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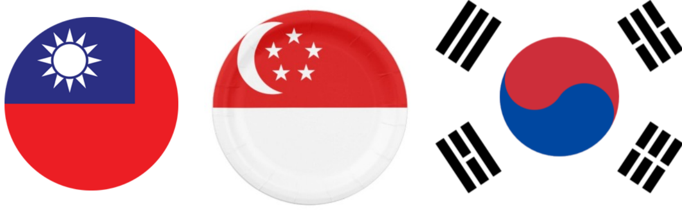
Investing in Human Capital: Nigeria's Untapped Resource

With Nigeria's Economic Recovery and Growth Plan well underway, expectations are high for GDP growth over the next few years. Economic diversification, employment creation and increased private sector participation are strong tenants of the plan. However, a critical component is missing, a focus on human capital development, specifically education, research and training. Human capital can be succinctly described as the know-how, ability, expertise or skills possessed by the workforce of a country at a given time. There is no denying that there is a strong positive correlation between the level of education and labour earnings. A more educated individual is more likely to participate in the job market, to have a job, to work more hours, and to be paid more, and less likely to be unemployed[1]. Education not only improves the quality of the individual but also lays the foundation for professional training, which can lead to mentoring and entrepreneurship (i.e. job creation), and to growth through innovation (research and development). The implication is, economies will continue to attain successive levels of economic growth so long as they are committed to investing in their human capital.

1 French, Lily, and Peter S. Fisher (2009). *"Education Pays in Iowa: The State's Return on Investment in Workforce Education"*. The Iowa Policy Project. http://www.iowapolicyproject.org/2009docs/090528-ROI-educ.pdf

Taiwan, Singapore and South Korea demonstrate the benefits of investing in human capital



Empirical studies have shown that while the abundance of resources might give a country a head start in economic growth, it is the focus on human capital development that provides for sustained growth. [2]Both Taiwan and Singapore are examples of this. While neither have resource endowments both have managed to attain impressive economic growth through human capital development. National integration, i.e. awareness of a common identity by citizens through a national education system, and industrial growth were both identified as the keys for economic survival of the countries. To attain this, the governments rightly recognized the necessity to provide every child with at least six years of education from the age of six - without discrimination of language, sex, wealth or status. The priority was to provide universal free primary education. This formed the basis for sustainable growth via industrialization, which accounts for about 65% of GDP in Taiwan and financial services which account for about 29% of GDP in Singapore. [3]South Korea is another success story, Samsung Group, which accounts for nearly 22% of South Korea's Gross domestic product (GDP), has its foundation in human capital development via research. This is evident by Samsung Electronics' impressive ranking (2nd) on the 2016 Intellectual Property Owners Association patent grants ranking. Further evidence of the company's commitment to the development of human capital is seen in the 2016 European Union Research and Development (R&D) Scoreboard, which ranked the company at 2nd out of 50, with €12.5bn R&D expenditure[4]. The company has climbed up 31 places since the inception of the report in 2004. Over this timeline, this has resulted in a boost in productivity and technological innovation with the Group's electronic subsidiary rolling out new products yearly.

Nigeria's Experience with Human Capital Investment remains lack lustre.

Conversely, in Nigeria public expenditure in education has remained substantially below the United Nations Education, Scientific and Cultural Organization (UNESCO) recommendation that 15% to 20% of the national budget should be allocated toward health and education[5]. The 2017 budget invested 6% in education, way off the UNESCO's benchmark. Its economic renewal efforts have not fared much better when it comes to human capital, despite its enormous young labour force. The poor investments in human capital are reflected in Nigeria's ranking near the bottom of the World Economic Forum's Global Human Capital Report. The report, which

1 Sachs, Jeffrey D., and Andrew M. Warner (1997). "Fundamental Sources of Long-Run Growth." *The American Economic Review* 87, no. 2: 184-88. http://www.jstor.org/stable/2950910 .

2 National Statistics Republic of China (Taiwan) [online] Available at: http://eng.stat.gov.tw/ct.asp?xItem=40651&ctNode=3570&mp=5 [Accessed 8 Nov. 2017].

3 Department of Statistics Singapore [online] Available at http://www.singstat.gov.sg/statistics/visualising-data/charts/share-of-gdp-by-industry [Accessed 8 Nov. 2017].

4 European Commission - Joint Research Centre (2016). "The 2016 EU Industrial R&D Investment Scoreboard". [ebook]. Available at http://iri.jrc.ec.europa.eu/scoreboard16.html [Accessed 8 Nov. 2017].

ranks 130 countries on how well they are developing and deploying their talent and evaluates levels of education, skills and employment, ranked Nigeria 114 in its 2017 report[6].

Focusing in on agriculture as an example, Nigeria's efforts primarily leveraged capital accumulation as a means of diversification from oil exports. Strategies such as the National Economic Empowerment and Development Strategy (NEEDS) and the Transformation Agenda have been adopted to boost growth in the economy. The NEEDS strategy involves employment creation, wealth creation, poverty reduction and value reorientation. With NEEDS the government realised the need to develop entrepreneurial skills and SMEs. The focus, however, was on capital support, not skill development. Hence the 2004 consolidation in the financial sector to provide cheap loans for the private sector. In a similar vein, the Transformation Agenda aimed at a hunger-free Nigeria through an agricultural sector that drives income growth, accelerates achievement of food and nutritional security, generates employment and transforms Nigeria into a leading player in global food markets to grow wealth for millions of farmers. Here again the government provided low interest loans and capital finance for the agricultural sector, and again it ignored intensive training of the labour force employed by the agriculture sector.

As these policies invested little in education and training, they failed to address the largely unskilled labour force. Hence, agricultural productivity remained subdued. The low productivity in the agricultural sector ensues from the use of obsolete farming techniques and equipment despite the government effort to enhance capital availability (e.g. equipment). This is evidenced by farms that still use manual labour despite the machineries they possess. In this case training the workers in the specific skills and expertise to operate these machines would lead to increased output.

5 UNESCO (2015). "Education 2030 Incheon Declaration and Framework for Action: Towards Inclusive and Equitable Quality Education and Lifelong Learning for All". Paris, UNESCO.
6 World Economic Forum (2017). "Global Human Capital Report". [online] Available at: http://reports.weforum.org/global-human-capital-report-2017/dataexplorer/#economy=NGA [Accessed 8 Nov. 2017].

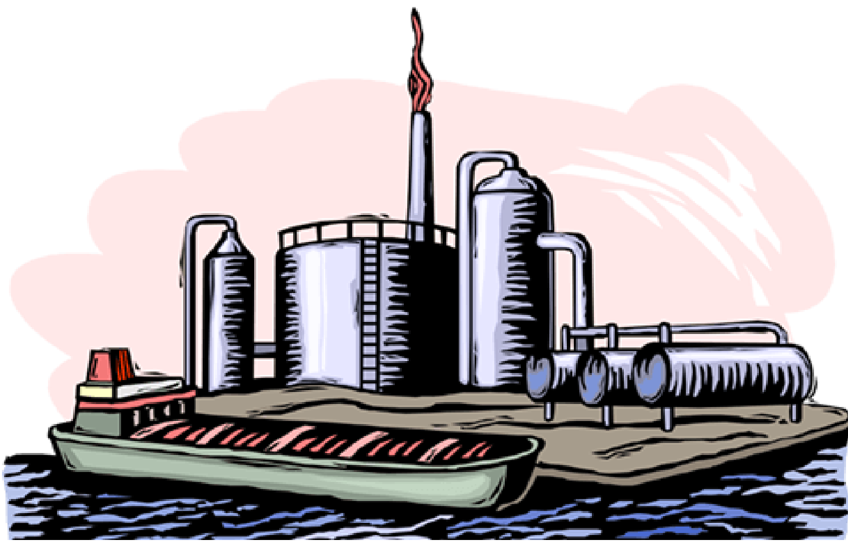
Nigeria needs to shift focus to realize its opportunities

Instead of focusing solely on diversification by capital accumulation, the nation needs to invest in the educational sector by building more affordable schools and universities, as private education is largely unaffordable and the public education institutions are overwhelmed with overfilled classrooms. Furthermore, there is need to establish research linkages between the existing universities and industries as most giant strides achieved by humanity have been through educational research funding and subsequent discoveries in health and technology. For example, the health research conducted at the University of Queensland in Brisbane, Australia led to the development of a vaccine to prevent cervical cancer in 2006 – the world's first cancer vaccine[7]. Nigeria can achieve similar success in its agricultural sector by allocating research funding to specialized universities such as the University of Agriculture in Makurdi, Benue State.

