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FDC MONTHLY ECONOMIC UPDATE

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In This Issue ...

Nigerian Stock Market – Ours to Plough, not to Plunder

The NSE All Share Index (ASI) got off to a good start at the start of 2018, as it gained 16% in January alone. But the tides have taken a quick turn since then, as the index lost 27.1% of its value in the 8 months that followed. This loss can be linked to a plethora of endogenous and exogenous factors – from election uncertainties to investors seeking higher real yields in advanced economies.[1]

September Blues – Is a bear market imminent?

The bourse's loss of 7.23% in the first half of September remains the highest loss within a 2-week period so far in 2018. The market also recorded the highest daily loss of 3.46% during the same period. This caused the market capitalization to drop below the N12trn mark. Consequently, the year-to-date loss of 15.5% affirms that the bourse is now in correction having dropped by more than 10%.[2]

Capital flow reversal weighs on the Bourse

The outflow of hot money in the form of foreign portfolio investment (FPI) reversal has adversely affected the performance of the NSE, especially given political squabbles and unfavorable government policies. Monthly FPI transactions on the NSE declined by 78.3% in July to $118.5mn, compared to January; and 64.7% below June 2018 trading value.[3] This postulates that foreign trades on the stock exchange will further stall in the short-term.

In addition, the controversy between MTN and the CBN and Attorney General of the Federation has put the bourse under immense pressure. This further intensified the withdrawal of hot money and could delay the impending listing by the Telecoms giant, which was expected to increase market capitalization by about N2trn. As a result, the NSE ASI lost 8.6% following the announcement of the government's decision (August 29th).

[1] NSE, FDC Think Tank
[2] Ibid
[3] NSE Domestic & Foreign Portfolio Participation in Equity Trading, July 2018

Manufacturing stocks pulls down NSE ASI

The weak demand for securities, undermined by abundant supply, is evident in the performance of sectoral indices with all sub-sectors in a negative YTD position. Consumer goods index (-22.7%) recorded the highest decline so far in 2018, largely as a result of the beer wars and the initial introduction of excise duties on alcoholic beverages, spirits and tobacco. This weighed on the enterprise value of these stocks, which rendered them underweight relative to other investor portfolios.

The industrial index also lost 22.4% of its value, as the impressive financial performance of the most capitalized stock (Dangote Cement) was not enough to overturn the negative investor sentiments. This is coupled with the inadequate internal efficiencies among the other industrial stocks, limiting the attractiveness of these stocks.

Outlook

The Nigerian stock market will likely experience a substantial correction swinging towards the bear territory (20% to 40%) in the near term. The negative sentiments caused by the widespread pessimism and political fracas will maintain the downward spiral of the market, at least until after elections in 2019.

What is Happening to the Currency Market in Nigeria?

The naira has been trading within a tight band of N359-N361/$ for the past 2 months in the parallel market, whilst the IEFX exchange rate traded within a band of N360-N362. However, this stability was tested recently when the IEFX window depreciated to a new low of N364/$ before retreating to N362. This is evidence of a build-up in forex demand pressures. As at September 17, the naira was trading at N362.93/$ at the IEFX window. This is 0.5% higher than the street rate of N361/$. This is happening simultaneously with a persistent decline in Nigeria's gross external reserves level, which is now below the psychological resistance level of $46bn at $45.20bn (as at Sept 14). This has reduced the CBN's intervention in the forex market with a total intervention of $3.55bn so far in Q3 compared to $4.26bn in Q2. The apex bank also failed to intervene in the forex market in the week ending September 14, the first time in the third quarter.

Political uncertainties are also affecting investor confidence in the Nigerian economy. As the build up to the 2019 general election intensifies, investors are liquidating their portfolios, resulting in a 9.76% decline (quarter-on-quarter) in foreign portfolio inflows into Nigeria in Q2.

Implications on the economy

CBN's intervention in the forex market has declined and this can be partly attributed to the depletion of Nigeria's external reserves level, which is treading close to the new psychological resistance level of $45bn. This raises some concerns about the CBN's ability to defend the naira in the near term. There are also concerns about the imminent demand pressures from politicians owing to political campaigns. Therefore, we expect the naira to come under pressure across all market segments in the short to medium term.

Tackling the Core Challenges of the Education Sector

The education sector in Nigeria is in dire straits. While all eyes seem to be on the economy and what Nigeria can do to diversify, little attention is paid to the sector that creates the country's future labor market and employers. Without a strong education sector that inspires creative thinking, it is challenging to see how Nigeria's next generation will think differently about its entrenched economic problems. Yet Nigeria's education sector remains grossly underfunded. Of its N9.12trn budget in 2018, just 5.9% (N542bn) was allocated to education.[4] That's a far cry from the 15-20% recommended by the United Nations Educational, Scientific and Cultural Organization (UNESCO).[5] The impact of inadequate funding should not be underestimated. It has broad impacts across the core components of a strong education system – personnel, infrastructure and curriculum development – and it is compounded by issues of poor governance and corruption. If Nigeria is truly to address the weaknesses in the education sector, it needs to prioritize funding by increasing its allocation, and it needs to ensure that money stays in the sector by cracking down on corruption.

What are the constraints?

The school per capita ratio is an excellent example of the impact of poor funding. There are about 82 million school-age children (below the age of 16 years) in the country and about 90,000 primary and junior secondary schools combined.[6] This results in a ratio of 900 pupils per school which is quite high. The lack of schools ultimately means many would-be students are excluded from the education system or subject to a sub-standard education due to issues that result from overcrowding. Increasing the number of fully equipped schools must be a priority for the federal and state governments to meet the need of the ever-growing population in the country.

[4] http://www.budgetoffice.gov.ng
[5] http://www.budgetoffice.gov.ng
[6] http://www.nigerianstat.gov.ng

Inadequate human capital is also, at least in part, a result of poor funding and low teaching standards. There are many teachers or instructors who are not qualified to teach in schools, having not obtained the proper certifications. Some also often opt for teaching jobs as a last resort when they are unable to find employment elsewhere. Teaching jobs are typically not sought-after positions as the salaries are poor and often irregular. Unsurprisingly, students suffer as a result. This issue was brought to nation-wide attention when a teaching assessment was carried out in Kaduna State in 2017. Many of the teachers failed the assessment and were sacked. While the test was restricted to Kaduna State, it is a testament to the quality of teaching personnel nation-wide and remains widely unaddressed.

Poor funding plus low teaching standards result in poor quality curriculum. The Nigerian curriculum is significantly outdated and lacking in applied learning. The lack of ICT curriculum and equipment especially in public schools, is a crystal-clear example of this. This is 2018. Information and communication technology (ICT) should be in the core curriculum of Nigerian schools. Yet, computer courses are lacking, as are computer labs. In some cases, ICT classes are taught without the use of computers. So while students may be exposed to some rudimentary ideas, their inability to actualize those ideas puts them at an extreme disadvantage when it comes to leveraging ICT skills in their day-to-day, and professional, lives.

Corruption in the education sector only makes these core challenges worse. The little funds that come through the system often fall victim to embezzlement. Hence, the development of key infrastructure, teacher and curriculum funding, and teacher quality, are further compromised. Diverted funds also incentivize teachers and administrators to augment their salaries and school budgets through corrupt practices such as selling test answers to students and charging illegal fees etc.

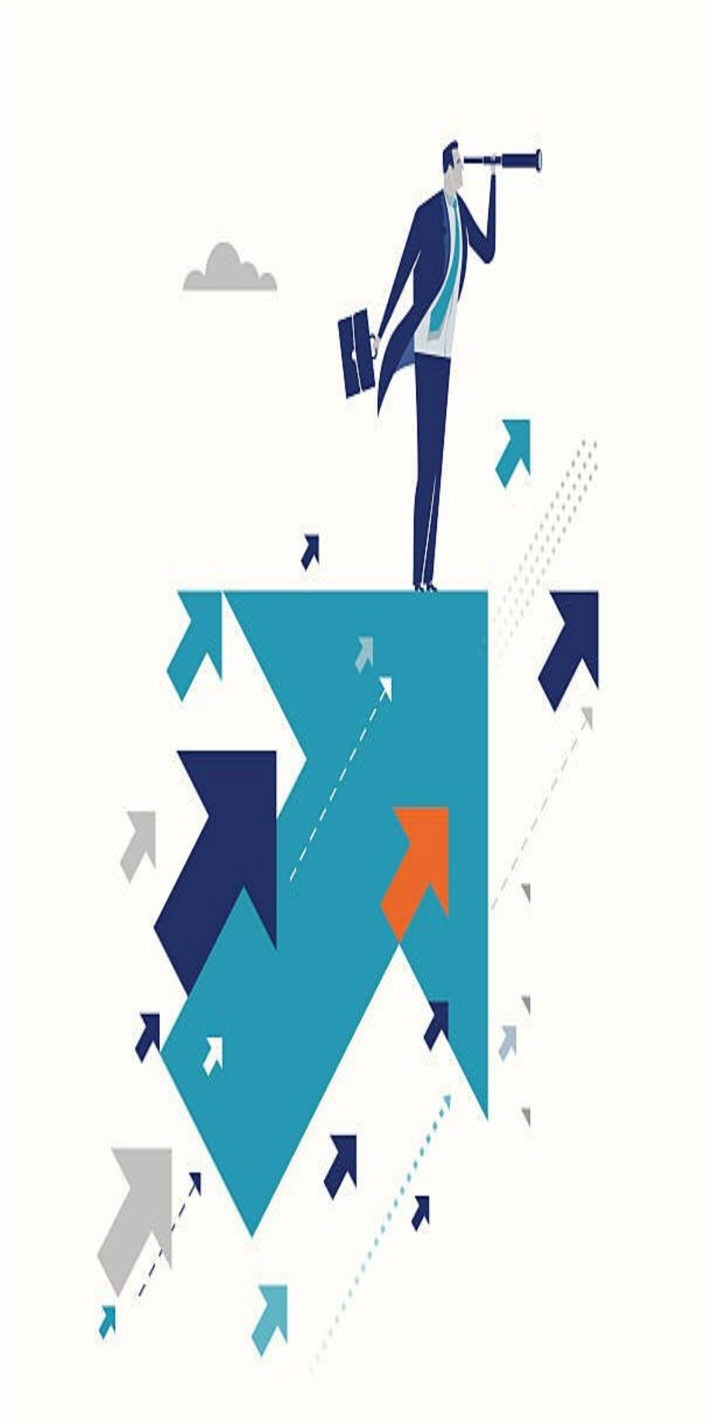
The way forward

Increased funding ensures teachers and administrators are properly compensated and less incentivized to participate in corruption. It also creates opportunities to improve the curriculum and support the procurement of equipment such as science and computer labs.

