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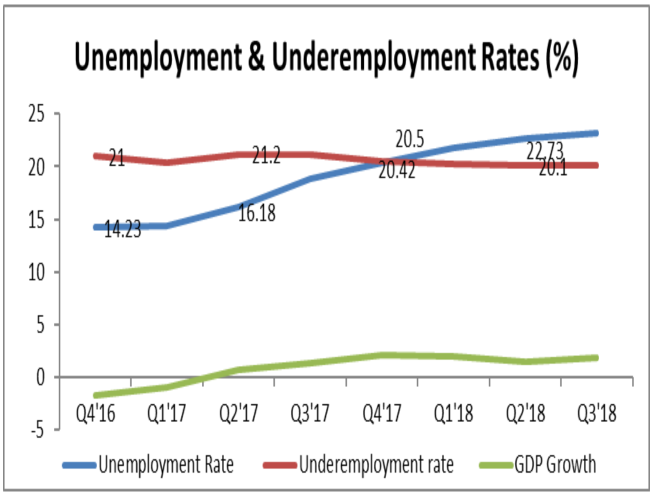
In This Issue ...

Unemployment rate up to 23.1% in Q3'18

The long-awaited data on labour statistics for Q4'17 - Q3'18 has been released. In line with expectations, Q3'18 unemployment numbers came in 4.3% higher at 23.1% while the underemployment rate declined by 1.1% to 20.1%. The unemployment + underemployment data shows an increase of 3.3%, much lower than the 4.8% decline in inflation within the review period. The rise in the unemployment numbers confirms the slowdown in the Q3 GDP growth of employment elastic sectors such as construction, industries and real estate. This highlights the sub-optimality of economic growth and the continued drag of negative labour productivity (-0.7%) on output.



[1]

Of the 20.9mn people stated as jobless in the Q3'18 Labour Statistics report, 5mn (23.9%) are frictionally unemployed (the number of people who are unemployed due to the time lag in transitioning between jobs). The structurally unemployed on the other hand are estimated at 4.6mn, 22.01% total unemployed. The definition of an unemployed citizen by the ILO is anybody gainfully employed for more than 48 hours.

Data Breakdown

Urban & Rural

Urban & Rural unemployment rate moved in opposite directions. Urban unemployment declined to 21.2% while rural unemployment increased to 23.9%. The lower urban unemployment rate reflects the brutal and fiercely competitive lifestyle in the cities. On the other hand, the rural economy which is mostly agrarian witnessed some growth constraints such as flooding and herdsmen/pastoral conflict. The agricultural sector growth slowed to its lowest level of 1.09% in over five years in 2018 which mirrored a decline in the sector's aggregate employment.

Youth Unemployment & underemployment

Youth unemployment increased to 29.7% in Q3'18 in the corresponding quarter in 2017.This shows that the level of job creation is insufficient to absorb the growing number of graduates that enter into the labour market on an annual basis. On the other hand, youth underemployment declined to 25.7%. This could likely be reflective of the success of some government intervention programs like N-Power which have empowered a significant section of Nigeria's young demography through skill development – allowing them achieve inclusion and boost productivity.

[1]NBS, FDC Think Tank

	Q3’17	Q4’17	Q1’18	Q2’18	Q3’18
Urban (%)	23.4	18.7	20.2	21.5	21.2
Rural (%)	16.4	21.1	22.7	23.3	23.9
Youth Unemployment (%)	25.5	26.6	29.0	30.5	29.7
Youth Underemployment (%)	27.2	26.4	26.1	25.6	25.7

[2]

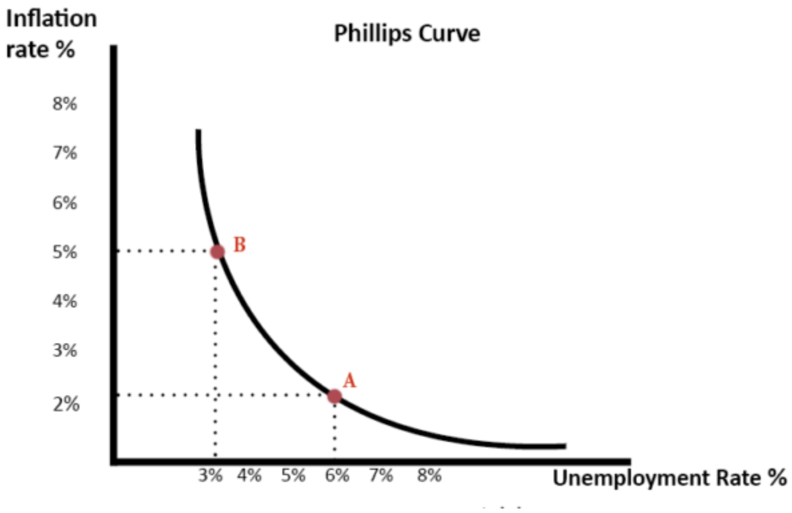
Implications on fiscal policy

The main objective of the FGN budget is to achieve inclusive growth which means growth that creates jobs. In spite of the slow but steady pick up in Nigeria’s GDP growth, it is still below the population growth rate of 2.8%. Several policy reforms have been implemented by the government to address this gap such as the inclusion of social programmes in the budget. The rise in the unemployment data further buttresses the fact that the government may need to be more aggressive in tackling this challenge. For instance increasing its spend on the economy- through infrastructure projects. Embarking on more capital projects would boost the demand for menial labour required in sectors like construction.

The risk to this is the widening of the budget deficit, currently estimated at N1.95trn (1.8% of GDP). By implication this means Nigeria would have to borrow more to bridge the fiscal gap, thus increasing the debt service currently at N2.01trn.

Trade-off between inflation and unemployment

The inflation data which shows an increase in unemployment and a decrease in inflation confirms the Phillips curve trade-off which postulates that inflation and unemployment will move in opposite directions. Policy makers will need to take these factors into consideration.



Outlook

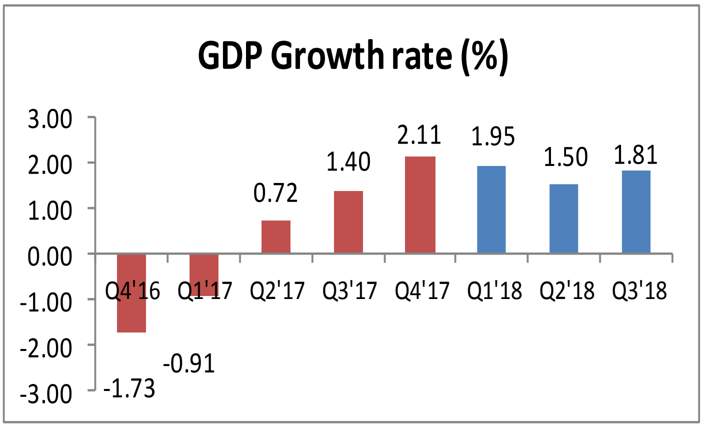
Unemployment is a lagging indicator. It reacts after the business cycle has changed. This means that the latest economic recovery is yet to have an impact on the job numbers. The decline in the underemployment numbers is a positive sign that the overall job data would improve in the short term. Hence we estimate that in subsequent quarter s the rate of unemployment would increase at a slower pace.

[2] NBS; FDC Think Tank

GDP growth expanded in Q3'18 to 1.81%

Q3 GDP expanded by 1.81% up from 1.5% in the previous quarter. This provided a temporary relief to policy makers who were concerned of a possible continuation of the slowing trend in Q2. However, when you decompose the growth we notice that interest rate and employment elastic sectors were mostly hit. The petroleum sector, an engine of growth posted an improvement over the last quarter even though still negative at -2.91%. The most important take away from the data is the sub optimality of the growth and the continued drag of negative labor productivity of -0.7% on output.

So far in 2018, the economy is growing at an average of 1.75%. In order to achieve the IMF's projection of 1.9% (FY'18), the economy needs to grow by at least 2.4% in Q4'18.



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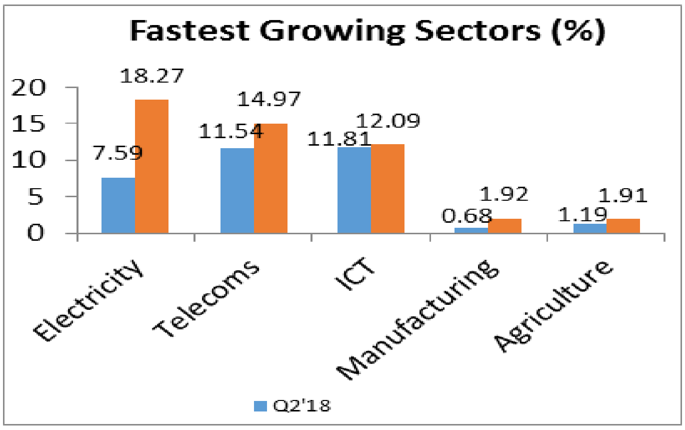

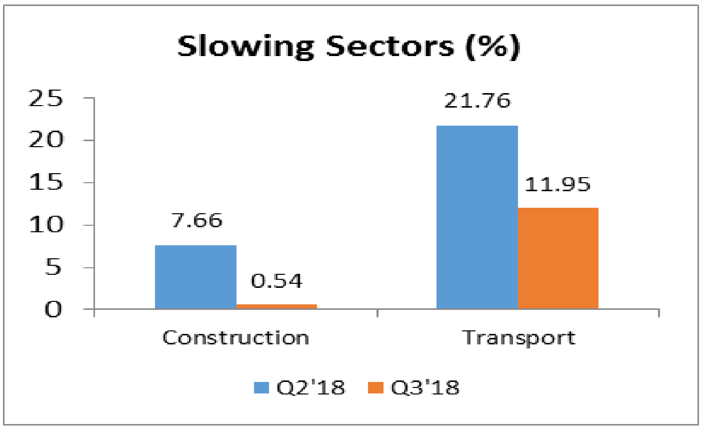

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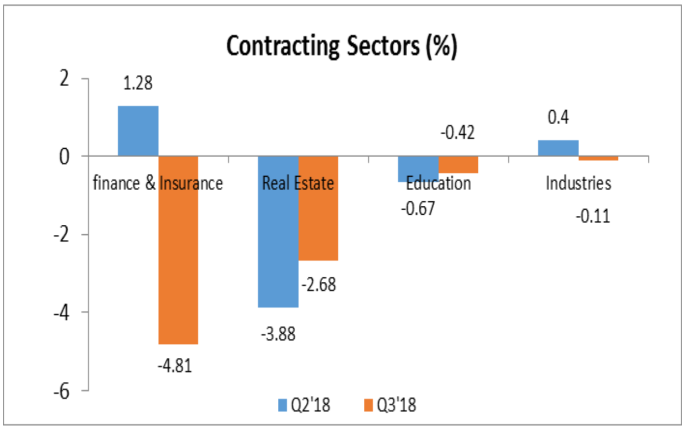


[3]NBS; FDC Think Tank
[4]NBS; FDC Think Tank

SECTORAL BREAKDOWN OF GDP

Non-oil sector recorded its highest growth in 11 quarters

The non-oil sector grew by 2.32% in Q3, the highest rate in 11 quarters. This improvement was largely underpinned by the sustained increase in the telecoms sector growth to14.97% from 1.88% in Q1'18. Capital importation into the telecoms sector increased by 2.7% to $11.42mn in Q3'18.

