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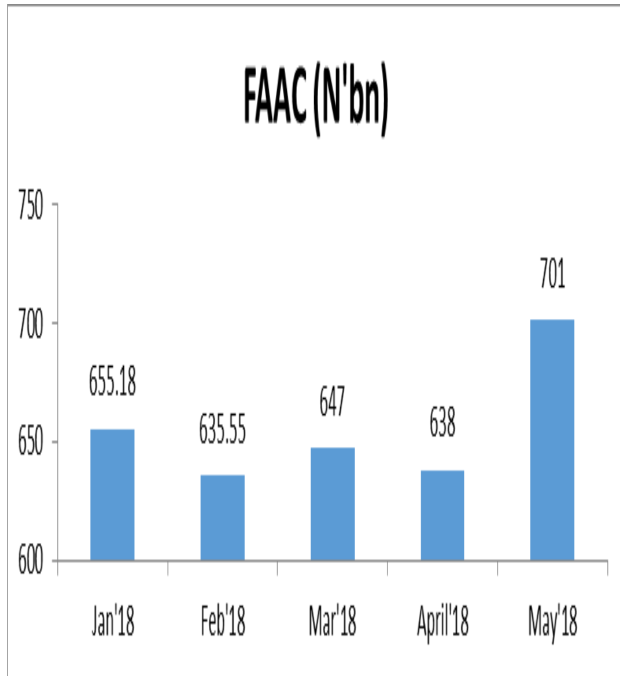
FAAC JUMPS TO 2 AND A HALF YEAR HIGH OF N701BN



For the first time since June 2014, the monthly statutory allocation disbursed crossed N700bn. This is a 9.87% jump from the amount disbursed in April (N638bn). One of the primary factors behind this jump is the new exchange rate for CBN dollar purchases from the government. Hitherto, the exchange rate was N305/$, but has now been adjusted by 6.15% to N325/$. This is a positive and significant move towards exchange rate convergence. Other factors included higher crude oil export sales. Year to date, the total Federal Account Allocation Committee (FAAC) funds is N3.28trn, compared to N2.33trn in the corresponding period of 2017.

Impact

The federal government's revenue has been on a steady increase thanks to higher oil proceeds and increased efforts at tax collection. This is good news especially for the insolvent states that are struggling to pay their salary arrears.

The liquidity impact was felt immediately as short term money market interest rates declined to less than 5% pa following the part disbursement of over N300bn on May 28th. Nonetheless, we expect these funds to be mopped up either via the sale of the CBN's OMO instruments or through its forex interventions.

Is this trend sustainable?

Yes it is provided oil prices remain high and production stable. Our forecast is that FAAC disbursements in 2018 will range between an average of N630bn-N650bn compared to 2017's average of N520bn.

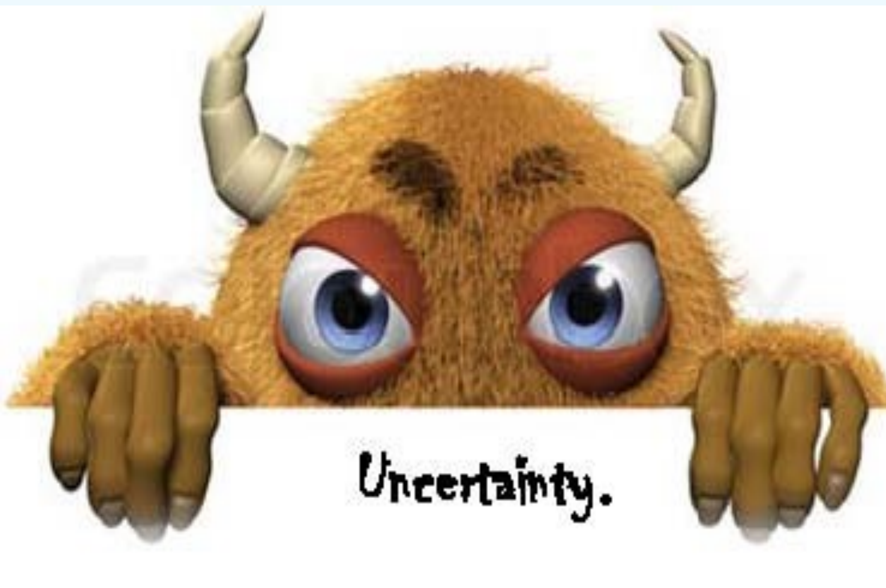
OPEC: REPORTS OF ITS DEMISE HAVE BEEN GREATLY EXAGGERATED

Two years ago, the Organization of Petroleum Exporting Countries (OPEC) was pronounced dead by many observers. Radically changing global oil dynamics had whittled down the immense influence of the once thriving cartel. Advancements in innovation meant the United States (US) – once its biggest buyer – was now one of its biggest competitors. The global oil market became awash with supply following the bitter battle for market share that ensued between OPEC and its competitors. US producers stayed competitive at lower prices, and the price-setting game was seemingly lost. Perhaps more importantly, the competition among OPEC member countries was viewed as the equivalent of pressing the self-destruct button.

In response, OPEC formed a marriage of convenience with Russia with the goal of draining the global oil inventory surplus. Fast-forward to today, this alliance is looking more and more like a stroke of genius – the supply overhang has pretty much vanished according to the International Energy Agency's (IEA) latest Oil Market Report, and oil prices have stayed above $62 per barrel (pb) in 2018. Critics and naysayers are scratching their heads in disbelief, wondering just how OPEC managed to pull this off from the cusp of irrelevance.

Market fundamentals: Uncertainty looms

The deal among members, and with Russia specifies an output cut of 1.2 million barrels per day (mbpd). The level of compliance has been one of the biggest factors responsible for the recorded success in balancing the oil markets. OPEC's compliance rate was up to 163% in March – driven by sharp declines from Venezuela and Mexico. This means OPEC members have cut production by about 1.95mbpd, 756,000bpd above the pledge. Inventories in developed economies have plunged to just 30mbpd above the latest five-year average – down from 340mbpd in January 2017. The IEA forecasts that inventories could decline at a pace of 0.6mbpd for the rest of 2018 if supply and demand forecasts meet expectations.



Market fundamentals appear stronger and are gaining in strength, but the potential US-China trade war could dampen any gains. Global demand is forecast to grow by 1.5mbpd by the IEA. However, the US-China unease could snowball into a global trade conflagration which could wipe $470bn off the world economy by 2020. Every basis point decline in global gross domestic product (GDP) growth is estimated to reduce global oil demand growth by 6,900bpd.

Supply side factors have been largely accommodative. The IEA expects a 1.8mbpd growth in international production in 2018 – supported by a 1.3mbpd growth from the US. Nevertheless, several downside risks exist. Growth in US shale supply could be slowed by the pipeline bottleneck rearing its head in the Permian Basin. Then there is the matter of rising geopolitical tensions in the Middle East. Missile attacks by the US on Syria have helped push oil prices up – even if Syria has not exported any oil since 2011.

The Trump Factor

News of the possible scrapping of the Iranian nuclear deal had already created some uncertainty in the oil markets. That possibility has become a reality as US President Donald Trump made good on his promise to do away with the "one-sided" deal. This would mean the likely re-imposition of sanctions on Iran – cutting its oil exports by about 1mbpd. Oil prices jumped over 3% to $77.47pb in response to this as Iran accounts for approximately 4% of global oil production – 3.813mbpd.[1] Crude prices are poised to trend higher as sanctions on Iran take effect in the coming months. That much supply going offline is likely to call into question the necessity of a pact between OPEC and Russia to curb output. Other OPEC members may raise production to ensure the current balance in the market continues. But which members and by how much, are details that may get complicated and problematic. US output has also soared recently, reaching a record high of 10.7mbpd[2] – in response to higher prices – and this could undo months of hard work by OPEC and its allies.

