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In This Issue ...

Access Bank-Diamond Bank Merger

Strategic Opportunity or Child of Necessity??

Access Bank and Diamond Bank announced what is styled as a merger but in reality is an elegant acquisition. The combination will produce Nigeria's largest retail bank by customer base (29mn customers) with an asset footing of N6.7trn. The parties agreed on a purchase consideration of N3.13/share for Diamond Bank's shareholders – split between a share exchange deal of two new Access Bank shares for every 7 held by Diamond Bank shareholders and a cash purchase of N1/share.

Access Bank to shore up capital

The current purchase consideration values Diamond Bank at N72.5bn. Access Bank has moved to raise N90bn in tier II capital and a further N75bn through a public issue before the end of Q1'19. This is to bolster its capital position given Diamond Bank's recent difficulties of liquidity and asset quality. The bank managed to stay afloat with a capital adequacy ratio (CAR) of 16.3%[1]* (SIBs) compared to Access Bank's CAR of 20.1%.

The best of both worlds

Access Bank will remain the dominant party after the consolidation, maintaining 81% of the new entity, while Diamond Bank will hold the rest (19%). The merger, subject to regulatory and shareholders' approval is expected to be finalized before the end of Q2'19. The successful combination will create an entity with strong presence in both corporate and retail banking.

[1]Diamond Bank 9M'18 Financial Report
*15% as minimum capital requirement for Systemically Important Banks (SIBs)

Are there potent integration costs?

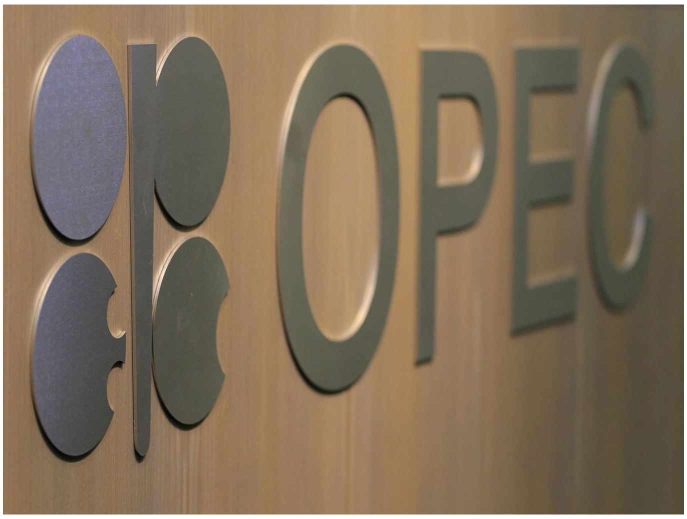
The new entity will have 548 branches, 6,824 employees (within Nigeria), and the second largest shareholders' fund of N695bn (after Zenith Bank - N778bn). However, the need for optimization will see the head count cut rationalization – at both branch and headquarters, especially given the tilt towards robust ICT platforms over the traditional physical transaction points. This is exacerbated by the threat to banks' transactional revenue, as a result of the rollout of payment service banks' framework (mobile banking license). This will further narrow margins and necessitate the need to tighten cost items. Additionally, the integration issues that follow a merger of this magnitude will increase operating costs in the short-term. The ability of the new entity to leverage economies of scale and scope will stem from the successful alignment of strategies and subsequent communication to stakeholders. This alignment will shape the organization's culture, which is a critical success factor to thrive in a highly competitive banking environment.

It is also expected that Access Bank will draw from its experiences of successful mergers and acquisitions, such as the acquisition of Intercontinental Bank, to manage expectations of key stakeholders and reap the benefits of this strategic alliance. However, the write-down of nonperforming loans (NPLs) will weigh considerably on the book value of Diamond Bank's equity, reducing the capital strength of the new entity.

Is the banking industry consolidating?

The implementation of IFRS 9 continues to weigh on the balance sheet footing of banks, a key constraint to its ability to generate additional risk assets. This emphasizes the need to strengthen respective capital buffers to withstand regulatory stress tests. However, global monetary tightening and stricter risk governance from the adoption of the Basel 3 Accords will limit most banks' access to foreign capital. Most tier-2 banks will jostle to consolidate, in the bid to leverage customer base, technology and economies of scale.

OPEC and its Growing Irrelevance



After a contentious meeting, the Organization of Petroleum Exporting Countries (OPEC) and its non-OPEC allies decided to adjust overall production by 1.2 million barrels per day (mbpd) from January 2019 in a bid to support crude oil prices.[2] The decision was made in view of the rising imbalance between global oil demand and supply. A review is scheduled for April 2019. Saudi Arabia had initially taken the wind out of the sails of the bullish oil traders by announcing that it would be content with a production cut of just 1mbpd – less than the 1.4mbpd the market had been pricing in. The Saudis cleverly managed expectations by lowering them and blindsiding the market with a larger cut. The additional 200,000bpd triggered a 5% spike in intra-day trading.

Going into the meeting, a "no-deal" scenario was clearly not an option. Qatar's announcement that it was leaving the cartel – the first Arab member to do so - in addition to Iran and Russia clearly not being keen on output cuts, meant that the meeting could hardly have gotten off to a worse start. Oil prices had declined by 22% in November alone to an 11-month low of $58.71pb. Growing US stockpiles and the anticipation of slower demand growth in 2019 continued to dampen prices. OPEC, in its monthly report, confirmed that demand growth was slowing and the danger of oversupply in 2019 was clear and present. The group lowered its forecast for global oil demand in 2019 by 70,000bpd to 1.29mbpd.

[2]Tom DiChristopher and Sam Meredith, Dec 7, 2018. "OPEC and allies agree to cut oil production by 1.2 million barrels per day", CNBC, Energy. https://www.cnbc.com/2018/12/07/opec-meeting-saudi-arabia-and-russia-look-to-impose-production-cuts.html

[3]Business and Economy Section, Dec 8, 2018. "Qatar's breakup with OPEC," Aljazeera, https://www.aljazeera.com/programmes/countingthecost/2018/12/qatar-break-opec-181208080831667.html

Given the circumstances, a 1.2mbpd cut looks highly successful and OPEC seems to have won again. Russia's role in achieving this feat cannot be downplayed. Its willingness to take a larger-than-expected cut is perhaps the most crucial factor in reaching a 1.2mbpd reduction. OPEC will shoulder 800,000bpd while the non-OPEC contribution will be 400,000bpd. Country-specific quotas remain unclear at this time. However, October production levels are to be used as the baseline. Interestingly, Saudi Arabia's October production reached a new high, of 10.630mbpd.[4] Taking 1.2mbpd out of the oil market – from January 2019 – will be far-reaching in significantly narrowing the oil market surplus. It also takes away the uncertainty that has recently beset oil markets. The last few months had seen rising US shale production coincide with Saudi production reaching an all-time high. The production cuts will go some way to ensure that the market surplus does not trigger dramatic short-run price swings.

Nigeria no longer qualifies for exemptions

Under the new agreement, Iran, Libya, and Venezuela have all been given exemptions from production cuts.[5] Iran and Venezuela were both exempted due to the sanctions from the US that they currently face – Iran over the nuclear deal and Venezuela over human rights violations. Asking them to join in the cuts would be grossly insensitive. The US granted exemptions from the sanctions to eight countries importing Iranian oil; these waivers expire in May. Libya continues to grapple with chronic production outages. Exemptions to these three members mean the other members will need to cut output even more. The October 2018 baseline for cuts means that, in theory, the production of the three exempt members could rise to higher volumes than October. This is important to note given that Venezuela recently signed a deal worth $5bn with Russia that will push its oil production by about 1mbpd.

However, Nigeria was not granted an exemption this time around and it is expected to cut its oil output by 3.04% (53,000bpd) to 1.685mbpd for the first six months of 2019. This cut is equivalent to 4.4% of OPEC's planned cut of 1.2mbpd and 3.04% of Nigeria's reference level oil output of 1.738mbpd (November's oil output level). Oil revenue is projected to fall by at least the equivalent unless it is offset by higher oil prices. It will have a negative impact on Nigeria's balance of trade – currently at a surplus of $1.87bn in the third quarter of 2018, and this will further exacerbate naira vulnerability.

[4]Julianne Geiger, Dec 7, 2018. "Libya, Iran, Venezuela Secure OPEC Production Cut Exemptions," oilprice.com, https://oilprice.com/Latest-Energy-News/World-News/Libya-Iran-Venezuela-Secure-OPEC-Production-Cut-Exemptions.html
[5]Julianne Geiger, Dec 7, 2018. "Ibid."

Risk of a Free Fall

A downside risk to the cuts by OPEC and its allies is that they could find it very challenging returning to the market. Typically, whenever agreements between cartel members fail, a disorderly market emerges. The battle for market share threatens to upend the cartel as individual members may abandon allocated quotas and compete among themselves and against US shale drillers. The ensuing free for all could result in a price war as it did in February 2016 when oil prices plunged below the $30pb threshold.

This cut will free up market share and allow US shale producers to raise output and move into a position of oil dominance. It gives US shale producers even more incentive to increase production, and they have, as the US is now the world's largest producer of crude oil[6] – also projected to hit 12.4mbpd by December 2018. If OPEC leaves prices low, it suffers. If it cuts production to raise prices, it loses market share. To some it may sound like a lose-lose situation.

The notion that Trump's $110bn arms deal[7] with Saudi Arabia would allow him to dictate what OPEC does has been dispelled rather quickly. How Trump and the US government react to OPEC is another piece of the uncertainty puzzle. Following the murder of Jamal Khashoggi[8] and the resultant international outrage, Trump appears to be one of the few friends the Saudis have left. If prices rise too high, all bets are off.

