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☏:01-2715414, 6320213; Email: info@fdc-ng.com; Website: www.fdcng.com

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Review of 2019 – A year of political trepidation and growing uncertainties

Nigeria kicked off the year with a hitch-free election. The president has so far spent 195 days in office – so much reform, so little change. The economy has been on a rollercoaster from the implementation of various taxes to submission and approval of the 2020 budget. The GDP growth, on the other hand, is still in the slow growth cycle. Although it is expected to grow marginally faster at 2% than the previous year (1.91%), it is remains non-inclusive.

Below is a highlight of major events in 2019

	Q1	Q2	Q3	Q4
Growth	2.01% - Fastest first-quarter growth since 2015	2.12% - Contracting sectors were mainly labour intensive and interest rate	2.28% - Marginal improvement in interest-rate sensitive and job elastic sectors	2.3% - Driven by increased consumer demand
Monetary policy guideline	MPC cut interest rate by 50 basis points to 13.5% per annum	CBN governor re-appointed	CBN raises LDR to 60%	LDR reviewed upwards to 65% effective December 31
Reserves	Gained 3.04% to close at $44.43 billion	Upward trend persisted Closed the quarter at $45.07 billion	Upward trend persisted Closed the quarter at $45.07 billion	Could end the year at $38 billion The persistent decline likely to spook investors
Stock market	Investors were wary of taking positions due to political tensions	MTN listed on the NSE	Airtel listed on the Nigerian Bourse	Q3 earnings were weak and dragged the market down
Policy thrust	Senate approved N30,000 as new minimum wage	New minimum wage bill signed into law	Closure of Nigeria's land borders Proposed VAT hike from 5% to 7.5% Nigeria signed AfCFTA	2020 budget approved by Senate Buhari assents to Deep Offshore Act

2020 Economic Outlook - A bumpy year ahead

Growth: GDP growth is expected to remain in a slow-growth cycle and well below potential GDP of 3.1%. Whilst improved credit conditions will boost the manufacturing sector growth, the government's trade protectionist stance will constrain growth in the trade and possibly services sector.

Inflation: Inflation will remain driven by both the cost-push and demand-pull factors. The border closure, infrastructure deficit and forex restrictions will be the major supply bottlenecks while the payment of the new minimum wage and its arrears would have a negative impact on inflation.

Exchange rate: Nigeria will continue to operate a multiple exchange rate system. Also, the CBN is expected to remain committed to supporting the naira and make it relatively stable within a band of N359 – 361/$ at the parallel market.

Conclusion

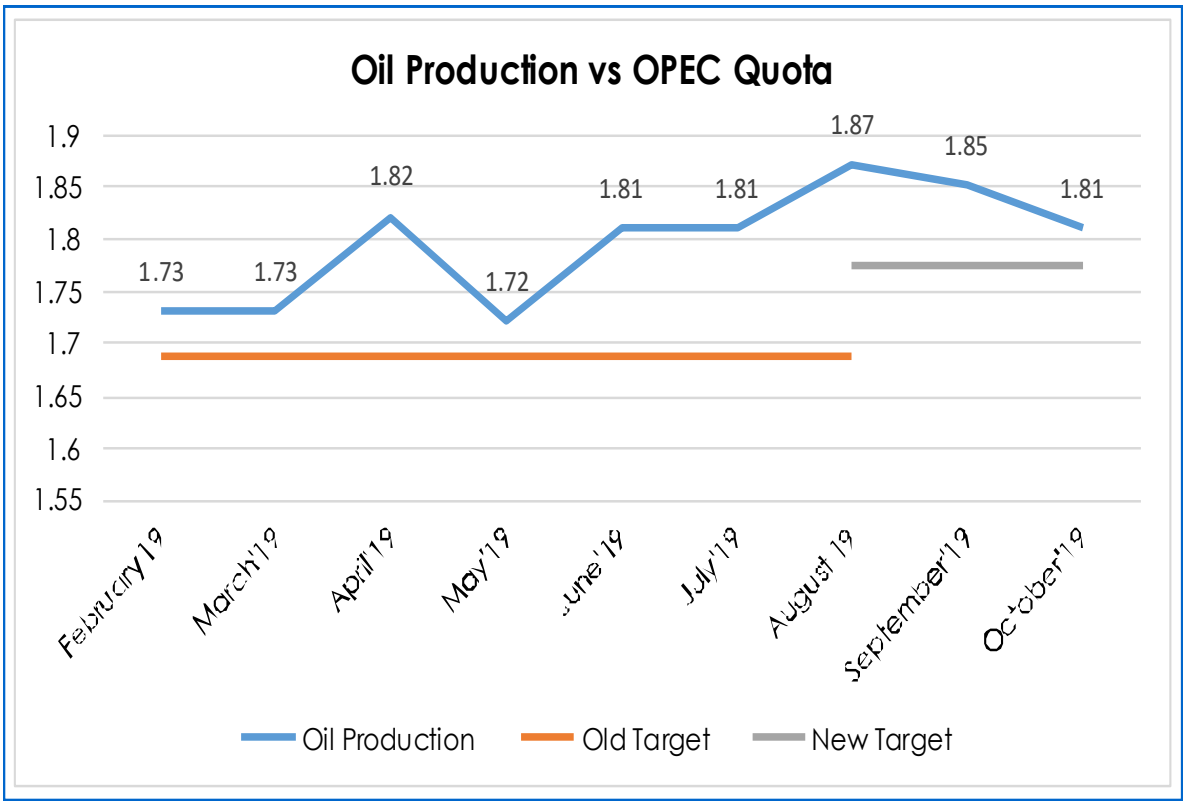
Globally, the focus will be on the US elections, the Fed's struggle for independence and the policy response of advanced economies to a global slowdown.

Domestically, consumers will feel the pinch of the multiple taxes and tariffs, from the hike in VAT to the restoration of tollgates and higher cost-reflective electricity tariffs. The good news is that the payment of the new minimum wage and the arrears would offer some relief to workers. Investors would also keep a close watch on the stock market and the impact of government policies on their portfolio strategy.

Is Nigeria ready for an OPEC cut?

At its just concluded bi-annual meeting in Vienna, OPEC and its allies agreed to deepen production cuts by 500,000 barrels per day, effective January 1 2020, until March 2020. This brings the total output cut to 1.7 million barrels per day. By implication, Nigeria could be one of the countries asked to reduce its production.

Recently, OPEC increased Nigeria's oil output target to accommodate its expanding oil industry. The country's allocation rose to 1.774 million barrels per day from 1.685 million bpd at the last OPEC meeting in July. Although, Nigeria's OPEC quota increased by 5.28%, oil production is still hovering above the quota of 1.774million barrels per day. Production increased to a 4-year high of 1.87 million barrels per day in August and it is currently at 1.81mbpd in October.