Conversely, the oil sector growth contracted, even though it showed a marginal increase (-2.91%) relative to -3.95% recorded in the previous quarter. This negative growth was spurred by a reduction in oil production to 1.94mbpd from 2.02mbpd in the corresponding period in 2017.

Agric sector remained the highest GDP contributor

The agric sector maintained its position as the highest GDP contributor despite the decline in the sector's growth to 1.91% from 3.07% in Q3'17. Meanwhile, it was an improvement from Q2 (1.19%), due to the harvest. Although, communal clashes and flooding in most of the agrarian states had an adverse effect on food supply, the impact was limited. Other major contributors to GDP were: trade (15.8%), information & communication (10.55%), manufacturing (8.84%) and mining & quarrying sectors (9.53%). The sectors that contributed the least to GDP are: the accommodation & food services (0.87%), human health & social services (0.65%), arts & entertainment (0.19%), electricity & air conditioning supply (0.42%) and admin & support services (0.02%).

Outlook

The FBN's purchasing managers' index (PMI) reading has been in the expansion region for four consecutive months. The index was up 2.4points to 58.9 points in November, reflecting an improvement in manufacturing sector activities. In addition, average power output crossed the 4,000MWh/h threshold in Q4. These factors coupled with the anticipated boost in aggregate demand during the festive season will further bolster economic growth in Q4'18.

A major threat to this outlook is the inclusion of Nigeria in the OPEC production cut by 40,000pb. This would have an adverse effect on oil proceeds especially at a period when oil prices have fallen below $65pb.

Nigeria's Balance of Trade Surplus Shrinks 67.6% as Imports Spike in Q3

Nigeria's balance of trade position deteriorated in the third quarter of 2018 as reported in the National Bureau of Statistics' Q3'18 Foreign Trade Report. Although still a surplus, it declined by 67.6% to N681.3bn ($1.89bn)[5] predominantly because of a spike of 73.8% in the import bill to N4.17trn ($11.58bn). The importation of manufactured goods and raw materials accounted for the largest part of the import bill. Nigeria's export revenue however increased at a slower pace of 7.8% to N4.85trn ($13.47bn), as a result of reductions in the value of agriculture, solid minerals and energy goods.

The key trading partners remain the same: China, India and Netherlands.

The sharp fall in Nigeria's trade balance has significant implications and it is an indication that the external imbalances are worsening. A smaller trade surplus highlights a deteriorating balance of payments, i.e. Nigeria's import prices are increasing faster than the prices of its exports. It also implies that the accretion into the external reserves level would be affected. The impact would also be felt on the naira as the currency comes under pressure.

[5] Using an exchange rate of N360/$

Increasing Life Expectancy in Nigeria through Higher Health Investments

According to the World Health Organization (WHO), an average Nigerian is expected to live approximately 55.2 years from birth.[6] This life expectancy is the sixth lowest in the world. It is also significantly below the global average of 72 years and Africa's average of 61.2 years.[7] A low life expectancy in Nigeria highlights inherent health threatening factors such as stress and a poor standard of living. It also undermines the country's international reputation.

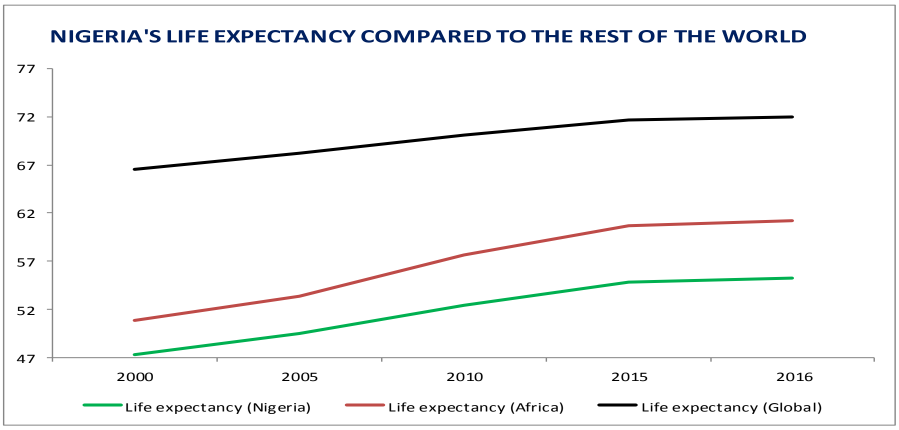
A low life expectancy is a strong indication of economic underdevelopment. Nigeria's low life expectancy also raises some concerns over an official retirement age of 62.5 years (the average for male and female). A life expectancy below the official retirement age underscores the extent of loss to the country's productive work force. The Nigerian government needs to swiftly address the issue of low life expectancy. Empirical evidence from countries with higher life expectancies shows huge investments in health care. Nigeria's budgetary allocation to the health sector is very low at a per capita rate of $4.7 compared to over $1,000 per person in countries with high life expectancy.[8] It is clear that the health sector in Nigeria needs more investment. The increase in government health investments should also be channeled towards tackling diseases, such as tuberculosis, influenza and pneumonia that are the leading causes of death in the country.

Life expectancy in Nigeria

Life expectancy is a statistic that measures the number of years a person may live in relationship to the general population. In Nigeria, the latest figures from WHO put it at 55.2 years (approximately 55 years, four months). The global life expectancy has been increasing since 2000. It currently stands at 72 years. The life expectancy in Africa has also risen to 61.2 years. While Nigeria's rate has increased, life expectancy in the country has been consistently below both the regional and the global figures. This poor performance has been attributed to a high prevalence of ailments such as influenza, pneumonia, tuberculosis, diarrhoea, stroke, HIV/AIDS and coronary heart disease.[9] Nigeria records the highest number of deaths from tuberculosis in the world. In terms of diarrhoea, the country ranks the fourth highest. [10]

[6]World Health Organization, 2018. "Life expectancy". United Nations, http://www.who.int/gho/mortality_burden_disease/life_tables/situation_trends/en/
[7]Ibid
[8]Budget Office of the Federation, 2018. "2018 Budget". Federal Government of Nigeria, http://www.budgetoffice.gov.ng/index.php/2018-budget
[9]World Health Rankings, 2018. "Leading Causes of Death Nigeria". WHO, https://www.worldlifeexpectancy.com/nigeria-life-expectancy
[10]Ibid

A low life expectancy mirrors little productivity. It contributed to Nigeria's low ranking on the global competitiveness index by the World Economic Forum. (Nigeria currently ranks 115th out of 140 countries on the global competitiveness list in 2018, an improvement from 125th in 2017).

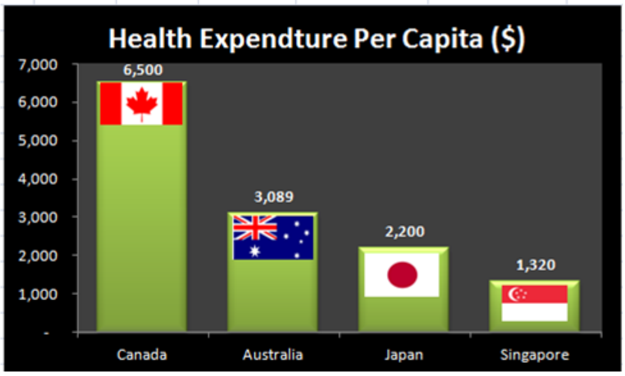


[11]

Raising life expectancy through health investment

Empirical evidence affirms a positive correlation between government health expenditure and life expectancy. Countries with the highest life expectancy globally, spend between $1,000 - $6,500 per capita on health. For instance, Canada has a life expectancy of 82.8 years with the government's health expenditure per capita at approximately $6,500.[12] The Australian government also spends over $3,000 on each citizen's health per annum, and the country has a life expectancy of 82.9 years. Nigeria's case shows the opposite. The country's health expenditure per capita is as low as $4.95, with an attendant negative impact on life expectancy. Other countries like Sierra Leone that have the lowest life expectancies in the world incur a health expenditure per capita of $1.7 - $33, which is very low compared to top ranking countries.[13]

HIGHEST LIFE EXPECTANCY



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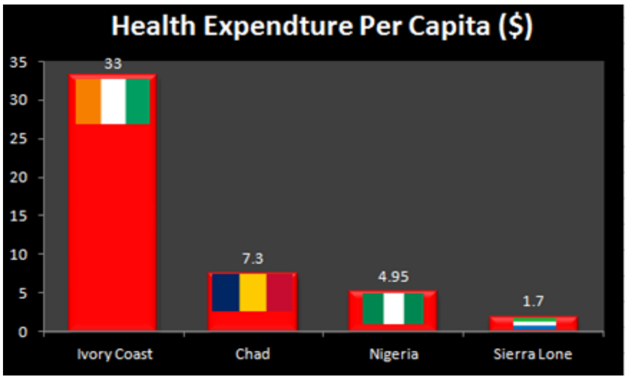
LOWEST LIFE EXPECTANCY



On the global competitiveness index (GCI), Canada, Austria, Japan and Singapore rank between 1st and 15th. On the other hand, all the four countries identified with the lowest life expectancies hold the lowest 30 positions on the GCI.[15] It is worthy of mention that while robust heath expenditure might not be the only contributor to a high life expectancy in Canada and its peers, it is a major factor.

