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RALLYING FOR RAILWAYS IN NIGERIA

It is quite remarkable how Nigeria has witnessed tremendous growth rates without an efficient rail network. After the virtual collapse in recent decades of the colonial-built railway network, the government has ambitious plans to revamp it. However, it has only limited funds and expertise to achieve this itself. As a result, it has attempted to bring in the requisite funding and skills, often from abroad. While it is prioritizing railway uses, specifically the movement of people, and better access for tourist attractions, an upgraded railway network also has the potential to be a key enabler of industrialization, playing a vital role in efficiently moving materials between mines, factories, and ports.

A track record of shared benefits

One of the most attractive features of rail is its ability to move a large number of people at once, which is very instrumental in driving productivity. This is at the heart of key railway investments currently in development in Nigeria. Of particular interest to the Nigerian government is the coastal railway project to link Lagos with Calabar, 1,402 km to the east, which is expected to be financed with a $12bn Chinese loan. West Africa's first light rail transit was recently launched in Abuja, connecting the city center to the Nnamdi Azikiwe International Airport. The second phase of the project is under construction and is planned to link Abuja with satellite towns such as Nyanya, Kubwa, and Lugbe.

Another rail project in the pipeline is the Lagos-Kano modernization project, of which only the Kaduna-Abuja segment has been completed. Improved connectivity would contribute significantly to elevating the living standards of Nigerians anywhere in the country. A dependable rail service could encourage less road use, which would significantly reduce pollution levels, and has the potential to transform the culture of entire cities.

The migration in and out of Lagos on a daily basis is immense. The inadequate supply of housing and prohibitive rents has led to people commuting from low rent neighboring states. These travels can stretch between two to four hours one way. With investment in commuter rail networks, the hope is to not only to shorten commutes but also free up road networks.

Railway stations also offer a myriad of attractive business opportunities to entrepreneurs. The retail sector can benefit significantly as rail stations become attractions in their own right with stores, restaurants and bars enhancing the travel experience. Users of the popular Marina car park have access to a dry-cleaning service that has a makeshift drop-off and pick-up point. This type of service provision can be adopted more formally in any Nigerian rail station. A developing country that has adopted this station retail model is India, whose metro stations are being developed in line with today's fast-paced consumer lifestyles. The country's lauded Delhi Metro Line was established in 1995 with plans to expand the network further. Passenger satisfaction is high and discipline is ensured to keep the metro rail clean. Furthermore, the network has helped develop areas previously considered uninhabitable because of lack of access to transport systems.

Laying the track for success- Lessons from peers

Realizing this potential may seem lofty, given only 10% of Nigeria's land commute moves by rail today. However, success in India and South Africa demonstrates it is not impossible. Not only does India boast of a robust commercial pairing with its railway network, it has taken very important steps to modernize the rail transport networks. In recent years, it has launched the Dedicated Freight Corridor (DFC), an ambitious program that involves the construction of two corridors: the Eastern Corridor from Ludhiana to Dankuni, covering a length of 1,839 km and the Western Corridor from Dadri to Jawaharlal Nehru Port, Mumbai, covering 1,499 km. These corridors promote a seamless movement of rail traffic.

South Africa, Nigeria's economic rival on the continent, is another country to emulate. While rail lines only account for 7% of Nigeria's landmass, they account for 19% of South Africa's, allowing for 2.2 million South Africans to take advantage of their country's extensive commuter rail network daily. The current train routes have the capacity to connect different regions to each other, for instance Durban, Pretoria, Johannesburg and the Eastern Cape Province. This level of interstate connectivity should be an example for Nigeria as it would be a catalyst towards realizing considerable gains from investments in capital projects.

Bridging the funding gap

Following in the footsteps of countries like India and South Africa is ambitious, but with the right strategy, that need not be a bad thing. The key is in how the state and federal governments organize their financing. Given the failure of the existing, publicly-run network and the high costs of a new modern one, alternative financial arrangements and private-sector partners will be needed. Public Private Partnerships (PPPs) and loans from countries such as China have been listed as viable financing alternatives. Recently, pension funds have also come into the conversation, as they are rightly considered an untapped source of funding for infrastructure projects. However, there are quite a number of potential risks associated with PPPs.

For instance, private firms will be cautious about accepting major risks beyond their control, such as exchange rate risks. If they bear these risks then their price for the rail service will reflect this. Moreover, given the long-term nature of these projects and the complexity associated, it is difficult to identify all possible contingencies during project development. It is more likely than not that the parties will need to renegotiate the contract to accommodate these contingencies. It is also possible that some of the projects may fail or may be terminated prior to the projected term of the project, for a number of reasons including changes in government policy.

Land acquisition is also important. Ownership disputes have slowed down progress on procuring land for the projects, with the government having procured a miniscule proportion of the right of way (legal right to use land) along the planned route so far. Consequently, significant effort will be involved in recovering lost land from encroachers, and acquire any new lands required for the routes.

As the nerve center of economic activity in any country, transport infrastructure should remain a priority for any responsible government looking to reflate its economy. Funding is expected to remain a big issue but should not serve as a deterrent since the expected economic gains are significant. Investment in rail infrastructure would be a major driving force behind achieving inclusive and sustainable economic growth.

Overall, there are mixed prospects for a functioning rail network in Nigeria. Given that the state remains highly beholden to private partners for expertise and finance, a fully integrated infrastructure network is unlikely to materialize. After all, private sector players will prioritize the most profitable and viable opportunities. To this end, it remains particularly doubtful whether any will take up the challenge to build totally new rail connections.

INFORMAL ECONOMY AND POVERTY REDUCTION IN NIGERIA

Nigeria is now the country with the highest number of extreme poor, with 87million Nigerians in abject poverty.[1] This is disheartening, but true. The country officially overtook India which has 73million of its population living in poverty. It is noteworthy that India's poverty numbers appear more benign than Nigeria's due to its high population. With an estimated population of 1.3billion, 5.26% of Indians live in extreme poverty. By comparison, 45% of Nigerians live in extreme poverty.

This poverty situation in Nigeria is unarguably worrisome and it demands urgent policies that boost employment and aggregate income. Meanwhile, the weak growth in the formal economy suggests that employment in this space will be relatively inadequate to reduce poverty. The sector grew by 0.8% in 2017. In fact, employment in Nigeria's formal sector does not guarantee a break from extreme poverty. The sector currently offers a minimum wage of N18,000 ($50), which translates to an average daily income of $1.67, still below the poverty threshold of $1.9 per day. The informal economy by contrast has grown faster in size at an annual average rate of about 8.5% between 2015 and 2017.[2] Growing Nigeria's informal economy would require skills development, cheaper credit accessibility and improved power supply.

[1]Homi Kharas, Kristofer Hamel and Martin Hofer. June 2018. "The start of a new poverty narrative". Brookings Institution.https://www.brookings.edu/blog/future-development/2018/06/19/the-start-of-a-new-poverty-narrative/
[2]National Bureau of Statistics, June 2016. "GDP 2015 formal and informal sector estimated split". Federal Government of Nigeria, http://nigerianstat.gov.ng/elibrary?queries[search]=informal

The structure of Nigeria's informal economy

The informal economy involves economic activities undertaken by individuals and organizations, which are not subject to full government regulations. Such activities include photography, catering, hairdressing, motorcycle services, tailoring, fashion designing, carpentry, painting, etc. This part of the economy is particularly large in Nigeria, with the International Monetary Fund (IMF) estimating it to constitute about 60% of the entire Nigerian economy.[3] This represents about $240bn. Informal activities are usually not captured in the process of computing GDP numbers.