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[1]OPEC

Rationale for a production cut

The cartel took note of oil market developments since its last meeting on July 1 and reviewed the oil market outlook for 2020. The forecast for global economic growth in 2020 remains at 3%, oil demand is expected to grow by 1.1 mb/d, and in recent months, expectations for non-OPEC supply have been revised downwards.[2] The committee also emphasized on uncertainties such as the US-China trade negotiations, macroeconomic developments and its impact on global inventory levels, as well as overall market and industry sentiment.

Impact of a production cut on Nigeria

Nigeria's 2020 budget is benchmarked on an oil price of $57pb and oil production of 2.13mbpd. The immediate impact of an extended OPEC production cut would force Nigeria to adhere to its current quota. This could also increase oil prices and keep them above $60pb. Nigeria is more sensitive to changes in oil production than to changes in prices.

The shortfall in revenue and forex earnings could trigger fiscal and monetary adjustments. This could lead to an increase in borrowings to bridge the fiscal gap. The monetary authorities will also allow a decline in reserves at the expense of maintaining the exchange rate at N360/$. Weakening reserves could fuel capital flights, which could further increase pressure on the currency. Persistent naira pressure may eventually lead to a depreciation of the naira towards N365-370/$.

[2]https://www.opec.org/opec_web/en/press_room/5794.htm

Rural Urban Migration and Agricultural development in Nigeria

The Nigerian government has been making efforts to facilitate agricultural development in the country as it seeks to diversify its revenue base away from oil. The agricultural sector used to be the leading contributor to GDP before the first oil boom and still employs a significant proportion of the population. The agricultural sector's contribution to real GDP stood at 29.25% year-on-year in Q3'19.[3] Also, the sector grew by 2.28% in Q3'19 up from 1.79% in Q2'19.[4] However, considering Nigeria's rapid population growth, estimated at 2.6% year-on-year in 2018 and a size of 195.9 million, the Nigerian agricultural sector remains grossly underdeveloped and holds great investment opportunities.[5]

Recent efforts to encourage agricultural productivity in Nigeria

A number of initiatives and development plans have been rolled out by successive governments to address Nigeria's decline in agricultural productivity. Recent policy actions include a restriction on foreign exchange for food importation and the closure of the Nigeria-Benin border to curb smuggling.[6] The need to protect domestic producers and encourage increased agricultural production in Nigeria prompted these policy actions. Importation of agricultural products is one of

[3]National Bureau of Statistics. 2019. "Nigerian Gross Domestic Product Report, Q3, 2019". https://www.nigerianstat.gov.ng/
[4]ibid
[5]TradingEconomics.com, 2019. "Nigeria population," Trading Economics .https://tradingeconomics.com/nigeria/population/
[6]Felix Onuah, 2019. "Nigeria closes part of border with Benin to check rice smuggling". Reuters. https://af.reuters.com/article/topNews/idAFKCN1VJ0PH-OZATP

the identified constraints to agricultural development in Nigeria. Imported food items compete with domestic agricultural produce and limit farmers' opportunities in the market. Nigeria's food import bill increased by 22.2% to N744.72 billion in the first quarter of 2019 from N608.96 billion in the corresponding period in 2018.[7]

The border closure helped to curb smuggling of food commodities into the country, as well as the smuggling of crude oil out of the country. However, it exposed the mismatch between current domestic food supply and consumer demand for food items. Prices of commodities like rice, cooking oil, chicken and turkey have spiked significantly in the last few months because domestic production has not been able to augment food shortages arising from the border closure. The shortage of food commodities due to the closure therefore highlights an urgent need for increased domestic agricultural production in Nigeria.

Rural-Urban migration -constraint to agricultural development in Nige-

Agriculture in Nigeria is concentrated mainly in the hands of peasant farmers in the rural areas. Rural-urban migration is therefore a fundamental challenge for domestic agricultural production because it creates shortage of labour supply for agriculture. Nigeria's urban population has grown significantly over the years and is expected to maintain an annual 3.26% growth rate until 2025.[8] Meanwhile, the rural population growth, which is currently at 1.2%, is expected to fall below 1% by 2025.[9] Low income of farmers due to the subsistence level of agriculture in Nigeria, use of crude agricultural tools, poor infrastructural development, among others are reasons rural youth migrate to the cities.

Way Forward: Lessons from Malaysia

Low youth participation in Malaysia has been one of the major banes of the country's agricultural productivity. Therefore, to address food security issues in the country, and promote agricultural development, the government introduced the National Agrofood Policy (2011-2020).[10] The National Agrofood Policy emphasizes the need to: increase the contribution of the agro-food Indus-

[7]National Bureau of Statistics."Q2 2019, Foreign trade statistics."http://nigeriaforeigntrade.opendataforafrica.org/ozdtkjf/summary-of-foreign-trade-statistics-of-nigeria
[8]United Nations, 2018. "World Urbanization Prospects 2018". Author. https://population.un.org/wup/Country-Profiles/
[9]ibid
[10]Rozhan Abu Dardak, 2018. "Impacts of national agrofood policy towards agriculture sector in Malaysia". Food and Fertilizer Technology Centre (FFTC) agricultural policy articles. http://ap.fftc.agnet.org/ap_db.php?id=853&print=1

try to GDP, strengthen human capital, encourage innovation, technology, research and development, strengthen the supply value chain, and promote private sector led business development.[11]

According to an assessment of the impact of the policy on agricultural development in the country in 2015, the agricultural sector grew 2.5% between 2011 and 2015 and was able to strengthen the ties between agro based industries and the agricultural sector as a major supplier of raw materials. The key achievement of the NAP was that it was able to improve farmers' income thereby creating an incentive for increased youth participation in the country. Salaries and wages of agricultural workers grew by a compounded annual growth rate of 10% between 2011 and 2015.[12]

Therefore to address the rural-urban challenge in Nigeria and encourage youth participation in agriculture, the government should:

* **Infrastructural development in the rural areas:** Access to basic social amenities such as a good road network, access to clean water, educational facilities, electricity etc are leading factors encouraging rural-urban migration. In the same vein, there is need for storage facilities, irrigation and water systems to ease agricultural activities in the country. Agricultural produce are generally perishable hence adequate storage facilities is essential for the preservation of the commodities.

* **Facilitate joint coordination of small scale farmers:** The government would need to strengthen the agricultural supply chain by promoting the formation of farmer groups and producer organizations to encourage large scale agriculture and enhance an improvement in farmers' income.

* **Encourage value-added productivity by connecting farmers to agro-based industries:** Rapidly expanding high value agricultural supply chain requires good connectivity between the agricultural sector and the industrial sectors who process raw materials supplied by farmers into finished goods. By linking farmers to potential agro-based industries, sales can be enhanced and increased production will be encouraged.

* **Encourage innovation and technological based agriculture to enhance productivity:** Agriculture activities in Nigeria are characterized by the use of old and outdated methods and farm implements. The introduction of technological based farming methods would attract youths and encourage them to participate in agriculture.

