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FDC MONTHLY ECONOMIC UPDATE

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In This Issue …

NSE rallies in last 12 days- a blip or a trend?

The Nigerian stock market was on a roll in the first half of February, as the market enjoyed a 9-day gaining streak. Its 6.08% gain in February alone helped topple January's downturn of 2.78%. Consequently, the NSE All Share Index (ASI) rose by 3.28% (YTD) to 32,462 points before retreating to 32,414 points (3.13%) on February 13. Buying interest, especially in banking stocks largely drove the momentum, as investor sentiment improved due to the hold back in US fed rate hikes. The banking sub-index, which accounts for about 35% of total market capitalization of N12.09, is up 8.95% YTD.

Early movers take position before election outcome

The stock market featured among the world's worst performers in 2018, after emerging as the 2nd best in 2017. This was largely due to political uncertainty, exacerbated by monetary policy normalization in most advanced economies. This saw foreign investors pull $2.1bn out of the bourse in 2018. However, rekindled interest in the Nigerian economy saw foreign portfolio investment inflows reach a 9-month high of $1.32bn in January. This pickup in foreign inflows is expected to trickledown to the stock market post elections in the event of a violence free election outcome.

Nigerian bourse will rally no matter who wins

Historic analysis has shown that Nigeria's general elections are usually followed by a short post-election rally and an immediate correction. The ability of the losing party to concede defeat and the ensuing seamless continuity or transition are critical factors that will determine the sustainability of the bull market run in 2019.

Tepid economic growth recovery, a possible downside

The Nigerian economy is in dire need of a boost in 2019, as the African giant recorded an anaemic growth of 1.93% in 2018, compared to Sub-Saharan Africa average of 2.4%. Policy inconsistency has seen a stall in investment flows into the oil-rich economy.

Given that investment has a huge multiplier effect on output, policy makers need to push for investor-friendly reforms that will not only attract foreign inflows, but promote the retention of stable funds. This could be pivotal to investor flows post-elections and the rebound of Nigeria's stock market.

Trade Truce & Sanctions: Effect on Oil Prices

Brent has lost approximately 27% from its peak of $86.29pb in October. Whilst the commodity has traded within a range of $55-$63pb for two consecutive months, it has gained 18% YTD. Currently, the key drivers of oil prices are a likely breakthrough in the US/China trade talks, US sanctions on Venezuela's oil output, and OPEC's restriction of output.

US/China Truce?

The 6-month trade war between powerhouses, US and China, may soon be a thing of the past as the countries are currently engaged in the third round of trade negotiations. This comes two weeks before a fresh round of US tariffs on Chinese imports is scheduled by March 1st. According to Citigroup, the three possible outcomes from the negotiations are:

* Bull case (Probability: 5%)- 'comprehensive' trade deal alongside a mutual tariff rollback
* Base case (Probability: 55%)- 'chances of a deadline roll-over, tariffs-limbo remains'
* Bear case (Probability: 40%) - the countries fail to reach a consensus before March 2nd deadline.

Any of the scenarios above would have an impact on the oil market. In the interim, oil price is likely to trade at current levels as the markets anticipate the outcome of the new round of negotiations.

US sanctions on Venezuela's Oil

President Trump imposed sanctions on Venezuela's state-owned oil company, Petroleos de Venezuela (PDVSA), owing to the political tensions in Venezuela. The immediate impact of the sanction was a jump in Brent prices by approximately 2.7%. In addition, analysts are projecting a reduction in global supply by at least 330,000bpd due to the imposed sanctions.

What does this mean for Nigeria?

Is the budget benchmark of $60pb realistic?

In the last four months, various analysts have reviewed their 2019 price forecast downwards due to weak global economic outlook. The table below shows the downward revision of various international bodies:

	Previous forecast	**New forecast**
Goldman Sachs	$70pb	$62.5pb
HSBC	$80pb	$64pb
EIA	$61.01pb	$60.52pb

Compared with the target range of $60-$65pb projected by several analysts, Nigeria's budget benchmark of $60pb is fair. However, with Nigeria being more production than price sensitive it is also important to pay attention to the budget proposal of 2.3mbpd (including condensates) in 2019. The cut in Nigeria's output to 1.68mbpd by OPEC may affect Nigeria's ability to meet this target.

Outlook

Brent above $80pb looks rather unattainable in the near future. In the short term, we expect the oil markets to be driven by the progress or non-progress of the US/China trade negotiations. Oil prices are expected to trade within a range of $61-$65pb in the coming weeks.

Offer-Circular

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NIGERIA

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and is authorized to receive applications for

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₦50,000,000,000 - 13.53% FGN MAR 2025 (7-Yr Re-opening)*
₦50,000,000,000 - 13.98% FGN FEB 2028 (10-Yr Re-opening)*

Auction Date: **February 20, 2019**
Settlement Date: **February 22, 2019**

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REDEMPTION:
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2. Qualifies as Government securities within the meaning of Company Income Tax Act ("CITA") and Personal Income Tax Act ("PITA") for Tax Exemption for Pension Funds amongst other investors.
3. Listed on the Nigerian Stock Exchange and FMDQ OTC Securities Exchange.
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Ecobank Nigeria Ltd.
FBNQuest Merchant Bank Ltd.
First Bank of Nigeria Ltd.
First City Monument Bank Plc.
FSDH Merchant Bank Ltd.
Guaranty Trust Bank Plc.
Stanbic IBTC Bank Plc.
Standard Chartered Bank Nigeria Ltd.
United Bank for Africa Plc.
Zenith Bank Plc.

* **The** DMO reserves the right to alter the amount allotted in response to market conditions.

Harnessing technology to improve tax administration and compliance in Nigeria

Taxes are arguably the backbone of any economy. Unfortunately for Nigeria, low mobilisation of tax revenue has compounded the country's dependence on oil revenue. According to the International Monetary Fund (IMF), Nigeria has one of the lowest tax revenue in the world, estimated at 5% of GDP.[1] This is well below the sub-Saharan Africa average of 22%. Against the backdrop of rising demand for infrastructural and social spending, weak domestic revenue mobilization presents a major fiscal challenge for the government.

Rampant culture of tax evasion and avoidance

A fundamental challenge with tax collection is the lack of confidence or trust in the government, which stems from the low quality of public service delivery. This has created a culture of rampant tax evasion and avoidance. This culture is deep-rooted, especially among small businesses and traders, who see few material benefits of paying taxes since public service delivery remains poor. There are also challenges linked to tax policy and administration, such as punitive tax rates, capacity deficiencies, and a dearth of data, which all contribute to an inefficient tax administration. It would be fair to say that Nigerian tax authorities lack the institutional capacity to collect taxes across the country or to properly enforce taxation measures. This is a self-perpetuating cycle, as low tax revenue weakens government institutions and reduces the administration's capacity to enact its pro-growth agenda.

Nigerian tax authorities also have to contend with the perception of being highly corrupt and often misappropriating funds. Whether or not this is justified, such perceptions damage the country's tax generation prospects. Moreover, in light of the recent economic downturn, taxpayers are currently struggling, amid weak economic growth and high interest rates. For businesses and public-sector workers, significant arrears from the government have undermined their tax-paying capacity.

Challenges with mobilizing internal resources

Another major challenge peculiar to Nigeria in terms of tax collection is the country's vast informal sector. According to the IMF, the informal sector accounts for as much as 65% of Nigeria's economy.[2] However, tax contributions from the informal sector are miniscule as businesses fear the administrative and financial burden of regularising their status. Since the informal economy accounts for a significant proportion of gross national income, expanding the tax base stands to have a more transformative impact on state finances, but progress on this front has been slow.

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[1] International Monetary Fund. February 2018. Mobilizing Tax Revenues in Nigeria https://www.imf.org/~/media/Files/Publications/CR/2018/cr1864.ashx
[2] International Monetary Fund. February 2018. Mobilizing Tax Revenues in Nigeria https://www.imf.org/~/media/Files/Publications/CR/2018/cr1864.ashx

Improving domestic revenue mobilization

Given the federal government's desire to gradually wean the economy off oil revenue, the current administration has begun undertaking reforms to boost tax compliance and widen the tax base. The primary focus has been on modernising and digitizing the federal tax paying systems, under the auspices of the Presidential Enabling Business Environment Council (PEBEC).[3]

Attempts to broaden the tax base are a step in the right direction, but such efforts are expected to be of limited effectiveness if they are not supported by significant transformation in the systems of taxation. Burundi provides lessons on how to achieve this with its taxpayer identification number in the informal sector. The Burundian Revenue Authority (OBR) ran an initiative to encourage informal traders to register for a taxpayer identification number (TIN), thereby bringing traders into the tax pool. The campaign started in shopping centers in the capital Bujumbura and was extended to markets and shops. This helped to improve taxpayer registration and tax compliance.[4] Such efforts could also be preceded by tax education campaigns to improve public awareness on their tax obligations and to improve tax literacy generally.

