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FDC MONTHLY ECONOMIC UPDATE

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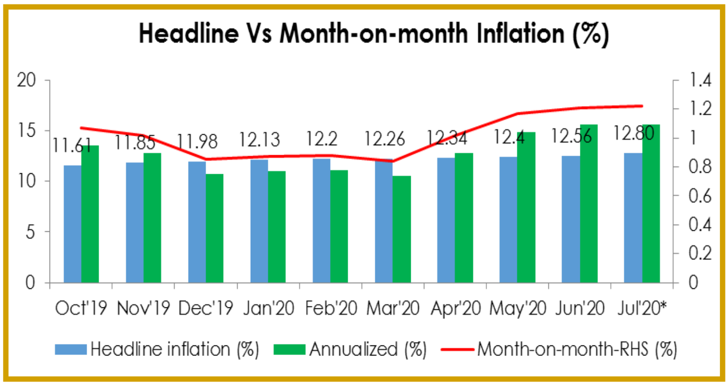
In This Issue ...

Headline inflation fast approaching the 13.0% threshold due to cost push factors

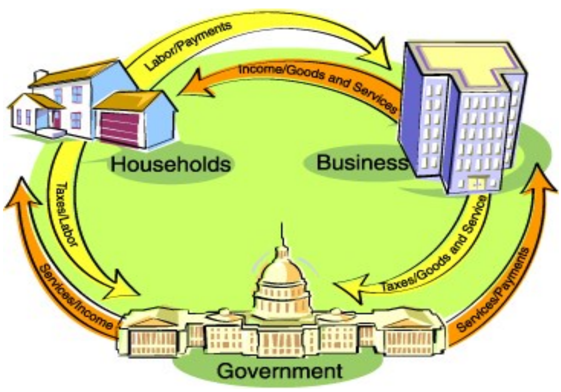
Our recent market survey reveals a further build-up in inflationary pressures as supply chain disruption continues to take its toll on prices. This is in addition to the limited exchange rate pass through to the market. Manufacturers are scratching their heads on how to get dollars not to talk of the rate of exchange if and when it is available. The forex uncertainty and the supply bottlenecks together with an increase in the price of PMS are culminating in a potential jump in the headline and food inflation to 12.8-13% in the days ahead. The price increase is not a Nigeria-specific feature as most peer countries are also reeling from a gradual climb in prices. The EIU is forecasting that SSA inflation will increase from 7.9% in 2019 to 8.4% in 2020.



[1]

Gradual Shift towards general equilibrium

The move towards reducing or eliminating subsidies, the adjustment effect of the exchange rate convergence and the adoption of cost reflective electricity tariffs point to a gradual shift from static to partial and eventually general equilibrium. The CBN has adjusted the exchange rate twice in the last six months to N381/$ at the official window. The EIU is also projecting another adjustment to N420/$ by the end of 2020 and N450/$ by the end of 2021. This is in line with the government's effort in unifying the multiple exchange rates as part of its COVID-induced Economic Sustainability Plan. The eventual swing towards a general equilibrium will reduce speculations and eliminate market distortions.



[1]NBS, FDC Think Tank

Harvest season sub-optimal to suppress inflationary pressures

The harvest season, which typically commences in the third quarter, is expected to taper inflationary pressures. This is because output usually increases during this period. However, the 6 months closure of the Third Mainland Bridge amongst other structural constraints such as higher logistics costs could disrupt commodity supply. This will limit the impact of the harvest in tapering inflationary pressures. According to a recent report by the Lagos Business School, 1,600 of 25MT, 5,060 of 8MT and 13,500 of 3MT trucks bring foodstuff into Lagos state on a daily basis. This is likely to push urban inflation higher to 13.25%.

Weighting or reconstructing the composition of the consumer basket: *A necessary evil*

The COVID-19 pandemic has disrupted both the global and domestic economy, causing a shift in consumer spending pattern. The squeeze in consumer disposable income due to the COVID-induced economic paralysis and the social distancing rule has compelled consumers to shift their spending pattern in favour of necessities such as food and internet services. However, this change is yet to reflect in the weights and composition of the CPI basket. It is advisable that a country reviews the weight and composition of its Consumer Price Index (CPI) basket periodically (5 years interval). In fact, most advanced economies revise their consumer basket on an annual basis. In Nigeria, the last time the basket constituents were reviewed was in 2009. This will lead to a significant bias in the measure of inflation and ultimately affect policy decision making. To eliminate this bias, it is important that the CPI basket is revised to reflect current market and economic realities.

Inflation Breakdown

Month-on-month inflation to climb to 15.71% annualized

Similar to the annual price level, month-on-month inflation is expected to increase again to 1.22% (15.71% annualized) in July from 1.21% (15.58% annualized) in June. Even though the direction of the inflation curve is to the upside, the marginal increase in the inflation rate could suggest that the harvest season is slowly cushioning the effect of the cost-push factors.

Food inflation to inch-up in spite of the harvest

Food inflation is expected to continue its rising trend, albeit at a slower pace of 0.02% to 15.20%. This is because of the impact of the prevailing supply chain disruptions, Third Mainland Bridge closure and PMS price hike. This will further reduce consumer purchasing power and lower aggregate demand. However, the harvest season could slowdown the pace of increase in food inflation rate.

Weaker naira and rising import bill to push up core inflation

The depreciation of the naira and its resultant impact on imported inflation will continue to impact on core sub-index (headline inflation less seasonalities). In the last seven months, the naira has lost approximately 23.79% at the parallel market while commodity prices have increased by over 100% in the last six months. In addition, the price of fuel has ranged from as low as N125/litre to N147.50/liter. Higher PMS pump price will increase transport costs, which will most likely be passed on to the final consumer. Therefore, we are projecting a 0.05% increase in the core inflation to 10.18% in July.

Peer Comparison – Mixed movement in Inflation – 5 Reds, 2 Greens

Country	July Inflation (%)		July Policy Rate (%)		Q1'20 GDP Growth (%)	
Nigeria	12.80*	⬆	12.50	⟷	1.87	⬇
Angola	22.93	⬆	15.50	⟷	-1.80	⬇
Kenya	4.36	⬇	7.00	⟷	4.90	⬇
South Africa	2.20 (June)	⬆	3.50	⬇	-0.10	⬇
Ghana	11.40	⬆	14.50	⟷	4.90	⬇
Uganda	4.70	⬆	7.00 (June)	⬇	1.80	⬇
Zambia	15.8	⬇	9.25[2] (May)	⬇	0.20 (Q'4 19)	⬇

[2]Trading Economics, FDC Think Tank

Concluding Thoughts

The next MPC meeting is scheduled to hold on September 21. We expect the release of some key data points such Q2 GDP growth, unemployment and inflation before then, and these will partly influence the decision making process of the committee.

Inflationary pressures are intensifying especially with the 20.4% increase in PMS pump price which may even increase further. In addition, the widely talked about cost reflective electricity tariffs may be implemented sooner than expected. However, consumer disposable income is being eroded gradually and with a budget constraint, the rational consumer will be forced to adjust spending patterns and ultimately reduce demand. This will limit to an extent the pace of increase in consumer prices.

Nigeria & the cocoa rally

In light of the earlier plunge in oil prices and the resultant fiscal and external shocks, Nigeria is gradually expanding its revenue base using cash crops such as cocoa.

Cocoa remains a priority area for Nigeria as the country currently ranks the fifth largest cocoa producing country in the world. With a total output of approximately 300,000tonnes, the country is behind Ivory Coast (2million tonnes), Ghana (883,652tonnes) and Indonesia (659,776tonnes). Production of cocoa in Nigeria was hitherto clustered in Southwest states such as Ogun, Osun and Oyo. However, Southeastern states such as Cross River are also tapping into the export potential of the commodity. The Cocoa Association of Nigeria (CAN) is targeting an increase in the state's cocoa output to 100,000 tons by 2028 from its current output of approximately 55,000 tons. The country has set a similar target to boost Ondo state's output to 100,000tons in the 2020/2021 season from 77,000tons in the previous season.

As an oil dependent economy, the Nigerian economy was severely affected by the slump in global oil price. This has forced the country to seek to revive its agricultural sector, which was the cash cow of the economy prior to the oil boom in the 1970s. Given the recent adjustment of the official exchange rate to N379/$ and the rally in global cocoa price, Nigeria stands to enjoy increased export revenue from higher cocoa output. However, as other African countries such as Cameroon intensify their cocoa output there would be increased competition in the global market. There is also the risk of smuggling especially with the price of cocoa increasing at the ports of Cameroon, which border's Nigeria on the South East. Nigeria must therefore ensure that its cocoa output is competitive in both price and quality terms.

COVID Testing in Nigeria – suboptimal & not enough

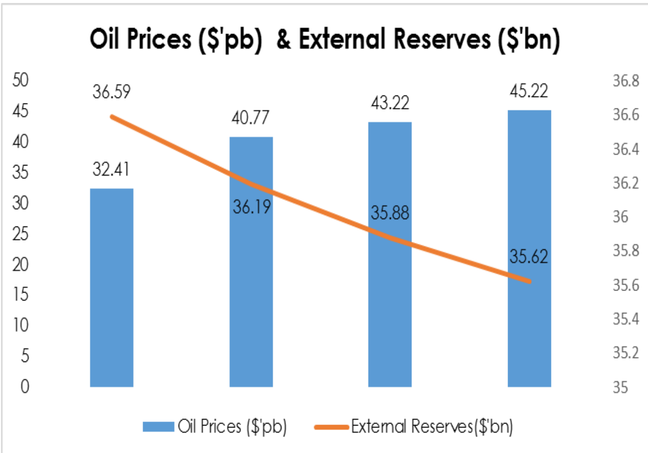
Since the outbreak of the virus, governments around the world have kept their eyes peeled on certain statistics that highlight their progress in containing the virus. One of such statistics is the number of samples tested.