Specifically, the government should focus on introducing more ICT courses to ensure Nigerian students are developing in line with the global standards in technology learning. Strong investment in ICT education not only makes the upcoming generation more employable but also boosts the opportunity for greater job creation by setting the foundations for an increase in tech start ups.

Apart from funding, corruption needs to be addressed head on. There should be compulsory training and ethics courses for all teachers, awareness building amongst parents and students, and support structures for whistleblowers. This combined with improved, and regular salaries, could have a positive effect on the sector through corruption reduction.

The performance of the education sector in Nigeria is poor due to a myriad of challenges. However, better funding paired with aggressive action against corruption would be key steps to grow and develop the sector (currently growing at 4.52% in Q2'2018). Investing in education is investing in the future.

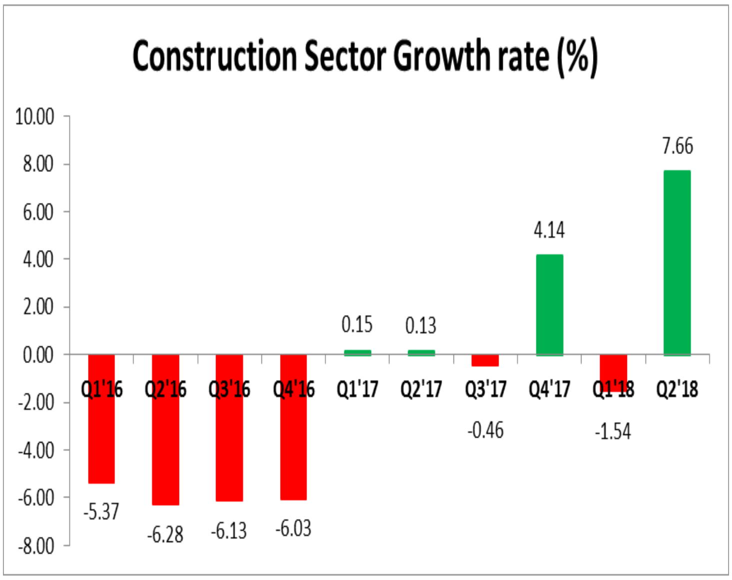


The Construction Sector in August

In the month of August, the NBS released the growth numbers for Q2 and the construction sector was among the fastest growing sectors. Nigeria's construction sector expanded by 7.66% in Q2'18, outperforming GDP growth of 1.5%. The sector's stellar performance in Q2 came as a surprise given the fact that the sector typically slows in the second quarter due to rains. In Q2'17 for instance, the sector's growth slowed to 0.13% from 0.15% in Q1'17. Similarly in 2016, the sector contracted more sharply by 6.28% in Q2 compared to a 5.37% contraction in Q1'16; the recession also had an impact. The sector's positive performance in Q2'18 could be attributed to several factors ranging from forex availability and expedition of projects delivery by political office holders ahead of the 2019 general elections. The sector contributed 4.51% to GDP in Q2'18. This is an increase compared to a 4.04% contribution in Q1'18.

The construction sector witnessed other positive events that bode favourable for the sector's growth trajectory in the medium term. The Federal Government of Nigeria formally unveiled the master plan for the construction of the Centenary City in Abuja. The Ebonyi State government also disclosed its intention to build an airport.

In SSA, African Development Bank (AfDB) has pledged to commit $105mn to upgrade a road linking Kenya and Uganda. Liberian government is also in talks with the World Bank for a concessional loan of $500mn to finance a coastal highway project in the country.



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[7]NBS, FDC Think Tank

FGN unveils master plan for Centenary City

The Federal Government of Nigeria formally unveiled the master plan for the construction of the Centenary City in Abuja. The Centenary City project was conceived in 2014 by the former President Jonathan administration to mark Nigeria's 100 years of existence. However, it has witnessed several administrative and procedural setbacks. The proposed city would be a free trade zone and funding would be absolutely provided by private investors.

The project is scheduled to utilize 100% local man power during the implementation phase. Meanwhile, it was disclosed that 40 local and foreign investors are pulling resources together to build the city, with $18.76bn being committed by foreign partners from the United Arab Emirates. The city is located along the Nnamdi Azikiwe International Airport road. Upon completion, it would have 360 luxury villas, 256 apartment buildings, 13 waterfront retail areas and 139 office buildings. It will also have 466,297mn integrated golf community, 313,697mn of hotel suites and service apartments, 5 major retail centres, 46 floors of premium office and 30 floors of luxury apartments among others. The plan also includes the provision of Nursery to Secondary schools and health care facilities for the neighbourhood.

Implications

The unveiling of the master plan demonstrates the current administration's support for the Centenary City project (conceived by the Jonathan administration), given the fact that Nigerian political office holders typically jettison their predecessors' policies and proposals. At completion, it is expected that the project would improve Nigeria's appeal to tourists. Lagos State is also embarking on a similar project- the Eko Atlantic City. The existence of free trade zones in the commercial hubs of the country bodes favourably for foreign exchange inflows into Nigeria and long term macroeconomic stability.

Ebonyi to commence Airport construction

Ebonyi state governor, David Umahi, disclosed the Ebonyi state government would commence the construction of an airport by 2019. Nigeria currently has about 30 airports and Ebonyi state has none. The Ebonyi State government is yet to disclose full information on how the project would be funded and whether it would be a local or international airport.

Implications

South Eastern Nigeria currently has two airports, one in Imo and Enugu. The construction of an airport in Ebonyi State would reduce passenger traffic especially at the Akanu Ibiam Airport in Enugu, which currently serves Enugu and nearby cities such as Abakaliki, Afikpo, Onitsha, Nnewi, Awka, Nsukka, Okigwe, Otukpo and Ogoja. A new airport in Ebonyi would at the minimum exclude Abakaliki and Afikpo (which are cities in Ebonyi State) from the group of cities the Enugu airport currently serves. The Enugu airport recorded total passenger traffic of 314,296 in 2017, the 7th highest in the country. The construction of an airport in Ebonyi would also boost economic activities in the state. Its GDP is estimated at $6bn, which is just 1.5% of Nigeria's total economic output and one of the lowest among Nigerian States. In 2017, the state recorded a total IGR of N5.1bn in 2017, the 6th lowest among other states. By comparison, Enugu State's IGR was N22.04bn, which is the 9th highest. It is expected that with an airport, Ebonyi State's economic and revenue positions relative to other states would improve significantly. This would also make the state more attractive for new businesses.

SSA

AfDB to commit $105mn to the Kenya-Uganda road upgrade

African Development Bank (AfDB) has pledged to commit $105mn to upgrade a 73KM road linking Kenya and Uganda. The rural road, Kapchorwa-Suam, is an important road network, especially for the transportation of agricultural commodities between both countries. Meanwhile, the road has been in a devastating state and this has compelled the AfDB to financially support its revamp.

Implications

An improved trade relation in recent years has strengthened bilateral trade ties between Kenya and Uganda. However, the poor condition of the road network that links both countries has had a severe impact on the quality of commodities transported. This has also lengthened delivery time of goods. An improved transport system would ease trade flows between both countries and facilitate economic growth especially in the rural agrarian area.

Liberia in talks with the World Bank to secure finance for a coastal highway project

Liberia's finance minister, Samuel Tweh, said that the Liberian government is in talks with the World Bank for a concessional loan of $500mn. The loan would be used to finance Liberia's coastal highway project of about 830KM. President George Weah had initially signed loan agreements worth about $956mn with two private companies. However, both loans were widely criticized for a lack of due diligence. This prompted the authorities to reconsider the finance package. The government is currently engaging the World Bank to secure partial funding for the project.

Implications

Liberia has consistently received financial support on the back of its democratic transition and the government's anti corruption agenda. The World Bank is Liberia's largest external creditor and it currently has 28 active projects in the country. Given the existing relationship between both parties, the World Bank is expected to approve the loan for Liberia's highway project. A World Bank's approval would provide a credible base for the project, which could entice other lenders such as the IMF and the Africa Development Bank (AfDB). The project would improve infrastructure development in the country.

Outlook

We are likely to see more construction activities in September as the frequency of rainfall reduces. Political office holders are also expected to expedite abandoned projects and embark on new projects as they seek public support in the 2019 polls.

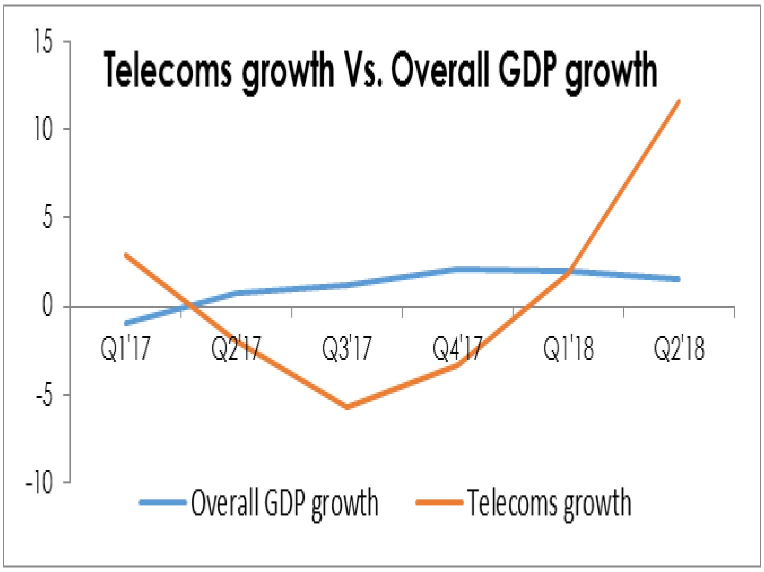
Total number of subscribers down 0.6% to 161.79mn

TELECOMMUNICATION SECTOR REPORT

According to the Nigerian Communications Commission (NCC) latest report, the total number of subscribers fell by 0.6% to 161.79mn in July. This originated primarily from the reduction in MTN's subscriber's base by approximately 1mn. Although, Airtel and Glo recorded an increase of 0.15mn and 0.21mn respectively, this increase was not enough to offset the shortfalls in MTN's subscribers' numbers. Teledensity also dipped by 0.69% to 115.57% in the review period. Interestingly, the total number of internet subscribers advanced to 103.67mn from 102.81mn in June. This reflects the budding preference for data services.