Low tax rates provide scope to boost domestic generated revenue

Nigeria's relatively low tax rates also provide scope to boost domestic generated revenue by increasing tax rates. The Federal Government of Nigeria has outlined plans to increase the VAT (Value Added Tax) on several items in 2019 under the auspices of the Strategic Growth Revenue Initiative (SGRI). However, it is important to state that increasing tax rates without stifling economic activity is an extremely delicate balancing act. For instance, Angola is planning to introduce a new "sin tax" on alcohol and tobacco as part of a wider shake-up aimed at raising fiscal revenue.[5] The proposed special consumption tax will apply to alcohol and tobacco products at a rate of 16%, in addition to the value-added tax (VAT) due to be introduced in July. The risk here is that because commodities like alcohol and tobacco are relatively price inelastic, the tax incidence would likely be passed to the consumer. This would reduce the consumer's discretionary income or have a negative impact on the alcohol and tobacco industries by reducing demand. Either situation could negatively impact the economy.

Another solution to improving tax administration is by reducing capacity constraints. Investing in the capacity of the tax authorities is a necessary step to boosting earnings. With more offices as well as the channeling of more resources towards training staff, the authorities should be able to increase compliance with direct taxes, particularly among small and medium enterprises.

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[3]Presidential Enabling Business Environment Council. June 2018. PEBEC Annual Report https://easeofdoingbusinessnigeria.com/images/Documents/PEBEC-Annual-Report-June-2018.pdf

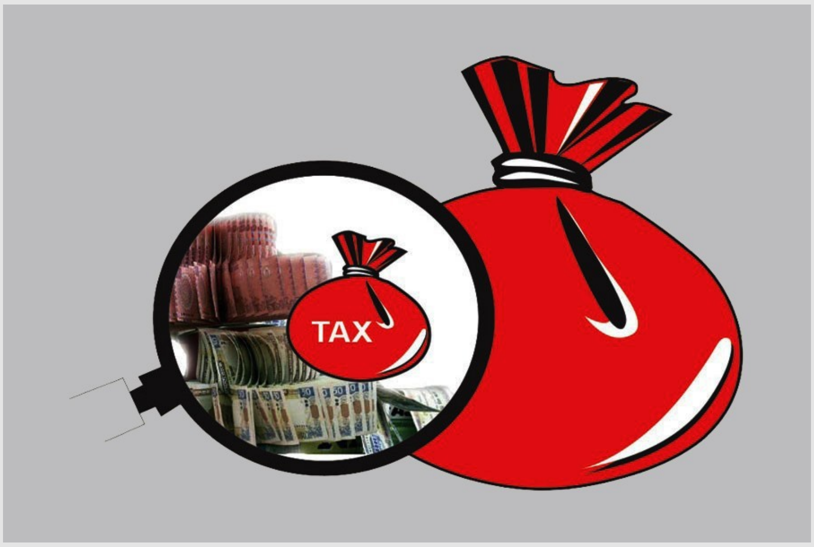
[4]The Republic. December 2018. Development via taxes https://www.republic.com.ng/december-18-january19/africa-taxation/

[5]The Economist Intelligence Unit. January 2019. "Angola to introduce new sin taxes"

Need to modernize tax collection mechanisms

Finally, Nigeria needs to modernize and digitize its tax collection mechanisms. A viable option is blockchain technology. Blockchain technology, in which a continuously growing list of records are linked and secured using cryptography, offers a number of advantages. It can streamline business processes and more importantly bolster protection against cyber security threats. The application of blockchain in tax has the potential to move the tax function from retroactive analysis and historical financial information gathering to a position where transactions can be recorded in real-time. This would help to minimize errors, risk and fraud.

Finally, there is an opportunity to improve tax collection by modernizing and automating tax administration. By introducing e-compliance, e-filing and e-paying, tax payments might become easier and more user-friendly, which would ultimately improve compliance. Lessons can be learnt from Uganda on this front. As part of wider efforts to improve Uganda's tax structures, the Taxpayer Register Expansion Programme (TREP)—a multi-agency collaboration between the URA, Kampala City Council Authority and the Uganda Registration Services Bureau – was set up to focus specifically on the registration of small businesses in a bid to move enterprises out of the informal sector. Initiatives include modernizing and integrating tax payment systems with mobile money platforms as well as establishing more "one-stop shops" across the country. The URA deemed the initial pilot phase of TREP to have been a success, with 130,000 small businesses registered in 2016 and approximately $14m generated in revenue.[6]



Higher tax revenue is a positive indication of broad-based growth

Boosting domestic revenue mobilization is crucial to achieving Nigeria's development goals. Growth in Nigeria's internal revenue collection is vital as it will increase budget sustainability and reduce borrowing. Moreover, taxation is the main source of internal income for a state. Increased tax revenue means more disposable funds to be spent on public goods and would contribute to the repayment of accumulated public debt. Higher tax revenue is a positive indication of broad-based economic growth as it shows increased household incomes and government collection. Given the increased adaptation of technology, it is imperative that Nigeria continually adapts and modernises its tax collection and administration policies in order to achieve its long term growth objectives.

[6]The Economist Intelligence Unit. September 2016. Uganda initiatives rolled out to tax small businesses

Maize production – Investing in its highly underdeveloped value chain

Nigeria is the second largest maize producer in Africa and the 14th globally, with an estimated 10.42 million metric tonnes (MT) produced in 2017.[7] Despite being one of the largest producers in Africa, Nigeria's average maize yield per hectare (Ha) fell by 8.62% to 1.59 (MT/Ha) in 2017 from 1.74 in 2016. This is one of the lowest yields among top maize producers in Africa. Nigeria lagged behind countries such as South Africa with a yield of 6.40MT / Ha and Algeria at 4.0MT/Ha in 2017.[8] According to research carried out by the U.S. Department of Agriculture, an increase in yield per hectare, and land expansion are two factors that determine growth in agriculture.[9] Improved yield growth can be achieved by expanding the adoption of improved varieties and increasing the farmer's access to land. Thus, by addressing these two factors, Nigeria could become the largest maize producer in Africa and one of the largest producers in the world.

Maize is essential for food security in West and Central Africa. The maize value chain is expanding due to the huge demand from producers of animal feed (poultry, fish, etc.), breweries and other industries. Global demand for maize increased at a surprising pace in the last year, rising by about 7% to 1.07 billion tonnes in 2016/17 from one billion tonnes in 2015/16.[10] About 55% of the global maize yield is used for animal feed production. This is reflective of the extensive gains in world meat production, especially of poultry and pork. The high starch content also makes maize an essential raw material for production of household items such as cosmetics, medicine, syrups, and shoe polish.[11] The global use for industrial processing totaled a record high of 305 MT in 2018/19. [12]

Maize is also used by leading companies in Nigeria such as NASCO (cornflakes), Nestle (Golden Morn and Cerelac), Flour Mills (Daily Delight) and AACE Foods (Soya Maize and Soso Nourish). It is also used in the production of bio-fuels in developing countries and for the brewing of beer and other drinks such as Amstel Malta by Nigerian Breweries.

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[7]Food and Agriculture Organization of the United Nations FAOSTAT. 2017. http://www.fao.org/faostat/en/#data/QC
[8]Food and Agriculture Organization of the United Nations FAOSTAT. 2017. http://www.fao.org/faostat/en/#data/QC
[9]Keith Fuglie, August 2015. "Accounting for growth in global agriculture." Firenze University Press https://www.odepa.gob.cl/wp-content/uploads/2017/10/fuglie_paper_1.pdf
[10]Intelligence Unit, January 2019. "World Commodity Forecasts - Food, Feedstuffs & Beverages," The Economist
[11]Celestine Amoke. December 22, 2017. "Investing In Maize Value Chain," Independent. https://www.independent.ng/author/amoke/
[12]EIU. World commodity forecasts: food, feedstuffs and beverages January 2019

Key challenges and solutions in the maize value chain

Low yield per hectare

In recent years, the maize value chain has been plagued with several challenges, keeping production at a suboptimal level. Nigeria's maize production remained as low as 10.42mn MT in 2017, which was below the total domestic consumption of 11.10mn MT[13], resulting in a demand shortfall of 680,000 MT in the year. The price for the commodity continues to increase on the back of a growing demand, reflecting stronger industrial use.

Nonetheless, the supply has been constrained by the average yield per hectare in Nigeria (1.59 MT/Ha), compared to other African producers such as South Africa (6.40 MT/Ha), Algeria (4.0MT/Ha) and Zambia (2.5MT/Ha) and the leading world producer, USA (11.08 MT/Ha). The low crop yield has been linked to various factors such as poor planting materials, climate change, soil infertility, erosion, and improper use of agro-chemicals but the one that stands out is poor grain variety.