[10]ibid
[11]ibid

* Government should revive agriculture related research institutes across the nation: the government should encourage agricultural extension programmes, research and development in the country. Scholarships can be provided for agricultural studies while agricultural educational institutions should also be provided with needed facilities to train students and create an incentive for youth involvement in Agriculture.

Conclusion

Youth participation in agriculture is indispensable for the desired growth in domestic agricultural production. Agriculture is labour intensive and the youths are needed to provide manpower and to drive technological innovations in the Nigerian agricultural sector. It is imperative for the government to make the rural areas and agriculture attractive to its youthful population. In addition to policies to promote easy access to credit facilities and the supply of farm inputs to rural farmers, the Nigerian government would need to introduce specific policy actions as identified above to address rural-urban migration in the country.

There are no easy fixes for Nigeria's problems

Reforms to its oil industry and a more efficient state are vital

Muhammadu Buhari, Nigeria's president, is six months into his second term. A former military leader who returned three decades later as an elected president in 2015, Mr Buhari still has three years to build a positive legacy. So far, he has disappointed. Nigeria is going backwards economically. A combination of anaemic growth and a fast-growing population means the economy has been shrinking in per capita terms throughout Mr Buhari's tenure. The security situation is unstable, despite some progress against Boko Haram, the Islamist terror group. Clashes between herdsmen and settled farmers are affecting much of the country. Crucially, Mr Buhari's reputation for personal integrity has not translated into a discernibly, more efficient, or honest state. To be fair, the job Mr Buhari inherited is next to impossible. Nigeria has at least 180m people and some 500 languages. By all rights the continent's wealthiest nation, it has more people living in absolute poverty - below $1.90 a day, than India. Oil has ruined Nigeria, making it a renter, rather than a production economy. The business of government becomes that of divvying up revenue, a task that has corrupted the institutions of state supposed to carry it out.

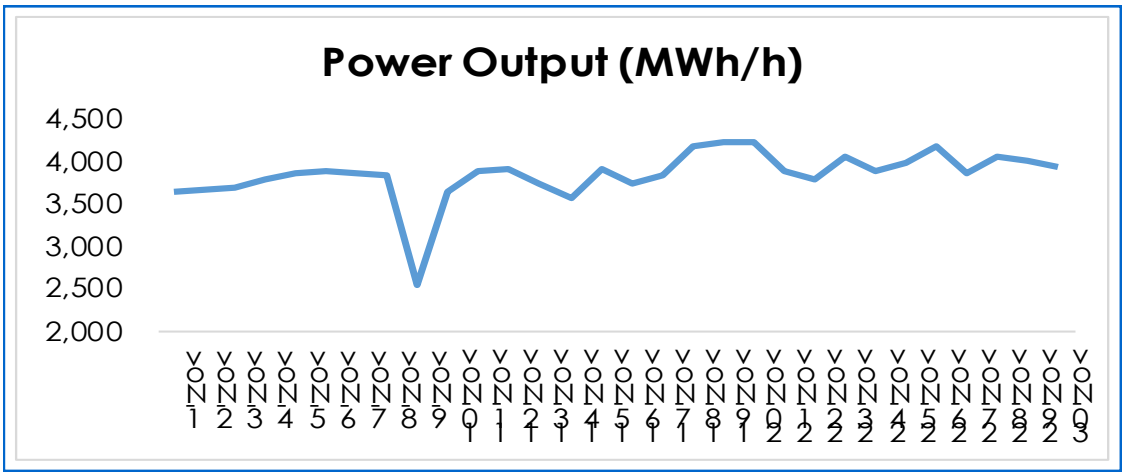
Mr Buhari has understood this, at least in theory. He has complained of the manufacturing sector's seeming inability to produce the simplest goods, hardly surprising given the lack of electricity, dire roads and absence of manufacturing inputs. Rightly, he wants diversification and support for farmers. Unfortunately, the president has sought statist solutions to these issues in a country where the state lacks credibility. That has involved allocating foreign exchange to favoured industries, which is not a good solution when institutions are weak.

In an effort to boost rice production, the government has funnelled capital to farmers and clamped down on imports of cheaper rice. Production has leapt 60 per cent since 2013, though ordinary Nigerians now pay more for the staple. Imports of smuggled rice are so large the government has taken the drastic step of closing all land borders. Few think that policy can hold. There are some glimmers. Nigeria is vying with Kenya as Africa's most dynamic tech hub. In November alone, its fintech companies attracted nearly $400m from foreign investors. Aliko Dangote, a businessman who has made money through state protection, is investing $12bn in a petrol refinery that could help curb the ludicrous practice of exporting crude oil and reimporting finished products. There are signs of more vigour in Mr Buhari's government too. He has begun to implement long-delayed reforms to the oil industry. He is also seeking to raise value added tax by 50 per cent to a still-modest 7.5 per cent, a small step but better than nothing in an economy that collects tax worth just 5.7 per cent of output, according to the most recent figures from the OECD. He could go one better by removing the petrol subsidy, which distorts the economy and helps the middle class the most. In the time he has left, Mr Buhari should try to improve the efficiency of the state and its ability to provide public goods. Turning things around does not mean micromanaging or getting in the business of capital allocation. Rather it means reducing the space for arbitrage and non-productive activities such as speculation. It also means providing the infrastructure, decent health and schooling that are the foundations of any national project. The task is formidable, but there is some low-hanging fruit here. Mr Buhari should grab it before it is too late.

Macroeconomic Indicators
1st – 30th November

Power Sector

In November, average power output rose to 3,809MWh/h from 3,464MWh/h in October representing an increase of 9.96%. The constraint during the month was gas constraint, which was mainly in Afam VI and Egbin. Total constraint in the month averaged 3,644MWh/h. On November 9th, average power output dipped to a 2-month low of 2,546MWh/h, which was because of high frequency and gas constraints.



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Outlook

The persistent gas constraint is expected to keep average power supply between 3,700.00MWh/h – 3,900MWh/h in the coming weeks.

Impact

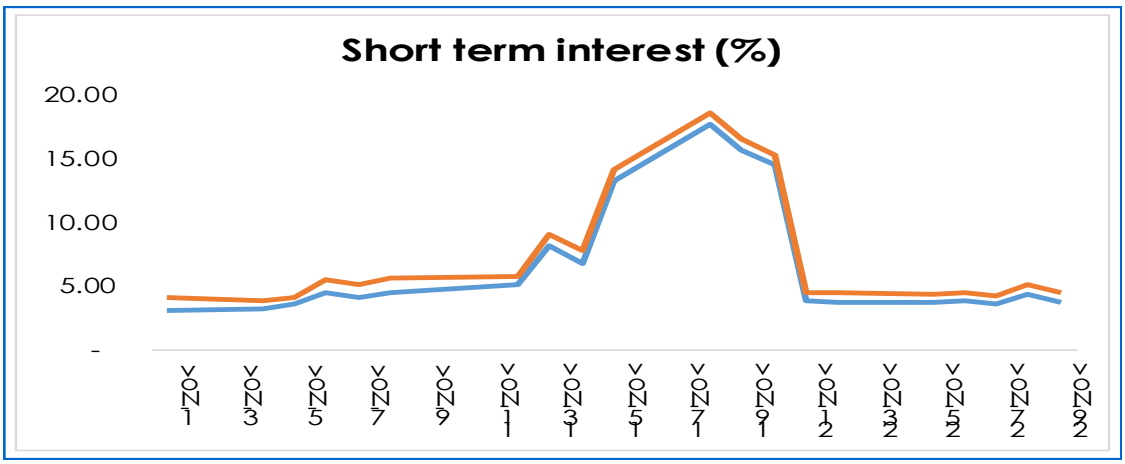
The issue of electricity in Nigeria serves as a major limitation as it results in industries having to source for alternative means of energy supply. A decline in electricity supply could increase the cost of production thereby increasing the costs of various commodities/services.