In addition, the Q2 telecoms data report was released by the National Bureau of Statistics (NBS), highlighting an increase in the active voice and internet subscribers. The total number of active voice and data subscribers advanced by 0.09% and 2.57% to 162.5mn and 103mn respectively. This increase was buoyed by the growing sophistication of customers.

The state-by-state breakdown of the report showed that Lagos had the highest active voice subscribers, followed by Ogun and Kano states while Bayelsa and Ebonyi states had the lowest. The top three states with the highest active internet subscribers were Lagos, Ogun and Abuja. Lagos and Kano are commercial hubs; Ogun is an industrial zone while Abuja is the state capital. MTN, the leading mobile operator had the highest share of both active voice and internet subscribers, followed by Glo, Airtel and 9mobile. However, MTN's on-going saga with the CBN could weigh on the firm's long term expansion plans.



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[8]NBS, FDC Think Tank

Telecoms sector outperformed overall real GDP growth in Q2

In August, some Q2 data points (Growth numbers, capital importation) were released by the National Bureau of Statistics (NBS). While the sector recorded an impressive growth, capital importation to the sector plunged. In Q2'18, the telecoms sector grew at a faster pace of 11.54% (Q1'18: 1.88%), outperforming the overall real GDP growth (1.5%). The sector's contribution to GDP was up 1.24% to 10.43%. The expansion in growth was largely driven by a 9.02% increase in the subscriber base to 162.76mn at the end of the second quarter.

Meanwhile, the total capital flows to the sector was marginal at $11.12mn, representing 0.2% of the total share ($5.51bn), compared to other sectors like banking ($294.96mn) and agric ($104.97mn). Also noteworthy is the fact that the share and absolute value of capital import into the telecom sector dropped sharply from Q1'18 when it was 1.38% and $87.25mn respectively. In Q4'17 telecoms attracted capital flows of $191mn.

The total bank credit to the telecoms sector was N814.57bn in Q2'18, 5.31% of the total bank credit to sectors (N15.34trn)

RECENT DEVELOPMENTS IN THE SECTOR

CBN orders MTN Nigeria to refund $8.1bn

Consequent upon the outcome of the investigation carried out by the CBN on illegal dealings relating to Certificates of Capital Importation (CCI), the CBN ordered the telecoms giant, MTN Nigeria to refund $8.1bn, which was claimed to be illegally repatriated between 2007 and 2015 as dividends. MTN has refuted the claims totally saying that there was no wrong doing.

The four banks that facilitated the transaction were also slammed fines worth N5.87bn ($16.23mn), of which the banks have been debited. The banks sanctioned include Standard Chartered Bank, Stanbic-IBTC, Citibank, and Diamond Bank.

The Attorney General has also requested the telecoms giant to remit $2bn as tax arrears.

Implications

Following the sanction, MTN Group's stock price crashed by 25% on the Johannesburg Stock Exchange on August 30th. MTN is a major investor in Nigeria and the re emergence of these claims could dampen investor confidence in the country. This could heighten capital outflows. It could also act as a disincentive to invest in CAPEX, of which MTN spends approximately $1.2bn- $1.5bn yearly on capital expenditure. Furthermore, there could be a delay in the Telco operator's listing on the Nigerian stock exchange. This would reduce both foreign direct and portfolio investments into the country and heighten the pressure on the naira. MTN's position as the dominant player could also be affected and lead to an industry consolidation.

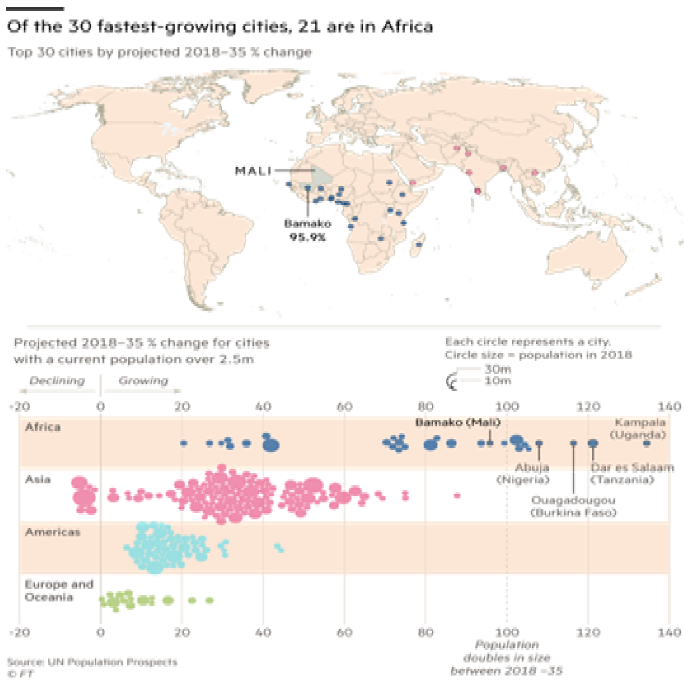
In addition, MTN Nigeria signed a N200bn loan agreement with a consortium of 12 Nigerian banks in August. This is targeted towards its long term expansion plans (enhance its quality of service and fund capital expenditure). The controversy over the CCIs could undermine the impact of these plans.

African cities surge to top of global growth league

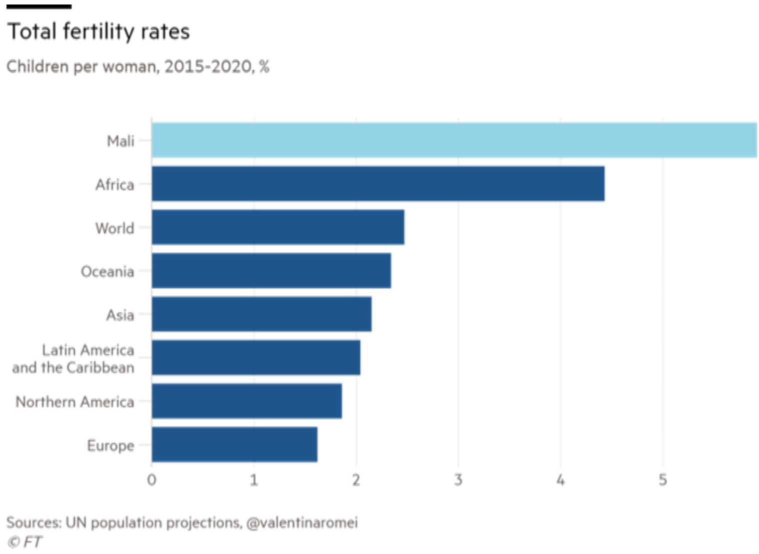
Global Perspective: Culled from Financial Times

Mali capital Bamako shows the strains created by rapid urban expansion

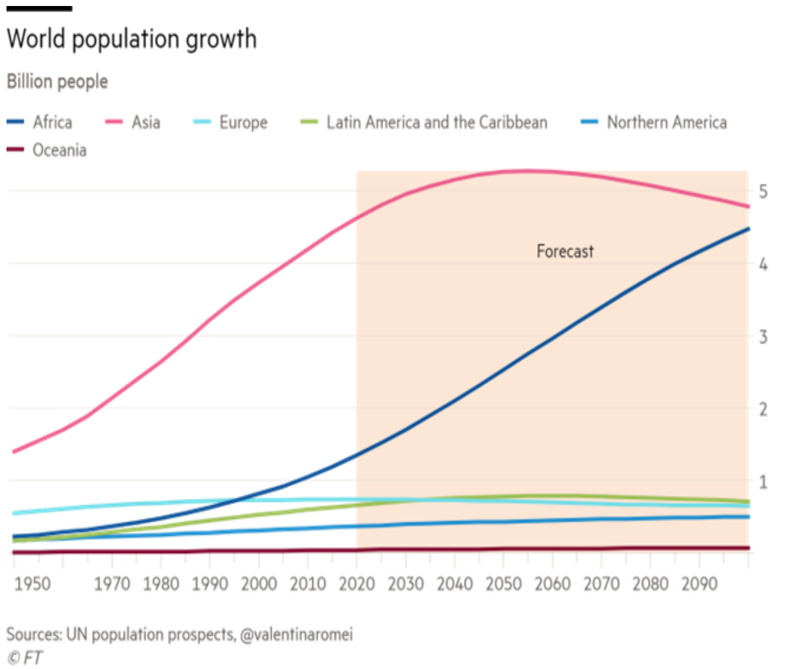
Karim Kane is a carpenter, not a speculator. But the plot of land he bought a decade ago is worth nearly 25 times what he paid for it. In 2007, the village chief sold it to him for the equivalent of about $450. Mr Kane built a house for his wife and six children on land that today he reckons is worth nearly $11,000. The area where Mr Kane lives is little more than muddy hills with scattered plots of land given over to cows and goats. Pedlars lead donkey carts loaded with plastic jerry cans of potable water. But despite its semi-rural appearance Mr Kane has no doubt that he is now a resident of Mali's capital. "I'm a Bamakois," he says, using the French word for a citizen of Bamako. Almost unnoticed, Africa has become the world's most rapidly urbanising continent. From 2018 to 2035, the UN predicts that the world's 10 fastest growing cities will be African. It's a trend that has already enveloped Mr Kane, whose land has been swallowed up by Yirimadio, the fastest-growing part of Bamako, which may itself be the fastest-growing city in Africa.