In the USA, which has recorded increments in maize grain yield, the expanding adoption of improved varieties helped with significant yield increase. For example, aflatoxin is a family of disease-causing toxins produced by certain fungi that affect maize and causes stunted growth. The International Institute of Tropical Agriculture (IITA) estimated that up to 60% of maize produced in Nigeria might be aflatoxin contaminated.[14] Another main pest that attacks maize in Nigeria is armyworm. According to the Maize Association of Nigeria (MAAN), in December 2018, fresh pest attacks increased importation of maize by 100% over 2017. Nigeria imported 400,000MT of maize valued at $146 million as against 200,000MT imported in 2017[15] to bridge the demand gap. If Nigeria is to have any chance at increased maize output, the government must embark on investments to produce disease-resistant seeds. This will help improve the yield per hectare and boost productivity overall.

[13]Index Mundi. https://www.indexmundi.com/agriculture/?country=ng&commodity=corn&graph=domestic-consumption
[14]Yun Yun Gong et al, 2015. "Building an Aflatoxin Safe East African Community: Technical Policy Paper 8 Aflatoxin Standards for Food Knowledge; Platform 2015 Situational Analysis East Africa Region,"IITA Research to Nourish Africa. https://aflasafe.com/wp-content/uploads/pdf/TPP-8-Aflatoxin-Standards-for-Food.pdf
[15]Godwin Okafor, Dec 26, 2018. "Nigeria maize production falls as army-worms attack farmlands, spends $532.1 million on importation," Naija 247 News. https://naija247news.com/2018/12/26/nigerias-maize-imports-rise-as-two-vessels-birth-in-lagos-calabar-ports/

Land use policy

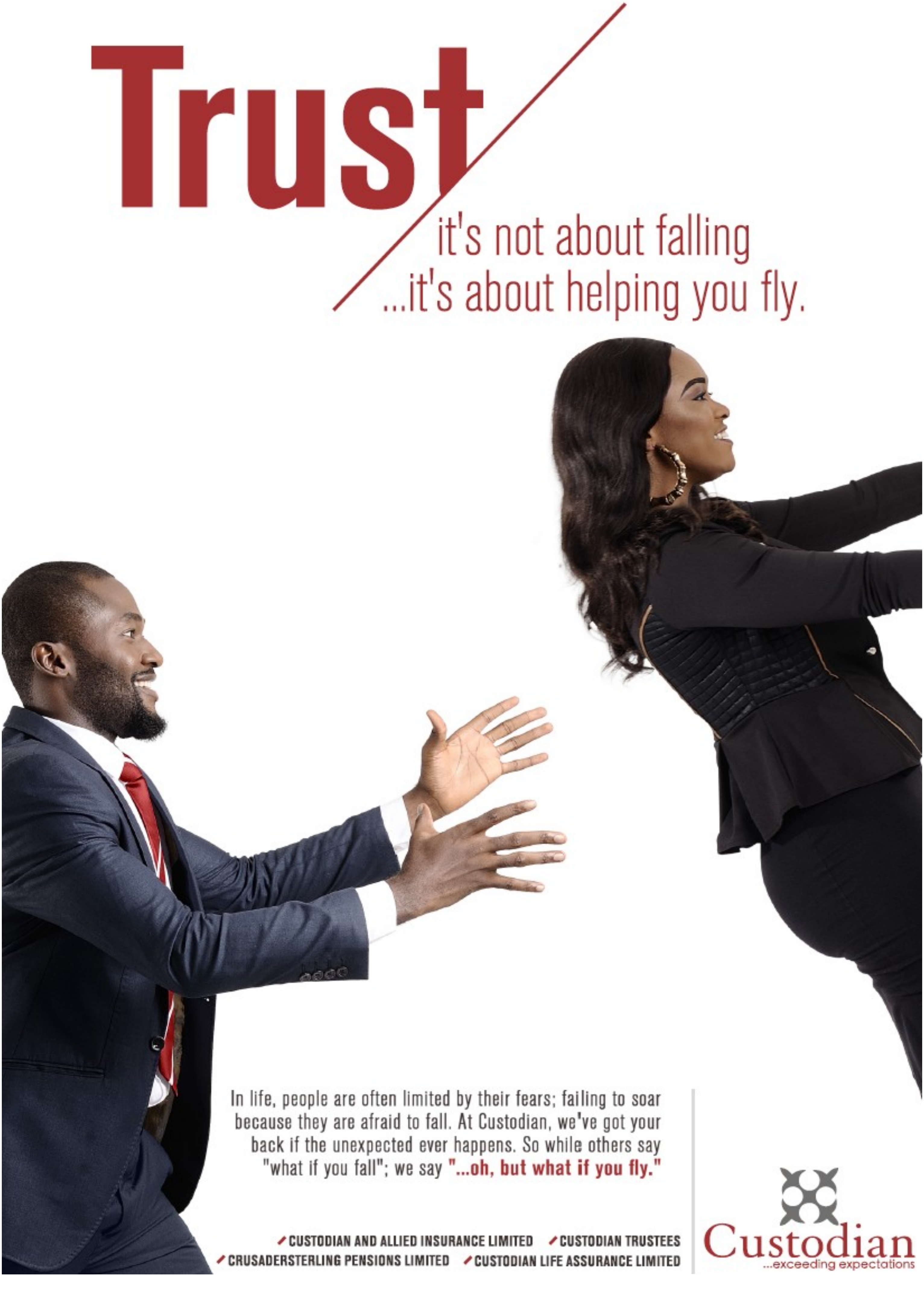
Another Nigerian problem is access to land through the Land Use Act. Land is a major challenge for farmers and a key limitation to maize farming. In Nigeria, lands are mostly entrusted to state governments, while private lands are held under customary arrangements. The Land Use Act imposes a ceiling of 0.5 hectares of undeveloped urban land for individual use, 500 hectares of non-urban land, or 5,000 hectares if granted for grazing purposes, unless the Governor gives permission to forego these limitations.[16]

This is unlike other African countries such as Mauritania, Togo, and Côte d'Ivoire, where there is easy access to land. For example, in Côte d'Ivoire, small and large-scale farmers own large hectares of land held under farm plantations. This reflects the growth of the agricultural sector of the economy. A liberalized land use policy empowers sustainable growth and development. The Land Use Act places a ceiling on private individuals and corporate bodies who may want to produce maize for commercial use.

To improve maize production, the Land Use Act should be amended. The implementation of the Act was necessary when state governments used it to control conflicts arising among farmers and groups. In today's economy, it has the potential to improve maize farming and the agricultural sector if the government can make it more flexible and sensitive to the present economic realities.

In view of the importance of maize in Nigeria, efforts should be made to improve access to land, and to extend areas where it can be grown. With adequate access to land, reduction of losses along the value chain and improved seed varieties, new industries can be encouraged to enter the Nigerian market, boosting the domestic production of the commodity.

[16] Land Use Act Chapter 202. Laws of the Federation of Nigeria. 1990 http://www.nigeria-law.org/Land%20Use%20Act.htm



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Global Perspective: Oil Fell, Unemployment Soared and Now Nigeria Votes

Culled from Bloomberg

Almost every Nigerian vote since independence in 1960 has been dogged by varying degrees of conflict and allegations of rigging. That's one reason why the 2015 election that saw Muhammadu Buhari, now 76, become the first candidate in the nation's history to topple a sitting president through the ballot box was such a watershed moment. But the former military ruler has fallen short on meeting pledges to rejuvenate and diversify the oil-dependent economy or quell rampant corruption during his four years in office. Now he is running for a second term in a Feb. 16 vote that pits him against dozens of rivals. The most prominent is Atiku Abubakar, 72, a wealthy businessman and former vice president, who has pledged to revive the economy and sell state-owned assets.

1. What are the key campaign issues?

The electorate's biggest gripes are about a lack of jobs and economic opportunities, falling living standards and high inflation. The unemployment rate hit 23.1 percent in the third quarter, its highest since at least 2010, and the World Bank estimates that almost half the population of 200 million live on $1.90 or less a day. Endemic corruption is another major concern, as is insecurity typified by conflict with Islamist militants in the northeast, perennial violence in the oil-rich Niger delta and escalating tensions over grazing rights. Then there are questions about the vote itself. On Jan. 25, Buhari suspended the nation's top judge, heightening concerns about the credibility of the election because the Supreme Court would likely have to rule on any challenges to the result.

2. What are the main candidates promising?

Buhari's popularity started to wane after falling oil prices triggered Nigeria's first economic contraction in a quarter century in 2016. Investors blame him for exacerbating the slump and deterring investment by imposing capital controls. He also leaned on the central bank not to weaken the currency, the naira, which it was eventually forced to do. He now pledges to bolster spending on new transport and electricity projects. His plans include building rail links between all state capitals and completing a $5 billion hydro power project funded by China. He has also promised to increase the minimum wage. Abubakar, who has business interests ranging from oil services to beverages, says he'll draw on his experience in the private sector to lift the economy. He favors incentives to encourage investment, selling most of the state oil company, floating the naira and removing a price cap that keeps Nigeria's gasoline prices among the lowest in the world.

