# FDC Bi-Monthly Update

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# Inside This Issue:

# IMF REAFFIRMS NIGERIA'S ECONOMIC GROWTH PROJECTIONS AT 2.1% IN 2018


The IMF, in its latest World Economic Outlook, reaffirmed its growth forecasts for Nigeria at 2.1% in 2018. According to the Fund, this growth will be driven by stronger oil price, stable production, and improved foreign exchange availability. On the other hand, global growth is expected to reach 3.9% in 2018, substantially above its October 2017 estimates of 3.7%. This increase is premised on output acceleration in advanced economies and a recovery of major commodity exporters. However, the downside risks include rising global debt, geopolitical tension, as well as monetary tightening among key economies.

Global debt hit a record high of $164trn in 2016, representing 225% of the world's output. Emerging markets, of which Nigeria is among, are recording historic highs of public debt. According to the DMO, Nigeria's total debt stock in 2017 increased to approximately N21trn ($70bn).

The cost of servicing this debt remains high at 63% as estimated by the IMF. Although the Fund did not include Nigeria in its schedule of heavily indebted countries, an increasing debt profile hinders the government's ability to spend more when it really counts (in a recession or recovery phase).

Rising public debt burden remains a key downside risk to the projected global growth, increasing the risk of debt distress. This is because a higher debt service cost will crowd out investments in capital project as debt servicing will dominate recurrent spending.

However, to mitigate against this risk, the IMF recommends that tax bases of emerging countries should be broadened. This ranges from removing tax exemptions to improving the collection process and increasing the taxes such as VAT. Whilst this point of view has some merit, a country like Nigeria just exiting a recession, needs injections. Taxes are withdrawals and increasing the tax base at a time when growth should be stimulated through investments and increased government spending in capital projects may prove counterproductive. We will recommend that the collection process is made more efficient and then widening the tax base (higher taxes rates-VAT, etc) is staggered in order to avoid strangulating the economy of the much needed funds.

# ALARMING RATE OF EMIGRATION

It is no longer news that the Nigerian economy is challenging for business owners and employers alike. Immigration in the past few decades was mainly intra-continental, following the lucrative gold mines and rail lines in Ghana and trading prospects in the Ivory Coast. However, a steady worsening of living and business conditions in most African economies has led to an increase in youths seeking greener pastures outside the shores of the continent, and often by any means possible. In 2017 alone it is estimated that 3,000 Nigerians died attempting to cross the Mediterranean Sea to European countries, while in Libya, there are Nigerians currently stranded, tortured and traded as slaves.

If Nigeria is to stem the tide of this dangerous trend of illegal immigration it must take action both to improve the overall economic prospects of the country and to support businesses of youths in the country.

Emigration remains a response to a pull of opportunities and a push of poverty. With an estimated population of 193.3 million, an output growth rate of 0.8% and unemployment rate of 18.8%, the odds are against the Nigerian youth. Demand pressures on limited job opportunities have left many jobless and vulnerable. The displacement of over 33 million Nigerians, owing to conflict and social unrest, has also pushed more Nigerians below the poverty line ($1.90) and heightened their desperation to leave the country for better prospects. Additionally, the fear of limited prospects for the next generation is driving many families to relocate to advanced economies.

## Migration patterns

The rising population leaving Nigeria sadly cuts across the nation, affecting both educated and uneducated citizens. A recent survey reported that one in three Nigerians have considered emigrating with reasons ranging from job hunting to escaping poverty, and a pursuit of better schools and business prospects.[1] The health sector is currently suffering from a huge deficit of doctors driven largely by a heightened rate of annual resignation. The Nigerian Medical Association (NMA) has reported that about 12% of registered doctors have relocated to advanced countries while others are taking exams necessary for relocation.[2] The main drivers of the sector's brain drain remain a lure of

advanced technologies and facilities together with prospects for career advancement in destination countries. Poor educational facilities have also led to education emigration in pursuit of relevant skill sets. At the tertiary level the rate is estimated at 36%. Popular destination countries for relocation include the United Kingdom, Canada, Australia and the United States, all G20 countries with a high GDP per capita and high output growth rates.

Sadly, there is also an increase in the number of young people searching for greener pastures through illegal means. Many Nigerian youth risk their lives trying to cross the Mediterranean Sea in a bid for a better life. While Nigeria's human development indices – poverty and unemployment – are high and rising, the extreme risks associated with illegal immigration suggest that greater education and awareness is needed so youth truly understand the choice they are making. Research shows that potential emigrants are being charged exorbitant prices, sometimes as high as N1million,[3] with the assurance of safe arrival to their destinations.

[1]CLEEN Foundation. December 18, 2017. https://afrobarometer.org/sites/default/files/press-release/Nigeria/nig_r7_pr2_youth_large_majority_of_potential_nigerian_emigrants_18122017_1.pdf

[2]Chukwuma Muanya. February 13, 2018. "Health sector dips as more Nigerian doctors move abroad". The Guardian. https://guardian.ng/features/health-sector-dips-as-more-nigerian-doctors-move-abroad/

[3]Segun Akande. January 19, 2018. "Are people smugglers the good guys or bad guys?" *Pulse.ng.* *http://www.pulse.ng/gist/pop-culture/are-people-smugglers-the-good-guys-or-the-bad-guys-id7867138.html*

These guarantees have, however, proved largely false as the emigrants often end up in slave markets or die in transit. The choice to spend these high amounts to embark on such a dangerous journey instead of setting up a small-scale business in Nigeria speaks of a high level of frustration and desperation.

## Impacts of increased emigration

There are arguments for and against migration out of Nigeria. Advocates for emigration argue that people leaving the country are likely to increase Diaspora remittance inflows. Nigeria's large population in Diaspora is reflected in its high remittance inflow, one of the largest in SSA. Inflows into the country from citizens abroad reached a high of $20.11 billion in 2016 from approximately $2.27 billion in 2004.[4] These remittances also serve as a survival strategy for many families, offering them a lifeline to pay rent and procure basic utilities. There is also an argument that a rise in emigration reduces pressure on Nigeria's resources. The more people leave the country the more jobs, output is available for the citizens left behind. Meanwhile, opponents argue that an increase in the number of people leaving Nigeria would worsen the brain drain in sectors across the country.

## Way Forward

Notwithstanding the support for emigration, it is important to address the root causes of the exodus. The increasing rate of emigration from Nigeria is not due to an absence of deterrence policies. Collaborative efforts with Niger and other neighboring states have been made in the past to report illegal Nigerian emigrants. However, people would always find a way if they lack opportunities, a conducive business environment and prospects for a brighter tomorrow. A good starting point in fixing this would be increased investment in the country's infrastructure. Countries such as Hong Kong, the United Kingdom, Japan and Switzerland, which are known for their developed infrastructure, have a higher rate of immigration than emigration. Infrastructural development would have ripple effects on the country's business environment and subsequently the ease of doing business. Medical and educational induced emigration is also likely to reduce provided facilities are up-to-date.

[4] Source: World Bank. October 2017. http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data

Finally, the risks and rates of illegal emigration have become so grave that Nigeria needs to start confronting this topic openly, as a nation.

The extremely high risks of a dangerous journey in pursuit of a 'better life' must be emphasized. Youth development programs aimed at teaching useful skill sets can help to keep young people busy and less susceptible to a false allure. In addition, the government can highlight the risks for illegal refugees in the popular destination countries. For instance, countries such as Canada, Australia have prosecution punishments for illegal emigrants.

In conclusion, failure to address the increasing rate of exit from Nigeria would have adverse effects in the long term. The already high human capital deficit would worsen and people would only explore more dangerous means to leave the country. Future generations would miss out on the rich Nigerian culture and lose a sense of patriotism.

