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Inside This Issue:

What the trade statistics tell us and the outlook and impact on the Naira in Q3	**3**
Q2 GDP growth slumps to 1.5%; full year growth of 2.1% unlikely	**5**
Reversal of international portfolio flows in Q2, any correlation with GDP growth?	**8**
Gas Pricing: central to Nigeria's electricity generation	**10**
Rubber: an untapped commodity for diversifying Nigeria's economy	**12**
Global Perspective: the contrarian case for emerging markets - *Culled from the Economist*	**17**
Macroeconomic indicators	**19**
Stock market review	**26**
Corporate focus : Dangote cement	**30**

WHAT THE TRADE STATISTICS TELL US AND THE OUTLOOK AND IMPACT ON THE NAIRA IN Q3

Rising Trade Surplus

Nigeria recorded a contraction in foreign trade in the second quarter of 2018 as the value of total merchandise trade contracted by 8.89% to N6.57trn from N7.2trn recorded in the preceding quarter. This is according to recently released trade statistics by the National Bureau of Statistics (NBS). This also marks the first contraction in foreign trade in the last 10 quarters – since Q1'16. The report reveals a significant rise in the trade surplus to N2.35trn from N2.17trn in Q1'18 in spite of a decline in both exports and imports. However, imports fell at a faster pace than exports.

Oil dependence Persists

Exports, accounting for 67.9% of the total trade, declined by 4.9% to N4.46trn in Q1'18 but grew by 43.8% quarter on quarter. Crude oil exports rose 4.2% to N3.73trn and continue to dominate exports at 83.5% of total exports in Q2'18, higher than 76% in Q1'18. This underlines the vulnerability of Nigeria's foreign trade to oil market volatility and production shut-ins in the Niger-Delta region. Agricultural exports rose 17.3% to N85.9bn in Q2'18, which is also 127.3% higher than the value recorded in Q2'17. This is all the more significant given the farmer/herdsmen crisis in the middle-belt region and the security concerns that are still rife in the northeast. The most significant decline in exports came in the manufacturing sector with an 83.9% contraction in Q2'18 to N69.86bn from N434.37bn. However, this was higher by 0.9% when compared to Q2'17 figures of N69.26bn

Imports shrank to N2.1trn in Q2'18, 16.3% lower than in Q1'18 and also 19.9% lower than in Q2'17. This was driven by an 8.3% decline in the value of raw materials imports to N261.1bn – a 14.2% drop compared to Q2'17. This dampened increases in energy goods imports which rose to N98.17mn, which was N202.6% higher than in Q1'18 and 288.5% higher than in Q2'2017. The major markets for our exports remain unchanged from the previous quarter: India (16.19%), Netherlands (10.25%), Spain (9.55%), South Africa (8.06%), and United States (6.87%)

Outlook and Impact

Oil revenues account for almost 70% of Federal Government revenue and we expect Q3'18 oil revenues to be negatively impacted by supply outages which restricted trade in Nigerian crude in July/August. This is negative for fiscal spending and is likely to result in additional borrowing. The trade surplus will shrink slightly as a result and it will negatively impact the current account balance and Nigeria's terms of trade. Lower foreign exchange earnings will result in slower external reserves accretion and provide the Central Bank of Nigeria with less ammunition to defend the currency.

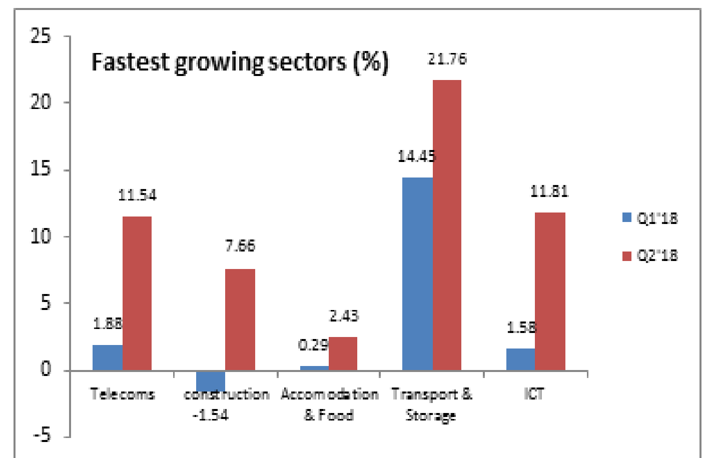
We expect the naira to come under increased pressure as the 2019 general elections approach and import demand rises. Election-related uncertainty will negatively impact foreign portfolio investment. This is in addition to pressure from a broader sell-off of emerging market currencies as the United States Federal Reserve tightens further. However, we expect oil prices to stay in the $70-80pb range for the rest of the quarter and oil production to rise back up to 1.8mbpd. This will improve Nigeria's external position and should provide some stability to the Naira.

Q2 GDP GROWTH SLUMPS TO 1.5%; FULL YEAR GROWTH OF 2.1% UNLIKELY

The sharp slowdown in Nigeria's Q2 GDP growth to 1.5% was unsurprising. This is because during the quarter under review, key events occurred that affected output levels. The first is the herdsmen/pastoral conflict that displaced farmers and affected the agric sector's growth and output levels significantly. For the first time in over three years, the sector grew at a paltry rate of 1.3%, a slowdown from the previous quarter's growth of 3%. Another major event that affected aggregate output was the force majeure, which limited oil production. As a result, Nigeria's oil output levels dropped 1.6% to an average of 1.84mbpd in Q2[1]. Other limiting factors to the level of economic output were logistics costs and poor storage.

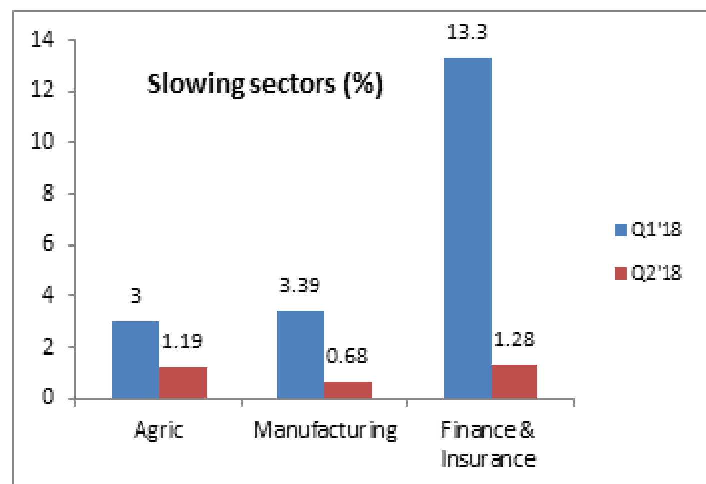
Sector Breakdown

The fastest growing sectors in Q2 were transport & storage (21.76%), ICT (11.81%) and telecoms (11.54%). These sectors contributed less than 10% to GDP output.



[2]

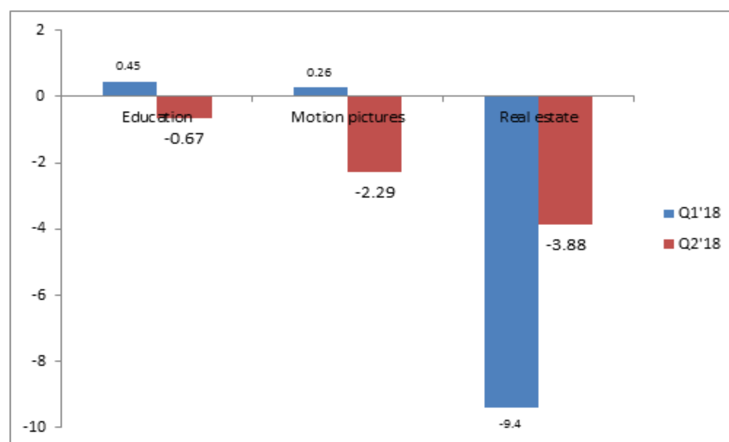
The slowing sectors were finance & insurance (1.28%), agric (1.19%) and manufacturing (0.68%). These three contributed an average of 11% to GDP. The slowing sectors are also predominantly interest rate sensitive and remain constrained by high borrowing costs at an average of 21% pa.



[3]

[1]NBS Q2 GDP report
[2]NBS Q2 GDP report
[3]NBS Q2 GDP report

The contracting sectors remain the usual suspects: real estate (-3.88%), motion pictures (-2.29%) and education (-0.67%).



[4]

Implications

Most analysts had earlier projected an annual GDP growth rate of at least 2% this year. The IMF projected a growth rate of 2.1%, while the Federal Government of Nigeria projected a highly optimistic growth of 3.5%. However, achieving anything remotely close to these numbers may be a tall order due to the weak growth numbers reported in Q2. Cumulatively, Nigeria's GDP growth is 1.73% and with the mounting uncertainty associated with the forthcoming elections, growth may be subdued at 1.7%-1.8%.

The weak growth data has also raised concerns of the possibility of Nigeria slipping back into recession, which would indicate that the recovery was short lived. This is also known as a double dip recession.

This will heighten the pressure on the CBN to adopt an accommodative stance to support growth at its next meeting September. Since July 2016, the CBN has maintained the status quo on key monetary policy parameters (monetary policy rate- MPR: 14% pa; liquidity ratio: 30%; cash reserve ratio: 22.5%, asymmetric corridor of 2%/-5% around the MPR), citing price and exchange rate stability as its primary objectives.

