FDC Bi-Monthly Update

Volume 8, Issue 23

November 1, 2018

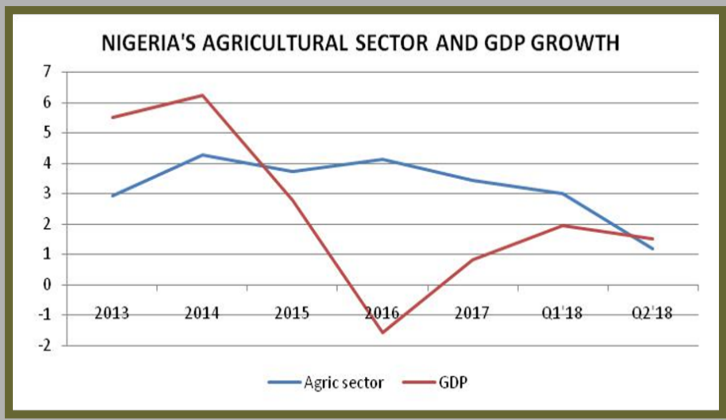
A Financial Derivatives Company Publication

☎:01-2715414, 6320213; Email: info@fdc-ng.com; Website: www.fdcng.com

In This Issue ...

The need for flood defence in Northern Nigeria

Nigeria's agricultural sector grew by only 1.19% in the second quarter of 2018, the slowest pace in over five years.[1] It is also the first time in over three years that the sector's production grew below aggregate output.[2] To understand the abrupt drop we need to look at northern Nigeria, which is where most of Nigeria's agricultural commodities are grown, such as rice, onions, beans and pepper. The region is a major contributor to Nigeria's agricultural sector.[3] Other commodities grown largely in the region include groundnuts, sorghum, garlic and wheat. However, production activities in the region have been constrained by insecurity and pastoral conflicts. Based on the most recent data, Nigeria's onion output has fallen by an average of about 4% in the last five years.[4] Rice output also dropped by 3%.[5] This trend is poised to intensify as flooding has increased in the region. There have been reports that flooding has washed away crops from farmlands in states such as Kebbi, Kano, Katsina and Niger.



[6]

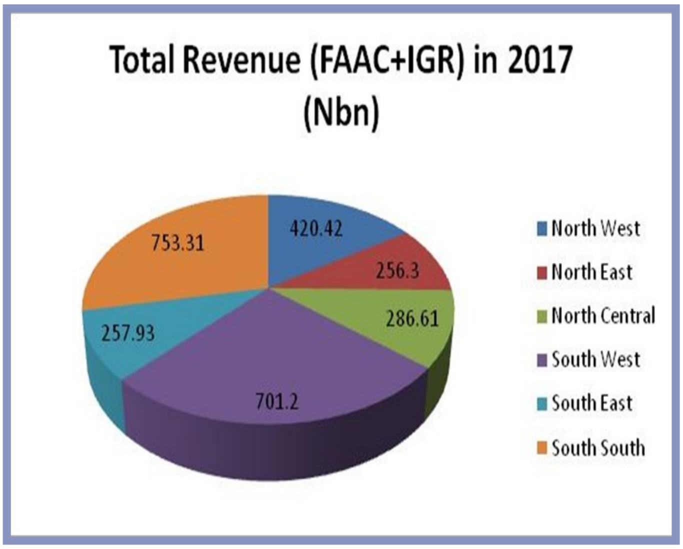
While official figures are not yet available to quantify the losses from the 2018 flooding, two sharp changes clearly articulate the impact of a reduced food supply. Firstly, food prices for northern produce are on the increase. Between April and September, the price of beans rose 14.9%, onions 95%, rice 14.3% and peppers 25%.[7]

[1]National Bureau of Statistics (NBS), 2018. "Nigerian Gross Domestic Product Report (Q2 2018)". Federal Government of Nigeria, http://nigerianstat.gov.ng/elibrary?queries[search]=gdp
[2]National Bureau of Statistics (NBS), 2018. Ibid. Federal Government of Nigeria, http://nigerianstat.gov.ng/elibrary?queries[search]=gdp
[3]National Bureau of Statistics (NBS), 2018. "Table: 1AREA OF NIGERIA BY STATE". Federal Government of Nigeria, www.nigerianstat.gov.ng/download/71
[4]The Food and Agriculture Organization Corporate Statistical Database, 2018. "Crops". Food and Agriculture Organization, http://www.fao.org/faostat/en/#data/QC
[5]The Food and Agriculture Organization Corporate Statistical Database, 2018.Ibid. Food and Agriculture Organization, http://www.fao.org/faostat/en/#data/QC
[6]NBS, FDC Think Tank
[7]FDC Think Tank

Commodity	Price (N) (April)	Price (N) (September)	%Change
Beans (per sac) 	23,500	27,000	14.9
Onions (per sac) 	18,000	35,000	94
Rice (per 50kg bag) 	14,000	16,000	14.3
Pepper (per sac) 	8,000	10,000	25

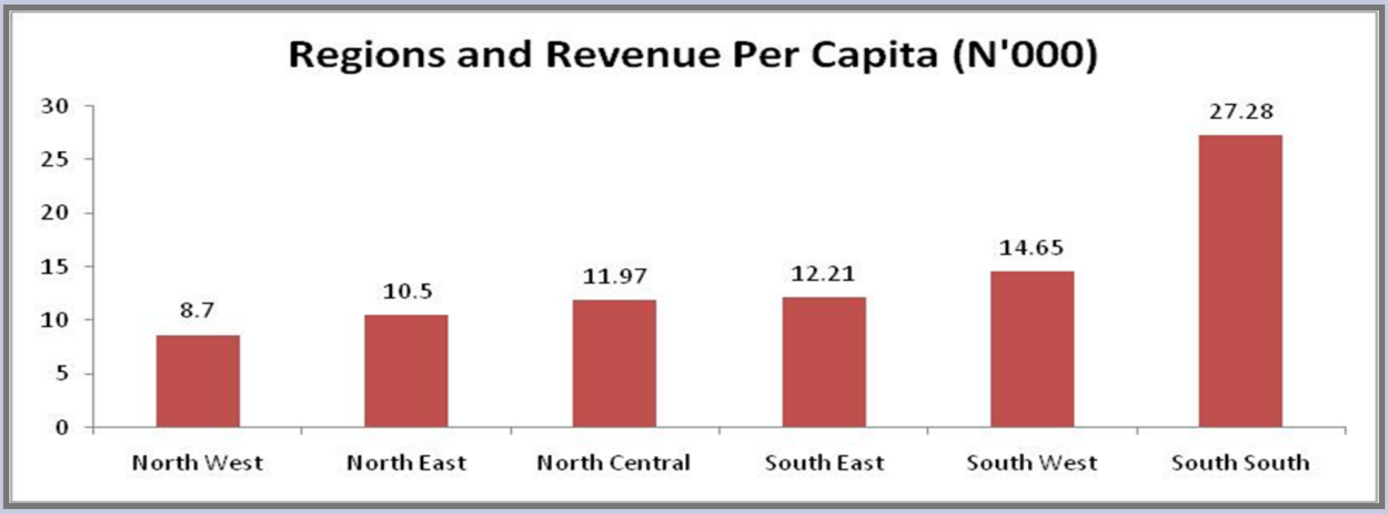
The food shortage also contributed to the end of Nigeria's inflation moderation. The inflation rate fell for 18 consecutive months until August 2018 when the trend reversed.[8] Inflation rate increased to 11.23% in August from 11.14% in July and further to 11.28% in September.[9] This upward trajectory will be sustained if food shortages persist. The monetary policy committee of the Central Bank of Nigeria shares the same view. This prompted some members of the committee to call for a tightening of monetary policy in September, in order to limit the amount of money in the economy and subdue demand pressures. Hence, the impact of the recent flooding has been severe on the economy.

However, northern states are hard pressed to respond. Their revenues are historically smaller than their southern neighbors. Northern states only accounted for 32% of the total internally generated revenue in 2017.[10] They also have the lowest per capita funding allocation from the Federal Account Allocation Committee (FAAC). The ongoing pastoral crisis has made 2018 particularly challenging as spending has been diverted to recurrent expenditure and the ongoing security demands. As a result, if northern farmers and the agricultural industry are going to have any reprieve, the Federal Government needs to support the northern states in flood control. A lower flood incidence would help soften the impact of the food shortage, and financial support from the Federal Government would reduce pressure on the states to split their limited financial means between two top priorities – flooding and the pastoral crisis.