[13] https://datastudio.google.com/u/0/reporting/1AdNVGt4smtyfL3h8tqUTUTsAb3DiB_Kb

Money Market

Average liquidity in the interbank money market declined by 10.09% in the month of November to close at N293.13bn from N326.04bn at the end of October 2019. Average short term rates (OBB, O/N) closed at 6.92% reflecting an increase of 31.4bps from 6.61% in October. OBB and ON closed at 3.74% and 4.50% from 4.46% and 5.36% respectively in October.

Total OMO sales for the month dipped to a 3-month low of N849.13billion, while OMO repayments stood at N1.9trillion. This resulted in net inflow of N1.05trillion as against N900billion in October. The sharp drop in OMO sales is as a result of the CBN's directive restricting OMO activities to only Banks and foreign investors. This has led to the sharp drop in demand for the fixed income instruments.



[14]

Yields across all tenors declined in both the primary and secondary markets. Primary market rates declined by an average of 157bps while rates in the secondary market declined by an average of 488bps. For the Nigerian Inter-bank Treasury True Yield (NITTY) rates, the 30-day and 90-day tenor increased while the 180-day tenor declined in November.

Primary Market

T/bills Tenor	Rate on Nov 13th (% pa)	Rate on Nov 27th (% pa)	Direction
91	7.79	6.49	↓
182	9.00	7.23	↓
364	10.00	8.37	↓

Secondary Market

T/bills Tenor	Rate on Nov 1st (% pa)	Rate on Nov 29th (%)pa	Direction
91	11.45	7.42	↓
182	11.68	7.3	↓
364	13.00	8.5	↓

[14]FMDQ, FDC Think Tank

Outlook

We expect increased liquidity in the coming weeks as banks work towards increasing their loan-to-deposit ratio to 65% in line with the CBN's directives.

Impact

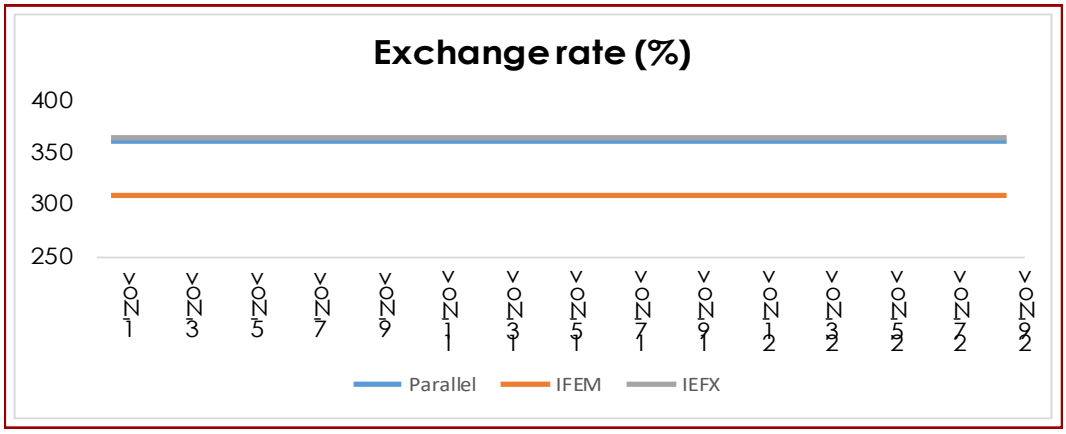
Increased liquidity in the system would cause interest rates to fall further and this would disincentivize savings. Also, the cost of borrowing for corporates will reduce as lending rates fall.

Foreign Exchange Market

The Nigerian forex market is segmented with multiple exchange rates. The most important rate is the Investors and Exporters window (IEFX). No less than 55%-60% of Nigerian forex transactions are traded on 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 Rates

The exchange rate across all windows showed moderate volatility in the month of November. While at the parallel market the currency depreciated to N360/$ from N359/$, partly due to the 46.35% reduction in the CBN's intervention in November ($341.75 million), the exchange rate at the interbank market ranged between N306.9/$ – N307/$. At the importers and exporters' window, the naira traded between N362.5/$ – N362.9/$. The value of forex sold at this market increased by 10.34% to $5.23billion in the month, reflecting a 10.34% increase from $4.74billion in the previous month.



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[15]FMDQ

Outlook

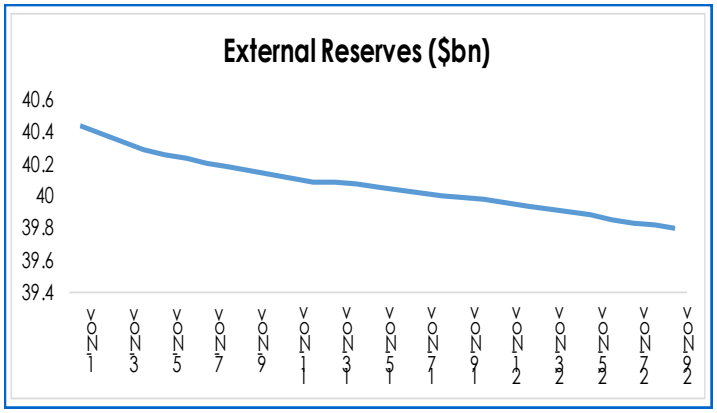
In December, we expect the supply-demand dynamics to determine the exchange rate movement. In the interim, growing forex demand from manufacturers and traders for raw materials, imports and inventory build-up will likely offset the expected boost in forex from visiting family and friends. Also, the CBN will stop its forex intervention by the middle of December, this could trigger some currency pressures if the supply gap is not met from the inflows from visiting family and friends.

Impact

A stable currency will have a positive impact on key sectors such as manufacturing that are highly dependent on imported inputs.

External Reserves

External reserves depleted further by 1.63% to $39.80billion on November 29, from $40.46 billion at the end of October. Consequently, the import cover has declined further to 9.91 months from 10.07 months at the end of October 2019.



[16]

Outlook

The external reserves is expected to decline at a slower pace in December due to inflows from visiting family and friends during the holiday season.