Conclusion

So far in the third quarter, the level of economic activity has remained largely unchanged. However, there has been a pickup in the level of oil production due to the resumption of activities on key pipelines such as the Trans forcados and Nembe Creek. Also the number of active oil rigs has increased to 16 (July) from 13 in June, an indication of more activity. The harvest season for most commodities is in the third quarter. This should have a positive impact on agric output and offset the loss from the herdsmen conflict. Hence we are projecting a marginal improvement in the growth numbers for the third quarter.

[4]NBS Q2 GDP report

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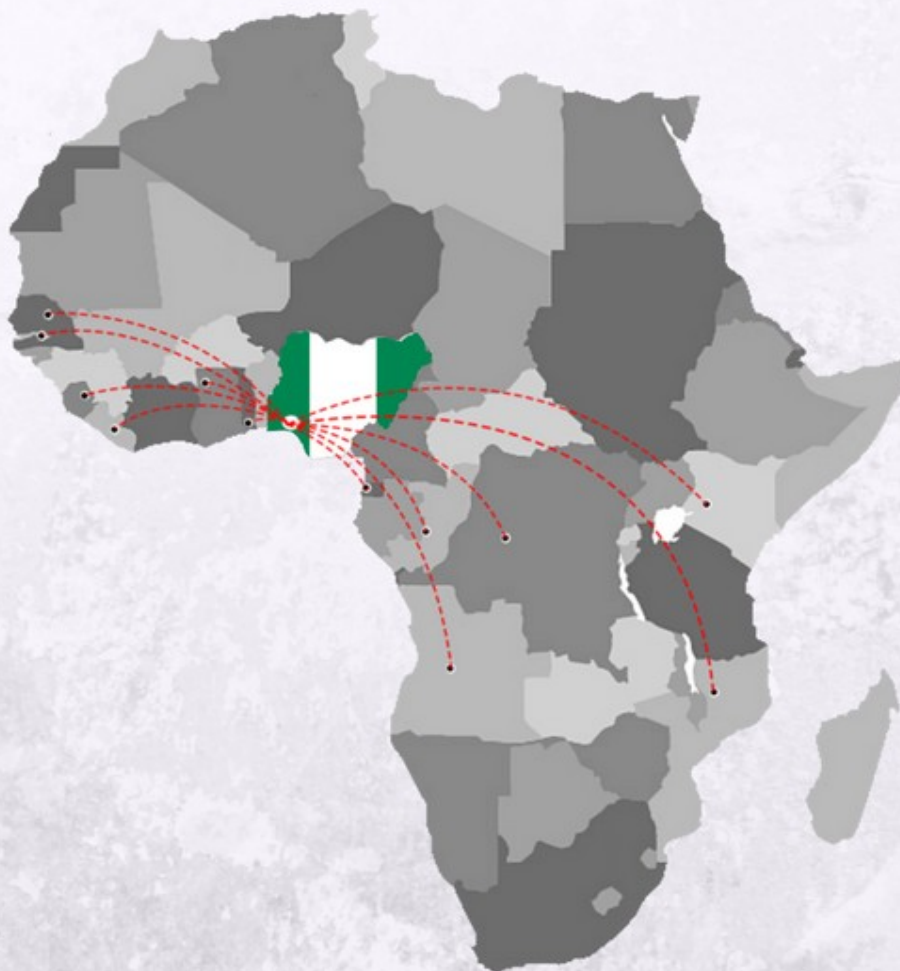

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REVERSAL OF INTERNATIONAL PORTFOLIO FLOWS IN Q2, ANY CORRELATION WITH GDP GROWTH?

Capital importation into Nigeria declined by 12.53% to $5.51bn in the second quarter of 2018. Whilst this comes as no surprise to many analysts, it raises the question as to whether there is any correlation to the weak growth also recorded in the same period.

First, we need to understand the different components that make up total capital import: foreign direct investments (FDIs), foreign portfolio investment (FPIs) and other investment. The last two components recorded declines in Q2, while FDI increased by 5.79%.

Hot money outflows weighing on total capital importation

FPIs, which are also called hot money (because of the ease with which they come and go), account for the largest share (74.7%) of capital imports. The decline in portfolio investments can be attributed to the continuous exit of international investors from the Nigerian markets in search for higher returns. It is a known fact that developed economies such as the United States and England are increasing their nominal interest rates. The US FED is scheduled to meet on September 25/26 and the consensus opinion is that another rate hike of 25 basis points (bps) would occur, pushing the US benchmark rate to 2%-2.25%. Two more rate hikes are expected before the end of 2018.

Another reason why FPIs, is the rising uncertainty in Nigeria. The 2019 elections are approximately 150 days away and the closer we get to the elections, the higher the uncertainty premium investors will place on the economy. This has further been compounded by the MTN saga which took the markets by surprise. If Q2 international flows declined by 12.53%, we should expect a further decline in Q3 because of this.

The sentiment towards Nigeria right now is pessimistic. A significant number of investors have put a hold on their portfolios in Nigeria and some are even considering a withdrawal. This will have significant implications on Nigeria's external balance position which is already under pressure. The external reserves level are down to $45.31bn[5] and could deplete further as forex demand pressures intensify.

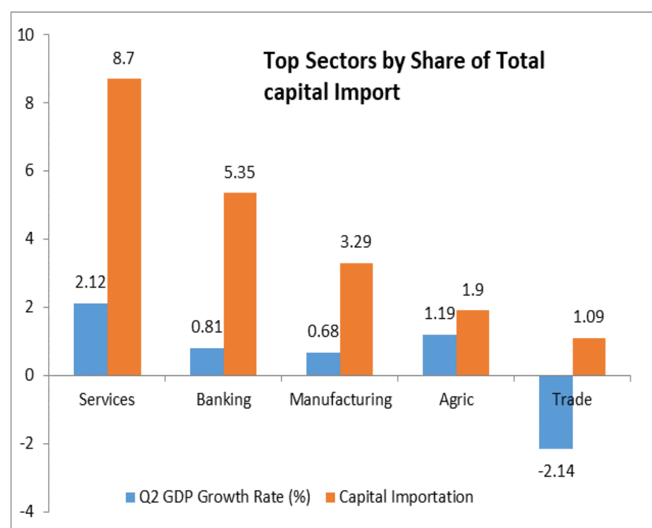
Is there any correlation between weak GDP growth and declining capital imports?

Going back to our first question of whether there is a correlation between the weak growth numbers and the exit of hot money. One of the major components of economic growth is capital accumulation. So if investment into a country declines, we can expect the pace of growth of that economy to be sub optimal. The investment multiplier, which refers to a concept that an increase in investment spending will have a more than proportionate increase in aggregate income and the general economy, will be low.

However, a breakdown of the capital importation report released by the National Bureau of Statistics shows that there may not be a direct correlation between sect oral growth and the amount of capital received. The top three recipients of capital by sectors were services ($479.85mn), banking ($294.96mn) and manufacturing ($208.92mn). However, these sectors were not the fastest growing in Q2.

The fastest growing sectors such as Telecoms, construction and transport accounted for a combined share of less than 1% of the total capital import.

Hence whilst on the aggregate level, the level of investment in a country would impact positively on the growth of the economy due to the investment multiplier, on a micro level (sector basis), the correlation is nonexistent or minuscule at best.



[6]

[5]CBN, as at September 10th
[6]NBS, FDC Think Tank

GAS PRICING: CENTRAL TO NIGERIA'S ELECTRICITY GENERATION

The pricing of gas is a major issue in Nigeria and is critical to electricity generation, availability and retail prices. About 50% of the current generation mix in Nigeria is thermal and this proportion is set to increase as further exploitation of hydro resources is difficult due to capital barriers. Gas is the logical choice for power generation in Nigeria, both in terms of gas availability and financing requirements. Nigeria has the 7th largest proven gas reserves in the world, with 182 TCF of high grade gas. It faces a significant demand boom, which will improve its industrial and economic development potential. However supply significantly lags demand, threatening economic growth. Utilization of gas resources is a challenge on account of various factors such as the militant attacks in the Niger Delta.

LNG, a national asset

Nigeria's gas, though abundant, has several chemical impurities requiring substantial processing before it can be used for electricity generation. Gas is available, both as associated gas and as dry gas in standalone gas fields. The original arrangements between the oil companies and the federal government were production sharing contracts for oil but do not cover gas. Oil companies, which are the primary producers of associated gas, want a commercial price for gas supplied to the domestic market that matches international prices. The FG, arguing that gas is a national asset, wants the commodity to be priced low, especially for the power sector in an attempt to keep the electricity retail prices low. Since global LNG prices are more attractive, oil companies have an incentive to divert gas to international export markets as much as they could and since they do not have an incentive to supply for the domestic market, flare the rest of the gas. The result is incessant gas flaring in Nigeria. Also, consequently, the local gas processing and transmission infrastructure is dilapidated. Inadequate and erratic availability of gas, resulting from lack of investments in infrastructure, poor planning and sabotage of pipelines, has also been a major cause of poor utilization of existing power generation capacity. For example, of the 4,000MW sent to the power grid, approximately 40% is lost due to gas, grid and water constraints.

