palm oil farmers who account for over 90% of locally produced crude palm oil (CPO).

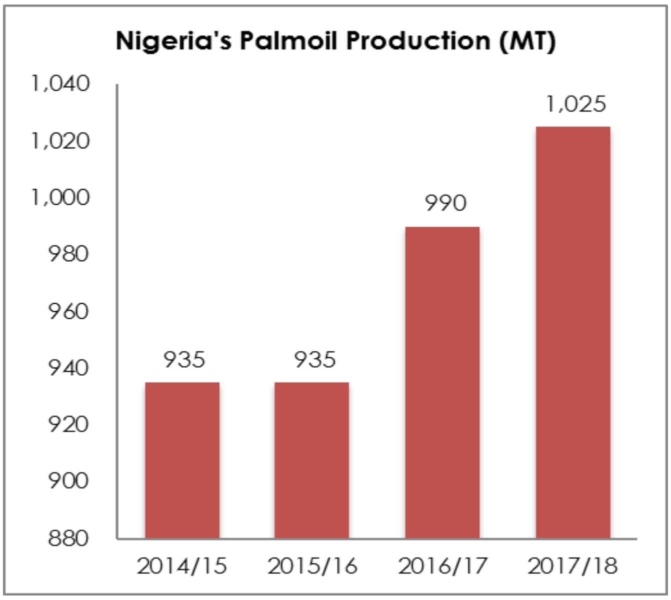
In the early 1960s, Nigeria was the world's largest palm oil producer with a global market share of 43%, supplying over 645,000 metric tons (MT) annually. As a result, palm oil was one of Nigeria's major sources of foreign exchange (forex) contributing approximately 82% to Nigeria's export revenue. However, by 1967, Indonesia and Malaysia displaced Nigeria as the world's leading producer and exporter.

The change in market share was because of the Nigerian civil war (1967-1970), which took place in predominantly oil palm producing states, destroying plantations and displacing small land holders of palm oil. Today, Nigeria is the fifth largest producer of palm oil globally and first in Sub-Saharan Africa (SSA), producing approximately 990,000MT. However, Nigeria's domestic demand outweighs production as domestic and industrial demand is approximately 2.8mnMT. Nigeria is now a net importer of palm oil with a supply gap estimated at 1.8mnMT.

In June 2015, the Central Bank of Nigeria (CBN) banned importers from accessing foreign exchange for 41 items including CPO, which resulted in an increase in demand of locally produced palm oil. Importers of palm oil were subject to the fluctuations of the naira in the parallel market. This provided a competitive advantage in pricing for local producers of palm oil. However, due to the huge supply gap, the CBN granted indigenous importers waivers as many companies had the refining capacity but no palm oil.

Figure 1 Global Market Share of Leading Palm Oil Producers & Nigeria's Palm Oil Production





The two major players in the domestic market include Presco and Okomu. Both companies are listed on the NSE. Other players include PZ Wilmar and DUFIL Prima Foods. However, Presco and Okomu remain the most recognized brands in crude oil palm production in Nigeria. Players in the sector cater to the industrial needs of a range of customers (consumer goods, cosmetics and pharmaceutical companies). Okomu is Nigeria's second largest producer of palm oil.

Okomu Oil Palm Plc began in 1976 as a federal government pilot project aimed at revamping the oil palm industry in Nigeria. The company was incorporated as a limited liability company on December 3, 1979. In 1990, Okomu was privatized. However, in 1997, Okomu was converted to a public limited company. The majority of Okomu's shares are held by Socfinaf SA (62.69%) and the remaining 37.31% by the Nigerian public.

Okomu operates through two segments: palm oil products and rubber products. (The rubber business segment comprises about 20% of Okomu's total revenue). Its principal activities include the cultivation of oil palm, processing of fresh fruit bunches into crude palm oil for resale, rubber plantation and processing rubber lumps to rubber cake for export. Its products include Banga Palm Oil, quality Noko 10 Rubber, Palm Kernel Cake, Palm Kernel Oil and Crude Palm Oil.

The company's growth can be seen through an increase in its total assets and revenue over the years.

