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FDC MONTHLY ECONOMIC UPDATE

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In This Issue ...

DRIVING EFFECTIVE FISCAL SPENDING IN NIGERIA AS A PART OF FISCAL CONSOLIDATION

Fiscal consolidation is a process by which the government adopts strategies to promote fiscal sustainability, through reduction in its deficits and debt accumulation. According to the International Monetary Fund (IMF), Nigeria's fiscal deficit stood at 4.3% in 2017.[1] In the 2018 article IV review, the Fund recommended an increase in non-oil revenues in order to reduce this deficit and ensure macroeconomic stability. Sub-Saharan African (SSA) economies such as Ghana and South Africa have also shown efforts towards fiscal consolidation. Ghana's debt to GDP ratio declined from 9% in 2016 to 6% in 2017. South Africa also recorded a debt to GDP ratio of 3.9% in 2017 down from 4.5% in 2016. The government's fiscal consolidation efforts in 2018 might however be limited by pre-election spending ahead of the 2019 polls.

The proposed expenditure in Nigeria's federal government's annual budget has consistently been inadequate to drive growth when compared to other advanced economies with higher growth rates. Even more worrisome is that the government consistently spends below its budgeted expenditure. Nigeria spent, on average, approximately 10% below its proposed budget between 2012-2015.[2] In 2016 the gap between budget and actual rose astronomically to 27.4%, decreasing only slightly in 2017 to 25.7% below its proposed expenditure.[3]

In the current 2018 budget, the government has proposed a total expenditure of N9.12trn, 22.6% above the 2017 proposed expenditure.[4] While this has been received optimistically due to its potential impact on growth, the actual performance in each year since 2012 dampens this positive outlook. Nigeria's pattern of budget under-spending and the resulting stunted growth are not expected to change in 2018 unless a new strategy is employed. The government needs to reduce the gap between the proposed-actual expenditure to result in a faster growth than preceding years. Raising more revenue through a concerted effort to expand tax compliance should be considered as an important part of the solution. An increase in government tax revenue could also complement the government's efforts to reduce its budget deficit and achieve fiscal consolidation.[5]

Federal Government expenditure profile in Nigeria

Governments typically adopt an expansionary fiscal policy to stimulate growth. It involves one or a combination of an increase in government expenditure and tax cuts. These strategies boost aggregate demand, production and employment. The Nigerian government has consistently proposed an expansionary budget since 2012. The exception was in 2014 which coincided with the global oil market crash. This expansionary policy is commendable as it suggests a positive intent towards growth. However, the strategy has largely been illusory as the federal government has spent well below its projections. In the last three years, the government has spent an average of 20% below its proposed expenditure, trending higher in the past two years.[6]

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[1] International Monetary Fund, March 2018. "2018 Article IV Consultation". Available at www.imf.org/~/media/Files/Publications/CR/2018/cr1863.ashx

[2] Budget Office of the Federation, 2018. "Quarterly Budget Implementation Reports". Federal Government of Nigeria, http://www.budgetoffice.gov.ng/index.php/resources/internal-resources/reports/quarterly-budget-implementation-report

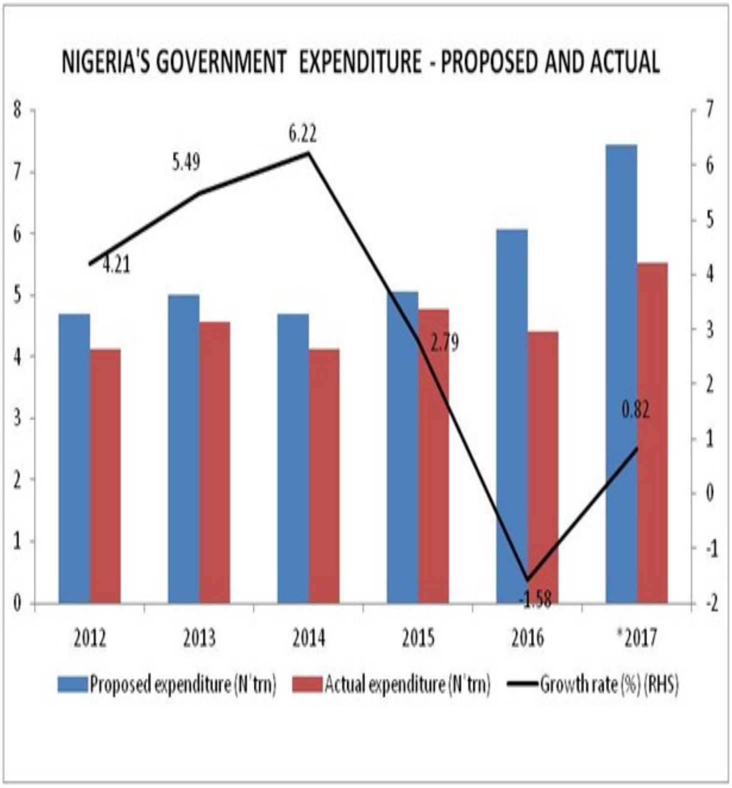
[3] Budget Office of the Federation, 2018. Ibid. Federal Government of Nigeria, http://www.budgetoffice.gov.ng/index.php/resources/internal-resources/reports/quarterly-budget-implementation-report

[4] Budget Office of the Federation, 2018. "2018 Budget". Federal Government of Nigeria, http://www.budgetoffice.gov.ng/index.php/2018-budget

[5] Fiscal Consolidation is defined as the process by which the government adopts policies to reduce budget deficits and debt accumulation

[6] Budget Office of the Federation, 2018. Ibid. Federal Government of Nigeria, http://www.budgetoffice.gov.ng/index.php/resources/internal-resources/reports/quarterly-budget-implementation-report

In fact, in 2016, when the government proposed a larger budget size, it ended up spending below the previous year in actual terms. Given a population estimated at 190 million people, ***proposed*** government spending per head in 2017 came in at about N39,000 ($127). This is well below other bigger and faster growing economies, such as China and Brazil, that spend approximately $2,200 and $4,100 respectively per citizen.[8,9] Economic growth is correlated with ***actual*** budgetary disbursements as against proposed amounts. Nigeria's actual spending per head has fallen below $120. In 2015, 2016 and 2017, actual spending per head came in at $131.6, $77.43 and $94.96 respectively.[10] While government expenditures are not expected to increase enough to significantly boost per capita spending, the government should at least ensure it spends up to its proposals.



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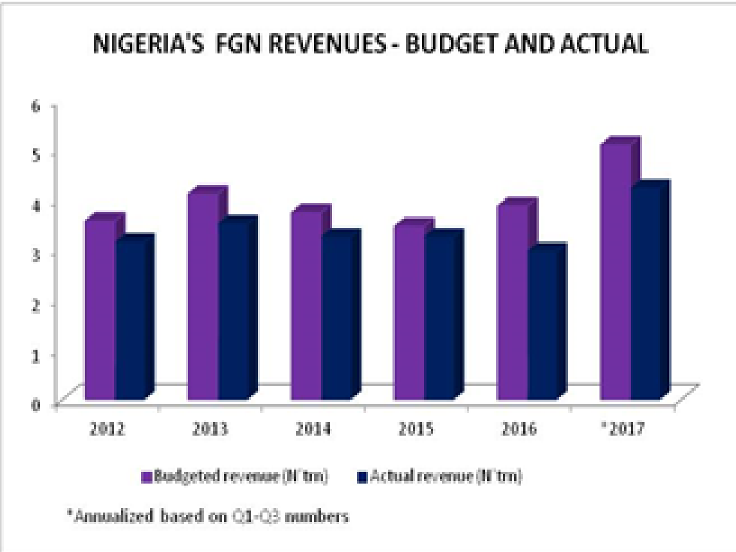
* Annualized based on Q1-Q3 numbers

Way forward – Raising fiscal revenues and spending through improved tax compliance

It is noteworthy that the Nigerian federal government's budgetary spending efforts have been largely subject to revenue shocks. The government's actual revenues have consistently stayed below projections. Between 2012-2016, revenue shortfall was at an average of 15% below the projection.[11] This largely explains why the federal government's expenditure has also fallen short of what it proposes. Raising revenues to close the proposed and actual spending gaps demands clear strategies.



[7]Budget Office of the Federation, FDC Think Tank

[8]Central Intelligence Agency, 2018. "EAST & SOUTHEAST ASIA :: CHINA". United States federal government, https://www.cia.gov/library/publications/the-world-factbook/geos/print_ch.html

[9]Central Intelligence Agency, 2018. "SOUTH AMERICA :: BRAZIL". United States federal government, https://www.cia.gov/library/publications/the-world-factbook/geos/print_br.html

[10]Budget Office of the Federation, 2018. Ibid. Federal Government of Nigeria, http://www.budgetoffice.gov.ng/index.php/resources/internal-resources/reports/quarterly-budget-implementation-report

[11]Budget Office of the Federation, 2018. Ibid. Federal Government of Nigeria, http://www.budgetoffice.gov.ng/index.php/resources/internal-resources/reports/quarterly-budget-implementation-report

Nigeria's aggregate government revenue stream is broadly composed of oil (crude oil sales) and non-oil revenues (taxes, royalties, etc). To boost total revenue, raising the non-oil component is more feasible. This is because oil revenues are more difficult to influence. Revenues from crude oil sales usually depend on global oil price and domestic output. The Organization of Petroleum Exporting Countries (OPEC) has capped Nigeria's crude oil output at 1.8 million barrels per day (mbpd) in an attempt to avoid a global supply glut and a price crash. Nigeria has little influence on the global price of crude as it remains a relatively small player among oil producing countries. This makes raising taxes, royalties and other non-oil components a more viable option to boost revenue inflows.