3. What the Candidates Are Promising?

Muhammadu Buhari's Pledges	Atiku Abubakar's Pledges
* Fight corruption	* Pursue pro-investment policies
* Create 10 million new jobs	* Build infrastructure, create employment
* Build roads, expand rail network	* Sell stakes in the state-owned oil company
* Defeat Islamist militants	* Abolish multiple exchange-rate system

4. How do they intend to tackle insecurity?

Buhari says he will intensify the battle against militants loyal to Islamic State and Boko Haram, and provide the military with additional resources. Abubakar says it's no accident that the country's poorest region has borne the brunt of the insurgency, and he'll promote jobs and development there, which would deny militants support and make it harder for them to recruit members.

5. What are their records on graft?

While Buhari has a reputation for honesty in what ranks as one of the world's most corrupt countries, Transparency International says his war on graft has not yielded the desired results. Other critics say he has been selective when deciding who to target. Abubakar has long been accused of engaging in illicit practices to amass a vast fortune, an allegation he denies. Though he has never been charged with or found guilty of corrupt practices, a U.S. Senate subcommittee report in 2010 said he and one of his wives wired $40 million of "suspect funds" to the country. Abubakar has pledged to shift the focus from "punitive" to "preventive" measures to tackle graft, including moving more government services online to make it harder for civil servants to demand bribes.

6. Who's likely to win?

An absence of reliable opinion polls makes it difficult to tell, and analysts have mixed views. New York-based risk adviser Teneo in December projected that Abubakar would win 57 percent of the vote to Buhari's 42 percent in a free and fair election, while Eurasia Group sees Buhari beating Abubakar by a 55 percent to 45 percent margin. If no candidate wins outright in the first round, a run-off will be held. The victor must also secure at least a quarter of the votes in two-thirds of the states, a requirement aimed at ensuring they have national appeal; failing that test could also trigger a run-off.

7. *Why is the race so close?*

In previous elections, the easiest way for a candidate to win the presidency was to corner the votes of two of the country's three main ethnic blocks -- the Hausa speakers in the north, the Yoruba from the southwest and the Igbo in the southeast -- and then try to tap into support from other minority groups. This time around, it's a more complicated calculus because both Buhari and Abubakar are Muslim Hausa speakers from the north. The Yoruba played a pivotal role in bringing Buhari to power in 2015, and he's hoping to retain their support by sticking with the same running mate, Yemi Osinbajo, who hails from the southwest. Abubakar chose Peter Obi as his deputy with a view to drawing support from fellow Igbos, and is targeting support from minorities in the oil-producing south by pledging to devolve more power to regional authorities.

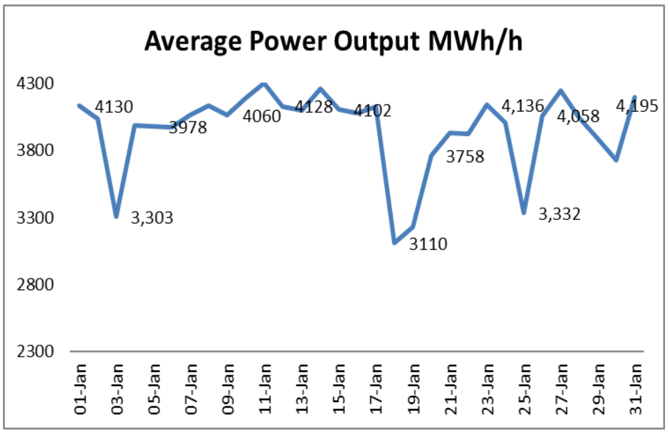
8. Will the elections be free, fair and peaceful?

That's the perennial question. With state power seen as the shortest route to wealth in Nigeria, elections are hotly contested. More than 800 people died in 2011 in the unrest following Buhari's loss to then-President Goodluck Jonathan. Widespread conflict was averted in 2015 when Jonathan conceded to Buhari before the final count was complete, although deaths still topped 100. Civil rights groups have expressed concern that the security forces are partisan in favor of the incumbent, a problem they identified during the election of governors in the south-western Ekiti and Osun states last year. Buhari's decision to suspend Chief Justice Walter Onnoghen just three weeks before the vote poses an even bigger threat to the election's credibility. Nigeria's Senate has asked the Supreme Court to rule on the validity of the move, which was condemned by the opposition and legal community and came shortly before judges who will oversee electoral tribunals and hear election-related cases were to due be sworn in.

Macro-economic Indicators (January 1st-31st)

Power Sector

Average power output from the national grid for the month of January was 3,952MWh/h, 3.35% lower than the monthly average of 4,089MWh/h in December. In the same vein, power output touched a three – month low of 3110MWh/h on January 18th due to a complete grid collapse making a total of three grid collapses in the month of January. However, gas remains a major constraint to power generation. The gas constraint during the period was 72.05% of total constraints. Revenue loss during the period amounted to N41.37bn (N496.44bn annualized).



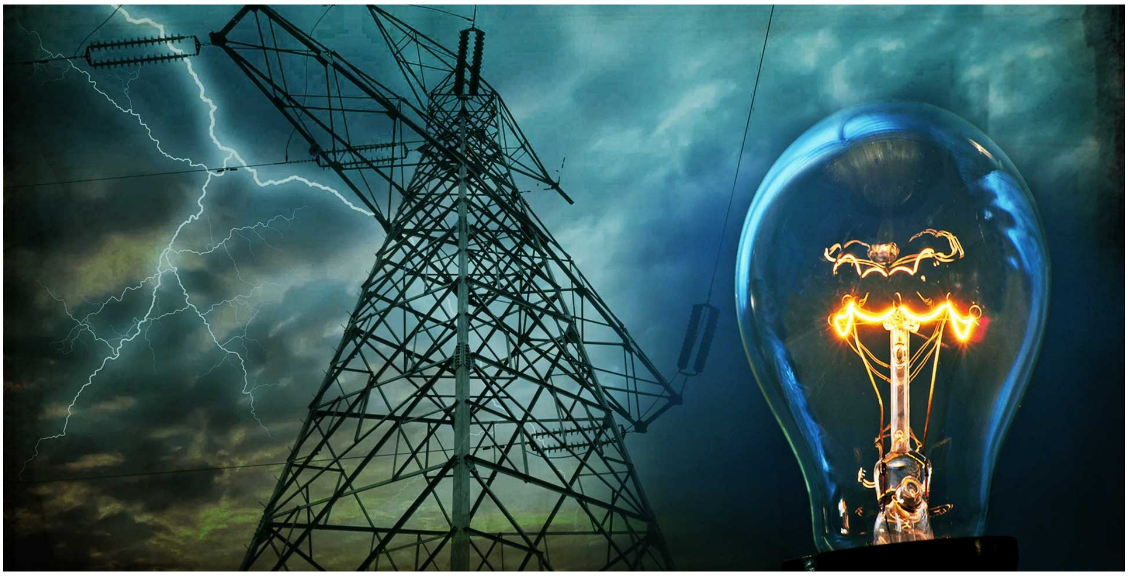
[17]

Outlook

We expect a reduction in the average power supplied from the national grid in the short term as gas suppliers have started shutting off supply to the GenCos due to lack of clear payment plan for 2019. Also, the GenCos have threatened to shut down power plants due to illiquidity. Therefore, we are projecting an average power output of 3,500-4000MWh/h in February.

Impact

A decline in power supply is expected to result in an increase in the demand for alternative energy sources. Currently the retail price of diesel in Lagos is ranging between N230/litre to N240/litre. This would increase the operating expenses of firms and reduce their bottom line.



[17]FGN, FDC Think Tank

Money Market

The average opening position of the interbank money market fell sharply by 42.87% to N77.73bn long in January. The illiquidity was as a result of higher OMO sales.

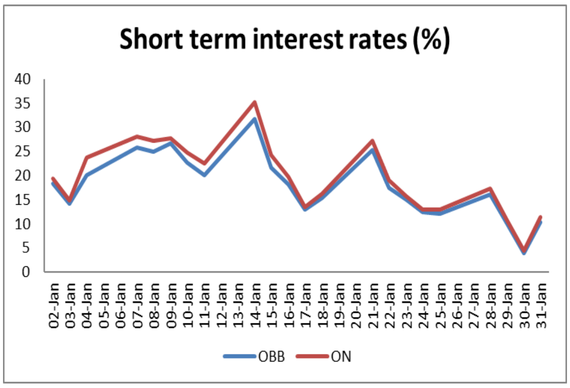
Average NIBOR (OBB/ON) fell to 18.73% from 23.91% in the corresponding period in December. However, the OBB/ON rate touched a two week-high of 31.67% and 35.25% on January 14th before easing to 10.29% and 11.36% respectively at the end of the month.

The CBN issued more OMO bills worth N2.38trn against a maturity of N2.09trn leading to a net outflow of N290bn compared to a net outflow of N20bn in December.