# OPTIMIZING PORTFOLIO PERFORMANCE IN LINE WITH THE BUSINESS CYCLE

Different asset classes, i.e. equities, fixed income (bonds), and derivatives, often exhibit time variations in their risks and return characteristics over the business cycle. When we talk about the business cycle we are referring to the fluctuation/movement in the aggregate economy. The movement affects the underlying fundamentals that affect the prices of assets. For example, in the economic recession phase of the business cycle, asset classes, such as equities, tend to perform negatively compared to other classes, such as fixed income (government bonds). During Nigeria's recession, the Nigerian Stock Exchange All Share Index (NSE-ASI) lost over 20% from January - August 2016. Meanwhile, fixed income assets, such as Treasury bills (T/bills), were yielding interest rates as high as 18%per annum (pa). The high interest rates on government securities, which are relatively risk free, saw investors and portfolio managers adjust their asset allocation toward the fixed income asset class. This demonstrates that the best strategy is to optimize portfolio performance and adjust investments to suit the varying phases of the business cycle.

## Phases/Stages of the Business Cycle

To determine an optimal portfolio strategy that maximizes returns compared to risks, it is essential to examine different asset classes relative to the business cycle. There are four major phases of the business cycle, namely: expansion, peak, contraction and recession.

- **Expansion:** The expansion phase is characterized by increasing economic growth, increased employment, as firms hire workers to meet rising demand, and the upward pressure on prices. Monetary policy tends to move towards an easing cycle. During expansion, risky assets, such as equities, are often the best-performing asset class, benefiting from sustained acceleration in economic growth and increased corporate earnings. Thus, investment strategies that put a higher weight on equities will optimize the investor's return. The presence of inflationary pressures makes fixed income investments (government bonds) a less desirable asset class as inflation erodes the real income of fixed earners.

- **Peak:** This is the highest point of the business cycle. As the economy continues to expand, inflation intensifies and interest rates rise. High interest rates tend to weigh on corporate profitability as the cost of funds/capital as well as labor increases. In this phase, all asset classes deliver similar returns in line with cash yields, which are rising because of the high interest rate environment.

- **Contraction:** This phase is symbolic of an overheated economy. It is typified by slow economic growth against the backdrop of tight monetary policy and declining corporate margins. Sales growth tends to decline due to weak demand. Risky assets such as equities tend to perform relatively low as corporates' profitability declines. Thus, a portfolio strategy, which reduces exposure on equities, is advised. Investor and fund managers could also invest in utilities, healthcare and consumer staples. The demand for these commodities is fairly inelastic. As a result, profit margins of companies within the sector would be fairly stable.

- **Recession:** The recession phase features negative growth in gross domestic product (GDP) and decline in corporate profits. Monetary policy moves towards a more accommodative one as the government attempts to stimulate economic activities. During a recession, risk free assets, such as government bonds, are often the best-performing asset class. This is largely due to the combination of investors' risk aversion and aggressive monetary policy easing in attempt to reignite economic growth. In this environment, the appropriate asset allocation strategy is one which reduces risk exposure by underweighting exposures to equities and credit, and overweighting on high grade government bonds.

**Tools to anticipate the Business Cycle**

An array of tools/indicators developed by reputable research institutes and government authorities can be employed by investors' in order to predict the business cycle. These include the Business Cycle Indicators (BCI) and the Purchasing Managers Index (PMI).

- **Business Cycle Indicators (BCI):** The BCI was created by the Conference Board.[5] It includes the composite leading indicator and coincident indexes, which is often used to forecast fluctuations in the overall economy of a country. The BCI can be used to confirm or predict the peaks and contraction of the business cycle. The composite leading indicator (CLI) is designed to provide early signals of turning points in business cycles showing fluctuation of the economic activity around its long term potential level. On the other hand, the composite coincident indicator provides a broad-based measurement of current economic condition in order to determine what phase of business cycle that the economy is experiencing.

- **Purchasing Manger's Index (PMI):** The PMI is an indicator that signals the health of the manufacturing sector. It provides information about current economic/business conditions to company decision makers, investors and analysts. For example, during the expansion phase, PMIs tend to increase at a steady pace as businesses hire more workers to meet rising consumer demand.

The Nigerian economy recovered from its first economic recession in 25 years as GDP expanded by 1.4% in Q2'17. This put the economy in the recovery phase i.e. early expansion. Thus, a general portfolio strategy, which increases exposure to the risky asset class such as equities and real estate, should optimise portfolio/investment returns over the risk free rate (Treasury bills). However, specific decision on which equity to include in a given portfolio would require additional fundamental analysis. For example, valuation metrics such as the price earnings ratio (P/E ratio) and price earning to growth ratio (PEG) could be employed to narrow down on specific equity.

In conclusion, there are strong fundamental linkages between economic growth, corporate earnings, the health of balance sheets, the ability of companies to invest productively, and consumers' ability to spend. Thus, when the business cycle is expanding, risky asset classes —equities

[5] The Conference Board is a non-profit research organization for businesses that distributes information about management and the marketplace. It is a widely quoted private source of business intelligence.

and credit in particular—perform well, and when in a recession or an economic downturn, risk-free assets, such as government bonds, outperform. It is imperative that investors and portfolio managers anticipate the business cycle through leading economic indicators, such as the Purchasing Mangers' Index (PMI) and adopt a dynamic asset allocation strategy that can be easily adapted to the fluctuations in the aggregate economy.

# AS FEARS OF HIDDEN DEBT MOUNT, AFRICA ISSUERS FACE MORE SCRUTINY


African Eurobond issuers face more scrutiny in the wake of questions about the true extent of the debt loads of Zambia and the Republic of Congo.

Few investors expect the situation in either nation to be as bad as that of Mozambique, where the discovery of hidden loans two years ago triggered a financial crisis and sovereign default. Still, several are querying whether their external liabilities are greater than public figures suggest. Zambia denied on Friday it is hiding debt and showed budget documents detailing borrowing. The Republic of Congo also denied concealing debt.

The development may complicate funding plans for African governments and companies. Rising geopolitical tensions in the Middle East and Russia and a tightening of monetary policy in the U.S. are making conditions tougher for emerging-market borrowers and prompting investors to be more scrupulous.

“In a rising tide, all boats are lifted,” said Ronak Gopaldas, a London-based analyst at Signal Risk, which advises companies in Africa. “But when the cycle turns, that’s when countries with ‘bad politics and bad economics’ are exposed. Investors will scratch below the surface more.”

Zambia's dollar-bond yields rose to the highest in more than a year last week as lenders including Bank of America Corp. and Nomura International Plc raised concerns about the government's official numbers for foreign debt. The securities have lost 2.4% this year, making them the worst performers in Africa in the Bloomberg Barclays Emerging Markets USD Sovereign Bond Index.

Bank of America said in an April 11 note that the continent's second-biggest copper producer may have contracted $10bn of new loans since 2015 that could increase its debt burden by the equivalent of 30% of Gross Domestic Product within five years. While a default in the near-term is unlikely, "debt worries are justified," said analysts Rukayat Yusuf and Andrew MacFarlane, who are based in London.


The government on Friday reiterated previous statements that its external debts were $8.7bn at the end of December, or around a third of economic output.

## 'Nothing to Hide'

The International Monetary Fund, which is in talks with Zambia and Republic of Congo about providing them loans, said this month that the latter needs to clarify exactly what it owes bilateral and commercial lenders. The central African oil producer's 2029 Eurobond yields have climbed around 180 basis points this year to more than 10%.

Republic of Congo has "nothing to hide" and "all financial transactions or debts with its bilateral and multilateral partners have already been given to the IMF," Thierry Moungalla, Minister of Communications, said.

The lack of transparency is often worse among oil exporters that haven't disclosed whether they've pledged future shipments to service debts, according to Bloomberg Economics' Mark Bohlund.

## Debt Ratio

The problems aren't reflective of Africa overall, but may make investors nervous about buying new bonds from the continent, he said. Fitch Ratings Ltd. said last week that refinancing risks in sub-Saharan Africa are rising and that the region's average government debt ratio had climbed about 20 percentage points in the past six years to more than 50% of GDP.

"In favorable market or economic conditions, investors lacking adequate transparency are inclined to assume credit fundamentals are in line with available information," London-based Bohlund said. "But this bias often switches with an adverse shift in those conditions. Investors fear that the situation is worse than what available information suggests."

Luckily for African borrowers, investors still crave higher yields at a time when those in the developed world remain near historical lows. Governments including Nigeria, Ivory Coast, Kenya and Egypt have sold more than $15 billion of Eurobonds so far in 2018, which is almost a full-year record for the continent.