Income Statement for Okomu Plc (FY Dec 2016)

N'000	2013	2014	2015	2016
Revenue	8,860,425	8,655,718	9,738,015	14,364,736
Other work performed by the entity capitalized	152	656,858	1,448,193	2,293,062
Changes in inventories of the finshed goods and WIP	(289,244)	100,328	(41,170)	145,543
Raw materials and consumables used	(1,589,087)	(2,071,942)	(1,803,659)	(3,305,572)
Other external charges	(2,063,217)	(2,244,939)	(2,885,254)	(2,658,798)
Employee expenses	(774,433)	(899,865)	(728,909)	(790,476)
Depreciation on property, plant & equipment	(706,541)	(734,977)	(916,786)	(960,333)
Depreciation on bearer biological assets	-	(223,500)	(228,288)	(234,786)
Other expenses	(1,956,344)	(1,477,914)	(1,490,374)	(2,016,548)
Other income	1,120,206	192,070	186,413	114,734
Profit from continuing operations	2,601,917	1,951,837	3,278,181	6,951,562
Finance income	102,295	85,701	43,111	291,273
Gain on disposal of assets	22,896	8,534	6,534	4,206
Finance costs	(33,553)	(141,576)	(429,181)	(1,340,588)
Profit before tax	2,693,555	1,904,496	2,898,645	5,906,453
Companies income tax charge	(324,381)	(344,541)	(239,038)	(996,180)
Deferred tax charge	(277,000)	(230,000)	-	-
Profit after tax	**2,092,174**	**1,329,955**	**2,659,607**	**4,910,273**

Balance Sheet for Okomu Plc (FY Dec 2016)

N'000	2013	2014	2015	2016
Property, plant & equipment	6,507,126	10,255,455	9,848,681	9,217,423
Biological assets	19,692,910	5,111,060	7,395,989	9,399,803
Non-current assets	26,200,036	15,366,515	17,244,670	18,617,226
Inventories	1,319,903	1,415,552	1,490,595	1,719,080
Trade and other receivables	133,971	105,304	62,856	121,086
Intercompany receivables	136,810	-	-	467,379
Other receivables	1,077,483	626,875	296,592	384,643
Cash and bank balance	1,182,444	358,082	905,527	3,198,251
Current assets	3,850,611	2,505,813	2,755,570	5,890,439
Total assets	**30,050,647**	**17,872,328**	**20,000,240**	**24,507,665**
Share capital	476,956	476,956	476,955	476,955
Share premium	1,867,095	1,867,095	1,867,096	1,867,096
Revenue reserves	20,273,107	7,260,471	9,801,309	14,667,990
Equity attributable to equity holders of the company	**22,617,158**	**9,604,522**	**12,145,360**	**17,012,041**
Deferred tax liabilities	2,924,091	1,704,811	1,733,273	1,755,473
Post-employment benefits obligations	659,999	496,256	352,650	315,965
Non-current financial liabilities	1,266,667	1,477,305	3,386,168	2,416,252
Non-current liabilities	4,850,757	3,678,372	5,472,091	4,487,690
Trade payables	415,242	772,216	888,636	641,148
Other current payables	179,784	97,585	67,477	114,929
Current provisions and accruals	148,555	359,328	483,085	429,810
Borrowings	400,000	2,285,898	340,417	372,351
Current tax payable	1,302,970	1,003,014	530,201	1,386,231
Retirement benefit obligations	72,716	-	-	-
Dividend payable	63,465	63,465	63,465	63,465
Intercompany payables	-	7,928	9,508	-
Current liabilities	2,582,732	4,589,434	2,382,789	3,007,934
Total liabilities	7,433,489	8,267,806	7,854,880	7,495,624
Total equity and liabilities	**30,050,647**	**17,872,328**	**20,000,240**	**24,507,665**

[36]

[36]Source: Okomu Oil Plc Annual Reports

MANAGEMENT

Mr Gbenga Oyebode

Chairman

Mr G D Hefer

Managing Director

The ability of Okomu's management to sustain returns and drive output in a period of weak economic growth can be attributed to its diversified business segments (oil palm and rubber).

To further drive growth and improve earnings, management has formally commissioned its Extension Two (2) Estate at Ovia North East Local Government Area of Edo state. This enables the company to establish a second oil palm mill which will increase Okomu's production capacity and financial returns.