Outlook

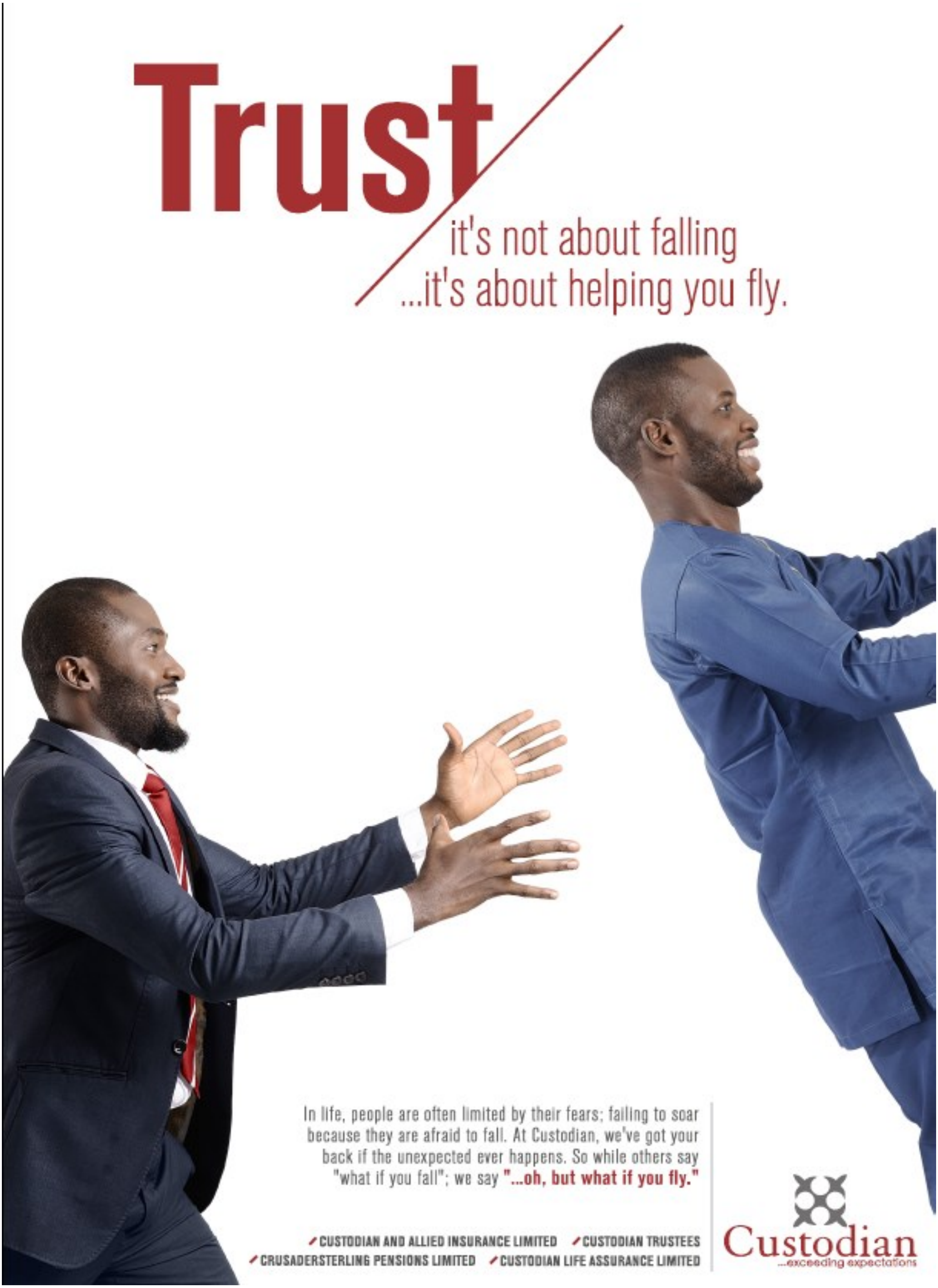
A crisis scenario may be on the horizon. The on-going production surge from countries like the US and Brazil means the perceived oil glut is not about to disappear. OPEC's production cut is at best a short-term solution to stabilize prices and push them back over $70pb. There is still no clear strategy to draining the growing global glut. There is also the possibility of the US-China trade war escalating and a possible hard Brexit which will have a negative effect on the demand for oil in 2019.

Few things are clear at this point. OPEC needs a new strategy and it must include the Russians. Achieving oil market stability without an alliance with Russia appears impossible so strengthening Saudi-Russian ties (economic and military), at a time when relations with the West are deteriorating, can only be a plus.

[6]Gaurav Sharma, Dec 10, 2018. "OPEC's output cut not enought to provide short-term $70 oil price floor," Forbes. https://www.forbes.com/sites/gauravsharma/2018/12/10/opecs-output-cut-not-enough-to-provide-short-term-70-oil-price-floor/#121252ed8d58

[7]Tom O'Connor, Nov 26, 2018. "US does not need Saudi Arabia military sales as much as Donald Trump says, reports show," Newsweek, https://www.newsweek.com/us-not-need-saudi-military-sales-trump-says-1232147

[8]Shane Harris, Greg Miller and Josh Dawsey, Nov 16, 2018. "CIA concludes Saudi crown prince ordered Jamal Khashoggi's assassination," Washington Post. https://www.washingtonpost.com/world/national-security/cia-concludes-saudi-crown-prince-ordered-jamal-khashoggis-assassination/2018/11/16/98c89fe6-e9b2-11e8-a939-9469f1166f9d_story.html


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."
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...exceeding expectations

Oil & Gas: Upstream

Global Developments

Brent crude traded at $67.06pb in November, 16.83% lower than the October average of $80.63pb. Currently, crude prices are trading at $54.29pb, after falling below $50pb for the first time in 2018. This was in response to weak global demand and a supply glut. The anticipation of slower demand growth in 2019, coupled with rising US stockpiles and the granting of waivers for some importers of Iranian oil, have weighed heavily on the price of Brent crude.

OPEC, in its monthly report, confirmed that demand growth is slowing and there is a threat of oversupply in 2019. The group lowered its forecast for global oil demand in 2019 by 70,000bpd to 1.29 million bpd from an initial forecast of 1.5 million bpd. It also agreed with its allies to cut production by 1.2mbpd. Nigeria was finally included in the output cuts and is expected to reduce its production by 40,000bpd.

In addition, Qatar, one of OPEC's smallest oil producers but the world's biggest liquefied natural gas (LNG) exporter, has disclosed its decision to quit the cartel from January 2019, to focus on developing its natural gas production in the coming years. Qatar joined OPEC in 1961, one year after the organization's establishment. However, since 2013, the amount of oil Qatar produced has steadily declined from about 728,000 barrels per day in 2013 to approximately 607,000 barrels per day in 2017. Qatar is a longstanding member of the oil cartel and this could undermine the bid to show a united front before a meeting that is expected to back a supply cut to shore up crude prices. However, we do not expect its exit to have a significant impact on prices or production as it is a fringe player.

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Outlook

We expect oil prices to trade lower in December. The Organization of the Petroleum Exporting Countries (OPEC) is scheduled to meet in Vienna on December 6 to discuss production cut targets. Saudi Arabia is expected to push for a production cut of up to 1.4 million bpd. However, we do not expect the supply cut to stem the slide in crude prices.

Domestic Production

According to OPEC's October oil report, Nigeria's oil production decreased by 1.13% to 1.75mbpd in October, from a revised figure of 1.77mbpd in September. Nonetheless, crude oil production averaged 32.90mbpd in October, an increase of 127,000 bpd over the previous month. Crude oil output increased mostly in the UAE, Saudi Arabia, Libya and Angola, while production declined in Iran, Venezuela, Kuwait and Nigeria. Despite the drop in production, Nigeria's oil rig count increased to 15 in October from 14 in the previous month.

According to Baker Hughes, the global rig count for November 2018 was 2266, down by 5 from the 2271 in October 2018, and up 209 (10%) from 2057 a year ago. The average U.S. rig count for November 2018 was 1,077, up by 15 from the 1,062 counted in October 2018, and up 166 (18.2%) from the 911 counted in November 2017. In Nigeria, the number of operational oil rigs fell from 15 in October 2018 to 9 in November 2018 – in line with the global trend. This is reflective of the bearish investor sentiment that has beclouded the oil market since reports of a glut surfaced amid projections of slowing demand growth in 2019.

Outlook

Given the sharp decline in crude oil prices in the month, there is a high probability that OPEC could allocate production cuts amongst its members to forestall a further decline in prices. Nigeria might see its output quota lowered below the current cap of 1.8mbpd.

According to loading programmes seen by trading sources, expectations are for exports of Nigeria's Bonny Light crude to fall to a two-month low in January. Bonny Light shipments will fall to 214,500 bpd in January from 263,483 bpd in December, based on a schedule that contains seven 950,000-barrel cargoes, compared with December's programme that contained nine cargoes. Spot trade has been fairly slow in the Nigerian market in the past couple of weeks, due in part to a fairly large number of unsold cargoes that have prevented differentials from gaining any upward traction.

Implications

At $55pb, Brent oil is 8.33% below the 2019 budget oil benchmark of $60pb. Oil receipts represent a significant proportion of Nigeria's revenue. A sustained decline in oil prices could erode Nigeria's trade surplus and render budgetary obligations unattainable. It would also limit forex inflows and constrain the CBN's ability to continue its interventionist strategy in the face of pressure from capital flow reversals, which could lead to a further depreciation of the currency.

The United States Federal Reserve Bank raised its interest rates by 25bps to 2.25%-25% and is expected to increase rates three more times in 2019. Capital flow reversal is expected to intensify as a result and the stronger US dollar will also have a depressing impact on oil prices and, in turn, government revenue.

Telecommunication - Back in the Driver Seat

In recent time, the Nigerian telecommunication sector has been faced with a myriad of challenges, most especially the regulatory high handedness on the industry's leading player, MTN. In spite of these challenges and the country's weak and tepid recovery, some noteworthy developments occurred in November. Teleology's acquisition of 9mobile was finalized and MTN declared its intentions to offer mobile banking in 2019 with Airtel likely to follow suit. In addition, the Q3 banking credit to sectors report was released. While the overall credit to sectors increased, allocations to the information & communication sector declined. Nonetheless, the telecoms sector remained one of the fastest growing at 14.97% in Q3.

The telecoms subscriber base is growing, internet services receiving increasing attention

According to the NCC's latest data, the total number of subscribers, internet subscribers and teledensity increased in the month of October. The telecoms subscriber base was up 1.96% to 165.24mn with teledensity rising to 118.03% from 115.76% in September. Total internet subscribers also advanced by 10.5% to 107.11mn from 105.98mn in September. The increase in total internet subscribers was witnessed across the players in the industry with the exception of 9mobile. More importantly is the fact that the rise in the total number of internet subscribers surpassed the increase in the overall subscribers' base, revealing the growing sophistication of customers. If this increase is sustained in 2019, it could play a crucial role in facilitating the Mobile Network Operators' (MNOs) mobile banking operations.

Credit to the private sector up in Q3; allocations to the telecoms sector down.

In Q3, the total credit to the private sector was up 1.62% to N15.59trn. The oil & gas (N3.6trn) and manufacturing (N2.15trn) sectors received the bulk of these credit allocations, accounting for 23.08% and 13.79% respectively, an increase from 25.52% and 13.16% in the previous quarter. However, credit allotment to the information & communication sector fell by 9.54% to N736.84bn, representing 4.73% of the total compared to 4.86% in Q2.

Additionally, the total volume and value of electronic payment transactions increased to 563.05mn and N33.96trn in Q3 from 509.67mn and N33.96trn respectively in Q2. As usual the Automated Teller Machine (ATM) transactions had the largest share accounting for 39.12% and 4.69% of total volume and value of transactions respectively.

Implications

The decline in the credit to the telecoms sector would limit the availability of funds for expansion and investment purposes. To bridge this gap, telecoms operators could consider securing foreign loans. However, the depreciating exchange rate could pose some threats.