## 'Broad Brush'

Bank of America kept a market-weight, or neutral, recommendation for Zambia's debt even as it said the chances of the IMF lending the government money anytime soon were slim.

With yields of around 8% on Zambian Eurobonds, "an underweight position would be expensive given the loss of carry," the analysts said.

"Although headlines about Zambia and Republic of Congo over the past couple of weeks have stirred memories of Mozambique's hidden debt crisis, it would be a mistake to use a broad brush," said Brett Rowley, a managing director at TCW Group Inc. in Los Angeles, which oversees $200 billion. A further sell-off of Zambian securities would probably present a buying opportunity, he said.

Still, the jitters over the two won't help other borrowers, especially with investors less bullish about emerging markets, according to Gopaldas of Signal Risk. Average African dollar yields have already risen 66 basis points since early January to 6.31 percent, according to Standard Bank Group Ltd.

"Zambia and the Republic of Congo's issues are more pronounced than those of other countries," he said. "But there are others with unsavory politics and weak balance sheets who could easily lose market confidence. There are a lot of countries in the firing line."


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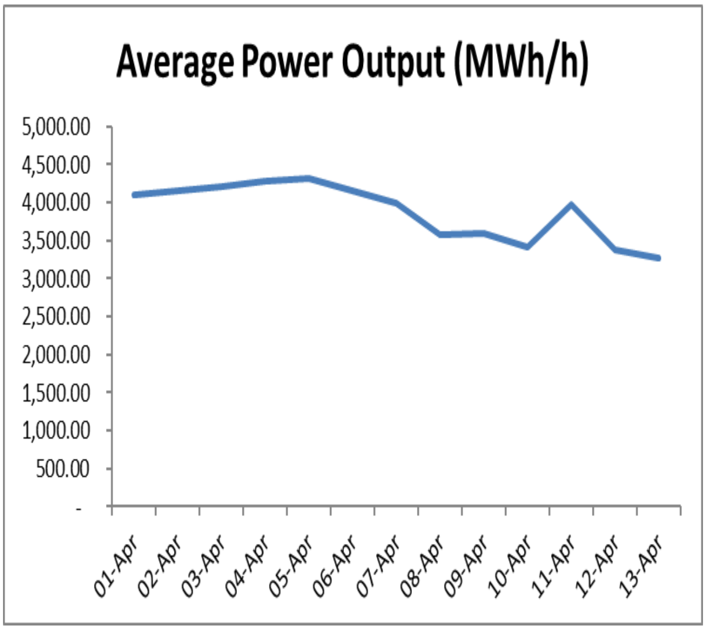
# MACROECONOMIC INDICATORS

## POWER SECTOR

On the average, the on-grid power output was 3,876.92MWh/h for the period April 1st – 13th. This was 4.86% lower than the average output of 4,075.15MWh/h in the corresponding period in March. During the review period, power output reached its peak at 4,310MWh/h on April 5thsupported by increased output at Azura-Edo IPP and Ibom. However, output dipped to its lowest level during the period of 3276MWh/h on April 13th. This was as a result of reduced output at Sapele.



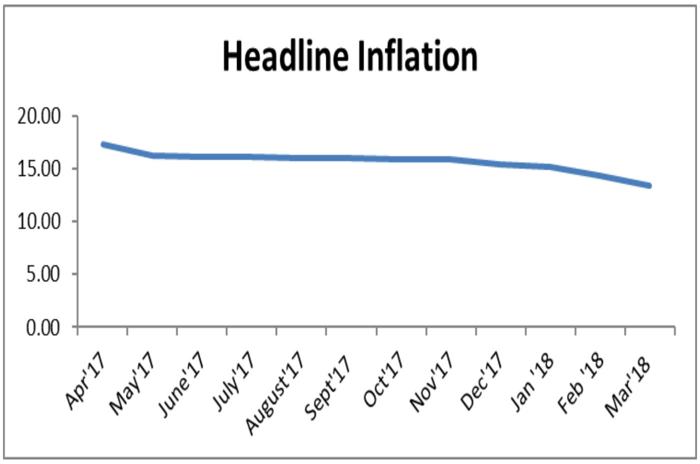
[6]

**Outlook**

As the rainy season commences, hydro generated power is expected to increase. However, gas constraint remains a major threat to total power supply.

## INFLATION

Headline inflation declined for the 14th consecutive month to 13.34% in March. This represents a 3.92% decline from the rate in the corresponding period in 2017. The decline in inflation was driven by the base year effect, stability in exchange rate and external reserves accretion.



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**Outlook**

In April, we expect to see a flattening of the slope as inflation reaches a point of inflection. Factors such as food shortages as a result of the planting season, and the start of the Ramadan fast in May will trigger cost push factors.

[6]Source: Nigerian Electricity Supply Industry; FDC Think Tank

[7]NBS; FDC Think Tank

# MONEY MARKET

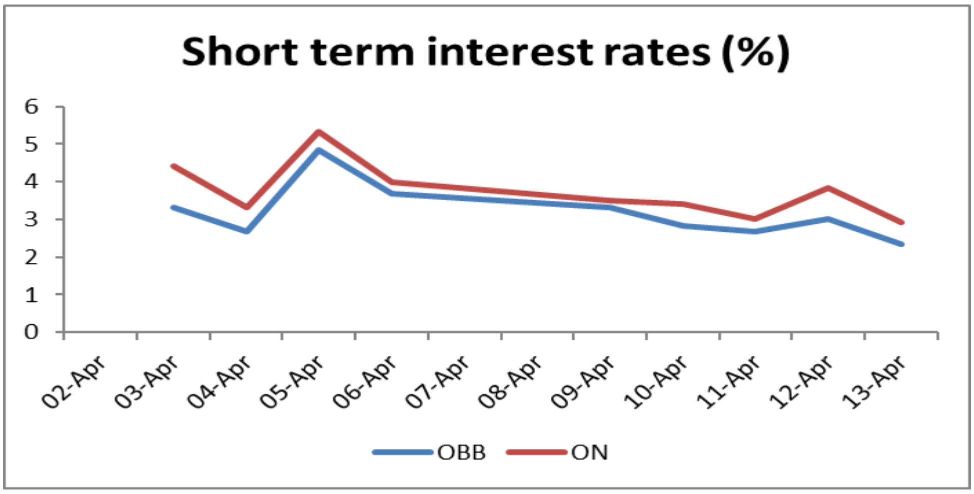
The average liquidity was N622.69bn long for the period April 1st – April 13th, compared to N265.60bn long in the corresponding period in March.

During the period, the total OMO issue stood at N1.59trn, 114.86% increase compared to N740bn in the corresponding period in March. Total OMO maturity for the period was N571.4bn compared to N109.4bn in the corresponding period in March. The net OMO issue during the period was 57.94% higher than the corresponding period in March.

At the primary market, yields on T/bills recorded a downward trend in the April 4th auction, to close at 11.75%, 12.7% & 13.04% for the 91-day, 182-day & 364-day tenors respectively.

| Tenor (Primary market auction) | Stop rates as at March 21st, 2018 (%) | Stop rates as at April 4th, 2018 (%) |
|---|---|---|
| 91-day | 11.95 | 11.75 |
| 182-day | 13.0 | 12.7 |
| 364-day | 13.15 | 13.04 |

The NIBOR (OBB/ON) rate averaged 3.52% pa for the period April 1st – April 13th. This was 6.81% lower than the average value of 10.33% in the corresponding period in March. During the review period, OBB & ON reached a high of 4.83% pa and 5.33% pa on April 5th respectively before retreating to close the period at 2.33% pa and 2.92% pa respectively.



[8]

## Outlook

The money market has been highly liquid due to the non issuance of OMO bills. FAAC disbursements are expected towards the end of the month and this will further boost liquidity. If the CBN fails to intervene in the market, the low level of interest rates will persist due to high liquidity. Also, we expect T/bills rates to maintain the downward trend owing to waning appetite for fixed income securities.