In February 2008, the FG approved measures to improve the medium- to long term development of the gas sector that included a new gas pricing policy, introduction of a Strategic Aggregator, rolling out of a Gas Master Plan that identifies the future gas infrastructure network to be built by the potential investors, and an obligation for gas producers to serve the domestic market. The policy mandates all oil and gas operators to set aside a pre-determined amount of gas for the domestic sector. It sets a penalty for default at $3.5/mcf of obligation that is under-supplied and otherwise flared, and is also not tax deductable. An environmental surcharge of 0.5 C/mcf is levied over this. The policy also stipulates that the relatively cheaper Nigerian gas will be directed to the domestic market first. The gas policy mandates a sector based pricing to match 3 categories, (a) Cost (b) Netback for the strategic industrial sector; (c) Alternative fuels pricing for commercial users. Lastly, it introduces the concept of strategic aggregator, who will be responsible for the volume and price of the gas supply. The price of gas to non-power consumers is expected to cross subsidize the price to power plants resulting in a pooled price of US $ 0.80/ MMBtu to the gas producers. This arrangement of a pooled price is expected to be managed through the proposed institutional arrangement of a gas aggregator. The Government also introduced a securitization framework to encourage investment in gas supply for the power sector. Both of these steps will provide the much needed boost to gas supply to the power sector.

Future investments in gas development could be affected by concerns relating to security, securitization package, and global gas prices. While the package of measures announced signals the government's interest in resolving the critical gas issues, a number of concerns have been raised by stakeholders. In particular, the concerns regarding the security situation and the securitization packages for gas supply to the power sector. It is also a concern whether the new gas pricing policy will be a sufficient incentive for operators to develop non-associated gas reserves.

RUBBER: AN UNTAPPED COMMODITY FOR DIVERSIFYING NIGERIA'S ECONOMY

As Nigeria continues its search for diversification opportunities, a strong candidate ought to be rubber. Nigeria is the second largest rubber producer in Africa and the 12th globally but it has failed to realize substantial export revenue from this commodity. Rather, Nigeria's rubber output has declined from approximately 100,000 metric tons (MT) per annum in the early 2000s to between 60,000-80,000mt per annum. Challenges such as aged trees, low government intervention and funding have cost Nigeria about $6bn in lost export revenue from this commodity.[7] These challenges coupled with a poor business environment, particularly incessant power failure, led to the exit of global tyre producing companies; Michelin left in 2007 and Dunlop in 2008. The exit of these companies from the Nigerian market led to a significant decline in the national industrial demand for rubber, which ultimately left Nigeria exposed to fluctuations in global rubber prices.

There is no doubt that rubber is a globally desirable cash crop with a robust demand from markets such as China, India and the United States. However, if Nigeria is to tap into the revenue potential of the commodity, it must address its fundamental challenges with effective policies and loan structures. It must also revive and develop its domestic market for it to be able to compete with international brands. With the International Rubber Group projecting global rubber demand to reach approximately 13.6mn mt by 2020 compared to global production projected at 12.5mn mt, now is the time for Nigeria to boost its rubber output.[8]

[7]Steve Agbota, 2017. "Nigeria's rubber plantation going extinct". http://sunnewsonline.com/nigerias-rubber-plantation-going-extinct/
[8]Josephine Okojie, 2016. "Revitalizing rubber production to spike non-oil revenue". https://www.businessdayonline.com/companies/agriculture/article/revitalizing-rubber-production-to-spike-non-oil-revenue/

Challenges of rubber production in Nigeria

With the advent of oil in 1960, rubber largely experienced the same fate as many of Nigeria's prized cash crops: neglect to the point of irrelevance. Apart from this, the rubber industry has been saddled with several challenges that have kept production at a suboptimal level. A main challenge of the industry is the issue of ageing trees. Rubber trees in producing states such as Abia, Akwa Ibom, Anambra, Oyo and Ebonyi have passed their production peak. The use of trees today, planted as far back as 1960, has led to a decline in the yields of these trees, which is discouraging for rubber. The challenge of deforestation is also affecting rubber yields in Nigeria. In the last two decades, 57% of Nigeria's forests have been affected given the large scale of deforestation. This has affected plantations and trees across Nigeria and has led to a decline in the output of commodities including rubber.

A second challenge that has crippled Nigeria's rubber industry is inadequate funding from the government. With a seedling to harvest lag of about five years, poor funding has led to the exit of many tappers from the market. In the first quarter of 2018, credit to the agricultural sector accounted for approximately 3% of total banking credit, with farmers feeling the pinch of both inaccessible credit and high borrowing costs.[9] For Nigeria to tap into the revenue generating potentials of rubber, both the public and private sectors must work together to develop the rubber industry.

Finally, like many agricultural sub-sectors in Nigeria, the rubber sector suffers from a significant infrastructure deficit. Nigeria's infrastructure deficit is currently estimated at $300 billion (N30trn) and this manifests as poor storage and farm equipment, hindering rubber output in Nigeria. Rubber materials require sophisticated storage facilities that unfortunately Nigeria does not have.

[9]National Bureau of Statistics

Learning from Thailand

Rubber production in Thailand has evolved from small-scale rubber plantations in the 1990s to becoming the world's leading rubber producer and exporter. Not surprisingly, multi-national companies such as Dunlop, Bridgestone, and Michelin-Siam have invested significantly in Thailand, which has contributed to transforming the country into an investment and research hub for rubber production. Rubber output in Thailand increased by 25% from 3.57mn mt in 2011 to 4.47mn mt in 2015.[10] Exports account for approximately 84% of total output, while domestic consumption accounts for approximately 13%.[11] Interestingly, 95% of Thailand's rubber output originates from family owned plantations while the processing is handled mainly by small farmers' cooperatives. Public policy commitments supporting the country's rubber output are over a decade old. However, more recent is the establishment of a Rubber City. The city which spans over 200 hectares is aimed at attracting investors, adding value to rubber products in Thailand and providing employment for many youths in Thailand. The government hopes to attract at least $10bn worth of investment and 70 rubber factories by 2021, when demand for latex rubber and rubber sheets is expected to rise significantly.[12] The Thailand government also encourages rubber farmers through subsidy payments and adequate loan programs for farmers.

Seizing the rubber opportunity for Nigeria

Thailand serves as a good example for Nigeria to follow in terms of rubber production and quality. With the right strategy, the Nigerian government can rebuild its rubber industry and boost its revenue from the said commodity. Efforts have been made in the past by the Nigerian government to revamp the rubber industry. One of such was the Agricultural Transformation Agenda, which was supposed to boost rubber plantations in the 18 producing states by at least 75,000 hectares. However, three years after its introduction, the plan has remained limited in scope and financial backing. If Nigeria is to have any chance at increased rubber output, the government must back its ambitions with sufficient funds. The aim of these funds should be to invest in cultivating new and improved rubber trees, expanding rubber plantations and investing in modernized technology for processing rubber. In addition to an increase in funds targeted at improving rubber production, there must be proper checks and balances in place to ensure that the money is not diverted to illegitimate purposes.

[10]Win, Hnin Ei. 2017. "Economic importance of rubber in Thailand". Food and Fertilizer Technology Center for the Asian and Pacific Region. http://ap.fftc.agnet.org/ap_db.php?id=819

[11]Win, Hnin Ei. 2017. "Economic importance of rubber in Thailand". Food and Fertilizer Technology Center for the Asian and Pacific Region. http://ap.fftc.agnet.org/ap_db.php?id=819

[12]Arno Maierbrugger, 2017. "Thailand to open rubber city in early 2018". http://investvine.com/thailand-open-rubber-city-early-2018/

That said, financing the industry is not enough on its own. Nigeria also needs to insulate itself from being overly dependent on the global rubber market. The significant drop in global rubber prices in 2015/2016 (owing to a supply glut from Thailand) is indicative of the need to boost domestic demand. Rubber has several other uses including gloves, hoses, belts, masks, amongst others and if explored can serve as inputs for several companies across different sectors. With adequate access to credit, lower borrowing costs and an improved business environment, new industries can be encouraged to enter the Nigerian market which would boost the domestic consumption of rubber.

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THE CONTRARIAN CASE FOR EMERGING MARKETS

"It is not that emerging markets are cheap, but they are not dear"

TWENTY years ago, on August 17th 1998, the Russian government devalued the rouble, defaulted on its domestic debts and suspended all payments to foreign creditors. It was one of the most dramatic days of a year-long emerging-market crisis that began with the devaluation of the Thai baht. South Korea and Malaysia would suffer brutal recessions. President Suharto of Indonesia was forced to resign after 32 years that May. But it was Russia's default that shook the world.

Talk of rich-world recession was soon in the air. The Federal Reserve would cut interest rates three times before the year was out. The MSCI index of emerging-market stocks, which had lost 40% of its dollar value in the year leading up to August 1998, dropped by more than a quarter in that month alone. Emerging-market assets are not as scorned now as they were then. The panic resulting from Turkey's crisis is not anything like as acute. But there is no shortage of reasons for investors to be wary. Unloved asset classes have at least one charm—they tend to sell at a discount.

The price you pay for a stream of company earnings in emerging markets is lower than in the rich world—and far lower than in America. After a Turkey-inspired sell-off in the foreign-exchange market, currencies look fairly valued. A lot of fund managers would be putting their careers at risk by buying assets that have just fallen a lot. But those with longer horizons may find it worthwhile to take a look.