[11]

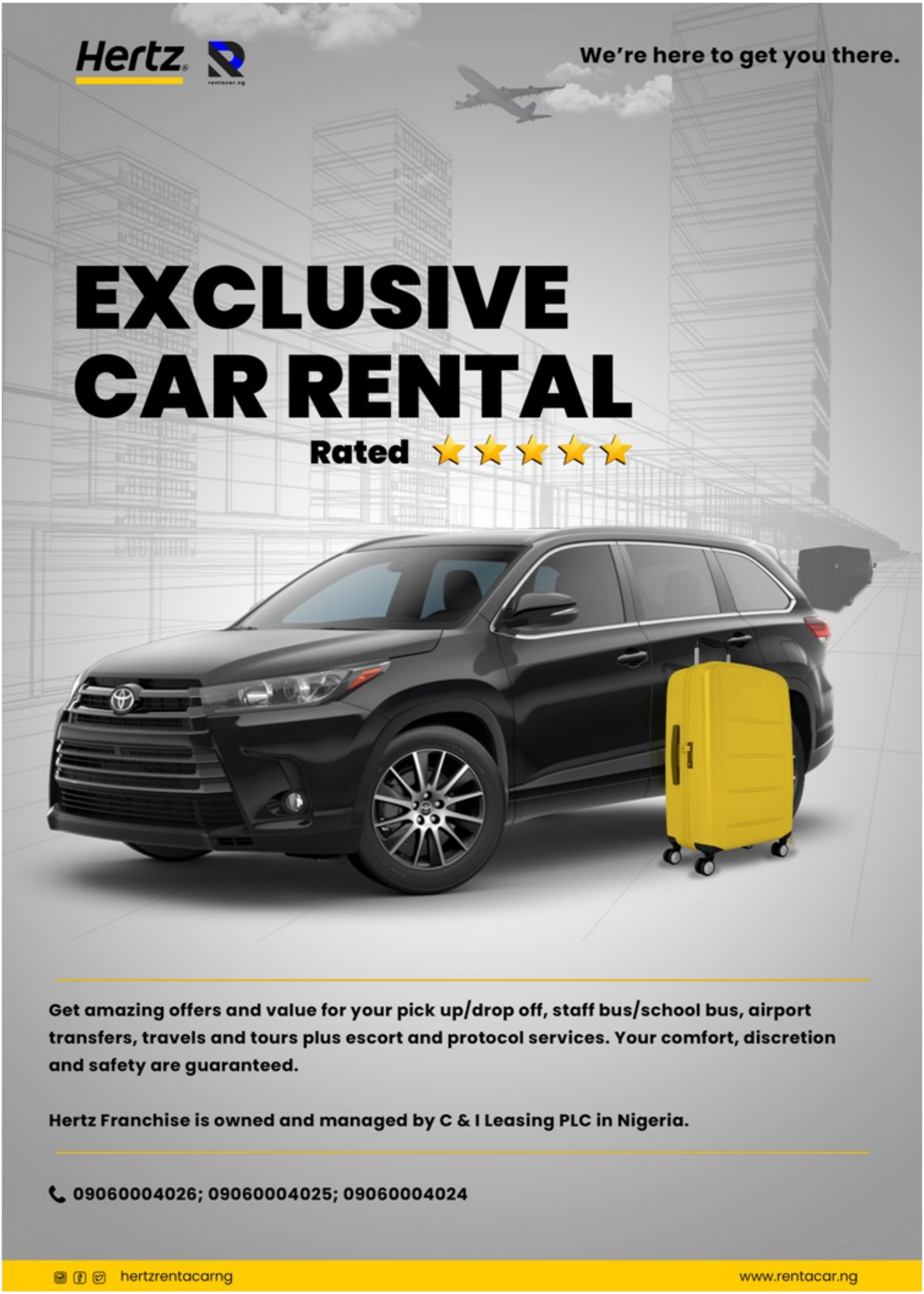
[8]National Bureau of Statistics (NBS), 2018. "CPI and Inflation Report August 2018". Federal Government of Nigeria, http://nigerianstat.gov.ng/elibrary
[9]National Bureau of Statistics (NBS), 2018. "CPI and Inflation Report September 2018". Federal Government of Nigeria, http://nigerianstat.gov.ng/elibrary
[10]National Bureau of Statistics (NBS), 2018. "Internally Generated Revenue at State Level 2017". Federal Government of Nigeria, http://nigerianstat.gov.ng/elibrary?queries[search]=igr
[11]NBS, FDC Think Tank



The provided funds could be in the form of a special intervention fund and could enable affected states to invest in flood prevention such as raising and rehabilitating river banks to prevent them from overflowing. This kind of intervention would be similar to the bail-out fund the federal government made available to state governments struggling with salary payments and low levels of economic activity in 2015. 14 of the 27 states that benefited from the package were from the north.[12] Kebbi, Katsina and Niger States were among the beneficiaries. This enabled the governments of these states to clear part of their salary backlogs, which boosted spending and economic activities in the region. These bail-out funds were, however, based on an interest of 9%-14.83%.[13] To avoid additional strain on already cash-strapped states, the federal government should consider reducing or eliminating the interest rates in this scenario. Instead strict conditions could be placed on the money. This would make funds more accessible to state governments, while ensuring the funds are appropriately spent.

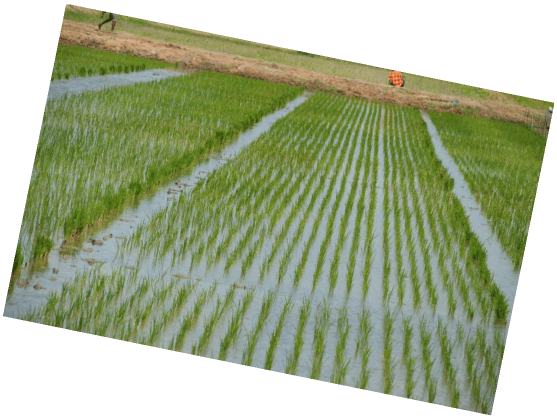
The federal government of Nigeria needs to show this commitment in order to preserve agricultural output in the country. The flooding is easier to control than insecurity. As state government finances remain limited, any reluctance or delay by the Federal Government to address the issue will ensure food shortages continue in the country. Consequently, it could further push up food prices and the inflation rate. It is also noteworthy that if food shortages raise inflation, the Central Bank of Nigeria might be forced to tighten its monetary policy stance, probably through raising interest rates. This decision would reduce credit availability to interest rate sensitive sectors of the economy, such as manufacturing and trade, and could ultimately further slow-down economic growth. These negative short and long term implications of flooding demand swift action.

[12]BudgIT, June 19, 2015. "States' Bailout Package". Available at http://yourbudgit.com/infographics/states-bailout-package/
[13]BudgIT, June 19, 2015.Ibid. Available at http://yourbudgit.com/infographics/states-bailout-package/


Hertz
rentacar.ng
We're here to get you there.
EXCLUSIVE
CAR RENTAL
Rated
Get amazing offers and value for your pick up/drop off, staff bus/school bus, airport transfers, travels and tours plus escort and protocol services. Your comfort, discretion and safety are guaranteed.
Hertz Franchise is owned and managed by C & I Leasing PLC in Nigeria.
09060004026; 09060004025; 09060004024
hertzrentacarng
www.rentacar.ng

Rice production in Nigeria, the journey to self-sufficiency

Rice is a common staple across many Nigerian households, and over 18 states across Nigeria produce the grain in a bid to meet demand. However, production remains sub-optimal, defying various government funding and policy interventions. There is still a demand gap of approximately 2.7 million tonnes, resulting in $5 million (mn) worth of imports. To address the increasing dependence on imported rice and to reduce its import bill, the government has set a target for Nigeria to become self-sufficient in rice production by 2020. However, there are still some challenges that are yet to be addressed on Nigeria's journey to self-sufficiency. While the government has introduced programs such as the Anchor Borrowers Program and the Nigeria Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL), the challenges of smuggling and poor infrastructure have prevented Nigeria from reaching its potential output of at least eight million tonnes. Without effectively tackling the challenges, Nigeria's rice output will remain at a sub-optimal level and its vision to be self-sufficient will fail.



Nigeria's journey to self-sufficiency

The Federal Government's plan for Nigeria to become self-sufficient in rice production by 2020 can only be achieved with effective policies. With demand at 6.4 million tonnes and production at 3.7 million tonnes, Nigeria needs to ramp up its output by at least 73% in less than two years.[14]

[14] https://www.pwc.com/ng/en/publications/boosting-rice-production-through-increased-mechanisation.html

The present administration has made significant progress in providing interventions to the rice sub-sector and boosting output. Initiatives such as the Anchor Borrowers Program and NIRSAL have focused on enhancing investments and loans needed to improve value chains in the agriculture sector. Through these programmes, the rice sub-sector has recorded successes such as a 100% increase in the number of rice farmers to 11 million, a decline in rice importation by approximately 91% between 2015-2017 and investments towards rice production in excess of N300bn.[15] These investments are also expected to provide over 5,000 jobs, which will have a positive (if limited) effect on Nigeria's unemployment rate.

However, local rice farmers are struggling against imported varieties in the Nigerian market. In 2016, rice importers were banned from accessing foreign exchange, in an attempt to support local producers. Now two years later, instead of curbing competition, rice importers have switched to smuggling from neighboring countries such as Benin Republic. The increasing rate of rice smuggling highlights two important facts for the government: Nigeria's land and sea borders remain porous, and the persistent demand gap is yet to be filled.

Locally produced rice vs imported rice

The influx of smuggled rice into the market has resulted in an almost decade long battle between local and imported rice dealers for market share. Major suppliers of imported rice into Nigeria include Thailand, India and China. Research has shown that domestic consumption of rice in Nigeria will spike to approximately 35 million metric tonnes by 2050 and Nigeria's largest supplier, Thailand, will increase its price by over 50%.[16] This will translate to an increase in Nigeria's import bill by at least 50% in the long term. To surmount this challenge Nigeria needs to compete on quality and price.

The quality of locally produced rice has been affected by a high amount of sand and stones. This is because the current rice infrastructure in most producing states is not sophisticated enough to remove foreign bodies. High transportation costs, high energy costs and a poor business environment have also negatively impacted on the cost of operations for rice farmers. This has in turn reflected in the price of locally produced rice.

Another reason for Nigeria to effectively boost its rice output and tackle the issue of smuggling is to protect the health of its citizens, as smuggling encourages dumping of adulterated products into an economy.

[15] Femi Adekoya. 2018. 'Rice importation from Thailand has dropped by 91 per cent'. https://guardian.ng/news/rice-importation-from-thailand-has-dropped-by-91-per-cent/

[16] https://www.vanguardngr.com/2012/02/nigerias-rice-consumption-to-reach-35m-tonnes-by-2050/

The closure of the land borders by the FGN would make it more difficult for importers of rice to smuggle the commodity and may encourage local production. However, without boosting output capacity to satisfy domestic demand, rice smuggling would remain. The important and more pertinent issue for the government to tackle should be on narrowing the demand-supply gap of the commodity. A narrower demand-supply gap would reduce the demand for imported rice, increase the supply of local rice and reduce its price.