Recent Developments in the Sector

Teleology Holdings finally acquires 9mobile; Commenced debt repayments to banks

Sequel to the fulfillment of the technical and financial capability requirements, Teleology Holdings Limited has been issued a final approval of no objection by the board of Nigerian Communications Commission (NCC) to take over the management of 9mobile. The decision comes approximately eight months after the initial non-refundable payment of $50 million. Following this decision, a new board of directors was constituted to resuscitate the distressed mobile network operator (MNO). The new board, chaired by Mr Nasiru Ado Bayero, took over from the interim board which was appointed by the Central Bank of Nigeria (CBN) to manage the firm during the bid and payment negotiations process.

Following the successful transfer of ownership to Teleology, 9mobile has commenced debt repayments to the consortium of banks. The total owed is $1.2bn.

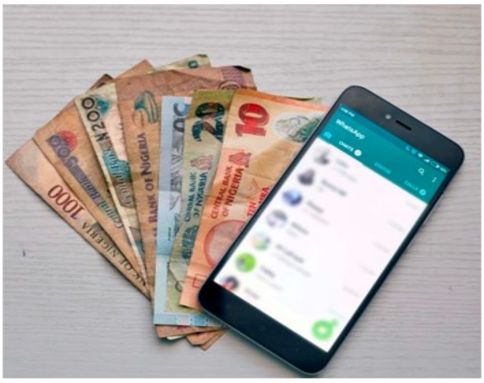
Meanwhile, Etisalat's ownership has become a subject of political acrimony. The presidential candidate of PDP, Atiku, has requested an inquiry into the ownership structure of Etisalat and Keystone bank, based on reports stating that members of President Buhari's family own substantial shares in the telecoms company.

Implications

We anticipate new capital investments to improve the quality of service for customers, encourage healthy competition amongst the MNOs, and help the industry increase its penetration rate which is currently at 22%. Currently 9mobile has the lowest market share (10%) having lost approximately 7.1mn internet subscribers since it touched its peak of 17.19mn in Apr'16. The commencement of debt repayment to the consortium of banks also signals the possibility of debt settlements to telecom infrastructure firms in the near term.

MTN to offer mobile banking in Nigeria in 2019

MTN Group has declared its intention to apply for a mobile banking license and launch mobile money services in Nigeria in 2019. This decision was announced after the CBN released its guidelines for licensing and regulating payment services. The telecoms operators are now allowed to serve as promoters of payment services via a subsidiary company.



Implications

The decision to commence the mobile banking payment system has its pros and cons. While it is positive for deepening financial inclusion, improving the efficiency of the payment system and increasing the velocity of money, it could pose some threats to deposit money banks' transaction fee income.

Construction Sector Report

Highlights

Julius Berger pledged to open all diversions along the Lagos/Ibadan express way during the December festivities and also rehabilitate all the bad portions on the road. This attempt would be remarkable as it is expected to ease traffic flow along the busy road at this period. The federal government of Nigeria also unveiled plans for a rail line running from northern Nigeria into the neighboring Niger Republic. In SSA, the Ghanaian government has signed a Memorandum of Understanding (MoU) with Africa Investment (AI) to construct the Accra Sky Train project. The project is expected to cost approximately \$3bn or 5.1% of Ghana's rebased GDP (\$58.9bn).

Nigeria

FRSC announces measures to ease traffic during Yuletide

The Federal Road Safety Corps has disclosed that Julius Berger Nigeria Plc, the construction company reconstructing the Lagos to Shagamu section of the Lagos/Ibadan Expressway, would open all diversions along the express way during the December festivities. The construction company would also rehabilitate all the bad portions on the road that cause gridlock. These are part of measures to ease traffic congestion during the Yuletide.

Implications

The month of December typically witnesses a surge in road traffic as people travel to celebrate with families and friends. One of the busiest routes in the country during this period is the Lagos/Ibadan expressway. It is a major route that serves commuters travelling from Lagos to Ibadan and other towns in Oyo State. The road is also explored by travelers heading to Osun State, Kwara State and other parts of Southern, Northern and Eastern Nigeria. As a result of its versatility, the Lagos/Ibadan express way is usually congested in December which lengthens travel hours for commuters. Julius Berger's decision to open all diversion routes and rehabilitate new routes is a welcome development. This would translate to freer flow of traffic and less travel hours along the road.

FG commences probe of construction sites

The Federal Government of Nigeria has commenced the audit of construction sites in the country. This exercise is intended to ascertain the level of compliance with Executive Order 5, which is targeted at improving local content in public procurement. The implementation committee of the executive order set up by the Ministry of Power, Works and Housing had started work. The committee had conducted a snap audit of 77 works construction sites and 50 housing sites. The ministry currently awaits the findings of the committee.

Implications

The commencement of a compliance audit affirms the commitment of the administration towards raising local content in infrastructure projects. Contractors and companies that would take up projects in future would be cautious of this. A reduction in foreign input in construction would limit forex outflows from Nigeria.

Nigeria plans railway to Niger Republic

The Federal Government of Nigeria has unveiled plans for a line running from northern Nigeria into the neighboring Niger Republic. The 248KM standard gauge route from Kano (Nigeria) to Maradi (Niger Republic) would also serve Nigeria's northern provinces of Jigawa and Katsina. The rail line will pass through Dutse, Kazaure, Daura and Katsina. The line is being developed by the governments of both countries in a partnership. The rail is part of efforts to promote regional integration and trade between the two countries.

Implications

In line with the rationale cited, the rail project is expected to boost trade flows between Nigeria and Niger Republic. Major exports to Niger Republic from Nigeria include cements and cigarettes. However, insecurity concerns in the Northern region of Nigeria and Niger republic would threaten the completion of the project.

SSA

Ghana signs $3bn deal for sky train project

The Ghanaian government has signed a Memorandum of Understanding (MoU) with South African firm Africa Investment (AI) to construct the Accra SkyTrain project at a cost of $3bn. Ai SkyTrain Consortium would conduct the feasibility assessment of the project and construction is expected to start by January 2020. The Sky Train Project is expected to contain increasing traffic congestion in Accra, Ghana. The SkyTrain is expected improve the city's public transport system through an elevated light railway system, which would reduce transportation costs.

Implications

The construction of the SkyTrain would be a major infrastructure milestone in Ghana as the country deals with rapid urbanization. Ghana's urban population has grown over the last 10 years to 55.41% in 2017.[9] In addition to urbanization management, the project would come with economic benefits. The proposed cost of the project represents approximately 5.1% of Ghana's rebased GDP. This investment is expected to have a positive multiplier effect on Ghana's GDP, which would consolidate macroeconomic stability in the country. Ghana is currently one of the fastest growing economies in West Africa.

Outlook

Political parties' campaign for the 2019 presidential and NASS elections commenced on November 18. This is expected to birth several infrastructure pledges. Meanwhile, given that electorates mostly premise their decisions on the previous delivery of each political party, we are likely to see the expedition of some abandoned projects. These are indications that the Nigerian construction industry would be more eventful in Q1'19.

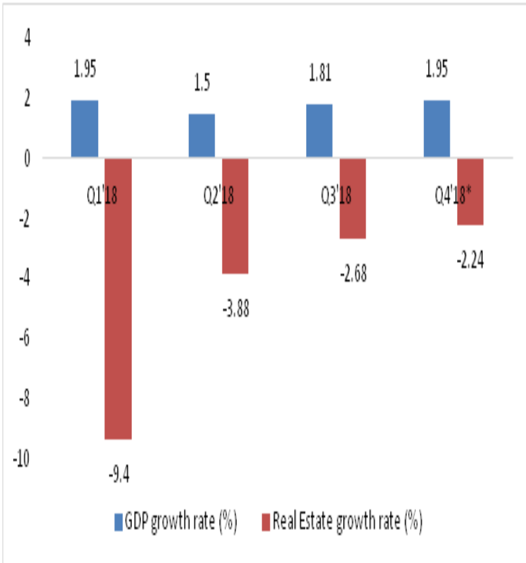
[9]Available at https://www.statista.com/statistics/455827/urbanization-in-ghana/

Review of the Nigerian real estate market in 2018

Activities in the real estate market improved marginally in 2018, although still growing at a negative rate of -2.68% in Q3'18 from -3.88% recorded in Q2'18. The sub-optimal growth rate recorded in Q3'18 could be attributed primarily to the peak of the rainy season which slowed activities within the sector. The sector's contribution to GDP declined from 6.83% in the preceding quarter to 6.5% in Q3'18. Challenges such as high interest rates, security concerns, dwindling consumer purchasing power and exchange rate volatility affected the sectoral activities.

Economic Trends in 2018 and its implications on the Real Estate sector

Depreciation in the Naira: The naira came under pressure in Q4'18 as speculative demand increased in the parallel market. The naira depreciated to a high of N374/$ before retreating to between N365-N366/$. This is likely to lead to an increase in the price of luxurious properties in the near term. Subsequently, the demand for such properties may reduce.



Performance of real estate companies in Nigeria

Reversal of the downward trend in headline inflation: After declining for 18 consecutive months, headline inflation inched upwards to 11.23% in Q3’18. Currently, Nigeria’s headline inflation rate is at 11.28% (November). Typically, consumers invest in the real estate sector as a hedge against inflation. The uptick in inflation increases the appeal of real estate as an investment choice.

Dwindling consumer purchasing power: The purchasing power of Nigerian consumers was negatively affected in 2018 following the uptick in certain commodity prices including cement. The price of cement increased by 1.96% to N2,600/kg in Q4’18. A decline in consumer purchasing power would likely have a negative impact on the real estate sector as demand for properties slows.

Anti-corruption fight: The current administration’s anti-corruption fight resulted in a clamp-down of high-profiled individuals and an increase in abandoned properties.

Domestic Developments

Companies	Price as at October 31, 2018	Price as at November 30, 2018	Directional change
UPDC	N8.10	N8.10	↔
UAC Property	N1.77	N1.57	↓
Union Homes	N45.20	N45.20	↔
Skye Shelter Fund	N95.00	N95.00	↔

Banking credit to the real estate sector declines to N710.2bn in Q3’18

According to the National Bureau of Statistics, banking sector credit to the real estate declined by 4.61% to N710.2bn in Q3’18 from N744.56bn in Q2’18. This is the second consecutive quarter of a decline in banking credit to the sector since Q1’18. This is indicative of banks reducing their exposure to the real estate sector despite the improvement in the growth rate of the sector. In the coming quarters, we expect banking credit to the real estate sector to remain around current levels. This would likely keep the growth rate of the sector in negative territory.

Currently, there are four companies, UPDC, UAC Property, Union Homes and Skye Shelter Fund, listed on the Nigerian Stock Exchange. In the period between October 31 and November 30, share prices of all but UAC Property remained flat. UAC Property share prices declined by 11.30% to N1.57.