Meanwhile, working in the sector is attractive due to the ease attached to operations as a result of the absence of a bureaucratic regulatory framework, and little or no formal educational requirements. At times, even Nigerians with high formal education find employment in the informal economy when well- paid formal sector jobs are unavailable. The big size of this economy, the inevitable demand for their goods and services and the ease attached to working therein, could be a strategic consideration for Nigeria to raise employment. This growth in the informal sector and an increase in employment would imply higher household income and lower poverty in Nigeria.

Strategies to spur informal economic growth

Nigerian government policies are typically lopsided in favor of the formal economy. The most notable of the current administration's policies corroborate this. In the quest for economic diversification from oil, the government has given priority to solid minerals and agricultural sectors. The N-power scheme, which aims to reduce youth unemployment, has also largely involved the employment of graduates in formal activities. With regards to informal economic activities, the government plans to empower 100,000 artisans across the country. This is commendable, albeit with a potential marginal impact as the amount only represents 0.05% of total population and 0.12% of the country's labor force. More attention is required.

The first strategy that is worth considering is the development of informal skills amongst Nigeria's working-age population. The government could create and sponsor well-equipped platforms that bring individuals who intend to learn skills and corresponding experts together. This should be at low costs in order to increase their attractiveness to prospective trainees.

[3]International Monetary Fund. July 2017. "The Informal Economy in Sub-Saharan Africa: Size and Determinants". Available at https://www.imf.org/~/media/Files/Publications/WP/2017/wp17156.ashx

In addition to skill acquisition, workers in Nigeria's informal economy have raised concerns over credit accessibility. New graduates from the would-be government skills development institutions are expected to be faced with the same challenge. These workers mostly require funds to acquire tools and equipment that are either fundamental to their operations and/or necessary for them to carry out their activities more easily. This highlights the need for the government to give low interest loans in this space. A grant might even be more effective in reducing poverty, as it has the advantage of taking off the burden of repayment. If this were the case it would allow workers to maximize their profits and further ease their escape from the poverty trap.

Furthermore, informal employees in Nigeria generally require electricity for their operations, although it varies across different segments. For instance, the electricity requirements are huge in areas such as laundry services, hairdressing and printing, while it is moderate for photography and catering for instance. Activities such as transport services generally have marginal electricity demand. Given the poor condition of power supply in the country, most of those who fall in the category of high users resort to generators. This is found to be relatively expensive and translates to a higher cost of production. Addressing power infrastructure challenges demands huge capital requirements and takes a long time to materialize. However, a short term focus on maximizing gas availability would be a good start. Nigeria's average electricity output per day of about 3,500MW/hour has been significantly below installed capacity of about 7,500MW, while gas unavailability accounts for approximately 45% of total generation constraints.[4] Maximizing gas availability could result in significant benefits, not just for the informal economy, but Nigeria as a whole. In the meantime, the government could focus on securing an adequate supply of gas to power stations. This could draw actual power output closer to its potential pending the time the country sees other significant investments that could raise capacity.

Nigeria might need to tilt towards an informal driven economy to create more employment and significantly reduce poverty. The formal sector of the economy, which represents the aggregate output, grew by 0.8% in 2017.[5] This weak growth might not be enough to reduce poverty levels in the country. A new approach is expedient.

[4]Advisory Power Team, Office of the Vice President
[5]National Bureau of Statistics, 2018. "Nigerian Gross Domestic Product Report (Q4 and Full Year 2017)". Federal Government of Nigeria, http://nigerianstat.gov.ng/elibrary?queries[search]=gdp

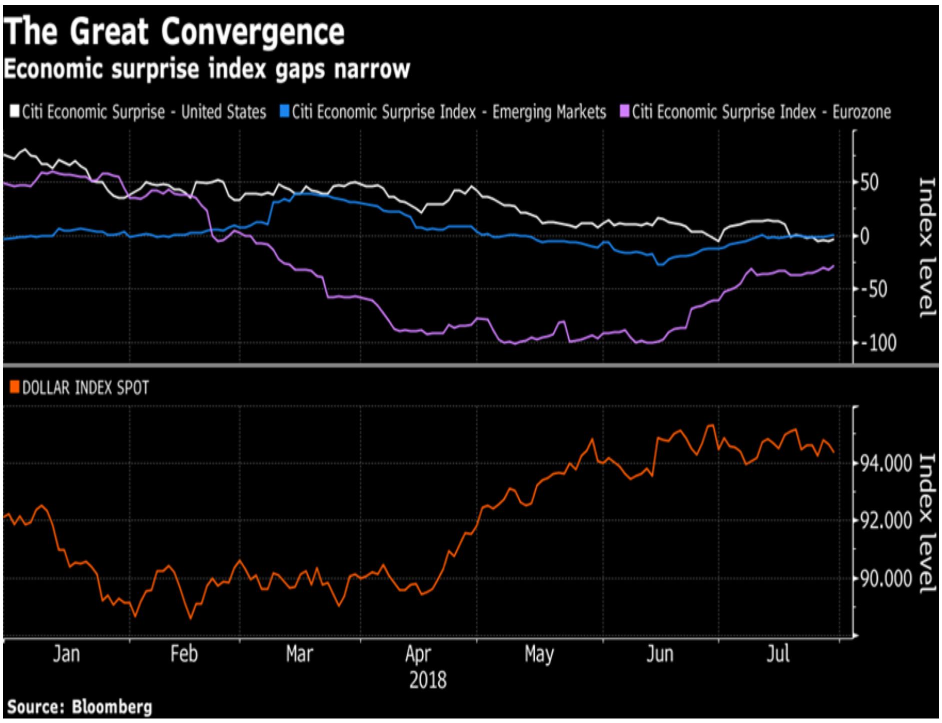
Global Perspective:

Culled from Bloomberg

GLOBAL CONVERGENCE ARRIVES TO SPOIL THE 'AMERICA FIRST' PARTY

The Trump Administration may be looking to put "America First" in global markets, but the rest of the world appears poised to catch up in the second half. The U.S. economy and financial assets pulled away from the pack at the start 2018, which culminated with the fastest growth since 2014 in the second quarter. But an easing of trade tensions and a concerted pro-growth shift by Beijing are set to amplify the underlying convergence in economic activity and help catalyze a new phase of market leadership.

Equities gained following reports that China and the U.S. are making renewed efforts to reach a détente on trade, with the MSCI World Index getting a bigger initial pop on the news than the S&P 500 Index. "The Q2 GDP numbers could mark the peak in the divergence trade, especially as the move by Chinese policy makers could mitigate the tail risks to global growth from trade wars," Mark McCormick, North American head of FX strategy at TD Securities, wrote in a note to clients, adding that "the reflation story is on the mend." The strategist recommends selling the U.S. Dollar Index around 95, anticipating that the euro will break to the upside against the U.S. currency into the fall.



The greenback has traded sideways the past six weeks as the rest of the world finds its economic footing, with the gaps narrowing between economic surprise indexes in the U.S. versus the euro zone and emerging markets. Meanwhile, analysts at Morgan Stanley, State Street Corp. and Wells Fargo & Co. say the dollar has just about peaked, and currency strategist Richard Franlovich of Westpac warned that it could see a "correction" if the index breaks below 93.

EM Comeback

Expectations have now been "right-sized," according to Erin Browne, head of asset allocation at UBS Asset Management, whose active equities division is bullish on developing-market stocks, particularly in Asia. Stability in the dollar means the "groundings in place for convergence with the rest of the world are starting to pick up," she said. Emerging market stocks trailed the Russell 2000 Index of domestically oriented U.S. equities by nearly 15 percentage points in the first six months of the year. But they are on track to best U.S. small-cap gauge this month for the first time since January. "A shakeout in emerging market equities has created value in a world where good quality value is scarce," Richard Turnhill, global chief investment strategist at BlackRock Inc., wrote in a note to clients. "The EM equity selloff is set against a backdrop of strong fundamentals: Attractive valuations, robust earnings growth and the highest return on equity in four years." Forecasts for earnings growth in 2018 and 2019 have been on the rise, he added.