The first way to improve output is to address the mechanization gap of rice farming in Nigeria. Nigeria's rate of mechanization is currently at 0.3 horsepower (hp) per hectare compared to top rice producers India (2.6hp/hectare), Vietnam (2.2hp/hectare) and China (8hp/hectare).[17] This has affected our milling capacity and in turn, the quality of locally produced rice. With the right infrastructure and mechanization level, rice production in Nigeria can double to approximately 7.2 million tonnes by 2023.

Another way to boost rice output is through improved state collaboration. Lagos and Kebbi state governments signed a Memorandum of Understanding in 2016 in a bid to boost rice production and improve Nigeria's food security. This resulted in 'Lake' rice which costs as low as N2,500 for a 10kg bag. The affordability of this brand of rice was partly due to efforts by both state governments in collaborating with local rice distributors and mall outlets to facilitate the distribution of the product. Increased collaboration of this type would lead to an increased supply of local rice in the market, which would lead to a fall in prices compared to the price of imported rice.

The first way to improve output is to address the mechanization gap of rice farming in Nigeria

Rice will remain a vital commodity in Nigeria in the long term. Nigeria's vision to attain self-sufficiency in rice production can be achieved if the government places more attention to boosting supply, rather than closing its borders to curb smuggling. The closure of the borders can achieve some level of compliance in the short term but if the supply challenge is not addressed, importers will always find a way. Technological advancement and state collaborations are possible options for the government to explore if rice output has any chance of increasing in the medium to long term. Increased rice production will reduce the demand for imported rice, generate employment opportunities and help Nigeria attain self-sufficiency.

[17]https://www.pwc.com/ng/en/publications/boosting-rice-production-through-increased-mechanisation.html

Volcker Recalls Another Time the Fed Clashed With the President's Crosshairs

Donald Trump's repeated public criticism of the Federal Reserve's monetary policy seems extraordinary, but he isn't the first president to oppose raising rates. Paul Volcker, 91, has had firsthand experience with this, both in Lyndon Johnson's Treasury Department and as Fed chairman during the Reagan administration, as he recalls in Keeping at It: The Quest for Sound Money and Good Government (Oct. 30, Public Affairs), written with Bloomberg Markets Editor Christine Harper. Volcker, who was Fed chairman from 1979 to 1987, is credited with ending an era of double-digit inflation by pushing short-term rates as high as 20 percent.

Later in the fall of 1965, Treasury Secretary Henry Fowler became deeply concerned about a warning he had received from Fed Chairman William McChesney Martin. The Fed planned to raise its discount rate, the rate the Fed charges banks for short-term loans, with the presumed effect of raising all market rates. Martin's clear aim was to forestall inflationary pressures as Vietnam War spending rose in an already fully employed economy. A spirited internal debate developed. The Council of Economic Advisers and the Bureau of the Budget lined up with Fowler in pleading for delay. Privately, I was sympathetic to Martin's argument and hoped to persuade the secretary into a compromise: perhaps a quarter-percentage-point increase instead of the planned half-point. The unfortunate result for me was the creation of a four-man ad hoc committee to examine the issue. The composition was odd. Although I was the Treasury's representative, I was eager to compromise. Dan Brill, the Fed's research chief, was strongly opposed to any rate hike despite his boss's view. So were, in varying degrees, representatives from the CEA and the Bureau of the Budget (now the Office of Management and Budget). Predictably, we concluded that the decision could wait until January so it could be coordinated with the new budget.

Martin persisted. A Quadriad (1) meeting of "principals only" with President Lyndon Johnson was scheduled for Oct. 6. Secretary Fowler brought me along. He laid out the issue. The president recoiled at the idea of raising interest rates. It would, he said with an arm outstretched and fingers clenched, "amount to squeezing blood from the American working man in the interest of Wall Street." Chairman Martin was unyielding. As he saw it, the restraint was needed and it was his responsibility. "Bill," the president finally said, "I have to have my gall bladder taken out tomorrow. You won't do this while I'm in the hospital, will you?" "No, Mr. President, we'll wait until you get out." And so it was done. In early December 1965, soon after I left the Treasury, the Fed did act, voting to raise the discount rate to 4.5 percent from 4 percent. Johnson, down in Texas, released a disappointed statement. Martin was called down to the "Ranch" to be given a mental, and by some reports a physical, trip to the proverbial woodshed. (2)

I don't know the full story, but it was a lesson for me. Over time two things did become clear. The Fed was slow to take further restrictive actions as Vietnam expenditures and the economy heated up. The president overruled his economic advisers' private pleas for a tax increase. My guess is that he understood that a tax vote in Congress would simply become a referendum on the unpopular Vietnam War—a referendum he would be bound to lose.

An Awkward Meeting

As this memoir makes clear, the Federal Reserve must have and always will have contacts with the administration in power. Some coordination in international affairs is imperative given the overlapping responsibilities with respect to exchange rates and regulation. Sweeping use of "emergency" and "implied" authority requires consultation if for no other reason than to reinforce the effectiveness of the action. But that needs to take place in the context of the Federal Reserve's independence to set monetary policy.

That was challenged only once in my direct experience, in the summer of 1984. I was summoned to a meeting with President Reagan at the White House. Strangely, it didn't take place in the Oval Office, but in the more informal library. As I arrived, the president, sitting there with Chief of Staff Jim Baker, seemed a bit uncomfortable. He didn't say a word. Instead, Baker delivered a message: "The president is ordering you not to raise interest rates before the election."

I was stunned. Not only was the president clearly overstepping his authority by giving an order to the Fed, but also it was disconcerting because I wasn't planning tighter monetary policy at the time. In the aftermath of Continental Illinois's collapse (3), market interest rates had risen and I thought the Federal Open Market Committee might need to calm the market by easing a bit.

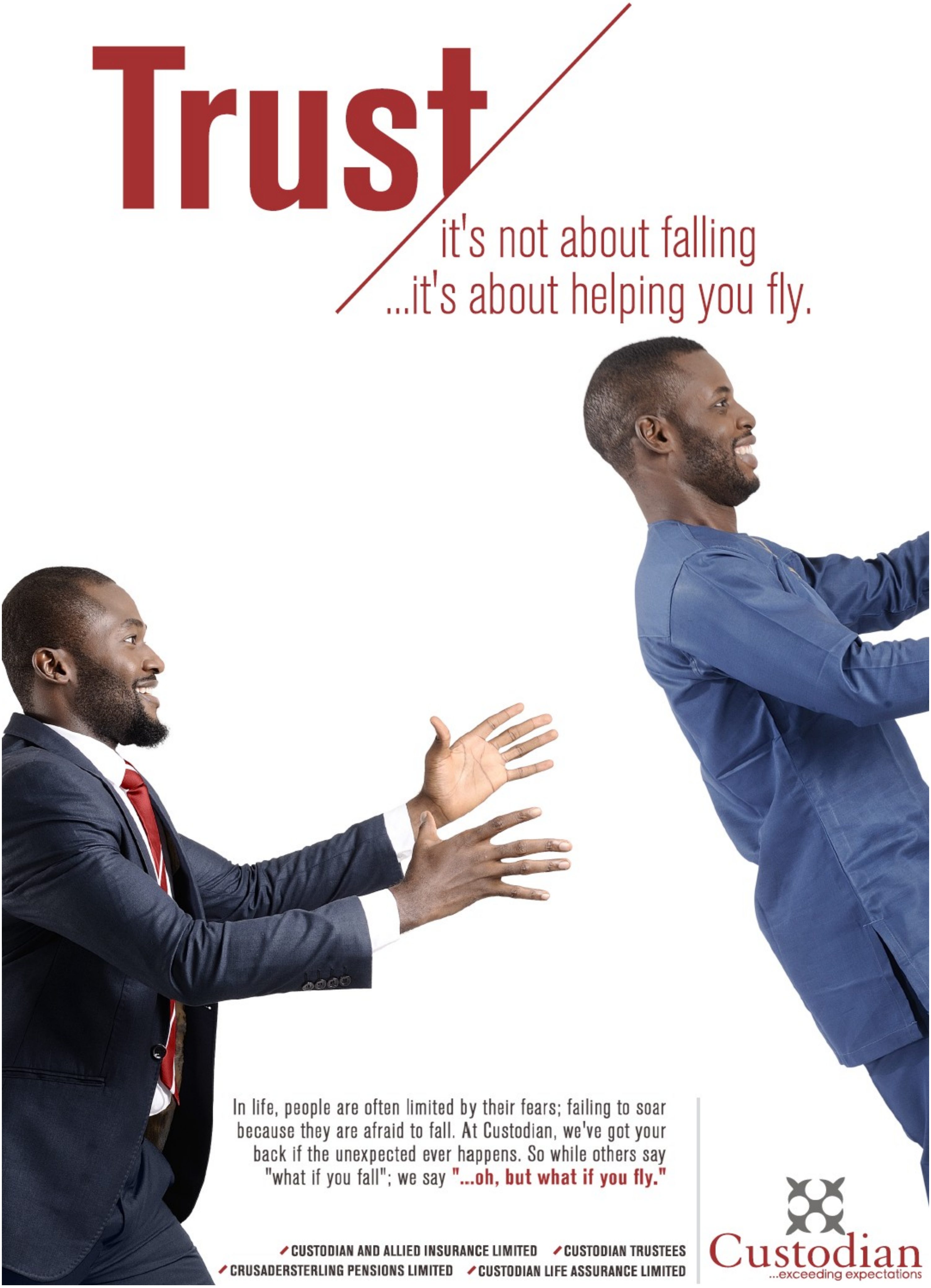
What to say? What to do?