Outlook for real estate in 2019

2019 will be divided into 2 halves:

- H1'19 will be strictly focused on politics and the general election in February
- H2'19 focused on economic related issues

The real estate sector in 2019 will be dependent on the dynamics of the 2019 elections. Ahead of the election, activities in the sector will remain status quo with minimal new developments. However, any violence ensuing from the election would slow activities in various sectors including real estate. After the election, it is likely that a tighter monetary policy stance could be adopted. If this happens, developers could be further constrained which is negative for the sector's growth rate in 2019.

Oil, Populist Leaders and the Dollar Guide to Emerging Market Risks in 2019

Emerging markets are tentatively picking themselves up from the floor after a rout that's wiped about $5 trillion off the value of stocks since January. But the reprieve may not last long.

Rising rates in the U.S., a stronger dollar, Beijing and Washington's trade war, lower oil prices and the emergence of populist leaders in Latin America's two biggest economies could all weigh on markets.

"The theory is dead simple: emerging-market assets have already bombed, so the downside, if things get worse, is much lower and if things recover they have greater potential to perform," said Anthony Peters, an independent analyst, formerly at Blockex Ltd., who's long covered developing nations. However, "they have the potential to go much lower for much longer than anybody had ever thought possible."

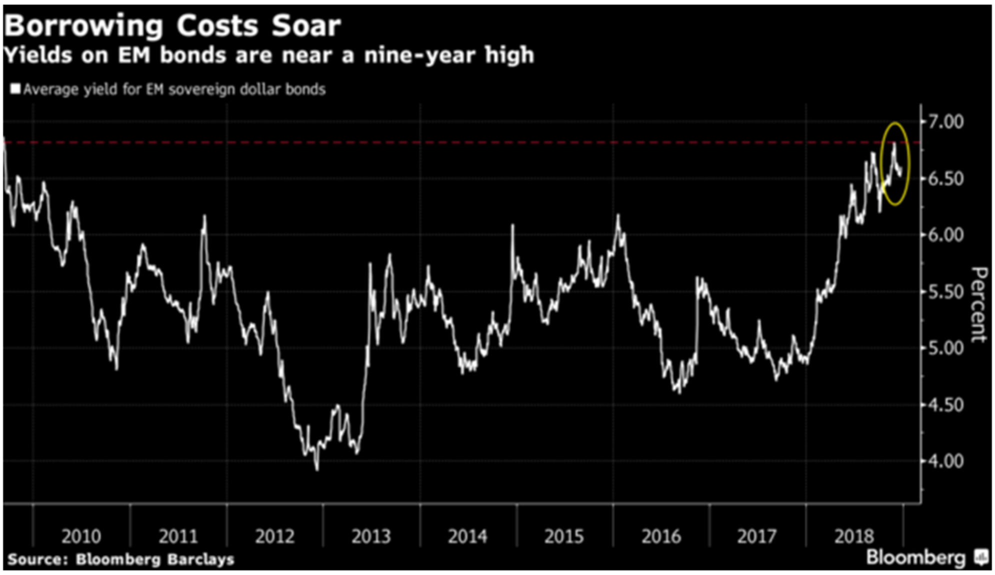
The Fed and the Dollar

Investors will be carefully watching the U.S. Federal Reserve after Chairman Jerome Powell wasn't as dovish as they'd hoped in comments that followed the central bank's interest-rate increase on Dec. 19.

A report said President Donald Trump has repeatedly discussed firing the central bank chief, but Treasury Secretary Steven Mnuchin moved to reassure financial markets that Federal Reserve Chairman Jerome Powell wouldn't be ousted.

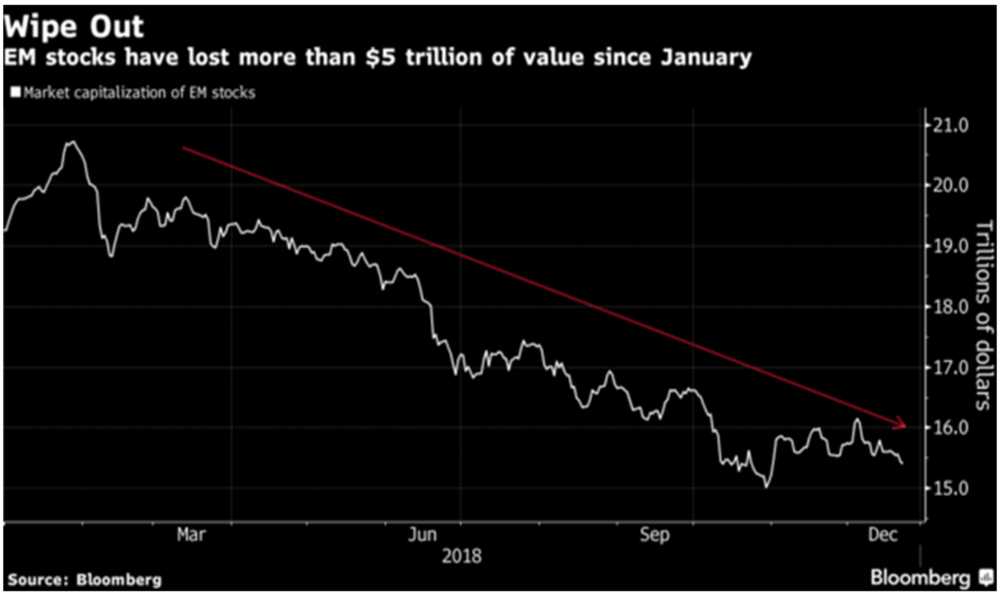
Added to that, the European Central Bank is set to end asset purchases that have pushed billions of euros into higher-yielding markets such as Poland and Hungary. That may force eastern European monetary authorities into rate increases they've long resisted.

In emerging Asia, economies heavily reliant on foreign investments, such as Indonesia, will face the challenge of maintaining currency stability and stemming outflows.



Trade Wars and China

Chinese President Xi Jinping remains defiant, telling some of the nation's most influential military and business figures that Beijing won't back down quickly to U.S. trade and investment demands. Any increase in tensions between the world's two dominant economies would probably deal a blow to Asian assets. They've already taken a hit, with China's main stock index on track for its worst year since 2008 and equities in South Korea and Taiwan also falling sharply.



Populists

Brazil and Mexico will start 2019 with new populist presidents, albeit from opposite ends of the spectrum. Brazilian stocks have risen to record highs after President-elect Jair Bolsonaro said he'd sell dozens of state-owned companies and picked University of Chicago-trained Paulo Guedes as his chief economic adviser. Still, the right-winger faces a tough challenge reforming the country's generous and exhausted pension system, which will be key to sustaining the market rally.

In Mexico, leftist Andres Manuel Lopez Obrador has traders on edge after cancelling a $13 billion airport. Some concerns diminished after he published a conservative fiscal plan for 2019 and after bondholders accepted Mexico's offer to buy back $1.8 billion of debt used to fund the airport's construction. Nonetheless, investors will watch to see if the president can maintain a primary budget surplus even while spending more on social programs.

Russian Sanctions

Even after the U.S. Treasury said it's ready to lift sanctions on one of Russia's biggest companies, United Co. Rusal, investors will be wary of moves by Congress. If Special Counsel Robert Mueller's investigation into the Kremlin's interference in the 2016 American election reaches a damning conclusion, that could trigger new penalties, including restrictions on trading Russian sovereign debt or banks.

Saudi Oil Woes

Brent crude's plunge since early October to below $55 a barrel is bad news for many major developing economies, not the least Saudi Arabia. It needs prices as high as $95 per barrel to balance its 2019 budget, according to Bloomberg Economics. The financial squeeze -- combined with the Western backlash over columnist Jamal Khashoggi's murder in Istanbul -- means that MSCI's decision to include Saudi stocks in its emerging-market index from next year might not be enough to attract the investment the kingdom desperately needs.

Elections

There are plenty of upcoming polls to keep traders on edge. Indians vote in a general election in April or May and analysts at Credit Suisse Group AG say markets haven't priced in the risk of a coalition government emerging, which could derail Prime Minister Narendra Modi's economic reforms.

Thailand is set to hold a vote Feb. 24 after several delays since the ruling party took over in a bloodless military coup in 2014, and investors are worried about the prospect of social unrest. Indonesia's turn is April 17 -- a rematch between President Joko Widodo and his rival Prabowo Subianto.

In Argentina, Mauricio Macri, who's popular with foreign investors, faces an election in October. With the economy in a recession and inflation at almost 50%, investors are concerned that voters may turn to former populist President Cristina Fernandez de Kirchner.

South Africa's election in May will be a key test for President Cyril Ramaphosa. If his party fails to win a significant majority, he may be forced to delay market-friendly reforms such as revamping debt-laden state companies by retrenching workers or selling assets. That could trigger a credit-rating downgrade and billions of dollars of outflows, according to Citigroup Inc.

Nigerians vote in mid-February. Their main choice is between President Muhammadu Buhari, who's struggling to buoy an anaemic economy, and former Vice President Atiku Abubakar, seen as more pro-business but who's long been dogged by allegations of corruption, which he's denied.

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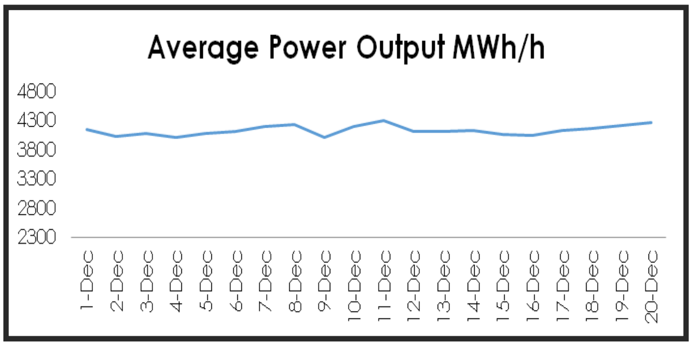
Macroeconomic Indicators

Power Sector- stays above 4,000mw

Average power output from the national grid increased by 2.68% to 4128.40MWh/h in the review period of December 1st -20th from the corresponding period in November. This improvement was largely driven by amplified gas supply to GenCos and a decline in losses at the transmission level. Also this is the period of harmattan. The colder temperature requires less use of air conditioners and hence, reduced demand for power.



[10]

Outlook

It is expected that average power output will remain around the current level of 4,000MWh/h – 4,300MWh/h in the next few months due to cooler temperatures.

Money Markets- NIBOR spikes on illiquidity

Average NIBOR (OBB, O/N) increased sharply to 26.05% pa, from 5.61% pa in the corresponding period in November. Interbank interest rates spiked to a high of 65% pa and 70.92% pa respectively on December 11. This was due to the CBN's wholesale forex auction.