Small-Cap Swoon

U.S. small caps were popular in the first half because they offered insulation from escalating clashes over commerce, as well as exposure to a robust domestic economy. But their appeal has waned as investors rotate out of the "trade war trade' in equities. Peak divergence means the Russell "will underperform and be a great risk-off hedge vehicle," said Michael Purves, chief global strategist at Weeden & Co. Of course, convergence might not be a straight-line story, as seen in China's underwhelming July factory gauge report, which reinforced the timeliness of the government's economic easing plan. Still, since June 18, when the U.S. and China traded tariff threats, the Russell 2000 is trailing the Shanghai Composite amid a cooling of cross-border commerce rhetoric. And during earnings season, these small U.S.-focused firms have failed to post upside surprises as often as their larger peers.

Caution on Europe

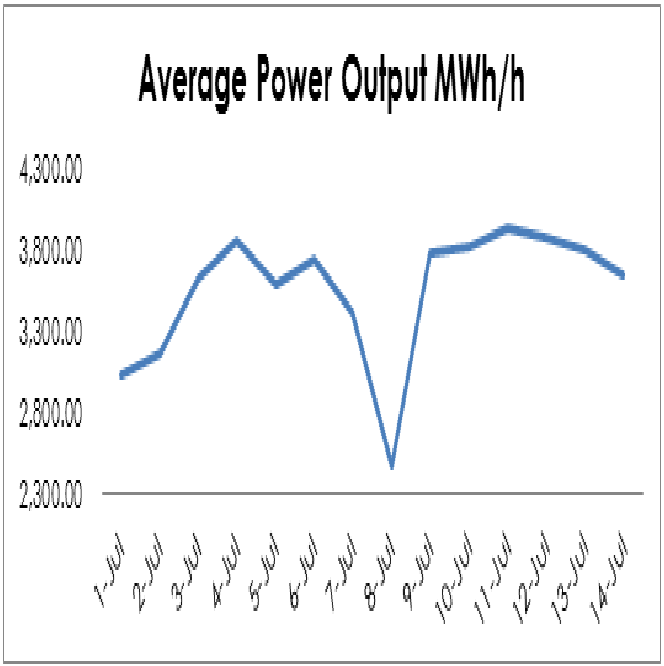
In some pockets of the market, traders remain wary of pricing in too much convergence. Take the difference between yields on two-year U.S. and German notes, which lingers near a record high. “This spread trades pretty much on policy differential between the ECB and the Fed,” said Antoine Bouvet, a strategist at Mizuho International Plc. “For the ECB, the market is not pricing enough tightening in 2020 after the end of Draghi’s tenure.” In the euro area, traders are redoubling bets that bund prices will remain well anchored by a dovish monetary stance, with the two-year note stuck around -0.6 percent. The swelling two-year Treasury yield reflects expectations that the Federal Reserve will press on with rate hikes in the near term, even as federal funds futures contracts show creeping doubts about the longevity of the tightening cycle. The gap between yields on December 2019 and 2020 contracts turned negative, a signal that easing is viewed as more likely than further tightening.

A similar reluctance to accept the case for convergence holds in European stocks. Even as earnings growth perks up on the continent, it’s still dwarfed by the pace of profit gains in the U.S. -- even after tax benefits are stripped out, according to Jonathan Golub, Credit Suisse Group AG’s chief U.S. equity strategist. “We remain underweight Europe versus U.S. equities, as our tactical models for both markets imply around 5 percent relative downside over the coming months,” Sebastian Raedler, head of European equity strategy at Deutsche Bank AG, wrote in a note.

MACROECONOMIC INDICATORS

Power Sector

Average power output from the national grid was 3,572.33MWh/h in the period July 1st -15th. This is 0.97% lower than the average of 3,607.40MWh/h in the corresponding period in June. This was due to insufficient gas supply, distribution and transmission constraints as well as inadequate water reserves despite the increased rainfall in the period. Average on grid power output dipped to its lowest YTD at 2,470MWh/h on July 8th, due to the decline in output at Afam VI, Odukpani NIPP, Olorunsogo NIPP and Geregu NIPP.



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Outlook

We expect the average power output to remain around the current level of 3,600-3,800MWh/h barring any further rupture in gas pipelines in the coming weeks.

Money Market

At the interbank market, the average opening position was long at N191.88bn between 2nd - 13th July. This is, however, 44.03% lower than the average long opening position of N342.84bn between 1st – 14th June. The decrease in the opening position indicates a reduction in market liquidity. During the period, the CBN issued more OMO bills of N411.71bn against a maturity of N238.65bn. The net outflow of N173.06bn is less than N249.17bn in the corresponding period in June as the CBN sold N968.74bn OMO sales and N719.57bn OMO maturity in the corresponding period in June. The net outflow in the review period in July was N173.06bn, compared to the net outflow of N640.92bn recorded in June.

Yields on 91-day T/Bills closed flat at 10.00% on July 4th. The 182-day tenor declined by 20bps to 10.30% from 10.50% while the 364-day T/Bills closed at 11.51%, from 11.50% on June 20th.

In the secondary market, T/bill yields maintained their downward trend, losing an average of 50bps during the period.

[6]Advisory Power Team, Office of the Vice President

Average NIBOR (OBB, O/N) was 13.99% pa, compared to 7.06% pa in the corresponding period in June. During the period, there was reduced liquidity due to the delay in the disbursement of FAAC, the OBB and O/N rates spiked to a period high of 20.83% pa and 23.79% pa respectively on July 9th in reaction to the wholesale forex auction of $778mn during the review period.

Tenor	Primary market (June 20th, 2018) (%)	Primary market (July 4th, 2018) (%)	Secondary market (July 2nd, 2018) (%)	Secondary market (July 13th, 2018) (%)
91-day	10.00	10.00	12.30	11.37
182-day	10.50	10.30	12.39	11.85
364-day	11.50	11.51	12.32	12.29

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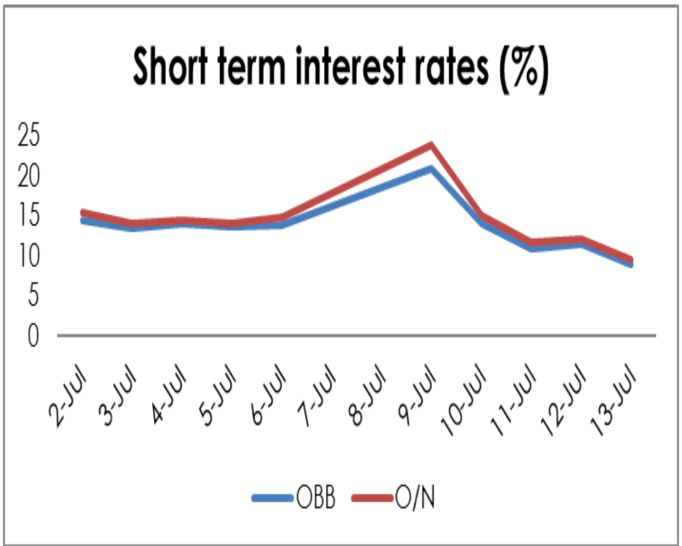

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Outlook

We expect an increase in market liquidity owing to the disbursement of budget funds. However, we expect the apex bank to continue to regulate liquidity levels in the money market by issuing OMO bills to mop up excess liquidity in the system.