Increased human capital development has the potential to result in a permanent increase in the growth rate of the economy ensuing from increased innovation and technological progress. Countries like Singapore, and South Korea, have experienced an upsurge in their economic growth due to massive investments in their educational sectors. Clearly, no country committed to improving its economy can afford to rank so badly in terms of educating its population. Nigeria has work to do.

7 The University of Queensland, Brisbane, Australia. [online] Available at: http://www.uq.edu.au/research/impact/stories/guardian-angel [Accessed 8 Nov. 2017].

The Need for Improved Domestic Refining Capacity in the Nigerian Oil Industry



How a low refining capacity translates to a narrow trade surplus, less import cover and higher government subsidy in Nigeria

Recent statistics have revealed that Nigeria's trade surplus with other countries declined in Q2'17 from Q1'17[8]. As the economy recovers and the domestic appetite for petroleum products grows, the government and private investors need to accelerate the operation of the country's four domestic refineries and make them produce to their full potential. This strategy will help reduce the imports of refined petroleum products, lessening Nigeria's overall imports and trimming the associated costs to the economy. The plan requires a joint action between the Federal Government of Nigeria (FGN) and private stakeholders i.e. private individuals and businesses. The FGN has been an inefficient operator of these refineries and thus needs to sell some or partner with private investors to manage them. The success will widen the country's trade surplus gap, bolstering its external reserves. It will also lessen the FGN's spending on a subsidy to offset the high cost of fuel and oil products.

Recent trade disclosures by the National Bureau of Statistics (NBS) show that Nigeria had a surplus trade balance of N506.5bn in Q2'2017 compared to a surplus of N719.4bn in Q1'17[9]. This represents a 29.6% decline. The value of total imports in the period was N2.6trn, a 13.51% increase when compared to Q1'17[10]. Oil product imports rose sharply in Q2'17 up 18.48% from Q1'17. Refined crude was a significant component of this overall import and it also contributed to the sharp upsurge in total imports in the period. Meanwhile, crude oil exports were 2% higher in the same period[11]. The Nigerian oil industry's upstream exports are growing; downstream imports are also expanding but at a much faster pace. This reality contributes to a narrowing trade surplus on the aggregate.

In the same vein, as oil imports grow and require payment from the foreign exchange earnings, they are competing with other non-domestically produced imported goods and services. An increased domestic refining capacity will free up the external reserves to be used elsewhere or reduce the overall annual spend, thereby prolonging the life of the reserves.

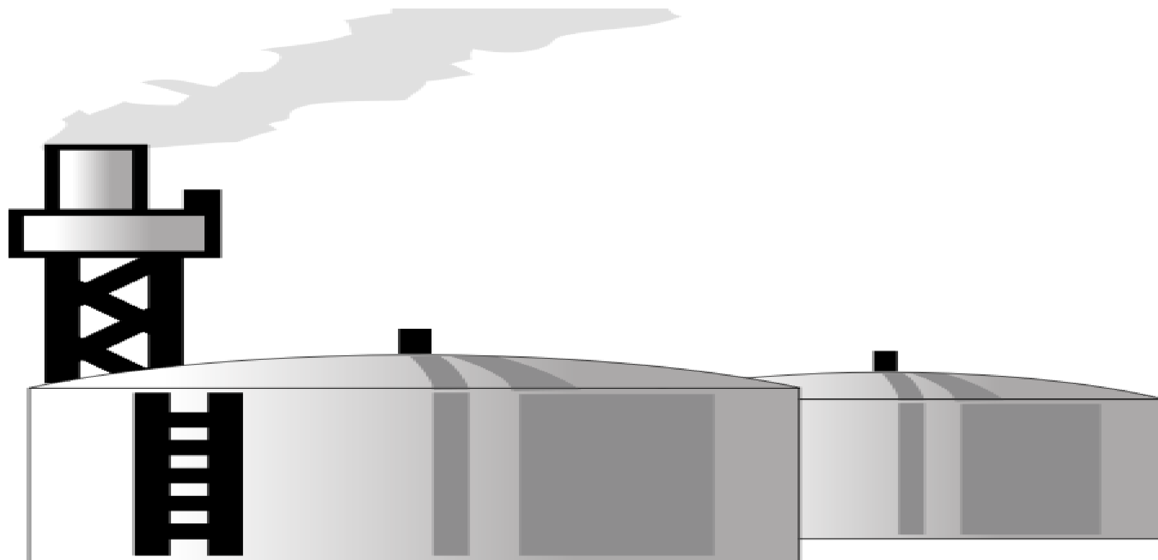
[8]National Bureau of Statistics, 2017, "Foreign trade in goods statistics (Q2 2017)", Federal Government of Nigeria, page 2

[9]National Bureau of Statistics, 2017, "Foreign trade in goods statistics (Q2 2017)", Federal Government of Nigeria, page 2

[10]National Bureau of Statistics, 2017, "Foreign trade in goods statistics (Q2 2017)", Federal Government of Nigeria, page 1

[11]National Bureau of Statistics, 2017, "Foreign trade in goods statistics (Q2 2017)", Federal Government of Nigeria, page 2

Higher oil product imports, coupled with rising crude prices in the international market, result in pressure on the government to increase its expenditure on a petroleum subsidy in Nigeria. An increase in the price of crude, the primary raw material used in producing petrol, diesel and other products, increases the price of the end products. As the FGN strives to keep the domestic prices of these commodities constant in order to avoid further inflationary pressures and protests in the country, it may to choose to bear this extra cost through an increased subsidy.



Why Refineries' capacity should be sped up

Local refining will protect the external reserves balance. The upstream sub-sector of the oil industry will add to the balance through exports, while the downstream will no longer use the foreign exchange earnings for the importation of refined crude. According to a recent release from the Organization of the Petroleum Exporting Countries (OPEC), Nigeria exported 1.56 million barrels per day (mbpd) of crude oil in 2016[12]. During this period, it also imported 420,000 bpd after refining it elsewhere (roughly 27% of its exports of 1.56mbpd). This cost the country $72bn (N2.6trn) in 2016[13]. If the demand for other goods remains constant, the external reserves will likely cover additional import demand or last longer if crude oil and its products no longer drain the reserves. Moreover, local refining would offset the landing cost of imports, which will translate to a lower price of petroleum products in the country. With a lower price for petroleum products, the subsidy contributed by the government may be completely offset or significantly reduced. This contains the need for higher borrowing by the FGN and enables earnings to be diverted towards other competing ends whose allocation could spur economic growth.

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[12]OPEC Secretariat, 2017, "OPEC Monthly Oil Market Report", Organization of the Petroleum Exporting Countries (OPEC),http://www.opec.org/opec_web/static_files_project/media/downloads/publications/MOMR%20September%202017.pdf

[13]National Bureau of Statistics (NBS), 2017, "Petroleum Products Imports Statistics 4th Quarter 2016", Federal Government of Nigeria, page 1

President Buhari has recently approved the refurbishment of the existing refineries, giving a nod to a strategic public-private partnership move. This indicates a pre-emptive interest on the federal government's part to restore the operational efficiency of the local refineries. In order to fully attract private investors, however, the government at all levels needs to secure the locations of the existing refineries. Three of the four refineries (two at Port Harcourt and one at Warri) are located in the South South region of the country (Niger Delta). The region has been experiencing incessant attacks and pipeline vandalization from militants. In the same vein, the location of the fourth refinery (Kaduna state) has been marred by deadly attacks from herdsmen. Stability needs to be restored to these regions to entice private investors to enter refinery development. The time lag to achieve full restoration is not too long if resources are readily available and efficiently mobilized. By estimate, it could take as little as three months.

Meanwhile, the refineries currently produce 53,500barrels per day[14]. This is approximately 13% of Nigeria's total daily import demand of 420,000, and only 12% of its installed capacity of 445,000[15]. The refineries, therefore, have to grow at least 685% to offset import needs. The government's anticipatory interest and the growing willingness of several investors are indicative of the potential for success. The total cost is estimated at $2bn (N720bn), which is less than 6% of the current external reserves balance. While addressing the press after the 2017 Africa's oil week, the Minister of State for Petroleum, Dr. Kachikwu, disclosed about 26 private firms have shown interest in investing in refineries. This would offset the finance cost on the part of the government.