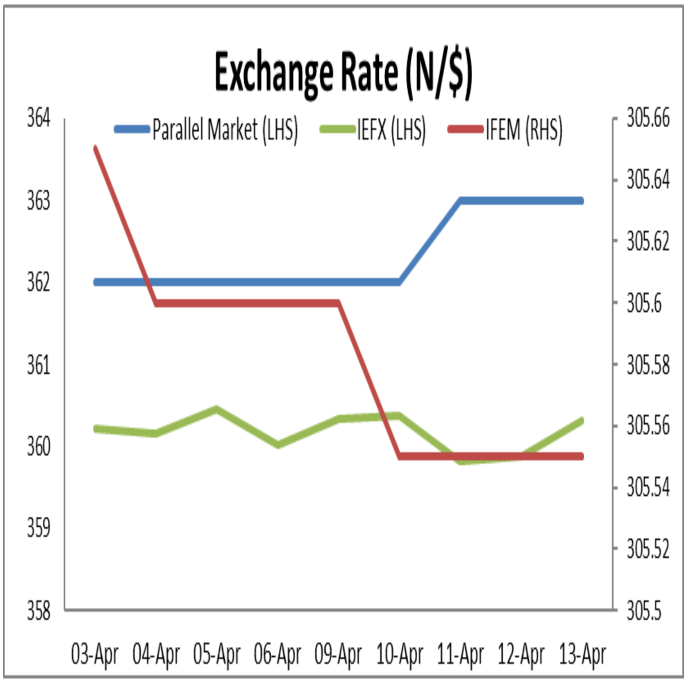
[8]Source: CBN, FMDQOTC, FDC Think Tank

## FOREX MARKET

### Exchange Rate

At the parallel market, the naira opened the month at N362/$ on April 1st and traded flat till April 10th before depreciating to close at N363/$. At the IEFX window, the naira traded within the tight band of N360.21/$ and N360.32/$. The total turnover at the IEFX window was $2.46bn for the period April 1st – April 13th compared to $2.73bn in the corresponding period in March.

The IEFM rate was flat within a range of N305.55/$ to N305.65/$.



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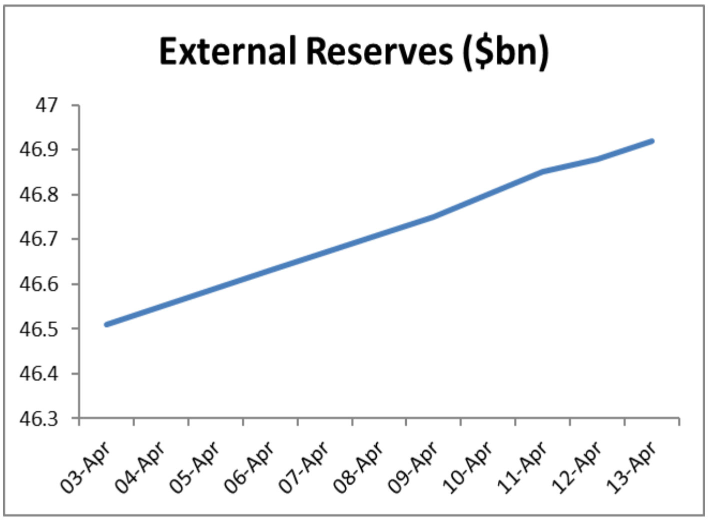
### Outlook

If the increased liquidity in the money market persists, this could exacerbate forex demand pressures. Nonetheless, we expect the CBN to maintain its interventions in the forex market especially with a robust external reserves level.

## EXTERNAL RESERVES

External reserves accretion was higher at 0.88% ($410mn) during the period of April 1st – April 13th. As at April 13th, Nigeria's gross external reserves level was $46.92bn. This is an 18- month high. Higher oil proceeds and a muted forex demand continue to impact positively on the level of accretion.



[10]

[9]Source: FDC Think Tank

[10]Source: CBN, FDC Think Tank

**Outlook**

We expect the external reserves accretion to persist increasing on the back of sustained oil revenue and favourable macro-economic fundamentals.

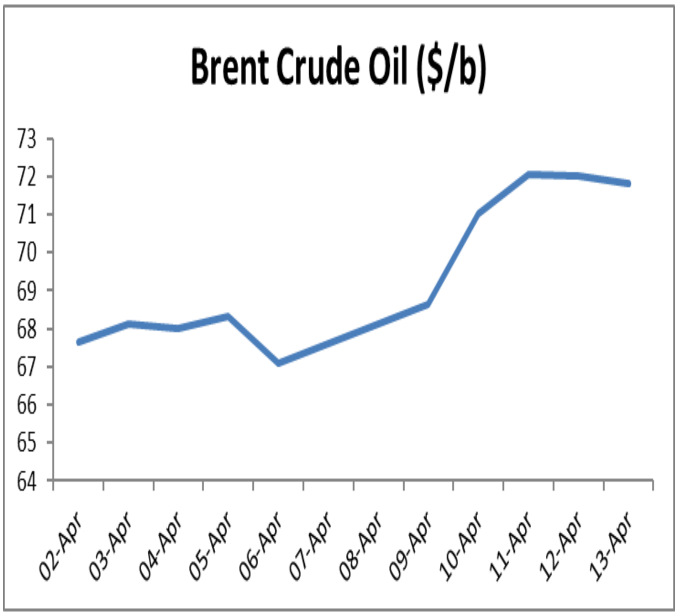
However, as the election period approaches, we expect accelerated demand for forex owing to an increase in naira liquidity. The election period is associated with political risk which is likely to pose constraints to foreign portfolio investment and trigger a reversal.

## COMMODITIES MARKET - EXPORTS

### Oil Prices

Oil prices increased by 7.3% to \$72.58pb on April 13th from \$67.64pb on April 1st. the average oil price during the review period was \$69.56pb during compared to \$64.73pb in the corresponding period in March.

During the review period, oil prices reached a Year to date peak of \$72.58pb on April 13th. This was supported by the geopolitical tension in the Middle East and OPEC's report which shows a decline in output in March.

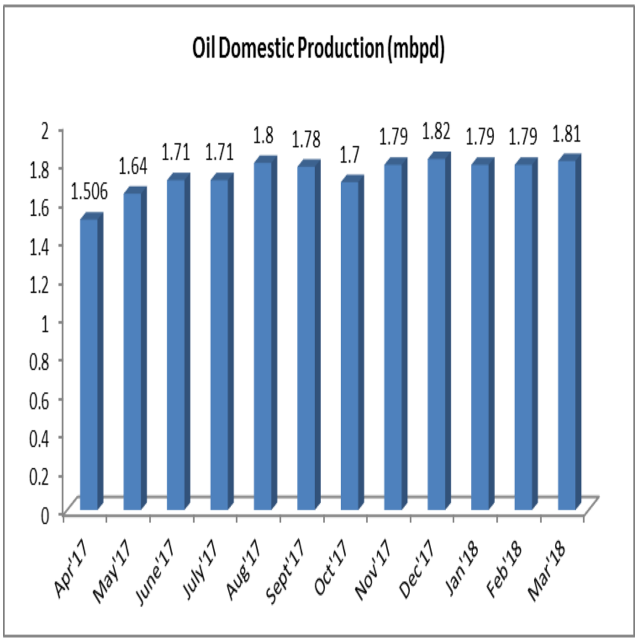


[11]

### Oil Prices

Oil production hit 1.81mbpd in March, the highest level year-to-date (YTD). This improvement in output contributed positively to the country's external reserves accretion. In spite of this good news, this is the level at which Nigeria's production has been capped by OPEC. Any further expansion in production could trigger a negative reaction from OPEC especially if sustained.

[11]Source: Bloomberg, FDC Think Tank



[12]

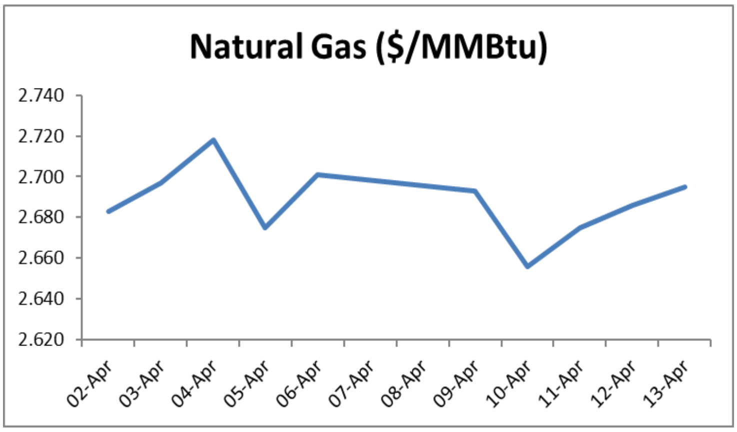
## Outlook

We expect oil prices to increase further if the Middle East tensions persist. However, the growing US shale oil production & crude inventories are threats to this positive trend.