Forex Market

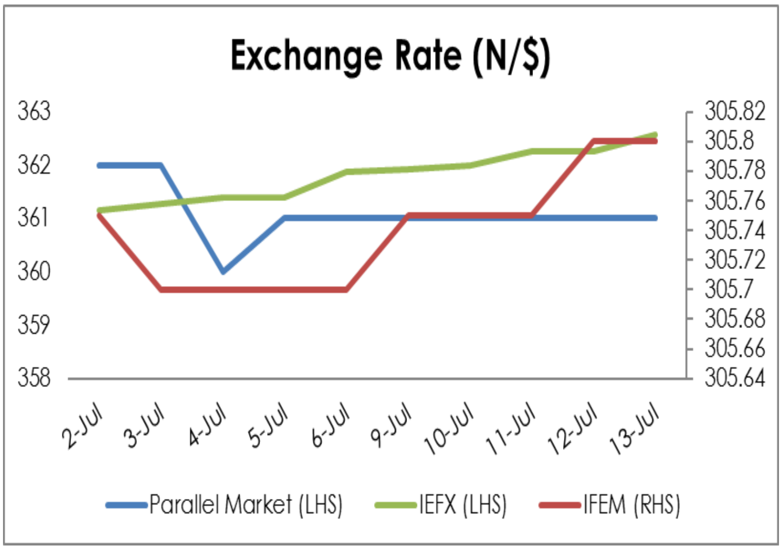
Exchange Rate

At the parallel market, the naira opened the month at N362/$, appreciated to a 2-year high of N360/$ on July 4th, before closing at N361/$ on July 13th. This can be attributed partly to the CBN's intervention of approximately $420mn in the period. At the IEFX window the naira traded between N361.16/$ and N362.58/$ in the review period. Total forex traded at the IEFX window in the first half of July was $1.72bn, compared to $2.29bn in the first half of June.

[7]FMDQ, FDC Think Tank
[8]FMDQ, CBN, FDC Think Tank

Outlook

We expect the naira to trade closely between N362/$ - N363/$, due to the CBN's regular interventions.



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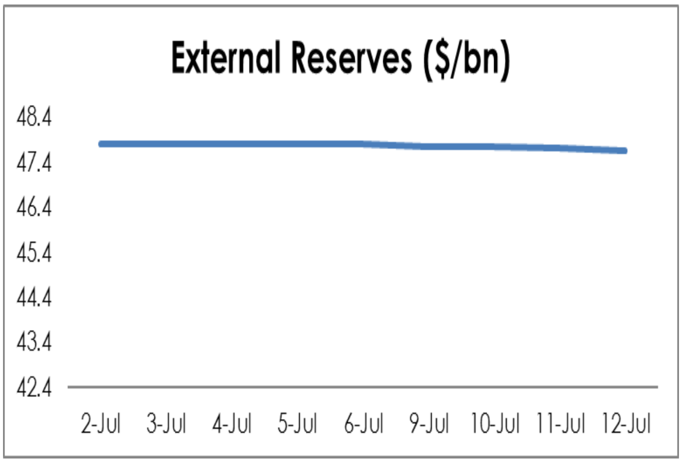
External Reserves

The external reserves decreased by 0.38% to close at $47.62bn on July 13th from $47.80bn on July 2nd. The gross external reserves decreased due to the CBN's intervention of $420mn during the period. The depletion in external reserves has decreased the import cover from 11.71 months to 11.66 months.



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Outlook

The currency is expected to weaken in the coming weeks as liquidity pressure builds up. The CBN is expected to continue supporting the currency and this will have a negative impact on external reserves.

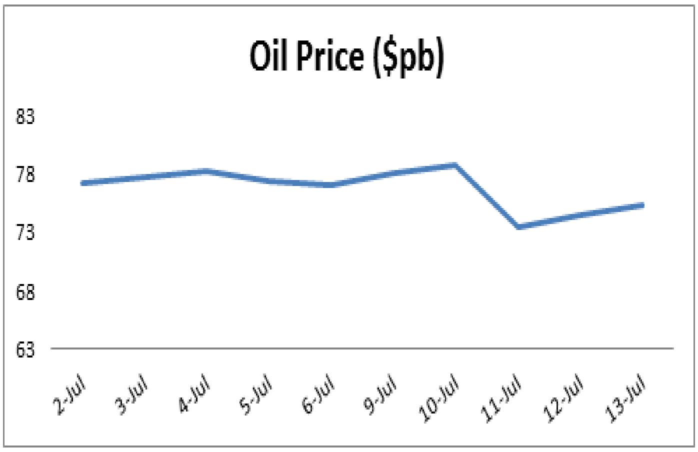
COMMODITIES MARKET - EXPORTS

Oil Prices

The price of Brent crude declined marginally to $75.33pb on July 13th from $77.3pb on July 1st. This decline was largely driven by the reopening of oil export terminals in Libya and the expected increase in production in Saudi Arabia. Saudi Arabia, is offering extra oil on top of its contractual volumes to some buyers in its key market-Asia. The country is boosting oil production to keep markets well supplied amid disruptions in Venezuela and Libya and the expected reduction of Iranian oil exports.

[9]FMDQ, CBN, FDC Think Tank
[10]CBN

In addition, the expected waivers for countries to continue importing Iranian crude eased fears of an extreme supply crunch after sanctions are re-imposed in November. The average price for the period was $76.79pb, 0.78% higher compared to $76.19pb in the corresponding period in June.



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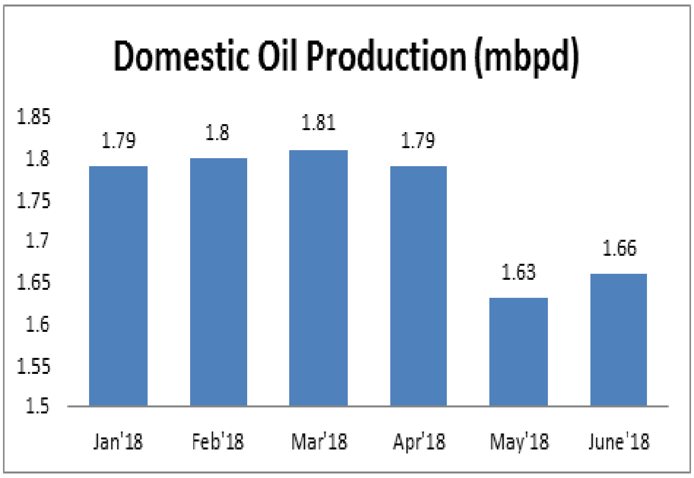
Outlook

The outlook for oil prices in the second half of July is bearish. This will be partly supported by the increase in production in Saudi Arabia and the reopening of oil export terminals in Libya. However, despite the expectation of a bearish trend, the Royal Dutch Shell has lifted its force majeure on Nigeria's Bonny Light crude and the Forcados terminal has been reopened after the repair of the sabotage leak. The increase in Nigeria's production should offset the impact of lower oil prices on export revenue. We however expect oil prices to remain around $70pb - $75pb, which is higher than Nigeria's 2018 budget benchmark of $51pb.