The Nigerian government with the private sector needs to improve the capacity of the four local refineries in the country. These refineries have the capacity to produce 445,000bpd, which is above Nigeria's average daily import of 420,000bpd. Currently, they produce below this potential. They only refine 53,500bpd. This refined output is also lower than the daily consumption demand roughly estimated at 429,000bpd[16]. The maximization of the potential capacities of these refineries alone would save the Nigerian government and the external reserves significant costs. The local refineries have enough capacity to cater to local demand, even without the construction of new ones. The strategy will also generate capacity to export to other countries as the country will be producing more than its domestic consumption requirements. The total installed capacity will leave an estimated four percent after meeting domestic demand, providing investors and the government with a reliable revenue source. In short, the case for the investment in upgrading the country's refin-

[14]OPEC Secretariat, 2017, "Nigeria facts and figures", Organization of the Petroleum Exporting Countries (OPEC), http://www.opec.org/opec_web/en/about_us/167.htm

[15]Nigerian National Petroleum Corporation, 2016, "Refineries and Petrochemicals", Federal Government of Nigeria, http://nnpcgroup.com/NNPCBusiness/MidstreamVentures/RefineriesPetrochemicals.aspx

[16] National Bureau of Statistics, 2016, "Petroleum Products Consumption Statistics (Q1–Q3 2016), Federal Government of Nigeria, page 3, 5, 6

Nigerian Aviation Industry & African Development Bank (AfDB)

The city of Abuja played host to the 3rd International Civil Aviation Organization (ICAO) World Aviation Forum (IWAF3). The theme of this year's event was "Financing the Development of Aviation Infrastructure". The timing could not be more opportune. World class aviation infrastructure across parts of Africa has led to the establishment of major aviation hubs in Addis Ababa, Johannesburg, Cairo and Nairobi. Unfortunately, West Africa, a primary market, lacks an effective hub – potential countries like Lagos, Abidjan and Lome have failed to rise up to the challenge. Nigeria is the largest economy in Africa and attaining regional hub status only seems like a natural step.

The African Development Bank (AfDB) reiterated its commitment to support the Nigerian government's efforts to revitalize the Nigerian aviation sector. The industry plays a critical role in the Nigerian economy. It transports 14.5 million passengers annually and is responsible for $45 million in total economic activity representing 0.09% of GDP. The sector grew by 0.48% in Q3'17 from 0.15% in the preceding quarter, which is reflective of increased passenger air travel and to some extent, increased air freight.

The AfDB has shown a long standing commitment to the development of various infrastructure projects across Africa with aviation remaining a key focus. As part of regional integration, aviation plays a significant role in Africa by connecting various cities which in turn help to boost tourism and investment interests.

The bank's support to Nigeria would focus on the development of a national airline, aviation leasing companies, maintenance, repairs and overhaul facilities. This is in addition to the development of an aero polis, and cargo terminals for agricultural produce for exports.

The Nigerian aviation sector has recovered from a period of contraction in activity which coincided with the economic recession. And as the economic recovery gains momentum and business confidence strengthens, overcoming the plethora of challenges confronting the aviation sector – especially infrastructure – is crucial to fast-tracking Nigeria's drive to regional hub status.

MPC Hold Rates for the 8th Consecutive Time

As widely anticipated, the MPC left the policy rate and other parameters unchanged. Members voted 8-1 in favour of the status quo. The committee suggested that more time was needed to ensure that the gains of the current policies are not squandered.

Considerations

In reaching its decision, the MPC considered several factors. These include

- ◊ Consecutive quarterly positive growth in GDP
- ◊ Slow deceleration in consumer price inflation
- ◊ Narrowing premium in exchange rate
- ◊ 7th consecutive monthly boost in PMI

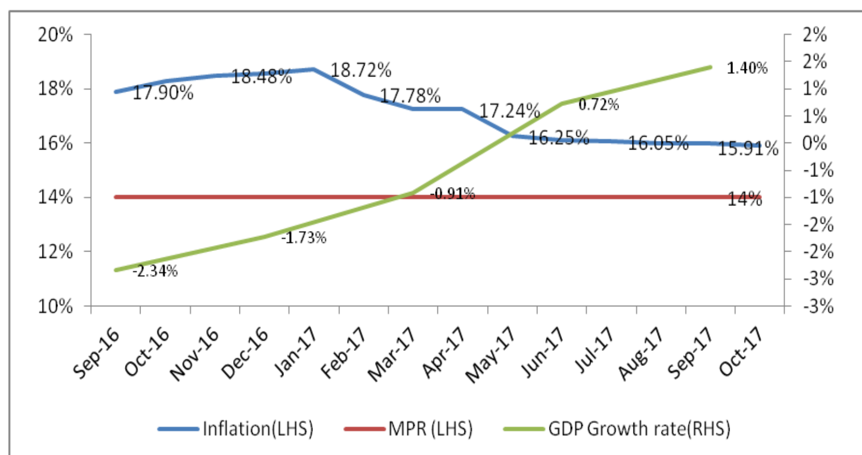
The MPC alluded to the fact that the GDP figures were reflective of an economy that is gaining momentum on the path to recovery, but expressed concerns that adopting an accommodative monetary stance would worsen the country's current account balance. This would lead to an increase in importation, prompting higher demand-pull inflation and exchange rate pressures.

Implications

The decomposition of the Q3'2017 GDP figures showed that growth is uneven and oil-dependent. The oil & gas sector recorded growth of 25.44% as over 200,000bpd in oil production came back on stream following the repair of pipelines in Q2'17. The Agric sector continues to benefit from massive government intervention in the form of lower interest rates, while interest rate sensitive sectors like manufacturing, trade, real estate and construction sectors all contracted, as the economy minus the oil and agriculture sectors would return Nigeria into a recession.

The service sector – accounting for about 50% of GDP – is in dire need of a stimulant in the form of lower interest rates and a catalyst like increased liquidity to galvanize output and give impetus to economic recovery.

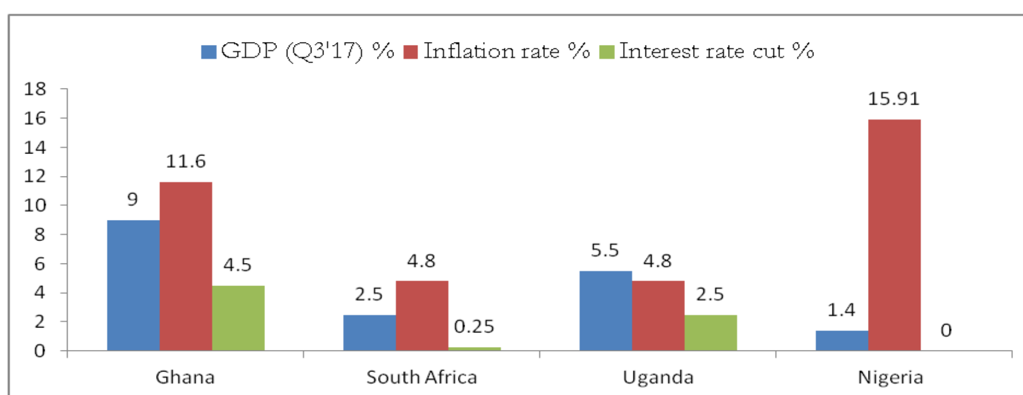
Also, because of the CBN's view that consumer inflation above 12% is growth retarding, it believes that a contractionary monetary policy to curb inflation is the appropriate measure required at this time. Money supply (M2) has contracted by 5.54% in October 2017 (annualized). At the same time, credit to the private sector contracted by 2.24%, as banks remain high risk averse. Consequently, companies without multinational parent companies are groining under liquidity pressure.



Source: FDC Think Tank

Country Comparison

The dogmatic belief that an expansionary monetary policy will lead to higher price level has been negated by the experiences of countries like Ghana, South Africa and Uganda where



Source: FDC Think Tank

Improved GDP growth in major economies in Sub-Saharan Africa has boosted the overall growth performance of the region. This is partly due to higher crude oil prices for the oil producing economies and a boost in domestic food yields.

Impact & Outlook

We expect market reaction to be neutral as the decision was already priced into instruments. Though interest rates are already in decline, the difference between the primary and secondary market is still wide enough to create distortions in the market.