At the primary market, the yields on the 91-day, 182-day and 364-day T/Bills tenors increased by average of 35bps. At the secondary market, the 91-day T/bill yields fell by 73bps while the 182-day and 364-day T/bill yields increased by an average of 59bps during the review period.

There was a mixed movement in the Nigerian Inter-Bank Treasury bill True Yield (NITTY) rates during the period - the 30-day and 90-day tenors declined by 166bps to 12.17% pa and 12.07% pa respectively while the 180-day tenor increased by 65bps to 14.17% pa.

T/bills Tenor	Secondary market rates as at Jan 2nd (%pa)	Secondary market rates as at Jan 31st (%pa)	Direction	Primary market rates as at Jan 2nd (%)	Primary market rates as at Jan. 30th (%)	Direction
91	12.24	11.51	↓	10.90	11.00	↑
182	12.41	13.53	↑	13.10	13.50	↑
364	14.87	14.92	↑	14.45	15.00	↑



[18]

NITTY Tenor	Rates on Jan 2nd (%pa)	Rate on Jan 30th (%pa)	Direction
30	14.94	12.17	↓
90	12.62	12.07	↓
180	13.52	14.17	↑

Outlook

Interest rates movement is a function of market liquidity. We expect the CBN to continue with its liquidity management measures in anticipation of injections from OMO maturities, FAAC and the eventual implementation of the minimum wage increase.

Impact

Nominal interest rates move at variance with the level of liquidity and will continue to hover around an average of 12-15%. This will filter through to higher government debt service, as it issues more OMO bills to mop up liquidity.

[18] FMDQ, FDC Think Tank

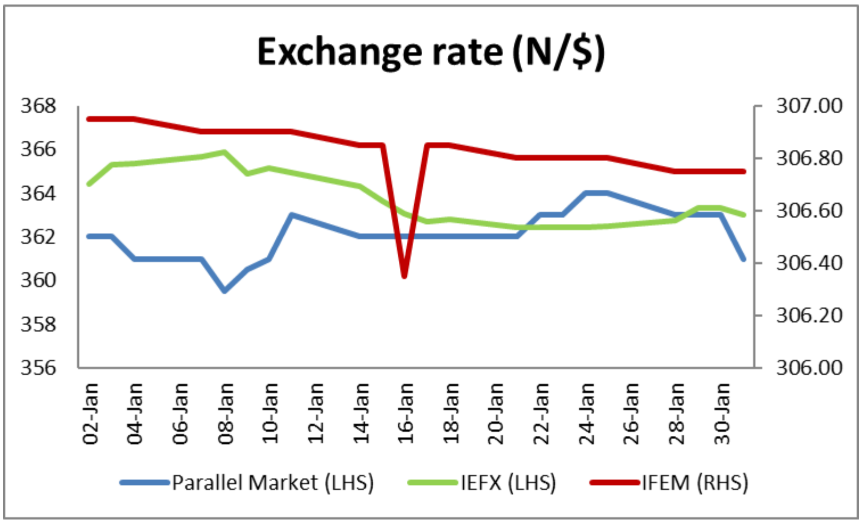
Forex Market

The Nigerian forex market is segmented with multiple exchange rates. The most important rate being the Investors and Exporters window (IEFX). No less than 55%-60% of Nigerian forex transactions are traded at this window. The CBN and most exporters and investors use this window. It serves not only as a source of price discovery but also a barometer for measuring potential and actual CBN intervention in the market. Some of the exchange rate determinants are balance of payments, capital inflows and trade balance.

Exchange Rate

There was an appreciation of the exchange rate across all the market segments. At the parallel market, the naira appreciated by 0.55% in January to N361/$. However, during the review period, the currency fluctuated between N359.5 and N364 against the dollar. The CBN increased the frequency of its intervention by 40.48%, selling $1.18bn compared to $840mn in December. The naira depreciated by 0.49% and 3.60% against the euro and pound to N411/€ and N472/£ respectively.

At the interbank foreign exchange market, the naira appreciated by 0.08% to N306.75/$ at the end of the review period. In the same vein, the naira at the IEFX window gained 0.27% to N363.03/$ despite the reduction in total turnover at the IEFX window which was down by 4.42% to $4.76bn.



[19]

Outlook

We expect the currency to depreciate by 1.12% to a range of N365-N367/$ as the elections draw closer. Nevertheless, the CBN is expected to continue its intervention in the forex market to stabilize the currency.

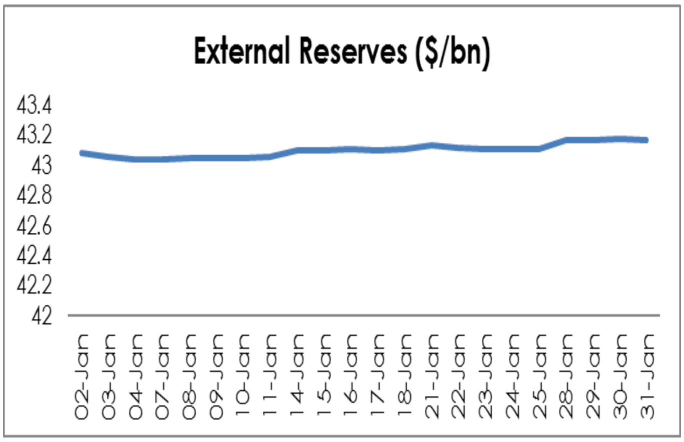
Impact

Currency depreciation will make dollar denominated loans more expensive to finance. It will also raise the country's import bill, given its large dependence on imports. On a positive note, a currency depreciation supports the government's import substitution policy and encourages the domestic production of imported goods, which become more expensive and unaffordable.

[19] FMDQ, CBN, FDC Think Tank

External Reserves

In the review period, gross external reserves increased by 0.12% to \$43.17bn in January from \$43.12bn in December. The increase was as a result of higher oil prices and drawdown of \$2.8bn Eurobond issued in November 2018. The import cover increased to 10.75 months from 10.74 months in the preceding month.



[20]

Outlook

The external reserves movement is largely dependent on the outcome of the gubernatorial election coming up in few weeks. If the election ends peacefully, we expect to see a build up in the level of external reserves as investors return to the market. However, any sign of instability could trigger capital flight. Also, oil prices have remained slightly above \$60pb, while Nigeria's production is expected to reduce as it complies with its new OPEC quota of 1.69mbpd. This means that oil proceeds could reduce ultimately affecting the build up of reserves.

Impact

The level of the external buffers is an indicator of the health of an economy's external balance. The CBN's ability to intervene in the market is also a function of the robustness of its reserves. Hence, a depletion of the buffers could affect the stability of the exchange rate.

[20] CBN, FDC Think Tank

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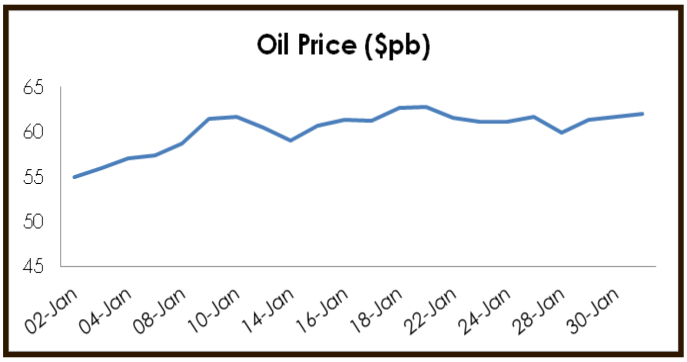
Commodities Market - Exports

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

Oil Prices

In January, the average price of Brent was $60.25pb, 4.47% higher than December's average of $57.67pb. The Brent crude price traded mostly above the benchmark of $60pb in the review period. The bullish sentiment was mainly driven by the implementation of the new output cut by OPEC and its allies. However, higher US Shale production limited the impact of the further production cuts on prices.



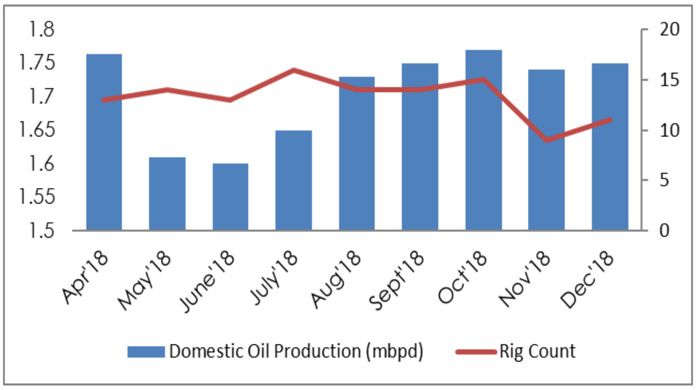
[21]

Outlook

We expect the bullish trend in prices to be sustained in the near term due to threats of U.S. sanction on Venezuela oil output. However, an increase in the U.S. shale production could moderate gains in prices.