I walked out without saying a word. I later surmised that the library location had been chosen because, unlike the Oval Office, it probably lacked a taping system. The meeting would go unrecorded. If I repeated the incident to the other members of the Federal Reserve Board or to the FOMC—or to [Wisconsin] Senator William Proxmire, as I had promised to do if such a situation arose—the story would have inevitably leaked, to nobody's benefit. How could I explain that I was ordered not to do something that at the time I had no intention of doing? As I considered the incident later, I thought that it was not precisely the right time for a short lecture on the constitutional authority of the Congress to oversee the Federal Reserve and the deliberate insulation of the Fed from direction by the executive branch. The president's silence, his apparent discomfort, and the meeting locale made me quite sure the White House would keep quiet . It was a matter to be kept between me and Catherine Mallardi, the longtime faithful assistant to Federal Reserve chairmen. But it was a striking reminder about the pressure that politics can exert on the Fed as elections approach.

1. The Quadriad had been established in the Kennedy years as an informal but influential grouping of the four top economics agency heads: Treasury, Budget, the CEA, and the Fed.

2. By some accounts the encounter got physical, with the 6-foot-4 president backing up the shorter Fed chief against a wall.

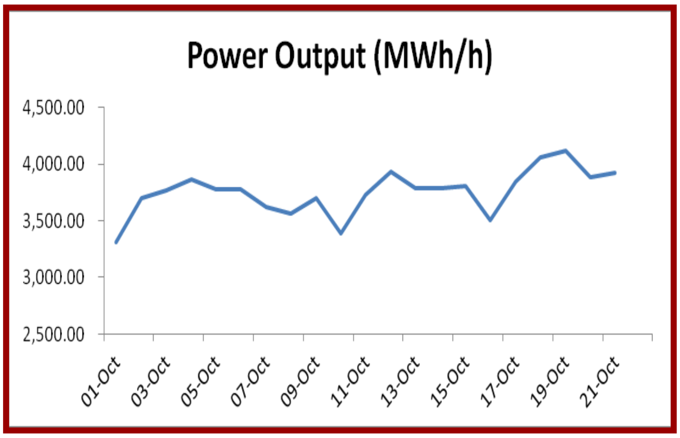
3. The failure of Continental Illinois National Bank & Trust Co. in 1984, the largest in U.S. history at the time, gave birth to the term "too big to fail."


Trust
it's not about falling
...it's about helping you fly.
In life, people are often limited by their fears; failing to soar because they are afraid to fall. At Custodian, we've got your back if the unexpected ever happens. So while others say "what if you fall"; we say "...oh, but what if you fly."
CUSTODIAN AND ALLIED INSURANCE LIMITED
CUSTODIAN TRUSTEES
CRUSADERSTERLING PENSIONS LIMITED
CUSTODIAN LIFE ASSURANCE LIMITED
Custodian
...exceeding expectations

Macro-economic indicators (October 1st - 22nd)

Power Sector

The average power output from the national grid was 3,753.95MWh/h for the period October 1st – October 22nd. This is 7.7% higher than 3,485.45MWh/h recorded in the corresponding period in September. During the period, average power supply touched a 5-month high of 4,115MWh/h on October 19th. The improvement in power supply was partly due to increased rainfall as there were no records of water constraints. Grid and gas limitations were the dominant challenges during the period. A sum of N36.21bn was lost due to the various shortfalls.



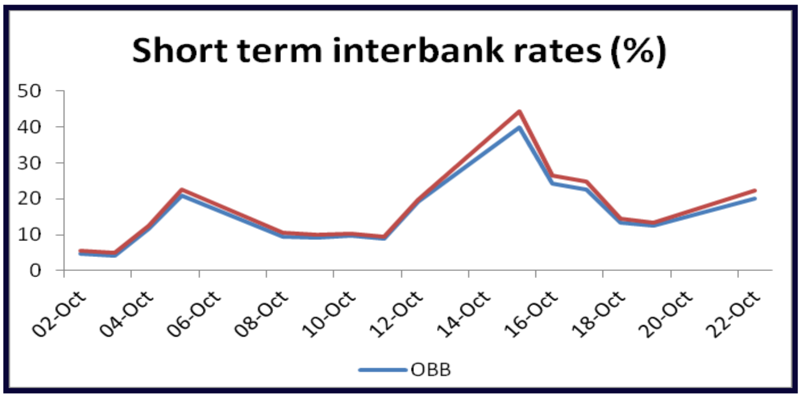
[18]

Outlook

Rainfall is expected to subside in subsequent months. Hence, the level of power output would be largely dependent on the availability of gas. Meanwhile, the African Development Bank (AFDB) has approved $10mn to the Nigeria Infrastructure Debt Fund (NIDF) which is managed by Chapel Hill Denham. The essence of this is to finance the country's infrastructure investment needs, including the power and energy infrastructure sectors. This is expected to have a long-term positive impact on power output.

Money Market

The average opening position of banks was N194.81bn long for the period under review, 60.03% lower than N487.43bn long for the period (September 1st– September 22nd). The sharp decline in market liquidity led to a spike in the short-term interbank rates. Average NIBOR (OBB/ON) rates for the period under review was 9.62% higher at 16.08% compared to 6.45% in the corresponding period in September. During the review period, OBB & ON reached a high of 39.92% pa and 44.33% pa respectively on October 15th before retreating to a low of 12.67% pa and 13.33% pa on October 21st respectively.



[19]

[18]FGN, FDC Think Tank
[19]FMDQ, FDC Think Tank

The CBN issued more OMO bills than was retired. Total OMO bills sold was N1.38trn against an aggregate maturity of N902.57bn; the net outflow was N480bn. The total OMO sales were also higher by 43.75% than in the corresponding period in September.

At the primary market, T/bill yields maintained an upward trend. However, the secondary market rates recorded a mixed movement. While the 91-day and 364- day increased, the 182-day declined. The NITTY rates increased by an average of 8bps during the review period.

Primary Market

T/bills Tenor	Rate on October 3rd (% pa)	Rate on October 17th (%pa)	Direction
91	10.9	10.96	⬆
182	12.10	12.69	⬆
364	13.33	13.45	⬆

Secondary Market

T/bills Tenor	Rate on October 3rd (% pa)	Rate on October 17th (%pa)	Direction
91	12.00	12.27	⬆
182	12.83	12.72	⬇
364	12.94	13.36	⬆

NITTY Tenor	Rate on Oct 2nd (%)	Rate on Oct 22nd (%)	Direction
30	13.5	13.54	⬆
90	13.76	13.79	⬆
180	14.59	14.6	⬆

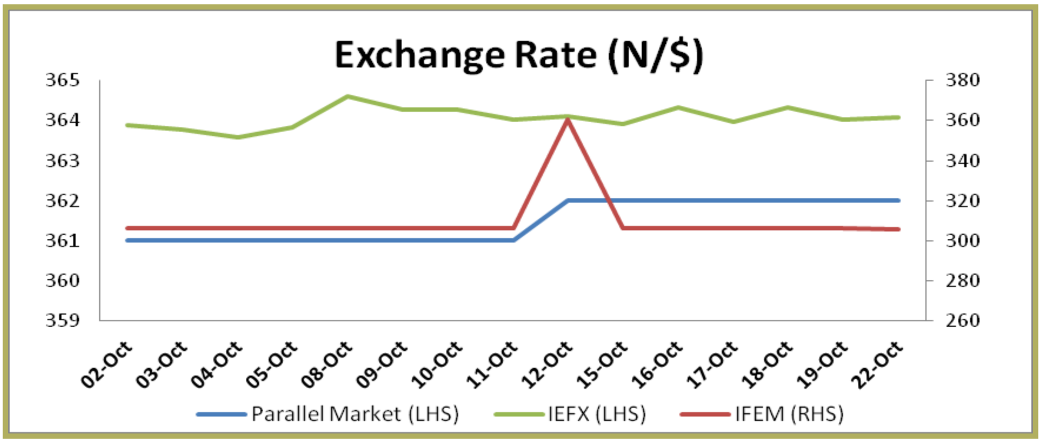
Outlook

We anticipate FAAC disbursements towards the end of the month. This is expected to boost market liquidity. Thus, short-term interest rates are expected to decline in the near term.

Forex Market

Exchange Rate

Currency pressures are building in the forex market especially at the IEFX window. Transactions are now being executed at an average rate of N364/$, compared to N362-N363 in previous months. However at the parallel market, the exchange rate has been relatively stable, within a band of N361-N362 against the US dollar. The CBN sold a total of $1.3bn during the review period, 25% higher than $1.04bn in the corresponding period in September while the total turnover at the IEFX window was 43.78% lower at $3.03bn.



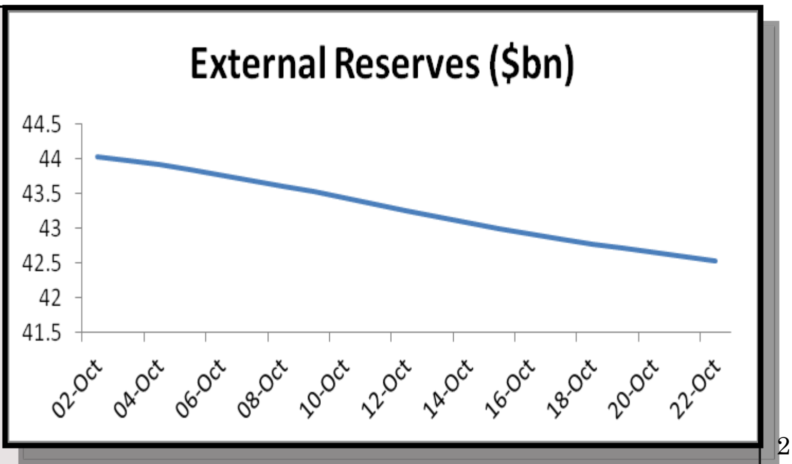
[20]

Outlook

Manufacturers have commenced inventory build-up for festive sales. This coupled with election spending could trigger forex demand pressures. However, the CBN has iterated its preference of exchange rate stability over external reserves accretion. Hence, we expect the currency to remain relatively stable in 2018.