The federal government has so far secured $3bn of the $5.5bn Eurobond, with the rest expected to be concluded before the end of the year 2017. The $3bn Eurobond was oversubscribed by $11bn due to its attractive rates and was priced into 10-year and 30-year debt instruments at interest rates of 6.5% and 7.25% respectively. These rates are better than the 15-year bond issued earlier in the year of 7.875%, implying an im-

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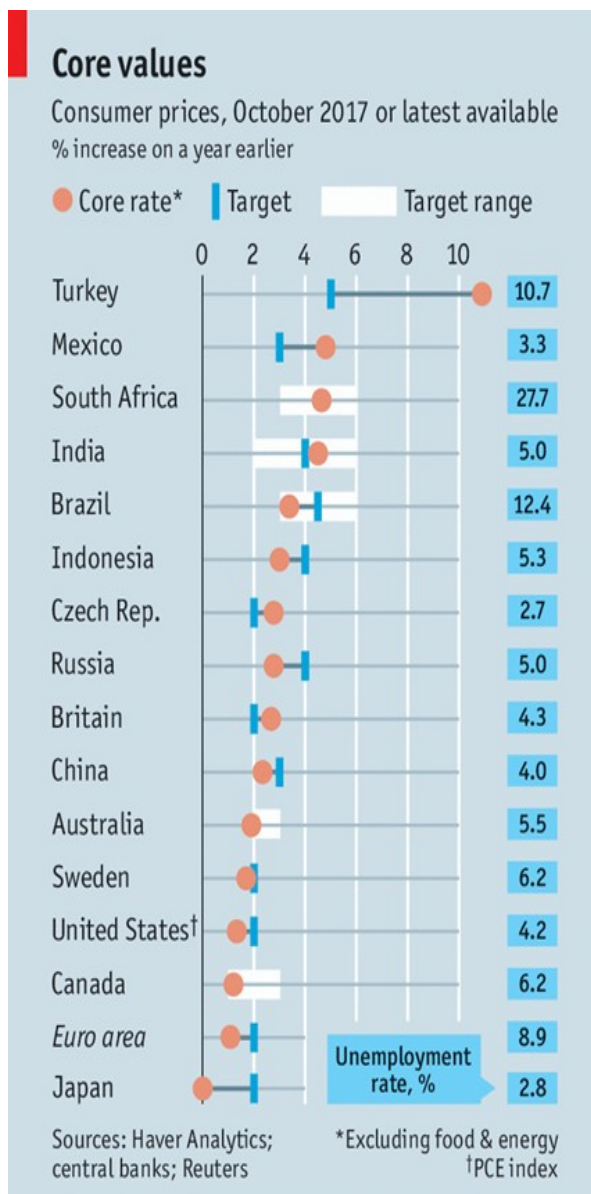
provement in perception and increased confidence of international investors in Nigeria.

We expect the change in Nigeria's debt structure – in favour of more international debt and less domestic debt – to greatly increase money supply and put downward pressure on interest rates. The surge in money supply will have an inflationary impact on prices, causing demand-pull inflation. In addition, pre-election spending, a possible increase in the minimum wage and increased CAPEX will have significant impact on the money supply level and stoke inflation further.

The next MPC meeting is scheduled to hold on January 23/24; we expect that the committee will be more dovish on its policy stance. We also believe a downward review of interest rates is almost inevitable in H1'2017 if non-oil revenue is to remain the key revenue source in 2018. This is because the committee would consider the lag between a policy shift and eventual impact.

As the Global Economy picks up, Inflation is Oddly Quiescent

A FEW years ago, the news about the euro-zone economy was uniformly bad to the point of tedium. These days, it is the humdrum diet of benign data that prompts a yawn. Figures this week show that GDP rose by 0.6% in the three months to the end of September (an annualised rate of 2.4%). The European Commission's economic-sentiment index rose to its highest level in almost 17 years. Yet when the European Central Bank's governing council gathered on October 26th, it decided to keep interest rates unchanged, at close to zero, and to extend its bond-buying programme (known as quantitative easing, or QE) for a further nine months.



The central bank said it would slow down the pace of bond purchases each month, to €30bn ($35bn) from January. But Mario Draghi, the bank's boss, declined to set an end-date for QE. A hefty dose of easy money will be necessary, he argued, until inflation durably converges on the ECB's target of just below 2%. It shows few signs of doing so, despite the economy's strength. Underlying, or core, inflation, which excludes the volatile prices of food and energy, fell from 1.1% to 0.9% in October, according to data published a few days after the ECB meeting. The euro zone's miseries of 2010-12 were unique. But in its present, happier state of vigorous activity, low inflation and easy monetary policy, it is like many other big economies (see chart).

After a decade of interest rates at record lows, those central banks that are inclined to tighten policy naturally attract attention. The Bank of England's monetary-policy committee raised its bench-

mark interest rate from 0.25% to 0.5% on November 2nd, the first increase since 2007. On the same day, the Czech National Bank raised interest rates for the second time this year. The Federal Reserve kept interest rates unchanged this week, having raised them in March and June, but a further increase is expected in December.

In Turkey, perhaps the only big economy that is obviously overheating, the central bank—which has been browbeaten by the president, Recep Tayyip Erdogan, who believes high interest rates cause inflation—opted on October 26th to keep interest rates on hold. Yet in most biggish economies, underlying inflation is below target (see chart) and monetary policy is being relaxed. Brazil's central bank cut interest rates on October 25th from 8.25% to 7.5%. Two days later, Russia's central bank trimmed its main interest rate, to 8.25%. This week the Bank of Japan voted to keep rates unchanged and to continue buying assets at a pace of around ¥80trn ($700bn) a year. These economies are gathering strength. It is a puzzle that, in such circumstances, global inflation is stubbornly low.

To figure out why, consider the model that modern central banks use to explain inflation. It has three elements: the price of imports; the public's expectations; and capacity pressures (or "slack") in the domestic economy. Start with imported inflation, which is determined by the balance of supply and demand in globally traded goods, such as commodities, as well as shifts in exchange rates. Commodity prices have picked up smartly from their nadir in early 2016. The oil price, which fell below $30 a barrel then, has risen above $60.

This has put upward pressure on headline inflation: in the euro zone it is 1.4%, half a percentage point higher than the core rate. Where inflation is noticeably high, it is generally in countries, such as Argentina (where it is 24%) or Egypt (32%), that have withdrawn costly price subsidies and whose currencies have

fallen sharply in value, making imported goods dearer. In Britain, rising import prices linked to a weaker pound have added around 0.75 percentage points to inflation, which is 3%.

A second influence on inflation is the public's expectations. Businesses will be more inclined to push up their prices and employees to bid for fatter pay packets if they believe inflation will rise. How these expectations are formed is not well understood. The measures that are available are broadly consistent with the central bank's inflation target in most rich economies. Japan is something of an outlier. It has struggled to meet its 2% inflation target in large part because firms and employees have become conditioned to expect a lower rate of inflation. Japan's Prime Minister, Shinzo Abe, recently called for companies to raise wages by 3% in next spring's wage round to kick-start inflation.

Leave aside the transient effects of import prices, and inflation becomes a tug-of-war between expectations and a third big influence, the amount of slack in the economy. The unemployment rate, a measure of labour-market slack, is the most-used gauge. As the economy approaches full employment, the scarcity of workers ought to put upward pressure on wages, which companies then pass on in higher prices. On some measures, Japan's labour market is as tight as it has been since the 1970s. America's jobless rate, at 4.2%, is the lowest for over 16 years. Inflation has nevertheless been surprisingly weak.

In other words, the trade-off between unemployment and inflation, known as the Phillips curve, has become less steep. A paper last year by Olivier Blanchard, of the Peterson Institute for International Economics, found that a drop in the unemployment rate in America has less than a third as much power to raise inflation as it did in the mid-1970s.

The central banks that see a need for tighter monetary policy are worried about diminishing slack. There are tentative signs of stronger pay pressures in Britain and America, and firm evidence of them in the Czech Republic, where wage growth is above 7%. Even so, with inflation expectations so steady, the flatter Phillips curve suggests that the cost for central banks in higher inflation of delaying interest-rate rises is rather low. The ECB is quite a way from such considerations. The unemployment rate is falling quickly, but remains high, at 8.9%. There is still room for the euro-zone economy to grow quickly without stoking inflation. The dull routine of good news is likely to continue.

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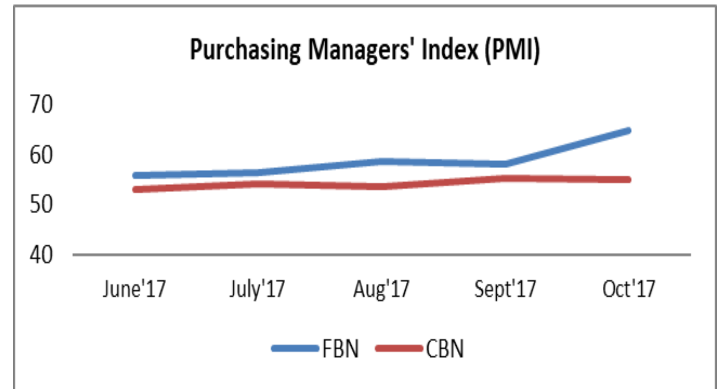
Purchasing Managers Index (PMI)

Nigeria's PMI reached a record level of 64.1 in October, compared to 58.5 in September according to FBN Quest. This is the 2nd highest level since the FBN PMI was launched in April 2013. This is reflective of the improvements in business environment and confidence driven by forex stability and availability. The FBN PMI has stayed above the expansion threshold of 50 for the ninth consecutive month.