OPEC: Mixed fortunes for member states

Rising prices would be great news for US shale and OPEC member states – or at least most of them. Obviously, higher oil prices and the consequent rise in profitability incentivize higher shale production. The Saudis are keen on higher oil prices for more than just the revenue implications. Saudi Arabia is set to launch an Initial Public Offering (IPO) of its national oil company – Saudi ARAMCO – and needs oil prices to climb to somewhere around $90pb to achieve the $2trn valuation that it seeks.[3] For Nigeria, oil prices have been the proverbial double-edged sword. Higher prices support government revenues, external reserves and strengthen the currency, but also create a petroleum subsidy headache for the government. It can ill afford queues at the pumps in the run-up to a general election. Nigeria has, rather sadly, been unable to refine its own petroleum and relies almost entirely on imports to plug the gap.

[1]https://www.ceicdata.com/en/indicator/iran/crude-oil-production
[2]https://www.cnbc.com/2018/05/14/opec-raises-oil-output-forecast-warns-about-global-growth-uncertainty.htm
[3]https://www.bloomberg.com/gadfly/articles/2018-04-13/saudi-aramco-may-have-to-settle-for-just-a-trillion-or-so

It spent N1.4trn[4] in subsidy payments in 2017 alone, and oil prices of $90-100pb would push the subsidy figure closer to N2trn – about 17% lower than the government's proposed capital budget (N2.43trn) for 2018. There is also the very potent risk that economic reforms, instituted because of lower oil proceeds, could slow down or be abandoned entirely as oil proceeds increase and political expedience takes priority over economic necessity and material convenience.

Outlook

OPEC's current deal to curb output is in place until the end of 2018. Where it may get tricky is winding down the supply cut as calls for an exit strategy have already started to surface within the cartel. The US Federal reserve is set to raise interest rates at least two more times in 2018. The stronger dollar would typically weigh on commodity prices as it dampens demand. The outlook is for geopolitical tensions to continue to prop up oil prices in the short term. OPEC will only know the true impact of its endeavours once balance is brought to the market and the inventory glut is lowered to its five-year average. It may not be "mission accomplished" just yet but it is beginning to look more and more like it.

[4] http://energymixreport.com/budgit-alleges-lack-of-accountability-over-n1-4tr-petrol-subsidy/

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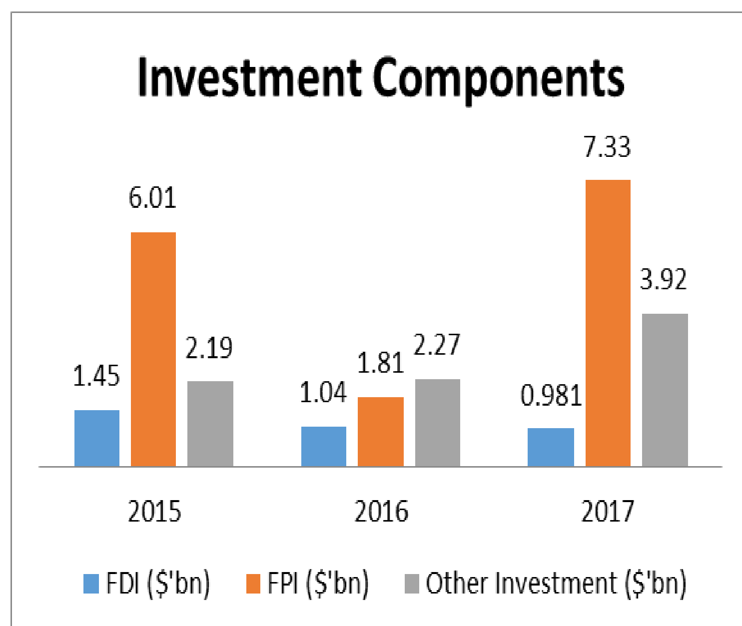
IMPROVING NIGERIA'S INVESTMENT ENVIRONMENT - A KEY TO ECONOMIC GROWTH

In recent times, the Nigerian government has increased the attention given to foreign investment in Nigeria attracting investments such as the Chinese railway deal. However, with barely two years to go from its 10-year target to be among the top 20 economies by 2020, Nigeria remains the 26th largest economy in the world. A key barrier to achieving this target is its poor investment environment. Investment is a key component of any economy's gross domestic product (GDP) as it stimulates growth across other key components of the GDP: government spending, private consumption and net exports. Improving the investment environment would translate to an increase in investment flows which would boost private and government consumption, improve trade balance, and ultimately lead to economic growth and development. Countries with the largest economies in 2016, such as the USA, China and Germany, all had significant foreign direct investment (FDI), amounting to 20%-25% of their GDP. In contrast, Nigeria's gross fixed investment makes up only 14.7% of its $405.1bn GDP, with private consumption dominating the other components at 81.6% or $330.7bn in 2016.

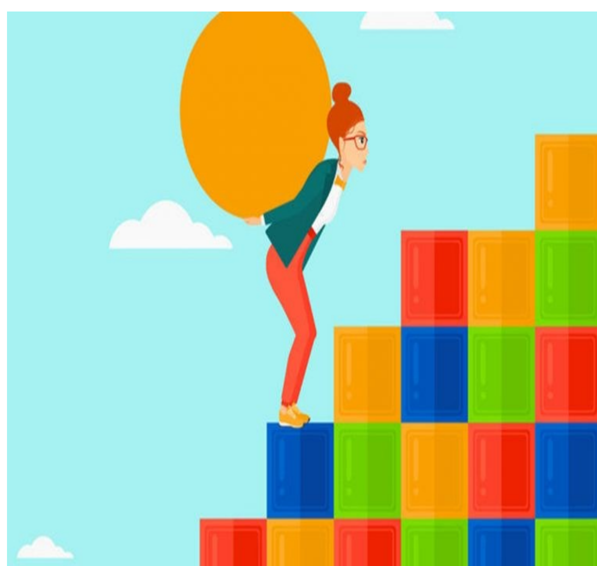
Output Component	2013	2014	2015	2016
Private consumption ($'bn)	375.4	407.9	388.0	330.7
Investment ($'bn)	73.0	85.7	73.2	59.6
Government consumption ($'bn)	36.8	36.8	29.3	21.8
Net export ($'bn)	26.1	34.0	-	-9.2

The National Bureau of Statistics divides investment flows to Nigeria into Foreign Direct Investment (FDI), Foreign Portfolio Investment (FPI) ('hot money') and other investment. The graph below shows the trend of these forms of investment in the last three years.



The table shows that investment flows are mainly in the form of Portfolio investments (also referred to as 'hot money') which is not sustainable for growth. The negative impact of hot money is its volatility, here today and gone tomorrow. It is imperative for FDI flows to weigh more in Nigeria's investment composition as that is the key driver of economic growth. The multiplier effect of an increase in investment flows to Nigeria cannot be overemphasized and to leverage it, Nigeria needs to improve its investment environment by addressing infrastructure and security issues, as well as high interest rates and poor access to credit. Failure to address the decline in confidence would limit output and could hinder the attainment of the 2020 target of being among the top 20 economies globally.

Challenges of Nigeria's investment environment



Investment flows to any country is mostly a function of growth rate, infrastructure development, political stability, exchange and interest rates, trade barriers and fiscal policies. With an estimated population of 180 million people, Nigeria's consumer market is huge and should be attracting a wide and diverse investor base. Unfortunately, security and economic challenges have deterred investors over the years. Some of the challenges to Nigeria's investment environment include:

Infrastructure deficit:

The poor state of infrastructure across all sectors in Nigeria have not only affected domestic performance but also hindered FDI flows to the country. Transportation systems - roads, rails, and ports - are not receiving sufficient attention and investments from the government and has resulted in an infrastructure deficit to the tune of over $300trn. In 2017, Nigeria spent N2.07trn (3% of GDP) on capital projects and is planning to spend N2.87trn in 2018. This pales in comparison, for example, to China's infrastructure development of 15% of its GDP between 1980 and 2005. To successfully compete with economies such as China, Nigeria would need to spend approximately $15bn (N5.4trn) annually for 15 years. The infrastructure gap in the power sector has also deterred investment flows. Nigeria's large population demands an energy generation of 98,000MW per day. Unfortunately, the country generates an average of 3,500MW daily, resulting in a deficit of 94,500MW. The low supply has made electricity costly, increased the cost of operations in Nigeria and discouraged investors from the country. The wider the infrastructure deficit the less investment flows Nigeria will receive, which will negatively affect the growth rate of the economy in the long term.