[11]WHO, FDC Think Tank
[12]Ibid
[13]Ibid
[14]WHO, budget documents, FDC Think Tank
[15]Klaus Schwab, October 2018. "The Global Competitiveness Report 2018". World Economic Forum, https://www.weforum.org/reports/the-global-competitveness-report-2018

The Japanese model

Nigeria could adopt the strategy of raising its per capita health expenditure in order to increase its life expectancy. However, an increase in funding without a strategic plan may not bear the intended results. It is imperative to channel this extra spending towards tackling diseases, such as tuberculosis and influenza that cause the highest number of deaths in the country. Japan provides a case study for how tuberculosis can be controlled through higher government expenditure, particularly if disbursed through subsidies. Tuberculosis used to be prevalent in Japan in the 1950s, accounting for approximately 15% of all deaths in the country.[16] During that period, the country's life expectancy was just 52 years, partly due to this epidemic.[17] Aside from other spending on basic financing for its health system development, the Japanese government was able to tackle this worrying disease by introducing subsidies to partly cover the cost of tuberculosis treatment. This strategy made treatment more accessible, thereby reducing the number of deaths. Tuberculosis now accounts for as low as 0.85 deaths per 100,000 in the country. Over the years, Japan's life expectancy has also increased by 62% to 84.2 years, to become the highest in the world.[18] Meanwhile, it is worth stating that aside from subsidizing health products, government health investment in Nigeria could be channeled towards health research and development. Private investment could also be attracted to build health infrastructure such as diagnostic centers. In the event that accessing these infrastructures are unaffordable for the middle and low income earners, the government could also partner with potential private firms to subsidize the cost of healthcare. This will enable affordability for more people.

The Nigerian government has to implement these measures to raise life expectancy in the country. The reality is as long as life expectancy remains low, the country will continue to lose its productive work force and remain less competitive in the world. Foreign investors will be wary of these factors, which could translate to a sub-optimal foreign direct investment inflow into the economy. The problem of a low life expectancy is now apparent, and a solution has been proffered. The government should take action.

[16]Akihiro Seita, October 2008. "Integration-based scale up of tuberculosis control in Japan". Harvard University, https://cdn1.sph.harvard.edu/wp-content/uploads/sites/114/2012/10/rp217.pdf

[17]Ibid

[18]Ibid

Climate Change and Food Security

Most Nigerians are well aware that the agricultural sector has been neglected in favor of oil and gas. A poorly performing agricultural sector limits the domestic supply of food, directly affecting its availability and affordability. This low productivity results in widespread food insecurity and poverty. Some studies have shown that up to 70% of Nigerians are food insecure. Moreover, as a major employer of labor, low agricultural productivity in Nigeria would affect income, increase poverty rates and limit purchasing power. It is important to note that although agricultural productivity has risen in recent years, it still lags population growth, insecurity and climate change.

Reasons for sub-optimal agricultural productivity are fairly well known: limited availability and high cost of quality inputs such as fertilizer, seed, chemicals and medicines for livestock, poor support infrastructure, weak extension services and underdeveloped financial markets. All of these factors result in troublingly low yields of staple crops. Despite efforts to increase rice production and favorable rice ecologies, average rice yields in Nigeria are between 1 and 2.5 tonnes/ha against potential yields of 5–6 tonnes/ha. Although Nigeria is a major maize producing country, maize yields are less than 2 tonnes per hectare on average compared to greater than 9 tonnes per hectare attained in the US.

Climate change would compound Nigeria's agriculture production challenges

Given the current challenges to agricultural production in Nigeria, climate change is expected to make the situation even worse. Both higher temperatures and shifting rainfall regimes will lower crop yields compared to what they could be under a stable climate. While scientists are not certain exactly how rainfall patterns in West Africa will change over the next century, the region will definitely be hotter, with negative consequences for crop production. Climate change can also exacerbate pest and disease outbreaks. It is fair to state that the armyworm outbreak seen across Africa in 2017 were made worse because of climate change.

There are also indirect ways in which climate change can affect Nigerian agriculture. Rising sea levels, heavier rainfall, and extreme heat can all take a toll on already stressed and inadequate infrastructure which is needed to grow, harvest, store, and transport crops. Heavy rains and storm surges in coastal areas can wash out bridges and roads, while droughts can deplete reservoirs needed to irrigate crops. Under higher temperatures, fruits, vegetables and animal products spoil more rapidly.

In addition, Nigeria is already experiencing conflicts between herdsmen and farmers, especially in the Middle Belt Region. As population and land pressure grow, climate change could make these conflicts even worse, and could support recruitment by terrorist groups. People whose livelihoods have failed because of drought, flooding, or other climate impacts may be desperate enough to resort to violence. Although it has not been directly proven, one can link the rise of Boko Haram with dwindling water resources in the Lake Chad basin which led to crop failure and reduced income from fishing. Farmers subsequently abandoned their fields as they fled from the terrorist group. This is an example of how food insecurity, poverty, and violence can feed on one another in a reinforcing spiral.

Reasons to be optimistic

Despite all of these grave concerns about how climate change will impact food security in Nigeria, there are reasons to be optimistic. Firstly, Nigeria is an incredibly diverse country climatically, agro-ecologically, and culturally, and scientists know that diversity contributes to resilience. 'Resilience' is the ability of a system (in this case, the Nigerian food system) to deal with changes and shocks, and continue to develop. For example, if maize output is sub-optimal due to drought in a given year, millet, sorghum, and root crops could provide generic alternatives for the population instead. If heavy rains and flooding destroy the harvest in the Southeast, production in the North could compensate. As Nigeria's agricultural sector develops, there should be a focus on maintaining and cultivating this rich diversity.

Investment in R&D is necessary

Moreover, Nigeria is still in the process of inventing itself and its future, and the country is fast becoming a hotbed for innovation in farming, which integrates scientific knowledge and will play a key role in climate adaptation in the medium to long term. Investment in R&D is necessary because results would be used to provide information, tools and infrastructure for farmers and food producers to increase efficiency without adversely affecting soil fertility, water and biodiversity. As the country progresses in its development, technological innovation such as drought resistant crops, more effective fertilizers, and dryers for safely storing grains would be utilized more frequently. Anecdotal evidence also suggests that some small scale farmers are beginning to experiment with diversifying crop production and also finding ways to protect poultry from rising temperatures using ice blocks and improved ventilation.

Technological solutions

Technological solutions can lead to improved crop yields. However, they will not solve all of Nigeria's climate woes on their own. A 'silver bullet', singular solution approach, must be avoided in preference of a systems approach to climate resilience. Solutions will have to come from every sector of society. For instance, we can adopt community-based approaches to climate resilience like community-scale water management, tree planting, community microfinance, and peer-to-peer education, just to name a few. Important lessons can be learned from other countries' success in building resilience to climate change. For example, Nepal has been lauded for its comprehensive approach to climate resilience at the community scale.

Broadening participation in agriculture, particularly by young people, is also an important part of building resilience to climate change. Younger Nigerians will face more of the effects of climate change over the course of their lifetimes so they should be integrally involved in designing solutions at the individual, community, and national scales.

Nigeria's situation is serious but not hopeless

Nigeria's situation with regards to climate change is serious, but not hopeless. If Nigeria is to effectively tackle the enormous challenges to food security presented by climate change, then innovation and awareness of climate change impacts should be cultivated in all parts of the agricultural ecosystem. Food security is a significant step in ensuring a life of dignity for every Nigerian. Given its vast resources, Nigeria has the opportunity to become a global leader in building a productive and resilient agricultural system for the 21st century.

Only Nigeria can develop Nigeria, not China

From a trade volume of about $12 billion in 2002 to over $254 billion in 2017, Africa and China have seen a boom in their economic and trade relations.[19] China is not only the continent's largest trading partner, but also its largest lender and investor. As a lender, Chinese banks, contractors, and the government loaned more than $143 billion to Africa between 2000 and 2017.[20] China also pledged $60 billion in loans to Africa in the Forum on China–Africa Cooperation, held in September 2018, in Beijing. As an investor, there are over 10,000 Chinese firms in Africa.[21] Chinese businesses participate in energy, mining, and telecommunication industries and they finance the construction of: roads, railways, ports, airports, and hospitals.

However, criticism of China's relationship with Africa is rising, with accusations of debt-trap diplomacy and resource exploitation. In 2011, Michael Sata won Zambia's presidency, in part by tapping into anti-Chinese sentiment after Chinese managers shot protesters at a large coal mine in southern Zambia.[22] In 2013, Sanusi Lamido Sanusi, then-governor of Nigeria's Central Bank, wrote "we must see China for what it is: a competitor."[23] He added: "Africa must recognize that China, like the US, Russia, Britain, Brazil, and the rest, is in Africa not for African interests but its own."[24] Lamido Sanusi's explanation is apt. Nigeria cannot see China as a generous friend; neither can we plan Nigeria's development on the magnanimity of the Chinese. Only Nigeria can develop Nigeria, not China.

Benefits of an economic relationship with China

China provides much needed investment and funds to bridge the infrastructure deficit of the continent. Nigeria, for example, currently lacks the capital and revenue generation capacity to build roads, rail, ports, power plants, and other mandatory infrastructure to unleash its growth potential and lift its people out of poverty. China has the capital, knowledge, and engineering skills to fill that gap. Nigeria could also benefit from the growing Chinese business investments. Firms like Tecno, Infinix, Huawei and Star Times are Chinese firms that have a strong presence and record in Nigeria. Other Chinese firms have already invested in Africa's energy, banking, and infrastructure sectors. Nigeria needs stable and continuous foreign direct investment to lift itself economically; China can provide that.

Additionally, China's population of 1.42 billion people offers Nigerian exports a large market. In 2017, Nigeria exported $612 million[25] to China, thus generating much needed foreign exchange from the relationship.[26] Primary commodities, such as mineral fuels, grains, oils, wood, and cocoa accounted for most of those exports. China could also be a large market for Nigerian finished products, particularly as China is shifting from an export driven economy to a consumer driven economy. If Nigerian leaders can effectively exploit this relationship there is significant opportunity.

[19] John Hopkins University, 2018, "Data: China-Africa Trade", http://www.sais-cari.org/data-china-africa-trade/

[20] John Hopkins University, 2018, "Data: China Loans to Africa", http://www.sais-cari.org/data-chinese-loans-and-aid-to-africa

[21] McKinsey & Company, 2017, The closest look yet at Chinese economic engagement in Africa, https://www.mckinsey.com/featured-insights/middle-east-and africa/the-closest-look-yet-at-Chinese-economic-engagement-in-africa

[22] Eleanor Albert, Christopher Alessi and Beina Xu. 2017. "China in Africa". Council on Foreign Relations. https://www.cfr.org/backgrounder/china-africa

[23] Eleanor Albert, "China in Africa", pp12, 2017, Council on Foreign Relations, https://www.cfr.org/backgrounder/china-africa.

[24] Eleanor Albert, "China in Africa", pp12, 2017, Council on Foreign Relations, https://www.cfr.org/backgrounder/china-africa

[25] ($1 = N360, Using the IFEX Exchange Rate Window)

[26] National Bureau of Statistics. 2017. "Foreign Trade in Goods Statistics (Q4 and Full Year 2017)". https://nigerianstat.gov.ng/elibrary?queries[search]=trade.