Oil Production

Nigeria's oil production increased marginally by 0.57% to 1.75mbpd in December.[22] However, OPEC's total crude oil production fell by 2.32% (750,000 bpd) to 31.58mb/d. The decline was as a result of the fall in Saudi Arabia, Libya, Iran and UAE's production. Iraq, Kuwait, and Nigeria recorded an increase. In the same vein, Nigeria's oil rig count increased to 11 in December from 9 in the previous month.[23]



[24]

Outlook

The increase in the oil rig count coupled with the expectation of approximately 200,000bpd from the Total Egina oil field suggests a potential increase in oil production in the near term. However, the OPEC production cut of 3.04% could be a limiting factor.

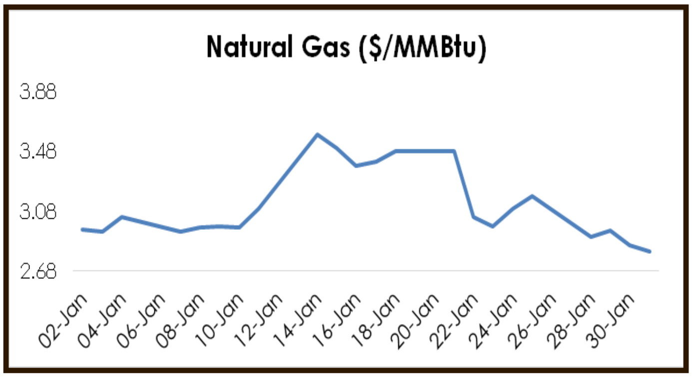
Impact

Crude oil accounts for approximately 90% of Nigeria's total export. A continuous increase in oil prices and production levels would result in higher oil proceeds. This would significantly boost the government's fiscal consolidation efforts and also have a positive impact on key economic indicators such as external reserves, exchange rates and balance of trade.

[21]Bloomberg
[22]OPEC's Monthly Oil Market Report for December
[23]Oilfield Knowledge Center, October 2018. Baker Hughes (a GE Company) Rig Count, http://phx.corporate-ir.net/phoenix.zhtml?c=79687&p=irol-rigcountsintl
[24]OPEC and Baker Hughes

Natural Gas

Natural gas prices averaged $3.12/mmbtu in the review period, 20.61% lower than the average of $3.93/mmbtu in the corresponding period in December. However, prices increased to $3.59/mmbtu on January 14th before dropping to close the period at $2.81/mmbtu. The bearish trend in the gas market was primarily influenced by low demand due to lower than normal temperatures and higher production.



[25]

Outlook

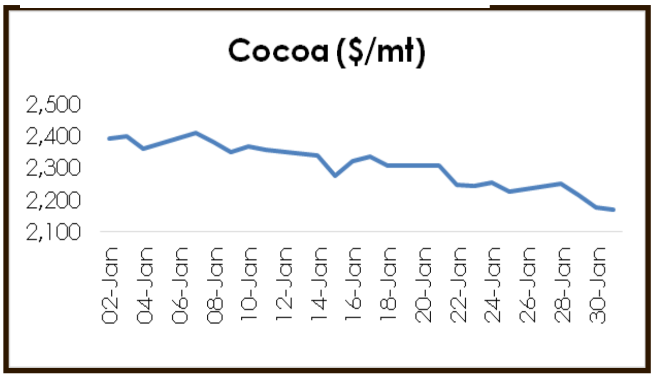
Prices are expected to sustain the downward trend in the coming weeks due to an increase in US production and Qatar's plan to focus on its natural gas production.

Impact

LNG accounts for 12.6% of Nigeria's export revenue. A further decline in prices will decrease the country's export revenue and have a negative impact on business proxies such as FAAC disbursements.

Cocoa

The average price of cocoa stood at $2,304/mt in the review period, 2.13% higher than the average of $2,256/mt in December. However, it dipped to a six-week low of $2,168/mt on January 31st. This was driven by strong European demand for cocoa.



[26]

Outlook

We expect a reversal in the trend as unfavourable weather conditions in Ivory Coast will affect its output. Thus, prices are expected to remain around $2,000/mt-$2,300/mt.

Impact

Nigeria is the 4th largest producer of cocoa in SSA. A bearish price outlook would have a negative impact on Nigeria's export revenue.

[25]Bloomberg
[26]Bloomberg

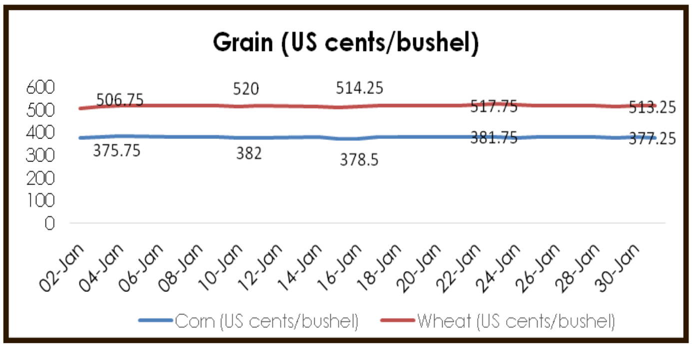
Commodities Market - Imports

Wheat

Average wheat prices fell by 0.77% to $5.17/bushel in January. This was as a result of lower global demand for wheat.

Corn

The average price of corn decreased by 0.52 % to $3.79/bushel from $3.81/bushel in December. This was due to a projection of higher global supply.



[27]

Grains- Outlook

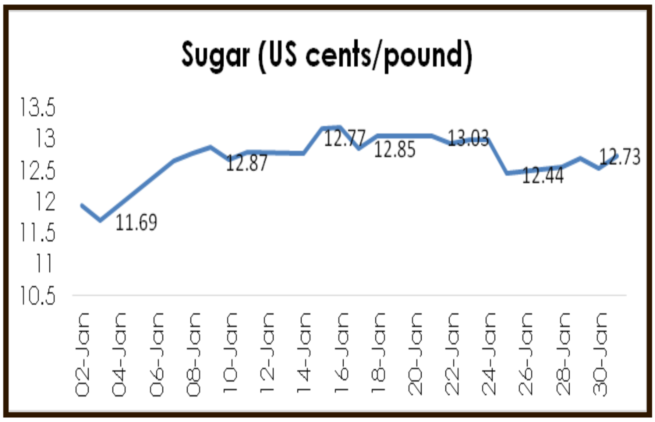
We anticipate an increase in the prices of grains in the coming weeks driven by an arid weather condition which will affect output levels in top producing countries.

Impact

Nigeria imports approximately $154.3mn of corn, 0.5% of world output and 4.8mn metric tonnes of wheat.[28] The increase in global grain prices would push up the prices of grain-dependent products such as cereals and flour and this might reduce the purchasing power of consumers.

Sugar

Sugar prices averaged $0.1269/pound in January, 1.12% higher than the December average of $0.1255/pound. In the same vein, sugar prices reached a two-month high of $0.1316/pound and $0.1317/pound on January 15th and 16th respectively. This is despite the growing health concerns and awareness of sugar consumption.



[29]

Outlook

The price of sugar is expected to trend upwards in the near term due to expectations of a production cut in Germany, a top exporter of sugar.

Impact

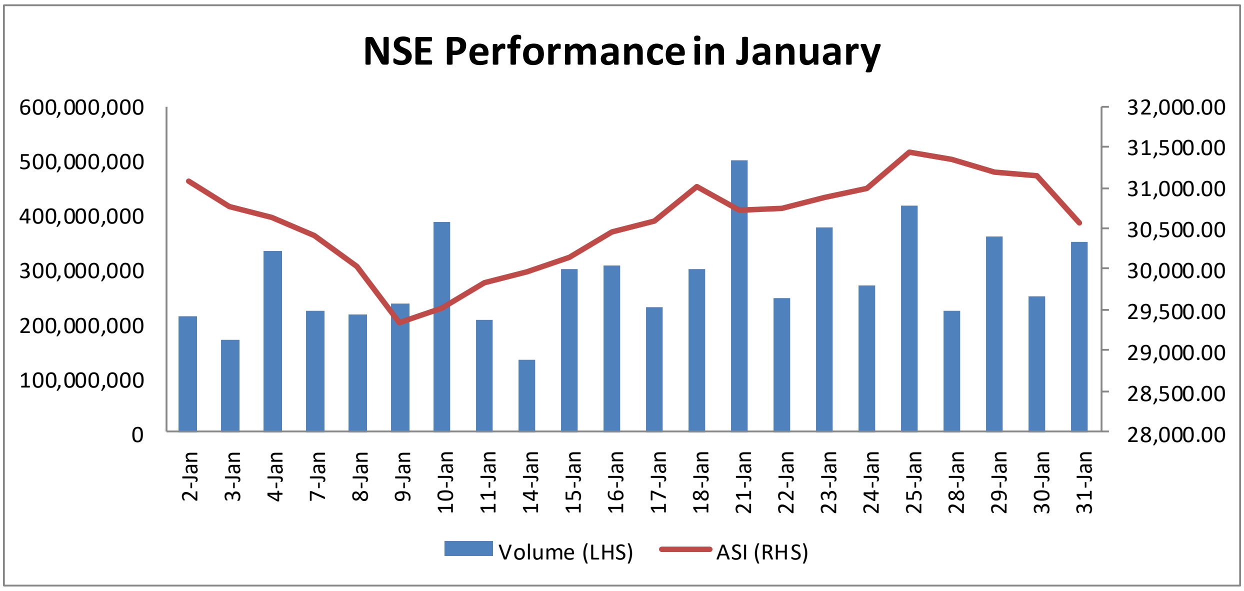
Nigeria is the 10th largest importer of sugar globally and imports approximately 1.5% of global output. An increase in the global price of sugar signals a possible increase in the input cost of companies such as Nasco foods and Cadbury that use sugar in their production process.