Also, oil production is expected to remain stable at 1.7mbpd-1.8mbpd, barring any social unrest and pipeline vandalism in the Niger Delta region. OPEC will be meeting in Vienna, Austria on June 22. If Nigeria's production levels continue to cross the imposed cap of 1.8mbpd, it could form one of the considerations at the meeting.

## Natural Gas

The average price of Natural gas for the period April 1st – April 13th was $2.688/mmbtu. This represents a 1.97% decline compared to $2.742/mmbtu recorded in the corresponding period in March.



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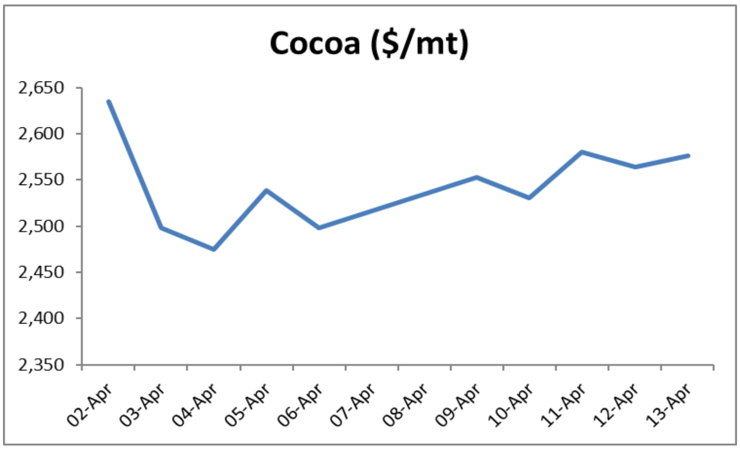
## Cocoa

Cocoa prices declined by 2.24% to $2,576/mt on April 13th from $2,635/mt on April 1st. This decline was driven by increased cocoa output in India.



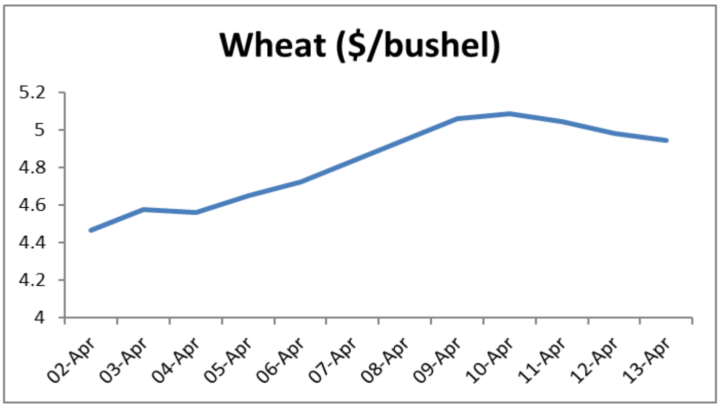
[14]

[12]Source: OPEC, FDC Think Tank
[13]Source: Bloomberg, FDC Think Tank
[14]Source: Bloomberg, FDC Think Tank

## IMPORTS

### Wheat

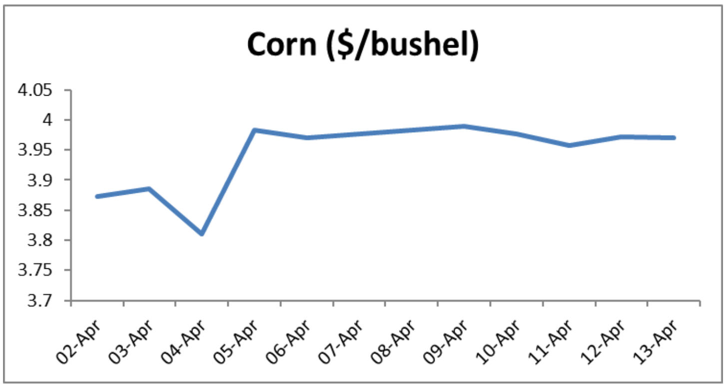
Wheat prices increased by 10.81% to $4.95/ bushel on April 13th from $4.46/bushel on April 1st. During the period, wheat price hit a high of $5.09/bushel before retreating to close the period at $4.95/bushel.



[15]

### Corn

Corn prices increased by 2.52% to close at $3.97/bushel on April 13th from $3.87/bushel on April 1st.During the period, corn prices touched a high of$3.99/bushel on April 9th.



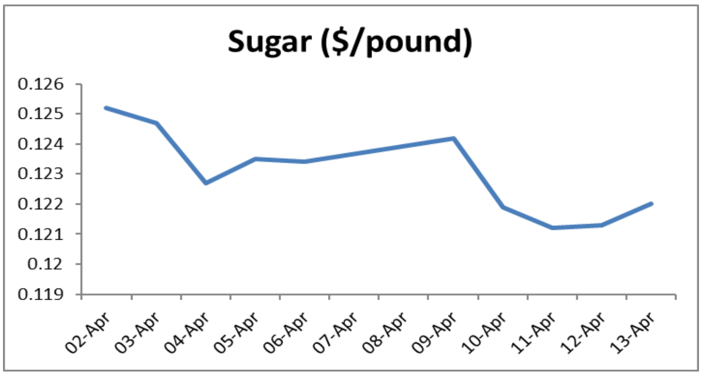
[16]

**Grains- Outlook**

We expect an improvement in crop yields and quality as weather conditions remain favourable. This could depress prices.

### Sugar

Sugar prices dipped 2.56% to $0.122/pound on April 13th from $0.1252/pound on April 1st, supported by the competition between local and imported sugar. Sugar prices reached a low of $0.1212/pound on April 11th before picking up.



[17]

**Outlook**

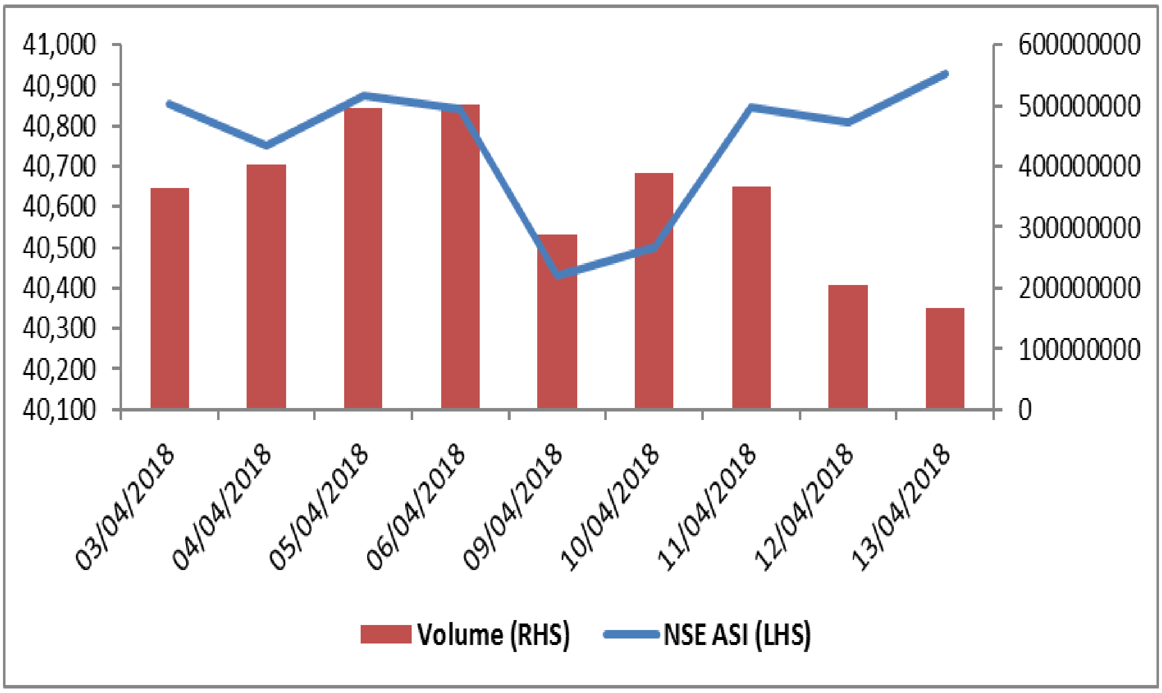
As health concerns receive global attention, we expect global demand for sugar to drop forcing prices down. Also, with the implementation of the UK government sugary drinks levy, we expect strict compliance by chocolate and confectionary firms, thereby reducing demand for sugar with the likely effect of a fall in price.