Impact

The external reserves is one of the indicators used to determine the health of a country's external sector. We are projecting a possible depletion to $39bn by the end of the year. This could trigger fears of a possible currency weakness as low external buffers mean the CBN's ability to support the currency would be constrained.

[16]CBN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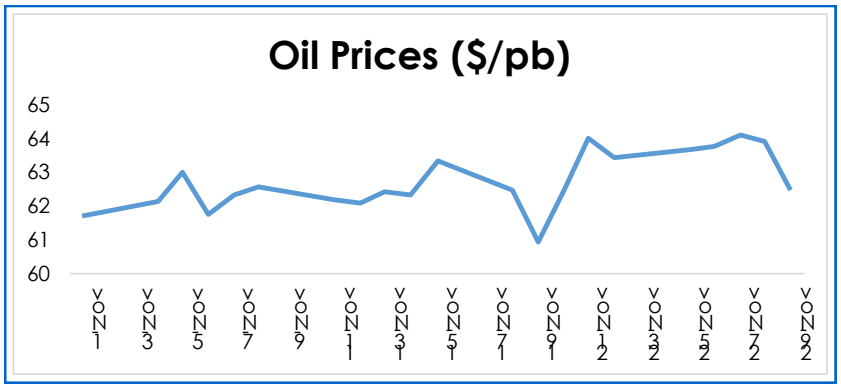
Commodities Market

Exports

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

Oil Prices

On the average, oil prices recorded a 5.02% increase in November to close at $62.68pb from $59.68pb in October. The OPEC meeting in December ended with a deeper cut by another 500,000 bpd to lead to a total output cut of 1.7mbpd. How the extra output cut would be shared is yet to be determined.



[17]

Outlook

Oil prices are expected to close the year within a range of $60 to $63 per barrel.

Oil Production

Nigeria's oil production in October declined by 2.16% to 1.81mbpd despite the increase in the country's rig count from 17 in the previous month to 18. Global crude supply increased by 1.67mbpd while OPEC's contribution to global output rose to 29.8%. The rise in global oil supplies in October was driven by increased oil inventories from the United States.

Outlook

Global crude supply is expected to rise further following increased supply from the US. OPEC is expected to keep crude oil supplies stable to prevent prices from declining. We expect Nigeria's oil output to decline further in November in line with OPEC's quota. Also, if Nigeria's quota is further reduced, it would have significant implications on the country's fiscal and external positions.

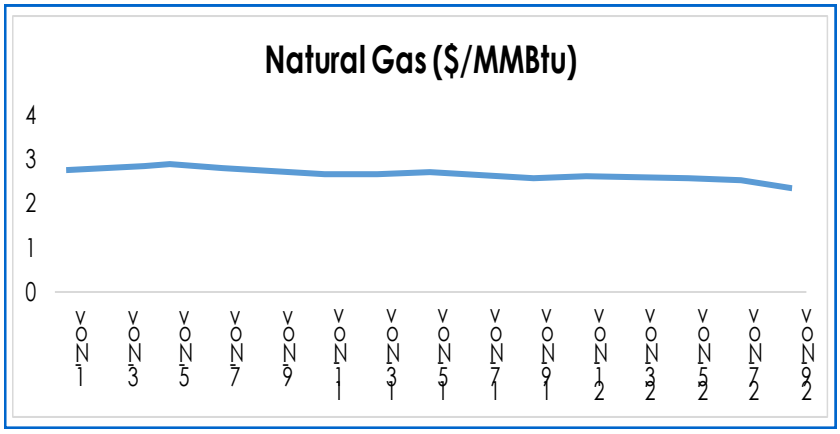
[17]Bloomberg, FDC Think Tank

Impact

Reduced oil output results in lower export earnings for the country. This will have a negative impact on Nigeria's revenue, FAAC disbursements and fiscal expenditure.

Natural Gas

Natural gas prices declined by 13.01% to close at $2.28/mmbtu at the end of November from $2.63/mmbtu in October. Prices also averaged $2.34/mmbtu, 12.21% decline from the average in October. This was despite the usual increase in demand for Natural gas during winter.



[18]

Outlook

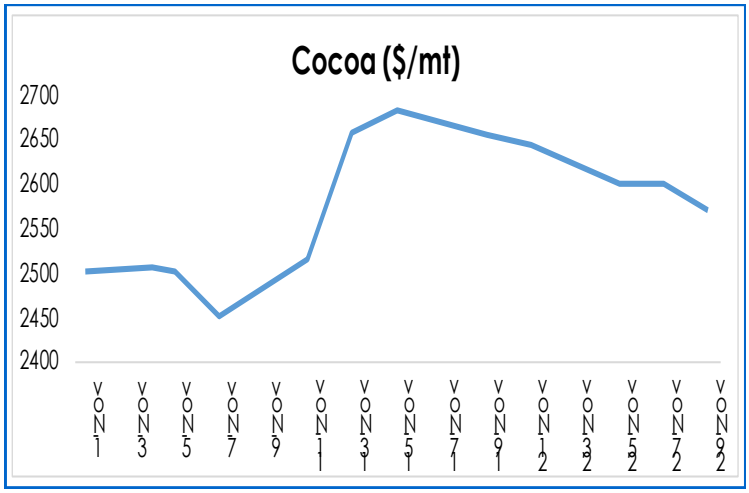
Natural gas price is expected to trend upwards as the demand improves due to the cold season.

Impact

Higher natural gas prices would have a positive impact on Nigeria's export earnings as the commodity is one of the country's main exports (14.2% of total exports).

Cocoa

Average cocoa prices increased by 4.15% to $2,585.05/mt from $2,482/mt in October. Prices closed the month at $2,568/mt, an increase of 4.98% from $2,446/mt at the end of October. The increase was mainly driven by increased demand for cocoa in Europe and North America as well as a reduction in supply from Ghana.



[18]

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

Outlook

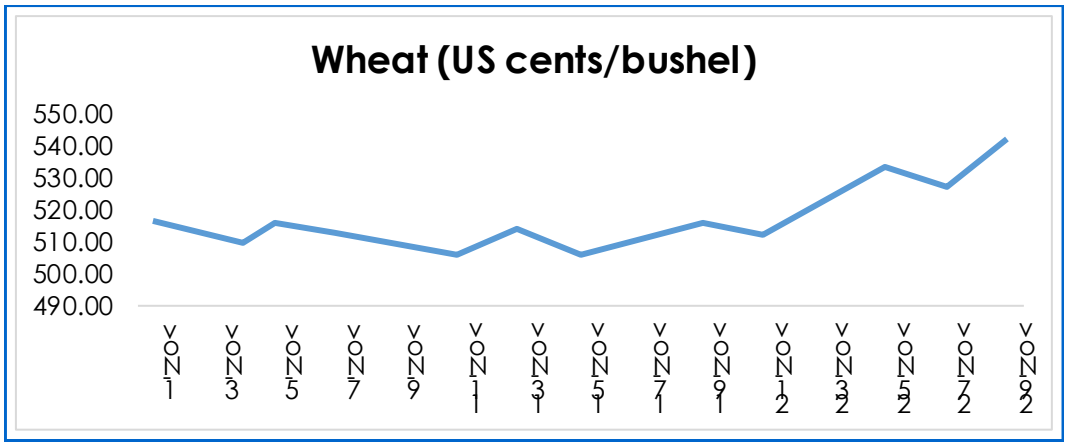
Cocoa prices are expected to maintain a bullish trend in the near term as approaching harmattan wind threatens cocoa production in Ivory Coast and Ghana.