Security risks:

There has been an increase in insurgency activities in Nigeria mainly in the Northern part of Nigeria. Although Boko Haram activities have reduced significantly, they remain a key threat to Nigeria's development and output. Another threat to Nigeria's food output is the recent attacks by Fulani herdsmen who attack farm lands in the food producing regions of Nigeria. Oil production is also at risk of a possible resurgence in attacks on pipelines. In 2016, average oil production dropped by 14.4% to 1.6mbpd which contributed significantly to the 2016/2017 recession. Failure to address these instances of social unrest will leave the Nigerian economy merely surviving through the tides.

Other challenges of Nigeria's investment environment include high interest rates and inaccessibility to credit facilities. Nigeria's high borrowing cost translates to high interest costs and low profit margins for investors. In addition, the concessionary loans from government owned institutions are largely perceived as being unavailable for most businesses.

Looking to Rwanda for guidance

The choice for the Nigerian government is clear: maintain the status quo or aggressively address key hindrances to investment flows. Nigeria doesn't have to reinvent the wheel in doing so, and it doesn't have to set an unattainable bar by looking to the top five global economies for lessons. Right here on the continent Rwanda is offering a new way forward. The country turned its investment environment around with significant implications on their growth.

Over 20 years ago, the Rwandan economy was saddled with the aftermath of its genocidal war. Not surprisingly, investors were keeping their distance. However, FDI flows to Rwanda increased by 114% to $254.5mn in 2016 from $118.67mn in 2009. The Rwanda Development Board (RDB), established in 2009 to attract and retain investments into the economy, deliberately reaches out to prospective investors, links them up with useful contacts in their sectors of interest and aids their investment decisions and process. While the RDB has been busy seeking prospective investors, the Rwandan government has been improving the business environment with reforms including enabling faster electricity access for businesses and reducing unnecessary bureaucracy across sectors. This moved the Rwandan Ease of Doing Business rank to the 2nd of 48 SSA countries in the World Bank 2018 Doing Business Report.

There are several lessons to be learnt and adopted from the history of Rwanda's investment environment for Nigeria. Nigeria needs to look at business policies that encourage SMEs, including their access to credit facilities, electricity and a conducive environment. The Presidential Enabling Business Environment Council (PEBEC) has rolled out business friendly policies that need to be closely monitored to enable these reforms make a difference. It is also important for Nigeria to lower its borrowing costs which would encourage increased borrowing and subsequently increased economic activity. The long-term benefits of improving Nigeria's investment environment could be profound. At a minimum it would help Nigeria progress against its 2020:20 goal, if not attain it, and it would benefit the present and future generations alike, but the Nigerian government needs to take the concrete steps to make the improvements.

A FRAGILE RECOVERY

AFRICA'S ECONOMIES ARE TURNING A CORNER

A MONTAGE of miracles plays on the giant screens in the Perez Dome, a Pentecostal church in Accra. A paralysed man tosses away his crutches. A woman's tumour vanishes. It is not only the sick who need help. "I pray for businesses," intones the pastor, promising that struggling ones will "resurrect". A stall outside sells recorded sermons on "financial prophecy" and "creating wealth God's way". Someone up there is listening. After several tough years Ghana's growth rate in 2017 was 8.4%, the third fastest in the world.

African economies often seem like victims of divine whimsy. Most of the continent's workers are farmers, reliant on the rains. Much of its wealth comes from oil and minerals, at the mercy of markets. When prices are high, as they were in the first decade of the century, Africa booms. But in recent times drought and a commodities slump have stymied growth. In 2016, economies in sub-Saharan Africa grew by just 1.4%, the slowest rate for two decades.

Now the gods are smiling, faintly. Commodity prices are up. Better harvests have helped reduce inflation. Governments in the region have already sold about $12bn of international bonds in 2018, a full-year record. In its latest regional update, published this week, the IMF forecasts growth across sub-Saharan Africa of 3.4% this year.

Abebe Aemro Selassie, the director of the IMF's African department, plays up the potential for faster growth. "The question I ask is why isn't a country growing at 6 or 7%?" But he frets that the recovery is fragile. Rising debt or a weaker world economy could stop it in its tracks.

Aggregate figures for the region are driven by three big economies, all recovering from recession. Nigeria and Angola stumbled when oil prices fell; in the former, militants also choked off production by blowing up pipelines. Both made their situation worse by trying, quixotically, to prop up exchange rates. They have now seen some sense. Nigeria partly eased restrictions on its currency last year to encourage investment and is pumping more of the black stuff. Angola has let its currency slide by 28% against the dollar this year, though the adjustment will make it costlier to repay dollar-denominated debts.

South Africa, the third big beast, is also on the mend. Cyril Ramaphosa, its new president, took over in February with promises to lure $100bn of investment and stop the rot in state-run firms. That was enough to save the country's only investment-grade credit rating. But Mr Ramaphosa will struggle to achieve many of his goals because of infighting in his party, the African National Congress, says Azar Jammine of Econometrix, a consultancy. One in four jobseekers can't find work.

These three countries are less of a drag on regional growth than they were (see chart). But their recoveries are modest. The IMF expects that income per person will shrink in all three in 2018, for the fourth consecutive year. This mirrors a wider trend. In 12 countries with about one-third of the region's population, incomes per person declined last year. They will fall again in most of them this year.

Instead, the sprightliest performers are a group of midsized economies, from Ivory Coast to Tanzania, with sustained growth rates above 5%. Most import oil. Their cities are swelling and they are reaping the rewards of innovations like mobile banking. Many (though far from all) have sound economic policies. Most are holding down inflation. Their consumer class is small but growing. And politicians are cutting plenty of ribbons. Kenya and Ethiopia have new railways. Senegal has a new airport. Public investment has added to growth in the short run. It could help in the long run, too, if better infrastructure boosts trade.

But three risks loom. The first is public finances. Governments have borrowed heavily to replace oil revenues or fund capital projects. The median level of public debt rose from 30% of GDP in 2012 to 53% last year. The median country's interest payments now swallow a tenth of revenues. Six governments are already in a debt crisis. Anzetse Were, an economist in Kenya, questions whether public investments will do much for productivity. She thinks some of the money may have been diverted into private pockets.

A second risk is the world economy. Distant trade wars could crimp demand for African raw materials. Hikes in American interest rates would push up the cost of refinancing debts. And the oil price is still too low for many African exporters. Even if it doubled, Cameroon and Nigeria would still not balance their books.

The third risk is politics. Elections typically rip holes in public budgets and can cause months of uncertainty. The only thing worse is not holding a vote at all. In the Democratic Republic of Congo, while billionaires bicker over cobalt, the president is driving his country off a cliff.

Some think growth rates are a distraction. "We don't see it," says Courage Gamli, a Ghanaian barman, of his country's recent spurt. The numbers are only a rough guess: a rebasing of the calculation next month may add more to Ghana's GDP than several years of actual growth. A more basic problem is how to share the benefits. "The economy is growing but it's not translating into jobs," says George Boateng of the African Centre for Economic Transformation, a think-tank in Accra.

In 2002, some 57% of Africans were extremely poor, based on the World Bank's benchmark income of $1.90 a day. In 2013, after a long resource-fuelled boom, 42% were. More children were in school; fewer died young. There is reason to worry, then, when the IMF says that regional growth will hover below 4% for the next few years. Since populations are rising, income per person will creep up by barely 1% a year. That makes Africa look more like Italy than China. Better keep praying.