External Reserves

External reserves depleted further during the review period. It lost 3.41% ($1.5bn) to close at $42.53bn on October 22nd from $44.03bn on October2nd. This was spurred by the CBN's continuous intervention amidst increased foreign capital outflows as a result of political uncertainties and monetary tightening in the advanced economies such as the United States. The rate of depletion in the external reserves has increased to 3.41% ($1.5bn) from 1.42% ($0.68bn) in July.



[21]

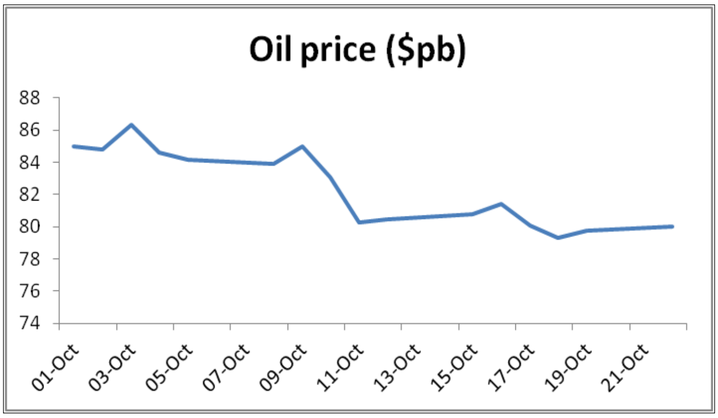
Outlook

The sustained depletion of the external reserves is expected to persist in subsequent weeks, owing to forex demand pressures arising from election and festive spending. In addition, we anticipate one more hike in US Fed's interest rate. This would further intensify capital outflows, mounting pressures on the exchange rate. However, higher oil proceeds could slowdown the pace of depletion.

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

Oil Prices

Oil prices fell by 5.87% to close at $79.99pb on October 22nd from $84.98pb on October 1st after trading above $80pb for 18 days. Average price for the period was $82.43pb compared to $78.23pb in the corresponding period in September. During the review period, oil prices touched a 56-month high of $86.29pb before retreating to $79.99pb on October 22nd. The rally was spurred by sentiments arising from the looming US' sanctions on Iran. However, the fall in oil prices is being driven by rising US crude inventories and projections of a slower global growth which could affect the demand for oil.



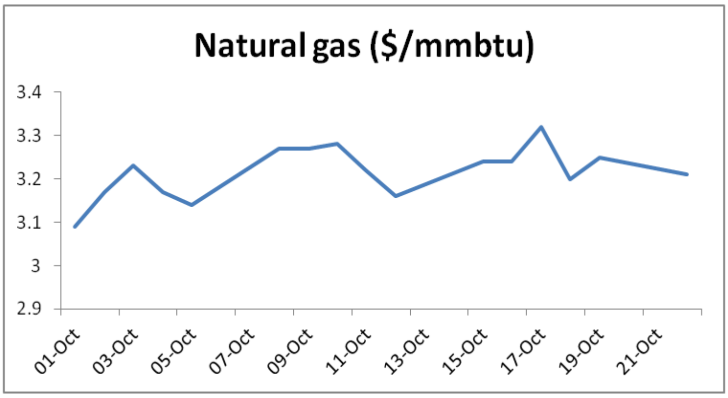
[22]

Outlook

Oil prices are likely to remain within the band of $75pb-$85pb due to imminent sanctions on OPEC's third largest producer, Iran. The risks to this outlook remain rising shale oil production and US crude inventories.

Natural Gas

During the review period, the price of Natural gas rose by 3.88% to close at $3.21/mmbtu on October 22nd. The average price for the period was $3.22/mmbtu compared to $2.84/mmbtu recorded in the same period last month. Higher demand as a result of the cold weather in the US at a time when the natural gas storage levels are at a decade low triggered this increase.



[23]

Outlook

There is a forecast warning of below-average cold weather across the US. This would increase the use of heaters and ultimately the demand for natural gas. Higher demand coupled with lower supply would drive prices up.

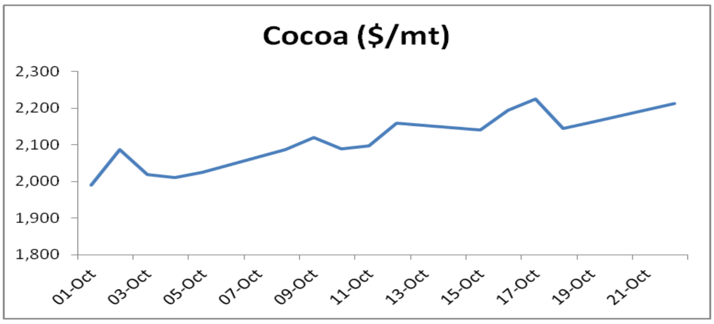
[22]Bloomberg, FDC Think Tank
[23]Bloomberg, FDC Think Tank

Cocoa

Cocoa price closed the review period 11.21% higher at $2,213/mt on October 22nd from $1,990/mt on October 1st, supported by strong demand from Asia and North America. However, the average price of cocoa during the period was $2,110/mt, 6.72% lower than the corresponding period in September.

Outlook

Favourable weather conditions in West African producing countries would boost supplies and depress prices.



24

Imports

Wheat

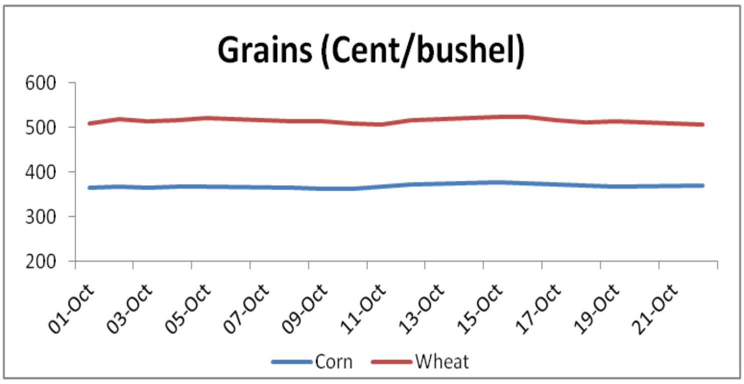
Wheat prices fell by 0.2% to close the review period at $5.08/bushel on October 22nd as the US-Chinese trade tensions weakened global demand for wheat. In addition, strong Russian output and improved weather conditions in the US also supported the price decline.

Corn

Corn prices increased 1.01% to close at $3.695/bushel on October 22nd from $3.658/bushel on October 1st, following the forecast of weak US corn output in 2018/2019. The average price of corn was $3.69/bushel during the period compared to $3.57/bushel in the equivalent period in September.

Grains- Outlook

Weather patterns in producing countries will influence prices. The forecast of higher production in most of these regions is expected to drive down prices in the near term.



25

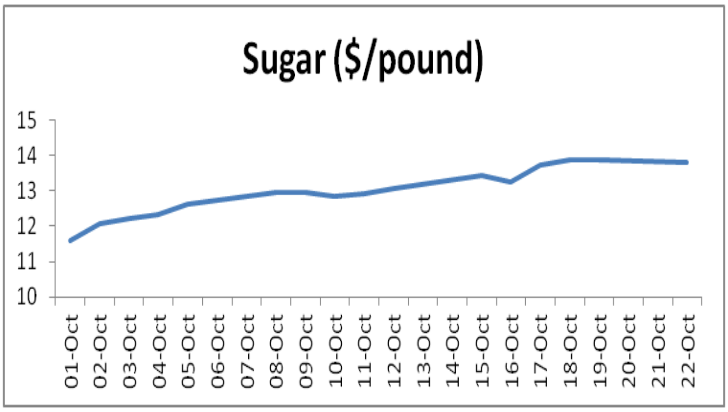
[24]Bloomberg, FDC Think Tank
[25]Bloomberg, FDC Think Tank

Sugar

Sugar prices increased by 19.04% to close at $0.1382/pound on October 22nd from $0.1161/pound on October 1st. On the average, sugar price was $0.1298/pound for the period (Oct 1st – Oct 22nd), 11.99% higher than $0.1159/pound recorded in the corresponding period in September. The surge in sugar prices was partly driven by reports of unfavourable weather conditions in Brazil (the world's largest sugar exporter).