The danger of depending on China

China is not the solution to Nigeria's problems nor can Nigeria depend solely on Chinese financing for its development. China has defined its national interests: they want a large market for Chinese goods, a steady supply of natural resources to fuel its industries, and a means of expanding its economic and political influence. To do so, however, China is employing a cycle of trade dependency. Between 2013 and 2016, Nigeria had a $16.9 billion trade deficit with China.[27] Nigeria exports mostly primary products to China, like mineral fuels, grains, oils, wood, and cocoa. Meanwhile, Nigeria imports mostly finished products such as machinery, transportation, communications equipment and manufactured goods from China. This shows the asymmetrical nature of trade between Nigeria and China, as Nigeria is mainly a source of primary products for China and a market for China's finished products. China wants to lock in Nigeria's support, and the continent's as a whole, but like the US before it, trade remains driven by self-interest, not altruism.

China's activities in Namibia's uranium sector demonstrate just how self-interested its practices can be. On 1 December 2011, the Namibian Industry of Mines and Energy awarded a mining license (Husab Mine) to Swakop Uranium, of which Taurus Mineral Ltd (a Chinese state-owned company) owns a 90% stake. The Epangelp Mining Company (a Namibian state-owned company) owns only a 10% stake in the project. The Husab mine, in Namibia, is expected to be the second largest uranium mine in the world, after the McArthur River uranium mine in Canada, and has the potential to produce 7,496 tonnes of uranium oxide per annum (the mine has approximately a total of 308.6 million tonnes of uranium ore). Yet with the current deal Namibia will get only 10% of the profits. [28,29]

Debt trap diplomacy is another reason to be weary of the Chinese. Chinese (foreign) debt threatens Nigeria's long-term economic growth prospects. Continuous borrowing will burden future generations, as money that could go to education, infrastructure, and health-care risks being lost to debt servicing. Yuan denominated debt puts pressure on Nigeria's already-threatened external reserves and further exposes the country to currency pressures. Massive borrowing from China also reduces Nigeria's credit-worthiness and its ability to borrow in the future; other international lenders, like the IMF and World Bank, will demand higher interest rates as Chinese debt makes Nigeria a riskier loan candidate.

Debt trap diplomacy also poses a more immediate threat. China lends big loans to countries that have a poor ability to pay back, and when their debtors' default, China ensures that strategic assets and natural resources are used as repayment. Zambia is just the latest country to suffer from the debt trap. China holds about 25-30% of Zambia's external debt. The fact that no one knows exactly how much, is cause for concern.[30] Zambia, which recently defaulted on its debt payments to China, now must hand over ZESCO (a state-owned power company which supplies 80% of Zambia's electricity demand) to China.[31]

Another example is Sri Lanka. China built and funded the Hambantota port in Sri Lanka. When the Sri Lankan government could not keep up with payments, Prime Minister Ranil Wickremesinghe handed over 70% of the port, alongside 15,000 acres of land, on a 99-year lease to China's state-owned Merchants Port Holding Company Ltd. The port gives China control of territory close to its rival, India, and a strategic position along a critical commercial and military waterway. Nigeria should avoid these vulnerable financial agreements.[32]

[27]Strafor Company. 2018. "Addressing Nigeria's Trade Deficit with China". https://worldview.stratfor.com/article/addressing-nigerias-trade-disparity-china

[28]World Nuclear News. 2011. "Mining license granted for Husab". World-nuclear-news.org. http://www.world-nuclear-news.org/ENF-Mining_licence_granted_for_Husab-3011114.html

[29]World Nuclear Association. 2018. "Uranium in Namibia". World-nuclear.org. http://www.world-nuclear.org/information-library/country-profiles/countries-g-n/namibia.aspx

[30]The Economist. 2018. "Zambia's looming debt crisis is a warning for the rest of Africa". Economist Group. https://www.economist.com/leaders/2018/09/15/zambias-looming-debt-crisis-is-a-warning-for-the-rest-of-africa

[31]Lusaka Times. 2018. "China to take over ZESCO - Africa Confidential". https://www.lusakatimes.com/2018/09/04/china-to-take-over-zesco-africa-confidential/

[32]Maria Abi-Habib. 2018. "How China Got Sri Lanka to Cough Up a Port". New York Times. https://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html

Mitigating Chinese trade risks

The first step Nigeria can take towards financial and economic independence is to enforce fiscal discipline and consolidation in public spending. Nigeria is notorious for its high cost of governance and inefficient use of public funds. Recurrent expenditure is usually higher than capital expenditure, thus the government usually spends most of its budget on paying salaries of public officials and running the affairs of the government. This results in insufficient funding for capital projects, which forces Nigeria to seek financing from international and local sources. The government needs to cut down on inflated contracts, luxurious allowances, ghost workers, redundant offices and wasteful expenses to adequately reduce governance costs and free up public funds that will be reallocated to capital expenditure.

Secondly, the Nigerian government must execute an effective and efficient tax system and find creative and efficient ways to generate revenue. An efficient tax system can be created by broadening the tax base, improving tax education, creating a database of taxpayers in Nigeria, improving the tax code, and using digital financial technology and information payments systems. Nigeria must work towards internally generated revenue self-sufficiency and sustenance.

The government needs to curb illicit outflows and money laundering, as well as suppress corruption and bureaucratic practices in the government. The federal government could use digital financial technology to monitor government financial transactions, making it easier to track and record funds.

Importantly: don't borrow what you can't pay back. Even if the government is compelled to borrow, it should have a well-planned debt management and efficient repayment strategy. Borrowing should be based on its ability to generate revenue and pay back. If we borrow unsustainably, without a clear repayment strategy and debt analysis, Nigeria may end up like Zambia, using oil wells and mineral resources to pay back Chinese loans.

Nigeria can benefit from an economic partnership with China. However, due to China's national and geo-political interests, debt-trap diplomacy, Nigerian leaders must realize that our economic future isn't dependent on our relationship with China, but dependent on the tenacity, ability, and competence of our leaders to deliver good governance, leadership, and development to the Nigerian people. The Nigeria of our dreams is an economically and financially self-sufficient economy.

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Working for a purpose

Global Perspective: Culled from The Economist

An academic calls for an overhaul of the conventional company

The modern company has morphed into a "money monster" enslaved to the doctrine of shareholder value. That is the thesis of a new book* by Colin Mayer, a professor at the Saïd Business School in Oxford. It is the latest challenge to the principle enunciated by Milton Friedman, an economist: namely, that "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game." An influential paper** by Oliver Hart and Luigi Zingales last year argued that profitability is not the only criterion that should apply and that shareholders' welfare is affected by a broad range of factors, including social and environmental conditions.

Mr Mayer takes a similar line, arguing that companies have relationships with many more people than just shareholders. As well as financial capital, they use several other types—human, intellectual, material (buildings and machinery), natural (the environment) and social (public goods like infrastructure).

He also notes that the original conception of a firm was quite different from now. The societas publicanorum were Roman bodies that performed public functions such as tax-collecting or maintaining buildings. They raised finance from shareholders and their shares were traded. The medieval idea of a company revolved around a family business. The founders were people who took bread together (hence the term cum panis). In the early-modern era, firms such as the Dutch and English East India Companies` were set up in order to pursue national trade objectives.

This mix of family and state-linked businesses still exists in many developing nations. The countries with a really narrow focus on shareholder value are America and Britain, and this is where Mr Mayer concentrates his criticism.

Mr Mayer thinks that companies should find a purpose that is broader than the amassing of profits. They should be "doing well by doing good". With that principle in place, the law should then require firms to demonstrate how their governance, leadership and incentives are organized so that purpose can be realized. Financial accounts should be redrawn to reflect the company's effect on human, social and natural capital, as well as its financial performance. He also proposes (along with other proponents of "long-term" capitalism) that interest payments on debt should no longer be tax-deductible and that the voting rights of shareholders should reflect the length of time that they have owned their certificates.

Mr Mayer's riposte to the charge that his ideas are overly idealistic is that the current system is simply not working according to conventional measures of economic success. Britain has a corporate model that is very friendly to investors, with dispersed share ownership, an active takeover market and strong creditor rights. The result, he posits, has been a poor national record on investment, productivity and innovation.

He also notes that firms which pursue approaches that come under the heading of "sustainability" or "social responsibility" enjoy higher returns, lower risks and lower costs of capital. (A recent paper by Robert Eccles, Ioannis Ioannou and George Serafeim showed as much.***)

Yet this line of reasoning also raises some objections to the author's broad thesis. If sustainability is profitable, then shareholders should push more companies in that direction without the need for an overhaul of the current system.

And the change of financial accounting that Mr Mayer recommends would create all sorts of headaches. Social and environmental costs would be tricky to calculate. Financial profits form the basis for corporate taxation and for the distribution of dividends. It is hard to see a new, lower figure being used for tax purposes (government receipts would fall) or dividend calculation (cash would pile up on companies' balance-sheets). So the main use of the number would be as a benchmark for incentive plans. And that would give scope to senior executives to game the new measure. Mr Mayer's prescriptions may be laudably virtuous overall, but there would be lots of devils in the details.

Thoughts from a Renaissance man

Global Perspective: Culled from Renaissance Capital

Will they know it's Christmas?

Most of Santa's travel time will be spent in Asia and Africa this Christmas, not Europe or the US. But the reindeers won't feel their present load lighten until the end of the night.

We know that many people will not be giving presents this Christmas, but if we all did...

Imagine John Lennon had his way and there was no religion, yet the whole world embraced the notion of Santa Claus, an ageing hipster who sneaks into children's bedrooms at night bearing presents ("imagine no possessions" wouldn't fly with my kids). Where would Santa spend most of Christmas Eve? And which countries would the reindeers be glad to see the back of, because the present pile was just so huuuge? Yes, you guessed correctly.

...then 81% of all presents would be delivered to children in Asia (56%) and Africa (25%)

We reckon Santa has to visit 2.3bn children, and global emerging market (GEM) fund managers will not be surprised that four of the top-five countries he'd visit are in Asia. The top five – India (20%), China (12%), Nigeria (4.2%), Indonesia (3.7%) and Pakistan (3.5%) – represent 43% of all the 0-17 year olds in the world today. In the top-20 countries globally, measured by number of children, there is just one developed market (the US at 3.2%). Children in the US, Canada and Europe (one in five of whom are Russian) had better cross their fingers that they've been good, because if Santa gets distracted by his new iPhone and runs out of time next week, they represent less than 10.0% of the children in the world.

Frontier fund managers won't be surprised that in the top-20 countries, seven are in Africa. With 584mn children, Africa accounts for 25% of the world's demographic future, compared with 56% in Asia (including 450mn in India and 285mn in China). Nigeria (96mn), Ethiopia (49mn) and the DRC (43mn) are in the top-10 countries and to bring this back to investment ideas for a minute, neither of the latter two have a stock market and the DRC has no eurobond either. Renaissance Capital will be ready when they do.