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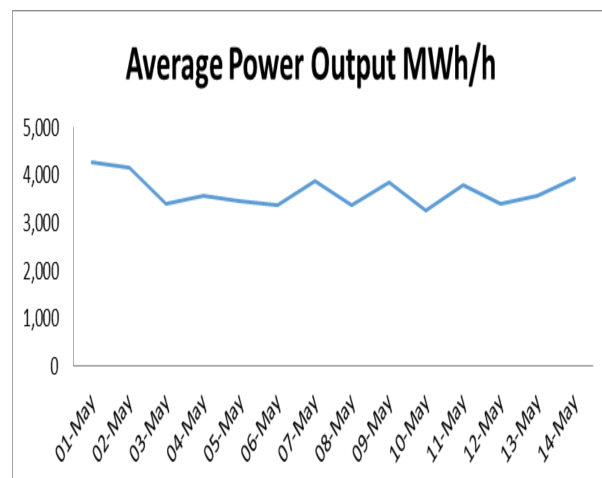
MACROECONOMIC INDICATORS

POWER SECTOR

Average power output from the national grid was 3,649MWh/h in the period May 1st – 13th. This is 5.93% lower than the average of 3,879MWh/h in the corresponding period in April. The lowest output during the period was 3,275MWh/h on May 10th, driven by an increase in the number of idle power plants across the country.



[5]

Outlook

We expect average power output to increase in the coming weeks driven by increased hydropower owing to the raining season.

MONEY MARKET

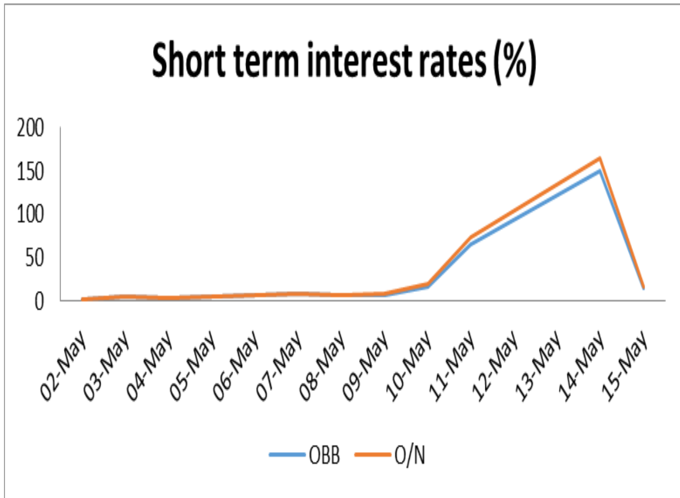
At the interbank market, the average opening position was N188.53bn long between May 1st - 15th, compared to N622.69bn long in the corresponding period in April. This is 46% lower than the average opening position of N475.28bn positive on April 15th - 30th. During the period, the CBN issued more OMO bills compared to the maturities. A total of N1.06trn was issued against a maturity of N604.96bn, compared to a total issue of N1.09trn and maturity of N571.41bn in the first half of April.

T/Bills yields maintained their downward trend, losing an average of 96bps during the period. The 91, 182 and 364- day tenors closed at 10.26%, 10.95% and 11.15% respectively in the primary market.

In the secondary market, the yields for 91, 182 and 364-day T/bills increased to 12.42%, 12.44% and 12.88% respectively from 11.30%, 10.37% and 11.92%.

Average NIBOR (OBB, O/N) was 29.14% pa within the review period, compared to 3.52% pa in the corresponding period in April. These interest rates spiked to 150% and 164.17% on May 14th driven by CBN forex sales debit before falling sharply to 15.33% and 16.42% on May 15th.

[5]Source: FGN



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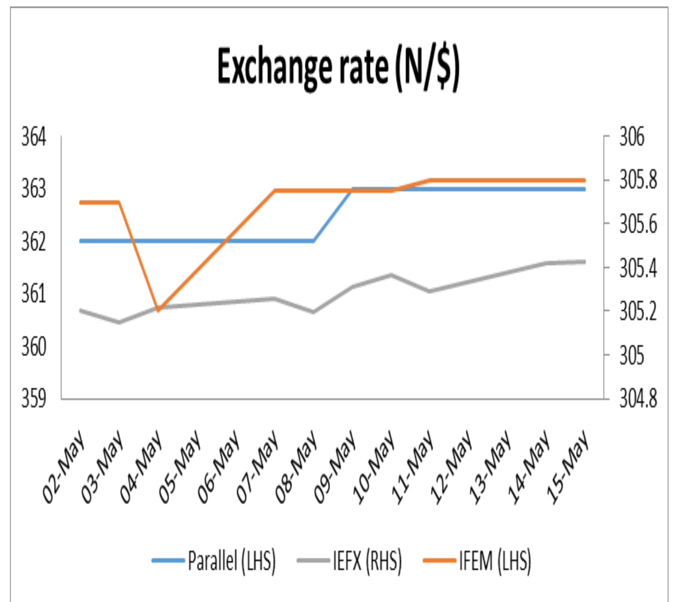
Outlook

The Senate has passed the 2018 budget (N9.12trn) following the upward review of expenditure projection by 6%. This would increase naira liquidity and lead to a decline in short term rates in the coming months.

FOREX MARKET

Exchange Rate

At the parallel market, the naira traded flat at N362/$ between May 01- 08 before depreciating to N363/$. Interbank foreign exchange market rate appreciated to N305.2/$ on May 4th before depreciating to close at N305.8/$. At the IEFX window the naira traded closely between N361/$ - N362/$ in the review period. Total forex traded at the IEFX window was $2.38bn, compared to $2.46bn in the corresponding period in April.



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Outlook

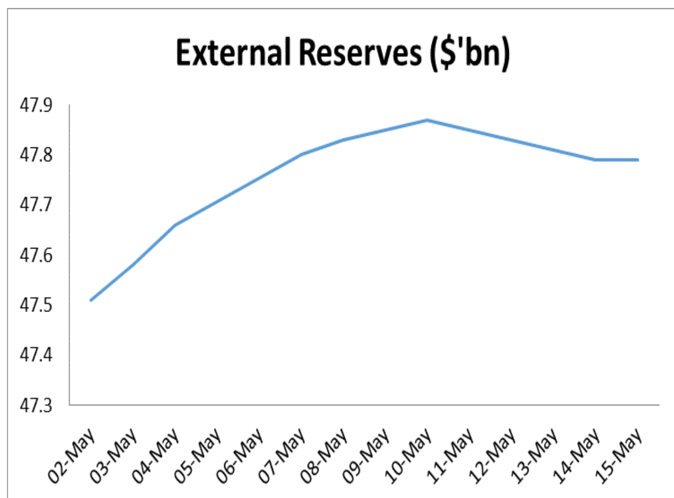
In the coming weeks, we expect naira liquidity to increase following the passage of the budget and increased election spending. The increase in liquidity would heighten demand pressure on forex. Nonetheless, regular CBN interventions would meet the increased demand and maintain naira stability.

[6]Source: FMDQ

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

EXTERNAL RESERVES

According to the CBN, Nigeria's external reserves level has increased to $47.93bn. However, on the CBN's website, gross external reserves were $47.85bn as at May 11. This represents an increase of 0.72% from $47.51bn as at May 2nd. Reserves declined marginally by 0.04% for the first time in 2018 on May 11 on the back of increased demand and increased pressure on the CBN to maintain naira stability.



[8]

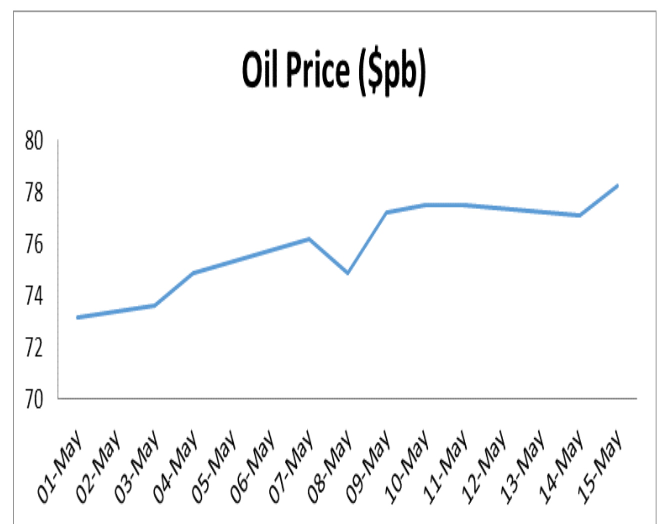
Outlook

While external reserves may have hit a ceiling at $47.79bn, the current level still allows CBN to intervene in the event of a shock. We expect strong oil prices (currently at $79.80pb) to sustain reserves in the near term.