Total samples tested in Nigeria currently stands at 319,851. This is a meager 0.16% of total population and lags behind the country's peers including South Africa and Ghana. Nigeria is currently testing only 2,500 samples per day due to human resource constraints, inadequate testing kits and the slow turnaround time for tested samples.

The suboptimal testing capacity of the country has resulted in the reliance on total fatalities as an anecdotal proxy of the true COVID-19 picture. The challenge with this strategy is differentiating between COVID related fatalities and non-COVID related fatalities.

Oil prices up ($45.25pb), Reserves down ($35.62bn)

Oil prices have been increasing steadily since May 2020 ($32.41) primarily due to the strict production cuts by OPEC and its allies. It crossed the $45pb threshold on August 5, following a sharp drop in US crude inventories by 7.4mn barrels. However, despite the steady increase in oil prices the gross external reserves have been depleting ($35.62bn as at August 10). The fall in reserves level can be attributed to increased backlog of demand, sharply lower forex demand coupled with the 20% decline in domestic oil production to 1.49mbpd (July) from 1.85mbpd in March.



Payments and Settlements data confirm lockdown trend

Since the outbreak of the virus, aggregate consumer demand has declined sharply given the job losses, rising inflation and currency volatility. This trend has corresponded with anecdotal evidence from the payments and settlements data. According to Nigeria Interbank Settlement System, total value of e-payments channels (cheques, POS, ACH & NIP) was N16.1trn, 16.3% higher than June (N13.84trn). This data set is closely matched by the NBS COVID Impact monitor, which confirmed that 36% of urban residents are either idle, unemployed or underemployed.

A further breakdown of the payments and settlements data revealed the following trends:

1. The total value of transactions in July (N16.1trn) was 56% lower than the total value recorded before the lockdown (Jan-Mar):

	January	**February**	**March**
Cheques (N'trn)	0.37	0.36	0.36
POS (N'trn)	0.31	0.33	0.37
ACH (N'trn)	1.15	0.99	1.18
NIP (N'trn)	10.23	9.97	10.97

2. All channels except cheques have since recovered to their pre-pandemic levels. Cheque payments declined sharply following the suspension of clearing houses during the lockdown:

	January	**February**	**March**	**July**
Cheques (N'trn)	0.37	0.36	0.36	0.25
POS (N'trn)	0.31	0.33	0.37	0.42
ACH (N'trn)	1.15	0.99	1.18	1.10
NIP (N'trn)	10.23	9.97	10.97	14.34

3. There was an average increase of 430% across all channels in May. This can be attributed to the post lockdown effect when business activities and operations picked up gradually.

Summary & Conclusion

Consumer aggregate demand will struggle to recover to its pre-pandemic levels especially as inflation climbs towards 13% in August. The recent 3% increase in PMS price to N148.7 per litre will further bore a hole in consumers' pockets.

Shoprite plans to exit Nigeria??

ShopRite, Africa's biggest grocer, contemplates the sale of all or a majority stake in its Nigerian supermarkets. This decision was due to supply-chain disruptions, delays in clearing goods from Nigerian seaports, traffic congestion and poor road accessibility, which makes it difficult for the supermarket to stock up its shelf. This coupled with lower sales as consumers' purchasing power drops owing to the COVID-19 pandemic.

ShopRite's proposed exit is the latest in a growing retreat by South African investors after attempts to build continent-wide businesses particularly in Nigeria, Africa's most populous nation. The company is also downsizing its operations in Kenya. It is set to lay off 115 workers and shutdown a second Kenyan store in barely 5 months.

Implications

ShopRite's planned exit is reflective of how challenging the Nigerian business environment has become. The unavailability of forex, which is a major constraint to the repatriation of profits and persistent currency weakness amid projections that the naira could still depreciate, is a huge blow to investor confidence. The weakening naira in addition to uncertainty about the CBN's plan to shift to a market-determined price mechanism will continue to be a major drag on foreign direct investment. However, the likely acquisition by domestic investors will ensure that jobs are not completely lost and domestic supply chains are established and deepened.

Is this the right time to defer AfCFTA?

The African Continental Free Trade Area (AFCFTA) is an attempt by African nations to boost intra-African regional trade, which is currently estimated at 15%. It aims to operate a single market for goods and services, just like the EU with a population estimated at more than 1.2billion and integrating 55 countries. The agreement is currently signed by all but one African nation, Eritrea out of Africa's 55 nations, with a view to be the largest free trade area in the world since the creation of the World Trade Organization in 1995.[3] Specifically, the Nigerian government signed the Agreement Establishing the African Continental Free Trade Area ("AfCFTA Agreement") on July 7 2019. The Agreement has been postponed from its initial commencement date (July 1) as most African states grapple with the covid-19 pandemic. This raises the question of whether this is the right time to postpone the agreement, considering the economic impact of either decision especially in this covid-19 period and contribution of trade to Africa's economy. Total trade accounts for about 53.64% of Sub-Saharan Africa's GDP.

The postponement may have a temporary positive impact on fiscal revenue, as African countries will retain their trade revenue from import tariffs in the short term. But this will be at the expense of businesses especially in this pandemic period.

[3]World Economic Forum. "Global Alliance speeds up international trade – unlocking unprecedented investment and growth benefits"accessed from https://www.weforum.org/our-impact/global-alliance-speeds-up-international-trade

The AfDB already predicts that Africa could see a deeper GDP contraction (-3.4%) in 2020 but will rebound (3.0%) in 2021. Most African states will still be exposed to external shocks from their international trade with other foreign countries, which will significantly impact their external reserves, export earnings and budget size especially for resource-dependent nations. Postponing the implementation date of AfCFTA will also see fiscal deficit and debt burden widening further as government trade earnings from free trade is lost thereby constraining government revenue. Furthermore, African countries may face a financing need of about $110 billion in 2020[4] thereby raising the necessity of promoting trade and developing new areas of growth to increase government revenue, boost intra-regional trade and reduce the reliance on external debt.

On the other hand, moving forward with the implementation of AfCFTA is expected to boost both trading volumes and government's export earnings of African states as well as help aid the recovery from the negative economic impact of the covid-19 pandemic. Overreliance on production and imports from Europe and China will be decreased thereby reducing the exposure of African countries to demand and supply shocks with external trade.

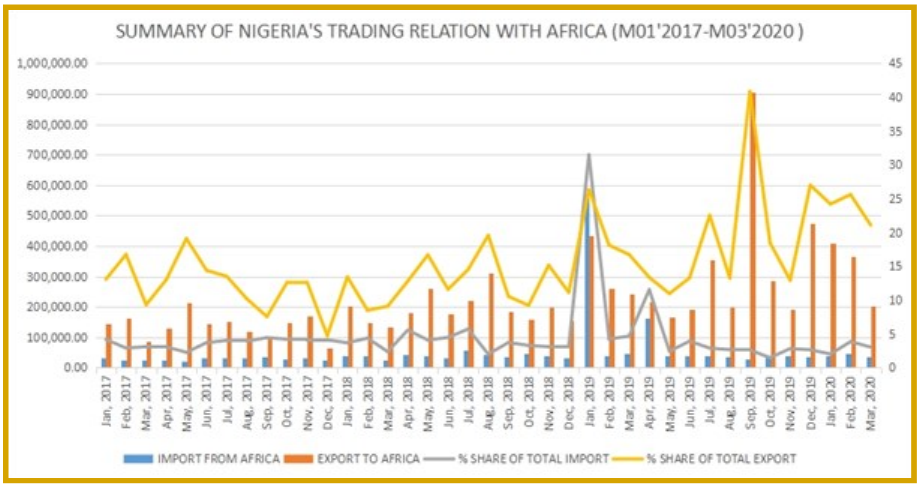
Free trade, which involves full or partial removal of import restriction, will lower the cost of importing raw materials and inventories by businesses thereby lowering their trading and operating costs. Lower production cost will be transferred to the consumer in the form of lower prices of goods and services, which in turn boosts real income, and consumer spending which have a positive impact on aggregate demand. Consumer welfare and businesses will generally be positively impacted. Moreover, this agreement will promote economic liberalization, integration, economic recovery from negative impact of covid-19 pandemic and other economic benefits among African nations.