At the interbank market, the average opening position was N90.79bn between 4th - 20th December. This is, however, 82.76% lower than the average long opening position of N526.52bn between 1st – 19th November. Liquidity in the banking system also declined to a negative position for 4 days in the review period. The decrease in the opening position indicates a reduction in market liquidity. During the period, the CBN issued more OMO bills of N1.43trn against a maturity of N1.18trn. The net outflow of N250bn is less than N828.29bn in the corresponding period in November as the CBN sold N1.65trn OMO sales and N821.06bn OMO maturity in the corresponding period in November.

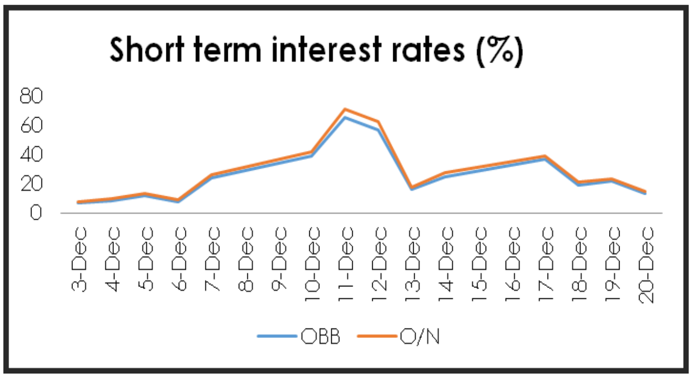
In the secondary market, the 182-day and 364-day T/bill yields increased by an average of 40bps, while the 91-day T/bill yield fell by 56bps during the period.

[10]FGN

The Nigerian Inter-Bank Treasury bill True Yield (NITTY) rates all increased by an average of 70bps during the review period. However, there was no primary market auction during the period under review

Tenor	Secondary market (Dec 3rd, 2018) (%)	Secondary market (Dec 20th, 2018) (%)	Tenor	NITTY Rate as at Dec 3	NITTY Rate as at Dec 13
91-day	13.54	12.98	30-day	13.76%p.a	15.01%p.a
182-day	12.50	13.05	90-day	13.79%p.a	14.55%p.a
364-day	14.63	14.87	180-day	14.20%p.a	14.29%p.a

[11]



[12]

Outlook

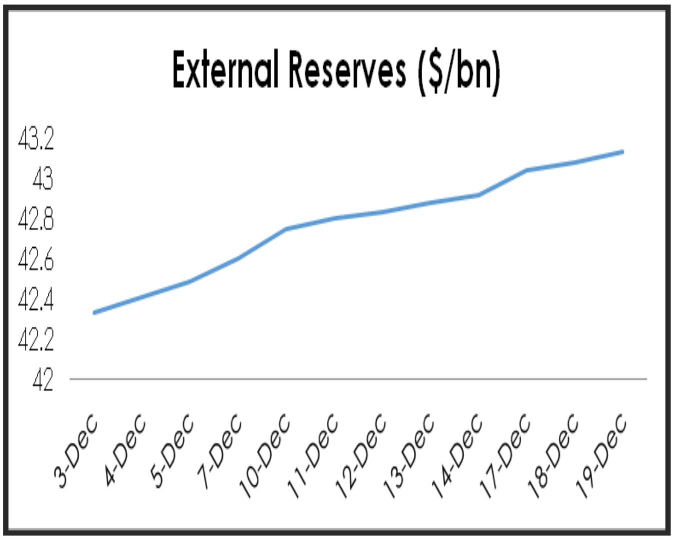
We expect the CBN to continue with its liquidity management measures. This coupled with the funding for forex interventions will keep the markets fairly liquid.

External Reserves

Nigeria's gross external reserves rose to $43.13bn on December 19th, 1.89% higher than the level of $42.33bn on December 3rd. The accretion occurred as a result of the drawdown in Eurobond proceeds. The import cover has increased from 10.54 months to 10.74 months.

Outlook & Implications

The recent accretion is temporary. We expect the CBN to defend the currency at all costs at the detriment of the external buffers. Also, due to lower oil prices and the anticipated decline in Nigeria's oil production (OPEC quota of 1.685mbpd), oil proceeds and ultimately forex revenue would reduce, impacting the reserves negatively



[13]

[11] FDC Think Tank
[12] FMDQ
[13] CBN

Forex Market

The Nigerian forex market is segmented with multiple exchange rates. The most important rate being that of the IE window. No less than 55%-60% of Nigerian forex transactions are traded at this window. The CBN and most exporters and investors patronize this window. It serves not only as a source of price discovery but also a barometer for measuring potential and actual CBN intervention in the market. The exchange rate determinants are balance of payments, capital inflows and trade balance. These have been declining. In Q3, Nigeria's balance of trade surplus narrowed by 67.6% while capital importation declined by 48.21%. Nonetheless, Nigeria's terms of trade are improving as the change in export prices (predominantly oil) far outweighs the price change of its imports.

Parallel Market

At the parallel market, the naira recorded aberrational movement. The naira opened the month at a 15-month low of N370/$ on December 3rd, before appreciating to close at N364/$ on December 28th. The aberrational movement was driven by increased speculative demand, ahead of the 2019 elections and Christmas season. There were dollar inflows from visiting family and friends but this had a limited impact on the volatility of the exchange rate.

Spot & Official

At the interbank foreign exchange market, the naira depreciated marginally by 0.03% to close at N306.95/$ from N306.85/$ on December 3.

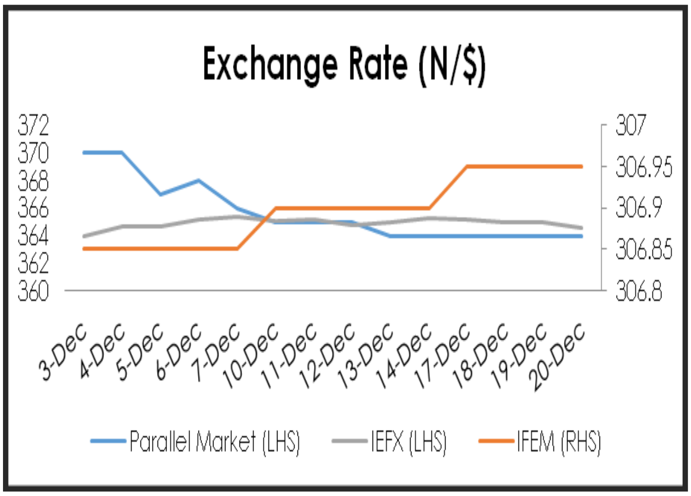
IE Window

At the IEFX window, the naira also depreciated by 0.16% to close the month at N364.57/$.

The value of the CBN's forex intervention fell by 99.91% in the review period to $630.02mn from $1.08bn in the corresponding period in November. However, the total turnover at the IEFX window in December was 92.04% higher at $3.86bn.

Outlook

The currency is expected to trade flat at N365/$ in the coming weeks. The US Federal Reserve, at its last meeting, increased its interest rates to 2.25% - 2.5% pa. This increase could intensify capital outflows from emerging markets such as Nigeria. Also, we expect a buildup in currency pressure post the election as the CBN is expected to defend the naira at all costs before the election. The exchange rate is also a politically sensitive variable and would be closely watched by investors and the public.



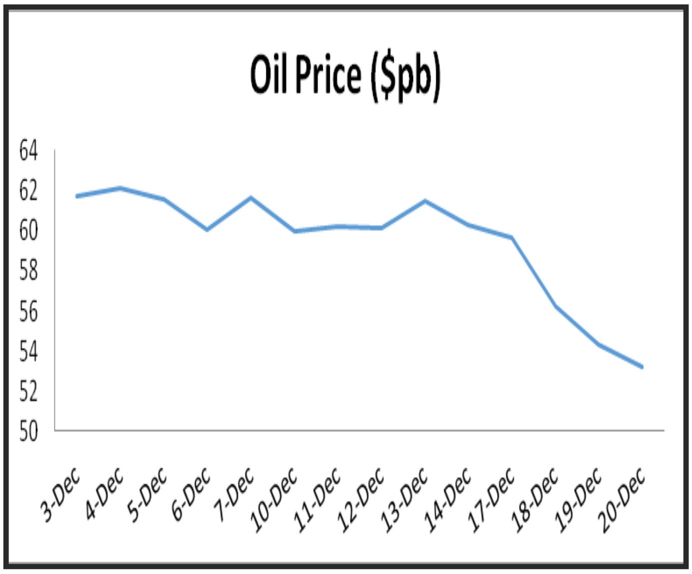
[14]

COMMODITIES MARKET - EXPORTS

Nigeria is an export dependent economy. It derives over 80%-90% of its export revenue from crude petroleum and LNG.

Exports- Crude Oil

The price of Brent fell sharply by 13.51% to settle at $54.35pb on December 20th from $61.69pb on December 3rd. This was due to the substantial increase in the global oil supply from top producers, the EIA forecast of an increase in shale oil production and the interest rate hike by the US Fed.



[15]

Outlook

We expect oil prices to remain bearish in coming weeks due to weakening demand, a deepening sense of global economic gloom, monetary policy normalization in the US and expected increases in shale production. However, we expect oil prices to be within the range of $50pb-$53pb.

[11]FMDQ, CBN, FDC Think Tank
[12]Bloomberg

Impact on Nigeria

The sharp drop in Brent price, which is at least 10% below the oil price benchmark in the 2019 budget, would reduce Nigeria's oil revenue by at least 5– 10%. A decline in government revenue would negatively affect FAAC disbursements and increase salary backlogs to over 7 months. The fiscal deficit could widen beyond the fiscal responsibility act of 3% of GDP and this would require increased borrowing to fund the revenue gap. Nigeria currently spends at least 65kobo of every naira earned to service its debt.

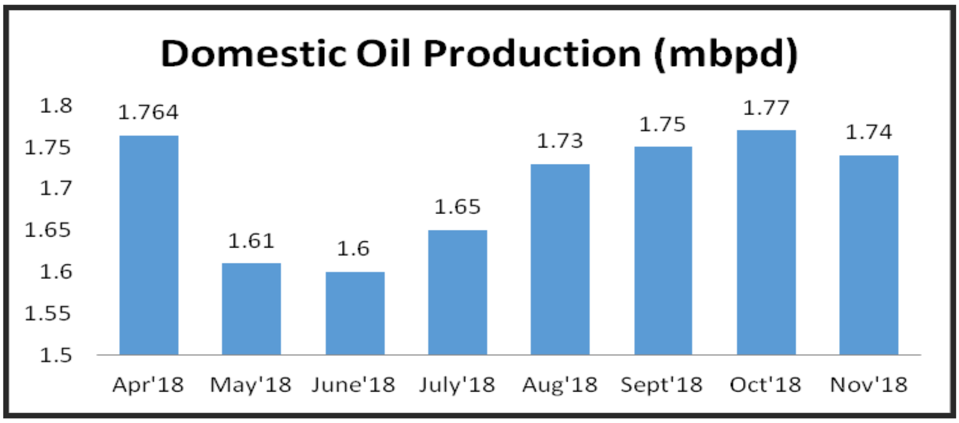
The external profile would also be affected. The narrowing of the trade surplus recorded in Q3 could worsen into a deficit position if oil prices should fall further. The terms of trade are also at risk of falling from the current level of 49.2.