Impact

Higher cocoa prices would increase Nigeria's export revenue from the commodity.

Wheat

The average price of wheat rose by 1.93% to $517.79/bushel in November from $507.99/bushel in October. Prices increased to a peak of $541.75/bushel on the last trading day of the month due to increased demand in the US during the Thanksgiving holiday amid tightening global supplies.



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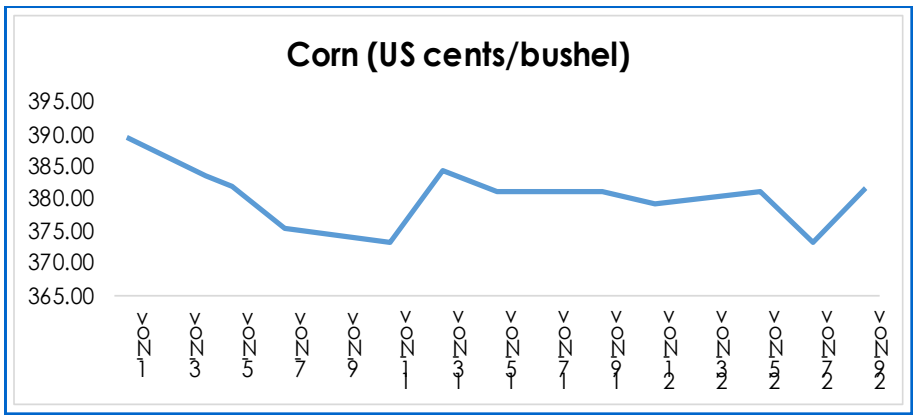
Corn

Corn prices recorded a decrease of 2.71% to an average of $379.31/bushel in November from $389.88/bushel in the preceding month. Price declined by 2.24% m-o-m to end the month at $381.25/bushel. The decline in price was largely supported by higher corn exports from major producers (India and Brazil).



[21]

[20]Bloomberg, FDC Think Tank
[21]Bloomberg, FDC Think Tank

Outlook

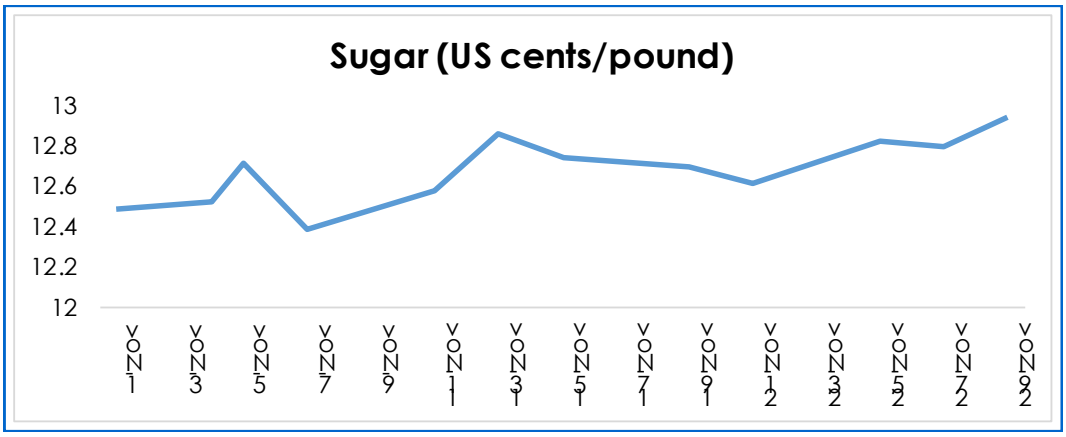
Grain prices particularly corn and wheat are expected to increase as global supplies fall. This is largely due to adverse weather conditions affecting production in the US.

Impact

Increased grain prices would lead to a higher import bill for Nigeria as the country is a net importer of grains.

Sugar

Sugar prices gained 1.84% for the month of November from an average price of $12.46/pound in October. The price of sugar increased m-o-m by 3.68% to close the month at $12.94/pound compared to $12.48/pound on October 31st. The increase was supported by a decline in India's sugar production.



[22]

Outlook

We expect sugar prices to rise due to reduced exports from India and growing global demand.

Impact

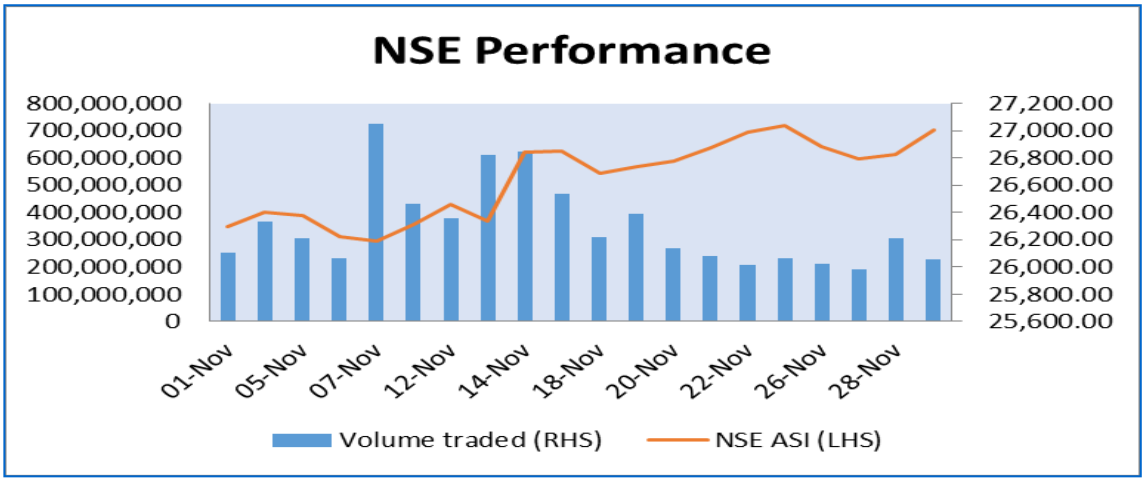
An increase in the price of sugar would increase cost incurred by companies that depend on the commodity. Nigeria being a major sugar importing country would experience higher import bill to meet demand.