[4]International Monetary Fund (IMF). "Sub-Saharan Africa: A Cautious Reopening" accessed from https://www.imf.org/en/News/Articles/2020/06/27/pr20249-sub-saharan-africa-a-cautious-reopening

Benefits of Going ahead with AfCFTA to Nigeria

Increase in intra-regional trading activities with other African nations

	% Share of Import From Africa To Total Import	% Share Of Export To Africa To Total Export
Jan, 2020	2.01	24.20
Feb, 2020	3.83	25.61
Mar, 2020	3.03	21.09[5]



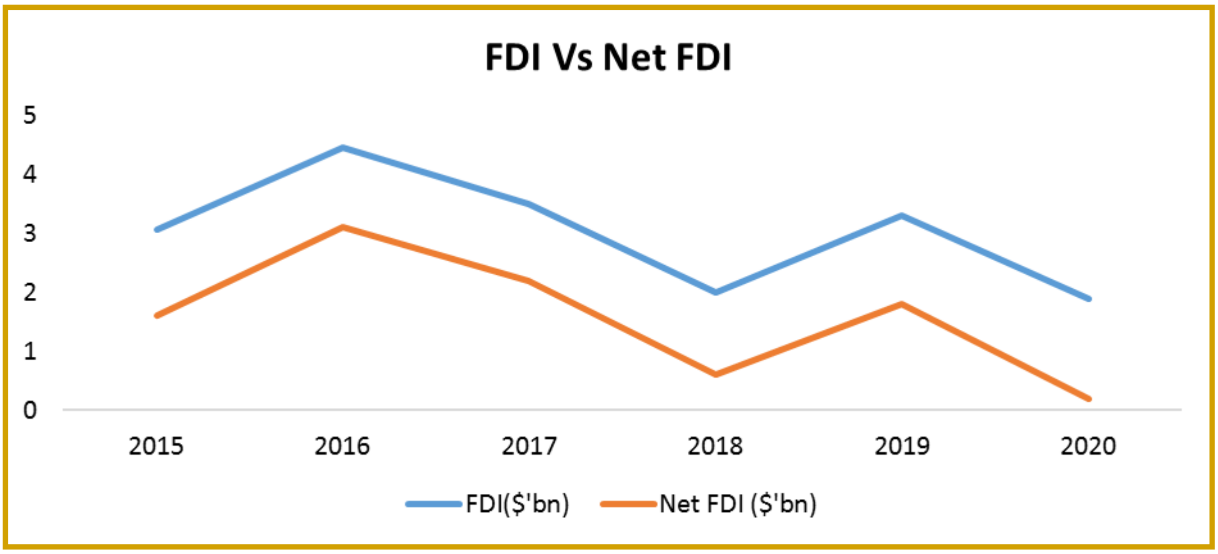
[6]

According to the African Development Bank (AfDB), the AfCFTA "will stimulate intra-African trade by up to $35 billion per year, creating a 52% additional trade by 2022 and a vital $10 billion decline in imports from outside Africa."[7] Over years, Nigeria's exports to other African nations have surpassed its imports from these nations. This signifies that increased intra-African trade is positive for Nigeria as it could increase its export to other African nation to about 36% thereby raising Nigeria's export revenue.

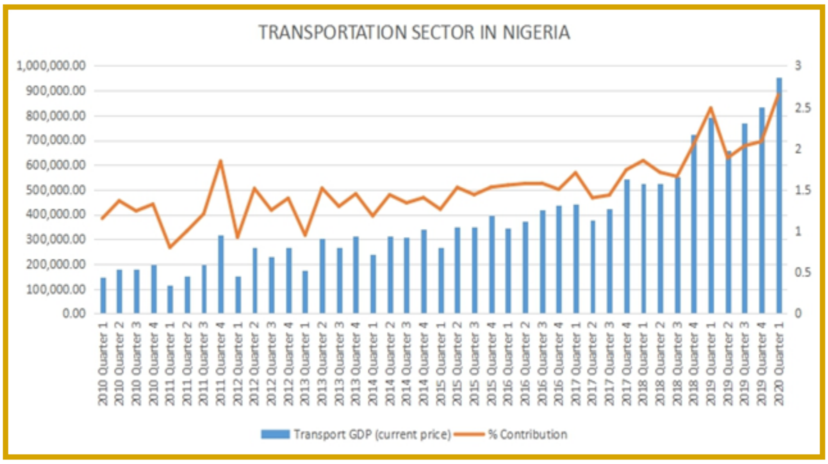
Foreign Direct Investment

Removing barriers to entry into Nigeria market will result in the influx of private investors into the country thereby raising Nigeria's foreign direct investment. Nigeria received $5.85 billion capital importation (inflows) in Q1'2020 out of which FDI accounted for only 3.66% ($214.25 million). Increased access to market will help foreign investors set up manufacturing hubs within Nigeria thereby increasing FDI and export to member nations of the AfCFTA. More FDI inflows will help boost external reserves, which is favourable for exchange rate.

[5]Nigeria Bureau of Statistics (NBS)
[6]Nigeria Bureau of Statistics (NBS)
[7]Centre for Study of Economics of Africa (2018). "AfCFTA: What It Means For Nigeria" accessed from http://cseaafrica.org/afcfta-what-it-means-for-nigeria/



Transportation Boom



[8]

The transportation sector is one of the sectors that is poised to benefit immensely from AFCFTA. Movement of people, goods and services is expected to increase with free trade, which will increase the demand for transportation services. This provides opportunities for rail, water and air transport to grow as well as raise their contributions to GDP output.

Conclusion

Now is the time for AfCFTA to begin as the economic cost of postponing this agreement far outweighs its benefits. To lose the momentum for this free trade agreement now would be a serious setback. Regional cooperation, collaboration and connectivity are important to effective implementation of this agreement. Specifically, AfCFTA is a good trade agreement to Nigeria, which would help aid economic liberalization and the country's recovery from covid-19 in the medium term.

[8] **Nigeria Bureau of Statistics (NBS)**

Fintech and Financial Development in Nigeria

Financial technology, or fintech, is the innovative use of technology in the design and delivery of financial services. It often results in new business models, applications, processes, or products with an accompanying effect on financial markets and institutions.

It promises faster, cheaper, more transparent and more user-friendly financial services for millions around the world.[9]

In Nigeria, the financial industry is semi-developed and has low levels of customer satisfaction. According to the Bank Verification Number statistics, less than 50 million of Nigeria's 200mn+ population has active bank accounts.[10] As a result, entrepreneurs and millennials are turning to fintech to develop financial innovations and disrupt traditional financial services. With fintech gaining traction, there will be an increase in the financial inclusion level as more unbanked customers will have access to financial services. Also, customers with bank accounts would achieve higher levels of customer satisfaction.

Evolution of Fintech in Nigeria

In 2007, the CBN launched its Payment Service Vision (PSV), sparking newfound interest in fintech firms. Fintech firms had been in operation in Nigeria prior to this time, though there was no widespread adoption. Until then, the use of physical cash for financial transactions such as payments, settlement of debt, and fundraising among others was predominant. As a result, the CBN was regularly using limited resources to maintain and print banknotes, which augmented the associated recurrent cost. For cost minimization, the federal government, through the CBN, spurred the growth of the fintech ecosystem in the country.

[9]Financial Stability Board. 2020. "Monitoring of Fintech". https://www.fsb.org/work-of-the-fsb/policy-development/additional-policy-areas/monitoring-of-fintech/
[10]E. Mesropyan. 2017 "56 Fintech Companies in Nigeria Enabling Inclusive Growth". MEDICI Global https://gomedici.com/56-fintech-companies-nigeria-extending-access-to-financial-products-for-inclusive-growth/

Interswitch (in 2008),[11] Etranzact (in 2011)[12] and Remitta (in 2011)[13] were the initial sets of fintech firms to draw on the benefits of these policies. The preliminary works of the pioneer fintech firms set the stage for Nigerian commercial banks to ride on years later. In time, commercial banks launched unstructured supplementary service data, internet banking and mobile apps. Since then, fintech has enjoyed rapid development in Nigeria and it is still on the increase.

The general fintech space breaks into categories including artificial intelligence, asset management, advisory services, big data, biometrics, peer to peer lending, crowd computing, digital payments, and blockchain among others. However, only some of the aforementioned categories have matured in Nigeria's fintech landscape. Financing, lending, payments and remittances currently account for 69% of Nigeria's fintech landscape, leaving 31% to relatively untapped categories such as crowd computing, big data, business solutions, insurance, and wealth management.[14]

Opportunities and Benefits of Fintech in Nigeria

Huge market size – Nigeria has a huge market of millennials that want financial services. Millennials are young adults born roughly between the early 1980s and 1996, and most of them today are internet-savvy and technology-driven. They make up roughly 30% of Nigeria's population. Coupled with the rapid growth of youth (about 115 million people below the age of 35[15]), there is a large potential for financial inclusion and the youth market is a valid indicator of the fintech opportunity in the country.

Income generation – Foreign and local investors have become increasingly interested in tapping into the fintech sector in Nigeria due to its great potential. Fintech companies in Nigeria have raised over $114 million as of 2018, of which global fintech investments account for 75% of the amount reportedly raised by tech firms.[16] In 2018, the fintech landscape in Nigeria gained approximately $86 million in funding.[17] Fintech has spurred the start-up and maintenance of several businesses in the service industry, which accounts for 55.80% of the GDP composition.[18]

[11]Lead Web Praxis. 2020. "Evolution of Fintech in Nigeria". https://leadwebpraxis.com/evolution-of-fintech-in-nigeria/
[12]Nigeriaa2z. 2011. "Mobile Money: eTranzact Gets Nod From CBN". https://www.nigeriaa2z.com/2011/11/29/mobile-money-etranzact-gets-nod-from-cbn/
[13]Jennifer Ugwa. 2019. "How CBN, three others milk Nigerians through Remita, extra bank charges". ICIR https://www.icirnigeria.org/the-four-pronged-profiteers-how-cbn-three-others-milked-nigerians-through-remita-extra-bank-charges/
[14]E. Mesropyan, (August 2017) '56 Fintech Companies in Nigeria Enabling Inclusive Growth' https://gomedici.com/56-fintech-companies-nigeria-extending-access-to-financial-products-for-inclusive-growth/ accessed on 13 March, 2019.
[15]Ibid
[16]Ojekunle, Aderemi. 2018. "These Startups are the leading Fintech innovators in Africa". Business Insider by Pulse. https://www.pulse.ng/bi/tech/tech-these-startups-are-the-leading-fintech-innovators-in-africa/q7x4rjz/
[17]Ibid
[18]Securities and Exchange Commission. 2019. "The Future of Fintech in Nigeria". https://sec.gov.ng/wp-content/uploads/2019/08/

Business solutions – Hackathons have played an interesting role in Nigeria's fintech space. Hackathons are idea innovation contests that bring together tech talent to compete and collaborate on solving business problems with technology. Some financial sector institutions are deploying these events to outsource ideas and solutions that will catalyze innovations in the financial services industry.