To shore up revenues, the government could consider raising taxes, which contribute approximately 82.5% to total non-oil revenues in Nigeria.[12] These include corporate income tax and value added tax (VAT) among others. An increase in these taxes could be justified as the tax revenue to gross domestic product (GDP) ratio is currently very low even though the country charges one of the highest corporate income tax rates in Sub-Saharan Africa. At 6%, Nigeria's tax to GDP ratio is one of the lowest in the world. It is significantly below that of other oil producing countries such as China (28%), US (10.89%), Angola (10.32%) and Russia (9.13%).[13] However, raising tax rates to boost government spending will not stimulate aggregate demand and economic growth as higher tax rates are part of a contractionary fiscal policy, inconsistent with a growth drive. Raising tax rates could also discourage the needed investment to spur growth. A more economic potent tool is to improve tax compliance in the country.

It is noteworthy that Nigeria's tax compliance rate has been very low, and this has filtered into sub-optimal tax revenue inflows. According to the International Monetary Fund (IMF), only 1.95% of the registered personal income tax payers in the country are active. For corporate income tax, the rate is 5.62%, while it is only 5.12% for VAT.[14] This low compliance rate has constrained the government's tax revenues and budget spending ability.

To improve tax compliance, Nigeria needs to invest in a tax monitoring system, which involves a scrutiny of tax receipts. Under this system, the government would be able to more easily detect and clamp down on tax evasion. To strengthen its ability to enforce compliance, the government could consider technology transfers from the US. The US has achieved a voluntary tax compliance rate of 81.7% in part because it employs an effective tax monitoring technology.[15]

The Nigerian federal government's budget underspending has typically undermined the effectiveness of expansionary fiscal policies in the country. If new steps are not taken, 2018 is poised to repeat the same trend. Reversing this trajectory is expected to call for an increase in government revenues, which would enhance the government's spending ability. These increased revenue measures should include an improvement in tax monitoring and compliance. The good news is the 2018 budget was just passed into law, which suggests ample time for the implementation of these recommendations.

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[12]Budget Office of the Federation, 2018. "2017 Third Quarter Budget Implementation Report". Federal Government of Nigeria, http://www.budgetoffice.gov.ng/index.php/draft-third-quarter-budget-implementation-report-2017?task=document.viewdoc&id=670

[13]The World Bank, 2018. "Tax revenue (% of GDP)". Available at https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?year_low_desc=false

[14]International Monetary Fund, February 15,2018. "IMF Country Report No. 18/64". Available at https://www.imf.org/~/media/Files/Publications/CR/2018/cr1864.ashx

[15]Internal Revenue Service, March 15, 2018. "IRS Statement on the Tax Gap Update". U.S Department of the Treasury, https://www.irs.gov/newsroom/the-tax-gap

Overview

Nigeria's Fast Moving Consumer Goods sector (FMCG) has faced a lot of challenges in the last four years. The decline in consumers' purchasing power due to the decline in global oil prices in 2014 and the disruption in oil production in the Niger Delta negatively affected the sector. It was also one of the hardest hit during the recession due to the challenging business environment. The inaccessibility of the dollar in the economy and delayed policy response resulted in weak macroeconomic conditions, which led to weak labor market dynamics (high unemployment and underemployment), reduced disposable income and poor corporate performance. The sector experienced a fall in patronage, production, turnover and profit margins.

Post-recession (Q1'18), the sector outperformed GDP growth (1.95%) as it recorded a growth rate of 5.46%. The introduction of the Investors & Exporters' Foreign Exchange window (IEFX) by the Central Bank of Nigeria (CBN) in late April 2017 boosted liquidity in the forex market. This in turn led to the expansion of the FMCG sector due to access to cheaper forex to import new technology, machinery replacements and purchase of raw materials. In addition, the sector has benefitted from cross-selling strategies and an efficient distribution network.

The FMCG sector remains highly fragmented and it is dominated by key players who leverage extensively on international alliances.

THE FMCG SECTOR

CONTRACTION IN INVENTORY LEVELS AS CONSUMER DEMAND FALLS

Recent Developments

In the month of July, the FMCG sector witnessed some noteworthy events such as Duet Private Equity Limited's (DPEL) $50mn investment in AJEAST Nigerian Ltd, a Nigerian beverage firm and the decline in the Purchasing Manager's Index (PMI).

PMI falls in July

FBN PMI plunged to an 18-month low of 48.9 points from 49.8 points in the preceding month. This marks the third negative reading in 2018 and a contraction of the manufacturing sector. According to the FBN report, all five variables declined with three (output, employment and stocks of purchases) below the 50 threshold. The manufacturing sector remains uncertain of future demand and has thus adopted a wait and sees approach.

The decline was primarily due to weak consumer demand and high carrying costs, despite the availability of forex through the IEFX window introduced by the CBN. In addition, the rainy season, poor electricity supply, high rates of import duty on raw materials and stiff competition from imported goods from China suppressed growth.

Similarly, the CBN PMI declined to 56.8points from 57.0 points in June. Contrary to the FBN report, the CBN PMI signifies an expansion in the manufacturing sector for the 16th consecutive month. The decline was as a result of the slowdown in four variables- production level, new orders, raw material inventories and employment. On the contrary, 13 out of 14 sub-sectors surveyed grew with the exception of plastic and rubber products.

Implications

The decline in PMI was mainly due to a decline in consumer demand which adversely affected inventory build-up of manufacturers. Furthermore, high carrying costs have reduced manufacturers' appetite for holding stock. We expect the PMI figures to contract further in July due to increased excise duties on alcoholic beverages and tobacco, power constraints and increased forex demand. Furthermore, if the external reserves depletion persists the CBN's ability to support the forex market could be affected. This is detrimental to manufacturing activities and could increase import and operating costs through a weaker exchange rate.

Performance of the Consumer Goods Sub-Index on the NSE

15 out of the 169 listed companies on the NSE are FMCG companies and constituted approximately 26% of total market capitalization in July (N13.41trn). The consumer goods index comprises of the most capitalized and liquid companies in the food, beverage and tobacco industry. This provides a benchmark to measure the performance of FMCG companies.

In July, the consumer goods sector lost 5.08% to 880.62pts from 927.72pts recorded in the preceding month. This was as a result of losses recorded by PZ Cussons (27%), Honeywell Flour Mills (23%) and Cadbury Nigeria Plc (18%). Year-to-date (YTD), the sub-index lost 9.78%.

The figure below shows the top gainers & losers in the consumer goods space.

TOP 2 GAINERS (N)				
Company	**Jul 31'18**	**Jun 29'18**	**% Change**	**Absolute Change**
NIG. FLOUR MILLS PLC	7.20	6.55	10%	0.65
NESTLE NIG. PLC	1.600.00	1,575.00	2%	25.00

TOP 3 LOSERS (N)				
Company	**Jul 31'18**	**Jun 29'18**	**% Change**	**Absolute Change**
PZ CUSSONS NIG PLC	15.10	20.70	27%	-5.60
HONEYWELL FLOUR MILLS	1.76	2.29	23%	-0.53
CADBURY NIGERIA PLC	10.70	13.00	18%	-2.30

H1'18 Financial Performance

Nestlé Nigeria Plc

Nestlé Nigeria recorded robust revenue sales up 10.97% to N135.3bn in H1'18. This was driven primarily by growth in its sales volume of both its food and beverage segment. The food segment recorded an 8.91% increase in revenue to N85.13bn, while its beverage segment recorded a 14.65% increase to N50.17bn in H1'18. The just concluded Ramadan season, which drove the high demand for Maggi (predominantly popular in the North), led to the rise in its food volume growth.

Nestlé's finance costs plunged 84.85% to N1.12bn in H1'18 from N7.39bn in H1'17due to a 99.03% reduction in net forex loss to N50.19mn from N5.17bn in H1'17. This in turn boosted Nestlé's margin by 23.8% in H1'18 due to access to cheaper forex to import new technology, machinery replacements and the purchase of raw materials such as coffee.

Outlook

We expect a negative performance to persist in the consumer goods sector in the coming month. This will be driven primarily by an expected fall in consumer demand due to increased excise duties on alcoholic beverages and tobacco and stiff competition from imported goods. In addition, power constraints and high carrying costs will continue to weigh on company performance.

Highlights

There has been an increase in activities in the construction sector. The most notable events include the construction of river dykes, the Lagos-Ibadan Standard Rail Gauge and the approval of N72.9bn ($202.5mn) for the reconstruction of Apapa road. The 3-day closure of the Third Mainland Bridge for investigative maintenance test, which was earlier slated to begin on July 27, was postponed to August 24. Meanwhile, listed construction companies on the Nigerian Stock Exchange released their financial results for the first half of 2018. These firms posted relatively positive financial performances in the period, from loss positions in 2017. In SSA, Africa's longest suspension bridge was completed in July. The new bridge will connect South Africa and Swaziland to Mozambique.