In parts of the neighbourhood, shacks built by people recently arrived from the countryside jostle with houses being constructed by Bamakois who are snapping up cheaper plots of land on the city edge. As Bamako has grown exponentially it poses huge logistical problems for the cash-starved authorities that are replicated across the continent. According to a World Bank study, 472m people in sub-Saharan Africa live in cities. High birth rates and migration from the countryside mean that by 2040 Africa's urban population will more than double to 1bn, it says, a rate that far outpaces urbanisation elsewhere in the world. Tann vom Hove, a senior fellow at City Mayors, which puts Mali's capital at the top of the list with an annual expansion rate of 4.5 per cent, says the trend is more important than the precise ranking.

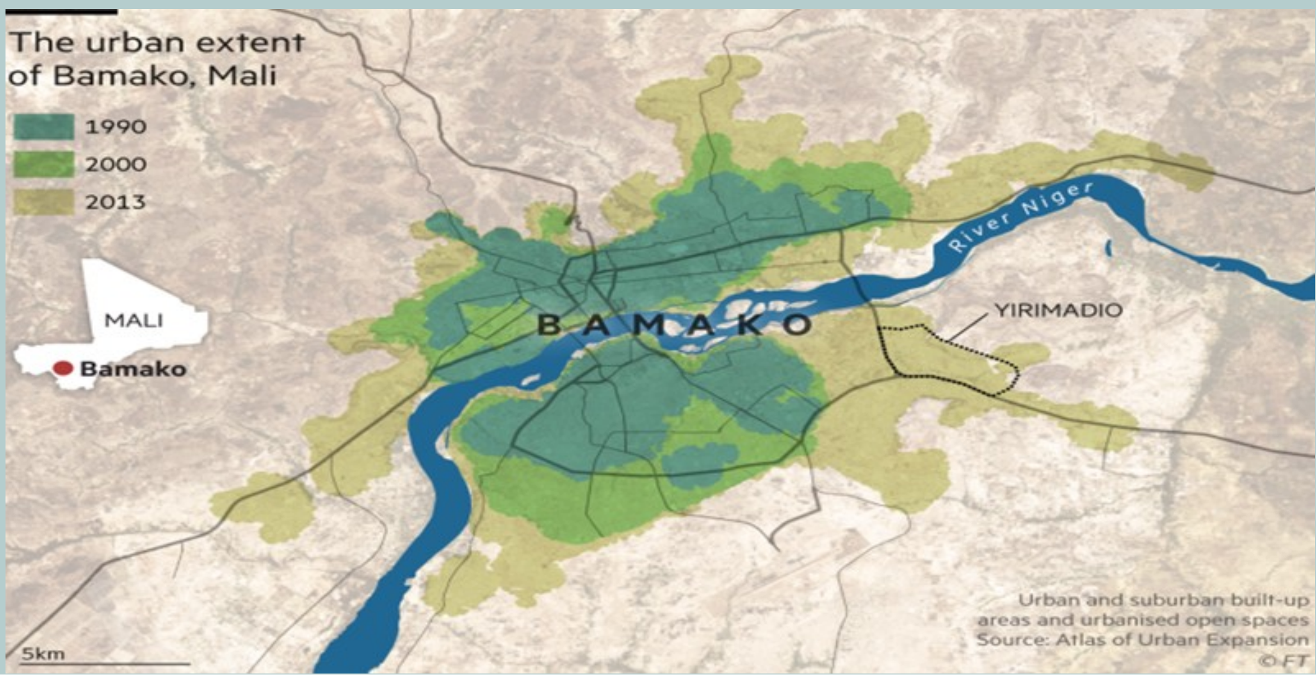


Estimates from the UN say other cities, including Dar es Salaam, a city of nearly 5m in Tanzania, are growing even faster than Bamako. Some of Africa's megacities, including Lagos, Nigeria's commercial capital of 21m people, and Kinshasa, the chaotic capital of the Democratic Republic of Congo, are sucking in hundreds of thousands of new people each year. Smaller cities, such as Yaounde in Cameroon, are growing almost as fast. Urbanisation is what helped ignite the " Africa rising" narrative promoted by the likes of McKinsey, a consultancy, whose 2016 Lions on the Move II report highlighted cities as an engine of productivity. From 2015 to 2045, McKinsey found, 24m more Africans would be living in cities each year, compared to 11m in India and 9m in China. "Urbanisation has a strong correlation with the rate of real GDP growth," it said, adding that "productivity in cities is more than double that in the countryside".



The World Bank estimates Bamako's population today at 3.5m, more than 10 times its size at independence in 1960. But managing urban growth, with its associated problems of service provision, housing, crime and congestion, has become one of the biggest policy challenges on the continent. "For me this is a catastrophe foretold," says Issa N'Diaye, a professor of philosophy at the University of Bamako, of his city's untrammelled growth. "Bamako is a time-bomb." Bamako, he says, and by implication many other cities in Africa, lacks the resources and institutional capacity to cope with explosive growth. There is not even a proper land registry, he says, meaning multiple claims on the same plot can be tied up in court for years. Skyrocketing land prices have led to rampant corruption, Mr N'Diaye says, alleging that land allocated for schools in his own neighbourhood has been sold off by unscrupulous officials. Rapid urban expansion has also left people bereft of services, he says. "There's been no planning whatsoever of the road system, water drainage, electricity or urban transport. The city is becoming more and more unlivable." Recommended The Big Read Nigerian economy: Why Lagos works Since 2005, Yirimadio's population alone has risen from about 20,000 to 190,000, according to officials from Muso, a health organisation that serves the area. In parts of the neighbourhood Yirimadio, locals have campaigned for a standing water pipe; in others they have dug their own wells. Yuba Diakite left what he says was the tedium of farming to try his luck at accounting in Bamako. The women in his rented quarters, where whole families are squashed into a single room, get up before dawn as they would in the village, he says. "Our women exhaust themselves over this question of water."

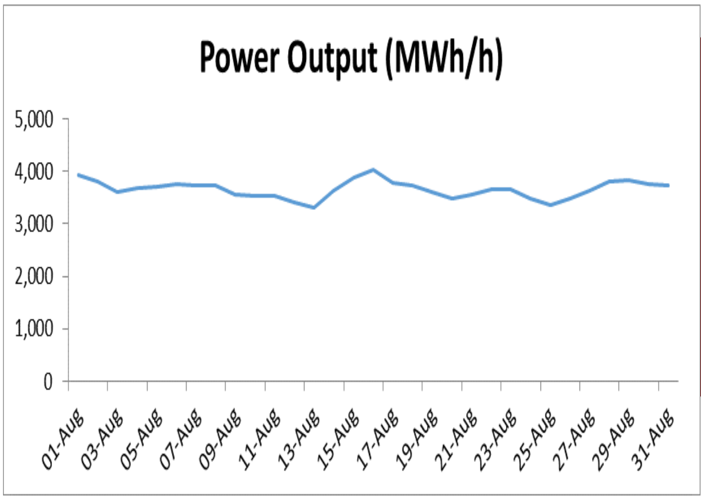
Somik Lall, the World Bank's lead economist for urban development in Africa, says the continent's urbanisation is running ahead of its income. Africa, he says, is 40 per cent urban with a per capita gross domestic product of roughly $1,100. By the time Asia reached 40 per cent urbanisation, its GDP per capita was $3,500, he says. Bamako's expansion has been especially rapid because of people fleeing north and central Mali, unstable since an al-Qaeda-linked group took control in 2012, before being expelled by a French-led military invasion. In the Ministry of Housing and Town Planning, Abdramane Diawara, the director, is well aware of the challenges. "It is difficult to implement the plans we have, let alone a plan for the future," he says, brandishing a document entitled Bamako Horizon 2030. "Bamako should be an asset to the country," he adds, before slumping back in his chair. "Instead, it's a problem."



Macroeconomic Indicators

Power Sector

The average power output from the national grid was 3660MWh/h within the period of August 1st – August 31st. This is 1.13% higher than the average of 3619MWh/h in the previous month of July. This improvement was largely driven by more rainfall which led to an increase in hydro-generated power. Despite this, the sector lost N2.01bn annualized at N733.65bn, which was as a result of insufficient gas supply.



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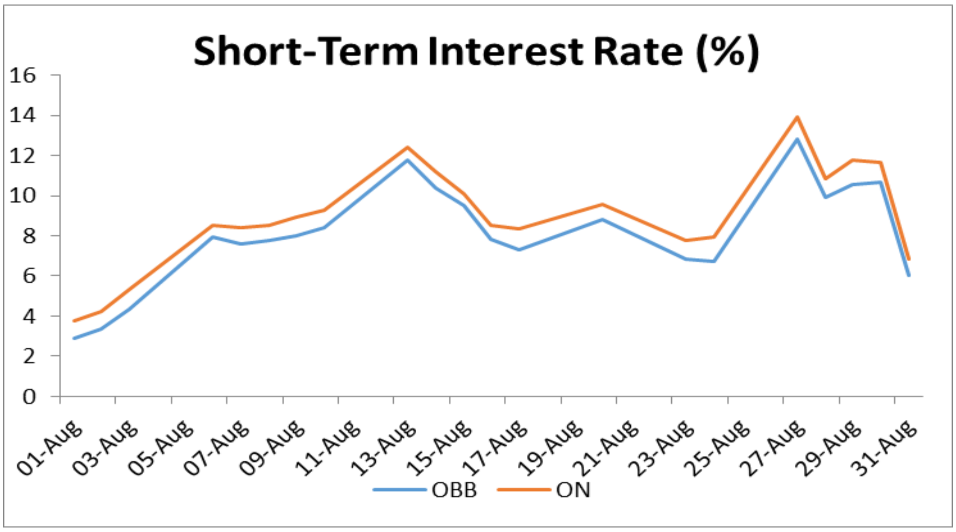
Outlook

We expect the average power supply to remain around current levels of 3,600MWh/h - 3,800MWh/h provided the gas pipelines are not subject to disruptions.