COMMODITIES MARKET - EXPORTS

Oil Prices

Brent price increased by 6.95%, to $78.21pb, a 4-year high, on May 15th. Average oil price for the period was $75.76pb compared to $69.48pb in the corresponding period in April. There was an increase in Brent prices on May 9th following President Trump's decision to withdraw the U.S. from the Iran nuclear deal.



[9]

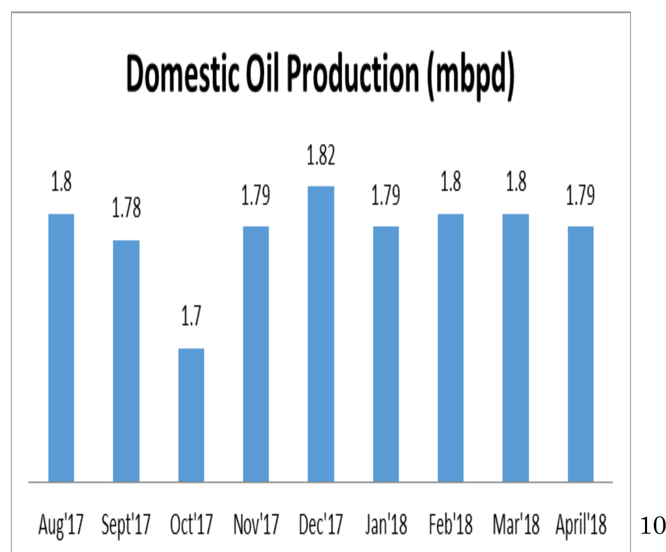
Outlook

The bullish trend in oil prices is supported by re-imposed Iran output sanctions by the U.S. government. In the coming weeks, we expect the sanctions to mop up approximately 1mpbd from the oil market and maintain the upward trend of prices.

[8]Source: CBN
[9]Source: Bloomberg

Oil Production

According to OPEC's monthly oil report, Nigeria's domestic oil production declined by 0.56% to 1.79mbpd in April from 1.8mbpd in March. Output has declined by approximately 250,000 bpd following the closure of the Trans-Forcados pipeline in the Niger Delta.



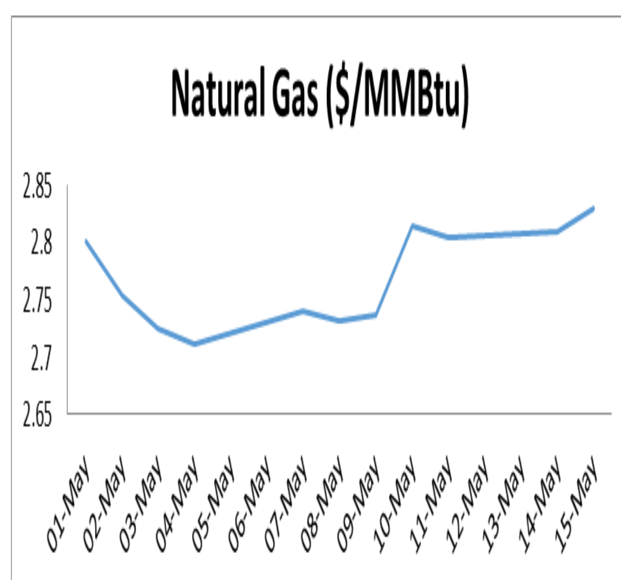
[10]

Outlook

We expect Nigeria's oil production to remain around current levels of 1.75mbpd – 1.81mbpd in May barring any disruption to pipelines.

Natural Gas

Natural gas increased by 1.07%, to close at $2.83/mmbtu on May 15th, from $2.80/mmbtu. Prices increased to a high of $2.814/mmbtu on May 10 driven by a drop in global output.



[11]

Outlook

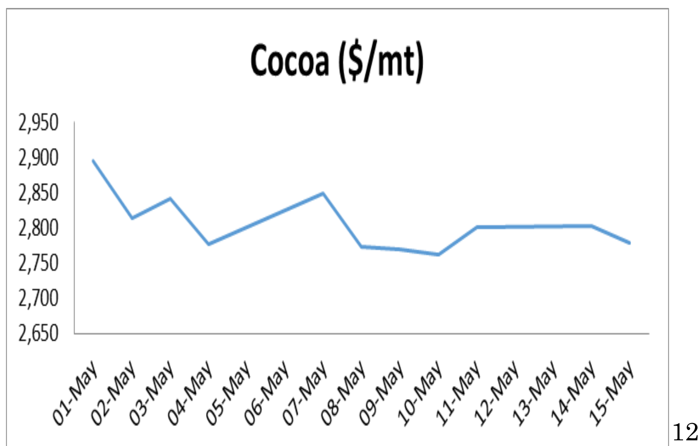
Natural Gas prices are expected to remain within the band of $2.75/mmbtu – $2.85/mmbtu in the coming weeks, pending any significant increase in the demand.

Cocoa

Cocoa prices declined by 7.71% to $2,671/mt on May 15th, from $2,894/mt on May 1st. The decline in price was largely due to reports of increase in global cocoa yields. The highest price of cocoa during the review period was $2,894/mt on May 1st. This was due largely to a drop in Ivory Coast output following an outbreak of a crop infestation.

[10]Source: OPEC

[11]Source: Bloomberg



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Outlook

According to the Economist Intelligence Unit, the Ivory Coast government is planning to reduce its supply of new and improved cocoa seeds to farmers. This would lead to a further drop in the country's supply and keep cocoa prices elevated in the short term.

IMPORTS

Wheat

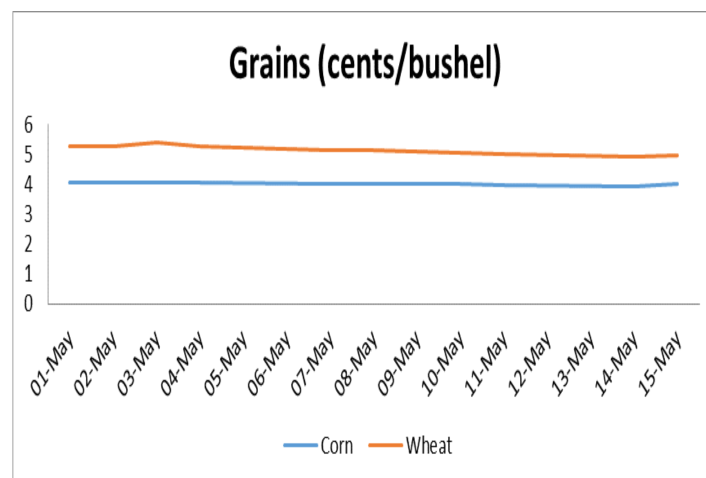
Wheat prices dropped 6.43% to $4.95/bushel on May 15th, from $5.29/bushel on May 1st. The decline in prices was in response to the U.S. Department of Agriculture's forecast of an increase in global output.

Grains- Outlook

We expect grain prices to record an uptick in prices as the wet/raining season approaches for several producing countries.

Corn

Corn prices dipped 1.48% to $4.00/bushel from $4.06/bushel. This was partly driven by increased corn yields in Brazil.