[27]Bloomberg
[28]World's Top Exports: http://www.worldstopexports.com/corn-imports-by-country/
[29]Bloomberg

Stock Market Review

Investor jitters ahead of the February general elections triggered a selloff on the Nigerian stock exchange in January. The NSE ASI fell by 2.78% to close at 30,557.20 points on January 31, compared to December 31. Similarly, market capitalization declined by 2.82% (N330bn) to N11.39trn.

The NSE ended the month of January with a price to earnings (P/E) ratio of 8.84x. This is a 6.16% decline over the close of the previous period's P/E of 9.42x. Market breadth remained negative at 0.60x, as 36 stocks gained, 73 stocks remained flat, while 60 declined.



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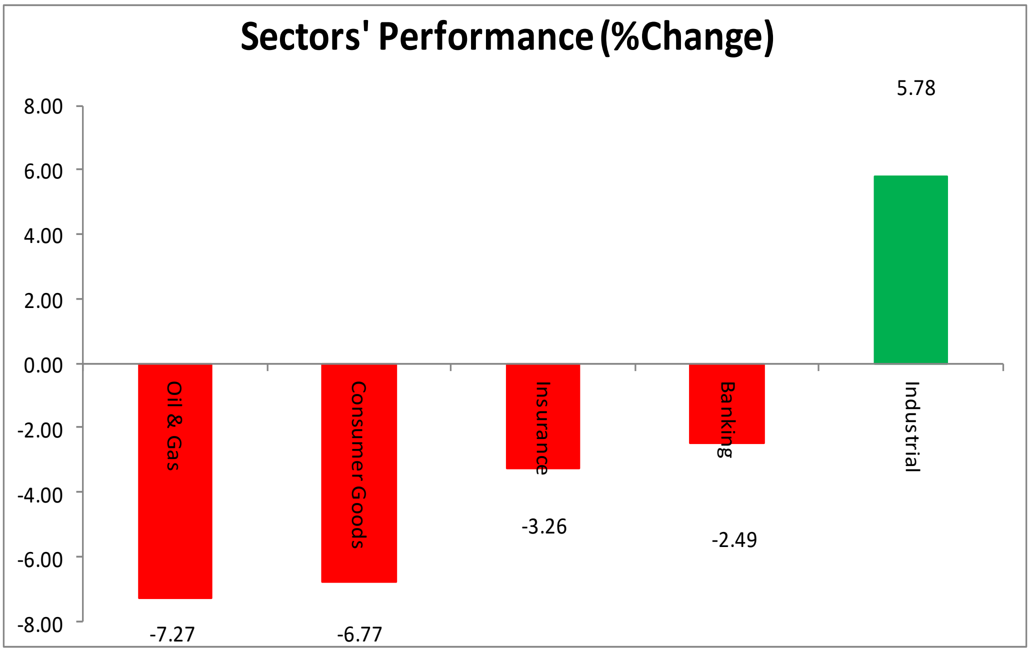
The NSE witnessed less trading activities in the month of January. Average volume traded on the floor fell sharply by 31.14% to 283mn units, whilst average value of trades declined by 18.13% to N2.71bn.



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[30]NSE, FDC Think Tank
[31]NSE, FDC Think Tank

All indices except the industrial sub sector closed the month of January in negative territory. The oil & gas sub-sector index was the biggest loser. The index lost a whopping 7.27% in January. The industrial sub-sector gained 5.78%.

C&I Leasing Plc (407.87%) led the advancers, followed by Royal Exchange Plc (31.82%), Julius Berger Nigeria Plc (29.35%), Sterling Bank Plc. (25.79%) and Cement Company of Northern Nigeria Plc (23.71%).

TOP 5 GAINERS (N)				
Company	Dec 31'18	Jan 31'19	% Change	Absolute Change
C & I LEASING PLC.	1.78	9.04	407.87	7.26
ROYAL EXCHANGE PLC.	0.22	0.29	31.82	0.07
JULIUS BERGER NIG. PLC.	20.10	26.00	29.35	5.9
STERLING BANK PLC.	1.90	2.39	25.79	0.49
CEMENT CO. OF NORTH.NIG. PLC	19.40	24.00	23.71	4.6

The laggards were led by Resort Savings & Loans Plc (-60%), McNichols Plc (-29.79%), Flour Mills Nigeria Plc (-19.70%), GlaxoSmithkline Consumer Nigeria Plc (-19.66%) and Berger Paints Plc. (-18.60%).

TOP 5 LOSERS (N)				
Company	Dec 31'18	Jan 31'19	% Change	Absolute Change
RESORT SAVINGS & LOANS PLC	0.50	0.20	-60.00	-0.30
MCNICHOLS PLC	0.47	0.33	-29.79	-0.14
FLOUR MILLS NIG. PLC.	23.10	18.55	-19.70	-4.55
GLAXO SMITHKLINE CONSUMER NIG. PLC.	14.50	11.65	-19.66	-2.85
BERGER PAINTS PLC	8.60	7.00	-18.60	-1.60

Outlook

Investors are expected to reduce their exposure to the equity market in view of the general elections in February. This is likely to translate to a negative performance. The release of corporate earnings for FY'18 would also influence market direction to a large extent.

Equity Report: International Breweries Plc

Analyst Recommendation: Hold

Market Capitalization: N445.27bn

Recommendation Period: 365 days

Current Price: N30.25

Industry: Food, Beverage & Tobacco

Target Price: N42.73

Analyst's note

The Nigerian food and beverage industry continues to face challenges due to weak consumer demand, particularly from sustained high levels of unemployment and underemployment (43.3% in Q3'18), rising input costs, transport and logistics constraints (due to the Apapa gridlock) and security challenges in the North. In addition, weak macroeconomic factors such as low GDP growth, a high inflationary environment (food inflation at 13.56% in Dec'18), and a high interest rate environment continue to impact negatively on the industry.

The decline in household income and consumer purchasing power during the economic recession has resulted in a major shift from premium products to value products. This is still prevalent given the weak macroeconomic environment.

Although International Breweries Plc deals mainly in value products, the company's financial performance was negative in 9M'18. Our International Breweries valuation is derived using intrinsic valuation and its share price has a modest head room. Accordingly, we place a HOLD rating on International Breweries Plc.

Profitability constrained by rising costs

International Breweries Plc posted a 128.57% jump in revenue to N83.35bn in 9M'18, compared to N36.53bn recorded in 9M'17. This was partly due to the combination of higher prices and the introduction of a new brand, Budweiser. However, the surge in revenue was outweighed by rising costs.

The company reported a 169.85% increase in cost of sales to N54.59bn, a 171.02% surge in administrative expenses to N19.08bn, and a 61.32% increase in finance costs to N11.20bn in 9M'18. These resulted in a 187.19% increase in International Breweries' loss before tax of N9.19bn compared to a loss before tax of N3.20bn in 9M'17. In addition, the company recorded a loss after tax of N7.14bn compared to a profit of N1.43bn in 9M'17.

Earnings per share (EPS) down 588.2%

International Breweries posted a loss per share of 50 kobo in 9M'18, compared to a profit of 17 kobo reported in 9M'17.

Industry Overview

The Nigerian brewery industry remains the largest segment of the food and beverages sector. It has evolved, over the years, from a duopoly (Nigerian Breweries and Guinness) to an oligopolistic market structure. Nigeria is the second largest beer market in Africa with a large youth population and an expanding middle class, both of which contribute to the growth of its brewery industry. The industry is expected to grow at a compound annual growth rate (CAGR) of 5.6% between 2011 and 2020.[32]

The industry is dominated by three key brewing giants, which are subsidiaries of global brands. These include Nigerian Breweries (a subsidiary of Heineken International), Guinness Nigeria (a subsidiary of Diego) and International Breweries (a subsidiary of AB InBev[33] - formally SABMiller). Other players include Casapreco and other indigenous manufacturers dealing mainly in low end gin. Each of the brewing giants have numerous brands that compete for consumer patronage in the market.

Over the years, International Breweries has remained resilient in gaining market share in the competitive market. Guinness Nigeria has leveraged on celebrity endorsements in order to compete for market share. Nonetheless, Nigerian Breweries remains the dominant player in the market.