It is not so much that emerging markets are cheap, but that they are not dear. The price-to-earnings, or PE, ratio for the dollar index of emerging-market stocks is 14, a bit below its average since 1996. It looks even better value when you compare its PE ratio to that of the S&P 500 index of American stocks over time. At the start of 1996, both had PE ratios of around 18. Whenever the S&P 500's valuation has since risen relative to that of emerging-market stocks, it has eventually fallen back again (see chart). America's stock market currently has a PE of 23. It has been even dearer relative to emerging-market stocks in the past—but only rarely.

There other factors to consider. Currency risk is one. In rich countries, stocks and currencies sometimes move in offsetting directions. When the pound slumped after the Brexit vote in June 2016, it prompted a rally in British stocks, as companies' foreign earnings became more valuable in sterling terms. Emerging markets are different. The prices of shares and currencies tend to rise and fall in tandem.

Buying cheap stocks is no good if the currencies they are denominated in are overvalued. But is not obvious that they are. Even before the recent selling, real exchange rates in most big emerging markets were below their ten-year averages. A bout of high inflation would upset that reckoning. Currencies might then need to fall to keep the real exchange rate steady and exports competitive. That is not a big risk. Of the 25 emerging markets listed on the indicator pages of The Economist, only three (Turkey, Argentina and Egypt) have inflation rates above 6%. Most are below 3%.

It is unsurprising, then, that emerging markets are favored by "value" investors. This austere band prefers stocks with a low PE or a low price relative to the book value of assets. GMO, a fund-management group with an almost fanatical devotion to value, has a heavy weighting of emerging-market shares in its discretionary portfolio (and no American equities).

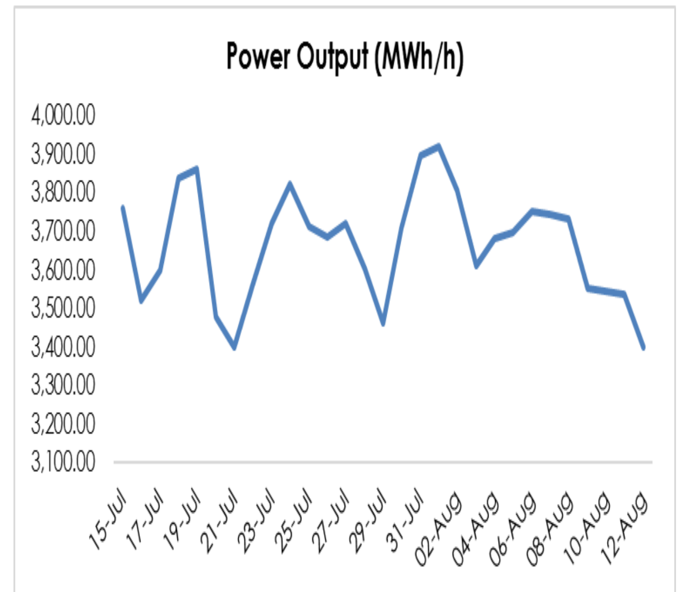
For many tastes, the value approach is a bit too virtuous, a little too much like a diet of steamed vegetables. There is no law that says cheap stocks cannot become cheaper. Turkey may be an outlier in terms of its erratic policymaking and the scale of its foreign debts, but its agonies seem likely to be protracted. Troubles elsewhere are a drain on confidence. Russia is another target of US sanctions. Mexico has NAFTA negotiations hanging over it. Elections in Brazil are likely to be fractious. China's economy is slowing. The valuation gap with America may already be stretched. But it could still widen.

It would be nice if it were easy to judge when to lighten up on dear stocks and load up on cheaper ones. People who can do this reliably are rare. For everyone else, valuation must come into the reckoning. Betting on emerging markets at this juncture would be gutsy. But sometimes the time to buy is when others are scared. There was plenty to fear 20 years ago. The emerging-market crisis had rattled much of Asia and would soon roil Brazil and Argentina. Even so, emerging-market stocks reached a low in dollar terms a few weeks after the Russian default. Within 18 months they had doubled.

MACROECONOMIC INDICATORS

Power Sector

The average power output from the national grid was 3667.03MWh/h within the period of July15th–August 12th. This is 3.26% lower than the average of 3551.11MWh/h in the corresponding period in June. This improvement was largely driven by amplified gas supply to GenCos and decline in losses at the transmission level. Despite this, the sector lost N2.14bn annualized at N776.82bn as at August 12th, which was predominantly due to gas constraints in power stations.



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Outlook

We expect the average power supply to remain around current levels of 3,600MWh/h - 3,800MWh/h provided there are no gas pipeline disruptions.

Money Market

Short-term interest rates (OBB and ON) decreased by 108bps and 125bps respectively to close at 8.42% and 9.25% pa on August 10th. Average opening position for banks closed positive at N316.79bn between 15th July - 10th August, compared to N229.44bn between 15th June - 10th July. Total OMO sales during the period amounted to N1.75trn compared to maturities of N1.83trn resulting in a net inflow of N80bn.

At the last primary market auction on August 1st, the 182-day and 364-day T/Bills tenor declined by an average of 15bps while the 91-day tenor remained flat at 10% pa. At the secondary market, the 182-day and 364-day T/Bills tenor increased by an average of 55bps while the 91-day tenor declined by 20bps.

[13]FGN

Tenor	Primary market (July 18th, 2018) (%)	Primary market (August 10th, 2018) (%)	Secondary market (July 16th, 2018) (%)	Secondary market (August 12th, 2018) (%)
91-day	10.00	10.00	11.11	10.91
182-day	10.50	10.40	11.99	12.16
364-day	11.49	11.30	11.99	12.92

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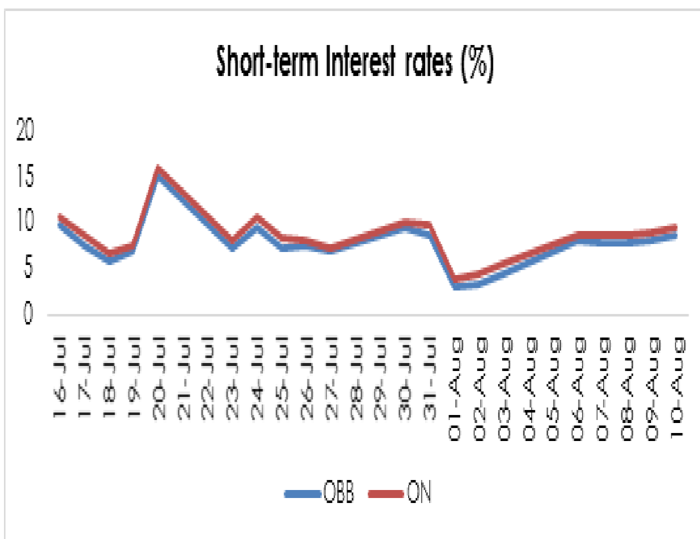

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Outlook

The anticipated increase in money supply due to budget disbursements and pre-election spending would keep interest rates lower. However, the CBN is expected to intervene regularly in the market to regulate the level of liquidity.

Forex Market

Exchange Rate

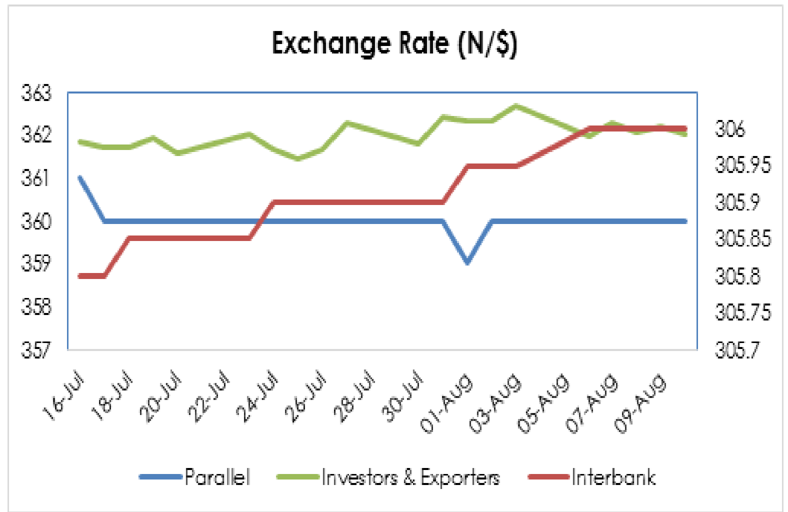
At the parallel market, the naira started the period at N361/$, traded at N360/$ for the next 11 days before appreciating to a 25-month high of N359/$. However, by the close of the period the Naira had dipped back to N360/$. At the interbank foreign exchange market, the naira started the period, July 16th at N305.80/$, and depreciated by 0.07% to close at N306.00/$ on August 10th. The naira depreciated by 0.04% to close at N362.00/$ at the IEFX window from N361.85/$ on July 16th. Total forex traded at the IEFX window was $3.51bn, compared to $3.20bn in the corresponding period in July.