Okomu is led by a highly talented and experienced team that drives the company towards sustainable growth. Mr G Oyebode is the Chairman of Okomu and has developed significant experience in project finance, corporate law, energy and natural resources, telecommunications and aviation law. He has served as a director of Nestle, Socfinaf SA, MTN Nigeria Ltd and Access Bank Plc. He has an LLB Honors from the University of Ife, Nigeria and an LLM Honors from the University of Pennsylvania, Philadelphia.

Mr G D Hefer is the Managing Director of Okomu Oil Palm Plc. He has served as an Executive Director since2007. He has an MSc and PhD in Agriculture. Mr. Hefer has held Director positions at Tongaat Cotton Limited and Noordelike Sentrale Katoen. He has also held the position of Lecturer/Research Fellow at the University of Natal. Under his visionary leadership, Okomu has expanded its plantation size and oil mill capacity to grow its revenue and production capacity.

THE BULLS SAY

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

THE BEARS SAY

* Intense competition from leading players such as Presco, PZ Wilmar
* Change in government policies could affect the competitiveness of companies in the agricultural sector, particularly the palm oil sector
* Persistent macroeconomic headwinds could dampen consumer demand for palm oil products

Risks and Outlook

The major risks that could prevent Okomu from achieving its goals of increasing production capacity, boosting earnings, and managing costs include currency risks, interest rate risks and possible changes in government policy.

Okomu is exposed to currency risk on sales, purchases and borrowings of raw materials denominated primarily in US dollars and euros, while it makes local payments and collects receipts in naira. The company mitigates these risks by holding foreign currency bank accounts, which act as a natural hedge for such transactions. Another risk is an increase in interest rates, which arises from trade finance for financing its transactions. The company mitigates this risk through negotiations with banks.

In relation to government policy, any change in policy towards agriculture and forex restrictions could affect Okomu's earnings potential. A policy reversal on the ban of oil palm from accessing foreign exchange on the official market will prove to be quite detrimental to the competitiveness of Okomu as it will hurt its market share and earnings.

Shocks in the global commodity market are a major threat to Okomu. The anticipated glut in global supply due to favorable weather conditions will lead to a plunge in global market price thereby encouraging importation. This in turn will dampen the company's earnings despite the foreign exchange restriction on imported oil palm.

The risks facing Okomu could limit management's ability to drive growth and sustain returns. Even though management has put structures in place to ensure sales growth and cost efficiency, the macroeconomic headwinds facing the company may be beyond the control of its competent leadership.

APPENDIX - Valuation

We derived our valuation for Okomu Oil Nigeria Plc by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate for Okomu Oil stood at N73.34, which is a 1.86% upside on its current share price of N72.00 as at March 19, 2018. The discount rate [weighted average cost of capital (WACC)] of 18.3% is derived using a 16.2% risk free rate, a beta of 0.3787, and a market risk premium of 6.4%. The calculated long-term cash flow growth rate to perpetuity is 4%.

DCF Valuation

N'000	2017E	2018E	2019E	2020E	2021E
EBIT	8,695,286	9,782,992	11,141,345	11,869,974	12,336,538
Less: Taxes	(1,466,543)	(1,649,996)	(1,879,095)	(2,001,985)	(2,080,676)
EBIAT	7,228,742	8,132,997	9,262,250	9,867,989	10,255,862
Plus: D&A Expense	1,804,035	2,148,179	2,344,456	2,394,044	2,586,755
Less: CAPEX	(900,000)	(945,000)	(992,250)	(1,041,863)	(1,093,956)
Less: Change in working capital	(388,610)	4,909	99,635	55,556	107,875
Free Cash Flow (FCF)	7,744,167	9,341,085	10,714,091	11,275,726	11,856,537
WACC	18.3%	18.3%	18.3%	18.3%	18.3%
Present Value (PV) of FCF	6,545,535	6,673,261	6,469,438	5,754,746	5,114,579

	2017	2018	2019	2020	2021
Terminal value					86,155,765
Present value of terminal value	37,165,195				

DCF Calculation	
PV of explicit period	30,557,560
PV of terminal value	37,165,195
Enterprise Value	67,722,755
+ Cash	3,198,251
- Borrowings	(957,113)
Equity Value	69,963,893
Share price	73.34
Shares outstanding ('000)	953,910