The case of China

When it comes to fintech, China has emerged to be a world leader, adopting technology faster than anywhere else. The structural shifts in its financial system took place during the internet boom. Increased mobile network and internet users created a long-tailed base of potential customers to promote financial inclusion with fintech.

China's financial system had been relatively immature compared to established markets, with clear structural imbalances and an underdeveloped infrastructure two decades ago. Under the Chinese government's recent financial reform efforts, structural shifts have begun to take place with an outburst of innovations and fintech startups. The likes of Alipay, Lufax, Tenpay and ZhongAn Insurance have made their names across the globe by developing some of the most disruptive business models. By the end of 2015, the country had 500 million fintech users, and its overall market size exceeded RMB 12 trillion ($1.87 trillion).[19]

China adopted incentives such as tax incentives, subsidies, incubation funds and other preferential government policies for fintech companies. Also, the People's Bank of China released the Fintech Development Plan (2019-2021) which encourages the development of fintech solutions by using various digital technologies.[20] This created an opportunity for fintech players to bridge the gap in traditional financial services by capitalizing on their strong online presence.

In addition, innovations and inventions in China are protected as copyrightable works under the PRC Copyright Law; as patentable creations under the PRC Patent Law; and as trade secrets under the PRC Anti-Unfair Competition Law.[21] These strong regulations are part of the reasons why China's fintech industry has developed so rapidly in recent years.

[19]Preen, Mark. 2018. "China's Fintech Industry". China Briefing https://www.china-briefing.com/news/chinas-fintech-industry/
[20]Pan, David and Yang, Xun. 2020. "Fintech Laws and Regulations in China". ICLG. https://iclg.com/practice-areas/fintech-laws-and-regulations/china
[21]Ibid

How Nigeria can seize the opportunity to improve the financial sector with fintech

In terms of policies, the capital requirement or shareholder funds stipulated in Nigeria's financial regulations should be modified. For instance, the CBN Licensing Regime provides for a N5 billion shareholder funds requirement for the highest license.[22] This regulation is not all welcoming as most fintech companies are start-ups and do not meet the shareholder funds requirement. This should be amended to allow applicability to small fintech businesses.

Furthermore, the fintech landscape in Nigeria could be made more appealing to local and foreign investors through income tax relief and government incentives. The President under the Industrial Development Act has the discretion to assign pioneer status to an industry. Due to the level of innovation produced by fintech, pioneer status would be beneficial. When granted, it provides corporate tax relief and holidays for the first three to five years of operation. This will serve as an incentive for the players in the fintech landscape to create more financial innovations.

Fintech finding its way forward

The increasing penetration of the internet and mobile internet stimulated the emergence of the first wave of fintech firms, which provided online product platforms to address the gaps in financial services. Since then, major segments of the fintech market such as online peer-to-peer lending, online wealth management, and digital insurance have improved over the years. With a combination of government support and industry collaboration like working directly with banks to support innovation and tap into existing customer bases, fintech is sure to continue its significant growth in Nigeria.

[22] Jenik, I. and Lauer, K. 2017. "Regulatory Sandboxes and Financial Inclusion" CGAP. https://www.cgap.org/sites/default/files/Working-Paper-Regulatory-Sandboxes-Oct-2017.pdf

The Nigerian education system post COVID-19: the place of virtual learning

Virtual learning has become imperative in promoting and sustaining educational development globally considering the disruptive effect of the COVID-19 pandemic on traditional learning. However, the closure of schools has once again highlighted the huge divide between the educational systems in developed economies compared to developing economies like Nigeria. In Nigeria, schools across all levels have been suspended for over three months and educational institutions in the country are finding it difficult to adopt digital education.

The current state of the Nigerian education system

Nigeria's education system is still largely built around traditional pedagogical learning, which is more focused on the physical learning environment. However, the outbreak of COVID-19 has revealed the inadequacies of this mode of education. Only 11 of the 170 universities in the country operate a distance learning platform while most of the institutions remain poorly equipped.[23] The low level of infrastructural development in Nigeria, in terms of energy and internet connectivity, also continues to constitute a setback for the adoption of virtual learning in the country.

Primary and secondary school education in Nigeria have also been negatively impacted by the lockdown imposed on schools. Although some schools have explored several mediums to keep their students engaged during the lockdown, many students are disadvantaged due to the prevailing inequality in the socio-economy. Students whose parents are unable to provide them with the requisite technology tools may not be able to participate. In addition, people living in rural areas, where connectivity is poor to nonexistent, are also affected.

[23]National Universities Commission (NUC), 2020. Distance Learning Centers. https://www.nuc.edu.ng/distance-learning-centers/

Challenges of virtual learning

Advocacy for the adoption of virtual learning in Nigeria, without identifying and addressing the attendant challenges, will only amount to unrealistic campaigns. According to the president of the Association of Staff of Universities Union (ASUU), the Nigerian education system is not yet prepared for virtual learning.[24] This statement is linked to a number of factors:

⇒ **Infrastructural challenges:** Nigeria's access to electricity rate stood at 56.5% in 2018 and only 30.95% of its rural population have access to power supply.[25] Schools located in the rural areas usually have to deal with the high cost of alternative power supply despite the low budgetary allocation to the education sector. Another closely linked constraint is poor internet connectivity. The level of internet usage in Nigeria was estimated at 122 million users as at May, 2019,[26] which represented approximately 59% of the country's population. However, the broadband penetration rate stood at 33.13%.[27] Online learning often requires a good and strong connection both for the educators and the learners, hence the low level of bandwidth connection is a fundamental limitation.

⇒ **Economic constraints:** The cost implication of virtual learning is another barrier to the effective implementation of the mode of education. Around 40.1% of Nigerians live below the national poverty threshold of N137,430 ($354.66) per annum, which translates to N376.52 per day (less than $1).[28] This suggests that the average Nigerian household cannot afford the financial requirements of virtual learning in terms of the technology tools like laptops, iPads, internet-enhanced mobile phones and data expenses.

Way forward

The Nigerian government needs to pay better attention to the development of the education sector as a fundamental component of the country's human capital development. Nigeria was ranked 158th out of 189 countries, according to the 2019 United Nations Human Development Index (HDI) ranking with an index score of 0.534, behind countries like South Africa (0.705) and Ghana (0.596).[29]

[24] Iyabo Lawal, 2020. ASUU faults proposed virtual learning in nation's tertiary institutions. The Guardian. https://guardian.ng/news/asuu-faults-proposed-virtual-learning-in-nations-tertiary-institutions-2/

[25] The World Bank, 2018. Access to electricity (% of population) – Nigeria. Author. https://data.worldbank.org/indicator/EG.ELC.ACCS.ZS?locations=NG

[26] Nigerian Communications Commission (NCC), 2019. NCC Hinges Nigeria's 122 million Internet users' protection on effective governance.Author. https://www.ncc.gov.ng/stakeholder/media-public/news- headlines/614-ncc-hinges-nigeria-s-122-million-internet-users-protection-on-effective-governance

[27] ibid

[28] National Bureau of Statistics (NBS), 2019. Poverty and Inequality in Nigeria: Executive Summary. Author. https://nigerianstat.gov.ng/download/1092

[29] United Nations Development Programme, 2019. Human Development Reports. Author. http://hdr.undp.org/en/content/2019-human-development-index-ranking

⇒ **Improved funding to the educational sector:** Nigeria's budgetary allocation to the education sector has consistently fallen short of the United Nations Educational Scientific and Cultural Organization (UNESCO) recommendation of at least 15%.[30] The 2020 budget allocation for education was N686.8bn, 6.48% of the initial 2020 budget of N10.59 trillion. However, this has been reduced by 54% despite the increase in the revised 2020 budget to N10.81 trillion.[31]

⇒ **Better electricity and internet connectivity:** The social distancing requirements brought about by COVID-19 have revealed the need to prioritize energy development issues in Nigeria. This has implications for every sector of the economy including education. Improved electricity access and a stronger bandwidth connection in Nigeria will enhance the practicability of virtual learning in the country.

⇒ **Pedagogical training for educators:** Nigerian educators are generally inexperienced and lack proper training on the pedagogical approach to virtual learning.[32] The traditional approach is still what is widely practiced in the country, hence, a re-orientation, review of teaching practices and training are required to bring educators up to speed on virtual learning.