Oil Production

According to OPEC's monthly oil report, Nigeria's oil production increased marginally by 1.84% to 1.66mbpd in June from a revised level of 1.63mbpd in May. During the period, the Trans-Forcados and Nembe Creek pipelines were shutdown due to leakages and ruptures, which resulted to a force majeure. Nigeria's oil rig count declined to 13 in June from 14 in May.[12]



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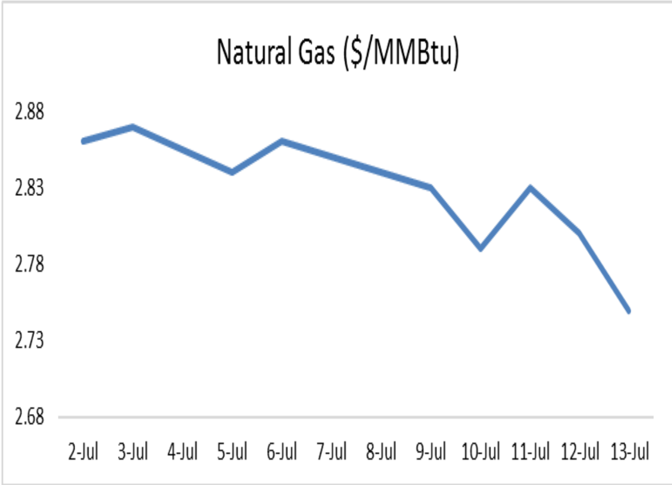
Outlook

The reopened Forcados terminal and the lifted force majeure on Nigeria's Bonny Light crude will impact positively on Nigeria's production in July. We expect production to stay around 1.70mbpd – 1.75mbpd in July.

[11]Bloomberg
[12]Bakers Hughes
[13]OPEC

Natural Gas

Natural gas lost 3.85%, to close at $2.75/mmbtu on July 13th, from $2.86/mmbtu on July 2nd. The bearish trend in the gas market was partly influenced by the rising natural gas production in the US amid thin demand from China and India.



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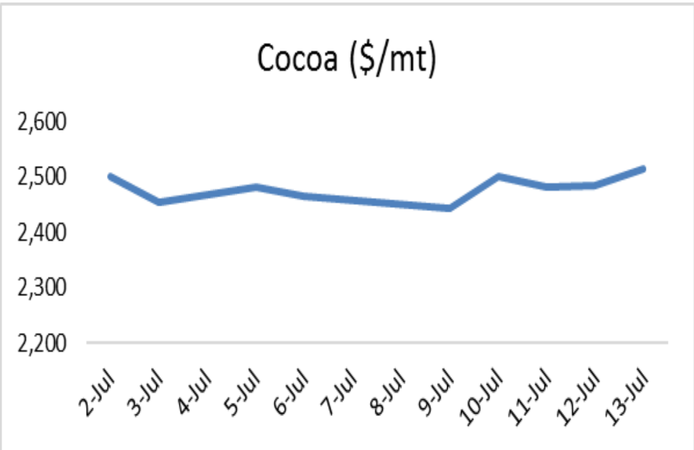
Outlook

Natural Gas prices are expected to remain volatile in the coming weeks. This will be as a result of the decline in EU output and a global demand.

Cocoa

Cocoa prices gained 0.48% to $2,513/mt on July 13th, from $2,501/mt on July 2nd. The increase in price was despite Ghana Cocoa Board's (COCOBOD) expectation of increased cocoa production in the near term.



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Outlook

The bullish trend in cocoa prices is expected to be sustained in the coming weeks. This will be driven by higher demand from China as the consumption of chocolate increases. Prices are thus expected to remain around $2,500-2,600/mt.

IMPORTS

Wheat

Wheat prices gained 3.54% to $4.97/bushel on July 13th, from $4.80/bushel on July 2nd. The increase was prompted by the forecast of reduced wheat production in the near term.

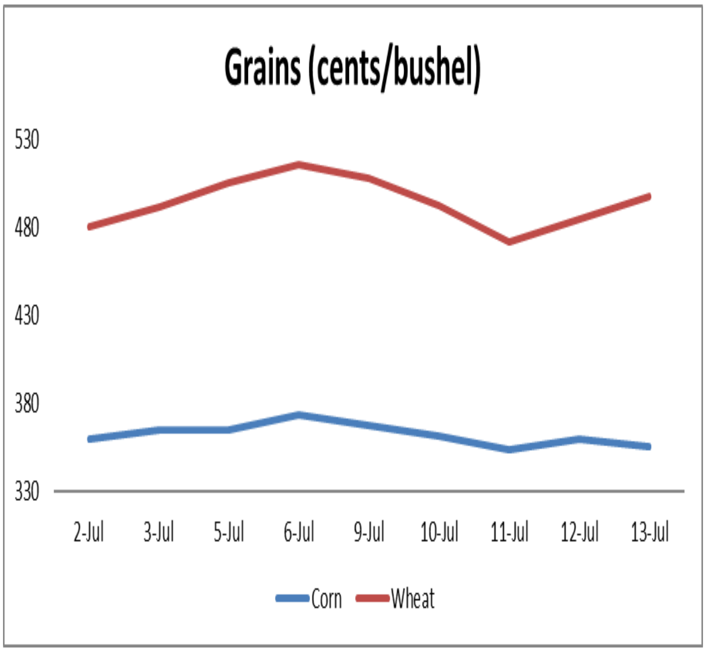
Corn

Corn prices decreased by 1.11% to $3.55/bushel from $3.59/bushel. This was driven by a cooler weather forecast suggesting favourable conditions in the US.

[14] Bloomberg.
[15] Bloomberg.

Grains- Outlook

The trade issues facing the United States and its trading partners around the world has a negative impact on grains. The United States is the world's leading producer and exporter of corn. Therefore, retaliatory measures by China and other trading partners will keep prices volatile in the near term. Also, favourable weather in the planting regions will lead to improved supply, thereby reducing prices.



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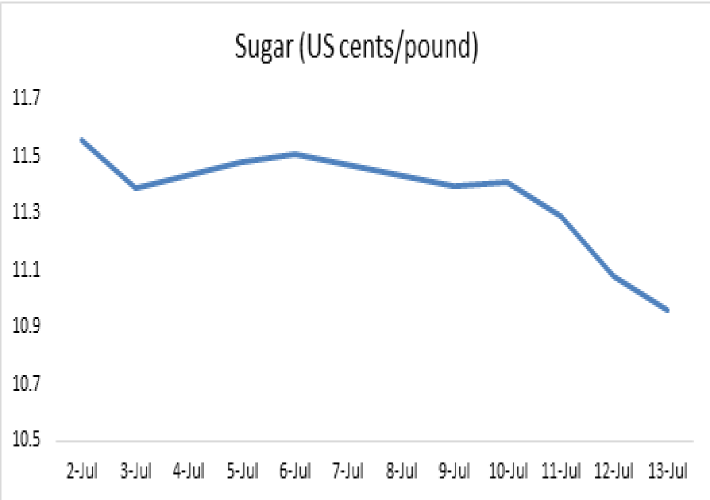
Sugar

Sugar prices decreased by 5.19% to $0.1096/ pound from $0.1156/pound, as the higher global surplus is sustained.



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Outlook

We expect prices to drop further as the market anticipates a possible supply glut in the coming days.