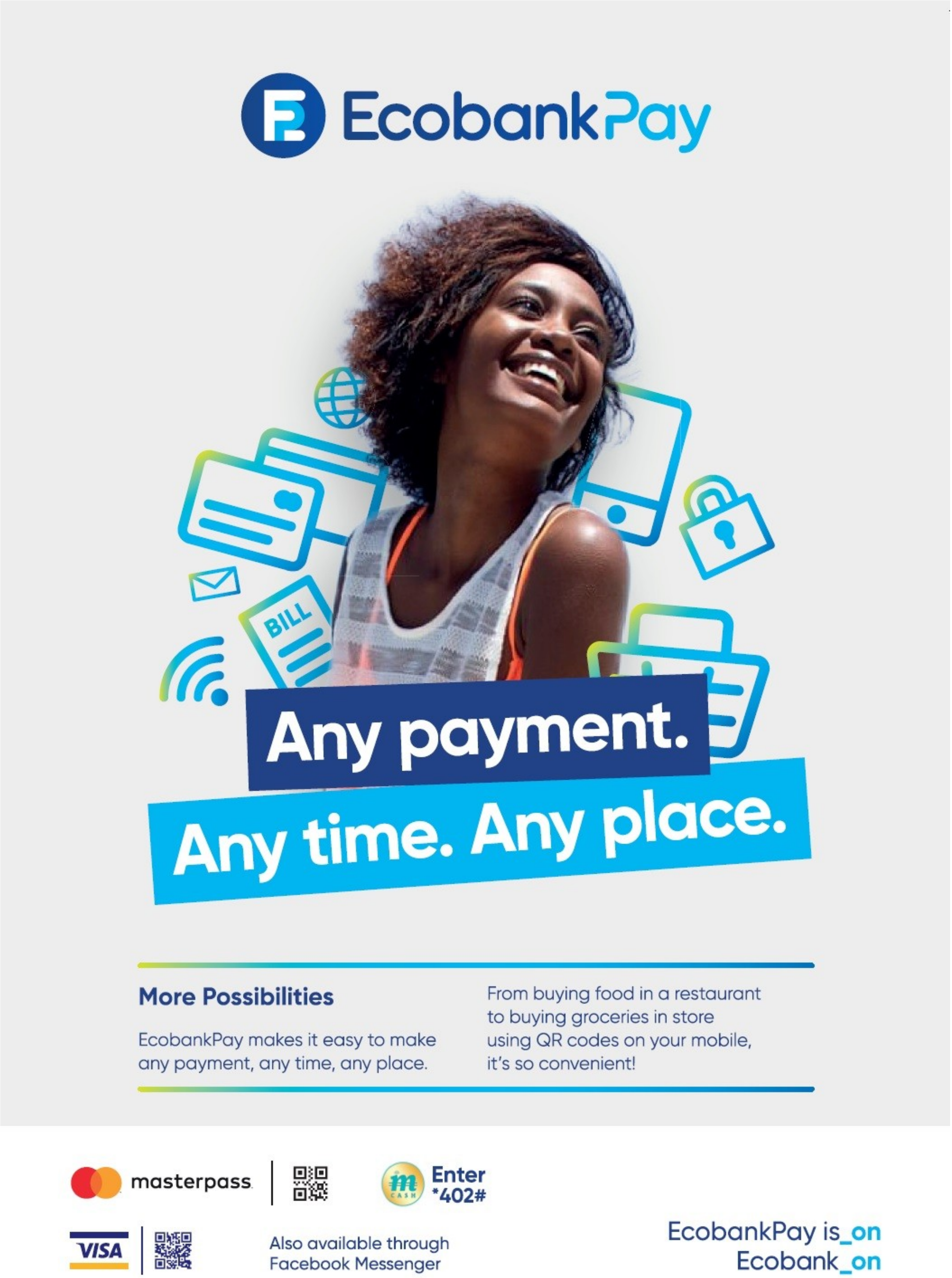
Outlook

Monsoon floods in India and Indonesia as well as the drought in Brazil would continue to weigh on sugar supplies, pushing up prices.



[26]

[26]Bloomberg, FDC Think Tank

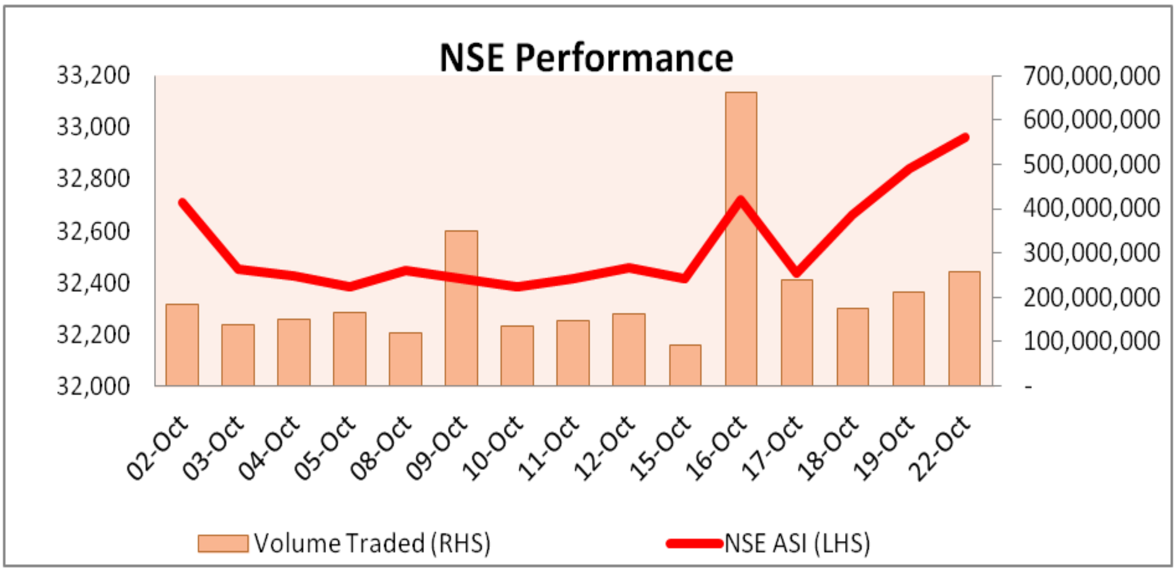

EcobankPay
BILL
Any payment.
Any time. Any place.
More Possibilities
EcobankPay makes it easy to make any payment, any time, any place.
From buying food in a restaurant to buying groceries in store using QR codes on your mobile, it's so convenient!
masterpass
Enter *402#
VISA
Also available through Facebook Messenger
EcobankPay is_on
Ecobank_on

Stock Market Update

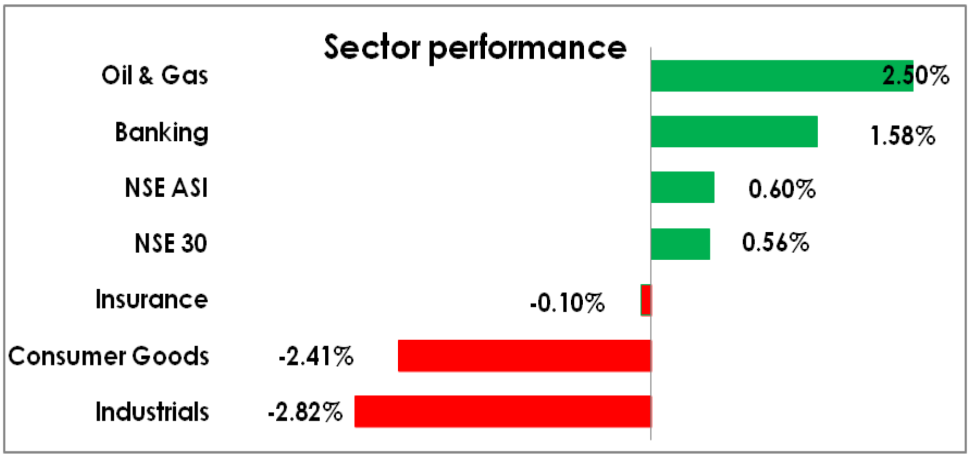
The Nigerian stock market bucked its losing streak, gaining 0.6% to close at 32,962.82 points on October 22 compared to September 28. Like the ASI, market capitalization advanced by 0.59% to N12.03trn. The market's YTD return narrowed to -13.81%. The market's performance was driven by the release of positive corporate earnings mostly from major players in the banking and industrial sectors.

On one hand, the tier one banks namely Zenith Bank, Guaranty Trust Bank, United Bank for Africa and Access Bank recorded an improvement in the profit after tax, driven by lower impairment cost. On the other hand, the major players in the industrial sector such as Dangote Cement and Lafarge posted mixed earnings. Corporate results from leading players in the insurance and oil & gas sectors are expected to be released in the next few weeks.

The NSE is currently trading at a price to earnings (P/E) ratio of 9.28x. This is a 0.64% decline over the close of the previous period's P/E ratio of 9.34x. The market breadth came in higher, but remained negative at 0.58x, as 33 stocks increased, 80 stocks remained flat, while 56 declined; compared to September, which came in at 0.44x. During the review period, the NSE recorded 8 days of losses and 7 days of gains.



Trading activities on the floor of the NSE suggests a paltry improvement in investor sentiment. Average volume traded increased by 2.42% to 212mn units, whilst average value of trades moved in the opposite direction, down 36.04% to N2.52bn.



The sub indices recorded a mixed performance in October. The industrial sub-index was the biggest loser. The index lost -2.82% partly due to the poor earnings result from Lafarge, which triggered sell offs of equities in the industrial sector. The Oil & Gas sub-index was the highest gainer (2.5%). The index's gain could be attributed to the recent rally in oil prices, which garnered interest in the Oil & Gas equities.

Fidelity Bank (12.35%) led the advancers, followed by Zenith Bank (11.63%), Cornerstone Insurance Company (10%), Caverton Offshore Support Group (10%) and Newrest ASL Nigeria (7.14%).

Top Gainers					
Symbol	**Sept'28 Price**	**Oct'22 Price**	**Change**	**% Change**	**PE Ratio**
FIDELITY BANK PLC	1.70	1.91	0.21	12.35%	1.44
ZENITH BANK PLC	21.50	24.00	2.50	11.63%	4.12
CORNERSTONE INSURANCE COMPANY PLC.	0.20	0.22	0.02	10.00%	-
CAVERTON OFFSHORE SUPPORT GROUP	1.80	1.98	0.18	10.00%	2.23
NEWREST ASL NIGERIA PLC	5.60	6.00	0.40	7.14%	3.35

The least performing stocks were Cutix Plc (-45.12%), Mcnichols (-25%), John Holt (-24.53%), Niger Insurance Co. (-24.32%) and Honeywell Flour Mills (-20.69%).