On the other hand, the Central Bank's Purchasing Managers' Index (PMI) posted a softer expansion of 55.0 in October compared to 55.3 in September. According to the apex bank, there were notable gains in supplier delivery times, employment level and inventory. However, this was dampened by the slower pace of growth recorded in production level and new orders. 11 of the 16 subsectors expanded during the month, these include plastic & rubber, paper and non-metallic, chemical & pharmaceutical, and textile, leather & footwear etc. The CBN PMI has stayed above the 50 threshold for the sixth consecutive month.

Nevertheless, both FBN & CBN numbers remain in the expansion territory, implying improvements in the overall health of the manufacturing sector. PMI is a coincidental indicator, thus a positive trend confirms that the economy is on a slow but steady recovery path.

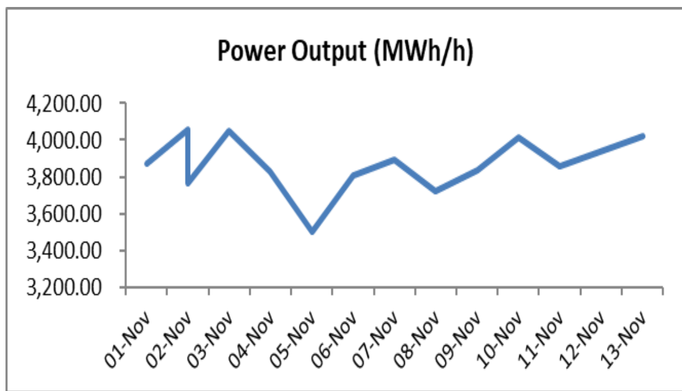


Outlook

The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A reading above 50 is indicative of an expansion in the manufacturing sector, while a reading below 50 shows a contraction in activity. The manufacturing sector is expected to remain in positive territory as macro-economic fundamentals continue to improve. Sustained forex liquidity and stability will continue to provide support to manufacturing activities. PMI is expected to inch up in the last months of the year, driven by inventory build-up in preparation for the festive season.

Power Sector

Average power output from the national grid was 3,863.32MWh/h in the period 01 – 13th November. This is 7.699% higher than the average of the corresponding period in October. Increased output from GenCos is the major factor behind the uptick in average output. On November 13th, the sector lost N989million naira, annualized at N360.98bn.



Outlook

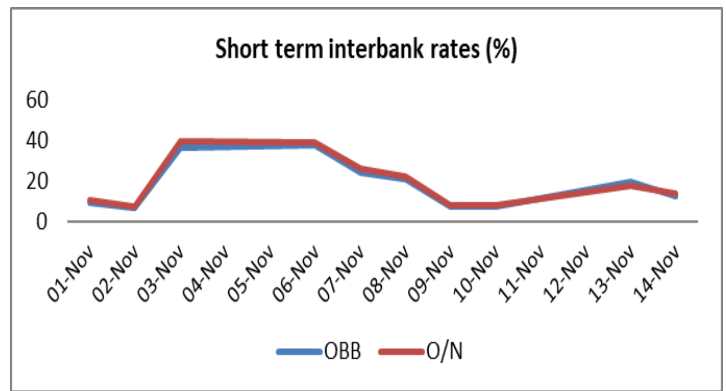
While there is higher efficiency at the generation level, there continues to be problems at the distribution stage. Dilapidated and insufficient infrastructure at the Discos will continue to cause generated power to be lost in transit. With the dry weather (Harmattan) in full swing, we expect the demand for electricity to climb. This indicates that the shortfall between power demand and supply will remain largely unchanged.

MONEY MARKET

Opening position of the interbank market for the period stood at N79.68bn long, on November 14th, a 13.2% loss compared to the position of N91.79bn long on November 1st. This is due to increase in market liquidity.

Average NIBOR (OBB, O/N) was 18.58% pa from November 1st-14th, relative to 25.96% in the corresponding period in September. The OBB and O/N rates reached a period-high of 37.50% pa and 38.92% pa respectively on 10th October.

In the Primary market, 91 and 182 days Treasury Bills rates fell by 0.06 (avg) to 13% and 15.25% respectively. During the period, while 364 days stayed flat at 15.6%.



Outlook

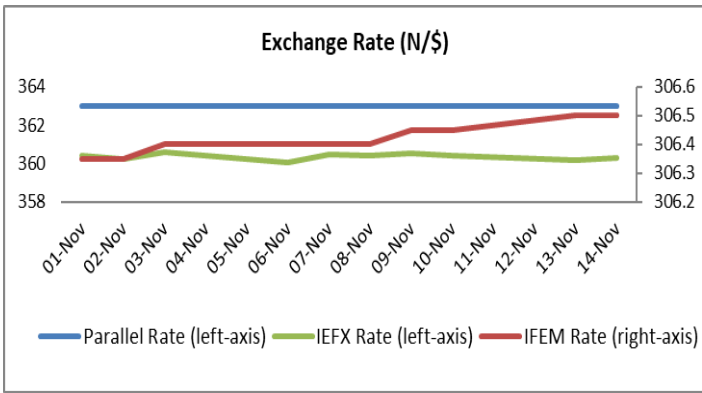
Liquidity during the period improved markedly compared to the previous period. We expect interest rates to stay within the lower band, especially as government securities mature.

FOREX MARKET

Exchange Rate

The consistent intervention of the CBN has successfully brought some stability into the 16 forex market. This has been further supported by robust external reserves and oil prices. Thus, during the period there were marginal movements in the exchange rates. At the parallel market, the exchange rate stayed flat at N363/$ during the period. The IFEM rate depreciated by 0.05% to N360.50/$. On the other hand, the naira gained 0.04% at the IEFX market to N360.27/S on November 14th from N306.40 on November 1st. The average rate at this window was N360.37/$ compared to N360.44/$.

Total turnover during the period was $1.56bn, while average daily turnover (ADT) was $156.46m. This is lower than October's total turnover of $2.09m, and ADT of $232.85m. The IFEM rate gained 0.2% to close at N305.60/$ on 10th October, from N306.20/$ on 3rd October.

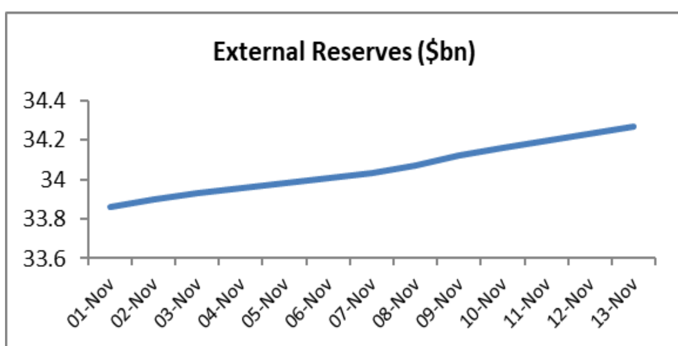


Outlook

The naira appears to have found its equilibrium. Despite the increase in forex demand as the Christmas season approaches, the naira has remained relatively flat at all windows. Thus, we do not expect any surprises or significant changes in the coming weeks.

EXTERNAL RESERVES

Nigeria's external reserves figures were last published on the 13th of November, when it stood at $34.27bn. This represents a 3.44% accretion when compared to the corresponding figure in October. This positive trend continues to be supported by strong oil prices and the stabilizing domestic oil production



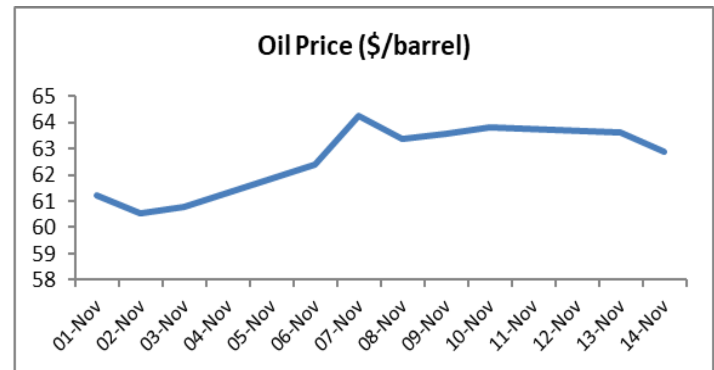
Outlook

Nigeria's gross external reserve is expected to continue to post gains in the last half of November. However, because this growth is primarily being driven by improvements in oil price & production, the issue of sustainability is raised.

COMMODITIES MARKET - EXPORTS

Oil Prices

Brent crude prices have proved resilient, staying above the $60pb threshold for 20 consecutive days. During the period, prices rose by 2.84%, to $62.21pb on November 14th, compared to $60.49pb. The average price for the period was $62.64pb, compared to $56.37pb in the corresponding period in October. This bullish momentum has been primarily supported by expectations of an extension in OPECs cut agreement and concerns about political tensions in Saudi Arabia.