[22]Bloomberg, FDC Think Tank

Stock Market Review

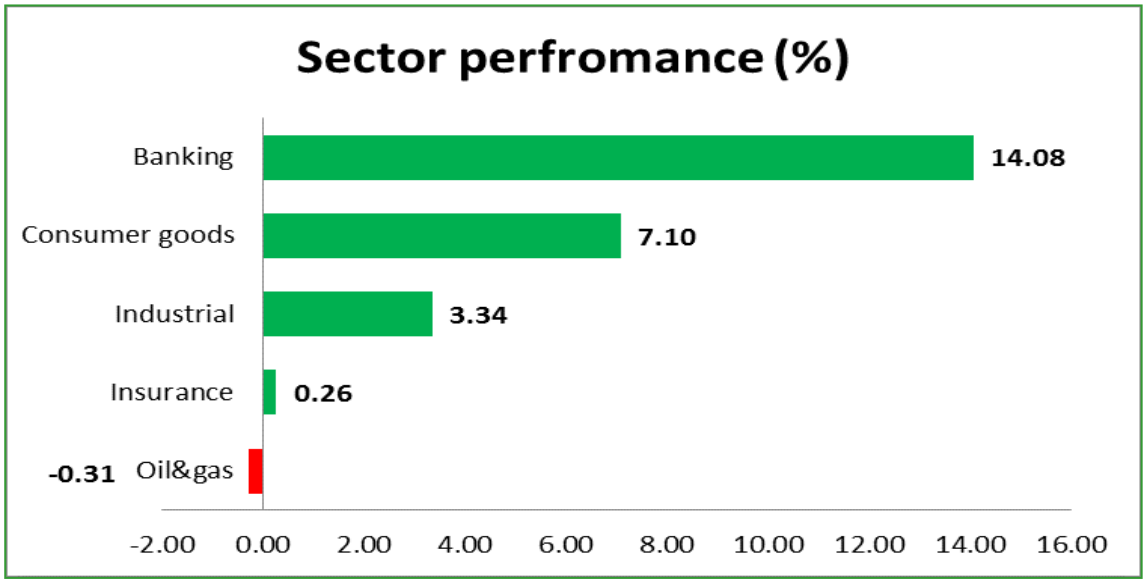
The NSE ASI gained 2.45% to close at 27,002.15 points on November 29th relative to its close of 26,355.35 points on October 31st. In the same vein, market capitalization rose 0.62% (N200bn) to N13.03trn. In the 20-trading day period, the market gained in 11days and lost in 9 days.

The NSE traded at a price to earnings (P/E) ratio of 7.09x as of November 29th, 4.7% lower than the close of October 31st (7.16x). The market breadth was positive at 1.8x as 54 stocks gained, 30 lost while 81 stocks remained unchanged. Dangote Flour Mills Plc was delisted during the period under review.



[23]

The market also saw an increase in activity level. The average volume traded rose by 6.72% to 2.34mn units, while the average value of trades increased by 15.80% to N37.73mn.



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[23]NSE, FDC Think Tank
[24]NSE, FDC Think Tank

All sector indices were positive during the review period except the oil and gas sector index (-0.31%). Banking sector gained the most with 14.08%, followed by the consumer goods sector (7.10%), industrial sector (3.34%) and insurance sector (0.26%).

Niger Insurance Plc topped the gainers' list with a 1710.00% increase in its share price. This was followed by UACN Property Development Co Plc (647.66%), Neimeth International Pharmaceuticals Plc (87.18%), Cornerstone Insurance Plc (75.56%) and Law Union & Rock Insurance Plc (54.76%).

TOP 5 GAINERS (N)				
Company	**Oct. 31'19**	**Nov. 29'19**	**Absolute Change**	**% Change**
Niger Insurance Plc	0.2	3.62	3.42	1710.00
UACN Property Development Co Plc	1.07	8	6.93	647.66
Neimeth International Pharmaceuticals Plc	0.39	0.73	0.34	87.18
Cornerstone Insurance Plc	0.45	0.79	0.34	75.56
Law Union & Rock Insurance Plc	0.42	0.65	0.23	54.76

The laggards were led by Nigerian-German Chemicals Plc (-94.48%), United Africa Company of Nigeria Plc (-83.87 %), Unilever Nigeria Plc (-39.70%), International Breweries Plc (-25.40%) and Total Nigeria Plc (-9.98%).

TOP 5 LOSERS (N)				
Company	**Oct. 31'19**	**Nov. 29'19**	**Absolute Change**	**% Change**
Nigerian-German Chemicals Plc	3.62	0.2	-3.42	-94.48
United Africa Company of Nigeria Plc	6.2	1	-5.20	-83.87
Unilever Nigeria Plc	26.7	16.1	-10.60	-39.70
International Breweries Plc	12.6	9.4	-3.20	-25.40
Total Nigeria Plc	123.2	110.9	-12.30	-9.98

Outlook

We expect investors to book profits from the recent rally in the coming weeks to meet their needs for the festive period.

Corporate Focus: Presco Plc

Analyst Recommendation: HOLD	**Market Capitalization:** N37.85 billion
Recommendation Period: 365 days	**Current Price:** N37.85
Industry: Agriculture	**Target Price:** N44.37

Analyst's note

Weak pricing weighs on revenue

Presco Plc recorded a marginal decline in its turnover in the first nine months of 2019 (9M'19). The drop of 5.17% to N15.40 billion in the company's revenue could be partly attributed to the decline of 1.94% to $506/tonne from $516/tonne in global palm oil prices.[25] This decline in prices was due to higher global supply of crude palm oil (CPO).

Higher operating expenses weigh on earnings

Despite a decline in global price of CPO, the company recorded an increase of 9.29% in its cost of sales and this dampened gross profit. The company's gross profit declined by 8.94% to N11.72 billion from N12.87 billion in the corresponding period in 2018.

Operating expenses moved in the same direction during the period. Selling, general and administrative expenses, which account for 94.97% of Presco's operating expenses, increased by 11.68% to N5.45 billion in 9M'19. Likewise, distribution expenses also rose by 3.08% to N288.41 million.

Finance costs also increased, rising 52.69% to N1.42 billion. The unimpressive performance of the Nigerian Stock Exchange (NSE) made debt capital the preferred funding option in the capital market. Although, there is an improvement in the interest rate environment, however, more companies have embraced alternative funding arrangements such as commercial paper. Due to the high operating costs and finance costs, the company's PBT and PAT declined by 35.88% and 30.87% to N4.79 billion and N3.65 billion respectively.

[25]EIU

Company to continue to benefit from governments policies

The Nigerian government in its effort to diversify the revenue base of the country has adopted a protectionist strategy. The most recent being the closure of the land borders. This protectionist stance is primarily targeted towards the agricultural sector. Therefore, Presco is well positioned to benefit from these various government policies geared towards improving non-oil revenue. In addition to this, the country's palm oil production is 1.02million metric tons, which is 31% lower than the consumption of 1.34 million metric tons. The demand gap of 320,000 metric tons creates room for expansion.

In determining Presco's intrinsic valuation, we considered current financial performance, growth prospects, expansion plans, competitive positioning and macroeconomic fundamentals. Accordingly, we place a HOLD rating on the company's stock.