[30]Budgit, 2020. 2020 Budget: Analysis and Opportunities. Author. https://yourbudgit.com/wp-content/uploads/2020/03/2020-Budget-Analysis.pdf
[31]ibid
[32]Iyabo Lawal, 2020. ASUU faults proposed virtual learning in nation's tertiary institutions. The Guardian.https://guardian.ng/news/asuu-faults-proposed-virtual-learning-in-nations-tertiary-institutions-2/

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• Each scratch card carries an alphabet + instant win
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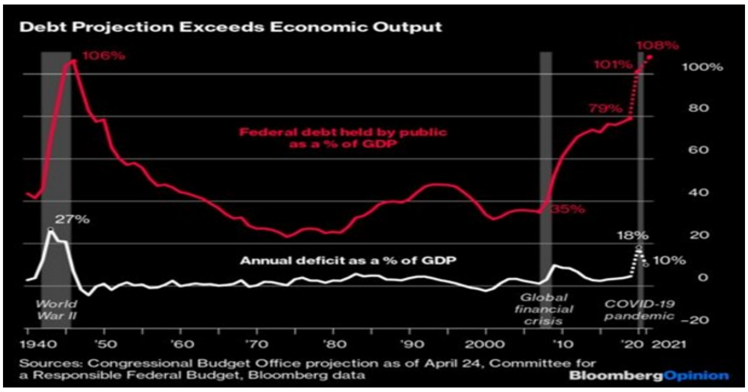
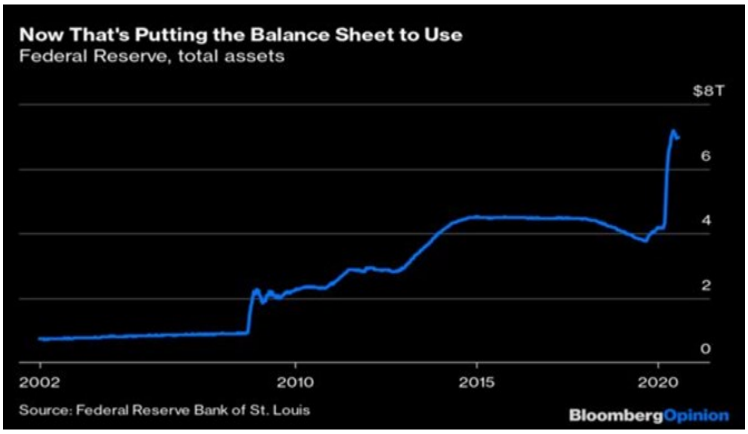
Economics Needs New Theories About Stimulus and Inflation

Global Perspective – Culled from Bloomberg

The coronavirus pandemic has raised deficit spending to new heights. Federal debt held by the public is expected to reach 100% of gross domestic product this year, effectively returning to the levels of World War II:



The Federal Reserve, meanwhile, has also taken unprecedented action, increasing its total assets from about $4 trillion at the start of the pandemic to about at the start of the pandemic to about $7 trillion now:



The big question is when, if ever, this aggressive government action starts to incur negative consequences, such as rapid inflation. Macroeconomists should be investigating this question vigorously. But so far, interest in the question has seemed strangely muted among mainstream academics.

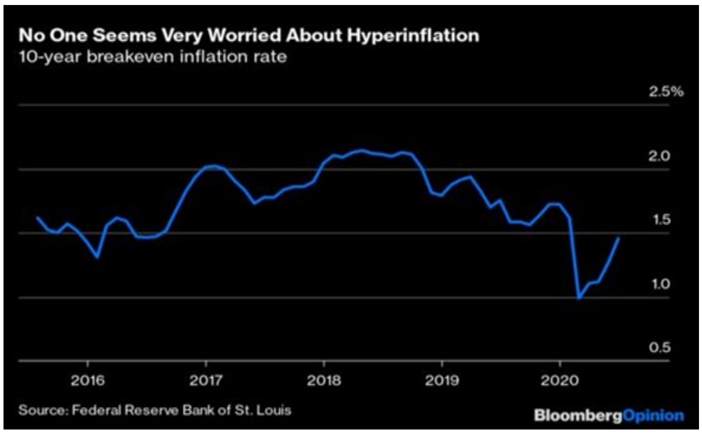
Before the financial crisis of 2008, the dominant academic model of the business cycle held that there was a tradeoff between inflation and unemployment -- a new version of what's known in economics as the Philips Curve. By managing interest rates, mainstream theorists argued, the central bank would navigate serenely between the rocks of inflation and the shoals of unemployment. There was not much room for government debt in that model.

The 2008 recession seemed like it might present a huge challenge for this paradigm, but most macroeconomists met the challenge by simply patching up the old models. They shoehorned in a financial sector, and allowed that when nominal interest rates approached zero, fiscal stimulus along with quantitative easing would have to be brought in.

But that still left the question of what the limits of stimulus and QE would be. Mainstream economists realized that because the government can use monetary policy to lower interest rates and even finance government borrowing directly, there would never be a real risk of sovereign default; if private investors stopped buying Treasuries and rates started to rise, the Fed could pick up the slack. The only real constraint on government action was the possibility of inflation, if the Fed created too much money.

But when would inflation kick in? Economists' only answer was, basically, that it would happen at some point. Some economists fretted that QE was about to cause rapid inflation, even writing an open letter to former Fed chairman Ben Bernanke warning him to stop QE. But Bernanke didn't stop, and inflation never came. The Bank of Japan engaged in an even more vigorous program, buying up an appreciable fraction of the country's stock market. But inflation never consistently reached the bank's 2% target:

The failure of inflation to materialize in response to enormous fiscal and monetary stimulus in the 2010s should have prompted vigorous activity among academics to try to figure out why. But oddly, it didn't. A few scholars suggested that low interest rates were actually deflationary, but this idea never caught on. Most macroeconomists, if they bothered to address the question at all, simply assumed that at some point inflation would pick up, and that developed countries simply hadn't reached that point yet. So far, the coronavirus pandemic looks like a repeat of the financial crisis in this respect; despite unprecedented deficits and monetary expansion, markets expect inflation to be below target for the next decade:



But inflation undeniably happens sometimes, in some places. Venezuela and Lebanon have both recently experienced hyperinflation, with the former reaching an annual rate of more than 130,000%. The economic consequences are devastating -- even worse than a sovereign default. The question is why, and where, and under what conditions hyperinflation happens, and how it can be stopped.

Instead of spinning theories that effectively just say that hyperinflation will happen at some unknown point, macroeconomists could look at countries that do experience hyperinflation, or come close but manage to avert it. They should use these historical and international examples to learn lessons about when and where and why this sort of catastrophe happens, and how it can be prevented. But the seminal work on hyperinflation continues to be economist Thomas Sargent's 1982 paper "The End of Four Big Inflations." This paper, in addition to being four decades old, draws all its examples from Central European economies in the aftermath of World War I -- very different circumstances than the economies of today.

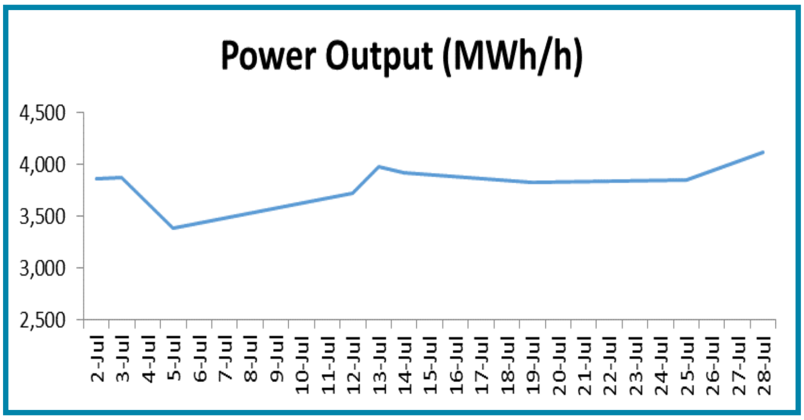
New work on hyperinflation is urgently needed. One key question is whether runaway inflation happens slowly enough that the government can reverse course in time, or whether it's instantaneous and catastrophic. Another question is whether direct monetary financing of new government borrowing is a trigger for hyperinflation. A third is whether and how capital flight is involved. A fourth is how the type of government spending changes whether markets expect deficits to be temporary or permanent. There are many other important questions besides these.

If academic macroeconomists continue to largely ignore this question, and focus on the models and ideas and questions that they were working on before coronavirus, it will represent a quiet but enormous failure of the discipline, just as significant as the profession's inability to see the 2008 crisis coming. With academics AWOL on the question of how much the government can safely spend and how much the central bank can safely print, policy makers, businesspeople and financial market participants will turn to poorly articulated theories, old nostrums, political agitators, gut instincts or the raving of random Twitter users.

Macroeconomic Indicators – July

Power Sector

Average power output from the national grid increased by 3.17% to 3,839MWh/h in July from 3,721MWh/h in June. This was partly due to increased hydro-generated power as no water constraint was recorded during the period. Gas and grid remained the dominant constraints especially at the Ihovbor and Geregu NIPP power plants. Both challenges account for more than 90% of total constraints. The sector lost approximately N18.56 billion (N222.72billion annualized).



[33]

Outlook

As we gradually approach the end of the rainy season, there is likely to be resurgence in water constraints. This alongside gas and grid challenges is likely to reduce power output in the coming month. Meanwhile, the cost reflective electricity tariff, which will most likely take effect in Q4'20/Q1'21, would increase investment in the power sector and boost power supply in the long term.