Outlook

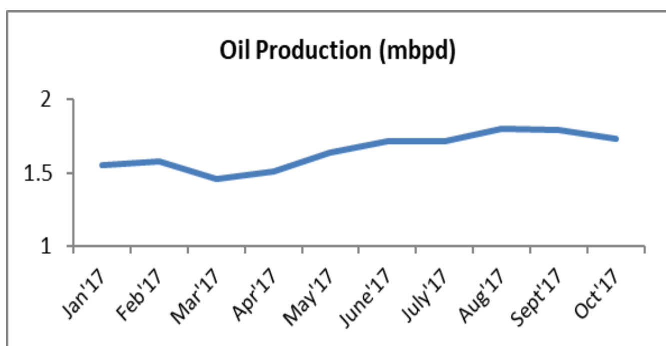
According to the Energy Information Administration (EIA), US crude inventories increased by 1.9 million barrels in the week ending November 10th. Thus, we maintain cautious optimism for oil prices, as US shale production and inventory levels continue to pose a threat to the impact of OPEC cuts.

Oil Production

According to OPEC, Nigeria's domestic production declined by 9.5% to 1.738mbpd in October from 1.792mbpd in September. This was driven by force majeure as domestic upstream oil companies slowed down production due to inventory build-up caused by cargo delays.

Oil exports in October also slid, as Asian refiners (primarily Taiwan and China) increasingly switched their slate to demand more of US crude. Thus, there has been a build-up of excess cargoes as some tenders failed to clear November-loading crude.

OPEC also made some changes to previously published figures, revising September's production level to 1.79mbpd from 1.855mbpd, and August figures to 1.802 from 1.804mpd.

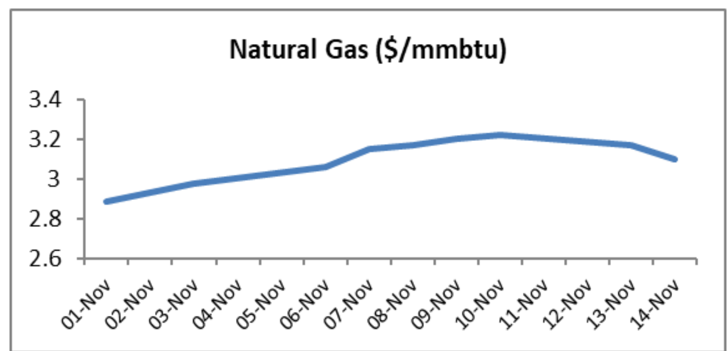


Outlook

The next OPEC meeting is scheduled to hold at the end of the month. During this meeting, the organization will review current cut agreements and strategize for 2018. Since production has remained below the cap of 1.8mpbd, Nigeria is unlikely to be included in the production cut agreement of 2018.

Natural Gas

From the November 1st – 14th, Natural gas traded at an average of $3.00/mmbtu. This represents a 3.1% gain in prices compared to the corresponding period in October. This was primarily stirred by higher demand as chilly weather sets in the Northern parts of US. Additionally, declines in US stockpiles have provided some support to prices.

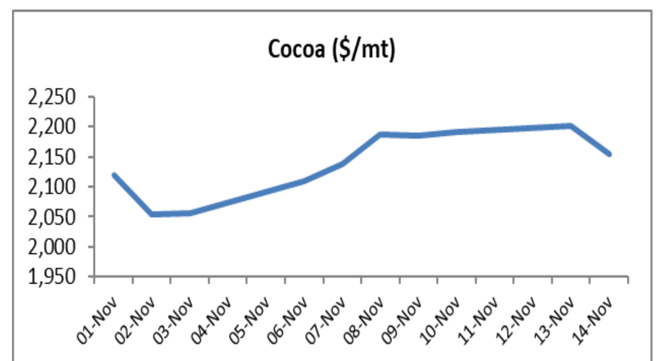


Outlook

Gas prices will post stronger gains in coming weeks as the temperature continues to drop. Weather forecasts show expectations of an arctic blast.

Cocoa

Cocoa prices strengthened during the period to reach an average of $2,140/mt, 3.33% higher than the relative period in October. Prices touched a 10-month high of $2,201/mt on November 13th. Gains were driven by the lower-than- expected harvests, due to an extended wet season. Heavy rains continued to



flood plantations and not allow harvested cocoa beans to dry properly- leading to rot.

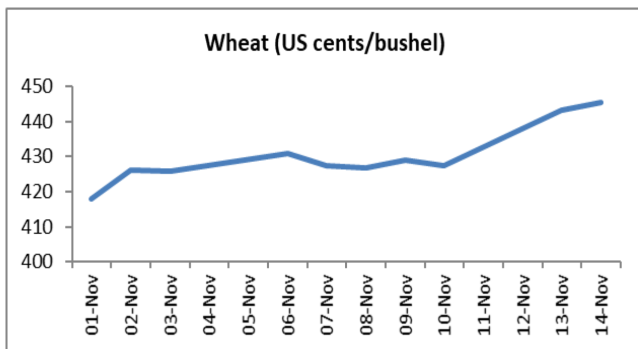
Outlook

Cocoa prices have lost up to 20% YTD. We expect choppy trading in the commodity to persist in the coming weeks.

IMPORTS

Wheat

Wheat prices averaged $4.29/bushel in the period November 1st-14th. This represents a decline of 1.61%, when compared to the average of $4.39/bushel in the corresponding period in October. Despite this, wheat prices actually gained 6.5% during the period, closing at $4.45/bushel on November 14th, from $4.18/bushel on November 1st. The USDA reduced its stock projections for the 2017/18 season.

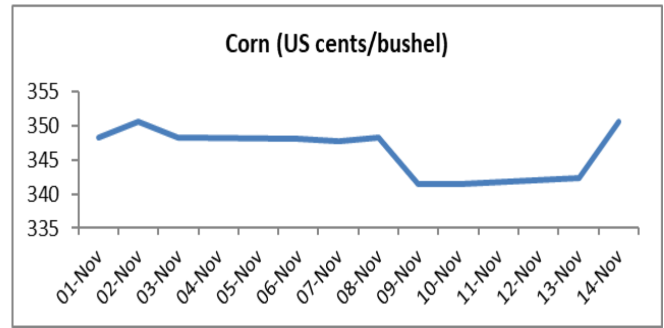


Outlook

Weather conditions is major producing regions (Russia, US and parts of Europe) will play a large role in determining the outlook of wheat prices. We expect cooler weather, to dampen harvest in in the coming weeks, in some areas. This will however, be balanced by increased output in other regions. Thus, do not expect significant changes in wheat prices.

Corn

Corn prices averaged $3.47/bushel in the review period, 0.57% less than the average of $3.49/bushel in the corresponding period in October. Ample US supply continues to weigh on prices.

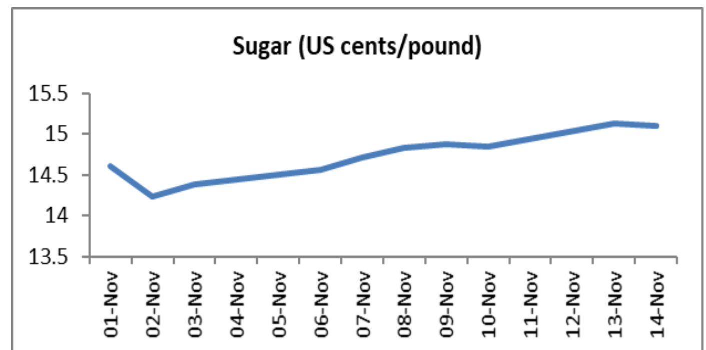


Outlook

The supply glut is expected to worsen in the coming months, as producers compete to gain market share of the increasing Asian demand. USDA raised estimates its estimates for corn by 7.6 million tons. The EU also adjusted its projections upward.

Sugar

Sugar prices averaged $0.1473/pound in the period November 1st- 14th, 3.29% lower than the average of $0.1426/pound in the relative period in October.