Money Market

Short-term interest rates (OBB and ON) both increased by 308bps to close at 6% pa and 6.83% pa on August 31st from 8.58% and 9.58% respectively on July 31st . Average opening position for banks closed positive at N338.96bn in August, compared to N235.85bn in July. The CBN issued fewer OMO bills (N991.46bn) compared to July. However, more bills matured (N2.02trn) in August compared to the previous month, resulting in a net inflow of N1.03trn.

At the last primary market auction on August 29th, the 91,182 and 364-day T/Bills tenor all increased. At the secondary market on August 31st, the closing rate for the three tenors increased by an average of 56bps from July 31st.



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[9]FGN, FDC Think Tank
[10]FMDQ

Primary Market

T/bills Tenor	Rate on August 15th (% pa)	Rate on August 29th (%)pa	Direction
91	10.00	11.00	⬆
182	10.40	12.30	⬆
364	11.22	13.05	⬆

Secondary Market

T/bills Tenor	Rate on July 31st (% pa)	Rate on August 31st (%)pa	Direction
91	10.86	11.37	⬆
182	12.06	12.26	⬆
364	11.71	12.68[11]	⬆

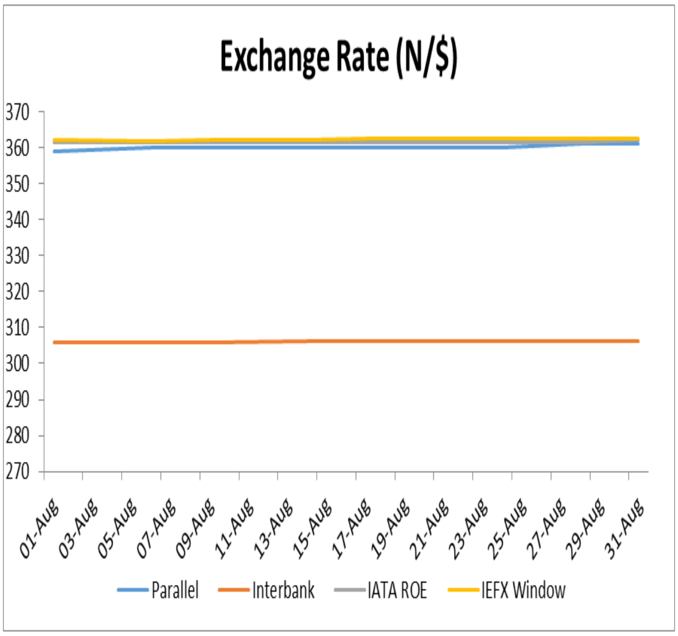
Outlook

We expect CBN interventions to continue to increase in the money market so as to regulate liquidity level.

Forex Market

Exchange Rate

At the parallel market, the naira started the period at a 25-month high of N359/$, before depreciating to close at N361/$. At the interbank foreign exchange market, the exchange rate depreciated by 0.07% to close at N306.15/$ at the end of August. The naira depreciated by 0.09% to close at N362.64/$ at the IEFX window from N362.33/$ on August 1st. Total forex traded at the IEFX window was $5.31bn, compared to $3.66bn in the corresponding period in July. The CBN's intervention in the forex market also depleted for the second successive month to $1.5bn in August from a total sale of $1.54bn in July.



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Outlook

In September we expect the naira to depreciate slightly as liquidity pressures build up amidst political uncertainties and higher interest rates in developed economies.

[11]CBN, FMDQ

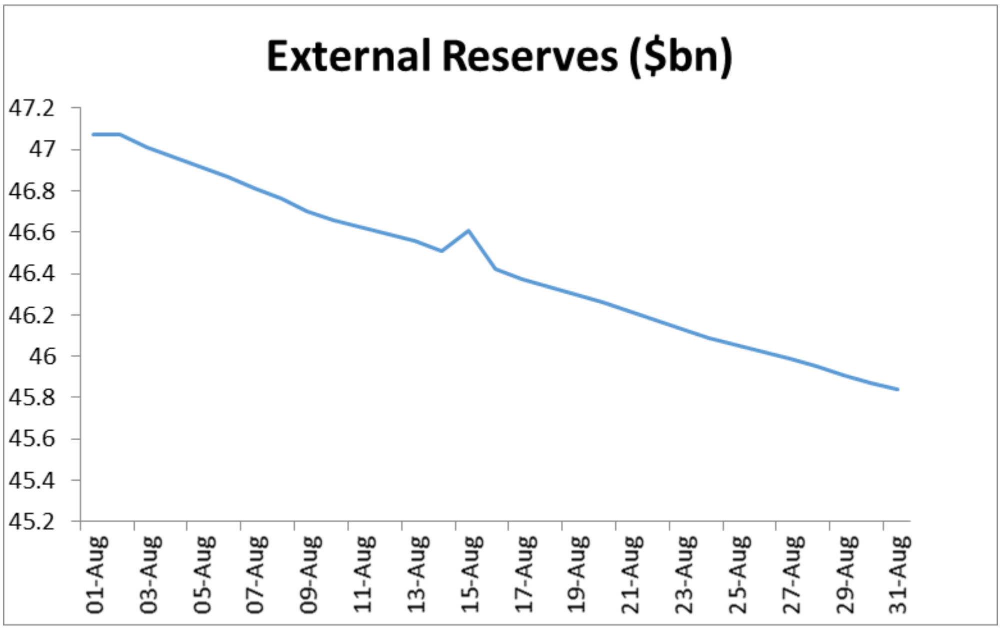
[12]FMDQ, CBN, FDC Think Tank

External Reserves

Nigeria's gross external reserves declined below $46bn to close the period at $45.84bn (August 31st) from $47.12bn on July 31st. The depletion in the reserves level is as a result of the combination of heightened political uncertainty and capital flight to developed economies. The CBN's intervention in the forex market declined for the second consecutive month to $1.5bn in August from the intervention of $1.54bn in July. The current external reserves level is sufficient to cover 11.17 months of imports and payments in the economy.

Outlook

Increased liquidity in the month of August weakened the currency. However, we expect the CBN to continue its interventions which will have a negative impact on the growth of the external reserves.



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[13] CBN, FDC Think Tank

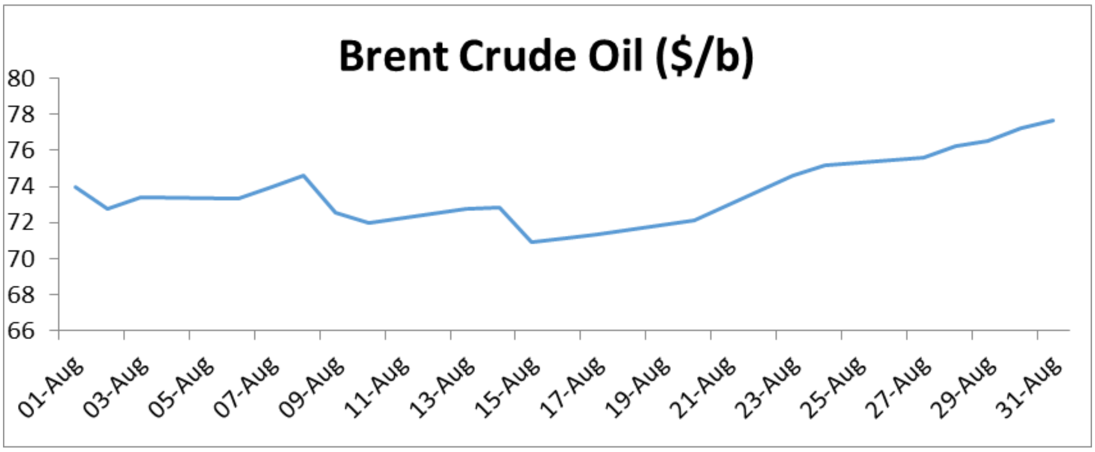
Commodities market - Exports

Oil prices

Oil prices in August recorded an optimistic growth movement. The price of the commodity increased from $73.98pb on August 1st to $77.7pb on August 31st. The oil prices touched a low of $70.76pb on August 15th and prices rose to a period high of $77.7pb on the last day of the month (August 31st), which was as a result of supply disruptions in Iran and Venezuela coupled with lower U.S. crude inventories. Iranian oil exports declined due to a fall in demand as a result of the anticipated U.S. sanction that will take effect in November 2018.

Outlook

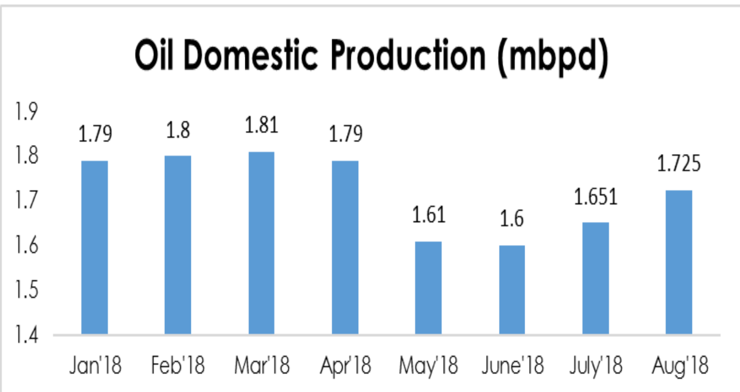
In the coming weeks we expect oil prices to remain buoyant amidst growing expectations of U.S. sanctions on Iran thereby leading to a decline in global supply coupled with the rising trade tensions between U.S. and China.