But nearly one-third of the value of all presents in larger population countries would be in the US

While Santa might forget about North America and Europe, his reindeer won't. If we guess that 0.5% of GDP per capita is spent on children's presents this year, that would amount to an average $313 in the US, $211 in the UK and just $8 in Pakistan. When we multiply this by the number of children, poor Rudolf will be lugging $23bn of presents around the US – nearly a third of the $74bn present pile for all countries with at least 10mn children. Another $9bn will be split equally by the UK, France and Germany. Despite the oft-quoted figure of more nappies being sold for the elderly than infants in Japan, it still accounts for the fourth-biggest market for children's presents at $3.9bn.

In EM, the big markets for presents would be China at $14bn (despite that one-child policy), India ($4.5bn), followed by Brazil ($2.6bn), Mexico ($2.0bn), Indonesia ($1.6bn) and Saudi Arabia ($1.2bn). Nigeria at $1.0bn would be nearly double the size of Pakistan ($0.6bn) and three times the size of Vietnam ($0.3bn).

And finally, a last-minute gift idea

All the charts are on the inside pages and are child-friendly. So you can use our graph on spending per child for wrapping paper and highlight to your little angels just how lucky they are. If they're old enough, wrap it around Factfulness by Hans Rosling.

Below we estimate how many children (aged 0-17) there are, using 2015 and 2020 media estimates of population size and age by the UN. *(See original document for chart)*

Here we show what percentage of the world's 2.3bn children are accounted for by countries with at least 0.50% of the world's children. These countries account for 84% of the world's children. *(See original document for chart)*

My dad used to amuse himself by wrapping vegetables up and telling us these were our Christmas presents. Below we estimate what the average spend by parents might be per child on presents (including carrots), if 0.5% of GDP was spent per capita. These figures are likely to be way out for many countries. Gallup estimates each US adult (there are roughly 254mn) will spend $794 on gifts at Christmas, down 10% from a month ago. *(See original document for chart)*

Lastly we multiply that estimate to produce a figure of the billions that might be spent on presents this year. We only do this for countries with over 10mn children, and the total for these countries comes to $74bn. Of course, those determined to use these data for investment ideas can ignore Christmas, and use these estimates to focus on where the next Hamleys and FAO Schwarz will be, the size of the advertising market for 0-17 year olds, etc. *(See original document for chart)*

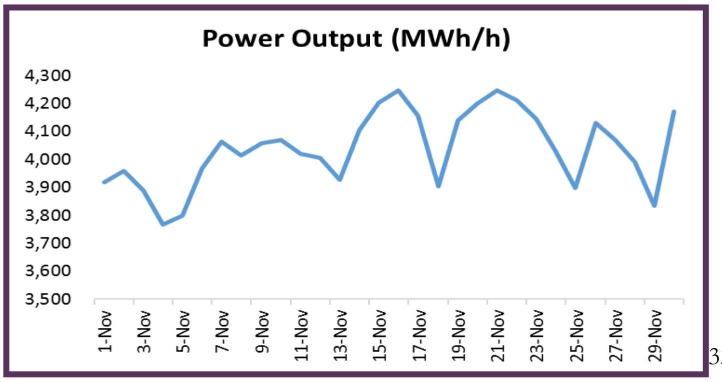
The serious points we want to highlight are: 1) the demographic shift globally, and 2) the relative size of spending power in countries even taking into account the demographic shift. Some of the data did surprise us. Despite knowing about the impact of the one-child policy, we did not know there were 58% more children in India than China, and that Germany has as few children as the UK and France. We did not expect Pakistan would be in fifth place globally. Nigeria already has the third most children in the world and is on course to have the third-largest population in the world in 2050. We were a little surprised that the 'gift' spend in Nigeria is three times that of Vietnam (but we expect that ratio to shrink in the coming decade thanks to Vietnamese industrialisation). Despite the reports about Russia's poor demographics, we were also surprised that one in five European children are Russian. A key point in Hans Rosling's book, Factfulness, which we recommend as a last minute gift idea, is that we need to keep abreast of the data. We hope this piece helps. We also hope you get a much needed break in the coming weeks.

See original document – Thoughts from a Renaissance man–Will they know it's Christmas? Renaissance Capital 17-12-2018

Macroeconomic Indicators

Power Sector– Improved power output

The average power output from the national grid within the review period was 4,038MWh/h, 7.62% higher than the average of 3,752MWh/h in the corresponding period in October. On grid power supply crossed the 4,000MWh/hour threshold in 19 out of the 30-day review period. This can be attributed partly to hydro-generated power output as there was no record of water constraints in November. Despite a significant improvement in power output, the sector lost N38.18bn (annualized at N458.16bn).



[33]

Outlook

We expect the average power supply to remain around current levels of 3,800MWh/h – 4,000MWh/h provided there are no gas pipeline disruptions.

Money Markets– Interest rates climb

After the CBN and DMO had reduced stop rates across most tenors for a period of time, the 91-day and 182-day T/Bills tenors declined by an average 24bps to 10.90% pa and 13.10% pa respectively at the last primary market auction on November 28th. On the other hand, 364-day tenor increased by 5bps to close at 14.45% pa. At the secondary market, the 91-day and 364-day T/Bills tenors increased by an average of 71bps to close at 13.11% pa and 14.72% pa. while the 182-day tenor declined by 28bps to 12.50% pa.

Short-term interest rates (OBB and ON) increased by 1,207bps and 1,244bps respectively to close at 16.57% and 17.36% pa on November 30th. Average liquidity within the banking system closed positive at N436.61bn during the period compared to N202.12bn in the corresponding period in October. Total OMO sales during the period was N2.38trn compared to maturities of N1.67trn. This resulted in a net outflow of N710bn.

NITTY Tenor	Rate on Nov 1st (%)	Rate on Nov 29th (%)	Direction
30	11.85	13.85	↑
90	12.67	13.94	↑
180	13.51	14.44	↑

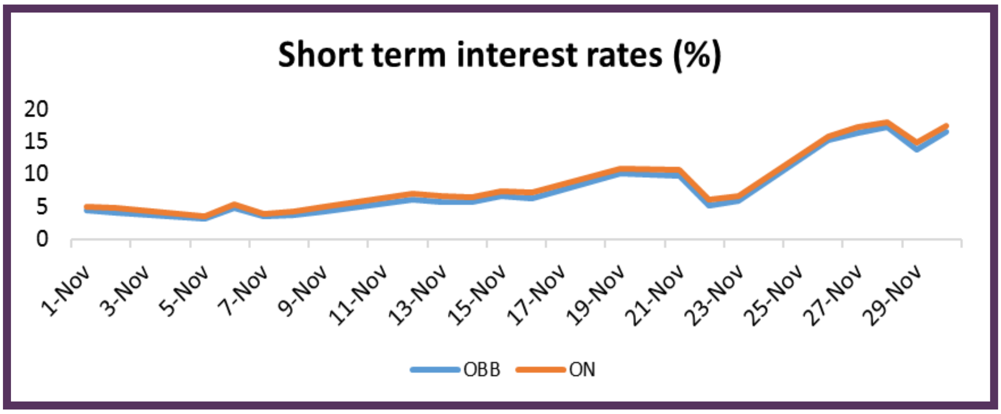
[33] FGN

Primary Market

T/bills Tenor	Rate on Oct 31st (% pa)	Rate on Nov 28th (%pa)	Direction
91	10.98	10.90	↓
182	13.49	13.10	↓
364	14.4	14.45	↑

Secondary Market

T/bills Tenor	Rate on Oct 31st (% pa)	Rate on Nov 30th (%pa)	Direction
91	12.22	13.11	↑
182	12.78	12.50	↓
364	14.20	14.72	↑



[34]

Outlook

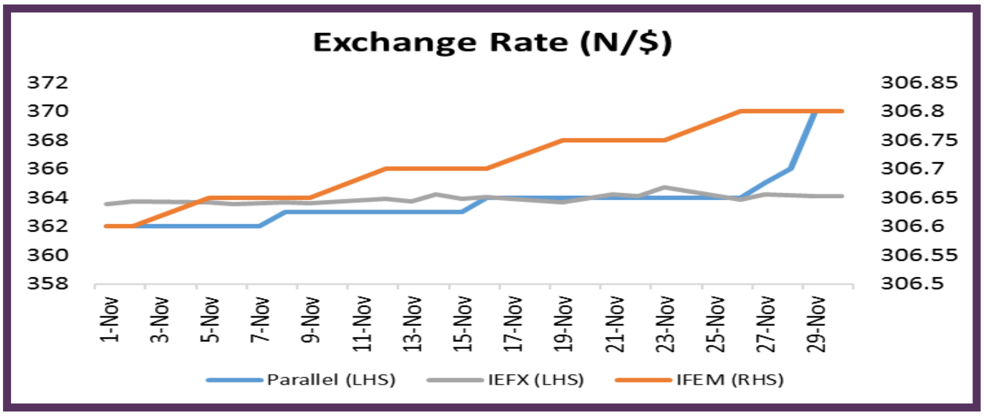
In the coming weeks, the impact of increased election spending and a likely minimum wage review will boost market liquidity. This is expected to drive interest rates downward.

Forex Markets

Exchange Rate– falls sharply at the parallel market

After trading within a tight band of N360-364/$ for several months, the naira fell sharply to a 1-year low of N370/$ in November. This can be attributed to increased speculative buying ahead of the 2019 elections, demand for dollar cash for campaign purposes and the sharp drop in oil prices (approximately 30% since October). This was despite an increase in the CBN's intervention in the forex market by 21.2% to $1.83bn compared to its intervention of $1.51bn in October. On the other hand, the naira appreciated by 0.15% to N364.10/$ at the I&E window. Total forex traded at the IEFX window was $4.55bn, 5.21% lower than a turnover of $4.80bn recorded in October. At the interbank foreign exchange market, the naira depreciated marginally by 0.07% to close the period at N306.80/$.

[34]FMDQ



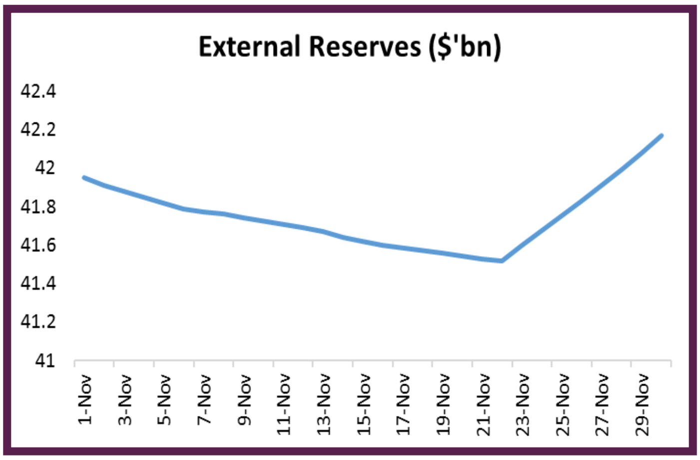
[35]

Outlook

The festive season is usually characterized by a stronger naira on the back of an increase in visiting friends and relatives. However, we expect the pressure on the naira to continue. The campaign and the subsequent election will result in increased demand from politicians and Nigerians who want to hedge against a further depreciation in the naira.