Oil Production

According to OPEC's monthly oil report, Nigeria's oil production decreased by 1.64% to 1.74mbpd in November from 1.77mbpd in October. During the period, global crude oil production averaged 32.97mbpd in November, a drop of 11,000 bpd over the previous month. Crude oil output increased mostly in Saudi Arabia, UAE and Kuwait, while production declined in Iran, Venezuela, Nigeria and Iraq. Nigeria's oil rig count fell sharply to 9 in November from 15 in October.[16]

Meanwhile, after the 5th OPEC and non-OPEC Ministerial Meeting which was held in Vienna, on December 7. OPEC and its non-OPEC allies decided to adjust the overall production by 1.2mbpd, effective as of January 2019 for an initial period of six months. This was in view of a growing imbalance between global oil supply and demand in 2019 and in a bid to support crude oil prices

Nigeria, was not granted an exemption as its quota was cut by 53,000bpd to 1.685mbpd.



[17]

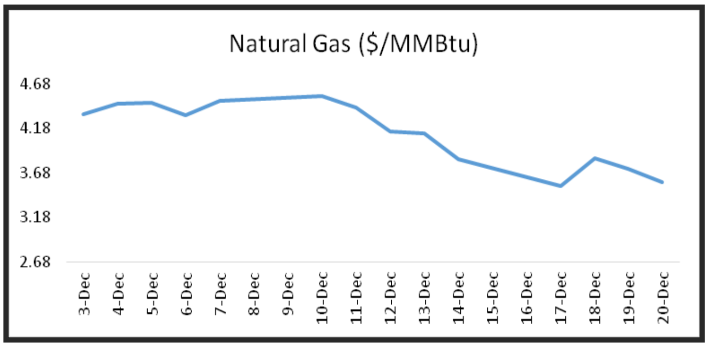
[16]Bakers Hughes
[17]OPEC

Outlook

This cut is equivalent to 3.3% of OPEC's planned cut of 1.2mbpd and 2.4% of Nigeria's oil output. Lower oil rig count suggests a potential decline in domestic oil production in December, this coupled with OPEC's decision to include Nigeria in its output cut implies that oil production will decline in the near term.

LNG

Natural gas lost 3.85%, to close at $3.58/mmbtu on December 20th, from $4.34/mmbtu on December 3rd. The bearish trend in the gas market was primarily influenced by low consumption due to lower than normal temperatures and higher production.



[18]

Outlook

Natural Gas prices are expected to increase in the near term due to extreme cold weather.

Impact on Nigeria

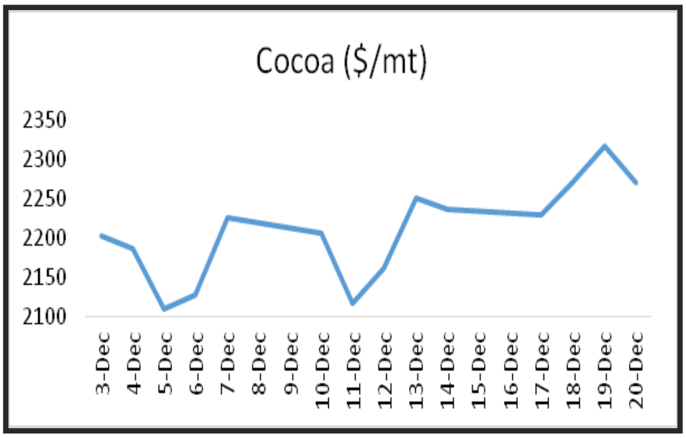
Nigeria is ranked the 2nd highest producer of natural gas in Nigeria after Algeria. An increase in global natural gas prices would increase Nigeria's export revenue in the near term.

Nonetheless, Qatar plans to double its production target from the North Field to 4bn cubic feet per day in 2023. This will increase the supply of natural gas global and reduce its price.

Cocoa

Cocoa prices gained 0.48% to $2,271/mt on December 20th, from $2,203/mt on December 3rd. The increase in price was partly due to higher demand of the commodity during this festive period and harsh weather, which weighed on the main crop harvest in Ivory Coast and Ghana, the major exporters of cocoa.

[18]Bloomberg



[19]

Impact on Nigeria

Nigeria is the 4th largest producer of cocoa in SSA. A bullish outlook of global cocoa prices would boost Nigeria's export revenue, reflecting positively in business proxies such as FAAC disbursements.

Outlook

The bullish trend in cocoa prices is expected to be sustained in the coming weeks. This will be driven by higher demand as a result of the end-of-year festivities and poor main crop yield in West Africa. Prices are thus expected to remain around $2,250-2,500/mt.

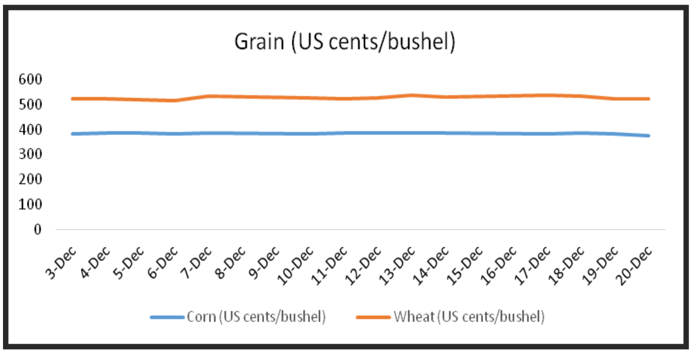
COMMODITIES MARKET - IMPORTS

Wheat

Wheat prices gained 0.58% to $5.24/bushel on December 20th, from $5.21/bushel on December 3rd. The increase was as a result of the export ban in Russia, a leading exporter of wheat.

Corn

Corn prices increased by 1.11% to $3.75/ bushel from $3.82/bushel. This was despite concerns of weak corn demand by US ethanol producers.



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Grains- Outlook

We expect grain prices to trend upwards in the near term due to the expected cold weather conditions in the U.S. Also, the ban Russia placed on exports in order to protect its citizens from high prices will lead to lower global wheat supplies and an increase in prices

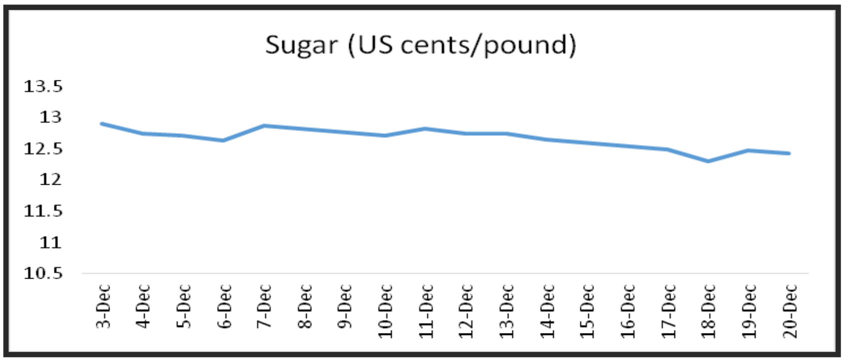
Impact on Nigeria

Nigeria is amongst the top consumers of wheat in SSA together with South Africa, Ethiopia and Kenya. An increase in global wheat prices would push up imported inflation rate, which would in turn reflect in the price of wheat dependent commodities including bread, noodles and pasta.

[19]Bloomberg
[20]Bloomberg

Sugar

Sugar prices declined from $0.1291/pound to $0.1243 by 3.72%, as Indonesia announces a quota on its raw sugar imports.



[21]

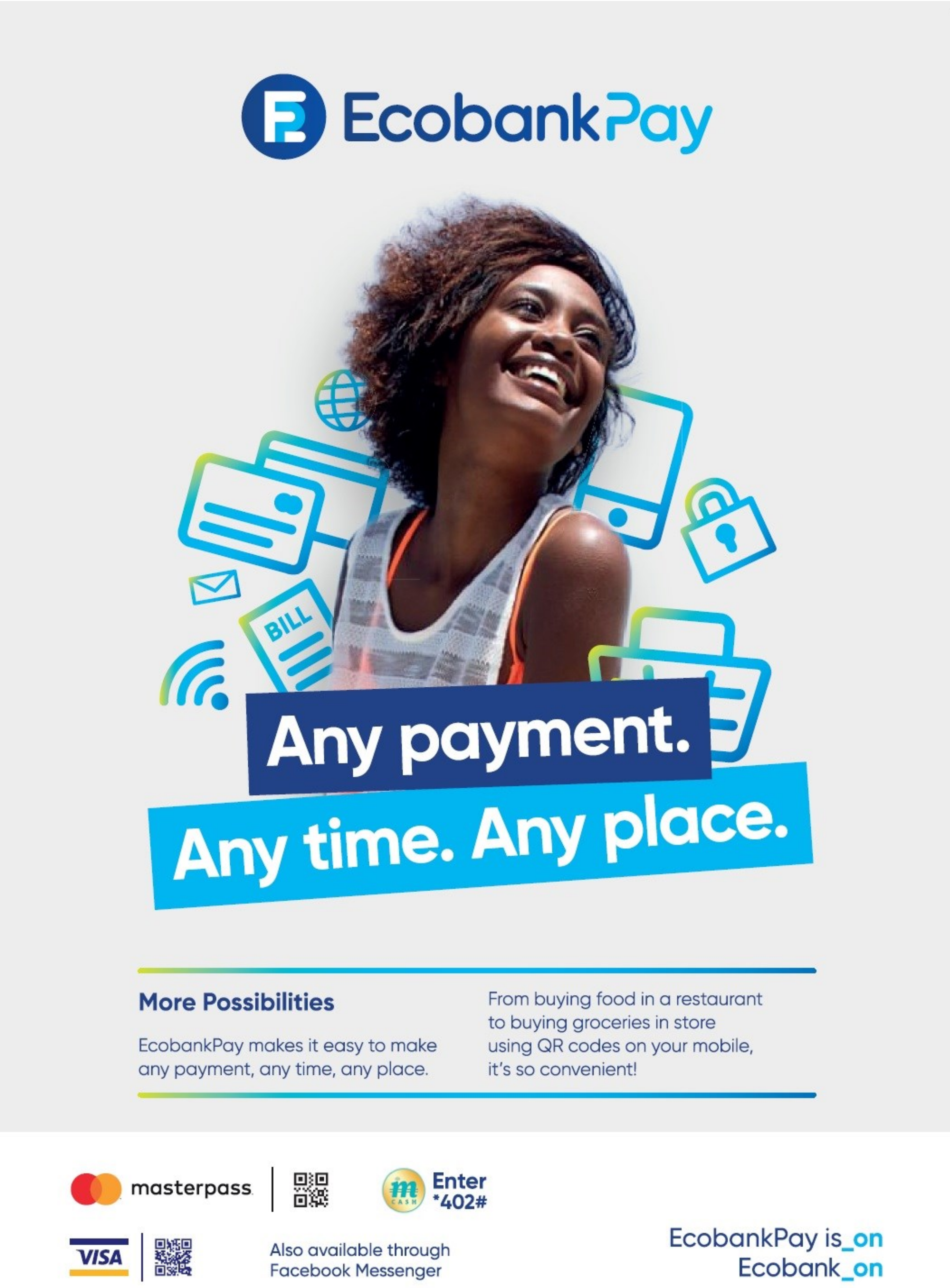
Outlook

The price of sugar is expected to remain at current levels on signs of lower consumer demand.