[14]

Oil Production

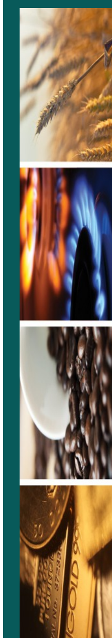
According to OPEC's monthly oil report, Nigeria's domestic oil production increased by 4.48% to 1.725mbpd in August, from 1.651mbpd in July. The increase in oil production was as a result of the resumption of activities on key pipelines that were initially shutdown due to force majeure. Nigeria's oil rig count declined to 14 in August from 16 in July.[15]



[16]

Outlook

We expect an increase in oil production in the next few months barring any disruptions to pipelines.



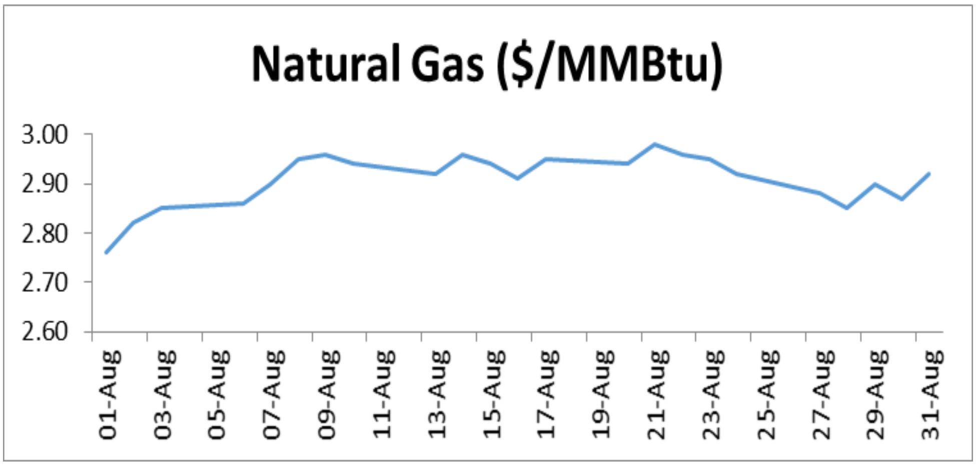
[14] Bloomberg, FDC Think Tank
[15] Bakers Hughes
[16] OPEC, FDC Think Tank

Natural Gas

Natural gas prices rose by 5.80% from $2.76/ mmbtu on August 1st to $2.92/mmbtu on August 31st. The bullish trend is largely influenced by the forecast of a strong Chinese demand.

Outlook

The prices of natural gas are expected to increase further in the near term despite expectations of a strong Chinese demand.



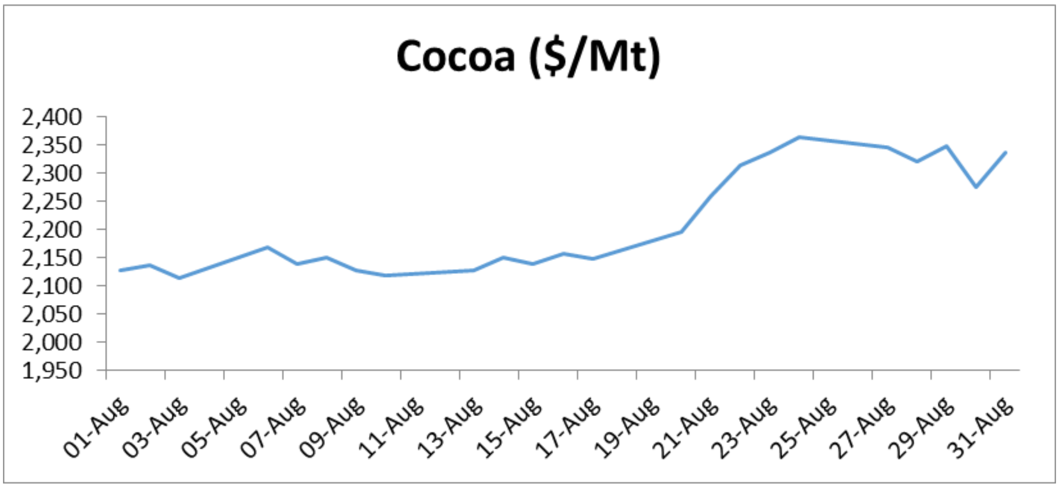
[17]

Cocoa

Cocoa prices were 9.72% higher at $2,336/MT on August 31st, from $2,129/MT on August 1st. This price increase was largely driven by strong global demand especially in U.S.

Outlook

We expect cocoa prices to continue to increase in coming weeks, as global demand increases.



[18]

[17]Bloomberg, FDC Think Tank
[18]Bloomberg, FDC Think Tank

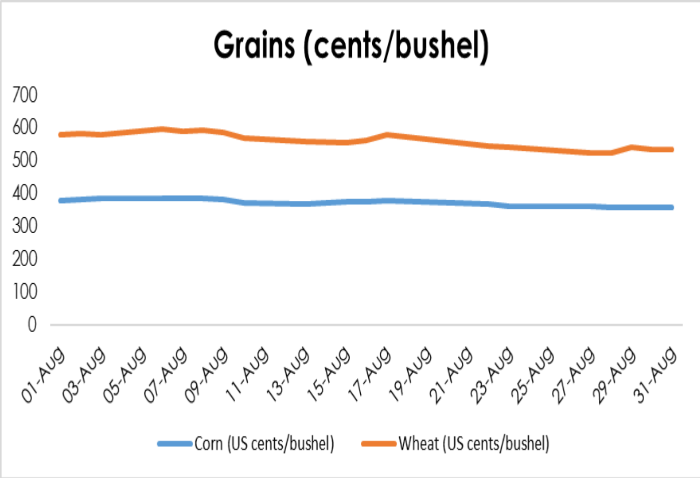
Commodities market - Imports

Wheat

Wheat prices declined by 7.55% to $5.35/ bushel on August 31st. The fall in price is as a result of Russia's resolution to ponder restriction policy of wheat exports thereby raising concerns of a global supply surplus.

Corn

Corn prices fell by 4.02% to $3.64/bushel from $3.80/bushel. This was inclined by projections of an increase in U.S. corn yield.



[19]

Outlook - Grains

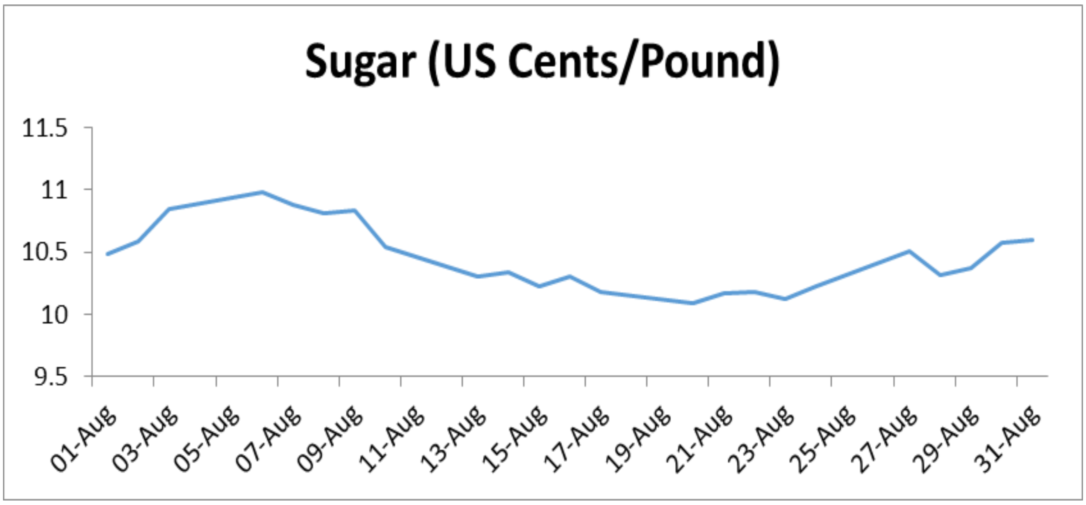
We expect that the price volatility of grains in coming weeks will continue by the weather conditions in the top producing countries globally.

Sugar

Sugar prices increased by 2.91% to $0.1060/pound on August 31st, from $0.1030/pound on August 1st despite lower demand amid growing health concerns.

Outlook

The price of sugar is expected to fall in coming weeks as demand declines amidst growing health concerns.



[20]