THE CONSTRUCTION SECTOR

INCREASED ACTIVITIES AS ELECTIONS DRAW CLOSER

Federal Government begins construction of dykes

According to the Federal Ministry of Water Resources, the Federal Government of Nigeria has commenced the construction of dykes, which are artificial slopes or walls erected to regulate water levels. This is in order to minimize risks that could arise from flooding. These dykes are being constructed in flood-prone areas such as Kwara and Kebbi States. Reserves in these dykes would be impounded for water supply and irrigation purposes.

Implications

Nigeria's average annual rainfall of about 1,200mm is one of the highest in SSA.[16] This high level of precipitation without a commensurate water management strategy has mostly led to flood incidence in the country. Flood in Nigeria submerges farm land, and this has been a major constraint to agricultural cultivation activities. It has also displaced people in the country and distorted transportation activities as roads become inaccessible. The construction of dykes would help manage water supply in the country and reduce floods and their negative effects. The decision to impound water for irrigation facilities should also secure the supply of agricultural commodities such as rice, maize, cowpea, groundnuts and soybeans at periods of water deficiencies.

FG restricts visa issuance to foreign engineers

President Buhari announced in July the restriction of the visa issuance to expatriates who seek to take up engineering roles in Nigeria. This restriction was enforced by the Ministry of Interior in compliance with Executive Order 5, which states that procuring authorities shall give preference to Nigerian companies and firms, when awarding contracts, in line with the Public Procurement Act 2007. The government pledged to strictly enforce the visa restriction policy.

[16]Data Africa, 2018. "Average Annual Rainfall". Available at https://dataafrica.io/map

Implications

The visa restriction to foreign engineers highlights the Nigerian government's willingness to improve local content in the country. While this is commendable, the relatively low competitiveness of Nigerian engineers suggests that foreign engineers would continue to earn the preference of contractors in the country. Meanwhile, the government's restriction will likely create a dearth of these preferred engineers, which would birth market imperfections in the industry and probably raise construction costs. The government might mull these restrictions in the near term.

NRC begins work on Standard Gauge in Lagos

The Nigerian Railway Corporation (NRC) disclosed that the construction of the Lagos-Ibadan Standard Rail Gauge has started fully as the challenges of underground pipelines and cables have been resolved. The project's cost is estimated at $1.5bn and it is being jointly funded by the Nigerian and Chinese governments. The rail line would span 156.65KM and it is expected to be completed by April 2020.

Implications

The Lagos-Ibadan express way is the busiest road in Nigeria. The road connects Lagos to Oyo State and other regions of the country. The construction of a rail line will provide a fair alternative route to commuters between these 2 cities. This would also reduce traffic on the express and ease the transportation of goods from Lagos to other parts of the country.

FEC approves N72.9bn for Apapa road in Lagos

The Federal Executive Council (FEC) approved N72.9bbn ($202.5mn) for the reconstruction of the 270.8 linear kilometres Apapa road. According to the Ministry of Power, Works and Housing, the project will be executed through a Public-Private Partnership model and the finance requirement of the project would be recovered through the funding credit tax policy of the government. Dangote Group has been selected as the constructing firm for the project. The road will have 10 lanes, with five on both sides.

Implications

This would be the first full reconstruction of the Apapa road since it was constructed in 1975. Previous efforts have only been towards repairing damaged sections. Meanwhile, the road has been in a poor state since 2017, and this has created a gridlock. This gridlock has constrained the distribution of goods that arrive at the Apapa port. A rehabilitation of this road would be a welcome development that would ease transportation and distribution activities along the Apapa axis.

AfDB pledges to help Nigeria bridge infrastructure financing gap

The African Development Bank (AfDB) has pledged to work with multilateral organizations and private sector operators to help Nigeria bridge its infrastructure gap. This would be through the development of effective public private partnerships and the provision of new innovative financing programmes and instruments for the country. Projects would span across the agricultural and energy sectors among others. The AfDB estimates Nigeria's annual infrastructure financing needs at $100bn and it is projected to reach $3trn by 2044.

Implications

The AfDB's commitment would complement the Nigerian government's efforts to improve infrastructure conditions in the country. The completion of projects in the key sectors of the economy would improve the country's business operating environment. Infrastructure spending is also expected to have a positive multiplier effect on aggregate output. This bodes favourably for Nigeria's macroeconomic stability in the medium term.

SSA- Africa's longest suspension bridge complete

The Maputo-Catembe Bridge, Africa's longest suspension bride, was completed in July in Mozambique. Construction activities on the project began in 2014 in a joint construction and management project between the Mozambique and Chinese governments under the China Road and Bridge Corporation (CRBC). It was initially set for completion in 2017, but postponed due to insufficient construction materials. The bridge aims to connect Maputo (Mozambique) with Catembe on the southern part of Maputo Bay. The bridge has a length of 3KM and a width of 680m, linking Mozambique with Swaziland and South Africa.

Implications

Apart from being Africa's longest suspension bridge, the Maputo-Catembe will also be ranked among the 60 largest suspended bridges in the world. The suspension bridge will be able to carry high volumes of traffic comfortably in both directions. This would effectively replace the current ferry system and various fragmented road systems that transport goods and tourists from South Africa and Swaziland into Mozambique.

CONSTRUCTION COMPANIES' PERFORMANCE ON THE NSE IN JULY

The stock prices of listed construction companies on the NSE lost an average of 3.03% in July. Share prices of Arbico and Road Nigeria were flat in the month, while Julius Berger lost 9.09%.

Copany	Share Price (June) (N)	Share Price (June) (N)	%Change	Directional Movement
Julius Berger Plc	27.50	25.00	-9.09	↓
Arbico Plc	4.79	4.79	0	↔
Roads Nigeria Plc	6.60	6.60	0	↔

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[17]NSE, FDC Think Tank

Corporate results (H1'18)

Julius Berger Plc.

Julius Berger Plc reported a stronger financial position in the first half of 2018, compared to 2017. Top line came in at N73.08bn, showing a y/y increase of 4.8%. Profit before tax increased sharply by 602% to N3.93bn. The profit after tax also jumped to N2.59bn, from a loss position of N364.73mn in H1'17. This is partly due to a sharp decline in the company's foreign exchange transaction loss to N127.22mn, from N2.73bn.

Arbico Plc

Arbico Plc's revenue declined by 12.3% to N2.14bn in H1'18. The company's cost of sales declined more sharply by 16.6% to N1.71bn. PBT and PAT were equal at N70.78mn, increasing from a loss position of N101.12mn.

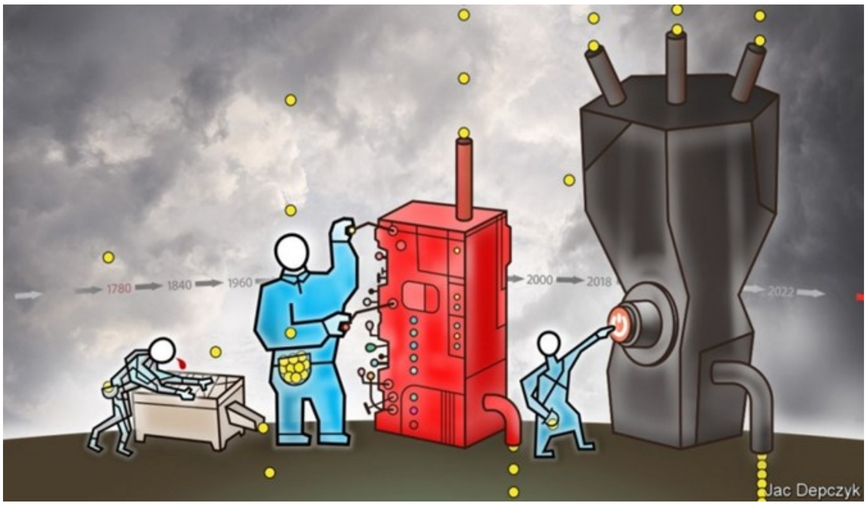
Outlook

Lagos State's Third Mainland Bridge will be shut for investigative maintenance test between August 24-26. This would distort transportation activities between the mainland and island this period. In the meantime, alternative routes such as the Eko and Carter Bridges will be available to commuters. We are likely to see more project approvals in the month as political office holders deliver more projects to win public support in the 2018 polls.

The industrial revolution could shed light on modern productivity

Global Perspective: Culled from The Economist

Researchers differ on whether rising wages gave the impetus to industrialize



HOW much yarn per day could an 18th-century British woman spin? Such questions are catnip for economic historians, whose debates typically unfold unnoticed by anyone outside their field. But a running debate concerning the productivity of pre-industrial spinners, and related questions, is spilling beyond academia. Each probably produced between a quarter of a pound and a pound of yarn a day, the historians have concluded. But at issue is something much more profound: a disagreement regarding the nature of technological progress that has important implications for the world economy.

Economic growth of the sort familiar today is a staggering departure from the pattern of pre-industrial human history. More than a century of study has not resolved the question of why it began where and when it did. This is a matter of more than historical interest. Weak growth in productivity has economists asking whether humanity is running out of ideas, and whether it is losing its ability to turn new technologies into rising incomes. A clearer understanding of what exactly happened in 18th-century Britain could shed light on the matter.