Impact

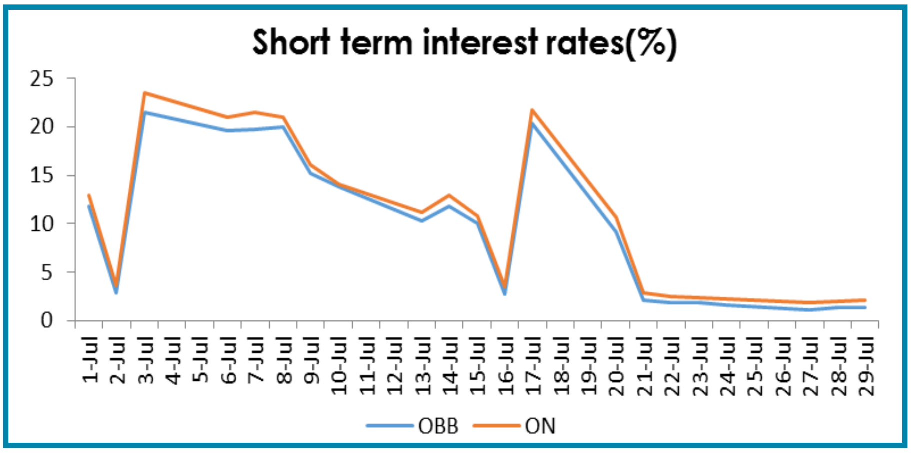
A decline in power supply means that firms will source for alternative energy, which will increase their operating expenses.

Money Markets

The average opening position of the banks was N246.43 billion in July, 2.09% lower than June's average of N251.70 billion. During the month, the opening position slipped into the negative territory for three consecutive days, before recovering to close the month positive at N769.20bn. The reduction in market liquidity was due to CRR debits and funding for the CBN's retail forex auction. During the period, OMO repayments (N536.75bn) surpassed OMO sales (N100bn), resulting in a net inflow of N436.75 billion, up from N277.62 billion in June.

[33] FG, FDC Think Tank

Average NIBOR rates (OBB, O/N) declined by 77bps to 10.06% from 10.83% in June. OBB and ON closed at 1.40% and 2.10% on July 29 compared to 11.80% and 12.90% respectively on July 01.



[34]

In July, there were two primary market T/Bills auctions, which amounted to N195.90 billion. T/bill yields for the 91-day and 182-day tenors declined by an average of 55bps while 34-day tenor remained relatively flat. At the secondary market, the 91-day and 182-day T/bill yields declined by an average of 36bps while 364-day tenor remained flat.

T/bills Tenor	Primary market rates as at July 1st (%pa)	Primary market rates as at July 29th (%pa)	Direction	Secondary market rates as at July 1st (%pa)	Secondary market rates as at July 29th (%pa)	Direction
91	1.79	1.20	⬇	1.66	1.21	⬇
182	1.91	1.40	⬇	2.07	1.80	⬇
364	3.39	3.40	⬌	2.88	2.88	⬌

Outlook

Interest rate movement is a function of market liquidity. We expect short-term interest rates to hover around the current levels in the near term pending any significant outflow from the system.

Impact

Lower interest rate will reduce cost of borrowing, which will in turn increase corporate margins.

[34]CBN

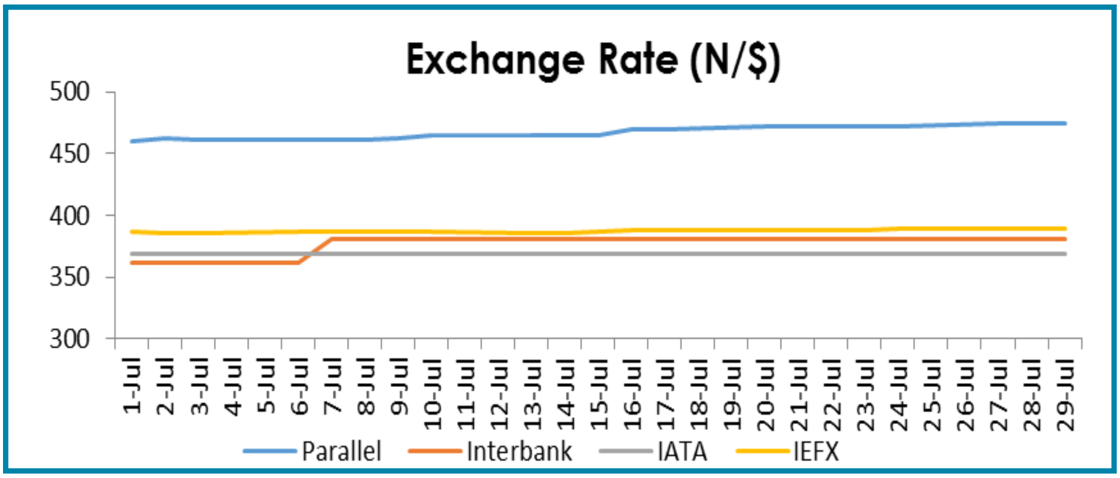
Forex Market

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

Currency depreciation continued across the various segments in July. At the parallel market, the naira depreciated by 3.26% to close the month at N475/$ from N460/$ at the start of the month. At the interbank market, the currency traded flat at N361/$ for the first week before weakening to close the period at N381/$. This was largely due to CBN's forex rationing and exchange rate adjustment at the official window to N381/$ from N361/$.

The naira lost 0.71% at the investors and exporters' window to close at N389.25/$ on July 29 from N386.5/$ at the beginning of the month. Total turnover at the IE window fell by 5.54% to $937.16 million from $992.11 million in June.



[35]

Outlook

We expect an increase in forex demand as economic activities further improve. This will further weaken the currency.

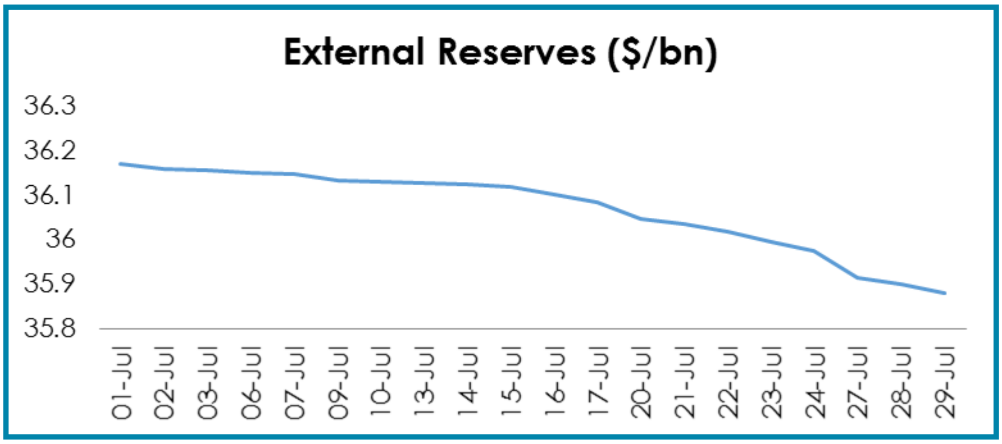
Impact

Currency depreciation will increase the cost of import as well as service costs of dollar obligations. As a result, corporate margins could fall especially for companies that are import dependent.

[35] FMDQ, CBN, FDC Think Tank

External Reserves

The gross external reserves continued its steady depletion in July, falling below the $36billion threshold. It lost 0.80% to close the month at $35.88bn. The country's payment and import cover declined to 8.93 months from 9.00 months at the beginning of the month.



[36]

Outlook

The external reserves level is expected to decline further as the CBN continues to intervene in the forex market to keep the exchange rate stable.

Impact

The continuous depletion of the external reserves level could intensify the CBN's forex rationing strategy, thus weakening the naira.

[36]CBN

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125 years of supporting and enabling dreams, 125 years of resilience, relevance, trust, safety and security.
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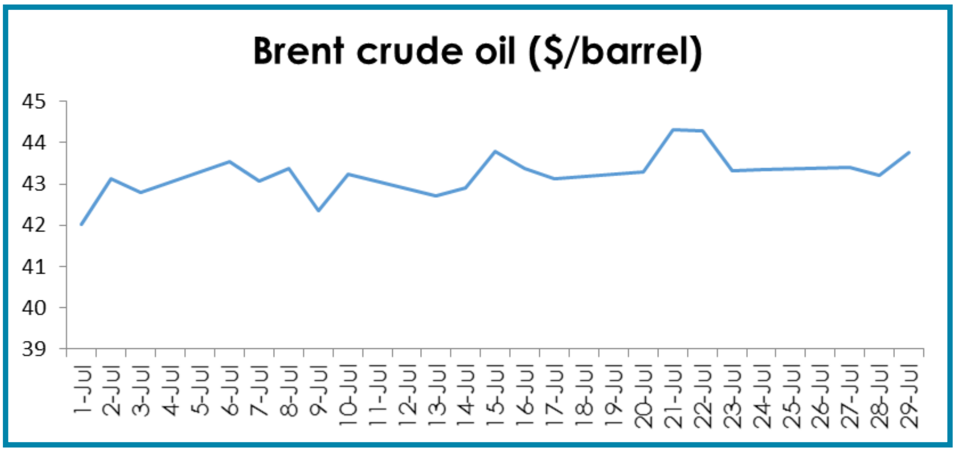
Commodities Market - Exports

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, Brent prices increased by 6.01% to $43.22pb in July from $40.77pb in June. During the period, oil prices traded slightly above $44pb for two consecutive days before retreating to close the period at $43.3pb. The bullish sentiment was partly due to consistent supply cuts amid a slight recovery in global oil demand.