[15] Bloomberg, FDC Think Tank
[16] Bloomberg, FDC Think Tank
[17] Bloomberg, FDC Think Tank

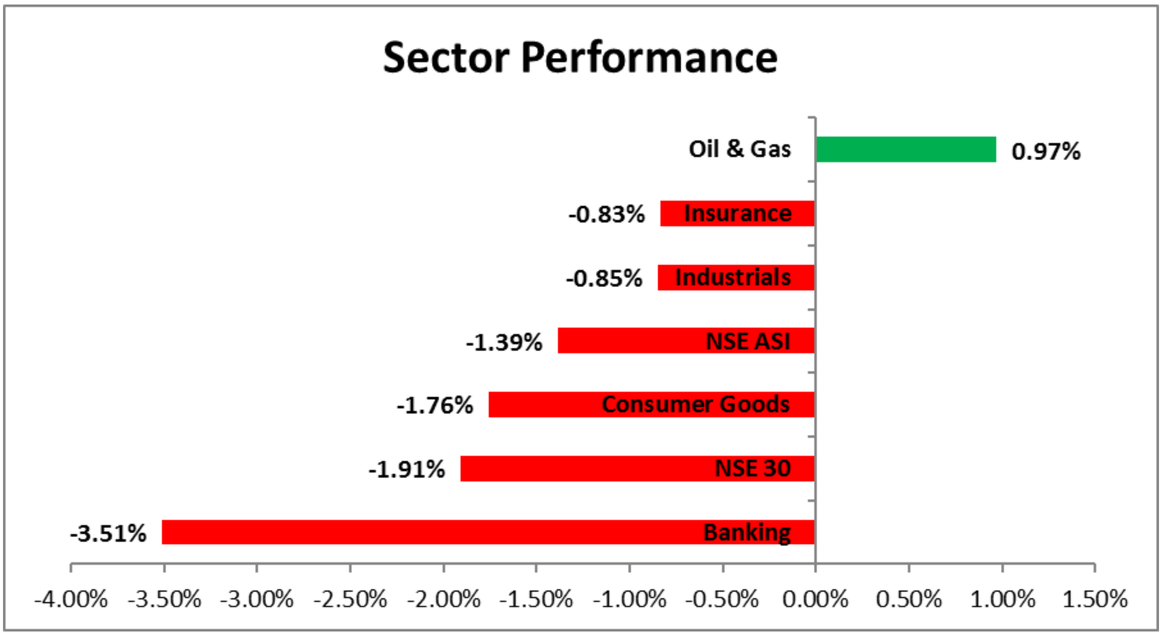
# STOCK MARKET UPDATE

The performance of the Nigerian bourse was relatively flat in the first half of April, as the NSE ASI recorded a marginal increase of 0.18% to close at 40,928.70 points on April 13, 2018. Like the NSE ASI, market capitalization recorded a negligible increase of 0.17% to close the period at N14.78trn. Despite this flat line performance, the NSE ASI reached a three-month low on April 9, as the index dipped to 40,429.18 points, as major stocks recorded price losses.

The price to earnings ratio (P/E) at the end of the first half of April was 12.11x, an improvement over mid March, which closed at 11.94x. Like mid March, market breadth remained negative at 0.63x, as 31 stocks gained, 89 remained flat and 49 declined.




Trading activities on the bourse slowed further in the first half of April. Average volume dipped by 49.64% to 352 million units over the first half of March, with average value moving in the same direction. Average of daily turnover declined by 32.5% to N5.13bn. Financial services stocks remained the most traded on the stock market, accounting for 81.88% of trading activities during the first half of April.




With the exception of the oil and gas sector, all indices recorded a contraction in the first half of April. The banking sub-index was the worst performer among the NSE indices, as it lost 3.51% of its value in less than 10 trading days. This can be largely attributed to profit taking activities, reversing its gains in the month of March.

The sub-sector indices were led by the oil and gas index in the first half of April. The index recorded a marginal gain of 0.97%, partly due to Brent oil prices, which rallied by 3.29% in the first half of April to $72.58pb.

The gainers chart was led by Learn Africa which advanced by 18.56%. Oando was the second best performing stock in the review period. The boost was triggered by the lifting of its technical suspension on April 11, 2017. The stock gained 15.19% in value. Prestige Assurance (13.95%), LASACO Assurance (11.76%) and May & Baker (8.27%) also featured among the gainers.

Top Gainers

| Symbol | Apr 13'18 Pr | Mar 29'18 Pric | Change | % Change | PE Ratio |
|---|---|---|---|---|---|
| LEARN AFRICA PLC. | 1.15 | 0.97 | 0.18 | 18.56% | 4.31 |
| OANDO PLC | 6.90 | 5.99 | 0.91 | 15.19% | 1.42 |
| PRESTIGE ASSURANCE CO. PLC. | 0.49 | 0.43 | 0.06 | 13.95% | 3.52 |
| LASACO ASSURANCE PLC. | 0.38 | 0.34 | 0.04 | 11.76% | 4.20 |
| MAY & BAKER NIGERIA PLC. | 2.88 | 2.66 | 0.22 | 8.27% | 21.22 |

The losers chart featured a diverse mix of stocks. The worst performing being C&I Leasing (-18.02%). It was closely followed by NEM Insurance (-16.08%), Glaxo Smithkline (-13.92%), Dangote Flour (-13.82%) and Courteville Business Solutions (-12.5%).

| Top Losers | | | | | | |
|---|---|---|---|---|---|---|
| **Symbol** | **Apr 13'18** | **Mar 29'18** | **Change** | | **% Change** | **PE Ratio** |
| C & I LEASING PLC. | 1.41 | 1.72 | - | 0.31 | -18.02% | 2.41 |
| N.E.M INSURANCE CO (NIG) PLC. | 2.40 | 2.86 | - | 0.46 | -16.08% | 5.61 |
| GLAXO SMITHKLINE CONSUMER NIG. PLC. | 30.00 | 34.85 | - | 4.85 | -13.92% | 15.09 |
| DANGOTE FLOUR MILLS PLC | 13.10 | 15.20 | - | 2.10 | -13.82% | 4.33 |
| COURTEVILLE BUSINESS SOLUTIONS PLC | 0.21 | 0.24 | - | 0.03 | -12.50% | 20.17 |

## REGULATORY ACTION

After 176 day, the NSE lifted its technical suspension on the trading of Oando shares. As a result, the stock gained 15.19% after just two trading days. This is a trend that might be maintained in the short-term, as the stock lost out on the market rally in Q4'17.

## OUTLOOK

Bargain hunting activities are expected to continue on the Nigerian bourse, as investors take position in underpriced stocks. In addition, investors will maintain position in companies with robust dividend policies.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# CORPORATE FOCUS - DANGOTE FLOUR MILLS PLC

## ANALYST'S NOTE

The Nigerian manufacturing sector was one of the hardest hit during the recession (Q1'16 - Q1'17). Even today it continues to face challenges due to increasing input costs, tight monetary and fiscal policy, security challenges in the North-East region and low consumer confidence despite an improving economy. Weak macroeconomic factors, such as a high inflationary environment (headline inflation at 14.33% in January 2018) and foreign exchange (forex) shortages continue to affect the industry negatively. During the collapse of global oil prices in 2014 and the disruption in oil production in the Niger Delta, consumers' purchasing power also declined. This resulted in a major shift from premium products to value-branded products. This move to value-brands remains even with an improving economy.