Those studying the productivity slowdown typically focus on supply-side factors such as workers' skills and investment in research and development. Explanations of the Industrial Revolution often draw on similar factors, namely the characteristics of Britain that made it a fertile place to apply new technologies to production. Some scholars emphasize institutional features such as the emergence of stable parliamentary democracy, the rule of law and secure property rights. Others credit Britain's capital markets, communities of skilled tinkerers and cultural habits that encouraged disciplined effort and entrepreneurial ambition.

But if such factors are necessary for industrialization, they do not appear to be sufficient. Though other parts of north-west Europe shared many such features with Britain, it was in Britain alone that industrialization began. Economic historians have therefore considered the "demand side" of industrialization: the conditions under which firms found it worth experimenting with unproven technologies. In particular, scholars are embroiled in a debate concerning the "high-wage hypothesis" put forward by Robert Allen.

Over the past two decades Mr Allen has argued that the key to Britain's industrialization lies in the expansion of commerce and trade that preceded it. That had pushed up wages for British workers, while pay elsewhere in Europe stayed flat. On the eve of the Industrial Revolution, British firms operated in a market where coal was cheap but labour was dear. It thus made sense for firms to seek ways to use coal-fired machines to wring more out of their workers. At British wage rates, tinkering with new spinning or weaving equipment made sense, Mr Allen writes, whereas in France, say, new modes of production were less likely to pay off. Not until decades of mechanization and innovation in Britain had boosted the efficiency of new equipment was it worth adopting on the continent.

Mr Allen's work has prompted a wave of research delineating the contours of the high-wage argument. No systematic income data existed at the time. Scholars must instead glean wage information wherever history chanced to leave it. They must determine how productive workers were (hence the debate about daily spinning rates), and whether they were typical of most labourers. And then they must work out what such workers bought with their earnings, and at what price. Consumption of expensive wheat bread might imply that real wages (that is, adjusted for living costs) were low—unless those workers could have bought cheaper bread, made from oats or barley, which would suggest they earned enough to afford a luxury.

This work has galvanized efforts to understand a critical period in economic history. New research by Jane Humphries and Benjamin Schneider, for example, reveals information on the economic role of women and children, who earned less than men, in the spinning industry. Judy Stephenson has uncovered new details about construction workers in London and shown that many estimates of working hours are probably too high.

Those who disagree with Mr Allen's thesis try to find evidence to support a rival, older, theory that the impetus to industrialize came from low wages rather than high ones. In this story vast pools of cheap labour in pre-industrial societies were a potentially lucrative resource and anyone who could put it to better use stood to benefit enormously. In Mr Allen's narrative, spinners' wages, though very low by modern standards, were high enough to motivate the development and deployment of equipment like the spinning jenny. For Ms Humphries, however, capitalists found the spinning jenny attractive because it enabled them to squeeze more out of the cheap labour of women and children.

Tinker tailor

For now Mr Allen's theory looks more compelling, though further work might easily alter the balance. Yet the central role of labour costs in both theories has lessons for economists studying productivity growth today. They tend to treat wage growth as a function of technological progress, rather than an influence on it. The ability to produce new ideas surely depends upon supply-side factors, from the number and quality of engineers a society produces to the competitive environment facing large firms. But if productivity is growing slowly, that might also be because labour costs discourage experimentation with new technologies.

Such experiments are slow, risky and expensive. When profits are high and wages stagnant, they are hardly worth the trouble. Until wages become too high, human burger-flippers and call-centre workers, like hand-spinners, will do.

FLEET MANAGEMENT

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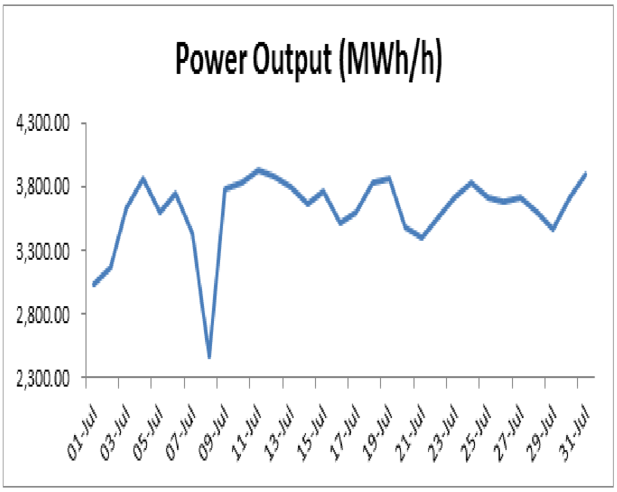
Macroeconomic Indicators

Power Sector

In July, the average on-grid power output was 3,618.71MWh/h, 0.87% higher than the average of 3,587.53MWh/h in June. This was as a result of the improved gas supply to generation companies. While this improvement is commendable, it is meager when compared to the total power demand, which stands at over 20,000MW/h and the 4000MWh/h daily threshold. Average power was at its lowest year to date (YTD) at 2,470.00MWh/h on July 8th. In the review period, the sector lost approximately N1.71bn, annualized at N620.73bn.



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Outlook

We expect this positive trend to be sustained in August barring any rupture in gas pipeline.

Money Market

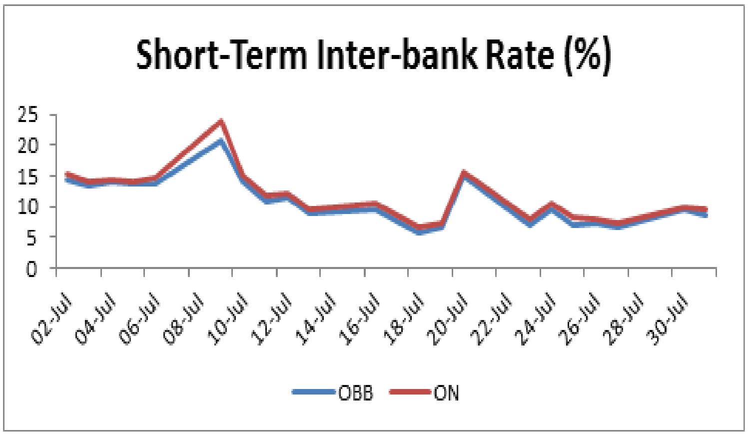
The average opening position of the interbank money market decreased sharply by 24.42% to N235.85bn long in July from N312.05bn long in the preceding month. The decrease in the opening position indicates a reduction in market liquidity. In July, the CBN issued more OMO bills of N1.42trn against a maturity of N1.23trn. The net outflow of N190bn was greater than the N30bn recorded in June as the CBN sold N1.31trn OMO sales against N1.28trn that matured.

The federal government disbursed a sum of N1.49trn within two weeks as its monthly statutory allocation for June and July. This increased liquidity in the money markets and decreased interest rates. July's FAAC disbursement of N821.9trn is the highest level in four years and this was attributable to robust oil proceeds.

The average interbank rate decreased to 11.15% pa from 11.94% pa in June. The average Open Buy Back (OBB) rate decreased by 57bps to 10.71% pa from 11.28% pa in June and the average Overnight (ON) rate also increased by 103bps to 11.58% pa compared to 12.61% pa in the previous month. Rates touched 20.83% pa (OBB) and 23.79% (O/N) on July 9th, due to high market illiquidity.

At the primary market, the closing rates for the 91-day and 182-day T/bills were flat at 10% and 10.50% respectively on July 18th, while the 364-day tenor declined to 11.49% from 11.51% on July 18th. At the secondary market, the yields on the 91-day, 182-day and 364-day declined to 10.86%, 12.06% and 11.71% on July 31st, compared to 12.30%, 12.39% and 12.32% respectively on July 2nd.

[18]FGN, FDC Think Tank



Short-Term Inter-bank Rate (%)[19]

Primary Market

T/bills Tenor	Rate on July 4th (% pa)	Rate on July 18th (%)pa	Direction
91	10.00	10.00	↔
182	10.50	10.50	↔
364	11.51	11.49	↓

Secondary Market

T/bills Tenor	Rate on July 2nd (% pa)	Rate on July 31st (%)pa	Direction
91	12.30	10.86	↓
182	12.39	12.06	↓
364	12.32	11.71	↓

Outlook

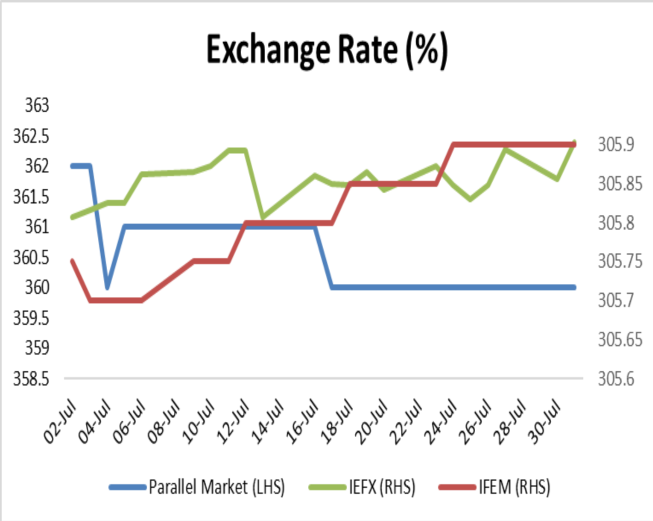
In August, we expect the increase in money supply due to budget disbursements, pre-election spending and the accumulated FAAC to keep interest rates lower. However, we expect the CBN to continue with its usual intervention scheme to mop up excess liquidity. In addition, the decision to maintain status quo at the last MPC meeting will impact negatively on private sector lending as lending rates is still high at 21% -22%.