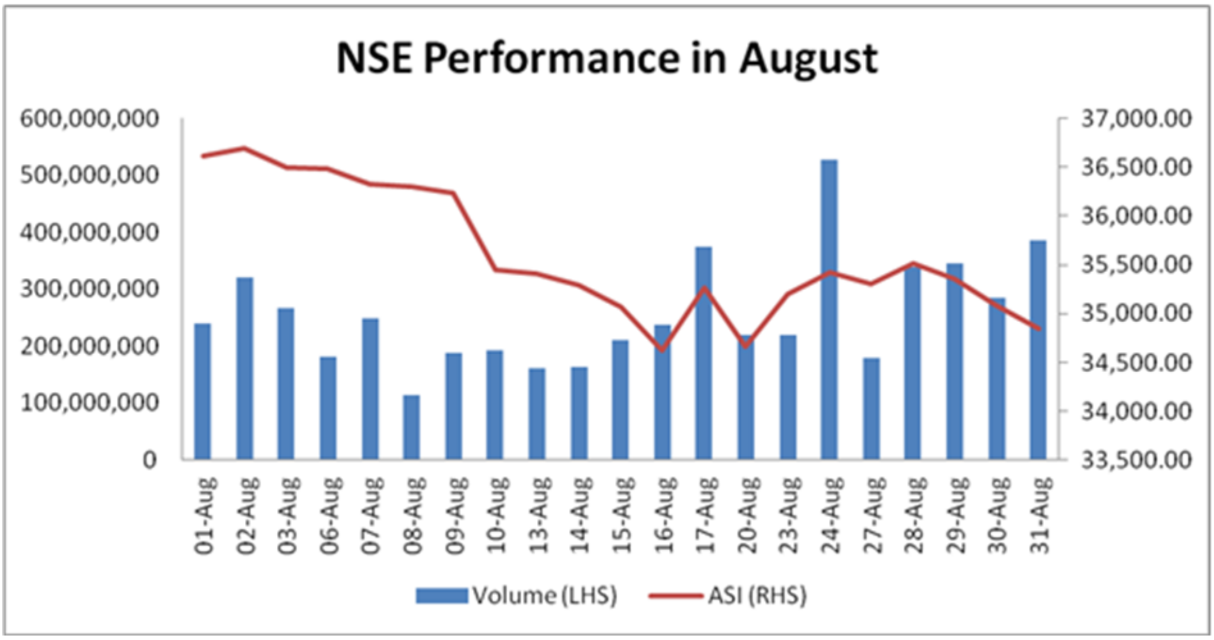
[19] FDC Think Tank

[20] FDC Think Tank

Stock Market Update

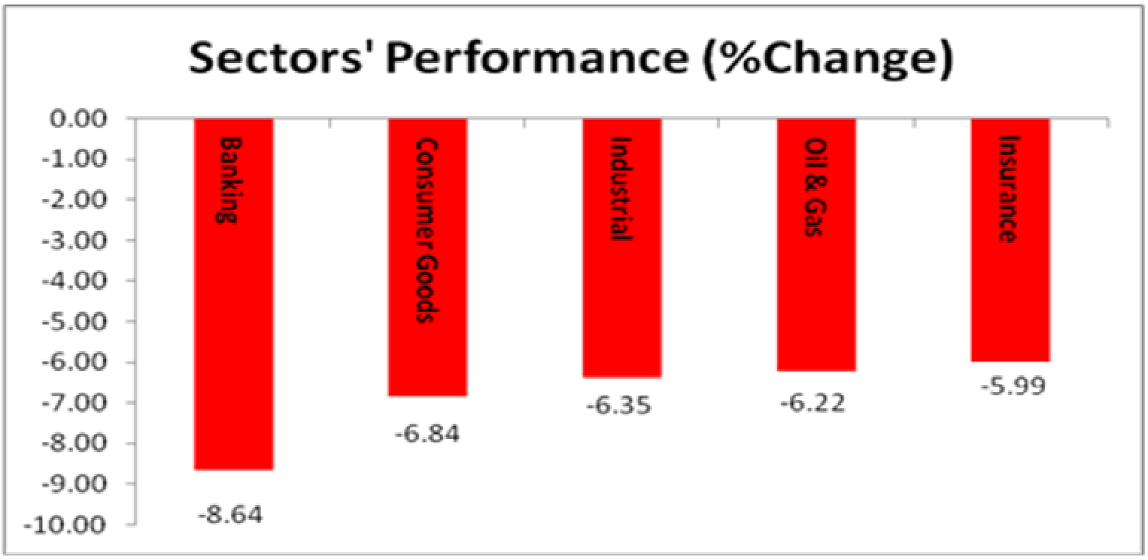
The Nigerian equities market continued its bear run in August, with the NSE ASI recording a cumulative loss of 5.86% to close at 34,848.45 points. Market capitalization moved in tandem with ASI, declining to N12.72trn in August from N13.41trn in July. The market lost in 16 out of 21 trading days in the month. The growing political uncertainty in the country triggered an equity sell off by foreign investors. The effect of political risks on market sentiment was compounded by the release of weak GDP growth number in Q2'18, relatively high yields in the fixed income securities market and higher interest rates in advanced economies.

The bourse traded at a price to earnings (P/E) ratio of 9.99x on August 31 compared to 10.79x on July 31. Market breadth was negative at 0.21x, as 17 stocks gained, 69 stocks remained flat, while 82 declined.



[21]

Trading activities on the floor of the NSE was relatively tepid in the month of August. Average volume traded fell by 15.46% to 257 million units compared to July. Average value of transactions moved in the same direction, declining by 5.72% to N3.13bn.



[22]

[21] NSE, FDC Think Tank
[22] NSE, FDC Think Tank

SECTOR PERFORMANCE

All indices closed the month of August in red with the banking sector losing 8.64%. The sector was dragged down by largely capitalized stocks in the sector such as United bank for Africa Plc (-16%) and Guaranty Trust Bank Plc (-10%). The news of the CBN's sanction on Stanbic IBTC Bank and Diamond Bank due to allegations of forex remittance using irregular Certificates of Capital Importation (CCIs) also weighed negatively on investors' sentiment in the banking sector.

Niger Insurance Plc (69%), Portland Paints & Products Nigeria Plc (45%), Newrest Asl Nigeria Plc (22%), Neimeth International Pharmaceuticals Plc (20%) and AIICO Insurance Plc (15%) led the gainers' list in August.

TOP 5 GAINERS (N)				
Company	**Jul 31'18**	**Aug 31'18**	**% Change**	**Absolute Change**
NIGER INSURANCE. PLC.	0.26	0.44	69	0.18
PORTLAND PAINTS & PRODUCTS NIGERIA PLC	2.05	2.98	45	0.93
NEWREST ASL NIGERIA PLC	4.50	5.50	22	1
NEIMETH INTERNATIONAL PHARMACEUTICALS PLC	0.50	0.60	20	0.1
AIICO INSURANCE PLC.	0.71	0.82	15	0.11

Secure Electronic Technology Plc (-50%), Ikeja Hotel Plc (-27%), Law Union and Rock Insurance Plc (-27%), GlaxoSmithKline Consumer Nigeria Plc (-23%) and Skye Bank Plc (-20%) led the decliners in the month.

TOP 5 LOSERS (N)				
Company	**Jul 31'18**	**Aug 31'18**	**% Change**	**Absolute Change**
SECURE ELECTRONIC TECHNOLOGY PLC	0.40	0.20	-50	-0.2
IKEJA HOTEL PLC	3.13	2.27	-27	-0.86
LAW UNION AND ROCK INS. PLC.	1.00	0.73	-27	-0.27
GLAXO SMITHKLINE CONSUMER NIG. PLC.	17.00	13.10	-23	-3.9
SKYE BANK PLC	0.64	0.51	-20	-0.13

Outlook

The NSE's negative performance in August was largely due to investors' weariness of elevated political risks in the country. This is expected to continue in September. The Debt Management Office also appears to be complementing the CBN's effort to mop naira liquidity and maintain exchange rate stability by raising the yields on government securities. Hence, we are likely to see fund managers rebalance their portfolios in favor of government securities. This reinforces our view that the market would dip further in September.

Equity Report :

Flour Mills Nigeria PLC

Analyst Recommendation: BUY

Market Capitalization: N88.16bn

Recommendation Period: 365 days

Current Price: N19.15

Industry: Food, Beverage and Tobacco

Target Price: N28.24

Analyst's note

The Nigerian food and beverage industry 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 and sustained rising unemployment and underemployment. Moreover, the relatively high inflation and interest rates have weighed on operations in the industry. Nonetheless, we expect cautious spending to prevail and consumption to be largely determined by price. Despite these economic challenges, Flour Mills Nigeria (FMN) Plc recorded a 3.47% increase in its top-line earnings in Q2'18 driven primarily by an increase in price and sales volume growth in the food and agro-allied segments. We expect FMN's backward integration program, its balance sheet restructuring and product diversification to continue to enhance its profitability and growth. Our valuation for the company's stock is derived using intrinsic valuation and its share price is currently undervalued. Thus, we place a ***buy*** rating on FMN.

Earnings growth continues to be driven by impressive sales and increased price

FMN reported positive top-line and bottom-line in Q2'18. It recorded a revenue of N542bn in Q2'18 (fiscal year end March 31, 2018), a 3.47% increase over N524.46bn in Q2'17. This increase was driven by growth in sales volume and price increases despite constraints emanating from the perennial gridlock in Apapa, Lagos. The food segment was the major driver of growth, accounting for 79.6% of total revenue in FY'18. The agro-allied business was the second highest contributor to earnings as it accounted for 16.7% of total revenue.

Profit before tax (PBT) increased by 57.98% to N16.54bn in FY'18. This was driven by improved foreign exchange (forex stability) as well as an increase in operating profit. The food segment was the highest contributor to the margin as profit increased by 73.4% to N26.27bn in FY'18. However, the agro-allied business segment weighed on the overall profit as the segment recorded a loss of N20.52bn in FY'18.

Industry and Company Overview

FMN was incorporated on September 29th, 1960 as a private limited liability company. It converted to a public limited company in November, 1978. The company diversified into various business ventures over the years. FMN pioneered flour milling in Nigeria through its first mill in Apapa in 1962 with a capacity of 500 metric tonnes/day. Now, its Apapa milling complex is the largest single site mill in the world with capacity in excess of 8,000 metric tonnes/day. The food segment comprises approximately 79% of the company's revenue base. FMN's food basket consists of pasta, semovita, snacks, margarine, vegetable oils, noodles, refined sugar, masavita and cereals.

The company diversified into woven polypropylene sack manufacturing in 1978 through its investment in BAGCO. With two plants in Kano and Lagos, the company engages in the packaging of flour, cement, grains, salt, fertilizers, detergent and farm harvests. It also exports polymer bags to other African countries and the US. FMN further diversified into its agro-allied business in 1978 through its investment in a 10,000-hectare Kaboji farm close to Niger state. There it processes locally grown soybean, palm fruit, cassava, maize and sugarcane; it also stores and distributes agro-inputs (fertilizers).

FMN invested greatly in support services which deal with the manufacturing and marketing of packaging materials, power generation, transport logistics and port operations. It is important to note that the company diversified into cement through a large cement terminal in Apapa under Burham Cement, and invested in United Cement Manufacturing Company Ltd (UNICEM) in 2012. However, the investment into cement was disposed of in 2015 to enable the company focus on its food and agro-allied businesses.

The leading players in the flour industry include FMN, Dangote Flour Mills and Honeywell Flour Mills.

The company's growth is evident in the increase in its total assets and revenue: during the years between 2013 and 2018, revenue increased by 10.3% and total assets by 6.5%. A snapshot of its latest annual financials is shown below.