External Reserves– increase on Eurobond drawdown

During the review period, Nigeria's gross external reserves inched up for the first time in 6 months. This resulted in an increase of 0.52% to $42.17bn from $41.95bn on November 1st. The increase is likely to be as a result of the drawdown from the $2.8bn Eurobond issued in November. The effect of this is an increase in the import cover from 10.44 months to 10.50 months.



[36]

Outlook

Pressure on the external reserves could likely persist in the coming months. With the naira depreciating to N370/$, the CBN would be under immense pressure to defend the currency ahead of the 2019 elections. This is likely to push external reserves down in the coming months.

[35]FMDQ, CBN, FDC Think Tank
[36]CBN

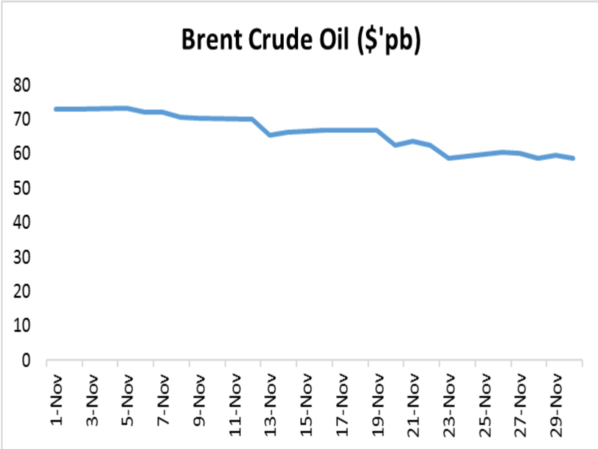
Commodities Market - Exports

Oil Prices– fall sharply on weak demand

During the period, average Brent price was $65.95pb, 18.21% lower than October's average of $80.63pb. Brent oil slipped below the $60pb threshold in November. A slow-down in the demand growth amidst trade tensions and struggling financial markets was the main reason of the sharp decline in oil prices. Another noteworthy development in the oil market was the cut in global demand growth by OPEC to 1.5mbpd in 2018 and 1.29mbpd in 2019. On the other hand, supply is growing at a healthy pace. Saudi Arabia's oil output reached a record high of 11.1-11.3mbpd in November.

Outlook

The outcome of OPEC's bi-annual meeting in Austria would determine the dynamics of the oil market in the coming months. Events such as the OPEC-Russia alliance, the US sanctions on Iran, increased oil supply from Saudi Arabia and the US would be front burner issues at this meeting. We also expect an increase in oil demand in the winter months for heating purposes. This could push up oil prices in the near term.



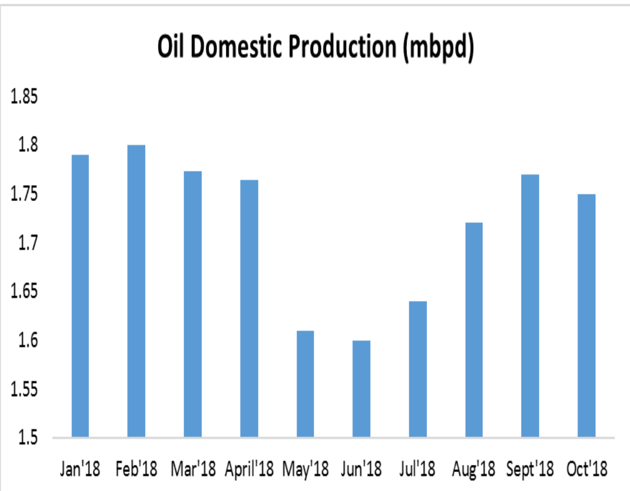
[37]

Impact on Nigeria

Lower oil price would reduce Nigeria's quarterly oil revenue by at least 5– 10%, which would reduce FAAC disbursements to an estimated average of N500bn. The average disbursement in 2018 was N710bn. A reduction in the monthly statutory allocations will lead to salary backlog across the Federation.

Oil Production– declines to 1.75mbpd

According to OPEC's monthly oil report, Nigeria's domestic oil production declined by 1.13% to 1.75mbpd in October from a revised figure of 1.77mbpd in September. This was in contrast to the increase in Nigeria's rig count from 14 in September to 15 in October.[38]



[39]

Outlook

There are indications of a likely output cut at OPEC's meeting on December 6th. Any cut to Nigeria's current quota of 1.8mbpd could negatively affect Nigeria's quarterly oil revenue if the downward trend in oil prices persists. However, we expect Nigeria's oil production to remain stable in the coming months with minimal disruptions to pipelines before the 2019 elections.

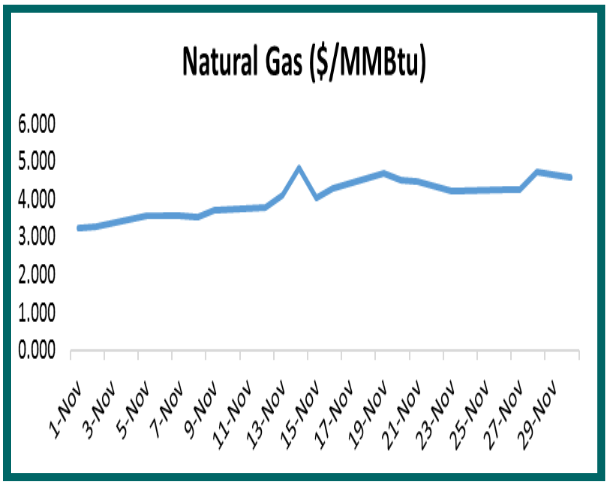
[37]Bloomberg
[38]Baker Hughes
[39]OPEC

Natural Gas

Natural gas prices spiked by 42.3% to close at $4.61/mmbtu on November 30th. The increase was partly driven by reports of a decline in US natural gas inventories. In addition, the disruption to gas supply in the United Kingdom also pushed prices up in November.

Outlook

Qatar, the world's largest exporter of natural gas, has announced its plan to leave the OPEC cartel in January 2019 to fully harness its natural gas output. This could likely boost global supply and reverse the upward trend of natural gas prices in the coming months.



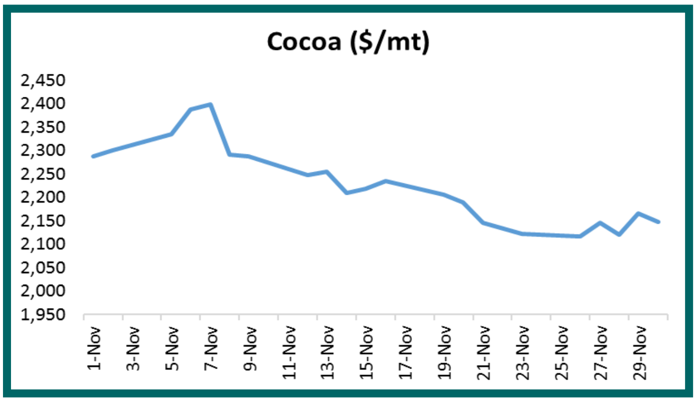
[40]

Impact on Nigeria

Qatar's plan to focus on its natural gas production threatens Nigeria's gas market share. Nigeria is currently the 4th largest LNG exporter in the world. An increase in global gas supply also threatens Nigeria's export revenue in the near to long term.

Cocoa

Cocoa prices decreased by 3.67% to $2,203/MT on November 30th, from $2,287/MT on November 1st. Forecasts of a surge in Ghanaian cocoa grinding was partly responsible for the decline in global cocoa prices.



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Outlook

Increased cocoa supply is expected to depress prices further in the coming weeks.

Impact on Nigeria

Nigeria currently accounts for 4.5% of global cocoa output. Any drop in global cocoa price will reflect negatively in Nigeria's export revenue.

[40]Bloomberg
[41]Bloomberg

Commodities Market - *Imports*

Wheat

Wheat prices increased by 1.57% to $5.16/bushel on November 30th, from $5.08/bushel on November 1st. The price increase was driven by expectations of an increase in global demand and higher demand for US cargoes.

Corn

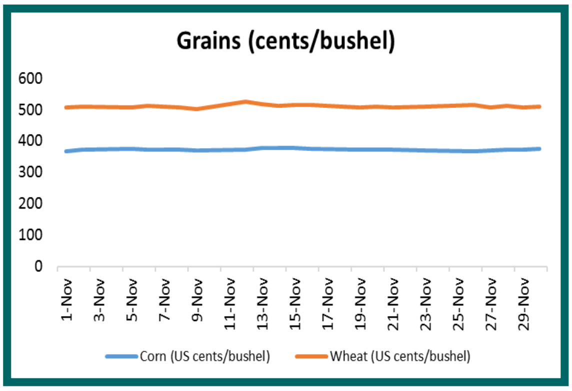
Corn prices rose by 3.00% to $3.78/bushel from $3.67/bushel. This was influenced by weaker than anticipated US harvest.

Impact on Nigeria

An increase in global wheat price could result in an increase in imported inflation and subsequently increase the local price of wheat dependent commodities such as bread.

Grains- Outlook

We expect weather conditions and increased US export demand to determine prices in the coming weeks.



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Sugar

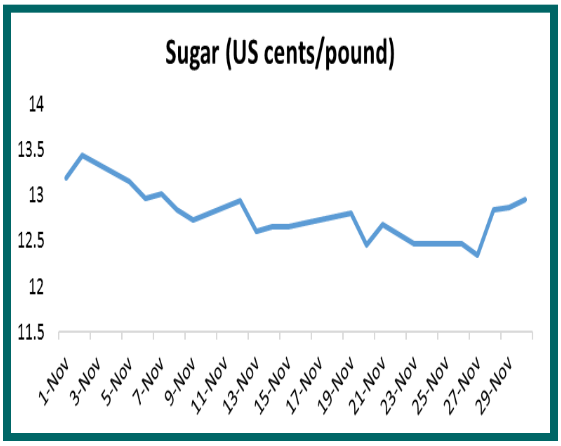
Sugar prices closed at $0.1284/pound on November 30th, 2.65% lower than its starting price of $0.1319/pound. This was on the back of increased demand for India's sugar output from China.