Forex Market

Exchange Rate

At the parallel market, the naira opened the month at N362/$ and appreciated to close the month at N360/$ (a 2-year high). At the interbank foreign exchange market, the naira depreciated marginally by 0.05% to close at N305.90/$ from N305.75/$ on July 2nd. At the Investors and Exporters Foreign Exchange (IFEX) window, the naira traded within the tight band of N361.16 - N362.40/$.The CBN sold forex worth $1.54bn in the month, 30% lower than June's sale of $2.20bn.Total turnover at the IEFX window in July was also lower at $3.68bn, compared to $4.38bn in the preceding month.

[19]FDC Think Tank



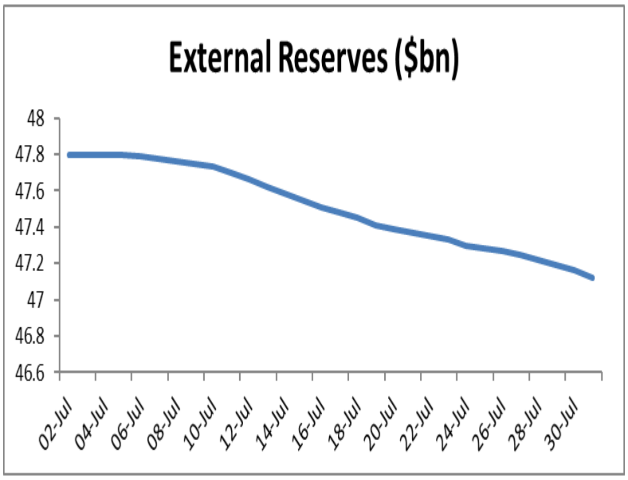
[20]

Outlook

We anticipate an increased demand for forex, following the disbursement of funds for capital project and FAAC allocations. This is expected to weaken the currency as liquidity builds up. However, with the consistency of the CBN's interventions, we expect the exchange rate to remain around N360/$ - N363/$ in August.

External Reserves

The gross external reserves decreased to $47.12bn on July 31st, from $47.80bn on July 2nd. The continuous depletion in external reserves was as a result of the increased forex demand by summer travelers coupled with the reduced oil proceeds due to the decline in crude oil prices. The import cover also decreased to 11.54 months from 11.71 months on July 2nd.



[21]

Outlook

The risk of the depreciation of the currency is rising due to anticipated increase in liquidity in subsequent months. Nonetheless, we expect the CBN to intervene to mop up excess liquidity. The consistency of the CBN's interventions will be at the expense of depleting the reserves.

[20]FDC Think Tank
[21]CBN, FDC Think Tank

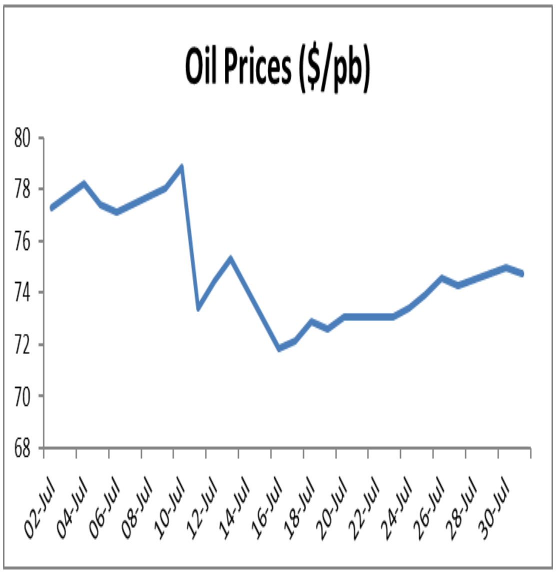
Commodities market - Exports

Oil prices

In July, the average Brent price was $74.97pb, 1.28% lower than June's average of $75.94pb. Brent crude prices touched a 3 month low of $71.84pb on July 16th. The decline was prompted by the reopening of oil export terminals in Libya and the expected increase in production in Saudi Arabia.

However, prices increased on July 25th, when Saudi Arabia, the world's largest oil producer announced a temporary suspension of all shipments through the strategic Red Sea shipping lane, following an attack on two of its major crude carriers.

Moreover, the decline in US crude inventories by about 6.1mn barrels to 404.9mn barrels (its lowest level since February 2015) also supported crude oil prices in July. Despite the decline in the average price of crude oil, prices remained higher than Nigeria's 2018 budget benchmark of $51pb.



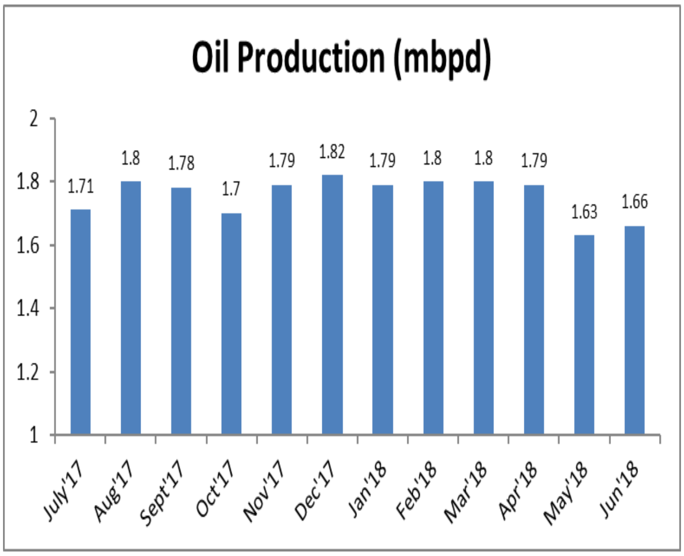
[22]

Outlook

Oil prices are expected to stay above $70pb in the near term. This will be driven by Saudi Arabia's decision to temporarily halt all oil shipments through the strategic Red Sea lane, a terminal that transports about 4.8 million barrels per day of crude oil and refined products to Europe, the United States and Asia. Also, growing demand from china during the summer period could put more pressure on the oil market, resulting to a further increase in oil prices in the near term.

Oil Production

According to the Organization of Petroleum Exporting Countries' (OPEC) monthly oil report, Nigeria's domestic oil production increased marginally by 1.84% to 1.66mbpd in June from a revised level of 1.63mbpd in May. The increase occurred in spite of the force majeure in June. However, it is still below the 2018 budget benchmark of 2.3mbpd.Nigeria's oil rig count decreased by 7.14% to 13 in June from 14 in the previous month.[23]



[24]

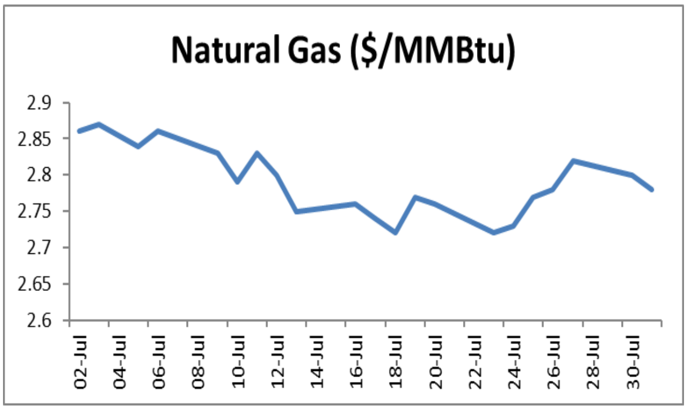
[22] Bloomberg, FDC Think Tank
[23] Bakers Hughes
[24] OPEC, FDC Think Tank

Outlook

We expect the increase in Nigeria's domestic oil production to be sustained in July. This will be driven by the lifting of the force majeure and the reopening of pipelines such as the Nembe Creek Trunk Line stream and the Forcados Oil Terminal that carries about 200,000 – 240,000 barrels per day.

Natural Gas

Natural gas prices declined by 2.80% to $2.78/ mmbtu on July 31stfrom $2.86/mmbtu on July 2nd. Natural Gas traded at an average of $2.79/MMBtu in July. This represents a 5.10% decline in prices compared to$2.94/MMBtu in June. The decrease in price was partly due to the rising natural gas production in the US coupled with the thin demand from China.



[25]

Outlook

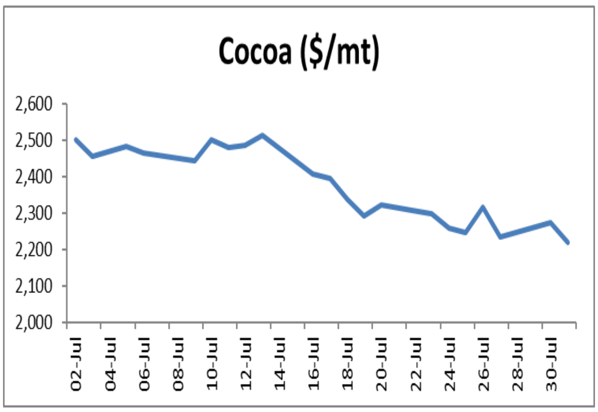
We expect a slowdown in Natural Gas prices. Warmer weather in August will lead to softer demand for gas for heating purposes.