Top Losers					
Symbol	**Sept'28 Price**	**Oct'22 Price**	**Change**	**% Change**	**PE Ratio**
CUTIX PLC.	4.10	2.25	-1.85	-45.12%	4.39
MCNICHOLS PLC	0.72	0.54	-0.18	-25.00%	4.27
JOHN HOLT PLC.	0.53	0.40	-0.13	-24.53%	-
NIGER INSURANCE CO. PLC.	0.37	0.28	-0.09	-24.32%	78.79
HONEYWELL FLOUR MILL PLC	1.45	1.15	-0.30	-20.69%	2.21

Corporate Disclosures

Zenith Bank Plc

Zenith Bank Plc's reported gross earnings of N474.61bn in 9M'18, a 10.67% decline from the corresponding period of 2017. However, PBT and PAT increased by 9.7% and 11.6% respectively to N167.31bn and N144.18bn respectively. This is partly attributed to a 69.5% decline in impairment charge to N14.34bn. The company's EPS increased by 11.4% to N4.58.

Guaranty Trust Bank Plc

GTBank Plc's net interest income came in at N170.64bn in 9M'18, a 10% decline from the corresponding period of 2017. PBT and PAT however increased by 9.48% and 13.25% respectively to N164.25bn and N142.22bn respectively. This is partly attributed to a 79.2% decline in impairment charge to N1.74bn. The company also benefited from a 19.5% spike in fees and commissions income to N40.35bn. The EPS increased by 13.3% to N5.03.

United Bank for Africa Plc

UBA Plc reported a flat net interest income of N150.70bn in the first nine months of 2018 relative to 9M'17. Profit before tax rose marginally by 1% to N79.11bn, while profit after tax increased by 1.28% to N61.70bn. This was partly due to a 17.35% decline in impairment loss to N10.67bn. The company's earnings per share (EPS) fell slightly by 1.15% to N1.72bn.

Access Bank Plc

Access Bank Plc's net interest income increased marginally by 1.22% to N122.95bn in the 9M'18, compared to the corresponding period in 2017. Profit before tax however fell by 3.62% to N70.27bn. This is largely attributed to a forex translation loss of N29.58bn in the period under review compared to a translation gain of N116.46bn in the same period in 2017. However, profit after tax increased by 11.54% to N62.91bn, given lower tax expenses.

Dangote Cement Plc

Dangote Cement Plc's revenue rose by 13.54% to N685.29bn in 9M'18 relative to the same period in 2017. Profit before tax increased by 12.34% to N247.36bn. Profit after tax however rose marginally by 2.7% to N158.28bn. This is partly due to a 20.2% increase in sales and distribution expenses to N97.15bn. The company's administrative expenses also spiked by 16.65% to N38.11bn in the period under review. Earnings per share increased by 2.66% to N9.25.

Lafarge Africa Plc

Lafarge Plc reported a topline of N234.30bn in 9M'18, 4.75% higher than 9M'17. However, the company recorded a loss before tax of N14.36bn compared to a profit of N1.09bn in the corresponding period in 2017. Loss after tax also came in at N10.37bn from a profit of N937.91mn. This negative performance is as a result of an 11.86% increase in administrative expenses to N32.63bn. Sales and marketing expenses also rose sharply by 49.3% to N4.45bn. The company reported an EPS of –N120, compared to N10 in 9M'17.

Outlook

Trading activities on the market are likely to remain volatile in the near term. The release of positive Q3'18 earnings will be counterbalanced by rising political uncertainty in the build up to the general elections. Thus, investment decisions are likely to be influenced by technical analysis, leading to some volatility in the index's performance.

Equity Report: Unilever Nigeria

Analyst Recommendation: HOLD

Market Capitalization: N351.81bn

Recommendation Period: 365 days

Current Price: N45.65

Industry: Consumer Goods

Target Price: N41.54

Analyst's note

Improvement in performance driven by sales volume and reduced finance cost

Unilever Nigeria posted a 10.74% increase in revenue to N72.31bn in 9M'18 from N65.3bn in the 9M'17. This implies a moderate earnings growth due to weak but improving macroeconomic fundamentals. The increased revenue was driven primarily by an increase in sales volume growth in the food product segment, as well as the company's commitment to the Backward Integration Plan (BIP).[27]

The food products segment recorded a 20.08% increase in revenue to N34.15bn, while the home and personal care segment's revenue for 9M'18 came in at N38.16bn (a 3.53% increase). Geographical analysis of revenue showed that domestic sales accounted for 97.98% of the total revenue, an increase of 10.21% to N70.84bn. Export sales also rose by 44.12% to N1.47bn in 9M'18. The increase in domestic sales suggests growing consumer confidence in the economy.

The profit after tax (PAT) for 9M'18 came in at N9.57bn, up 98.14% from N4.83bn in 9M'17. The impressive growth in PAT can be attributed to the management's successful rights issue of N58.9bn in 2017. This led to a substantial reduction in finance cost as some proceeds from the rights issue were used to offset foreign currency liabilities. As a result, finance costs declined by 90.27% to N274.12mn in 9M'18 from N2.82bn in 9M'17. Meanwhile, finance income increased to N2.46bn in 9M'18. It is important to note that there was a one off profit of N119mn recognized from discontinued operations.

[27]Backward Integration Plan (BIP) is a government incentive put in place to promote the sourcing of raw materials in-house and stop the importation of raw materials by 2020

Operating cost containment continues to be a constraint

Unilever Nigeria has found operating cost containment to be a challenging task. The marketing and administrative expenses increased by 28.92% to N11.50bn in 9M'18. The increase in marketing and administrative expenses was not surprising given the need to drive volume sales in the face of relatively higher product prices. Thus, the increase in marketing expense is likely to filter into the fourth quarter result.

Based on the mixed signals in its performance, we recommend a HOLD on Unilever Nigeria's stocks.

Industry & company overview

The consumer goods sector continues to face challenges due to increasing input costs and low improvements in consumer confidence despite an improving economy. Sales and profit margins have been dampened by accelerating food prices and weak labor market dynamics (high unemployment and underemployment). Moreover, relatively high inflation rates (food inflation at 13.31%) and high interest rates have continued to affect the industry adversely. Consumers' personal incomes have been under pressure due to rising inflation and a weaker currency. Thus, aggregate demand has been weak. The Nigerian consumer goods sector 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.

Unilever Nigeria is one of the longest serving fast moving consumer goods (FMCGs) companies in Nigeria, with over 12 household brands. It started operations as Lever Brothers Nigeria (West Africa Soap Company) Limited in April 1923, promoting community welfare and delivering superior service. Globally more than six in every 10 households make use of at least one Unilever product, from a range of over 400 brands.

Food Products	Personal Care Products	Home Care Products
• Knorr	• Close Up	• Omo
• Lipton	• Pepsodent	• Sunlight
• Royco	• Lifebuoy	
	• Lux	
	• Pears	
	• Vaseline	
	• Rexona	

Unilever Nigeria's products can be broadly categorized into three business segments: food products including tea, savory and spreads; personal care products, including skin and oral care products; and, home care products, including fabric care, household cleaning and water purification products.

Unilever Nigeria has maintained a terrific top line over the years, with a five-year compound annual growth rate (CAGR) of 10.9%. The bottom-line has also moved in tandem with a five-year CAGR of 12.06% due to a significant fall in finance cost and the economy's recovery.

In its bid to reduce production cost, Unilever Nigeria partnered with sister companies in Ghana and Côte d'Ivoire to take advantage of large scale economies. This arrangement contributed about 2% to company revenue, increasing Unilever's foreign exchange (forex) earnings and access to cheaper raw materials. The company has also intensified efforts to collaborate with domestic vendors for the local raw materials such as cassava and starch. The company has achieved 90% local sourcing of packaging materials. Its aim is to achieve 100% by the end of 2019 and overcome the current challenges of local vendors' capacity to meet up with global best standards. In addition, Unilever Nigeria is investing in the production of palm oil for use in BlueBand and soaps and exploring local production of herbs and spice for seasoning cubes.

Improved forex liquidity provides boost for FMCG companies

Unilever, like other major import dependent manufacturers, has had to enter into forward contracts to hedge against the volatility of the exchange rate. This was partly due to the forex exposure of the company and the hesitation of financial institutions (banks) to take on riskier assets, given high non-performing loans in the banking industry and the high returns on the risk free assets such as Treasury Bills.

The introduction of the Investors' and Exporters' Foreign Exchange (IEFX) window has boosted forex liquidity and accessibility, and also eased importation costs for net importers like Unilever. The availability of foreign exchange in the market has ultimately eased pressures on margins and enhanced profitability. As a result, half year results for most FMCGs have continued to show a remarkable improvement compared to previous years.

Nonetheless, access to financing has remained a general constraint for Nigerian companies. Large cap companies have continued to raise capital through non-bank means.

Divestment from spread business (Blueband Margarine)

Unilever Nigeria's parent company, Unilever UK, has been known to pursue shareholders' returns by focusing on new product and emerging markets. This is because most of the parent company's products are at the maturity stage, experiencing lackluster growth. Unilever UK has been known to push growth by investing and controlling medium size companies, aggressively cutting costs and improving efficiency of these acquisitions.

Outside the Nigerian market, Unilever has moved to gradually divest from its food brands, while focusing on its personal and home care business segments.

In a bid to mirror the investment strategy of its parent company, Unilever Nigeria has divested from its spread business. The company sold its spread business (Blueband margarine). The divestment of the spread business in line with the parent would enable Unilever maintain its current momentum in the home and personal care segment, which is gaining traction.