[37]

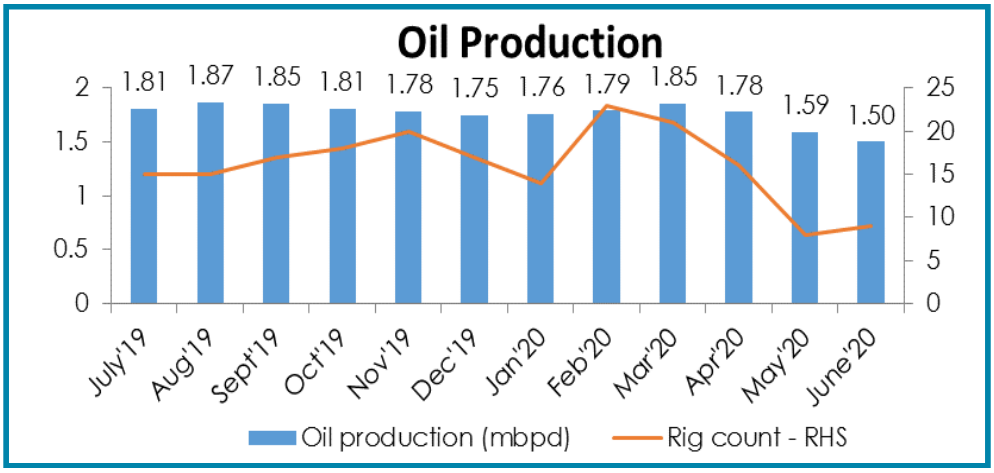
Outlook

Oil price volatility will continue in the coming weeks due to supply and demand concerns. The relaxation of output cuts by 2mbpd in August will keep oil prices within the $42-$45pb band.

Oil Production

Nigeria's oil production declined for the 3rd consecutive month to 1.50mbpd in June from 1.59mbpd in May. This was in spite of the 12.5% increase in oil rig count to 9. Total OPEC oil production averaged 22.27mbpd in June, down 7.94% from 24.19mbpd in May. Oil output decreased in Saudi Arabia, Iraq, Venezuela, UAE and Kuwait, while production increased in Equatorial Guinea and Libya.

[37] Bloomberg



[38]

Outlook

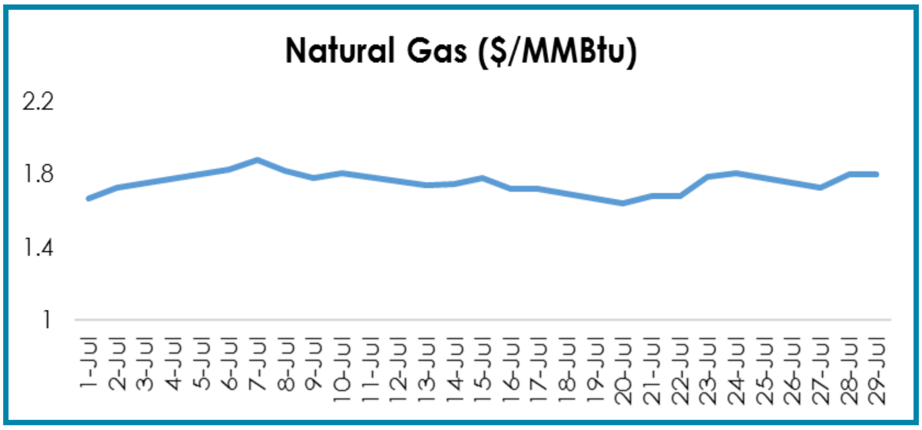
With the ease in OPEC+ supply cuts, oil producers are likely to increase production in the coming months. However, defaulters like Nigeria would be made to pay for previously producing above their quota.

Impact

The Nigerian economy is more sensitive to oil production than prices. Hence, lower oil production will adversely affect oil revenues. However, the shortfall is likely to be offsetted by exchange rate gains and higher tax revenues as more companies re-open and tax collection improves. Hence, FAAC disbursements are likely to increase in the coming month.

Natural Gas

Natural gas prices averaged \$1.77/mmbtu in July, up 4.12% from \$1.70/mmbtu in June. The increase in price was as a result of higher US LNG demand.



[39]

Outlook

Natural gas price is expected to decline in the near term due to increased global LNG supply amid slow recovery in demand.

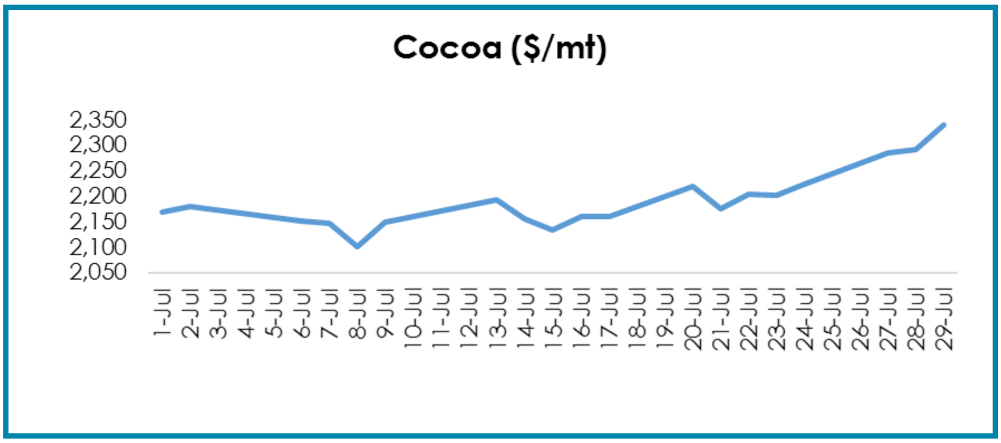
[38]OPEC and Baker Hughes
[39]Bloomberg

Impact

Lower natural gas prices will trigger a decline in Nigeria's export earnings, as the commodity is one of the country's main exports (13%[40] of total exports).

Cocoa

The average price of cocoa declined by 4.83% to $2,207/mt in July from $2,319/mt in the preceding month. During the period, prices touched a 21-month low of $2,100/mt before increasing to close the month at $2,400/mt. This was due to improved global cocoa demand on Covid-19 vaccine hopes.



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Outlook

The recovery in global cocoa demand is expected to push up prices in the near term.

Impact

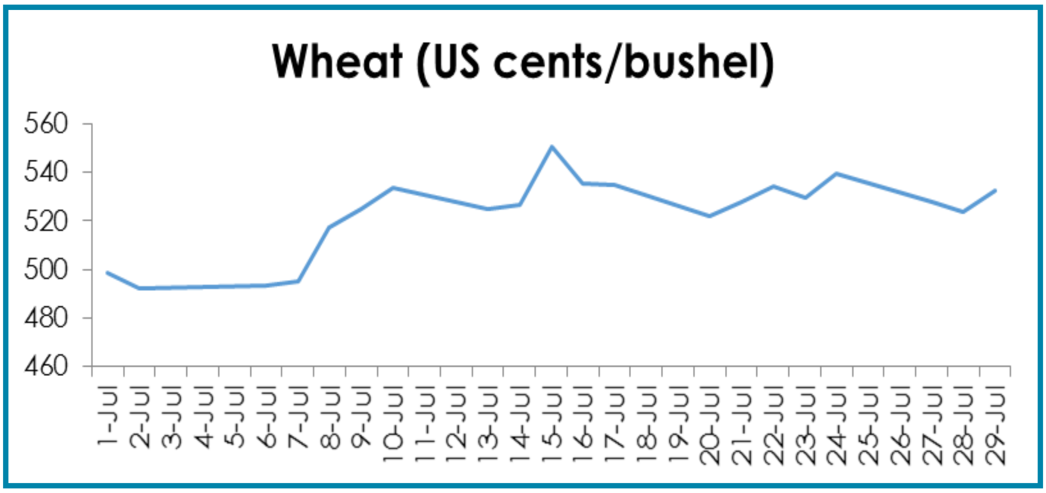
Cocoa is one of Nigeria's major non-oil exports. Higher prices will increase the country's export revenue.

Imports

Wheat

In July, the average price of wheat was up 4.74% to $523.86/bushel from the average of $500.13/bushel in the previous month. The uptick in prices was partly driven by expectations of lower wheat supply due to weather concerns in the US.

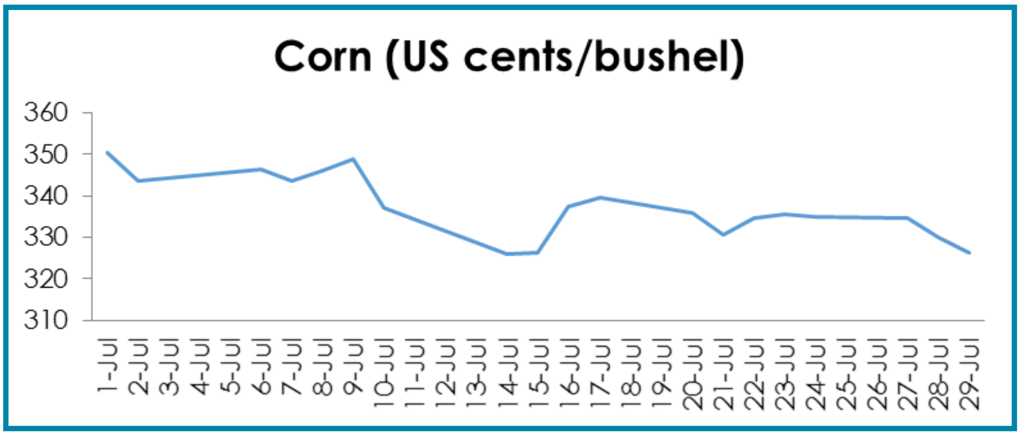
[40] EIU
[41] Bloomberg



[42]

Corn

Corn prices increased by 1.67% to average $335.94/bushel in July from an average of $330.41/ bushel in June. This was in spite of improved crop conditions in the US.



[43]

Outlook - Grains

Grain prices are expected to decline in the near term as US-China trade tensions weigh on demand outlook amid positive crop prospects in the US.