Industry and company overview

The Nigerian palm oil industry has been a major beneficiary of government's protectionist policy, particularly as it is featured among the list of items banned from accessing foreign exchange. This is consistent with the declaration of the government to discourage the importation of products that can be produced locally.

Despite these developments, Nigeria still depends on imports. Nigeria's demand is roughly 1.34 million metric tons. Only one million of that is met through domestic supply, meaning 340,000 metric tons are imported. This demand for imports paired with a supply glut in the international market and the crash in prices have promoted smuggling activities. This somewhat limited the gains of key players in the palm oil industry. In addition, the long gestation period has limited investment flows into the sector. The major players in the industry include Presco, Okomu, PZ Wilmar and Olam.

Presco began in 1991 as Presco Industrial Limited. The company listed on the NSE in 2002, expanding its reach. The company currently engages in the cultivation and processing of oil palm and palm kernel, through four major oil palm plantations – Obaretin, Sakponba and Ologbo (in Edo State), while the fourth, Cowan, is in Delta State.

Siat SA, the parent company, controls 60% of the company. Siat SA is a Belgian agro-industrial group with core competences in the setup and operation of oil palm and rubber plantations and processing. Some of its major customers include Nestle Nigeria, Wamco Nigeria, PZ Wilmar, and Promasidor among other household consumer goods brands.

Income Statement for Presco Plc (FY Dec 2018)				
N'000	**2015**	**2016**	**2017**	**2018**
Revenue	10,448,353	15,716,198	22,365,372	21,648,457
Cost of Sales	(3,813,137)	(4,404,785)	(5,941,308)	(5,258,975)
Gross Profit	6,635,216	11,311,413	16,424,064	16,389,483
Gain/(loss) on biological assets revaluation	1,062,230	24,879,287	2,789,304	493,064
Distribution expenses	(198,608)	(223,945)	(317,248)	(373,068)
Selling, General & Administrative expenses	(2,940,936)	(4,378,794)	(7,184,418)	(5,735,065)
Other operating income	364,639	323,146	213,358	426,175
Operating profit	4,922,541	31,911,107	11,925,060	11,200,588
Net finance cost	(707,800)	(684,655)	(973,479)	(1,238,048)
Exchange gains/(losses)				
Profit Before Tax	4,214,741	31,226,452	10,951,581	9,962,540
Income tax expense	(1,721,146)	(9,490,987)	14,452,033	(2,922,063)
Profit for the year	**2,493,595**	**21,735,465**	**25,403,614**	**7,040,477**

Balance Sheet for Presco Plc (FY Dec 2018)				
N'000	**2015**	**2016**	**2017**	**2018**
Intangible assets	183,581	192,566	370,234	601,892
Biological Assets	29,291,216	44,920,219	49,274,503	55,203,708
Property, Plant & Equipment	19,990,011	22,444,657	28,122,101	40,191,016
Other non current assets	110	110	-	-
Non-current assets	49,464,918	67,557,552	77,766,838	95,996,615
Inventories	1,105,632	1,420,597	4,704,706	4,778,754
Trade and other receivables	2,777,782	1,095,901	3,607,661	5,720,509
Other current assets (includes bio as	1,252,376	10,502,660	8,937,680	6,632,827
Cash and cash equivalent	877,291	2,585,128	3,307,211	6,238,482
Current assets	6,013,081	15,604,286	20,557,258	23,370,573
Total assets	**55,477,999**	**83,161,838**	**98,324,096**	**119,367,189**
Share capital	500,000	500,000	500,000	500,000
Share premium	1,173,528	1,173,528	1,173,528	1,173,528
Retained earnings	29,622,561	50,358,026	74,261,641	83,406,319
Other reserves	58,724	87,448	45,003	47,503
Equity attributable to equity holders	31,354,813	52,119,002	75,980,172	85,127,350
Non controlling interests	-	-	-	-
Total equity	31,354,813	52,119,002	75,980,172	85,127,350
Provisions	-	-	-	-
Provisions for employee benefits	271,481	313,445	409,751	497,761
Financial Liabilities	4,787,517	4,781,433	4,557,822	10,783,297
Deferred tax liabilities	12,638,125	20,340,405	4,401,851	31,075
Non-current liabilities	17,697,123	25,435,283	9,369,424	11,312,132
Financial liabilities	2,069,896	1,917,514	4,575,635	8,251,488
Trade and other payables	3,356,707	1,699,761	7,428,137	9,461,532
Current tax liabilities	905,058	1,792,041	860,163	1,208,242
Other Current liabilites	94,401	198,235	110,565	4,006,444
Current liabilities	6,426,062	5,607,551	12,974,500	22,927,706
Total liabilities	24,123,185	31,042,834	22,343,924	34,239,839
Total equity and liabilities	**55,477,998**	**83,161,836**	**98,324,096**	**119,367,189**

Management

Presco's management team is led by Felix Onwuchekwa Nwabuko, a chartered accountant with extensive cross-border experience in project management and consulting. He became the Managing Director of Presco in 2015, having also served in various leadership roles within the group. He was part of the team responsible for the successful listing on the NSE. He is accompanied by a team of versatile and experienced executives, who have built a company with strong fundamentals.

Managing Director

Felix Onwuchekwa Nwabuko

Presco's board has been led by Mr. Pierre Vandebeeck since 2010. Vandebeeck has been instrumental to Presco's successes. He was the pioneer Managing Director, building the agro-processing company from infancy to date and was responsible for the setup of Presco's oil palm plantations in Nigeria. He remains an invaluable asset to the company and has proven to be the vital link between Presco and Siat SA.

Chairman Board of Directors

Mr. Pierre Vandebeeck

Bulls and Bears say

Bulls say:

* Key player in the oil palm industry
* Alignment between Presco Plc and parent company
* Consistent clampdown on production cost over the years
* Favorable government policies
* Gradual diversification into rubber production
* Experienced and talented management

Bears say:

* Declining commodity prices
* Rising operating and finance costs
* Highly dependent on one commodity
* Highly dependent on government protection to thrive
* Competitive rivalry among the leading players

Risk and Outlook

The major risks that could dampen the attainment of Presco's key objectives and priorities include interest rate risks, regulatory policy risks, currency risks and other systemic risks.

The high-risk premium of the Nigerian economy has adversely impacted the business expansion plans and operations of companies such as Presco. Similarly, Presco's large funding needs and the susceptibility of agriculture farm-products, especially to weather, pest and storage, have weighed on the debt servicing costs. So, the management of Presco needs to evaluate the adoption of other funding options and other complex financing mechanics.

Our valuation

Using the discounted cash flow methodology, we estimated a stock price of N44.37, which is a 14.69% upside on the current price of N37.85 as of December 10, 2019. The discount rate (weighted average cost of capital) of 15.1% was derived using a 14.55% risk free rate, a beta of 0.2360, an after-tax cost of debt of 13.50%, and a market risk premium of 7.64%. The long-term cash flow growth rate to perpetuity calculated is 7.50%.

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