Impact on Nigeria

Nigeria is currently the largest importer of sugar in SSA, spending $100mn on its imports annually. The decline in sugar price would reduce Nigeria's import bill.

Outlook

Increased demand for India's sugar output is likely to push the global price of sugar up.



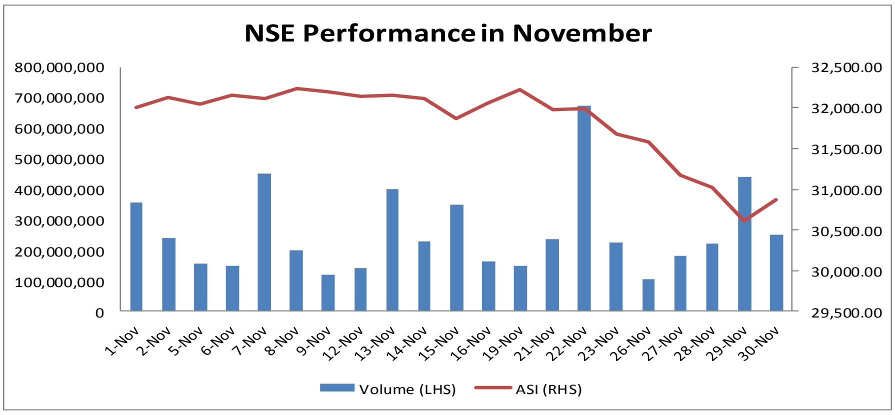
[43]

[42] Bloomberg
[43] Bloomberg

Stock Market Update

The Nigerian equities market sustained its losses into November as the NSE ASI dipped 4.9% to close at 30,874.17 points. Similar to the ASI, market capitalization declined by 4.89% (N580bn) to N11.27trn. Some observers attributed the negative performance on the bourse to the absence of any incentive in November, compared to October that witnessed the release of some impressive corporate earnings.

The NSE ended the month of November at a price to earnings (P/E) ratio of 9.44x. This is a 2.94% increase over the close of the previous period's P/E of 9.17x. Market breadth remained negative at 0.47x, as 27 stocks increased, 84 stocks remained flat, while 58 declined, compared to October.



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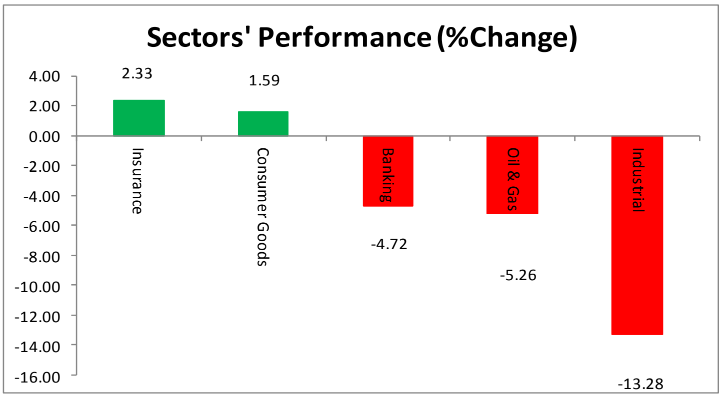
The NSE witnessed more trading activities in the month of November. Average volume traded on the floor rose 13.6% to 259mn units, whilst average value of trades increased by 29% to N3.57bn.



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All indices except insurance and consumer goods closed the month of November in negative territory. The industrial sub-sector index was the biggest loser. The index lost a whopping 13.28% in November. The share prices of industry heavyweights (Dangote Cement Plc, Lafarge Africa Plc and Cement Company of Northern Nigeria Plc) declined sharply by an average of 21.05%.

The insurance sub-sector index gained the most among the NSE sub-sector indices. The sector's performance was driven by sharp rises in the price of shares such as Continental Reinsurance Plc (35.14%) and Consolidated Hallmark Insurance Plc (15.15%).

[44]NSE, FDC Think Tank
[45]NSE, FDC Think Tank

Continental Reinsurance Plc (35.14%) led the advancers, followed by Glaxo Smithkline Consumer Nigeria Plc. (30.63%), Consolidated Hallmark Insurance Plc (15.15%), McNichols Plc. (14.63%) and Presco Plc (10.59%).

TOP 5 GAINERS (N)				
Company	**Oct 31'18**	**Nov 30'18**	**% Change**	**Absolute Change**
CONTINENTAL REINSURANCE PLC	1.48	2.00	35.14	0.52
GLAXO SMITHKLINE CONSUMER NIG. PLC.	11.10	14.50	30.63	3.4
CONSOLIDATED HALLMARK INSURANCE PLC	0.33	0.38	15.15	0.05
MCNICHOLS PLC	0.41	0.47	14.63	0.06
PRESCO PLC	56.20	62.15	10.59	5.95

The laggards were led by Diamond Bank Plc. (-53.9%), Eterna Plc (-30.58%), Cement Company of Northern Nigeria Plc (-27.86%), C & I Leasing Plc. (-26.43%) and Ikeja Hotel Plc. (-25.99%).

TOP 5 LOSERS (N)				
Company	**Oct 31'18**	**Nov 30'18**	**% Change**	**Absolute Change**
DIAMOND BANK PLC	1.41	0.65	-53.90	-0.76
ETERNA PLC.	6.05	4.20	-30.58	-1.85
CEMENT CO. OF NORTH.NIG. PLC	24.95	18.00	-27.86	-6.95
C & I LEASING PLC.	2.80	2.06	-26.43	-0.74
IKEJA HOTEL PLC	2.27	1.68	-25.99	-0.59

Outlook

The NSE is expected to sustain its bearish streak in December as heightened political tensions, lower oil prices and a depreciating currency cause investor jitters and trigger foreign portfolio investment outflows.

Analyst Recommendation: BUY

Market Capitalization: N27.7billion

Recommendation Period: 365 days

Current Price: N21

Industry: Construction/Real Estate

Target Price: N27.95

Equity Report: Julius Berger Nigeria

Analyst's note

Julius Berger turns the corner

Julius Berger Nigeria (Julius Berger) recorded an impressive performance in the first nine months of 2018 (9M'18). The construction giant continued its road to recovery with a 12.31% increase in revenue to N118.47bn in 9M'18 from N105.49bn in 9M'17. This sustained boost to its top line is mainly attributed to the gradual improvement in Nigeria's economic and business environment.

Julius Berger saw remarkable expansion across all major service lines. The main source of the group's revenue remained civil works, accounting for 52.37% and building, accounting for 42.36%. Other services accounted for 5.28%. These revenues were mainly from Nigerian operations (96.4%), with the rest (3.6%) from Europe and Asia.

Mixed directions in key cost items

The group's production cost increased at a much steeper pace compared to its revenue. Its cost of sales rose by 19.51% to N94.11bn in 9M'18 relative to N78.74bn in 9M'17. Similarly, Julius Berger's cost-to-sales ratio moved from 74.7% in 9M'17 to 79.4% in 9M'18. This resulted in a 9.89% decline in gross profit to N24.36bn during the same period.

However, the 14.85% drop in administrative expenses to N19.33bn helped Julius Berger record a decent operating profit of N4.96bn, a 23.68% boost over 9M'17. The overhaul of the group's operations helped overturn the poor performance of 9M'17.

Surge in other income sources buoy rebound

Julius Berger also witnessed a surge in non-operating income in its 9M'18 period. These items were mainly one-off transactions, such as sale of property, plant and equipment, foreign exchange gains and other interest income. This is noteworthy given the 79.85% growth in other income to N4.65bn from 9M'17 that aided the company's turnaround in 9M'18. Equally, the 97.03% decline in Julius Berger's foreign exchange acquisition losses propped its profits. This resulted in a 6099.18% spike in its profit before tax to N5.06bn, moving the group from a loss after tax of N349mn to a profit after tax of N3.4bn in 9M'18.

As the Federal Government of Nigeria strives to boost economic activities and sustainable economic growth, Julius Berger is well positioned, as one of the leading construction companies, to benefit from the current growth momentum. In addition, the renewed interest in bolstering infrastructure and easing business operations in Nigeria is another key consideration that will help maintain the group's current momentum. Accordingly, we place a **BUY** rating on the company's stock, considering its potential upsides and growth.

Industry and Company Overview

Diversifying in a highly competitive market

Julius Berger is currently the largest construction company by market capitalization on the Nigerian Stock Exchange (NSE), with a value of N27.72bn. Like the NSE All-Share-Index (ASI), Julius Berger's stocks have lost considerable value in 2018. The jostle for political power and the ensuing fracas weighed on the performance of most stock indices. However, Julius Berger has maintained its resolve to improve its internal operating efficiencies.

Julius Berger succeeded in creating a niche segment by delivering superior value on highly technical projects. The construction giant has been a key strategic partner to the Nigerian government since the construction of the Eko Bridge in 1965, its pioneer project. Other notable works include Akwa Ibom Stadium, Lekki-Ikoyi Bridge and Central Bank of Nigeria's offices in Abuja and Lagos among other commendable projects. Before listing on the NSE in 1991, Julius Berger was owned by Bilfinger Berger, a German construction firm, which now maintains a 16.5% in the company as of the end of 2017. Likewise, an additional 48.4% of shareholding in the group is also strategically owned.

With government contracts accounting for more than 50% of its earnings over the years, Julius Berger has been exposed to the cyclical trends of the economy. Management has made a deliberate effort to diversify its investment portfolio and exposure, through the acquisition of supporting segments and other interests outside its value chain. Due to its extensive investment in state-of-the-art technology and methodologies, Julius Berger developed expertise in delivering integrated solutions that span from planning, design, engineering, and construction to maintenance services. However, the construction segment still accounts for 96.4% of the group's earnings.

Few players in a high potential industry

Though a lower proportion of the Nigerian budget is earmarked for infrastructural development as opposed to recurrent spending, the presence of very few players has made the sector attractive to Julius Berger. In addition, the sector is strengthened by a high rate of urbanization and the emergence of the upper middleclass. Julius Berger plays in the premium segment of the construction sector, where the barrier to entry is high due to the required level of investment in fixed assets and the high maintenance cost of those assets. The sector is highly influenced by the cyclical nature of the economy. This niche consists of clients with specialized technical needs and the affluent, seeking quality in terms of value, durability and creativity. Client needs vary from the construction of dams, stadiums, essential bridges, roads, buildings, for residential and commercial purposes, to facility services.