Cocoa

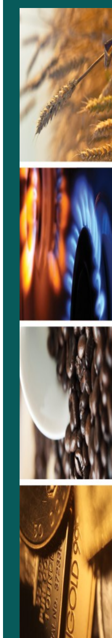
Cocoa prices dipped by 11.23% to close the month at $2,220/mt from $2,501/mt on July 2nd. The average price of cocoa was $2,377/mt in July, 2.66% lower than $2,442/mt in June. This decline was prompted by the improved supply from Cote d'Ivoire, the world's largest producer of cocoa and Ghana. Increased rainfall in West Africa also boosted output significantly, driving prices lower.

Outlook

Heavy rainfall in West Africa (top producing regions) will continue to boost cocoa output, keeping prices depressed in the month of August. The sustained decline in cocoa prices would weigh on farmers' revenue and profitability.



[26]

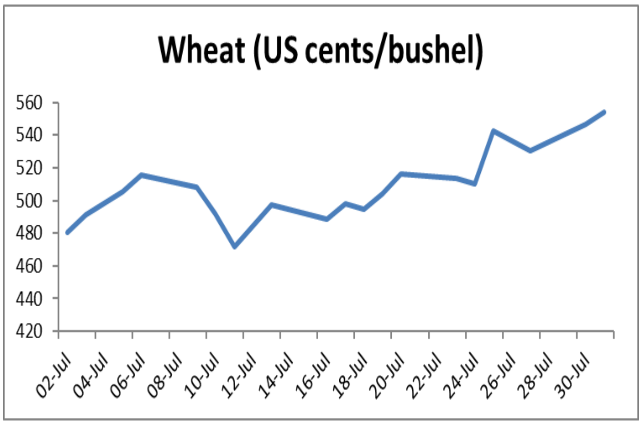


[25]Bloomberg, FDC Think Tank
[26]Bloomberg, FDC Think Tank

Commodities market - Imports

Wheat

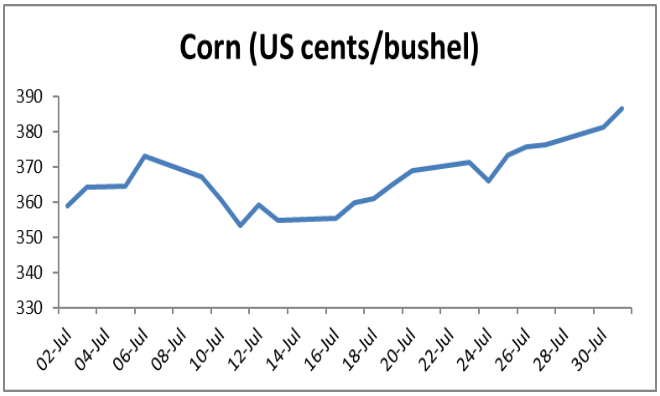
Wheat prices increased sharply by 15.42% to $5.54/ bushel on July 31st from $4.80/bushel on July 2nd. The bullish trend was due to the reduced output from the leading wheat producers, Germany and France. This was as a result of the severe heat wave in Germany and the flooding in France. Increased demand from India and China also boosted prices. However, the average price of wheat in July traded flat at $5.09/bushel compared to the previous month.



[27]

Corn

Corn prices increased by7.80% to close the month at $3.87/bushel from $3.59/bushel on July 2nd.Prices were affected by the unfavourable weather condition in Europe. The average price of corn was $3.66/bushel in July, 3.68% decline compared to the average of $3.80/bushel in June.



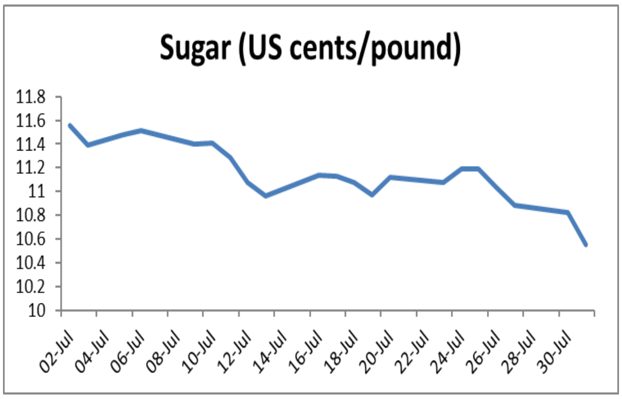
[28]

Outlook - Grains

The trade war facing the United States and its trading partners around the world will keep prices volatile in the near term.

Sugar

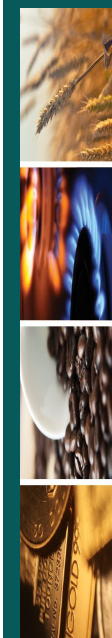
The average price of sugar dipped by 9.42% to $0.1116/pound in July from the average of $0.1232/pound in the preceding month. Sugar prices declined by 8.74% to $0.1055/pound on July 31st from $0.1156/ pound on July 2nd, resulting from ample global supply and the sharp decline in demand due to health consciousness.



[29]

Outlook

The bearish trend is expected to be sustained. This will be supported by the increased supply from key producing regions and the limited global demand resulting from the health implications of the commodity.

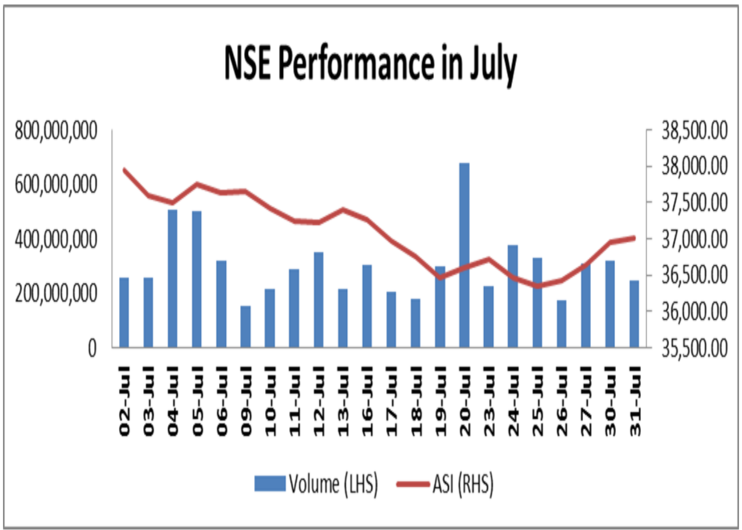


[27]Bloomberg, FDC Think Tank
[28]Bloomberg, FDC Think Tank
[29]Bloomberg, FDC Think Tank

Stock Market

The Nigerian stock market reversed June's positive trend and has now recorded a negative performance in 5 of the 7 months of the year. NSE ASI recorded a cumulative loss of 3.79% to close at 37,017.78 points. Market capitalization moved in tandem with ASI, declining to N13.41trn in July from N13.87trn in June. Although many market observers believe that stocks in the Nigerian market are relatively cheaper, the market has resumed its downward trend as some investors have remained on the sidelines watching developments in the political environment.

The bourse is currently trading at a price to earnings (P/E) ratio of 10.79x. Market breadth came in higher, but remained negative at 0.84x, as 41 stocks increased, 79 stocks remained flat, while 49 declined; compared to May, which came in at 0.47x.



[30]

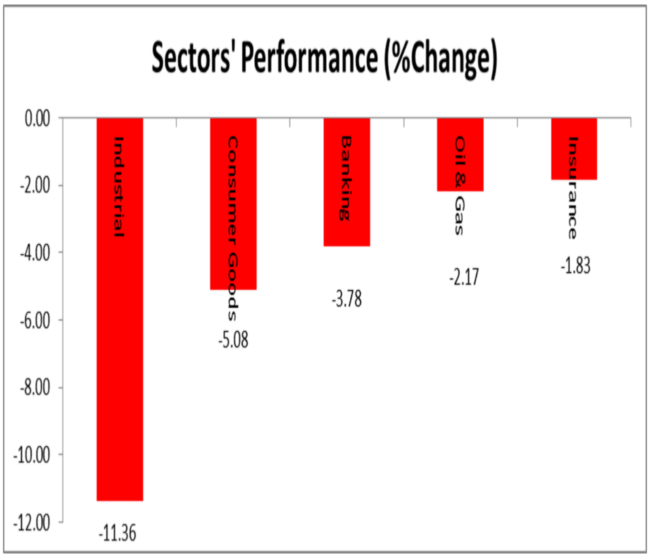
Trading activities on the floor of the NSE established that the stock market remained liquid in the month of July. Average volume traded increased by 5.06% to 374 million units, but value traded moved in the opposite direction, declining by 35% to N4.94bn.

Stocks in the financial services sub sector dominated market transactions during the period. Financial institutions stock activities accounted for 76% of volume traded on the bourse in June.

Sector performance

All indices closed the month of July in red with the industrial sector losing a whopping 11.36%. The sector was dragged down by heavyweights in the sector. The oil and gas sector lost 2.17% partly due to lower oil prices, while the banking sector shed 3.78%.

Low priced stocks dominated the gainers' chart, largely attributed to bargain hunting on undervalued stocks. Cutix Plc (46%) led the advancers, followed by Cement Co of North Nig Plc (29.17%), C & I Leasing Plc (16.55%), Continental reinsurance (16.55%) and AIICO Insurance (16.39%).