Dangote Flour Mill was able to turn around from a loss-generating company during the recession and has since continued to record positive results. The company's FY'17 results show that revenue rose by 18.6% to N125.44bn while profit before tax surged by 89.86% to N22.09bn. This will mark the second consecutive growth for the company.

Even though Dangote Flour Mill was resilient in a weak macroeconomic environment, using intrinsic valuation and taking into consideration possible risk factors, its share price is currently overvalued. Accordingly, we place a SELL rating on Dangote Flour Mills Plc.

DANGOTE FLOUR

**Analyst Recommendation:** *SELL*

**Market Capitalization:** *N65.50 billion*

**Recommendation Period:** *365 Days*

**Current Price:** *N13.10*

**Industry:** *Agriculture*

**Target Price:** *N8.50*

## Top-line growth sustained in FY'17

DangoteFlour Mills posted a revenue of N125.44bn in FY'17, an 18.6% increase compared to N105.77bn in FY'16. This was due to the increase in its product prices in the financial year. As a result, flour sales increased by 31.97% year-on-year(y-o-y) to N107.81bn in FY'17. Its pasta segment (spaghetti, macaroni and other pasta products) stood at N16.61bn, a more moderate sales growth of 5.97% y-o-y.

## Effective cost management drives earnings growth

Dangote Flour Mills posted strong bottom-line earnings for FY'17. Profit before tax (PBT) surged by 89.86% to N22.09bn while profit after tax (PAT) increased by 43.14% to N15.13bn from N10.57bn in FY'16. A lower finance cost of N2.84bn (down 42% y-o-y) was recorded, due to an improvement in net debt to N347.88mn from a negative of N4.22bn in FY16. The company did not post any foreign exchange losses during the period and this resulted in an increase in bottom-line earnings. However, except for the one-off income (N3.56bn) from the disposal of the company's noodles subsidiary, earnings from the core business were relatively flat at N11.56bn in FY'17.

## Declares dividend for the first time since FY'12

Dangote Flour Mills declared a final dividend of 20 kobo per 50 kobo ordinary share for the first time in over six years. This translates to a pay-out ratio of approximately 7% and dividend yield of approximately 1.5%.

## Mixed results in Q4'17

Dangote Flour reported weak sales in Q4'17 as revenue declined by 29% quarter-on-quarter (q-o-q). This was despite a 4% price increase in Q4'17. Flour sales declined by 30% while pasta sales were down by 31% in Q4'17. On a positive note, the company maintained its cost-efficiency strategy. Its operating expenses as a percentage of sales declined to 4%, an all-time low, compared to the 9% recorded in Q3'17.

Nigeria is the second largest consumer of wheat in Sub-Saharan Africa (SSA) - behind South Africa. Wheat is generally processed into flour, which is used for a wide range of food products including bread, noodles, pasta, cereal, and other savory snacks. Although Nigeria produced approximately 60,000 megatonnes (MT) of wheat (2016 statistics), the demand is higher at 4.63mn tonnes creating a huge demand gap of 4.57mn tonnes.[18] As a result, Nigeria imports approximately 90% of the wheat it needs, spending approximately $1.50bn (2016). This makes Nigeria the least-self sufficient country in wheat production in SSA.[19] Nigeria's low wheat production and overreliance on imports is primarily due to an unfavorable local climate to produce quality wheat, insecurities in the wheat belt region, low capacity utilization and erratic power supply.

The Nigerian flour milling industry has four major players: Flour Mills of Nigeria; Dangote Flour Mills; Olam International; and Honeywell Flour Mills. These four companies control over 75% of market share. The industry's profitability depends largely on the companies' abilities to increase sales volume. However, due to the high importation of wheat, surging global wheat prices remain a threat to the operations of flour milling companies. Wheat is currently priced at $178.61 (April 13, 2018).

Dangote Flour Mills commenced operations in 1999 as a division of Dangote Industries Limited (DIL). It was incorporated in 2006 following a strategic decision by DIL to unbundle its various operations. It was listed on the Nigerian Stock Exchange (NSE) in February 2008. The company started with an installed capacity of 500 MT/day at its Apapa mill and has since expanded rapidly by opening three mills in Kano (2000), Calabar (2011) and Ilorin (2005).

In 2012, the South African company, Tiger Brands, acquired 65.7% of Dangote Flour Mill for approximately $200mn. Tiger Brands, South Africa's largest consumer food maker, had hopes of turning the loss makingcompany around. Tiger Brands changed the name to Tiger Branded Consumer Goods Plc. However, in 2013, the company's losses increased to N7.2bn and by 2015, the company's share price plummeted to N1.23 from N9.

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

[19]Global Forecasting Service, 2018. "World Commodity Forecasts - Food, Feedstuffs & Beverages," The Economist Intelligence Unit, http://gfs.eiu.com/Archive.aspx?archiveType=commodities overview.

Consequently, in December 2015, Dangote bought back the company at $1 and currently holds a 75.67% stake in Dangote Flour Mills. The company was changed to Dangote Flour Mills Plc effective July 25th, 2016.

Dangote Flour had three wholly owned subsidiaries which included Dangote Pasta Ltd. (manufactures and sells macaroni, spaghetti & other pasta products), Dangote Agro Sacks Ltd and Dangote Noodles Ltd (manufactures and sells noodles). It disposed of Dangote Agro Sacks Ltd effective November 2015 for N7.55bn. Furthermore, it sold off its noodles business to Dufil Prima Foods, the makers of Indomie Noodles, to enable the company to focus on its strengths in flour and pasta, and improve on its quality, distribution and marketing of its products.

Its principal activities include the manufacturing and selling of bread and confectionery flour, wheat offal (bran), semolina and wheat meal. The company has high-tech plants and equipment that transforms wheat into high quality flour. Dangote Flour Mills has sustained growth for two consecutive years. This can be seen through the increases in its revenue and total assets. A snapshot of Dangote Flour Mill's latest annual financials from 2013 to 2017 is shown below.

**Income Statement for Dangote Flour Mills Plc (FY Dec 2017)**

| N'000 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Revenue | 29,960,419 | 41,268,771 | 48,026,674 | 105,765,324 | 125,444,270 |
| Cost of Sales | (29,317,791) | (38,057,750) | (43,558,620) | (76,417,616) | (96,011,138) |
| **Gross Profit** | **642,628** | **3,211,021** | **4,468,054** | **29,347,708** | **29,433,132** |
| Other Income | 233,975 | 302,997 | 1,177,590 | 1,382,450 | 1,151,635 |
| Distribution & Administrative Expenses | (6,743,190) | (7,993,657) | (9,788,360) | (11,804,608) | (12,058,061) |
| **Operating Profit Before Impairment & Foreign Exchange Losses** | **(5,866,587)** | **(4,479,639)** | **(4,142,716)** | **18,925,550** | **18,526,706** |
| Profit/Loss on Significant Disposals of Property | (130,678) | - | - | - | 3,565,285 |
| Foreign Exchange Losses | - | (360,212) | (1,775,755) | (3,940,279) | - |
| Impairment of Plant & Equipment and Investment | - | (1,592,372) | (2,658,820) | 1,050,659 | - |
| **Operating Profit/Loss from Continuing Operations** | **(5,997,265)** | **(6,432,223)** | **(8,577,291)** | **16,035,930** | **22,091,991** |
| Finance Income | 19,927 | 10,398 | 2,613 | 670,662 | 3,188,435 |
| Finance Costs | (2,364,956) | (2,863,188) | (3,891,530) | (4,887,626) | (2,840,555) |
| Net Finance Cost | (2,345,029) | (2,852,790) | (3,888,917) | (4,216,964) | 347,880 |
| **Profit/Loss Before Taxation from Continuing Operations** | (8,342,294) | (9,285,013) | (12,466,208) | 11,818,966 | 22,439,871 |
| Taxation | 1,577,990 | 3,006,708 | (213,097) | (1,249,679) | (7,310,665) |
| **Profit/Loss After Taxation from Continuing Operations** | (6,764,304) | (6,278,305) | (12,679,305) | 10,569,287 | 15,129,206 |
| Discontinued Operations | (452,697) | 168,797 | - | - | - |
| **Profit/Loss for the Year** | **(7,217,001)** | **(6,109,508)** | **(12,679,305)** | **10,569,287** | **15,129,206** |