[14]Source: FMDQ

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

Outlook

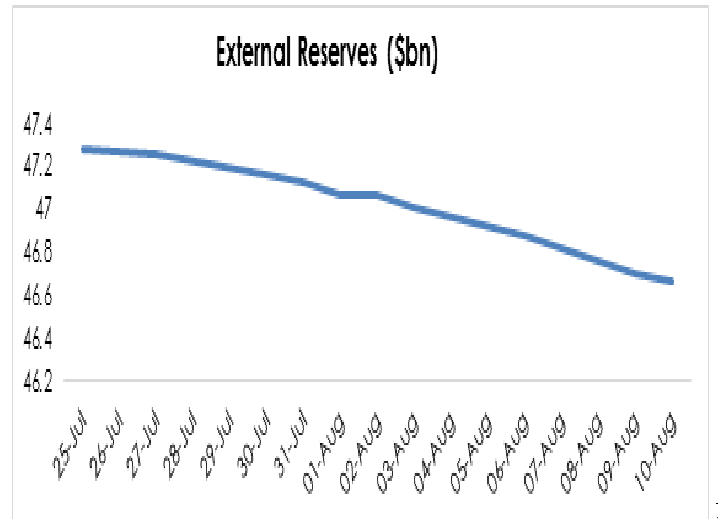
The consistency of the CBN interventions has kept the exchange rate relatively stable. We expect the naira to depreciate slightly as liquidity pressure build up.



16

External Reserves

Nigeria's gross external reserves declined below $47bn to close the period at $46.66bn (August 10th) from $47.51bn on July 16th. The decline in reserves was as a result of the increase in CBN's intervention in the forex market-$1.30bn in the review period compared to $1.23bn in the corresponding period in July. As a result, the import cover decreased from 11.64 months to 11.43 months.



17

Outlook

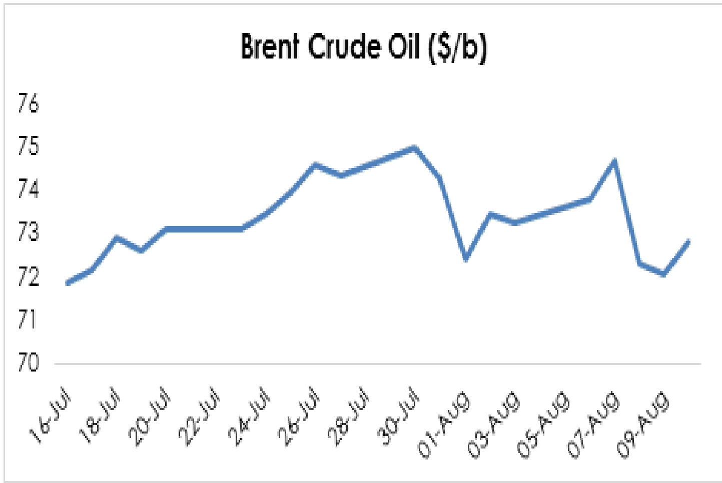
Increased liquidity in the coming weeks is expected to weaken the currency. However, we expect the CBN to continue its interventions. This will have an impact on the pace of the accretion of the external reserves.

COMMODITIES MARKET - EXPORTS

Oil Prices

During the period, oil prices recorded a choppy movement. The price of the commodity increased from $71.84pb on July 16th to $72.81pb on August 10th. Brent oil prices rose to a period high of $74.97pb on July 30th, which was as a result of Saudi Arabia's temporary suspension of all shipments through the strategic Red Sea shipping lane, following an attack on two of its major crude carriers. However, prices declined to close the period at $72.81pbas a result of the increase in the global supply of the commodity.

[16]FMDQ, CBN, FDC Think Tank
[17]CBN



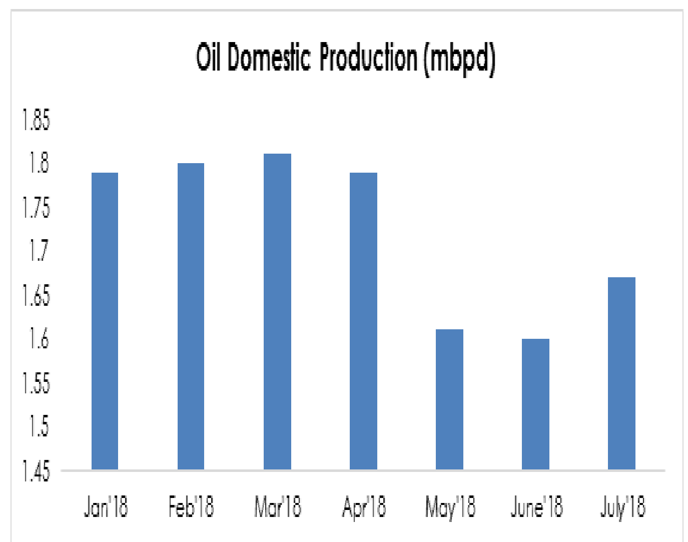
18

Outlook

In the coming weeks we expect oil prices to remain bearish amid growing geopolitical tensions and the increase in the global oil supply.

Oil Production

According to OPEC's monthly oil report, Nigeria's domestic oil production increased by 4.38% to 1.67mbpd in July, from 1.60mbpd in June. The increase in oil production was partly driven by the reopened Forcados terminal and the lifted force majeure on exports of Bonny light oil terminal. Nigeria's oil rig count increased to 16 in July from 13 in June.[19]



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Outlook

An increase in oil rig count implies an increase in production activities. We expect Nigeria's oil production to increase in the coming weeks as activities increases and barring no disruption to pipelines.

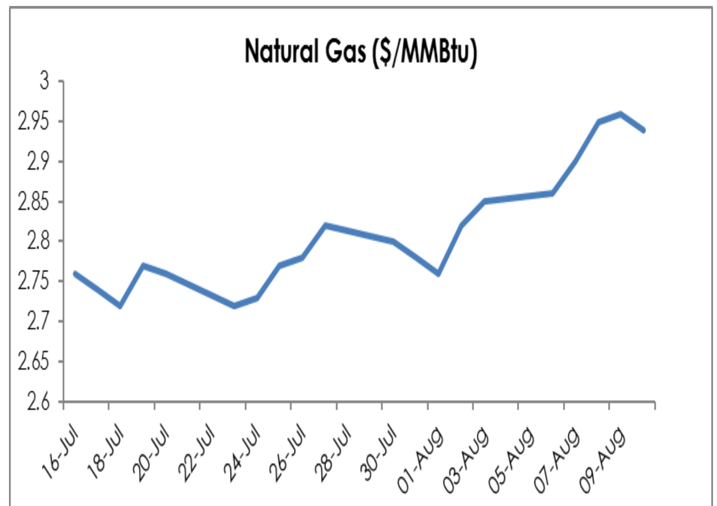
Natural Gas

Natural gas prices rose by steadily 6.52% from $2.76/mmbtu on July 16th to $2.94/mmbtu on August 10th. The bullish trend is largely influenced by the rising global demand for natural gas, largely influenced by China.

[18]Bloomberg
[19]Bakers Hughes
[20]OPEC

Outlook

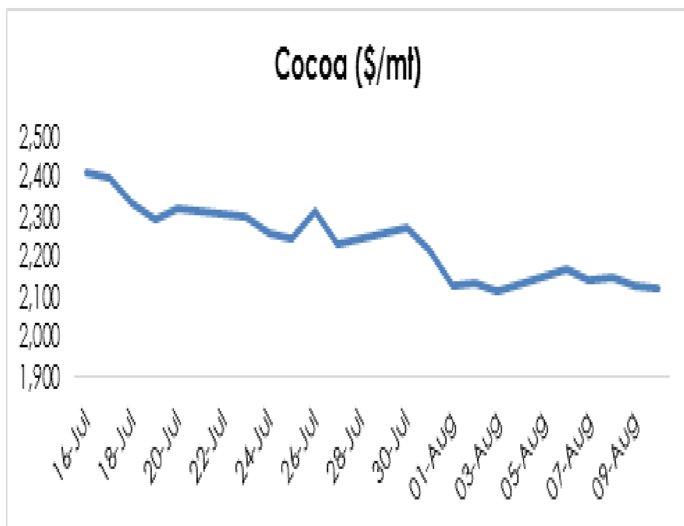
The prices of natural gas are expected to remain volatile in the near term. This will be partly due to the decline in the European domestic production, and the standoff between Qatar, a major supplier of the world's liquefied natural gas (LNG), and its neighboring countries.



[21]

Cocoa

Cocoa prices decreased by 11.97% to $2,118/MT on August 10th, from $2,406/MT on July 16th. This price decrease was largely driven by abundant rainfall in the Ivory Coast, which increased global supply.



[22]

Outlook

We expect cocoa prices to continue declining in the coming weeks, as a result of the consistent favorable weather in the Ivory Coast, which would further increase supply.

IMPORTS

Wheat

Wheat prices increased by 16.56% to $5.70/bushel on August 10th, from $4.89/bushel on July 16th. The price increase is as a result of the high heat waves in Russia, Australia, and the European Union.