Impact on Nigeria

Nigeria currently has a demand gap of approximately 900,000 tonnes in the consumption of sugar. This gap is filled by incurring an import bill of at least $100mn annually. Any movement in global sugar prices would reflect on Nigeria's import bill.

[21]Bloomberg



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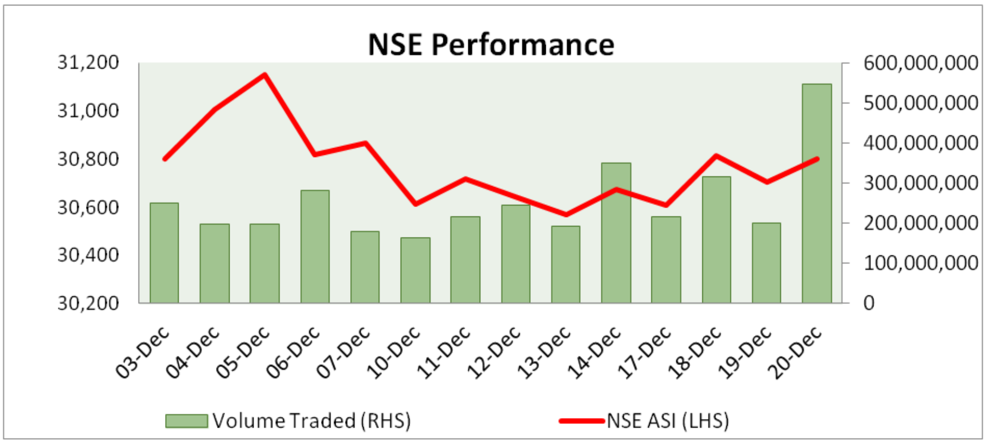
STOCK MARKET UPDATE

Nigeria's bourse maintained its choppy movement throughout December, as daily changes of the ASI ranged between -2.07% and 3.88% during the period. The NSE ASI recorded a marginal loss of 0.21% to close at 30,802.9 points as at December 20. Market capitalization also moved in the same direction, declining by 0.18% to N11.25trn.

The Nigerian stock market entered into bear market on the 13th of December, as it recorded a loss of 20.07% (to close at 30,568.05 pts). But the market was quick to recover owing to renewed interest in large cap stocks.

The increasing uncertainty, as political parties jostle for power, has continued to unsettle the market. Consequently, YTD loss is just shy of the bear territory at 19.46%.

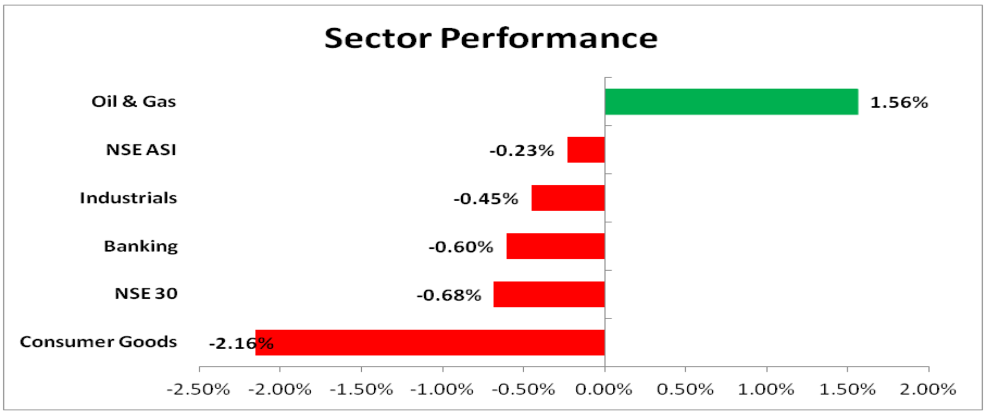
The NSE is currently trading at a price to earnings (P/E) ratio of 9.31x. This is a 1.38% decline over the close of the previous month (9.44x). However, market breadth came in higher, but remained negative at 0.95x, as 42 stocks increased, 82 stocks remained flat, while 44 declined, compared to November, which came in at 0.47x.



[22]

Trading activities on the floor of the NSE reflected the fragility in investor sentiments. Average volume traded declined by 1.16% to 256mn units and average value of trades recorded a steeper decline – down 17.93% to N2.93bn.

[22]NSE, FDC Think Tank



[23]

With the exception of the oil and gas index, all indices closed in negative territory during the period. The consumer sub-sector was the biggest loser. The index lost 2.16% owing to the illiquidity of most stocks under the index. The lower than expected financial numbers for the first nine months of 2018 (9m'18) continues to add to the woes of the index.

The oil and gas sub-sector was the only index in the green during the review period. The index gained 1.56% to claw back some of the losses recorded in November. A downside risk to a sustained growth is the blurry future of oil prices given the fragility of the OPEC-Russia pact. This may adversely impact the index going forward despite the decent performance of most players in the upstream oil and gas sector.

Penny stocks dominated the gainers' chart, largely attributed to bargain hunting on undervalued stocks and speculative trading. Diamond Bank (110.8%) led the advancers, followed by Forte Oil (44.2%), Unity Bank (27.5%), Neimeth (26.3%) and Jaiz Bank (25%).

Top Gainers

Symbol	Nov 30'18 Price	Dec 20'18 Price	Change	% Chang	PE Ratio
DIAMOND BANK PLC	0.65	1.37	0.72	110.8%	-
FORTE OIL PLC.	18.00	25.95	7.95	44.2%	2.09
UNITY BANK PLC	0.69	0.88	0.19	27.5%	-
NEIMETH INTERNATIONAL PHA	0.57	0.72	0.15	26.3%	6.75
JAIZ BANK PLC	0.40	0.50	0.10	25.0%	183.11

[23]NBS, FDC Think Tank

Lagging stocks comprised of penny stocks, with Mutual Benefits Assurance leading the pack (-20%), followed by UPDC (-18.5%), Chams (-16.7%), Prestige Assurance (-14.5%) and AG Leventis (-13.8%)

Top Losers					
Symbol	Nov 30'18 Price	Dec 20'18 Price	Change	% Chang	PE Ratio
MUTUAL BENEFITS ASSURANCE	0.25	0.2	- 0.05	-20.0%	1.78
UPDC REAL ESTATE INVESTMEN	8.1	6.6	- 1.50	-18.5%	7.97
CHAMS PLC	0.24	0.2	- 0.04	-16.7%	-
PRESTIGE ASSURANCE CO. PLC	0.55	0.47	- 0.08	-14.5%	3.55
A.G. LEVENTIS NIGERIA PLC.	0.29	0.25	- 0.04	-13.8%	-

Corporate Action

Access Bank and Diamond Bank announced plans of a strategic merger. The synergy will produce Nigeria's largest retail bank by customer base (29mn customers) with total assets of N6.7trn. The parties agreed on a purchase consideration of N3.13/share for Diamond Bank's shareholders – split between a cash purchase of N1/share and a share exchange of two Access Bank shares for every seven held by Diamond Bank shareholders. However, Access Bank will remain the dominant party after the consolidation, maintaining 81% of the new entity. An approval in principle has been granted by the CBN and the SEC.

Outlook

The 2019 elections is currently a toss-up, as analysts' consensus has been mixed. The absence of a clear-cut direction alludes to the fact that the bourse may close the year in the bear territory. However, buy interest in lag caps may turn the tides for good.

Equity Report: Dangote Flour Mills Plc

Analyst Recommendation: Buy

Market Capitalization: N34bn

Recommendation Period: 365 days

Current Price: N6.85

Industry: Consumer Goods

Target Price: N9.85

Analyst's Note

The Nigerian consumer goods sector continues to face constraints from rising input costs and subdued consumer confidence. Sales and profit margins have been dampened by accelerating food prices, weak purchasing power, logistics constraints and sustained high unemployment and underemployment. In addition, the relatively high inflation rates (above single digit) and interest rates have weighed on operations in the industry. The weak consumer confidence and purchasing power has ultimately led to a shift in demand from premium products to value products.

Macroeconomic headwinds weighed on the operations of Dangote Flour Mills as profit before tax plunged by 75.29% to N4.45bn.

Although Dangote Flour Mills performance was constrained by the weak macroeconomic environment and high logistics cost, using intrinsic valuation and taking into consideration possible risk factors, its share price is currently undervalued. Accordingly, we place a BUY rating on its stock.

Top-line declined due to weak demand and logistics constraint

The company posted revenue of N83.30bn in 9M'18, a 16.93% decline compared to N100.28bn in 9M'17. This was due to logistics constraints amid tepid consumer demand. As a result, flour sales declined by 16.07% year-on-year (y-o-y) to N72.44bn in 9M'18. The pasta segment (spaghetti, macaroni and other pasta products) also declined by 17.1% to N16.61bn in 9M'18.

Profitability constrained by high operating cost

Dangote Flour Mills posted low bottom-line earnings for 9M'18. Profit before tax (PBT) plunged by 75.29% to N4.45bn while profit after tax (PAT) declined by 43.14% to N3.26bn from N13.05bn in 9M'17. This could be attributed to the company's inefficient cost strategy as operating costs, as a percentage of revenue, increased by 137 basis points to 10.3% in 9M'18 from 8.93% in 9M'17. The lower distribution and administrative expenses of N8.85bn (down 4.24%) were insufficient to outweigh the impact of the 16.93% drop in revenue in 9M'18.

Industry and Company Overview

Nigeria is the second largest consumer of wheat in Sub-Saharan Africa (SSA) - behind South Africa. Wheat is generally processed into flour, which is used for a wide range of food products including bread, noodles, pasta, cereal, and other savory snacks. Nigeria's wheat production has increased to approximately 900,000 megatons (MT). However, the demand is higher at 4.63mn tonnes creating a huge demand gap of 3.73mn tonnes.[24] Thus, the country relies on imports to meet its growing demand. It is also worth stating that Nigeria's low wheat production and overreliance on imports emanate from an unfavorable local climate to produce quality wheat as well as insecurities in the planting region i.e. the middle belt region of the country.