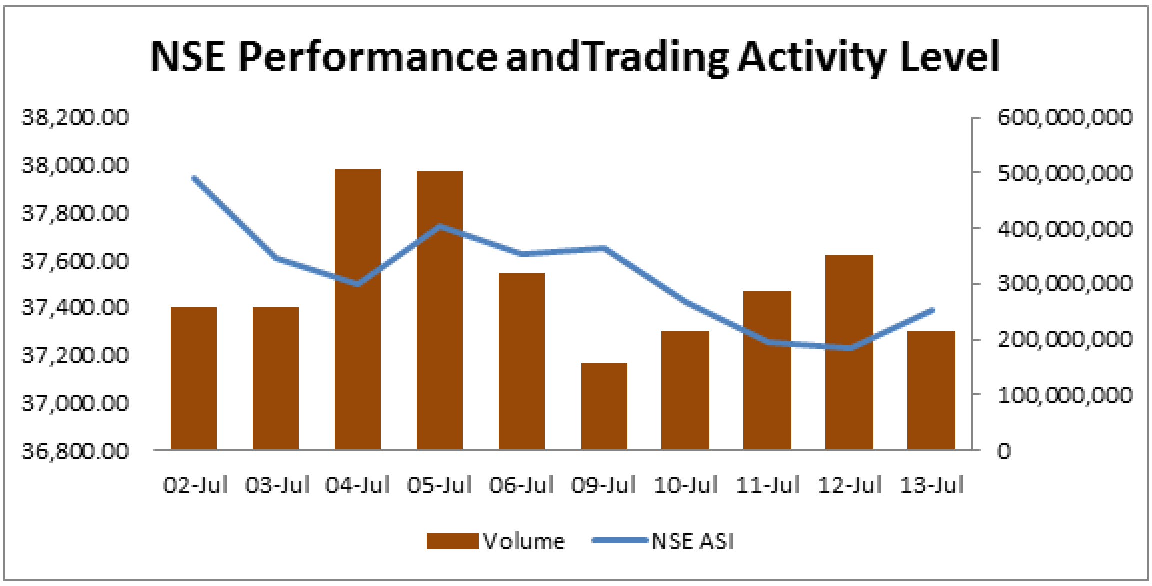
[16] Bloomberg.
[17] Bloomberg.

STOCK MARKET UPDATE

The Nigerian equities market extended its bearish streak to the first half of July, with the NSE-All Share Index (NSE ASI) losing 2.31% to close at 37,392.77points on July 13 from the 29th of June's close. Investors are minimizing their stockholding partly due to rising political uncertainty ahead of the 2019 election. The YTD return on the index stood at -2.22%.

The market gained 2.31% (N320bn) as the market capitalization closed the period at N13.55trn. The stock market is currently trading at a price to earnings (P/E) ratio of 10.63x (July 13th), a 1.48% decline compared to its close of 10.79x as at 29th of June, 2018. During the review period, the NSE recorded 3 days of gains and 7 days of losses.

The market breadth was also negative at 0.28x, as the number of losers (69) outpaced the number of gainers (19), while 81 stocks remained unchanged.



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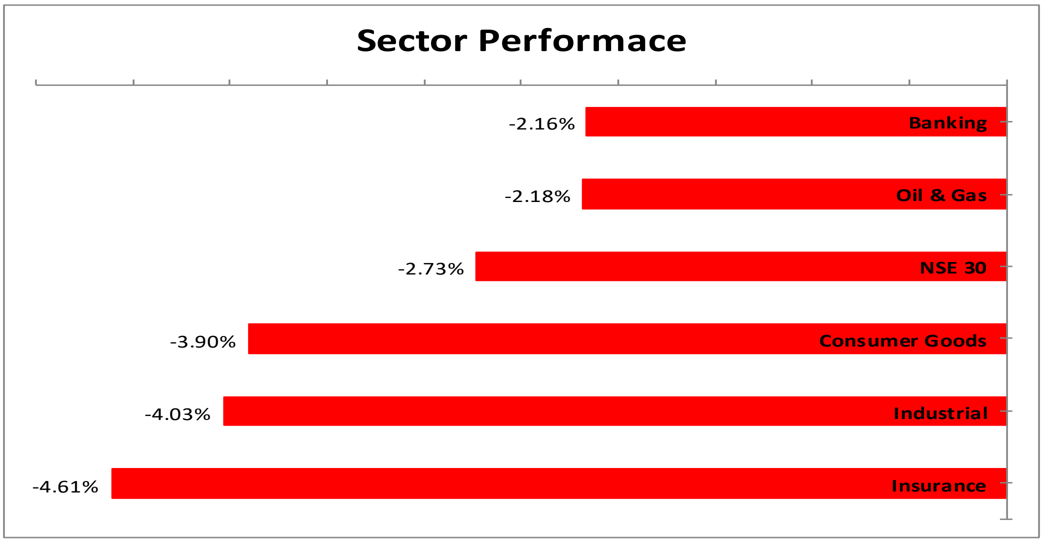
The bourse witnessed reduced trading activities in the first half of July. Average volume slid 11.05% to 306mn units compared to 344mn units recorded in the second half of June. Average value of transactions showed the same trend as it was down 16.26% to N3.40bn in the review period.

[18]NSE, FDC Think Tank

SECTOR PERFORMANCE

In the period under review, all the NSE sub-indices closed negative with the insurance sector performing the worst. Insurance stocks typically overreact to market volatilities due to their high level of sensitivity.



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The best performing stocks were C&I LEASING PLC (20%), CUSTODIAN INVESTMENT PLC (20%), EQUITY ASSURANCE PLC (14%), AIICO INSURANCE PLC (10%) and UNIVERSITY PRESS PLC (9%).

TOP 5 GAINERS (N)				
Company	**Jun '29**	**Jul 13'18**	**% Change**	**Absolute Change**
C&I LEASING PLC.	2.07	2.48	20	0.41
CUSTODIAN INVESTMENT PLC.	5.12	6.12	20	1.00
EQUITY ASSURANCE PLC.	0.21	0.24	14	0.03
AIICO INSURANCE PLC.	0.61	0.67	10	0.06
UNIVERSITY PRESS PLC.	2.33	2.55	9	0.22

[19]Source: NSE, FDC Think Tank

The least performing stocks were MCNICHOLS PLC (-26%), TANTALIZERS PLC (-25%), SOVEREIGN TRUST INSURANCE PLC (-23%), DN TYRE & RUBBER PLC (-21%) and B. OMOLUABI MORTGAGE BANK PLC (-19%).

TOP 5 LOSERS (N)				
Company	**Jun '29**	**Jul 13'18**	**% Change**	**Absolute Change**
MCNICHOLS PLC	0.98	0.73	-26	-0.25
TANTALIZERS PLC	0.36	0.27	-25	-0.09
SOVEREIGN TRUST INSURANCE PLC	0.30	0.23	-23	-0.07
DN TYRE & RUBBER PLC	0.29	0.23	-21	-0.06
OMOLUABI MORTGAGE BANK PLC	0.72	0.58	-19	-0.14

OUTLOOK

The country is currently in a state of growing political uncertainty. Portfolio managers would be weary of this, influencing the sentiment to reduce their exposures to the Nigerian equities market. Even though we expect some bargain hunting activities on the exchange, it is unlikely to reverse the market's positive performance in the near term. Therefore, we expect the stock market to continue its bearish streak in the second half of July.

CORPORATE FOCUS : CUSTODIAN INVESTMENT PLC

ANALYST'S NOTE

Non-life business segment – Key to success

Custodian Investment (Custodian) witnessed an 11.67% growth in gross revenue to N43.05bn in 2017. This is impressive given that the financial and insurance services sector recorded a nominal growth of 6.7% during the same period.[20]

Even more remarkable is the growth in Custodian's gross premium income (life and non-life premiums), which grew by 12.8% to N32bn in 2017 (insurance industry nominal growth was 2.5%). This remarkable feat was largely driven by the performance of its non-life business, which contributed 61% to its gross premiums.

Synergy between subsidiaries

The group has remained resilient despite the low visibility and penetration in the industry it operates. Interestingly, the trustee and other business portfolio was the most profitable among the group's four business segments. It recorded the highest net income margin of 96.73% compared to non-life (22.65%), life (8.22%) and pension administration (38.87%).

This notable achievement can be largely attributed to the group's philosophy of operating complementary portfolios. For instance, the group's insurance business segment has one of the lowest loss ratios in the industry of 93.75%, leveraging on sister subsidiaries to ensure access to credit at minimum cost. On the other hand, its combined ratio appeared less favorable at 115% due to uptick in operating expenses.