| Balance Sheet for Dangote Flour Mills Plc (FY Dec 2017) | | | | | |
|---|---|---|---|---|---|
| **N'000** | **2013** | **2014** | **2015** | **2016** | **2017** |
| Property, Plant & Equipment | 30,002,456 | 26,342,645 | 23,027,073 | 25,103,593 | 31,150,740 |
| Investment in Subsidiaries | - | - | - | - | - |
| Intangible Assets | - | - | - | - | 239,218 |
| Deferred Tax Assets | 2,896,528 | 4,928,320 | 4,753,851 | 4,159,474 | 584,422 |
| **Non-current Assets** | 32,898,984 | 31,270,965 | 27,780,924 | 29,263,067 | 31,974,380 |
| | | | | | |
| Inventories | 9,372,457 | 5,429,059 | 5,738,870 | 10,784,629 | 28,347,918 |
| Amount Owned by Subsidiaries | - | - | - | - | - |
| Trade and Other Receivables | 7,789,466 | 6,933,990 | 5,102,397 | 9,480,169 | 8,992,460 |
| Cash and Cash Equivalent | 1,423,664 | 4,547,552 | 3,317,838 | 23,658,102 | 54,125,522 |
| Short Term Loans Receivable | 6,183,288 | 6,619,923 | 7,414,953 | 5,787,872 | 5,916,838 |
| **Current Assets** | 24,768,875 | 23,530,524 | 21,574,058 | 49,710,772 | 97,382,738 |
| Non-Current Assets Held for Sale | 17,813,681 | - | - | 6,143 | - |
| **Total Assets** | 75,481,540 | 54,801,489 | 49,354,982 | 78,979,982 | 129,357,118 |
| | | | | | |
| Share Capital | 2,500,000 | 2,500,000 | 2,500,000 | 2,500,000 | 2,500,000 |
| Share Premium | 18,116,249 | 18,116,249 | 18,116,249 | 11,527,612 | 11,527,612 |
| Foreign Exchange Reserve | - | - | - | - | |
| Capital Reserves | - | - | - | 23,276,829 | 21,412,878 |
| Retained Earnings/Loss | (4,305,067) | (10,524,972) | (23,052,118) | (12,443,563) | 2,121,367 |
| **Equity Attributable to Equity Holders of the Compar** | 16,311,182 | 10,091,277 | (2,435,869) | 24,860,878 | 37,561,857 |
| Non Controlling Interests | 1,795,343 | (483,145) | (635,304) | (674,572) | (110,296) |
| **Total Equity** | 18,106,525 | 9,608,132 | (3,071,173) | 24,186,306 | 37,451,561 |
| | | | | | |
| Deferred Tax Liabilities | 2,453,251 | 1,470,936 | 1,486,995 | 1,526,319 | 4,165,886 |
| Borrowings | 9,646,302 | 5,044,448 | 999,908 | 5,860,194 | 371,256 |
| **Non-current Liabilities** | 12,099,553 | 6,515,384 | 2,486,903 | 7,386,513 | 4,537,142 |
| | | | | | |
| Borrowings | 21,040,451 | 27,282,725 | 37,869,079 | 30,377,313 | 69,249,108 |
| Current Income Tax Liabilities | 238,448 | 171,276 | 184,526 | 788,968 | 1,330,264 |
| Trade and Other Payables | 11,992,772 | 9,841,355 | 9,929,759 | 16,240,882 | 16,789,043 |
| Bank Overdraft | 2,399,913 | 1,382,617 | 1,955,888 | - | - |
| Liabilities Held for Sale | 9,603,878 | - | - | - | - |
| **Current Liabilities** | 45,275,462 | 38,677,973 | 49,939,252 | 47,407,163 | 87,368,415 |
| **Total Liabilities** | 57,375,015 | 45,193,357 | 52,426,155 | 54,793,676 | 91,905,557 |
| **Total Equity and Liabilities** | 75,481,540 | 54,801,489 | 49,354,982 | 78,979,982 | 129,357,118 |

20

[20]Source: Dangote Flour Mills Plc Annual Reports

# MANAGEMENT

Mr. Thabo Mabe

Group CEO and Director of Board

Mr. Asue Ighodalo

Non—Executive Chairman

The company's management team has been able to sustain returns, drive growth and remain a major player in Nigeria's flour mill industry in a period of fragile economic growth. It re-positioned the company through expansion, an effective cost management strategy and focus on increasing shareholders value and offerings to customers. Its ability to sustain returns is evident as it maintained revenue growth during a period when many companies were challenged with tepid sales and enhanced shareholder value.

Mr Thabo Mabe joined Dangote Flour Mills in 2014 as the Group CEO and director of its Board. He started his career in Unilever Plc where he gained experience in manufacturing, production and sales. He held several leadership positions and eventually became the CEO of Unilever Plc for over four years. He holds a BSc Degree in Chemistry from Fort Hare University, South Africa.

Mr. Asue Ighodalo is the Non-Executive Chairman of the Board of Directors. He has a BSc in Economics from the University of Ibadan and a law degree from the London School of Economics and Political Science. He is also the Chairman of the Board of Sterling Bank Plc and sits on boards of public, private companies, and non-governmental organizations.

Management plans to continue repositioning the company to drive growth, focus on core businesses, manage costs and focus on maximization of shareholder value. It also plans to re-launch a new and improved pasta product, "Eccellente" with new packaging. The product is expected to reduce the dependency on rice consumption in Nigeria.

## THE BULLS SAY

* Leading player in the Nigerian flour mill industry
* Unrelenting government support for indigenous companies
* Rich product portfolio which ensures sustainability of revenue
* Proposed upward review of minimum wage in Q3'18 could bolster consumer spending
* Cost-effective management techniques
* Growing local demand for wheat related food products

## THE BEARS SAY

* Stiff competition from other leading players such as Flour Mills Nigeria Plc, Honeywell Flour Mills Plc and Olam International as well as smaller local flour mills
* Shocks in global wheat market as company imports hard red wheat from the US
* Persistent forex challenges could lead to higher cost of imported raw materials affecting earnings negatively
* Persistent macroeconomic headwinds have affected consumer demand for goods
* The Apapa gridlock continues to cause logistics issues
* Shift of market preference to low-priced products
* Poor infrastructure increases operating costs

## Risks and Outlook

The major risks that could prevent Dangote Flour Mills from achieving its goals of improving revenue and managing cost effectively include capital management risk, market risk (currency risk, interest rate and commodity price risk), credit, and liquidity risks amid security challenges in the country. The Group's Risk Management Committee uses the company's risk policies to identify and evaluate these potential challenges.

The company is exposed to fluctuations in US dollars (USD) on purchases of raw material (wheat) and goods and services. Although there have been recent improvements in the availability of forex in the country through the introduction of the Investor's and Exporter's Foreign Exchange window (IEFX), the company was still affected by currency fluctuations in 2017. Short term financial liabili ties, in USD, increased by 192.3% to N59.0bn in 2017 from N20.18bn in the previous year.

The company is exposed to commodity price shocks as it needs to purchase specific quantities and qualities of raw materials (wheat and polypropylene) to meet its milling requirements. Management mitigates this risk partly by using derivative instruments to reduce the volatility of commodity input. The company makes sure derivative contracts are taken out and match an underlying physical requirement for the raw materials.

Dangote Flour Mills addresses credit risk by applying credit limits and credit monitoring procedures. The company monitors daily certain significant receivables and obtains credit guarantee insurance when appropriate. The company manages its liquidity risks by monitoring weekly cash flows and ensuring that adequate cash is available through borrowing facilities with shareholders and holding company structures.

The risks facing Dangote Flour Mills 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 Dangote Flour Mills by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate for Flour Mills stood at N8.50, which is a38.41% downside on its current share price of N13.80 as at April 6, 2018. The discount rate [weighted average cost of capital (WACC)] of 12.3% is derived using a 16.2% risk free rate [the yield for a 10-year Federal Government of Nigeria (FGN) bond maturing in March 2027], a beta of 1.4003 an after-tax cost of debt of 7.8%, and a market risk premium of 6.4%. The calculated long-term cash flow growth rate to perpetuity is 5.0%.