Outlook

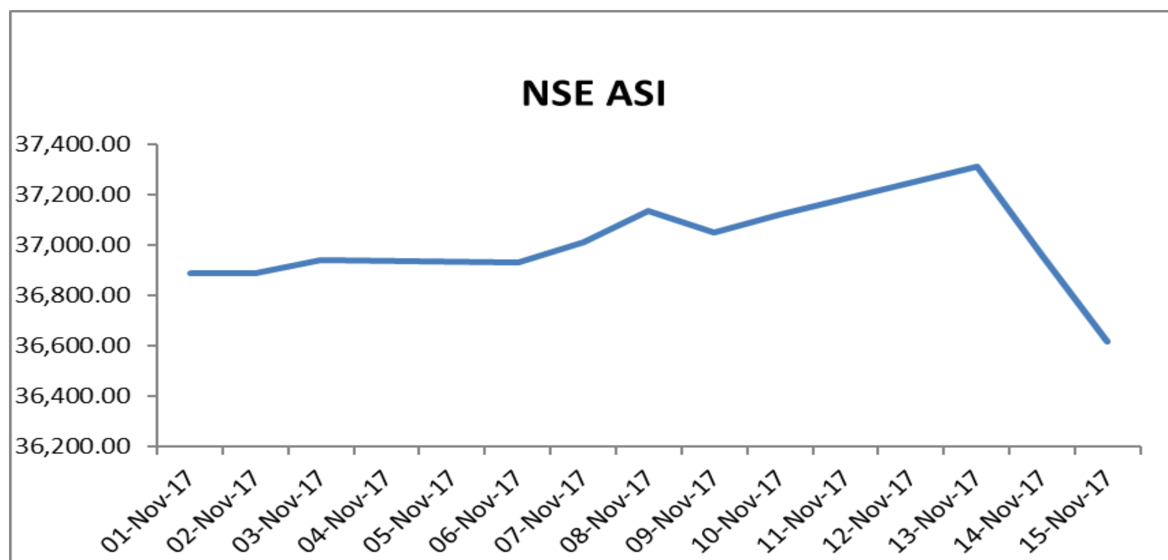
Sugar prices actually gained 3.35%. We expected increased demand as the festive season approaches, to push up prices of sugar.

STOCK MARKET UPDATE

Negative investor sentiment, particularly on large cap stocks saw the NSEASI lose 0.73% to close at 36,617.47 points in the review period. The YTD return on the index declined to 36.25%, while market capitalization closed at N12.68trn. Market PE ratio stood at 12.65x.

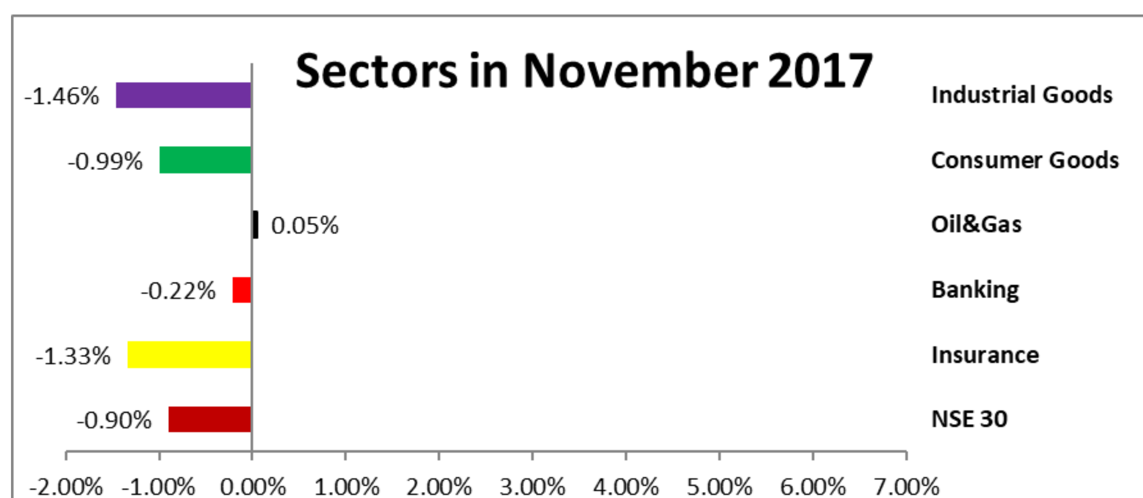
The reign of the bears continued The reign of the bears continued unabated on the trading floor of the Nigerian Stock Exchange (NSE), as the prices of major large capitalized stocks declined.,

This resulted in a decline in the All Share Index (ASI) in the first half of November by 0.73% to close at 36,617.47 from October's close of 36,887.20. The YTD return on the index declined to 36.25% while market capitalization closed at N12.65trn after it lost N120bn during the review period. The market is currently trading at a price to earnings ratio of 12.33x from 12.99x at the start of the review period. Activity on the bourse was mixed resulting in 7 days of gains against 4 days of losses. Daily changes, representing volatility on the ASI, ranged between -0.96% and 0.52% during the review period.



In the first half of November, five out of six NSE sectoral indices closed negative, with the industrial sub-index performing the worst, losing 1.46%. The banking sub sector lost the least, declining by 0.22% during the review period. The downgrade of eight Nigerian banks by Moody's did not have a long-lasting impact on the sub-sector despite the potential risk of a higher debt service burden resulting from reduced liquidity. The oil & gas sub sector recorded the best performance, increasing by a meager 0.05%. There is upside for the oil & gas sector given the recent rally in the oil market. Brent oil rose to its highest level in 27 months ($64pb) on the back of improving market fundamentals. The general performance of the sectors can be attributed to profit-taking activities.

SECTOR PERFORMANCE



Source: NSE, FDC Think Tank

The best performing stocks for the month were UNIVERSITY PRESS 30.23%, FORTE OIL 21.55%, LEARN AFRICA PLC 15.92% and CAVERTON OFFSHORE SUPPORT 15.08%.

TOP 5 GAINERS (N)				
Company	**Nov 15'17**	**Nov 01'17**	**% Change**	**Absolute Change**
UNIVERSITY PRESS	2.80	2.15	30.23%	23.00
FORTE OIL PLC.	48.62	40.00	21.55%	5.05
LEARN AFRICA PLC.	1.02	0.88	15.92%	0.12
CAVERTON OFFSHORE SUPPORT	1.45	1.26	15.08%	0.20

Top price losers were MAY & BAKER (-26.8%), CONOIL (-25.47%), NEIMETH (-18.6%) and CADBURY (-18.6%).

TOP 5 LOSERS (N)				
Company	**Nov 15'17**	**Nov 01 '17**	**% Change**	**Absolute Change**
LINKAGE ASSURANCE PLC.	0.59	0.86	-31.40%	-0.89
C & I LEASING PLC.	1.32	1.78	-25.84%	-4.68
AIRLINE SERVICES AND LOGISTICS	6.15	7.48	-17.78%	-0.39
CHAMPION BREW. PLC.	1.32	1.78	-15.45%	-2.60

OUTLOOK

With equities still looking attractive at current levels, we may see investors taking positions, especially in stocks with good fundamentals, for year-end gains. This may result in the ASI inching up slightly in the second half of November.

ANALYST'S NOTE

The Nigerian food and beverage industry continues to face challenges as a fall in consumption persists despite an improving economy. Accelerating food prices and the weak labor market dampened growth in consumer spending. The sector has been adversely affected by high inflation rates (food inflation at 20.32%, the highest since July of 2008) and the current currency movements in Nigeria. We foresee cautious spending as consumption will be largely determined by price. Food sales are expected to contract by 15.3%; top line food consumption is expected to contract throughout 2017. Even with these market contractions, Nestlé Nigeria recorded a 29% increase in its top-line earnings in Q3'17 despite prevailing economic conditions, as the company managed to achieve an increase in sales volume. However, sales volume growth was at a slower pace than H1'17. While the company's resilience shows the strength of its brand and management, an intrinsic valuation of the company reveals that it only has a marginal upside of 0.23%. Taking into account its future top-line growth, product range, cost management strategy and relative valuation, Nestlé's current price is hovering around its intrinsic valuation. Accordingly, we place a HOLD rating on Nestlé Nigeria Plc.

Industry: Food, Beverage & Tobacco

Recommendation Period: 365 days

Market Cap: N1.023trn

Analyst Recommendation: HOLD

Current Price: N1290.00

Target Price: N1292.00

Top-line growth driven by volume growth

Nestlé Nigeria recorded solid revenue sales of N63.3bn in Q3'17 (a 29.1% increase) and N185.2bn in 9M'17 (a 43% increase). Nestlé's revenue grew at a slower rate in Q3'17 from 52% in H1'17 due to the effect of high food inflation which led to the increase in its prices in FY'16 (double-digit price increases).

Its volume growth slowed from double-digit in the earlier part of 2017 to a high single digit in Q3'17. However, volume growth was sustained but at a relatively slower pace. The decline in competition from imported products due to foreign exchange (FX) shortages contributed to the increase in sales volumes. This shows the company's resilience in a period of weak economic fundamentals. Despite a shift in the market to cheaper alternatives, we expect Nestlé to sustain volume growth in Q4'17 (festive season) and its top-line earnings to maintain an upward trend.