Custodian

CUSTODIAN AND ALLIED PLC

Analyst Recommendation: BUY

Market Capitalization: N30.88bn

Recommendation Period: 365 days

Current Price: N5.77

Industry: Financial Services

Target Price: N7.57

[20]Nigerian Gross Domestic Product Report 2017 – National Bureau of Statistics

Nonetheless, the group has maintained positive growth over the last four years, with a compound annual growth rate (CAGR) of 14.92% in gross revenue. The group is currently trading at a price to book of 0.85x, implying some upsides, as this alludes to the fact that the share price is undervalued.

Operational expenses slow growth momentum

The group's operating expenses have been increasing. In 2017, cost of operations increased by 15.89% to N30bn. This was largely attributed to the 30.3% increase in reinsurance expenses to N13.19bn. There are very few reinsurance players in the marketplace resulting in Custodian's limited ability to bargain for a better deal.

Profit remains resilient

Despite the uptick in costs, the group's profit growth remained positive. Its profit after tax (PAT) increased by 37.25% to N7.32bn in 2017. The remarkable growth in profit can be partly attributed to the 21.51% decline in the group's income tax expense to N1.62bn, as a result of a larger tax differential on gains. Custodian also saw arise in the group's gains on quoted investments, which recorded a 2422.31% increase to N879mn in 2017.

Accordingly, we place a **BUY** rating on the group's stock, bearing in mind the considerable upside to potential growth. This is largely supported by the competitive advantage of Custodian Investment's subsidiaries, especially the insurance business segments, in the wake of a review in regulatory capital requirement. The synergy among subsidiaries, coupled with a robust and consistent dividend policy, support our investment case for growth.

Strong potential despite weak penetration

Nigeria has one of the lowest levels of insurance penetration in the world. The economy's insurance premium to gross domestic product (GDP) remains negligible at 0.4%. This is much lower than other emerging markets in Africa, such as South Africa (16.9%), Kenya (2.9%) and Ghana (1.1%).[21]

Nigeria's insurance growth has also been undermined by weak market acceptance. This is coupled with a lax regulatory thrust, as policy compliance and enforcement of appropriate sanctions and penalties have been slack. However, efforts have intensified to sensitize the public on the benefits of the array of insurance products.

The industry has gone through a series of reforms since the establishment of the National Insurance Commission (NAICOM) in 1997 and the subsequent enactment of the Insurance Act 2003. The continuous restructuring of the industry is aimed at improving insurance penetration. This has been through implementation and enforcement of compulsory insurance, as well as insurers developing the technical and financial capacity needed to thrive in the space. In addition, the National Pension Commission (PenCom), through the Pension Act 2004, issued a directive on Group Life Insurance. This complemented the insurance regulator's efforts of deepening penetration and promoting public interest.

The increasing awareness and sophistication of the market, coupled with stricter regulations, are expected to increase penetration by the key industry players. This clear potential growth of the insurance industry has led to increased international interest. This is evident from the increased foreign capital inflows into the ailing industry.

The improvement in the visibility and intensity of competition has fed into innovation in the industry. Some insurers have introduced innovative rebate and refund policies in some asset classes, especially those with low risks profiles. This strategy will boost patronage and could be one of the critical success factors to achieve double digit growth in the industry.

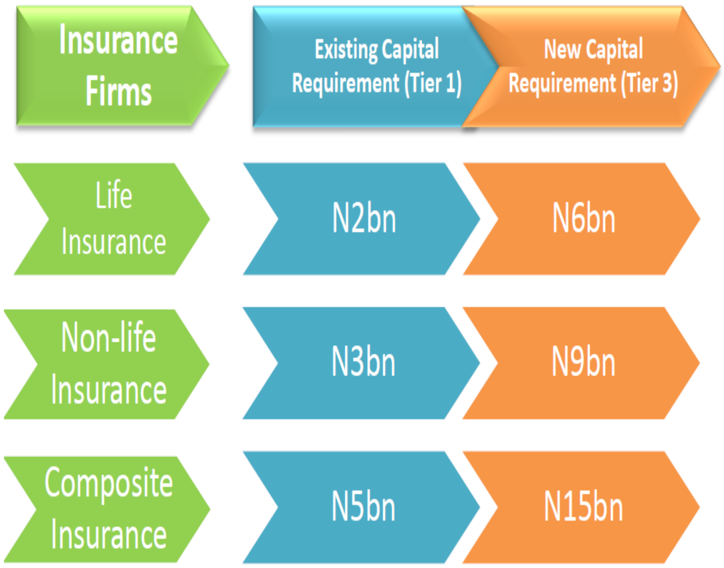
[21]Nigerian Gross Domestic Product Report Q1'18 – National Bureau of Statistics; Country GDP Statistics

Regulator tripled minimum capital requirement

The insurance industry is going through another structural evolution as NAICOM increased the capital base requirement for insurance firms. The new guideline, which takes effect January 1st, 2019, seeks to deepen the financial capacity of the industry to take on more risk. This is poised to improve confidence in the industry, as well as the ability to offer more complex insurance products.

The new capital requirement will lead to further consolidation in the underdeveloped industry, especially for insurers that intend to play in the Tier 1 space. Life insurance firms looking to appeal to the whole market will have to boost their capital to N6bn (from N2bn); non-life operators underwriting risks will have to increase capital to N9bn (from N3bn); while composite insurers, including oil and gas, will be required to shore up capital to N15bn (from N5bn).

Insurers who wish to maintain the current capital requirement will be limited to Tier 3 market activities; while Tier 2 will require a 50% increase over the existing minimum capital.



A segment of the Nigerian insurance industry that is widely underrepresented is the reinsurance market. The market is dominated by foreign reinsurance firms as the local reinsurance companies lack the capacity to embark on big ticket deals. This emphasizes the capital gap in the space.

COMPANY OVERVIEW

Custodian is an investment holding company from the successful merger of Custodian and Allied Insurance Plc and Crusader Plc. Custodian and Allied Insurance Plc (previously Accident and General Insurance Limited) was incorporated in 1991 as a private limited liability and subsequently quoted on the Nigerian Stock Exchange (NSE) in 2007. In 2018, the shareholders formally approved the change of the group's name to Custodian Investment from Custodian and Allied Plc.

Custodian is a diversified holding company with interest in life and non-life insurance, pensions, trustees and properties. Although a holding company, the group remains the most capitalized insurance affiliate on the NSE, boasting a share price appreciation of 34.96% year-to-date, despite the NSE All Share Index (ASI) losing 4.26%.

Subsidiaries	
Non-Life Insurance	• Custodian & Allied Insurance
Life Insurance	• Custodian Life Assurance
Trusteeship	• Custodian Trustees
Pension	• CrusaderSterling Pension
Associate	
Security Trading	• Interstate Securities

Non-life insurance

This business segment is the largest contributor to the group's revenue, and accounts for 50% of its revenue. Custodian and Allied Insurance, a wholly owned subsidiary, offers an array of insurance products to individual and corporate consumers. Some of these products range from energy, property, marine liability among others.

Life insurance

This business segment is undertaken by Custodian Life Assurance (fully owned), offering insurance products that cover both individual and group insurance, including annuity, endowment and investment-oriented products.

Pension administration

This business segment is undertaken by Crusader Sterling Pension, a 76.55% owned subsidiary of the group. The revenue earned includes administrative and management fees received from member's contribution and the net assets value of funds under management. Key activities in the segment revolve around investment decisions, collection of contributions and monthly disbursement of retiree benefits in line with Pension Reform Act 2014. This segment remains critical to the success of the group, as the pension fund asset is more than N8trn.