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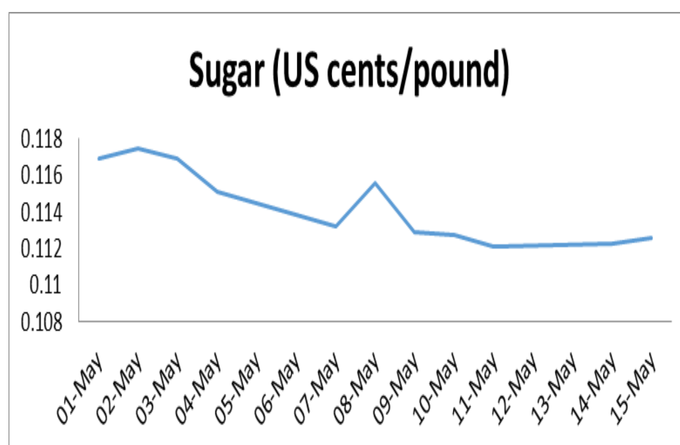
Sugar

Sugar prices decreased by 3.68% to $0.1126/ pound on May 15th from $0.1169/pound, due largely to robust global supply.

Outlook

We expect prices to remain driven by demand and supply movements in the coming weeks.



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[12]Bloomberg.
[13]Bloomberg.
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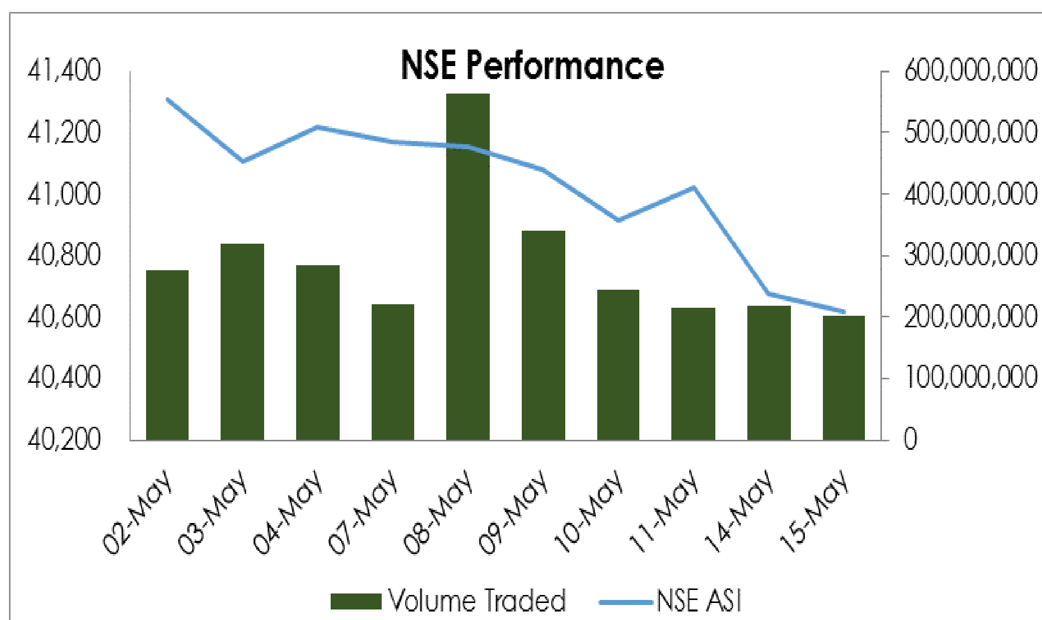
STOCK MARKET UPDATE

The Nigerian stock market maintained its bearish trend in the first half of May 2018 (1 May – 15 May) despite the surge in crude oil prices (average $75.05pb in May compared to $71.76pb in Apr'18). The NSE-All Share Index (NSE ASI) lost 1.58% to close at 40,615.42points on May 15, 2018 from the 30th of April's close of 41,268.01points. The YTD return on the index stood at 6.20%.

The market lost 1.43% (N213.86bn) as the market capitalization closed the period at N14.71trn. The stock market is currently trading at a price to earnings (P/E) ratio of 11.50x (May 15th), a 2.46% decline compared to its close of 11.79x as at 30th of April 2018. During the review period, the NSE recorded 3 days of gains and 7 days of losses.

The market breadth was negative at 0.66x, as the number of losers (50) outpaced the number of gainers (33) while 86 stocks remained unchanged.



[15]

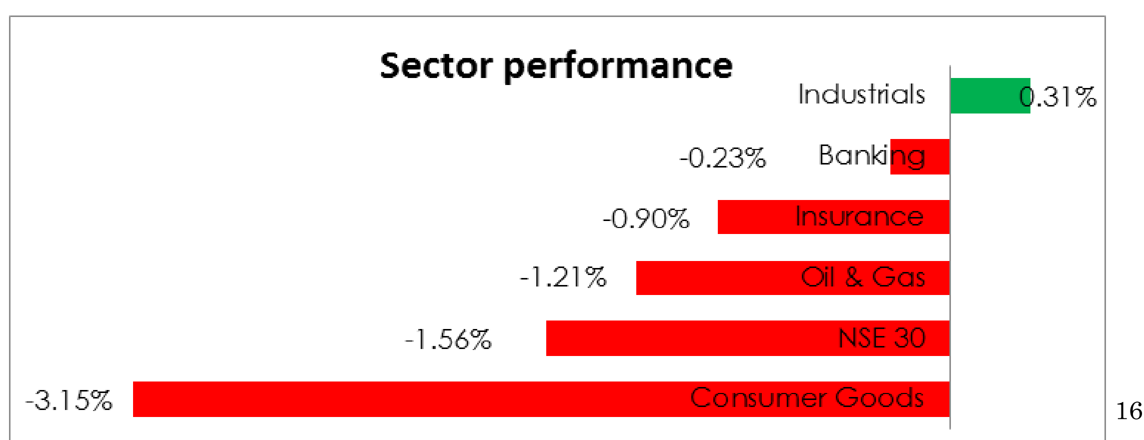
Trading activity on the bourse slowed further in the first half of May. Average volume fell by 18.26% to 289mn units compared to 352mn units recorded in the first half of March. Average value moved in the same direction as it declined by 5.48% to N4.85bn in the review period.

[15]Source: NSE, FDC Think Tank

SECTOR PERFORMANCE

In the review period, only the Industrial sub-sector index closed positive, gaining 0.31%. The up-tick in performance was driven primarily by the gains recorded by Cement Co. of Northern Nig. Plc (42%), CUTIX Plc. (7%) and BETA Glass Co Plc (5%).

Alternatively, the Consumer Goods sub-index performed the least, losing 3.15% in the review period. This was due to the losses recorded by the major companies in the sector- Dangote Flour Mills Plc (-15%), Champion Brewery Plc (-15%), Dangote Sugar Refinery Plc (-10%), Unilever Nigeria Plc (-10%) and Cadbury Nigeria Plc (-6%).



[16]

The best performing stocks were CEMENT CO. OF NORTH.NIG. PLC (42%), VERITAS KAPITAL ASSURANCE PLC (31%), MUTUAL BENEFITS ASSURANCE PLC (25%), LIVESTOCK FEEDS PLC (17%) and ETERNA PLC (12%).

TOP 5 GAINERS (N)				
Company	May 15'18	Apr 30'18	% Change	Absolute Change
CEMENT CO. OF NORTH.NIG. PLC	29.00	20.45	42%	8.55
VERITAS KAPITAL ASSURANCE PLC	0.38	0.29	31%	0.09
MUTUAL BENEFITS ASSURANCE PLC	0.30	0.24	25%	0.06
LIVESTOCK FEEDS PLC.	0.90	0.77	17%	0.13
ETERNA PLC.	7.00	6.27	12%	0.73

The least performing stocks were JAPAUL OIL & MARITIME SERVICES PLC (-27%), NIGER INSURANCE CO. PLC (-20%), OANDO PLC (-19%), DIAMOND BANK PLC (-19%) and CONSOLIDATED HALLMARK INSURANCE (-18%).

[16]Source: NSE, FDC Think Tank

TOP 5 LOSERS (N)				
Company	May 15'18	Apr 30'18	% Change	Absolute Change
JAPAUL OIL & MARITIME SERVICES PLC	0.35	0.48	-27%	-0.13
NIGER INSURANCE CO. PLC	0.24	0.30	-20%	-0.06
OANDO PLC	7.40	9.15	-19%	-1.75
DIAMOND BANK PLC	1.64	2.02	-19%	-0.38
CONSOLIDATED HALLMARK INSURANCE	0.28	0.34	-18%	-0.06

OUTLOOK

The All Share Index (ASI) has recorded a cumulative gain of 6.20% YTD largely due to bargain-hunting activities. In the second half of May, we expect the bearish trend to persist as investors take position in value stocks with forward earnings expectations as the Q1'18 earning season continues.