Margin expansion due to access to foreign exchange (FX)

Prior to 2014, Nigeria was blessed with a stable currency due to the rise in global oil prices. However, the significant fall in oil prices in 2016 resulted in a shortage of dollars and revenue shortfalls. The naira's severe devaluation by 215% to N490/$ as at December 30th, 2016, compared to N155.71/$ at the start of 2014 pushed up the costs of imported materials. The fall in global oil prices led to a demand pressure in the Nigerian foreign exchange (FX) market which adversely affected earnings. However, the introduction of the Investors' and Exporters' Foreign Exchange Window (IEFX) by the Central Bank of Nigeria (CBN) in late April 2017 boosted liquidity in the FX market. This in turn boosted Nestlé's margin by 43.4% in Q3'17 and 46.1% in 9M'17 due to access to cheaper FX to import new technology, machinery replacements and the purchase of raw materials such as coffee.

FX loss insufficient to offset gains

Despite Nestlé's accessibility to cheaper FX, the company still recorded a FX loss of N6bn. This was due to Nestlé repaying about $36mn of its shareholder loan using the IEFX rate of N360/$ compared to the official rate (N305/$) on which the loan was valued on its balance sheet. Even so, the FX loss was not large enough to offset its top-line and bottom-line gains.

INDUSTRY AND COMPANY OVERVIEW

Nestlé Nigeria (a subsidiary of Nestlé SA) was incorporated in 1961 and was listed on the Nigerian Stock Exchange (NSE) in April 1978. Nestlé SA currently holds a 66.18% stake in Nestlé Nigeria. Its key business activities include the manufacturing, marketing and distribution of food products. The company has three factories in Nigeria: Abaji factory, Agbara Manufacturing Complex, and Flowergate factory. Nestlé Nigeria Breweries produces a wide range of culinary products (Maggi), baby food (Cerelac), cereal (Golden Morn), chocolate drinks and confectionery products (Milo Powder, Milo Ready-to-drink, Chocomilo, Kit Kat), dairy products (Nido), coffee (Nescafé and water (Pure Life).

The food and processing industry in Nigeria faces a couple of challenges. Nigeria imports most of its packaged foods and the overall import bills are steadily growing as the population increases. Capacity utilization in local factories averages 35%[17] which signals external impediments such as lack of uninterrupted power supply. Apart from these external impediments, the food processing industry in Nigeria is plagued by structural deficiencies. Nigeria is one of the highest cost markets in Africa with a highly price sensitive consumer base. This makes competitive pricing difficult for food producers and affects Nigeria's export capabilities to the wider West African region and world at large. In a bid to support local food producers, the government, placed an import ban on various food products, increased import duties, and implemented the dual inspection policy. It also introduced policies aimed at self-sufficiency in the production of major agricultural products

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

to ensure cheaper raw materials for food processing companies. Nigeria's large (and mostly young) population makes the market lucrative for investors as the company can tailor its products to suit the tastes and purchasing power of the people.

The food and beverage (coffee) industry in Nigeria is dominated by multinational players which include Nestlé, Unilever and Cadbury. Other players include domestic food processing companies such as UACN Foods which manufactures snacks and a range of sweets. Despite the harsh economic conditions, Nestlé Nigeria has recorded remarkable profitability compared to its competitors. This is evident in its earnings per share (EPS) of N28.99, 2,165% higher than that of Unilever Nigeria Plc (N1.28) and 96,733% higher than Cadbury Nigeria's EPS (-N0.03).

The Financial Year (FY) 2016 was a tough year for Nestlé due to a significant fall in oil prices which resulted in the shortage of dollars, revenue shortfalls, high inflation (18.55% as at December 2016) and ultimately a recession in Nigeria. There was a fall in consumption due to low purchasing power which affected the company's bottom line profit. Its non-current assets had a Compound Annual Growth Rate (CAGR) of 4% between 2013 and 2016. However, its net assets had a negative CAGR of 3%. Between 2015 and 2016, its gross profit margin decreased by 3.1% while its operating profit margin decreased by 1.3%. Profit after tax (PAT) during FY'16 was down by 67% due to high raw material costs, increased energy cost and higher finance costs. Nestlé, however, experienced an overall revenue growth of 20% for FY'16 due to an increase in the prices of its products. The cost of sales as a percentage of revenue increased by 3.1% for FY'17 due to the rise in cost of raw materials, while administrative expenses as a percentage of revenue fell marginally by 0.5%. Selling and distribution expenses, as a percentage of revenue, also fell by 1.3%.

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

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

Capable of Capitalizing on Potential Growth Opportunities

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

CEO & Managing Director, Nestle Nigeria

Mr. Mauricio Alarcon

Mr. David Ifezulike is the Chairman of the Board of Directors since May 2013. He has a BSc. in Mechanical Engineering from the University of Manchester and a MSc. in Petroleum Engineering from Imperial College, London. He joined Nestlé in 1980 and has over 22 years' extensive experience in various capacities and locations including Nigeria, Ghana and Switzerland. Other key members of Nestlé's management team and long-time associates include Mr. Syed Saiful Islam (Finance and Control Director) and Mr. Bode Ayeku (Company Legal Adviser).

Chairman Board of Directors, Nestle Nigeria

Mr. David Ifezulike

This team introduced a new product, Milo Ready-to-drink, into the market in Q4'17 to meet the nutritional needs of children and to drive sales growth. For now, the product is just gaining market acceptance and is expected to have a positive impact on the company's 2018 sales. In a bid to further manage its costs efficiently, Nestlé continues to explore the use of local materials in its production processes and it has successfully introduced the use of locally produced items such as soya bean, maize, cocoa, palm olein and sorghum. This helps in reducing Nestlé's exposure to the volatility of the FX market, helping it manage input costs efficiently.

Management's ability to drive growth in revenue and earnings by leveraging its solid brand, in a period of weak economic activity, should give investors confidence in the management team. Nestlé's size and brand is expected to benefit from the long term projection of growth in disposable income. In addition, the rising consumption of bottled water provides an opportunity for Nestlé to expand its Pure Life water brand.

THE BULL SAYS

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

THE BEAR SAYS

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

Risks and Outlook:

Growth potential constrained by macroeconomic risks

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

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

Nestlé is exposed to currency risk on sales, purchases and borrowings denominated in foreign currency primarily in euro, US dollars (USD), pounds sterling (GBP) and Swiss francs (CHF).

This is one of Nestlé's key risks as the company recorded a 9.93% increase in net finance costs between Q3'16 and Q3'17 and a 92.18% increase between Q2'17 and Q3'17. Although there have been recent improvements in the availability of FX in the country and the company mitigates this risk by maintaining foreign dominated bank accounts and keeping Letters of Credit (LC), there is still a level of uncertainty in the FX market due to possible oil price and production shocks.

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

Nigeria is currently out of a recession with a positive GDP growth of 0.55% (Q2'17). However, any obstruction in the implementation of the government's recovery plans, a decline in global oil prices and/or Nigeria's oil production could lead to a contraction in GDP.

Even though Nestlé's management has the ability to manage the macroeconomic challenges it faces in the near future, the intensity of the macro headwinds could negatively affect the company's performance. While Q3'17 and 9M'17 were outstanding, several macroeconomic factors and risks may reduce its performance in the future.

APPENDIX - Valuation

We derived our valuation for Nestlé Nigeria by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate for Nestlé stood at **N1292.92**, which is a 0.23% upside on its current share price of N1290.00 as at November 8, 2017. The discount rate [weighted average cost of capital (WACC)] of 11.62% is derived using a 16.2% risk free rate [the yield for a 10-year Federal Government of Nigeria (FGN) bond maturing in March 2027], a beta of 1.0592[18] an after-tax cost of debt of 4.67%, and a market risk premium of 6.4%. The calculated long-term cash flow growth rate to perpetuity is 7%.

[18] Financial Times

DCF Valuation			
N'000	**2017**	**2018**	**2019**
EBIT	45,262,307	51,068,195	59,247,305
Less: Taxes	(10,997,049)	(12,407,662)	(14,394,880)
EBIAT	34,265,259	38,660,533	44,852,425
Plus: Depreciation & Amortization Expense	5,859,972	6,117,822	6,374,834
Less: CAPEX	(5,691,029)	(6,441,112)	(7,481,330)
Less: Change in Working Capital	(16,718,525)	3,336,828	4,439,358
Free Cash Flow (FCF)	17,715,677	41,674,071	48,185,287
WACC	11.62%	11.62%	11.62%
Present Value (PV) of FCF	15,871,771	33,450,389	34,651,124
Terminal Value @ Perpetual Growth Rate (2019)	**2017**	**2018**	**2019**
Terminal Value as of 2019	-	-	1,307,402,221
Present Value of Terminal Value	940,182,357		

DCF Calculation	Valuation
PV of Explicit Period	83,973,284
PV of Terminal Value	940,182,357
Enterprise Value	1,024,155,640
+ Cash	51,351,152
- Borrowings	(50,669,298)
Equity Value	1,024,837,494
Share Price	***1,292.92***
Shares Outstanding ('000)	792,656

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