CUSTODIAN AND ALLIED PLC

FIVE-YEAR FINANCIAL SUMMARY - GROUP

STATEMENT OF FINANCIAL POSITION

	<-----AS AT 31 DECEMBER				---->
	2017	**2016**	**2015**	**2014**	**2013**
Assets	**=N='000**	**=N='000**	**=N='000**	**=N='000**	**=N='000**
Cash and cash equivalents	7,909,809	7,467,649	24,416,886	15,868,039	15,420,426
Trade receivables	91,845	61,678	88,243	191,479	96,049
Financial assets	49,425,235	39,981,461	14,272,664	11,946,916	7,462,379
Reinsurance assets	7,221,303	6,409,135	6,005,182	7,760,736	11,041,983
Deferred acquisition costs	591,725	444,879	377,467	556,955	372,021
Other receivables and prepayments	1,935,196	802,780	818,283	1,154,338	784,722
Investment in associates	573,871	537,130	-	668,166	556,638
Investment properties	8,812,700	8,141,275	7,362,533	7,314,011	6,272,666
Property, plant and equipment	3,258,879	3,039,638	2,761,272	2,469,421	2,463,747
Intangible assets	212,733	106,653	77,537	84,362	333,182
Deferred tax assets	367,721	300,379	387,112	489,977	83,832
Statutory deposits	500,000	802,000	802,000	850,000	850,000
Total assets	80,901,017	68,094,657	57,369,179	49,354,400	45,737,645
Liabilities					
Insurance contracts liabilities	33,830,930	26,604,797	18,813,643	15,806,783	17,658,373
Investment contract liabilities	3,514,935	3,487,613	3,376,778	3,030,332	3,080,315
Trade payables	1,228,531	2,778,161	2,592,006	1,709,081	826,187
Other payables	2,788,018	1,771,096	1,410,727	1,481,604	1,079,387
Current income tax	1,518,293	1,609,044	1,475,265	1,098,447	1,207,501
Deferred tax liabilities	1,719,433	1,749,277	1,131,015	1,075,600	397,578
Borrowings	-	-	2,498,286	2,066,248	1,870,284
Derivative financial liabilities	-	-	-	119,635	113,087
Total liabilities	44,600,140	37,999,988	31,297,720	26,387,730	26,232,712
Equity					
Share capital	2,940,933	2,940,933	2,940,933	2,940,933	2,940,933
Share premium	6,412,357	6,412,357	6,412,357	6,405,632	6,405,632
Treasury Shares	-	-	-	(140,120)	-140,120
Retained earnings	16,814,192	12,719,469	9,991,704	7,770,006	5,536,587
Contingency reserve	7,947,255	6,663,389	5,510,478	4,779,369	4,128,408
Available-for-sale reserve	862,753	310,205	244,664	663,711	203,567
Asset revaluation reserve	437,642	283,888	277,327	-	-
Equity attributable to owners of the parent	35,415,132	29,330,241	25,377,463	22,419,531	19,075,007
Non-controlling interests	885,745	764,428	693,996	547,139	429,926
Total equity	36,300,877	30,094,669	26,071,459	22,966,670	19,504,933
Total liabilities and equity	80,901,017	68,094,657	57,369,179	49,354,400	45,737,645

MANAGEMENT

The board of Custodian is currently led by Dr. Mrs. Omobola Johnson, an ardent philanthropist. She has over thirty years of corporate experience spanning the private and public sectors both locally and internationally. She also serves on the board of several well-established companies. Her goodwill in the Nigerian business space is positive for the perceived reputation of Custodian Group. The subsidiaries can leverage extensively on her network in the technology space to build robust systems to penetrate the largely underserved financial market.

Mr. Oluwole Oshin is the founder and Group Managing Director of the Custodian Investment Group. Drawing from over three decades work experience, he has shown commitment to the building and transformation of the economy through the development of insurance and risk management. This has been achieved through discipline and operating under a robust risk management framework in line with international best practice, despite operating in an underdeveloped industry. These high standards have earned the group a positive reputation within the business segments it operates.

The management has also embarked on strategic partnerships to complement current efforts. Information sharing and synergy of ideas between subsidiaries and associate have helped in the attainment of major milestones. For instance, Custodian and Allied Insurance boasts of one of the lowest loss ratios in the insurance industry. Unlike its peers in the insurance industry, Custodian and Allied Insurance leverages on its sister subsidiaries to facilitate access to credit, thereby keeping its cost of funds low.

The rest of the board is comprised of seasoned professionals with rich backgrounds. The group boasts a stable, yet resilient team.

Dr. Mrs. Omobola Johnson

Chairperson Board of Directors

Mr. Oluwole Oshin

Group Managing Director

THE BULLS SAY

* Experienced and versatile management team
* Strong brand name
* Synergy between subsidiaries – diverse portfolio of complementary subsidiaries
* Strong organic growth in the insurance industry
* Firm position in consolidating industries
* Operational autonomy of subsidiaries – different management teams
* Robust risk management framework
* Improved policy and regulatory enforcement
* Balance between funds and insurance cover

THE BEARS SAY

* Intense competitive rivalry in restricted markets
* Inadequate reinsurance firms to take on high value risk assets
* High and increasing reinsurance costs
* Delay in remittances to Custodian and Allied Insurance
* Bottlenecks in policy enforcement – undermining progress
* Poor image and widespread negative connotations of insurance – due to trust and disbelief
* Adverse perception of consumer – due to incomprehension of complex computation of premiums

RISKS AND OUTLOOK

The most potent risks that undermine performance in the insurance industry are credit and operational risks. These risks surround issues such as access to credit, internal system efficiencies, as well as external events. They all impact the ability to meet operational obligations when due.

More importantly, the timely payment of claims has a high impact on customer retention and acquisition. To tackle this, Custodian has shown great commitment to building a brand that will outlive the founders. They have a robust risk framework in line with international best practice and have abided by the ethical framework required to build a sustainable brand. This has enabled the management to envisage eventual outcomes of multiple scenarios and mitigate losses arising from operational risk.

The group is also faced with market and liquidity risks in form of volatilities in exchange rate, interest rates, as well as prices. To hedge these uncertainties, the group has maintained a portfolio of complementary subsidiaries and associates. The synchronization and information symmetry have helped reduce the impact of fluctuations in the market. In addition, the group has also chosen to minimize foreign exchange risks by matching foreign currency assets with respective liabilities. This helps mitigate currency volatility.

For goal congruence, the management has maintained a value enhancing portfolio, which aligns with the overall aim of the group. Custodian has also given leeway to the subsidiaries, ensuring accountability and responsibility at the subsidiary levels.

APPENDIX - OUR VALUATION

Using the dividend growth methodology, we estimated a stock price of N7.57, which is a 31.2% upside on the current price of N5.77 as at August 3rd, 2018. The discount rate (cost of equity) of 16.3% was derived using a 13.5% risk free rate (FGN 5-year Bond as at June 2018), a Beta of 0.4368, and a market risk premium of 6.34%.

The terminal P/BV, which is factored into calculating for exit multiple, was derived using the formula (Return on Average Equity (RoAE) – Net Income Growth)/ (Cost of Equity – Net Income Growth). The intuition behind using this formula is considering how much of Custodian Investment's RoAE is being allocated to grow dividends and how much does it cost. Based on this intrinsic valuation, Custodian Investment is an undervalued stock with a potential for significant appreciation

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

Custodian Investment Plc					
NGNmn	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**
Dividends	1,900	2,110	2,381	2,602	2,662
Discount period	1	2	3	4	5
PV of Dividends	1,634	1,561	1,515	1,424	1,253
Equity	42,410	49,548	57,796	67,778	79,735
Terminal Value:					
Terminal P/BV	0.99				
Terminal Value (Exit Multiple)	78,941				
PV of Terminal Value	37,152				
PV of Dividends	7,387				
Present Value (NGNmn)	44,538				
Shares outstanding (mn)	5,882				
Share price (NGN)	**7.57**				