Income Statement for Flour Mills of Nigeria Plc FY March

N'000	2013	2014	2015	2016	2017	2018
Revenue	301,941,329	325,790,187	308,756,526	342,586,459	524,464,448	542,670,409
Cost of Sales	(263,931,207)	(288,485,692)	(273,389,567)	(304,961,737)	(457,775,380)	(473,895,352)
Gross Profit	**38,010,122**	**37,304,495**	**35,366,959**	**37,624,722**	**66,689,068**	**68,775,057**
Other Gains and Losses (Other Income)	5,407,308	3,873,953	(685,050)	(7,720,517)	(1,488,216)	5,943,332
Selling and Distribution Expenses	(10,066,912)	(6,081,666)	(4,184,382)	(5,003,801)	(5,341,148)	(6,180,092)
Administration Expenses	(15,204,512)	(15,721,482)	(20,281,760)	(15,848,261)	(18,419,807)	(20,115,372)
Operating Profit	**18,146,006**	**19,375,300**	**10,215,767**	**9,052,143**	**41,439,897**	**48,422,925**
Investment Income	5,464,686	5,027,713	2,303,588	1,103,475	1,562,304	816,319
Finance Costs	(11,407,268)	(16,101,379)	(18,703,526)	(22,397,762)	(32,529,354)	(32,697,477)
Share of Loss in Associate Company	(1,037,993)	(73,651)	(381,012)	-	-	-
Gain on Disposal of Investment in Associate	-	-	14,289,953	23,731,422	-	-
Profit Before Tax	**11,165,431**	**8,227,983**	**7,724,770**	**11,489,278**	**10,472,847**	**16,541,767**
Income Tax Credit/(Expense)	(3,438,760)	(2,860,108)	738,292	2,931,006	(1,636,395)	(2,925,993)
Profit After Tax	**7,726,671**	**5,367,875**	**8,463,062**	**14,420,284**	**8,836,452**	**13,615,774**
Profit from Discontinued Operations			11,280	-		-
Profit for the Year	7,726,671	5,367,875	8,474,342	14,420,284	8,836,452	13,615,774

Balance Sheet for Flour Mills of Nigeria Plc FY March

N'000	2013	2014	2015	2016	2017	2018
Property, Plant and Equipment	144,346,381	169,287,517	208,940,475	211,588,076	216,866,184	217,901,400
Intangible Assets	672,908	554,905	496,248	735,330	208,370	1,095,317
Goodwill	4,148,022	4,148,022	4,148,022	4,148,022	4,148,022	4,148,022
Investment Properties	-	-	-	2,023,379	1,929,196	1,841,977
Investment in Subsidiaries	-	-	-	-	-	
Investment in Associates	2,058,203	7,790,094	-	-	-	
Other Financial Assets/Investments	24,948	135,456	114,716	45,696	24,140	62,900
Deferred Charges/Deferred Tax Assets	311,072	-	411,431	66,022	1,846,674	6,459,761
Long-term Loans Receivable	19,717,445	11,457,561	3,904,188	-	989,022	944,472
Biological Assets		609,112	58,509	352,020	29,131	37,710
Deposit for Shares	-	-	-	-		
Other long Term Assets		1,734,837	1,583,075	1,703,939	1,679,252	1,610,730
Non-current Assets	**171,278,979**	**195,717,504**	**219,656,664**	**220,662,484**	**227,719,991**	**234,102,289**
Inventories	64,366,539	63,683,942	68,426,003	58,698,768	117,296,162	111,373,409
Biological Assets	696	144,885	399,081	182,613	558,480	179,653
Trade and Other Receivables	19,467,295	15,478,510	15,373,448	18,966,168	21,403,132	19,083,085
Prepayments	1,710,231	4,004,007	3,060,090	13,625,250	69,851,473	21,364,109
Non-current Assets Held for Sale	-	-	3,514,035	-	755,516	-
Due from Related Companies	1,585,988	3,331,669	1,699,790	-	-	
Cash and Bank Balances	21,837,482	16,825,163	31,131,719	33,213,043	45,018,503	22,245,372
Current Assets	**108,968,231**	**103,468,176**	**123,604,166**	**124,685,842**	**254,883,266**	**174,245,628**
Total Assets	**280,247,210**	**299,185,680**	**343,260,830**	**345,348,326**	**482,603,257**	**408,347,917**

[23]

Management

Exploiting potential growth opportunities in the food industry

FMN's management ability to sustain returns, drive growth and remain a major player in Nigeria's food industry in a period of tepid economic growth can be attributed to its capacity enhancement projects and effective cost management strategy. This ability was demonstrated as FMN maintained revenue growth during a period when many companies recorded tepid revenue growth.

The successful N39.9bn rights issue will provide the management with the much needed funds to pay down outstanding short term debt. This will help reduce finance cost. The reduction in the leverage will provide an avenue to strengthen its balance sheet and the management's drive at business expansion.

Mr. Paul Gbededo is the Group Managing Director and Chief Executive Officer (CEO) of FMN. He is a graduate of the Plastic and Rubber Institute (London) as well as an associate of the National College of Rubber Technology (London, 1980). He holds an MSc Degree in Polymer Technology from Loughborough University of Technology, UK. He joined the company in 1998 as the General Manager in charge of Golden Fertilizer and has since gained over 30 years of extensive experience in the Flour Milling industry.

Group Managing Director/ CEO

Mr. Paul Gbededo

[23]Flour Mills Nigeria Plc Annual Reports

Mr. John George Coumantaros is the Non-Executive Chairman of the Board of Directors since September 2014. He has a BA in History from Yale University (1984) and has over 30 years' extensive experience in international trade, logistics, and manufacturing industries. He was appointed to the board as a Non-Executive Director in 1990. Mr. Coumantaros sits on the board of several international companies such as Oxbow Carbon LLC (an international energy company) and ELBISCO (a fast-moving consumer food business in Athens, Greece). He took over from Mr. George Coumantaros, the founder of the company. George Coumantaros led the company through its inception in 1962 when it produced 600 metric tonnes/day to its current milling capacity of over 8,000 metric tonnes per day.

Non-Executive Chairman of the Board of Directors

Mr. John George Coumantaros

The Bull and the Bear Says:

- Leading player in the Nigerian flour milling industry
- Rich product portfolio which ensures sustainability of revenue
- Renowned brand value
- Proposed upward review of minimum wage could bolster consumer spending
- Talented and experienced management team proficient in technical and marketing skills
- The company benefits from cheaper raw materials and reduced production cost through its Investments in backward integration program

- Intense competition from other leading players such as Dangote Flour Mills 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
- Shift of market preference to low-priced products

Risk and Outlook

Growth potential constrained by weak macroeconomic fundamentals

The key risks that could prevent FMN from achieving its strategic goals include market risk (exchange rate, interest rate and commodity price risk), credit, liquidity, and capital risks amid rising political uncertainty. To mitigate these, the Risk Management Committee, in co-operation with the group's operating units, identifies and evaluates risks under the company's risk policies approved by the board of directors.

The company is exposed to interest rate risk. As a result of this, the management has put various strategies in place to control interest rate risks. It maintains a centralized treasury department, carrying out group borrowing to obtain lower interest rates. The group negotiates long term credit facilities and obtains subsidized loans from the government in order to reduce the risk associated with high cost of borrowing.

The company is also exposed to foreign exchange volatility on purchases of raw materials. The company is currently involved in the backward integration of agro-allied products in order to reduce the foreign exchange risk associated with high dependence on imported raw materials.

FMN addresses credit risk by setting credit limits and dealing primarily with credit worthy counterparts. The company transacts solely with corporate entities that are rated the equivalent of an investment grade or above. The company manages its liquidity risks by maintaining adequate reserves, banking facilities and reserve borrowing facilities. Credit exposure is controlled by counterparty limits that are reviewed and approved by the risk management committee annually.

Capital risk management is also important to FMN. The company maintains an efficient capital structure by adjusting the amount of dividends paid to shareholders, issuing new shares through right issues or selling investments in order to optimize its cost of capital and maximize returns for its shareholders. This was demonstrated recently as the company raised N39.9bn equity capital to reduce its balance sheet leverage. This is expected to translate to lower interest expenses and reduce debt to equity ratio.

OUR valuation

We derived our valuation for FMN by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate for FMN stood at **N28.24**, which is a 22.5% upside on its current share price of N23.05 as at August 24, 2018. The discount rate [weighted average cost of capital (WACC)] of 18.4% is derived using a 14.91% risk free rate [the yield for a 10-year Federal Government of Nigeria (FGN) bond maturing in March 2027], a beta of 0.9665, an after-tax cost of debt of 14.9%, and a market risk premium of 6.4%. The calculated long-term cash flow growth rate to perpetuity is 5.0%.

DCF Valuation				
N'000	**2019E**	**2020E**	**2021E**	**2022E**
EBIT	52,475,864	56,163,930	59,377,421	61,360,307
Less: Taxes	(15,742,759)	(16,849,179)	(17,813,226)	(18,408,092)
EBIAT	36,733,105	39,314,751	41,564,194	42,952,215
Plus: Depreciation & Amortization Expense	16,219,906	17,566,879	17,968,370	18,403,674
Less: CAPEX	(21,324,361)	(22,823,062)	(24,128,912)	(24,934,688)
Change in Working Capital	(9,494,025)	(6,352,654)	(7,362,917)	2,812,842
Free Cash Flow (FCF)	22,134,625	27,705,914	28,040,735	39,234,042
WACC	18.4%	18.4%	18.4%	18.4%
Present Value (PV) of FCF	13,342,172	16,700,399	14,277,819	16,875,384
Terminal Value @ Perpetual Growth Rate (2021)	**2019**	**2019**	**2020**	**2021**
Terminal Value as of 2020				307,868,241
Present Value of Terminal Value	185,574,908			
DCF Calculation	**Valuation**			
PV of Explicit Period	61,195,773			
PV of Terminal Value	185,574,908			
Enterprise Value	246,770,682			
+ Cash	22,245,372			
- Borrowings	(153,233,129)			
Equity Value	115,782,925			
Share Price	***28.24***			

Important Notice

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