The Nigerian flour milling industry has four major players: Flour Mills of Nigeria, Dangote Flour Mills, Olam International, and Honeywell Flour Mills. These four control over 75% of the market share. The industry's profitability depends largely on the companies' abilities to increase sales volume amid a tough macroeconomic environment.

Dangote Flour Mills commenced operations in 1999 as a division of Dangote Industries Limited (DIL). It was incorporated in 2006 following a strategic decision by DIL to unbundle its various operations. It was listed on the Nigerian Stock Exchange (NSE) in February 2008. The company started with an installed capacity of 500 MT/day at its Apapa mill and has since expanded rapidly by opening three mills in Kano (2000), Calabar (2011) and Ilorin (2005).

Dangote Flour had three wholly owned subsidiaries which include Dangote Pasta Ltd. (manufactures and sells macaroni, spaghetti and other pasta products), Dangote Agro Sacks Ltd and Dangote Noodles Ltd (manufactures and sells noodles). It disposed of Dangote Agro Sacks Ltd in November 2015 for N7.55bn. In 2017, Dangote Flour sold off its noodles business to Dufil Prima Foods to enable it focus on its strengths in flour and pasta, and improve on the quality, distribution and marketing of its products.

Its principal activities include the manufacturing and selling of bread and confectionery flour, wheat offal (bran), semolina and wheat meal. The company has high-tech plants and equipment that transform wheat into high quality flour.

[24]Intelligence Unit, "World Commodity Forecasts: Food Feedstuffs and Beverages", The Economist. https://store.eiu.com/product/world-commodity-forecasts/food-feedstuffs-and-beverages

Income Statement for Dangote Flour Mills Plc (FY Dec 2017)					
N'000	2013	2014	2015	2016	2017
Revenue	29,960,419	41,268,771	48,026,674	105,765,324	125,444,270
Cost of Sales	(29,317,791)	(38,057,750)	(43,558,620)	(76,417,616)	(96,011,138)
Gross Profit	**642,628**	**3,211,021**	**4,468,054**	**29,347,708**	**29,433,132**
Other Income	233,975	302,997	1,177,590	1,382,450	1,151,635
Distribution & Administrative Expenses	(6,743,190)	(7,993,657)	(9,788,360)	(11,804,608)	(12,058,061)
Operating Profit Before Impairment & Foreign Exchange Losses	**(5,866,587)**	**(4,479,639)**	**(4,142,716)**	**18,925,550**	**18,526,706**
Profit/Loss on Significant Disposals of Property	(130,678)	-	-	-	3,565,285
Foreign Exchange Losses	-	(360,212)	(1,775,755)	(3,940,279)	-
Impairment of Plant & Equipment and Investment	-	(1,592,372)	(2,658,820)	1,050,659	-
Operating Profit/Loss from Continuing Operations	**(5,997,265)**	**(6,432,223)**	**(8,577,291)**	**16,035,930**	**22,091,991**
Finance Income	19,927	10,398	2,613	670,662	3,188,435
Finance Costs	(2,364,956)	(2,863,188)	(3,891,530)	(4,887,626)	(2,840,555)
Net Finance Cost	(2,345,029)	(2,852,790)	(3,888,917)	(4,216,964)	347,880
Profit/Loss Before Taxation from Continuing Operations	(8,342,294)	(9,285,013)	(12,466,208)	11,818,966	22,439,871
Taxation	1,577,990	3,006,708	(213,097)	(1,249,679)	(7,310,665)
Profit/Loss After Taxation from Continuing Operations	(6,764,304)	(6,278,305)	(12,679,305)	10,569,287	15,129,206
Discontinued Operations	(452,697)	168,797	-	-	-
Profit/Loss for the Year	**(7,217,001)**	**(6,109,508)**	**(12,679,305)**	**10,569,287**	**15,129,206**

Balance Sheet for Dangote Flour Mills Plc (FY Dec 2017)					
N'000	2013	2014	2015	2016	2017
Property, Plant & Equipment	30,002,456	26,342,645	23,027,073	25,103,593	31,150,740
Investment in Subsidiaries	-	-	-	-	-
Intangible Assets	-	-	-	-	239,218
Deferred Tax Assets	2,896,528	4,928,320	4,753,851	4,159,474	584,422
Non-current Assets	32,898,984	31,270,965	27,780,924	29,263,067	31,974,380
Inventories	9,372,457	5,429,059	5,738,870	10,784,629	28,347,918
Amount Owned by Subsidiaries	-	-	-	-	-
Trade and Other Receivables	7,789,466	6,933,990	5,102,397	9,480,169	8,992,460
Cash and Cash Equivalent	1,423,664	4,547,552	3,317,838	23,658,102	54,125,522
Short Term Loans Receivable	6,183,288	6,619,923	7,414,953	5,787,872	5,916,838
Current Assets	24,768,875	23,530,524	21,574,058	49,710,772	97,382,738
Non-Current Assets Held for Sale	17,813,681	-	-	6,143	-
Total Assets	75,481,540	54,801,489	49,354,982	78,979,982	129,357,118
Share Capital	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000
Share Premium	18,116,249	18,116,249	18,116,249	11,527,612	11,527,612
Foreign Exchange Reserve	-	-	-	-	
Capital Reserves	-	-	-	23,276,829	21,412,878
Retained Earnings/Loss	(4,305,067)	(10,524,972)	(23,052,118)	(12,443,563)	2,121,367
Equity Attributable to Equity Holders of the Compar	16,311,182	10,091,277	(2,435,869)	24,860,878	37,561,857
Non Controlling Interests	1,795,343	(483,145)	(635,304)	(674,572)	(110,296)
Total Equity	18,106,525	9,608,132	(3,071,173)	24,186,306	37,451,561
Deferred Tax Liabilities	2,453,251	1,470,936	1,486,995	1,526,319	4,165,886
Borrowings	9,646,302	5,044,448	999,908	5,860,194	371,256
Non-current Liabilities	12,099,553	6,515,384	2,486,903	7,386,513	4,537,142
Borrowings	21,040,451	27,282,725	37,869,079	30,377,313	69,249,108
Current Income Tax Liabilities	238,448	171,276	184,526	788,968	1,330,264
Trade and Other Payables	11,992,772	9,841,355	9,929,759	16,240,882	16,789,043
Bank Overdraft	2,399,913	1,382,617	1,955,888	-	-
Liabilities Held for Sale	9,603,878	-	-	-	-
Current Liabilities	45,275,462	38,677,973	49,939,252	47,407,163	87,368,415
Total Liabilities	57,375,015	45,193,357	52,426,155	54,793,676	91,905,557
Total Equity and Liabilities	75,481,540	54,801,489	49,354,982	78,979,982	129,357,118

Source: Dangote Flour Mills Plc Annual Reports

Management Overview

The company's management team has been able to sustain returns and remain a major player in Nigeria's flour mill industry despite the macroeconomic headwinds and a challenging business environment. The company maintained profitability during a period when many companies were challenged with tepid revenue growth due to weak consumer demand. The management was able to achieve this by cost reduction via the backward integration policy.

Mr Thabo Mabe joined Dangote Flour Mills in 2014 as the Group CEO and Director of its Board. He started his career in Unilever Plc where he gained experience in manufacturing, production and sales. He held several leadership positions and eventually became the CEO of Unilever Plc for over four years. He holds a BSc in Chemistry from Fort Hare University, South Africa.

Mr. Asue Ighodalo is the Non-Executive Chairman of the Board of Directors. He has a BSc in Economics from the University of Ibadan and a law degree from the London School of Economics and Political Science. He is also the Chairman of the Board for Sterling Bank Plc and sits on boards of public, private companies, and non-governmental organizations.

The management plans to continue to drive earnings and develop strategies to harness opportunities occasioned by improvements in economic indices, while mitigating the adverse effects of high logistics costs and subdued consumer demand. It aims to achieve this by improving its customer engagement strategies, strengthening supply chain capabilities and improving cost management.

CEO/Managing Director

Mr. Thabo Mabe

Non-Executive Chairman of the Board of Directors

Mr. Asue Ighodalo

The Bulls Say and the Bears Say

Bulls say:

- Leading player in the Nigerian flour mill industry
- Government support for indigenous companies
- Rich product portfolio which ensures sustainability of revenue
- Imminent upward review of minimum wage to boost consumer demand
- Growing local demand for wheat related food products

Bears say:

- Intense competition from other leading players such as Flour Mills of Nigeria Plc, Honeywell Flour Mills Plc and Olam International as well as smaller local flour mills
- Poor infrastructure increases pressure on operating margins
- Persistent macroeconomic headwinds have affected consumer demand for goods
- Persistent forex challenges could lead to higher cost of imported raw materials affecting earnings negatively
- The Apapa gridlock continues to cause logistics issues

Risks and Outlook

The major risks that could prevent Dangote Flour Mills from achieving its goals of improving revenue and managing cost effectively include capital management risk, market risk (currency risk, interest rate and commodity price risk), credit, and liquidity risks amid security challenges in the country. The Group's Risk Management Committee uses the company's risk policies to identify and evaluate these potential challenges.

The company is exposed to foreign exchange risk (fluctuations in US dollars) on purchases of raw materials. The company is currently involved in the backward integration of agro-allied products in order to reduce the currency risk associated with high dependence on imported raw materials (wheat).

The company is also exposed to commodity price risks as it needs to purchase specific quantities and qualities of raw materials (wheat and polypropylene) to meet its milling requirements. Management mitigates this partly by using derivative instruments such as forward contracts. Global wheat production is expected to fall by 5.8% in 2018/19 owing to adverse weather conditions. Major wheat producers, such as the EU, China, the US and Australia, are expected to register lower than average harvests. As global demand remains strong, the wheat market is likely to register a deficit. This will help to boost prices by an average of 3.2% per year in 2019 and 2020.[25]

Dangote Flour Mills addresses credit risk by applying credit limits and credit monitoring procedures. The company monitors daily certain significant receivables and obtains credit guarantee insurance when appropriate. The company manages its liquidity risks by monitoring weekly cash flows and ensuring that adequate cash is available through borrowing facilities with shareholders and holding company structures.

[25]Intelligence Unit, "World Commodity Forecasts: Food Feedstuffs and Beverages", The Economist. https://store.eiu.com/product/world-commodity-forecasts/food-feedstuffs-and-beverages

APPENDIX - Valuation

We derived our valuation for Dangote Flour Mills by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate for Flour Mills stood at N9.85, which is a 43.8% upside on its current share price of N6.85 as at December 19, 2018. The discount rate [weighted average cost of capital (WACC)] of 12.3% is derived using a 15.83% risk free rate [the yield for a 10-year Federal Government of Nigeria (FGN) bond maturing in February 2028], a beta of 1.4032 an after-tax cost of debt of 11.4%, and a market risk premium of 6.3%.