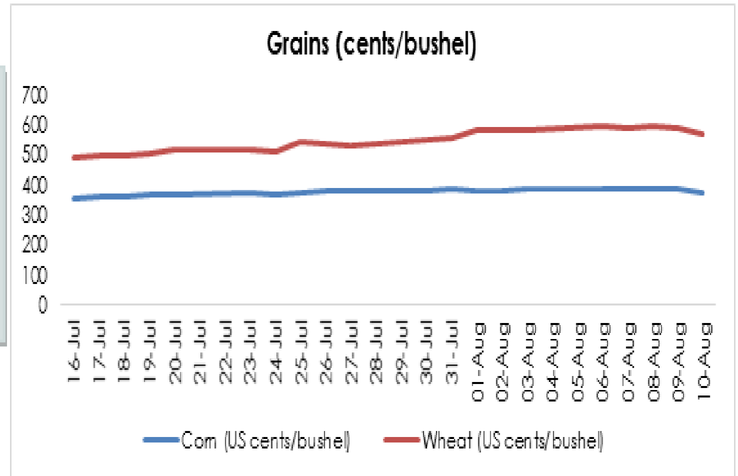
Corn

Corn prices rose by 3.33% to $3.72/bushel from $3.60/bushel. This was influenced by weak harvests in the U.S.

[21] Bloomberg.
[22] Bloomberg.

Grains- Outlook

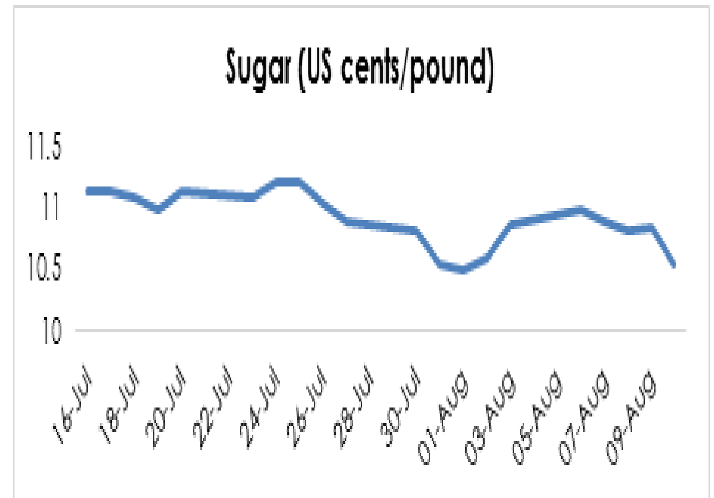
We expect grain prices to trend downwards in the near term due to warmer weather conditions in the U.S.



[23]

Sugar

Sugar prices decreased by 5.39% to $0.1054/pound on August 10th, from $0.1114/pound, on the back of ample global supply.



[24]

Outlook

The price of sugar is expected to remain at current levels on signs of lower consumer demand as people opt for alternatives.

[23] Bloomberg.

[24] Bloomberg.

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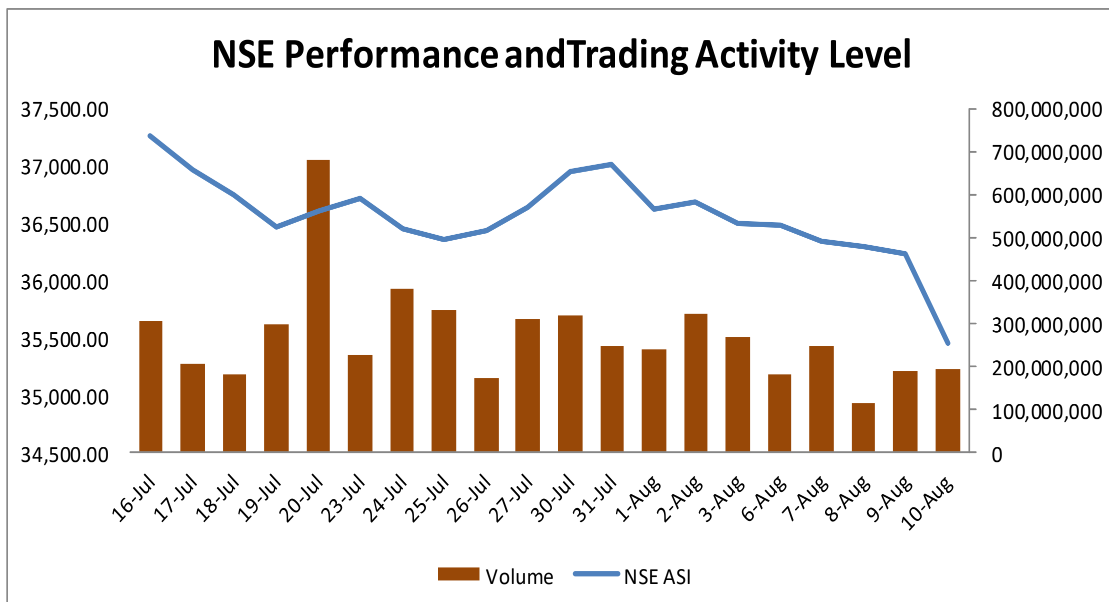
STOCK MARKET UPDATE

The NSE-All Share Index (NSE ASI) lost 5.21% to close at 35,446.47points on August 10 from the close of business on July. The equity market was hit by a massive outflow of foreign direct investment due to the exit of international investors who are looking for higher returns. Also the political uncertainty in Nigeria has dampened investor confidence. The YTD return on the index stood at -7.31% on August 10.

The market lost 4.5% (N610bn) as the market capitalization closed the period at N12.94trn. The stock market is currently trading at a price to earnings (P/E) ratio of 10.27x (August 10th), a 3.39% decline compared to its close of 10.63x as at 13th of July, 2018. During the review period, the NSE recorded 13 days of losses and 7 days of gains.

The market breadth was also negative at 0.23x, as the number of losers (88) outpaced the number of gainers (20), while 61 stocks remained unchanged.



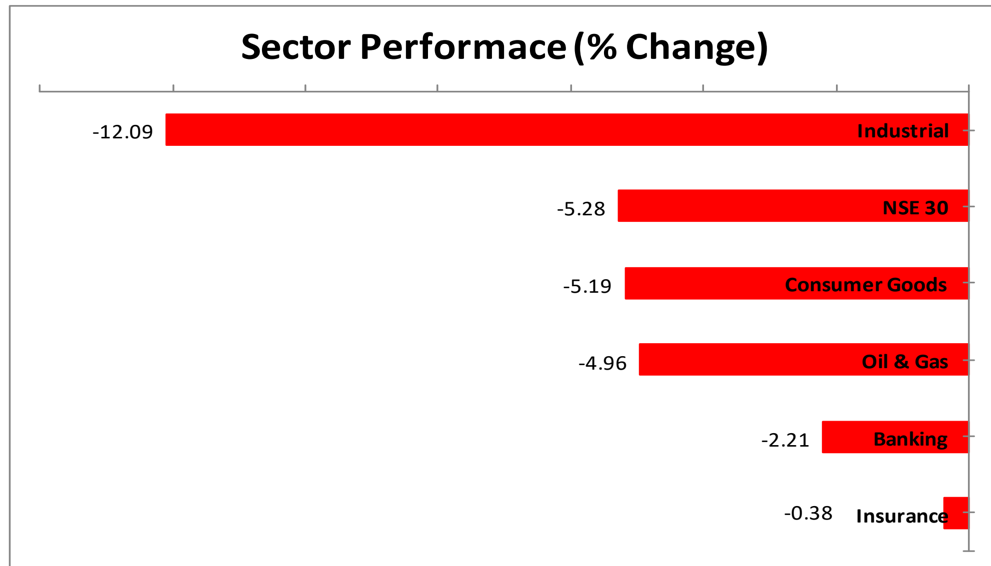
[25]

The bourse witnessed less trading activities in the period under review. Average volume slid 11.76% to 270mn units compared to 306mn units recorded in the first half of July. Average value of transactions showed the same trend as it was down 12.94% to N2.96bn in the review period.

[25]NSE, FDC Think Tank

SECTOR PERFORMANCE

In the period under review, all the NSE sub-indices closed negative with the industrial sector performing the worst (-12.09%). This was partly driven by the negative financial performance of Lafarge Africa Plc in the first half of 2018.



26

The best performing stocks were NEIMETH INTERNATIONAL PHARMACEUTICALS PLC (54%), NIGER INSURANCE PLC (50%), CEMENT COMPANY OF NORTHERN NIGERIA PLC (34%), CUTIX PLC (33%) and CONTINENTAL REINSURANCE PLC (17%).

TOP 5 GAINERS (N)				
Company	Jul '13	Aug'10	% Change	Absolute Change
NEIMETH INTERNATIONAL PHARMACEUTICALS PLC	0.52	0.80	54	0.28
NIGER INSURANCE CO. PLC.	0.26	0.39	50	0.13
CEMENT CO. OF NORTH.NIG. PLC	23.00	30.90	34	7.9
CUTIX PLC.	3.00	4.00	33	1
CONTINENTAL REINSURANCE PLC	1.45	1.69	17	0.24

[26] NSE, FDC Think Tank

The least performing stocks were SECURE ELECTRONIC TECHNOLOGY PLC (-40%), PZ CUSSONS NIGERIA PLC (-26%), LAFARGE AFRICA PLC (-25%), ROYAL EXCHANGE PLC (-25%) and CAP PLC (-23%).