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CORPORATE FOCUS : FIDSON HEALTHCARE PLC

ANALYST'S NOTE

Analyst Recommendation: *BUY*

Market Capitalization: *N8.24bn*

Recommendation Period: *365 days*

Current Price: *N5.49*

Industry: *Healthcare*

Target Price: *N7.38*

New plant helps consolidate market position

Fidson Healthcare Plc (Fidson) recorded an impressive growth in its full-year (FY) 2017 financials. Revenue turnover improved by 83.6% to N14.06bn from N7.66bn in 2016. This remarkable achievement, amid tough economic conditions in the pharmaceutical industry, can be attributed to the apt decision making by the company's management team of the company. Prior to the economic recession in 2016, Fidson embarked on extensive capacity expansion projects. During 2017, the company commenced operations in its ultra-modern plant in Sango-Ota, which is one of the largest biotech plants in West Africa. This plant was also key to the growth recorded in volume sales during the period.

Production, marketing and finance costs continue to increase

Despite the impressive growth in revenue in FY'17, the company saw its cost of production to sales increase to 49.1% in 2017, from 47% in both 2015 and 2016.

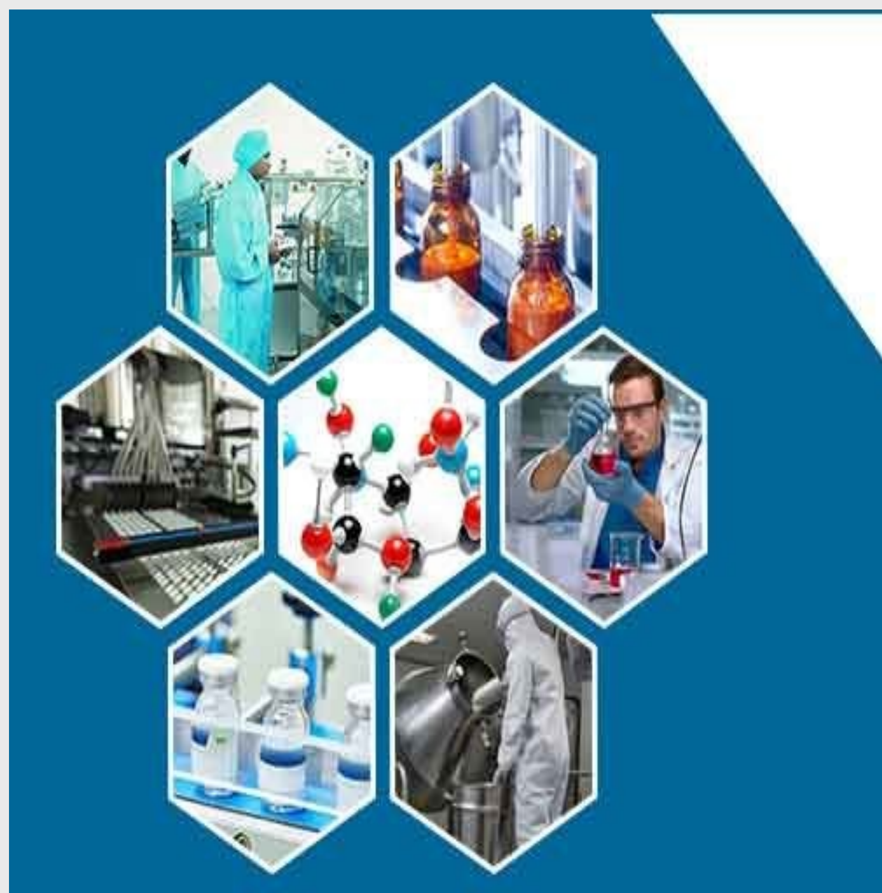
Cost of sales increased by 91.7% to N6.9bn, while revenue increased by 83.6%. This is of utmost concern as the company's direct costs continue to increase at a higher rate than its revenue growth. In addition, Fidson's selling and distribution expenses increased by 141.23% to N2.35bn, owing to surges in its promotion, advertisement and sales expenses. However, the slowdown in the growth rate of administrative expenses helped boost the company's operating profit, which improved by 133.85% to N2.55bn in FY'17 compared to FY'16.

The high interest rate environment throughout 2017 weighed on Fidson's debt servicing, as finance costs also increased by 44.77% to N1bn during the period. Notwithstanding, profit before tax increased by 255.7% to N1.58bn and profit after tax by 234.89% to N1.06bn.

Favorable policies boost market penetration

The clampdown on unregulated drugs and vaccines by the Nigerian government has been a major boost to the operations of Fidson. This is coupled with the government's incentives to encourage the manufacturing of finished drugs and vaccines in Nigeria, which provided government grants and intervention loans at low interest rates.

As the Federal Government of Nigeria strives to look inward to boost economic activities and sustainable economic growth, pharmaceutical companies, such as Fidson, will continue to benefit from favorable government policies and regulations. Accordingly, we place a BUY rating on the company's stock, considering its potential upsides and growth



The pharmaceutical industry in the Nigerian economic space is largely fragmented with some dominant household names. The industry can be broadly categorized into consumer healthcare and pharmaceutical categories. Consumer healthcare focuses on drugs administered over-the-counter (OTC), without prescriptions, while pharmaceuticals include prescription drugs and vaccines.

Key players in the industry include multinational pharmaceutical companies, such as GSK, Pfizer, Novartis, and Sanofi, while local players include Fidson, May & Baker, Neimeth, Swipha and Evans Pharmaceutical Industries.

The industry is also plagued with economic uncertainties as it faces stiff competition from unregulated and unbranded drugs, as well as cheaper imported variants. However, new policies and guidelines, by the regulatory authorities and the Nigerian Custom Service, have helped industry players remain competitive in the healthcare industry.

Fidson, a Nigerian pharmaceutical company, was incorporated as a private limited liability company in March 1995. It commenced local manufacturing of pharmaceutical products in July 2002 and went public in June 2008. The company engages in the manufacturing and distribution of pharmaceutical products, which include drugs, infusions and injectables.

It has over 200 drug variants for treating various diseases and pharmacological ailments. They range from retroviral, cardiovascular to OTC drugs and vaccines.

The company commissioned a manufacturing facility, compliant with the World Health Organization (WHO) standards, in Sango Ota, Ogun State. This ultramodern plant is the largest manufacturing facility among its peers in West Africa and was a major driver for the boost in its FY'17 revenue. It enables the company to position itself for nongovernmental organization relief programs aimed at tackling diseases such as malaria, tuberculosis, typhoid, and hepatitis among other health issues.

In the face of both political and economic challenges, Fidson remained resilient, as it put adequate measures in place to take advantage of Nigeria's economic recovery and deepened its brand visibility within the pharmaceutical industry.

Fidson is exposed to a "key man risk", as 57.4% of shareholdings are strategically owned, with the Chairman and Managing Director (directly and indirectly) controlling over 40% of the company's total paid up share portfolio. A substantial amount of shareholding is also under Stanbic Nominee (9.73%) and CSP Nominee (12.16%) with no voting rights ascribed to them. Concentration risk also stems from the fact that 1% of shareholders control 87.27% of the company's total share portfolio.