There are very few competitors that can effectively compete with Julius Berger in Nigeria, due to the sophistication of private and public project needs of its clients. Most competitors are foreign construction companies in partnership with local players. The competitors include China Civil Engineering Construction Corporation (CCECC), Reynolds Construction Company (RCC), Arab Contractors, Setraco Nigeria Limited, and Dantata & Sowoe Construction Company Nigeria Limited, which are all private companies and not listed on the Nigerian Stock Exchange (NSE). CCECC, a Chinese state-owned company, has access to financing from China at single digit rates. This gives CCECC better working capital flow and finance cost savings as compared to Julius Berger. To add to this, the renewed partnership between the Nigerian and Chinese governments, especially in the rail segment, could be a penetration strategy by CCECC to establish its foothold in the construction industry

Julius Berger has a narrow customer base and a high exposure (*to revenue generation*). Its premiums make up for the narrow customer base, but the market and concentration risks have left them at risk to the volatile performance of its major client, the Nigerian government, which accounts for more than 50% of its earnings.

Another feature of the upscale construction sector is the prevalence of both high receivables and payables. Construction companies receive advances on payments prior to the commencement of work from clients and then accrue income as work is completed. This has made cash management cumbersome leading to high financing costs, and in extreme cases, illiquidity and bankruptcy. This has been a major constraint for Julius Berger, as delay in the release of funds by the government has weighed on its short term borrowings and consequently finance cost.

Income statement for Julius Berger Plc

N'000	2013	2014	2015	2016	2017
Revenue	212,737,291	196,808,632	133,807,574	138,993,752	141,890,498
Cost of sales	(161,134,675)	(146,313,712)	(100,473,106)	(84,767,291)	(97,591,978)
Gross profit	**51,602,616**	**50,494,920**	**33,334,468**	**54,226,461**	**44,298,520**
Marketing and distribution expenses	(111,209)	(116,879)	(75,140)	(53,327)	(47,851)
Administrative expenses	(32,624,772)	(32,885,108)	(21,445,734)	(37,380,880)	(35,564,107)
Operating profit	**18,866,635**	**17,492,933**	**11,813,594**	**16,792,254**	**8,686,562**
Investment income	19,949	405,811	139,763	284,681	1,126,493
Other gains and losses	295,816	(170,361)	695,388	1,443,523	4,076,096
Finance cost	(2,961,864)	(4,593,487)	(6,148,772)	(5,784,246)	(6,900,051)
Foreing exchange acquisition loss				(14,234,241)	(3,249,960)
Profit before tax	**16,220,536**	**13,134,896**	**6,499,973**	**(1,498,029)**	**3,739,140**
Income tax expense	(8,367,196)	(4,894,917)	(4,059,833)	(2,318,763)	(1,167,100)
Profit after tax	**7,853,340**	**8,239,979**	**2,440,140**	**(3,816,792)**	**2,572,040**

Balance sheet for Julius Berger Plc					
N'000	**2013**	**2014**	**2015**	**2016**	**2017**
Property, plant and equipment	67,995,915	68,369,671	58,376,513	49,712,834	43,621,129
Goodwill	4,842,708	4,606,412	5,041,184	8,348,748	9,781,954
Other intangible assets	118,297	77,402	32,712	2,766	1,383
Investment property	780,177	2,648,412	2,546,436	2,444,460	2,342,484
Trade and other receivables	1,469,591	2,334,764	844,122	569,619	
Tax receivable	31,075,595	35,060,509	21,039,915	26,026,032	14,875,011
Deferred tax assets	7,468,271	8,041,407	10,087,301	5,453,858	2,816,807
Other financial assets					
Non-current assets	**113,750,554**	**121,138,577**	**97,968,183**	**92,558,317**	**73,438,768**
Inventories	11,432,482	12,111,830	11,110,116	11,699,526	10,649,880
Amounts due from customers and other contracts	20,898,658	29,122,120	27,228,427	33,082,455	31,581,219
Trade and other receivables	52,245,757	63,425,208	88,634,246	108,291,146	120,705,171
Tax receivable	7,430,849	5,575,112	5,292,205	1,417,845	341,132
Cash and cash equivalents	20,475,649	23,473,159	13,360,038	10,584,522	37,590,125
Assets classified as held for sale	1,027,308	1,199,775	1,493,055	1,545,121	1,087,498
Current assets	**113,510,703**	**134,907,204**	**147,118,087**	**166,620,615**	**201,955,025**
Total assets	**227,261,257**	**256,045,781**	**245,086,270**	**259,178,932**	**275,393,793**
Share capital	600,000	660,000	660,000	660,000	660,000
Share premium	425,440	425,440	425,440	425,440	425,440
Foreign currency translation reserve	687,896	919,411	419,755	7,119,062	9,508,398
Retained earnings	18,863,052	23,420,332	22,729,580	17,065,287	19,447,014
Equity attributable to owners of the company	**20,576,388**	**25,425,183**	**24,234,775**	**25,269,789**	**30,040,852**
Non-controlling interest	458,040	670,660	57,180	46,526	55,079
Total equity	**21,034,428**	**26,095,843**	**24,291,955**	**25,316,315**	**30,095,931**
Borrowings	6,435,141	3,201,710	-	-	-
Retirement benefit liabilities	2,033,004	1,996,506	1,853,781	2,463,491	2,587,335
Deferred tax liabilities	12,336,676	13,220,121	12,989,322	9,185,562	7,214,400
Amount due to customers under contracts	80,214,852	93,690,330	106,971,355	119,098,895	122,881,472
Provisions		2,135,994	404,308	454,232	474,296
Non-current liabilites	**101,019,673**	**114,244,661**	**122,218,766**	**131,202,180**	**133,157,503**
Amount due to customers under contracts	46,472,088	35,188,722	32,912,602	24,009,265	26,879,477
Trade and other payables	34,016,585	42,138,848	34,596,825	44,015,318	51,198,752
Borrowings	19,279,413	34,809,060	24,807,936	33,172,798	33,597,303
Current tax payable	5,314,810	3,473,353	6,106,748	1,423,923	351,854
Retirement benefit liabilities	124,260	95,294	151,438	39,133	112,973
Provisions					
Current liabilites	**105,207,156**	**115,705,277**	**98,575,549**	**102,660,437**	**112,140,359**
Total liabilites	**206,226,829**	**229,949,938**	**220,794,315**	**233,862,617**	**245,297,862**
Total equity and liabilites	**227,261,257**	**256,045,781**	**245,086,270**	**259,178,932**	**275,393,793**

Management

Julius Berger's management team is led by Dr. Lars Richter, a civil engineer who spent about 16 years with the group. Before his appointment as Managing Director in October 2018, he served in various capacities across numerous key projects. In the last 10 years, he has managed the acquisition, operations and successful completion of some landmark projects in Nigeria – such as the Akwa Ibom Stadium.

The Board of Julius Berger is led by Mr. Mutiu Olaniyi Sunmonu, CON, formally a Managing Director of the Shell Petroleum Development Company (SPDC) from 2004 to 2015. He is a Fellow of the Nigeria Society of Engineers (FNSE) and also serves as Executive Consultant to Pan Ocean and Newcross EP, providing leadership across the operations, regulatory compliance and external relationship management, thereby establishing his wealth of experience in high value projects and leadership.

CEO/Managing Director

Dr. Lars Richter

Chairman of the Board of Directors

Mr. Mutiu Olaniyi Sunmonu

Considering the network and experience of the current Chairman in the oil and gas sector, with a career spanning over 36 years in Nigeria, United Kingdom and Netherlands, Julius Berger might successfully diversify into the oil and gas sector. Also, the current partnership with Petralon Energy, an upstream energy company, where Mr. Mutiu also serves as chairman, has the potential of creating a synergy for the two parties.

The Board of Julius Berger consists of other seasoned professional (locals and expatriates) with extensive experience in construction and a good knowledge of the Nigerian operating environment.

Bulls and Bears say

Bulls Say:

- Reputable company with a proven track record in the construction sector
- Dominant player in a high potential market
- The wide infrastructure gap in the Nigerian economic space shows an opportunity for growth
- Pickup in the demand for high quality construction works – shopping malls and skyscrapers etc.
- Impending move to further diversify portfolio and reduce its concentration risk

Bears Say:

- High finance cost is a threat to profitability
- Government delay in the approval and execution of the national budget is slowing implementation and release of funds for capital projects
- High dependence on government patronage, and exposure to economic volatility
- High production costs eroding impact of revenue drive, increasing production cost-to-sales ratio
- Tepid economic recovery

Risks and Outlook

Facing significant market and concentration risk, Julius Berger will be under immense pressure to further improve operating efficiencies. As political parties prepare for the 2019 Presidential elections in Nigeria, we believe there will be considerable pressure on the earnings of Julius Berger as infrastructure projects are postponed or deferred indefinitely.

Another risk is the emergence of other foreign-affiliated construction companies like Arab Contractors and CCECC in the infrastructure projects space. Their arrival can erode the large market share that Julius Berger currently enjoys.

Though these risks pose immense challenges on the company's outlook, Julius Berger has devised a practical risk management structure. The company manages foreign exchange exposures by utilizing forward foreign exchange contracts. The company's foreign debt is repayable on demand with its carrying amount reflecting the fair value and exposure to interest rate risk as of the reporting date.

Market risk is currently managed through forward funding, where achievable, in order to hedge against market volatility, currency movement. The group aims at minimizing concentration risk through continuous diversification of its investment portfolio.

Our valuation

Using the Discounted Cash Flow (DCF) methodology, we estimated a stock price of N27.95, which is a 33.1% upside on the current price of N21 as of December 11, 2018. The discount rate (Weighted Average Cost of Capital (WACC)) of 16.3% was derived using a 15% risk free rate (FGN 5-year Bond as at September 2018), a Beta of 0.5377, an after-tax cost of debt of 14.4%, and a market risk premium of 6.34%. The long-term cash flow growth rate to perpetuity calculated is 2.9%.

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

DCF Valuation			
N'000	2018E	2019E	2020E
EBIT	6,838,185	3,131,336	4,576,579
Less: Taxes	(2,051,455)	(939,401)	(1,372,974)
EBIAT	4,786,729	2,191,935	3,203,606
Plus: depreciation expense	9,026,526	7,743,701	6,067,620
Less: CAPEX	(713,101)	(688,989)	(728,465)
Less: Change in working capital	4,251,572	(1,175,218)	(6,041,389)
Free Cash Flow (FCF)	17,351,725	8,071,428	2,501,372
WACC	16.3%	16.3%	16.3%
Present value (PV) of FCF	14,922,134	5,969,349	1,590,901
Terminal value @ perpetual growth rate (2020)	**2018**	**2019**	**2020**
Terminal value as of 2020			17,736,226
Present value of terminal value	11,280,440		
DCF Calculation	**Valuation**		
PV of explicit period	22,482,383		
PV of terminal value	11,280,440		
Enterprise Value	33,762,823		
+ Cash	37,590,125		
- Borrowings	(33,597,303)		
Equity value	37,755,645		
Share Price	**28.60**		