[31]

[30] NSE, FDC Think Tank
[31] NSE, FDC Think Tank

TOP 5 GAINERS (N)				
Company	**Jun 29'18**	**Jul 31'18**	**% Change**	**Absolute Change**
CUTIX PLC.	3.00	4.38	46.00	1.38
CEMENT CO. OF NORTH.NIG. PLC	24.00	31.00	29.17	7
C & I LEASING PLC.	2.07	2.44	17.87	0.37
CONTINENTAL REINSURANCE PLC	1.45	1.69	16.55	0.24
AIICO INSURANCE PLC.	0.61	0.71	16.39	0.1

FMCG and industrial stocks led the laggards with Tantalizers Plc (-41.67%) topping the chart. Lafarge Africa Plc (-32.84%), Union Diagnostic & Clinical Services (-31.58%), DN Tyre & Rubber Plc (-31.03%) and PZ Cussons Nigeria Plc (-27.05%) also featured among the decliners.

TOP 5 LOSERS (N)				
Company	**Jun 29'18**	**Jul 31'18**	**% Change**	**Absolute Change**
TANTALIZERS PLC	0.36	0.21	-41.67	-0.15
LAFARGE AFRICA PLC.	40.95	27.50	-32.84	-13.45
UNION DIAGNOSTIC & CLINICAL SERVICES PLC	0.38	0.26	-31.58	-0.12
DN TYRE & RUBBER PLC	0.29	0.20	-31.03	-0.09
P Z CUSSONS NIGERIA PLC.	20.70	15.10	-27.05	-5.6

Outlook

The market is likely to record a similar performance in August as investors continue to monitor political and economic developments. However, low valued stock prices could present investors with attractive buying opportunities.

Equity Report :

NESTLÉ NIGERIA PLC

Analyst Recommendation: BUY

Market Capitalization: N1.24trn

Recommendation Period: 365 days

Current Price: N1560.00

Industry: Food, Beverage and Tobacco

Target Price: N1605.00

Analyst's note

Top-line growth driven by volume growth

Nestlé Nigeria recorded solid revenue sales of N135.3bn in H1'18 (a 10.97% increase). This was driven primarily by growth in its sales volume of both its food and beverage segment. The food segment recorded an 8.91% increase in revenue to N85.13bn, while its beverage segment recorded a 14.65% increase to N50.17bn in H1'18. The just concluded Ramadan season, which drove the high demand for Maggi (predominantly popular in the North), led to the rise in its food volume growth. Sales of goods in Nigeria accounted for 98.81% of Nestlé's total revenue, up 10.45% to N133.69bn, while export sales rose by 81.62% to N1.61bn in the period.

This shows the company's resilience in a period of weak economic fundamentals. Despite a shift in the market to cheaper alternatives, we expect Nestlé to sustain volume growth in H2'18 (festive season) and its top-line earnings to maintain an upward trend.

Margin expansion due to reduced finance costs

Prior to 2014, Nigeria was blessed with a stable currency due to the rise in global oil prices. However, the significant fall in oil prices in 2016 resulted in a shortage of dollars and revenue shortfalls. The naira's severe devaluation by 215% to N490/$ as at December 30th, 2016, compared to N155.71/$ at the start of 2014 pushed up the costs of imported materials. The fall in global oil prices led to a demand pressure in the Nigerian foreign exchange (forex) market which adversely affected earnings. However, the introduction of the Investors' and Exporters' Foreign Exchange Window (IEFX) by the CBN in late April 2017 boosted liquidity in the forex market. As a result of a 99.03% reduction in net forex loss to N50.19mn from N5.17bn in H1'17, Nestlé's finance costs plunged 84.85% to N1.12bn in H1'18 from N7.39bn in H1'17. This in turn boosted Nestlé's margin by 23.8% in H1'18 due to access to cheaper forex to import new technology, machinery replacements and the purchase of raw materials such as coffee.

Impairment loss insufficient to offset gains

Nestlé recorded a strong margin expansion of 23.8% in H1'18 despite a one-off impairment loss of N1.04bn in its food segment. This occurred after an impairment loss of N3.4bn in its beverage segment (water plant) in Q1'18.

Our valuation is derived using intrinsic valuation and its share price is currently undervalued. Accordingly, we place a BUY rating on Nestlé's stock.

Nigeria's food and processing industry, a significant component of the agro industry, is currently valued at $10bn and it provides an estimated 10mn jobs. However, the industry has remained dull, despite Nigeria's comparative advantage in agriculture, as the country is yet to derive the maximum benefit from the industry. The level of food processing and value addition is quite low due to a couple of challenges.

The level of wastage of agriculture produce at a time when population is projected to increase by 2.62% to 196mn in 2018 remains alarming.[32] The industry also lacks the required level of investment needed to purchase suitable storage infrastructure to reduce post-harvest loss (estimated at 40%) to the barest minimum. Capacity utilization in local factories is at an average of 35%, which signals external impediments such as poor power supply.[33] Access to credit remains a major challenge in the industry as creditors have flagged it a high risk for investment. It is notoriously difficult to borrow at affordable interest rates, without valuable collateral or a recognizable family name. The worst hit is the small and medium scale enterprises (SMEs), which form a bulk of the food processing industry. Anecdotal evidence suggests that very few SMEs can obtain loans from financial institutions in Nigeria. The lack of a viable credit history database has deterred domestic banks from injecting more credit into the economy.

Apart from these external impediments, the food processing industry in Nigeria is plagued by structural deficiencies. Nigeria is one of the highest cost markets in Africa with a highly price sensitive consumer base. This makes competitive pricing difficult for food producers and affects Nigeria's export capabilities to the wider West African region and world at large.

In a bid to support local food producers, the government, placed an import ban on various food products, increased import duties, and implemented the dual inspection policy. It also introduced policies aimed at self-sufficiency in the production of major agricultural products to ensure cheaper raw materials for food processing companies. Nigeria's large (and mostly young) population makes the market lucrative for investors as companies can tailor their products to suit the tastes and purchasing power of the people.

The food and beverage industry in Nigeria is dominated by multinational players which include Nestlé, Unilever and Cadbury. Other players include domestic food processing companies such as UACN Foods, which manufacture snacks and a range of sweets. Despite the weak economic conditions, Nestlé Nigeria has recorded remarkable profitability compared to its competitors. This is evident in its earnings per share (EPS) of N27.07, 2,165% higher than that of Unilever Nigeria Plc (N1.28) and 96,733% higher than Cadbury Nigeria's EPS (-N0.03).

Nestlé Nigeria (a subsidiary of Nestlé SA) was incorporated in 1961 and was listed on the Nigerian Stock Exchange (NSE) in April 1979. Nestlé SA, Switzerland, currently holds a 66.18% stake in Nestlé Nigeria. Its principal activities include the manufacturing, marketing and distribution of food products domestically and internationally. The company has three factories in Nigeria: Abaji factory in Abuja, Agbara Manufacturing Complex in Ogun State, and Flowergate factory in Ogun State. Nestlé procures its raw materials on a commercial basis from both domestic and international suppliers. The company continues to explore the use of local raw materials and has successfully introduced the use of locally produced agricultural items such as soya bean, maize, cocoa, palm olein and sorghum.

Nestlé Nigeria produces a wide range of culinary products (Maggi), baby food (Cerelac, Nutrend), cereal (Golden Morn), chocolate drinks and confectionery products (Milo Powder, Milo Ready-to-drink, and Chocomilo), dairy products (Nido), coffee (Nescafé), and water (Pure Life). Its products are distributed through various distributors (over 100) spread across the country.

[32] The Economist Intelligence Unit (EIU). 2018. "Country Forecast Nigeria"

[33] BMI Research, 2017, "Nigeria Food & Drink Report".

Income Statement for Nestlé Nigeria Plc						
N'000	2012	2013	2014	2015	2016	2017
Revenue	116,707,394	133,084,076	143,328,982	151,271,526	181,910,977	244,151,411
Cost of Sales	(66,538,762)	(76,298,147)	(82,099,051)	(83,925,957)	(106,583,385)	(143,280,260)
Gross Profit	**50,168,632**	**56,785,929**	**61,229,931**	**67,345,569**	**75,327,592**	**100,871,151**
Marketing and Distribution Expense	(18,866,526)	(22,932,923)	(24,689,301)	(25,904,586)	(28,775,263)	(35,157,152)
Administrative Expenses	(5,312,537)	(6,020,026)	(7,340,409)	(7,693,740)	(8,338,992)	(10,015,626)
Operating Profit	**25,989,569**	**27,832,980**	**29,200,221**	**33,747,243**	**38,213,337**	**55,698,373**
Finance Income	909,074	361,307	551,594	443,805	4,199,314	6,239,371
Finance Costs	(1,848,471)	(2,146,697)	(5,305,837)	(4,868,571)	(20,864,243)	(15,109,062)
Net Finance Cost	(939,397)	(1,785,390)	(4,754,243)	(4,424,766)	(16,664,929)	(8,869,691)
Profit Before Tax	**25,050,172**	**26,047,590**	**24,445,978**	**29,322,477**	**21,548,408**	**46,828,682**
Income Tax Expense	(3,912,897)	(3,789,311)	(2,210,338)	(5,585,700)	(13,623,440)	(13,104,952)
Profit After Tax	**21,137,275**	**22,258,279**	**22,235,640**	**23,736,777**	**7,924,968**	**33,723,730**