Company Overview

International Breweries Plc. was incorporated in 1971 as a private limited liability company under the name International Breweries Limited and commenced operations in December 1978. It became a public limited liability company in 1994 and was listed on the Nigerian Stock Exchange (NSE) in 1995. In August through November 2017, AB InBev acquired controlling interests in International Breweries as it acquired 72.17% of SAB Miller's shares in the company.

In November 2017, International Breweries, Intafact Beverages Limited and Pabod Breweries Limited (all subsidiaries of AB InBev) consolidated their operations through a merger. As a result, it listed an additional 5,301,612,656 shares on the NSE in December 2017 bringing the total issued and fully paid shares to 8,595,861,936.

Its key business activities remain brewing, packaging and marketing of beer, alcoholic and non-alcoholic beverages and soft drinks. International Breweries deals primarily in low priced products.

Following the merger with its sister companies, International Breweries changed its reporting period to January 1 – December 31 from April 1 – March 31. Its

[32] A Focus on the Nigeria Brewery Sector – GTI Research 2015
[33] Anheuser-Busch InBev

Income Statement for International Breweries Plc						
N'000	**2013**	**2014**	**2015**	**2016**	**2017**	**2017**
Revenue	17,388,632	18,493,907	20,649,295	23,269,364	32,711,218	36,527,807
Cost of Sales	(9,687,402)	(9,591,273)	(11,587,817)	(12,560,429)	(17,546,759)	(22,819,920)
Gross Profit	**7,701,230**	**8,902,634**	**9,061,478**	**10,708,935**	**15,164,459**	**13,707,887**
Other Income	30,121	13,966	191,192	44,772	102,403	123,387
Marketing and Promotion Expenses	(2,201,408)	(2,412,707)	(2,859,260)	(3,596,407)	(5,089,755)	(6,086,719)
Administrative Expenses	(2,085,746)	(1,492,671)	(1,758,149)	(2,016,188)	(2,092,682)	(4,549,768)
Operating Profit/EBIT	**3,444,197**	**5,011,222**	**4,635,261**	**5,141,112**	**8,084,425**	**3,194,787**
Interest Income	308,974	41,620	1,327	225,101	2,983	532,971
Finance Cost	(197,625)	(1,127,342)	(1,821,034)	(1,709,387)	(5,195,659)	(6,927,374)
Profit Before Tax (PBT)	**3,555,546**	**3,925,500**	**2,815,554**	**3,656,826**	**2,891,749**	**(3,199,616)**
Income Tax Expense	(1,228,204)	(1,820,000)	(869,064)	(1,004,078)	(1,857,392)	4,628,936
Total Comprehensive Income for the Period (PAT)	2,327,342	2,105,500	1,946,490	2,652,748	1,034,357	1,429,320

Balance Sheet for International Breweries Plc						
N'000	**2013**	**2014**	**2015**	**2016**	**2017**	**2017***
Non-Current Assets						
Property, Plant and Equipment	15,496,354	18,677,771	22,679,842	25,216,244	31,748,068	191,554,980
Intangible Asset	24,765	22,444	54,383	54,923	45,738	432,592
Available for Sale Investment	1,000	1,000	1,000	-	-	1,481,590
Deferred Tax Assets	890,325	94,254	106,699	127,458	1,229,680	20,298,380
Total Non-Current Assets	**16,412,444**	**18,795,469**	**22,841,924**	**25,398,625**	**33,023,486**	**213,767,542**
Current Assets						
Inventories	2,439,885	2,236,649	2,800,392	2,909,333	3,835,324	16,204,786
Trade and Other Receivables	3,142,040	2,945,043	3,675,605	4,072,090	6,938,722	15,750,190
Cash and Cash Equivalents	1,042,393	393,379	853,668	1,102,058	1,165,203	8,098,186
Total Current Assets	**6,624,318**	**5,575,071**	**7,329,665**	**8,083,481**	**11,939,249**	**40,053,162**
Total Assets	**23,036,762**	**24,370,540**	**30,171,589**	**33,482,106**	**44,962,735**	**253,820,704**
Equity						
Share Capital	1,631,263	1,647,125	1,647,125	1,647,125	1,647,125	4,297,931
Share Premium	5,570,705	6,154,725	6,160,731	6,160,731	6,160,731	6,160,731
Retained Earnings	817,449	2,107,317	2,999,647	4,828,779	4,710,148	30,556,574
Total Shareholders' Equity	8,019,417	9,909,167	10,807,503	12,636,635	12,518,004	41,015,236
Other Reserves	1,360,756	1,360,756	1,360,756	1,360,756	1,360,756	1,360,756
Total Equity	**9,380,173**	**11,269,923**	**12,168,259**	**13,997,391**	**13,878,760**	**42,375,992**
Non-Current Liabilities						
Borrowings	3,789,474	3,854,913	4,901,221	-	-	18,170,989
Deferred Tax Liabilities	1,749,928	2,322,550	2,771,238	3,119,122	4,385,556	24,453,739
Employee Benefits	257,852	318,707	355,664	424,859	509,803	793,826
Other Payables	-	-	-	93,848	136,522	147,489
Total Non-Current Liabilities	**5,797,254**	**6,496,170**	**8,028,123**	**3,637,829**	**5,031,881**	**43,566,043**
				3,543,981		
Current Liabilities						
Trade and Other Payables	5,331,892	5,927,015	4,671,165	6,479,361	12,476,472	94,828,183
Employee Benefits	17,820	79,335	59,054	138,153	165,438	544,620
Borrowings/Financial Liabilities	2,421,689	771,856	4,844,127	8,552,420	11,987,582	69,871,674
Current Tax Liabilities	87,934	456,241	400,862	676,952	1,422,602	2,634,192
Total Current Liabilities	**7,859,335**	**7,234,447**	**9,975,208**	**15,846,886**	**26,052,094**	**167,878,669**
Total Liabilities	**13,656,589**	**13,730,617**	**18,003,331**	**19,484,715**	**31,083,975**	**211,444,712**
Total Equities and Liabilities	**23,036,762**	**25,000,540**	**30,171,590**	**33,482,106**	**44,962,735**	**253,820,704**

Source: International Breweries Plc Annual Reports

Management: Management capable of exploring growth opportunities

International Breweries Plc's growth over the years can be attributed to its detailed regional and ethnic segmentation, which has focused solely on the value beer category to capture a larger consumer base.

In an effort to expand its product portfolio to reach a wider consumer base, Budweiser, a premium category of AB InBev brand and the official beer of the 2018 FIFA world cup, was launched in Nigeria on April 14th. The company also unveiled its "Light Up the FIFA world cup campaign". This played a big role in increasing awareness, market share and revenue.

In addition, International Breweries is constructing a new brewery worth over $250 million in Sagamu, Ogun State. This will be the second largest brewery in Africa and will increase the company's capacity and production resulting in revenue growth. Nonetheless, the weak macroeconomic environment (forex volatility and weak consumer demand) could weigh on the management's ability to increase market share, reduce cost and improve operational efficiencies to ensure growth in the short run.

The Bulls Say and the Bears Say

Bulls say:

* Shift of market preference to low-priced products
* Rich product portfolio for alcoholic and non-alcoholic drinks
* Innovative malt brands
* Talented and experienced management
* Leverage on international parent company
* Increase in capacity to reduce unit cost of production

Bears say:

* Intense competition from other leading players such as Nigerian Breweries and Guinness, as well as smaller local breweries
* Rising costs of raw materials and key inputs
* Increases in excise duties
* Possible integration challenges

Risks and Outlook: Great prospects constrained by macroeconomic risks

International Breweries is exposed to market risks (currency and interest rate), credit, liquidity and operational amid persistent macroeconomic and security challenges in the country. These risks could prevent International Breweries from growing its sales volume and top-line earnings, managing cost and increasing its market share.

Most of the company's debt stems from foreign currency borrowings, purchases of some of its raw materials in foreign currency and interest expense. Thus, the company is exposed to currency risks on purchases and borrowings denominated in foreign currency mainly US dollars (USD), SA rand and Euro pounds sterling (GBP) and Swiss francs (CHF). Although there have been recent improvements in the availability of forex in the country, there is still a level of uncertainty in the forex market due to possible oil price and production shocks. A significant shortfall in oil revenue could exacerbate pressures on the external reserves and reduce the ability of the CBN to continue to defend the naira. A further devaluation of the naira will increase the company's operating and interest expenses.

Appendix- Valuation

We derived our valuation for International Breweries Plc by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate for International Breweries is N42.73, which is a 41% upside on the price of its share as at January 22, 2019. The discount rate [weighted average cost of capital (WACC)] of 17.19% is derived using a 15.3% risk free rate, a beta of 1.0066,[34] an after-tax cost of debt of 7.58%, and a market risk premium of 6.4%. The calculated long term cash flow growth rate to perpetuity is 5.0%.

[34] Financial Times Data