TOP 5 LOSERS (N)				
Company	Jul '13	Aug'10	% Change	Absolute Change
SECURE ELECTRONIC TECHNOLOGY PLC	0.48	0.29	-40	-0.19
P Z CUSSONS NIGERIA PLC.	19.00	14.05	-26	-4.95
LAFARGE AFRICA PLC.	37.50	28.00	-25	-9.5
ROYAL EXCHANGE PLC.	0.36	0.27	-25	-0.09
CAP PLC	37.00	28.35	-23	-8.65

OUTLOOK

We expect Nigeria's political risk to remain elevated in the month of August. This would sustain the bearish sentiment on the exchange. However, the decline in share prices would likely present portfolio managers with attractive entry opportunities. This should limit the NSE's negative performance.

At Dangote, we are committed to producing cement of dependable quality, so when you buy our product, you're not just buying cement, you're also buying a **promise of strength**

DANGOTE CEMENT... **build with peace of mind**

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COUNTRY/LOCATION	PLANT TYPE
Cameroon	(Integrated Plant)
* Cote d'Ivore	(Grinding Plant)
Ethiopia	(Integrated Plant)
* Ghana, Takoradi	(Grinding Plant)
Ghana, Tema	(Import Terminal)
* Kenya	(Integrated Plant)
* Liberia	(Import Terminal)
Nigeria, Gboko	(Integrated Plant)
Nigeria, Ibese	(Integrated Plant)
Nigeria, Obajana	(Integrated Plant)
* Niger Republic	(Integrated Plant)
Rep. of Congo	(Integrated Plant)
Senegal	(Integrated Plant)
* Sierra Leone	(Import Terminal)
South Africa	(Integrated Plant)
* Mali	(Grinding Plant)
Tanzania	(Integrated Plant)
Zambia	(Integrated Plant)
* Nepal	(Integrated Plant)

* Under Construction/Commissioning * Planned

CORPORATE FOCUS : DANGOTE CEMENT

Analyst Recommendation: Hold	**Industry:** CEMENT
Market Capitalization: N3.9trn	**Target Price:** N268.08
Recommendation Period: 365 days	**Float**: N1.51bn
Current Price: N223	**Ticker symbol:** DANGCEM NL

ANALYST'S NOTE

Dangote Cement, the largest player in the African cement industry, concluded the issuance of Series 3 and 4 Notes on August 17th, 2018. The combined worth is N50 billion (bn) as part of its N150bn commercial paper program. The issue was oversubscribed by 158%, with the order book closing at N79bn. The proceeds will be used for capital expenditure, working capital and general corporate purposes. Management also confirmed the addition international non-executive directors in preparation for the listing on the London Stock Exchange.

Dangote Cement classifies its operations in Africa into two regions: Nigeria (home market) and Pan-Africa. It has consistently delivered strong results, which makes its stock attractive and a favorite pick among investors. Revenue from the Pan-African region increased, supported by a 5% price increase in South Africa. Although the production shutdown in Tanzania created a drag on sales volume for the Pan-African region in H1'18, there is potential for the region to improve once gas turbines become fully operational in Tanzania and the sea-based clinker Nigerian exports to Ghana and Cote d'Ivoire commence. Dangote Cement's capacity expansion in the fast-growing Pan-Africa cement market is expected to further enhance the company's growth opportunity.

Compared to our target price for Dangote Cement (268.08), which was based on both intrinsic (80%) and relative (20%) valuation, the share price is currently undervalued. Currently, Dangote Cement has a higher return on equity (ROE) of 21.75 and return on investment (ROI) of 16.13 compared to industry average of 5.65 and 4.95 respectively. Also, we expect Dangote Cement to trade at a P/E of 11.85x in 2019E, representing a discount of 14% relative to frontier peers. Accordingly, we recommend a HOLD rating on Dangote Cement. Based on the current price of N229, our target price implies a 19% upside potential for the stock.

Earnings growth driven by increased volumes and cost management

The strong performance of the H1'2018 was driven by a recovery in the Nigerian market. Group sales volume ramped up by 7.4%. Volumes from Nigeria were up 13.9% while Pan-African volumes declined by 3.9% in H1'18. The reduction in volumes from the Pan-African region was mainly due to the production shutdown in Tanzania and civil unrest in Ethiopia. The Tanzanian operations make up about 6% of the group's installed capacity. Group revenue increased by 16.9% to N482.4bn. Revenue from Nigeria increased by 18% to N344.1bn while revenue from Pan-African region increased by 11% to N138.7bn. Although there was a slight decrease in sales volume in Pan-African region, both revenue and EBITDA for the region improved due to better pricing and currency conversion. Group EBITDA increased by 20.8% while EBITDA from Nigeria increased by 19.3%.

The increase in EBITDA can be mainly attributed to higher volumes and favorable fuel mix. Dangote Cement has been able to eliminate the use of expensive fuel (Low Pour Fuel Oil – LPFO) in its two biggest plants (Obajana and Ibese). The company converted to cheaper alternatives such as gas, own-mined and third-party Nigerian coal. This was of significant benefit to both margins and foreign currency demands.

The Nigerian cement industry has experienced substantial growth over the past few years. With a population of about 194 million people and a population growth rate of approximately 3% per annum, the demand for and consumption of cement is expected to increase. Cement sales volume ramped up by 10% year-over-year (YoY) to 11.2 metric tonnes (Mt) in H1'18.

The demand for cement is driven by infrastructure, commercial, and residential real estate development. The government, especially at the federal level, is usually the major driver of cement demand in Nigeria with an estimated 50% of total cement consumption. The frequency of road and bridge reconstruction as well as rehabilitation of social infrastructure emphasizes the government's continued patronage of the industry. If the 2018 budget is properly implemented, the projected capital expenditure (CAPEX) of N2.4trn should result in an increase in demand for cement. Private sector construction is highly positively (96%) correlated with government expenditure on infrastructure. The increase in government expenditure on infrastructure will spur private construction. Demand from individual home builders might not change significantly as the new minimum wage can be viewed as a double-edged sword. On one hand, disposable income increases due to higher wages. On the other hand, employers of labor may be forced to lay off staff to remain lean and cost efficient. The need for infrastructure is augmented by a growing population and urbanization.

Nigeria is currently the largest cement producer in Africa and in the light of optimizing utilization of products, the producers of cement have identified an opportunity in the existing infrastructure gap, estimated at $300mn.[27] The use of cement roads has a higher initial cost but lower maintenance cost and relatively longer life span (27 years vs 17 years for asphalt roads). The switch to cement roads is also expected to ease the pressure on the naira from the importation of bitumen.

[27]African Development Bank (AfDB)

The cement industry is characterized with product homogeneity, high barriers to entry and no close substitute for the product. It is also concentrated with Dangote Cement controlling about 66% of the Nigerian market share while Lafarge controls about 23%. Competition within the cement industry is expected to intensify as BUA Cement ramps up production that is expected to make up about 35% of the entire volume of cement sold in Nigeria. Lafarge is more likely to see its market share decline than Dangote is as a result of BUA Cement increase in cement production capacity. BUA Cement's new plant is also very close to Niger republic, which increases its export potential.

Dangote Cement is a subsidiary of Dangote Industries, which was founded by Aliko Dangote in 1981 as a trading business with an initial focus on importation of bagged cement and other commodities such as rice, sugar, flour, salt and fish. In the 1990s the group made a strategic decision to transition from a trading-based business into a fully-fledged integrated manufacturing operation.

Dangote Cement was incorporated as Obajana Cement Plc by Kogi state government in November 1992. The name was changed to Dangote Cement Plc in July 2010 just before the company listed on the Nigerian Stock Exchange (NSE) in October 2010. Prior to 2007, Lafarge WAPCO dominated cement production in Nigeria with a market share of about 60%. The Dangote Group was initially the largest importer of cement. However, its backward integration, which culminated in the commissioning of the Obajana Plant in 2007, pushed its dominance to local production, hence displacing Lafarge WAPCO.

Dangote Cement is Africa's leading cement producer with nearly 46 million metric tons per annum (Mta) production capacity across Africa. A fully integrated quarry-to-customer producer, it has a production capacity of 29.25Mta in its home market of Nigeria. The Obajana Plant in Kogi state, Nigeria, is the largest in Africa with a production capacity of 13.25Mta across four lines. The Ibese Plant in Ogun State has four cement lines with a combined installed capacity of 12Mta, while the Gboko Plant in Benue state has a 4Mta production capacity. The entry of the Dangote Group into cement production created a fundamental shift in the industry by eliminating the dependence on imported cement and transforming Nigeria into a net exporter of cement.

Dangote Cement's Nigerian operations sold 12.7Mt of cement in 2017, of which about 6% (714 kiloton) was exported to countries including Ghana, Niger and Togo. West Africa is of particular focus as Dangote Cement stands to benefit from duty free trade within the Economic Community of West African States (ECOWAS). The lack of limestone in these countries limits cement production and defines Dangote Cement's export strategy to these regions. Dangote Cement currently has a presence in 10 African countries and is the most capitalized quoted company on the Nigerian Stock Exchange.

Dangote Cement has a wide economic moat from favorable markets, efficient scale, cost efficiency, access to capital at a competitive rate, access to raw material and large infrastructure. All of these attributes are difficult to replicate.