Balance Sheet for Nestlé Nigeria Plc						
N'000	2012	2013	2014	2015	2016	2017
Non-Current Assets						
Property, Plant and Equipmen	62,159,796	65,878,425	67,514,854	69,148,171	70,171,526	72,377,943
Intangible Assets	26,347	-	-	-	-	-
Long-term Receivables	420,930	573,247	1,157,883	1,352,196	1,678,251	1,921,232
Total Non-current Assets	**62,607,073**	**66,451,672**	**68,672,737**	**70,500,367**	**71,849,777**	**74,299,175**
Current Assets						
Inventories	8,784,909	9,853,893	10,956,010	10,813,960	20,637,750	23,910,303
Trade and Other Receivables	13,457,105	17,884,775	22,330,813	24,445,995	24,035,411	31,430,450
Prepayments	300,066	300,637	398,002	525,205	1,711,842	2,025,346
Cash and Cash Equivalents	3,814,065	13,716,503	3,704,505	12,929,526	51,351,152	15,138,854
Total Current Assets	**26,356,145**	**41,755,808**	**37,389,330**	**48,714,686**	**97,736,155**	**72,504,953**
Total Assets	**88,963,218**	**108,207,480**	**106,062,067**	**119,215,053**	**169,585,932**	**146,804,128**
Equity						
Share Capital	396,328	396,328	396,328	396,328	396,328	396,328
Share Premium	32,262	32,262	32,262	32,262	32,262	32,262
Share Based Payment Reserve	49,543	26,585	44,637	150,466	126,480	147,236
Retained Earnings	33,707,429	40,139,626	35,466,416	37,428,018	30,323,005	44,302,351
Total Equity	**34,185,562**	**40,594,801**	**35,939,643**	**38,007,074**	**30,878,075**	**44,878,177**
Non-Current Liabilities						
Loans and Borrowings	23,556,616	26,471,275	18,385,876	12,530,361	10,384,341	9,564,664
Employee Benefits	1,082,673	1,821,829	1,827,773	2,382,213	2,103,744	2,275,921
Deferred Tax Liabilities	4,958,723	6,086,480	5,270,723	6,563,548	5,186,338	10,404,871
Total Non-current Liabilites	**29,598,012**	**34,379,584**	**25,484,372**	**21,476,122**	**17,674,423**	**22,245,456**
Current Liabilities						
Bank Overdraft		-	1,237,606	305,024	154,582	3,714,087
Current Tax Liabilities	2,349,901	2,803,623	3,478,733	5,040,468	15,489,634	15,098,670
Loans and Borrowings	3,457,431	947,809	12,730,126	17,108,803	40,130,375	10,913,246
Trade and Other Payables	19,003,142	29,066,050	26,656,779	36,661,728	64,662,096	49,055,624
Provisions	369,170	415,613	534,808	615,834	596,747	898,868
Total Current Liabilites	**25,179,644**	**33,233,095**	**44,638,052**	**59,731,857**	**121,033,434**	**79,680,495**
Total Liabilites	**54,777,656**	**67,612,679**	**70,122,424**	**81,207,979**	**138,707,857**	**101,925,951**
Total Equity and Liabilites	**88,963,218**	**108,207,480**	**106,062,067**	**119,215,053**	**169,585,932**	**146,804,128**
Net Assets	**34,185,562**	**40,594,801**	**35,939,643**	**38,007,074**	**30,878,075**	**44,878,177**

[34]

[34] Nestlé Nigeria Plc. 2012-2017. "Annual Reports"

Management

Nestlé Nigeria's approach to sustaining returns over the years can be attributed to its effective cost management, top-line growth and strategic investments in key brands in Nigeria. Its ability to sustain returns is evident as it maintained revenue growth during a period when many companies were challenged with tepid sales. Mr. Mauricio Alarcon is the CEO and Managing Director effective October 2016. He has extensive experience across the different regions in which Nestlé is located. He joined Nestlé Mexico in 1999 where he worked in several sales and marketing assignments in the ice cream business. Across Africa, Mr. Alarcon served as Business Executive Manager, Ice Cream, in Nestlé Egypt where he transformed the business by driving a substantial revenue and profitability growth. He also drove strong top-line growth in Nestlé Cote d'Ivoire through his engaging leadership skills.

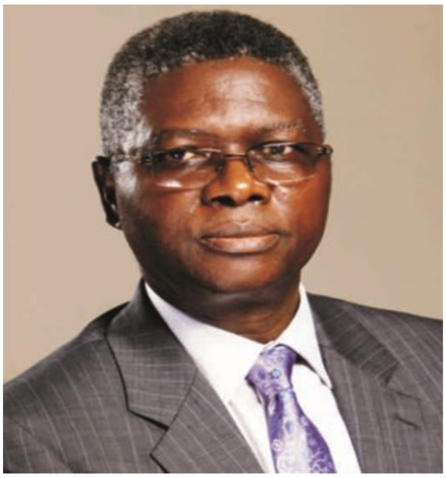
Mr. David Ifezulike is the Chairman of the Board of Directors since May 2013. He has a BSc. in Mechanical Engineering from the University of Manchester and an MSc. in Petroleum Engineering from Imperial College, London. He joined Nestlé in 1980 and has over 22 years' extensive experience in various capacities and locations including Nigeria, Ghana and Switzerland.

Nestlé's management has pledged to play an active role in combating plastic pollution globally and in Nigeria by making its packaging recyclable/reusable by 2025. The company aims to develop well organized collection, sorting and recycling schemes across Nigeria to help its consumers dispose of used materials in the appropriate way. It aims to promote a market for recycled plastics by increasing its proportion of recycled plastics in its packaging.

Nestlé has successfully completed the development of a viable collection and recycling plant which has focused on major food and beverage packaging materials that are a significant challenge to the Nigerian national waste management. It has started the recycling of Maggi wrappers and has set objectives to use sustainably managed/renewed resources to achieve zero waste for disposal and improve its waste management.

In addition, it continues to seek opportunities to increase local sourcing of raw materials as it has enhanced its local capacity by patronizing Nigeria's entrepreneurs, farmers and vendors in its value chain. Nestlé also works with local suppliers in the community to produce goods of quality standard. This will help Nestlé reduce its exposure to the volatility of the forex market, helping it manage input costs efficiently. This in turn will improve profit margin growth.

Management's ability to drive growth in revenue and earnings by leveraging its solid brand, in a period of fragile economic growth, should give investors confidence in the management team.



Chairman of the Board of Directors

Mr. David Ifezulike

CEO/Managing Director

Mr. Mauricio Alarcon

The Bull and the Bear Say:

- Nigeria's largest food company in terms of revenue and assets
- Internationally renowned brand in the food and beverages segment
- Offers quality brands
- Proposed upward review of minimum wage could bolster consumer spending
- Nestlé's share price has performed strongly against the Nigerian All-Share Index (NSE-ASI) for the past few years
- Robust distribution network and a talented sales force
- Talented and experienced management team

- Volatility in global cocoa prices can impact Nestlé's profit margins negatively
- Higher interest payments on dollar-denominated borrowings
- High inflation rates could further affect consumer spending
- Persistent foreign exchange challenges
- Shift of market preference to low-priced products

Risk and Outlook

Growth potential constrained by macroeconomic risks

Nestlé Nigeria is exposed to market risks (currency and interest rate risk), credit risks, liquidity risk, and operational risk amid persistent macroeconomic and security challenges in the country. These risks could prevent Nestlé from growing its sales volume and top-line earnings, managing cost, optimizing resources and increasing its market share. Nestlé, through the Risk Management Committee, identifies risks, analyses, sets appropriate risk limits and monitors the company's risk policies.

Nestlé's primary exposure to credit risk stems from the individual characteristics of each distribution customer. In order to address this risk, the company established a distributor activation process that analyzes each individual's credit worthiness through external ratings and bank references (if applicable) before a distributor agreement is sealed. The company manages its liquidity risks by ensuring it has sufficient cash to meet its financial liabilities, when due, to prevent the company from incurring unwanted losses.

Nestlé is exposed to currency risks on sales, purchases and borrowings denominated in foreign currency primarily in euro, US dollars (USD), pounds sterling (GBP) and Swiss francs (CHF). Although there have been recent improvements in the availability of forex in the country and the company mitigates this risk by maintaining foreign dominated bank accounts and keeping Letters of Credit (LC), there is still a level of uncertainty in the forex market due to possible oil price and production shocks.

Security concerns in the northern region have limited Nestlé's sales and distribution. The continuous attacks from Boko Haram and herdsmen have impeded sales as the insurgence has prevented Nestlé from growing its market share in the region.

Even though Nestlé's management has the ability to manage the macroeconomic challenges it faces in the near future, the intensity of the macro headwinds could negatively affect the company's performance. While Q2'18 and H1'18 were outstanding, several macroeconomic factors and risks may reduce its performance in the future.

OUR valuation

We derived our valuation for Nestlé Nigeria by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate for Nestlé stood at N1605.00, which is a 2.88% upside on its current share price of N1560.00 as at August 6, 2018. The discount rate [weighted average cost of capital (WACC)] of 11.62% is derived using a 16.2% risk free rate [the yield for a 10-year Federal Government of Nigeria (FGN) bond maturing in March 2027], a beta of 0.8754[35] an after-tax cost of debt of 4.67%, and a market risk premium of 6.4%. The calculated long-term cash flow growth rate to perpetuity is 7%.

[35] Financial Times