Income statement for Fidson Plc

N'000	2013	2014	2015	2016	2017
Revenue	9,247,056	9,725,185	8,210,760	7,655,029	14,057,394
Cost of sales	(4,133,123)	(4,285,596)	(3,858,896)	(3,599,666)	(6,902,227)
Gross Profit	**5,113,933**	**5,439,589**	**4,351,864**	**4,055,363**	**7,155,167**
Other operating income	46,653	85,337	94,264	105,110	103,145
Administration expenses	(4,503,298)	(4,099,620)	(2,060,962)	(2,096,585)	(2,360,681)
Selling and distribution expenses			(868,844)	(973,574)	(2,348,506)
Operating Profit	**657,288**	**1,425,306**	**1,516,322**	**1,090,314**	**2,549,125**
Finance income			38,675	44,249	31,072
Finance cost	(407,697)	(554,494)	(716,958)	(690,776)	(1,001,650)
Profit Before Tax	**249,591**	**870,812**	**838,039**	**443,787**	**1,578,547**
Tax credit/(Tax expense)	(94,611)	(238,987)	(93,661)	(127,025)	(517,758)
Profit After Tax	**154,980**	**631,825**	**744,378**	**316,762**	**1,060,789**

Balance sheet for Fidson Plc					
N'000	**2013**	**2014**	**2015**	**2016**	**2017**
Property, plant and equipment	7,043,474	10,790,758	11,501,335	12,206,210	12,363,213
Investment property	39,019	38,100	37,183	36,265	35,347
Intangible assets	3,245	22,440	11,016	92,483	60,184
Available for sale investment	31,904	36,702	2,810	2,938	5,128
Loans and receiveables			29,484	79,193	47,805
Other assets	355,748	230,082	476,717	291,144	294,423
Non-Current Assets	**7,473,390**	**11,118,082**	**12,058,545**	**12,708,233**	**12,806,100**
Inventories	1,497,332	1,145,540	697,502	1,085,535	1,756,629
Trade and other receivables	2,344,387	3,187,471	3,779,823	2,420,491	2,502,642
Prepayment	790,952	117,247	12,079	118,448	22,691
Other assets					
Cash and bank balances	137,027	204,154	122,376	334,228	359,656
Current Assets	**4,769,698**	**4,654,412**	**4,611,780**	**3,958,702**	**4,641,618**
Total Assets	**12,243,088**	**15,772,494**	**16,670,325**	**16,666,935**	**17,447,718**
Ordinary share capital	750,000	750,000	750,000	750,000	750,000
Share premium	2,973,043	2,973,043	2,973,043	2,973,043	2,973,043
Retained earnings	1,521,257	2,043,001	2,602,420	2,871,730	3,899,194
Available for sale reserve	1,035	(763)	(1,635)	(1,507)	683
Equity Attributable to Owners of the Company	**5,245,335**	**5,765,281**	**6,323,828**	**6,593,266**	**7,622,920**
Non-Controlling Interest					
Total Equity	**5,245,335**	**5,765,281**	**6,323,828**	**6,593,266**	**7,622,920**
Interest bearing loans and borrowings	1,779,115	2,992,245	2,600,218	2,231,835	1,246,254
Obligation under finance lease	-	-	161,698	199,620	218,303
Provisions	582,830	391,801	-	-	-
Retirement benefit obligation	-	-	377,776	342,750	309,831
Government grant	-	-	212,691	235,106	143,124
Deferred revenue	211,577	261,592	5,000	3,000	1,000
Deferred tax liability	310,085	452,549	342,566	418,452	817,544
Non-Current Liabilites	**2,883,607**	**4,098,187**	**3,699,949**	**3,430,763**	**2,736,056**
Trade and other payables	1,692,585	3,779,619	4,212,210	4,229,119	3,637,147
Interest bearing loans and borrowi	-	-	1,157,741	1,283,048	1,746,349
Current financial liabilities	2,245,005	1,909,220			
Bank overdraft			442,177	365,293	954,819
Other financial liabilities			65,000	65,000	65,000
Obligation for fianance lease			218,435	242,986	386,076
Govenement grant			60,782	91,982	91,982
Deferred revenue			2,000	2,000	2,000
Current taxation	176,556	220,187	440,991	301,367	149,261
Unclaimed dividend			47,212	62,111	56,108
Current Liabilites	**4,114,146**	**5,909,026**	**6,646,548**	**6,642,906**	**7,088,742**
Total Liabilites	**6,997,753**	**10,007,213**	**10,346,497**	**10,073,669**	**9,824,798**
Total Equity and Liabilites	**12,243,088**	**15,772,494**	**16,670,325**	**16,666,935**	**17,447,718**

MANAGEMENT

The foresight of Fidson's management team has helped the company consolidate its position in the healthcare manufacturing sector. The move to expand its production capacity, especially for intravenous fluids, proved to be a step in the right direction. The management identified a demand-supply gap (due to import duties on finished drugs and medicines) and leveraged on first mover's advantage to become the household name in many healthcare products.

The increase of the company's production capacity enabled Fidson to focus on higher volumes complemented by low prices in the wake of the economic recovery. This has helped the company penetrate the pharmaceutical market and remain top of mind among its key customers.

The management also focused its efforts on supply chain management. This was embarked on through a combination of strategic partnerships and the engagement of sales agents to reach the nooks and crannies of the Nigerian market. However, this led to the141.23% surge in Fidson's selling and distribution expenses, to N2.35bn in 2017 compared to the previous year.

THE BULLS SAY

* Growing brand visibility
* WHO approved ultra modern plant
* Opportunity for growth in the fragmented market
* Introduction of new product line (Infusion)
* Favorable government policies and regulations
* Robust reward system to motivate distributors and merchants

THE BEARS SAY

* Increasing production cost to sales ratio
* Prevalence of cheaper unbranded substitutes and stiff competition
* Foreign exchange risk
* Interest rate risk
* Tepid economic recovery

Risks and Outlook

Fidson could be burdened by differentiation risk from weak entry barriers of the pharmaceutical market in Nigeria. This is as a result of the commoditization of numerous healthcare needs. Most generic variants remain relatively cheaper despite government efforts to discourage dumping and protect local industries. However, there is increased effort to encourage the Nigerian public to patronize only registered healthcare drugs. These are expected to discourage the consumption of unregistered products and promote locally registered pharmaceutical companies.

Fidson also faces market risk due to the volatility in economic variables, such as exchange rates, outside the control of the management. Foreign goods and services account for about 65% of the company's expenses on goods and services. The management has shown devotion to embark on naira denominated transactions to mitigate against exchange rate volatility. In addition, the management is also looking at raising additional capital to pay off its expensive loans. This would

drastically reduce its debt servicing cost, as well as provide adequate buffers to negotiate other interest based obligations.

Faced with stiff competition in the industry, Fidson has provided its products on credit, increasing the likelihood of credit default. However, the management has drawn up a compensation plan for its distribution agents, which aims to facilitate prompt payment, as well as drive sales.

APPENDIX - Our valuation

Using the Discounted Cash Flow (DCF) methodology, we estimated a stock price of N7.38, which is a 34.43% upside on the current price of N5.49 as at May 14, 2018. The discount rate (Weighted Average Cost of Capital (WACC)) of 19% was derived using a 12.75% risk free rate (FGN 5-year Bond as at April 2018), a Beta of 1.2948, an after tax cost of debt of 24.2%, and a market risk premium of 6.34%. The long-term cash flow growth rate to perpetuity calculated is 5%.

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

DCF Valuation for Fidson Plc			
N'000	**2018E**	**2019E**	**2020E**
EBIT	2,919,423	3,286,827	3,603,409
Less: Taxes	(706,489)	(795,399)	(872,011)
EBIAT	2,212,934	2,491,428	2,731,398
Plus: depreciation expense	288,937	387,315	336,866
Less: CAPEX	(267,101)	(306,382)	(332,757)
Less: Change in working capital	(460,361)	127,894	(690,816)
Free Cash Flow (FCF)	1,774,408	2,700,255	2,044,691
WACC	19.0%	19.0%	19.0%
Present value (PV) of FCF	1,491,053	1,906,705	1,213,238
Terminal value @ perpetual growth rate (2020)	**2018**	**2019**	**2020**
Terminal value as of 2020	-	-	19,107,225
Present value of terminal value	11,337,464		
2017			
DCF Calculation	**Valuation**		
PV of explicit period	4,610,996		
PV of terminal value	11,337,464		
Enterprise Value	15,948,460		
+ Cash	359,656		
- Borrowings	(2,992,603)		
Equity value	13,315,513		
Share Price	**8.88**		
Shares outstanding ('000)	1,500,000		

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