Financial Statement Summary									
Income Statement	2013	2014	2015	2016	2017	2018E	2019F	2020F	2021F
Revenues	386,177	391,639	491,725	615,103	805,582	882,830	965,336	1,105,491	1,194,062
COGS	142,517	143,058	201,808	323,816	351,290	353,132	376,481	431,142	465,684
Gross Profit	243,660	248,581	289,917	291,287	454,292	529,698	588,855	674,350	728,378
OPEX	49,502	65,088	86,046	119,336	155,297	154,495	154,454	165,824	167,169
EBIT	195,882	187,102	207,822	182,493	304,208	382,265	442,124	517,370	570,762
Net Finance	(5,121)	(2,413)	(19,528)	(1,564)	(16,785)	(41,851)	(28,838)	(19,911)	(5,620)
PBT	190,761	184,689	188,294	180,929	289,590	340,415	413,286	497,459	565,142
Tax	(10,437)	25,187	6,971	(5,695)	85,342	68,083	82,657	99,492	113,028
PAT	201,198	159,501	181,323	186,624	204,248	272,332	330,629	397,967	452,113
Balance Sheet									
Assets									
PPE	581,465	747,794	917,212	1,155,711	1,192,140	1,223,458	1,263,310	1,318,592	1,381,519
Non-current Assets	695,123	847,617	944,963	1,224,744	1,255,584	1,286,902	1,326,754	1,382,036	1,444,963
Inventory	27,667	42,687	53,118	82,903	94,594	77,689	82,826	94,851	102,450
Trade Receivables	11,488	9,803	11,544	26,279	30,155	17,657	19,307	22,110	23,881
Cash	70,502	20,593	40,792	115,693	168,387	175,870	271,809	381,871	515,897
Total Assets	844,425	984,720	1,110,943	1,527,908	1,665,883	1,683,381	1,837,509	2,026,248	2,244,087
Liabilities									
Payables	83,438	94,308	127,597	268,966	270,721	257,786	274,831	314,733	339,949
ST Debt	56,289	117,263	47,275	220,300	144,783	177,828	203,163	217,096	246,358
LT Debt	124,850	131,942	208,329	152,475	242,894	120,455	86,728	62,444	44,960
Total liabilities	294,332	392,835	466,223	730,563	884,523	782,195	790,846	820,399	857,392
Equity	550,093	591,885	644,720	797,345	781,360	901,186	1,046,663	1,205,850	1,386,695
Key Data & Ratios									
EPS	11.81	9.36	10.64	11.34	11.99	15.98	19.40	23.35	26.53
BVPS	32.28	34.73	37.83	46.79	45.85	52.88	61.42	70.76	81.38
Divident Yield	3.2%	4.5%	4.6%	4.9%	4.6%	3.9%	4.7%	6.1%	7.0%
ROE	41.5%	27.9%	29.3%	25.9%	25.9%	32.4%	33.9%	35.3%	34.9%
ROA	26.5%	17.4%	17.3%	14.1%	12.8%	16.3%	18.8%	20.6%	21.2%
Gross Margins	63.1%	63.5%	59.0%	47.4%	56.4%	60.0%	61.0%	61.0%	61.0%
EBITDA Margins	59.5%	57.0%	53.4%	41.8%	48.2%	52.8%	54.7%	54.8%	55.5%
Net Margins	52%	41%	37%	30%	25%	31%	34%	36%	38%
Debt Equity	37%	45%	40%	47%	50%	33%	28%	23%	21%
PE	18.55	14.21	15.98	15.34	19.19	14.33	11.80	9.81	8.63
EV/EBITDA	16.86	11.27	11.83	12.47	10.70	8.67	7.45	6.29	5.57

Dangote Cement's management has successfully operated the company since inception as evidenced by the firm's continuing record of excellent returns on invested capital. Management has done remarkably well in maintaining the firm's reputation as a force to contend with in the industry.

We find most of the qualities of the board to be in line with best practices. The board is made up of 16 members of which five are independent directors. The board members have the necessary skills and vast experience across regions that make them more than capable to make sound decisions for the company. The role of the Chairman is separated from the CEO's and the board looks at risk and strategy on both short and long-term basis. However, there is no female on the company's board.

Alhaji Aliko Dangote is the Chairman of the Board of Directors. He holds a BSc in Business Studies from the Al-Azahar University, Egypt. He is the founder and Chief Executive Officer of the Dangote Group. He serves on various boards, foundations, institutes and committees of the Federal Government of Nigeria.

Mr Joseph Makoju became the Group CEO in April 2018. He has a BSc and an M.Phil in Mechanical Engineering. He has worked in several world class corporations including Shell BP, Blue Circle (UK) and WAPCO (now Lafarge Africa), which he led as Managing Director/CEO for a decade before taking up the appointment as Managing Director/CEO of National Electric Power Authority. He also served as Special Adviser (Electric Power) to the President, Federal Republic of Nigeria, under two separate administrations.

Chairman of the Board of Directors

Alhaji Aliko Dangote

CEO

Mr Joseph Makoju

THE BULLS SAY

- Better regional presence in Nigeria compared to peers
- Talented and well experienced management
- Presence across Africa
- Wide economic moat

THE BEARS SAY

- Price risk
- Delay in pioneer tax approval

RISKS AND OUTLOOK

Dangote Cement is exposed to both financial and non-financial risks with each making up 50% of the total risk profile.

Currency risk accounts for the highest element of the company's total risk profile at 33%. Although being a net exporter dampens the effect of foreign currency scarcity, it is still a key concern for the group. Another market risk of interest is price risk; the company's top-line might be affected by volatile commodity prices.

Operational risk makes up about 28% of the company's total risk profile. Inadequate or failed internal processes, people and systems from external events will significantly affect the company's profitability. An example is the civil unrest in Ethiopia which affected production, similar situation in Nigeria will result in a significant loss for the group. A higher effective tax rate poses a risk to the estimated value as the company has encountered delay in obtaining pioneer tax approval from the Nigerian Investment Promotion Commission (NIPC). Dangote Cement restated group tax charge in H1'18 to N45.87bn from N11.54bn being reversal of tax-deductible profit earned from Ibese lines 3 and 4 and Obajana line 4 that were entitled to a tax holiday under the Pioneer Status Incentive. The outcome of the two-year extension request will affect its bottom line.

We expect cement prices to stabilize for the rest of 2018 in Nigeria. After the April 2018 price increase to N2,570, Dangote cement being the industry price leader, indicated prices will remain unchanged in the near term if macro indicators remain stable. However, we expect downward pressure on prices in 2019 due to excess capacity from Dangote Cement and BUA Cement.

APPENDIX - OUR VALUATION

The valuation for Dangote Cement was derived at using both absolute and relative valuation methods. The target value is the weighted average of Free Cash Flow to Firm discounted model (50%), Dividend Discount Model (30%) and Relative Value (20%). The terminal value for the discounted models were derived using H-model as we expect a gradual decline in the current high growth rate to a lower sustainable growth rate. The discounted rate [weighted average cost of capital (WACC)] of 13.7% was derived using a 14.9% risk free rate [the yield for a 10-year Federal Government of Nigeria (FGN) bond], a beta of 1.13, an after-tax cost of debt of 11.76%, market risk premium of 5%, short term growth rate of 13% and long term growth rate of 5% and 10-year period of high growth rate. The relative value was derived using enterprise value to EBITDA.

Free Cash Flow to Firm Discount Model							
Period			0.32	1.32	2.32	3.32	4.32
Year			2018E	2019E	2020E	2021E	2022E
Revenue			882,830,242	965,336,066	1,105,491,456	1,194,061,746	1,272,913,694
% y/y				9.3%	14.5%	8.0%	6.6%
EBIT			382,265,495	442,123,918	517,370,001	570,761,515	621,181,882
% y/y				15.7%	17.0%	10.3%	8.8%
EBIT margins			43.3%	45.8%	46.8%	47.8%	48.8%
EBIT*(1-t)			305,812,396	353,699,134	413,896,001	456,609,212	496,945,506
Add: Depreciation and Amortization			83,449,800	85,642,069	88,431,683	92,301,437	96,706,298
% of Revenue			9.5%	8.9%	8.0%	7.7%	7.6%
Less: Capex			(114,767,932)	(125,493,689)	(143,713,889)	(155,228,027)	(165,478,780)
% of Revenue			13.0%	13.0%	13.0%	13.0%	13.0%
Less Change in WC			16,468,765	10,257,858	25,073,799	15,845,225	14,106,613
% of Revenue			1.9%	1.1%	2.3%	1.3%	1.1%
Free Cash flow to firm			**258,025,500**	**303,589,658**	**333,539,995**	**377,837,397**	**414,066,411**
Terminal Value Based on H Model							**6,921,792,664**
Discount Factor			0.96	0.84	0.74	0.65	0.57
Present Value			**247,552,928**	**256,230,762**	**247,645,860**	**246,789,656**	**4,215,138,500**
Equity Value	5,213,357,706						
Less Net Debt/Add Net Cas	219,290,000						
DCF Equity Value	4,994,067,706						
Shares Outstanding	17,040,507						
Fair Value	293.07						

Dividend Discount Model								
Year			2018E	2019E	2020E	2021E	2022E	TV
DPS			8.95	10.87	14.01	15.92	17.70	295.89
Discount factor			0.96	0.84	0.74	0.65	0.57	
PV of Dividends			8.59	9.17	10.40	10.40	180.19	
Fair Value	218.74							

Relative Valuation	
Average	10.27
2018E EBITDA	4,783,561,386.44
Net Debt	219,290,000.00
Enterprise Value	4,564,271,386.44
Fair Value	267.85

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