Income Statement for Unilever Nigeria Plc					
N'000	**2013**	**2014**	**2015**	**2016**	**2017**
Revenue	60,004,119	55,754,309	59,221,748	69,777,061	90,771,306
Cost of Sales	37,554,111	35,584,016	38,174,248	49,481,020	61,828,042
Gross Profit	**22,450,008**	**20,170,293**	**21,047,500**	**20,296,041**	**28,943,264**
Selling and Distribution Expenses	(2,720,863)	(2,516,345)	(2,844,098)	(3,151,087)	(3,992,935)
Marketing andAdministrative Expenses	(11,938,169)	(13,039,204)	(13,563,712)	(11,339,909)	(12,000,605)
Operating Profit	**7,790,976**	**4,614,744**	**4,639,690**	**5,805,045**	**12,949,724**
Finance Income	163,470	168,462	301,889	1,027,622	1,667,747
Finance Costs	(1,160,831)	(1,909,971)	(3,170,516)	(2,726,245)	(3,410,258)
Net Finance Cost					
Profit Before Tax	**6,793,615**	**2,873,235**	**1,771,063**	**4,106,422**	**11,207,213**
Income Tax Expense	(2,069,186)	(460,892)	(578,697)	(1,034,537)	(3,757,128)
Profit After Tax	**4,724,429**	**2,412,343**	**1,192,366**	**3,071,885**	**7,450,085**

[28]

Balance Sheet for Unilever Nigeria Plc					
N'000	**2013**	**2014**	**2015**	**2016**	**2017**
Non-Current Assets					
Property, Plant and Equipment	23,224,938	24,830,779	27,368,919	29,272,186	29,880,704
Intangible Assets	1,627,836	1,398,037	1,168,581	940,124	705,890
Other Non-current Assets	222,070	398,220	208,809	140,160	79,486
Employee Loan Receivable	122,301	128,348	127,979	111,671	130,310
Retirement Benefits Surplus	155,642	409,712	290,382	484,621	329,235
Total Non-current Assets	**25,352,787**	**27,165,096**	**29,164,670**	**30,948,762**	**31,125,625**
Current Assets					
Inventories	6,988,379	8,614,597	6,173,113	9,878,499	11,478,532
Asset Held for Sale	-	-	171,411	171,411	-
Trade and Other Receivables	8,143,362	8,544,431	10,142,845	18,945,578	27,621,489
Employee Loan Receivable	85,628	77,215	85,201	72,918	79,384
Derivative Assets					285,740
Cash and Bank balances	3,183,958	1,334,916	4,435,244	12,474,141	50,493,595
Total Current Assets	**18,401,327**	**18,571,159**	**21,007,814**	**41,542,547**	**89,958,740**
Total Assets	**43,754,114**	**45,736,255**	**50,172,484**	**72,491,309**	**121,084,365**
Equity					
Ordinary Share Capital	1,891,649	1,891,649	1,891,649	1,891,649	2,872,503
Share Premium	45,717	45,717	45,717	45,717	56,812,810
Share Based Payment Reserve					
Retained Earnings	7,410,556	5,541,442	6,065,887	9,752,577	16,223,062
Total Equity	**9,347,922**	**7,478,808**	**8,003,253**	**11,689,943**	**75,908,375**
Non-Current Liabilities					
Loans and Borrowings	782,074	762,602	591,055	414,275	219,770
Retirement Benefits Obligations	2,707,428	2,756,505	3,369,353	2,613,268	3,454,370
Long Service Award Obligation	355,974	341,871	266,548	181,166	205,745
Other Employee Benefits	60,846	44,104	88,494	74,150	85,902
Deferred Income	86,250	128,292	95,537	62,781	30,025
Deferred Tax Liabilities	2,340,980	2,853,240	3,060,591	3,942,337	4,484,871
Total Non-current Liabilites	**6,333,552**	**6,886,614**	**7,471,578**	**7,287,977**	**8,480,683**
Current Liabilities					
Bank Overdraft	2,570,758	3,953,395	4,535,672	-	-
Income Tax	1,360,447	212,770	159,840	502,855	2,799,203
Loans and Borrowings	3,027,668	12,060,749	7,426,543	20,501,276	454,528
Trade and Other Payables	21,091,750	15,111,163	22,542,842	32,476,502	33,408,820
Deferred Income	22,017	32,756	32,756	32,756	32,756
Restructuring Provisions	-	-	-	-	-
Total Current Liabilites	**28,072,640**	**31,370,833**	**34,697,653**	**53,513,389**	**36,695,307**
Total Liabilites	**34,406,192**	**38,257,447**	**42,169,231**	**60,801,366**	**45,175,990**
Total Equity and Liabilites	**43,754,114**	**45,736,255**	**50,172,484**	**72,491,309**	**121,084,365**

[29]

[28]Unilever Nigeria Plc. 2013-2017. "Annual Reports". Available at https://www.unilever-ewa.com/investor-relations/financial-results-and-reports/
[29]Unilever Nigeria Plc Annual Report. Available at https://www.unilever-ewa.com/investor-relations/financial-results-and-reports/

Management overview

Chairman of the Board
of Directors
His Majesty Nnaemeka
A. Achebe

Managing Director
Mr. Yaw Nsarkoh

Unilever Nigeria's Board is led by His Majesty Nnaemeka A. Achebe CFR, MNI, Obi of Onitsha. He is a well travelled monarch, with extensive leadership experience having served as director on numerous company boards.

The management is led by Mr. Yaw Nsarkoh, a Ghanaian who joined the company in 1994. Prior to his appointment as Managing Director of Unilever Nigeria and Executive Vice President (EVP) of Unilever Nigeria and Ghana in 2014, he served in various positions within the company in East and Southern Africa. He is a seasoned speaker on business issues, specifically marketing and leadership. Mr. Nsarkoh has been pivotal to aligning Unilever Nigeria's vision to that of the parent company.

The Board of Unilever Nigeria consists of other seasoned professionals with good knowledge and technical skills in the consumer goods space. The management of Unilever Nigeria has reiterated its commitment to improve shareholders' value and the company's environmental footprint. Thus, the management has used proceeds from its N58.9bn right issue to offset finance cost and deleverage the balance sheet. This has helped to boost working capital and promote greater financial flexibility.

More than 70% of Unilever Nigeria's ownership is strategically owned; Unilever Oversees Holdings BV Holland and Unilever Oversees Holdings BV control more than 60%, while Stanbic Nominees Nigeria controls about 10% (directly and indirectly). The parent company retains a strong grip on the company and has stated its intention to acquire up to 75% of Unilever Nigeria as part of its long-term strategic plan. This demonstrates the commitment of the parent and the growth potential of the Nigerian market.

Bears Say

- Revenue growth largely driven by increase in prices and not volume
- Maturing food product segment and intense competition
- Increase in parent company control to threaten minority shareholders' interest
- High import dependence exposes Unilever Nigeria to forex volatility

Bulls Say:

- Unilever Nigeria has the capacity to charge a premium due to its reputation and brand loyalty
- Unilever Nigeria operates a well diversified product portfolio across premium and value brands to minimize risk
- Strategic alliance and support from the parent company provides a competitive advantage
- Improved containment of finance cost to boost margins
- Move to achieve 100% local sourcing by 2019 will reduce costs
- Growing awareness and sophistication to drive sales in personal care segment

Risk and Outlook

Over the years, Unilever Nigeria has consistently outperformed the economy. This is evident by revenue growth over the last six quarters, which exceeded economic growth throughout the period. The recent economic recession created a niche market for value brands, as numerous consumers switched to low-end value brands. Most of these brands, through innovation and creativity, have used the path to recovery to further establish a firm customer base to improve their foothold in the market. This poses a real threat to Unilever Nigeria who has lagged in new product development.

Being a net importer, Unilever Nigeria is looking to improve its forex earnings, thereby exposing it to volatility in destination countries. The move by the management to mitigate these risks in the short term will determine the company's position in the long term.

Our valuation of Unilever Nigeria

Using Discounted Cash flow (DCF) methodology, we estimated a stock price of N41.54, which is a 3.4% downside on the current price of stock of N43.00 as at October 24, 2018. With a discount rate [Weighted Average Cost of Capital (WACC)] of 15.34% derived using a 15% risk free rate (FGN 5-year Bond as at April 2023), a Beta of 0.6672, after cost of debt of 13.14%, and a market risk premium of 6.4%. The long term cash flow growth rate to perpetuity calculated is 7%.

DCF Valuation			
N'000	**2018**	**2019**	**2020**
EBIT	10,594,596	11,804,194	14,657,593
Less: Taxes	(2,921,802)	(3,255,388)	(4,042,305)
EBIAT	7,672,794	8,548,807	10,615,289
Plus: Depreciation & Amortization Expense	2,558,292	2,847,730	3,210,046
Less: CAPEX	(5,554,659)	(6,515,447)	(7,842,769)
Less: Change in Working Capital	(1,867,111)	2,665,112	20,535,205
Free Cash Flow (FCF)	2,809,315	7,546,202	26,517,771
WACC	15.34%	15.34%	15.34%
Present Value (PV) of FCF	2,435,667	5,672,352	17,281,804
Terminal Value @ Perpetual Growth Rate (2019)	**2018**	**2019**	**2020**
Terminal Value as of 2020	-	-	340,186,740
Present Value of Terminal Value	221,701,910		
DCF Calculation	**Valuation**		
PV of Explicit Period	25,389,822		
PV of Terminal Value	221,701,910		
Enterprise Value	247,091,732		
+ Cash	12,474,141		
- Borrowings	(20,915,551)		
Equity Value	238,650,322		
Share Price	***41.54***		

Important Notice

This document is issued by Financial Derivatives Company. It is for information purposes only. It does not constitute any offer, recommendation or solicitation to any person to enter into any transaction or adopt any hedging, trading or investment strategy, nor does it constitute any prediction of likely future movements in rates or prices or any representation that any such future movements will not exceed those shown in any illustration. All rates and figures appearing are for illustrative purposes. You are advised to make your own independent judgment with respect to any matter contained herein.