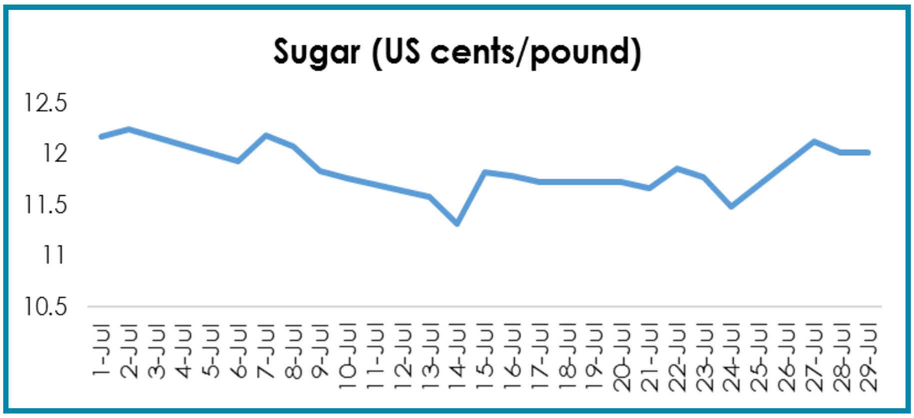
Impact

Nigeria is a major importer of grains. Therefore, lower grain prices means a reduced import bill for the country.

Sugar

On the average, sugar fell by 0.25% to $11.90/pound in July from $11.93/pound in June. This was partly due to improved sugar production in Brazil.

[42]Bloomberg
[43]Bloomberg



[44]

Outlook

We expect sugar prices to pick up in the near term on expectations of higher global demand, particularly from China.

Impact

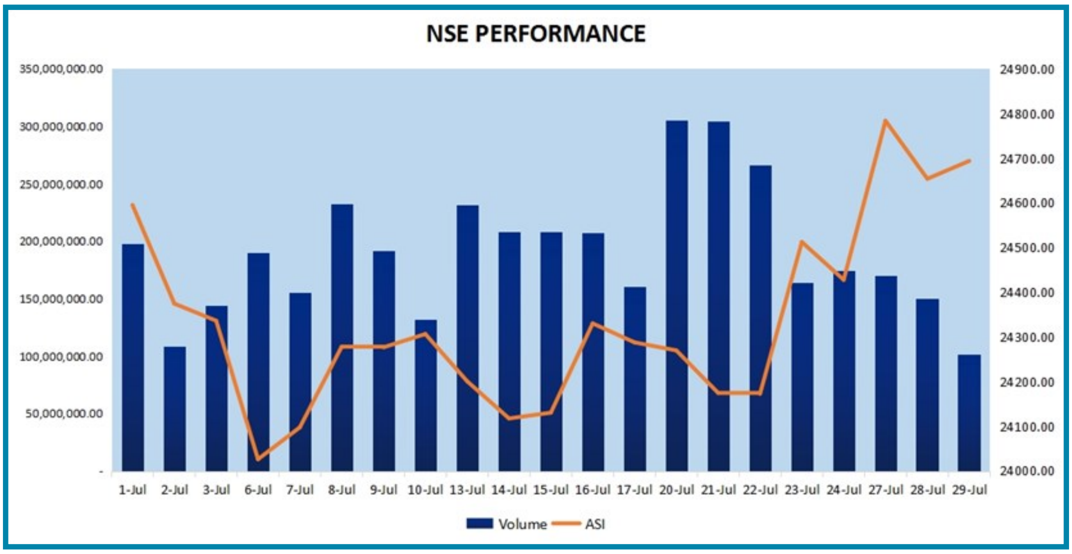
An increase in the price of sugar would lead to higher raw material costs for manufacturing companies that use the commodity. More importantly, Nigeria's import bill will increase, being a major sugar importing country.

[44]Bloomberg

Stock Market Review

The Nigerian bourse closed positive July as it gained 0.88% to close at 24,693.73 points on July 29th compared to close of 24,479.16 points in June. However, market capitalization was down 2.58% to N12.83trn relative to its June close of N13.17trn. Also, the market has lost 8% YTD so far in 2020. So far, in the 21 trading days of the review period, the market gained in 9 days and lost in 12.

The NSE traded at a price to earnings (P/E) ratio of 8.59x as of July 29th, 5.66% higher than the close in June (8.13x). The market breadth was negative at 0.62x as 32 stocks gained, 52 lost while 79 stocks remained unchanged.



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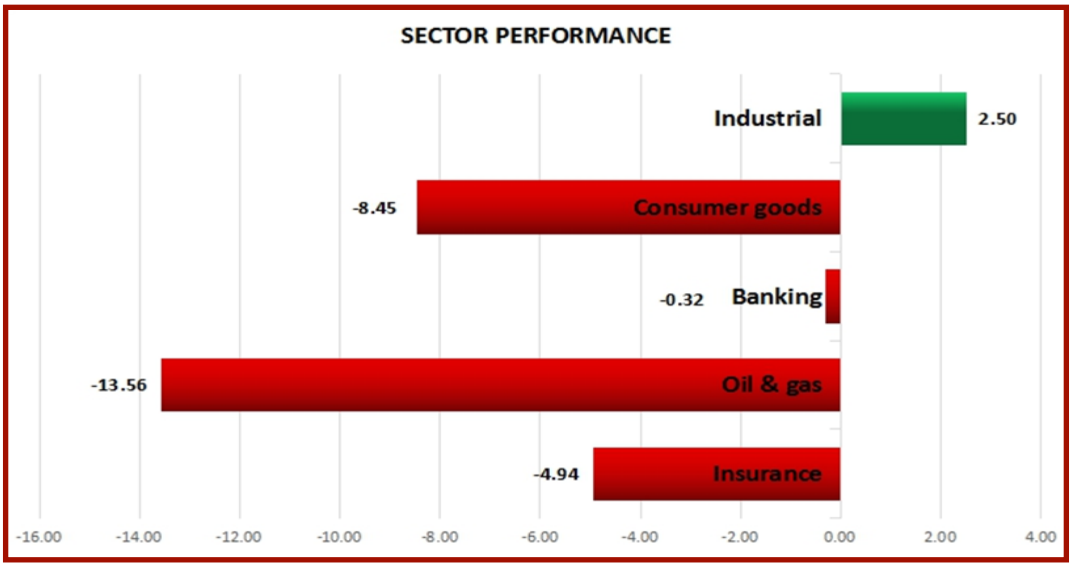
On the other hand, market activity level was negative in the review period. The average volume traded fell by 16.61% to 190.64mn units from 228.61mn units in the month of June. Similarly, the average value of trades decreased by 22.14% to N2.11bn in the review period.



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[46]NSE and FDC Think tank
[47]NSE and FDC Think tank

The sector indices were broadly negative during the review period. The oil & gas sector lost the most (13.56%), followed by the consumer goods sector (8.45%), insurance sector (4.94%) and banking sector (0.32%). Only the industrial sector gained by 2.50%.

Royal Exchange Plc topped the gainers' list with a 34.78% increase in its share price. This was followed by Unity Bank Plc (29.79%), Ikeja Hotel Plc (17.89%), Ardova Plc (13.98%) and Lafarge Africa Plc (11.90%).

TOP 5 GAINERS				
Company	Jul-01 (N)	Jul-29 (N)	Absolute Change	Change (%)
Royal Exchange Plc	0.23	0.31	0.08	34.78
Unity Bank Plc	0.47	0.61	0.14	29.79
Ikeja Hotel Plc	0.95	1.12	0.17	17.89
Ardova Plc	11.80	13.45	1.65	13.98
Lafarge Africa Plc	10.50	11.75	1.25	11.90

The laggards were led by Smart Products Nigeria Plc (-31.03%), Arbico Plc (26.46%), Julius Berger Nigeria Plc (-24.43%), Unilever Nigeria Plc (-19.93%) and Seplat Petroleum Development Co Plc (-19.64%).

TOP 5 LOSERS				
Company	Jul-01 (N)	Jul-29 (N)	Absolute Change	Change (%)
Smart Products Nigeria Plc	0.29	0.20	0.09	-31.03
Arbico Plc	1.89	1.39	0.50	-26.46
Julius Berger Nigeria Plc	19.85	15.00	4.85	-24.43
Unilever Nigeria Plc	15.30	12.25	3.05	-19.93
Seplat Petroleum Development Co Plc	386.00	310.20	75.80	-19.64

Outlook

We expect the positive market performance to be shortlived as the market is expected to be bearish in the coming months owing to low market liquidity, poor Q2'2020 corporate earnings of companies and uncertainty in the macroeconomic environment. This is expected to drive cautious trading by investors, which will drag down demand for stocks thereby negatively impacting the stock market performance.

Equity Report: Fidson Healthcare Plc

Analyst Recommendation: Buy

Market Capitalization: ₦7.72bn

Recommendation Period: 365 days

Current Price: ₦3.7

Industry: Healthcare

Target Price: ₦4.81

Analyst's note

Fidson Healthcare Plc, a leading pharmaceutical company in Nigeria, started as a local distributor of pharmaceutical products in 1995 and set up its first local manufacturing facility in July 2002. The company manufactures and distributes pharmaceutical products, which include drugs, infusions and injectables. In March 2005, it became the first company in Sub-Saharan Africa to manufacture antiretroviral drugs.

Fidson Healthcare has over 200 quality drug products for treating various diseases and pharmacological ailments. They include anti-infectives, gastrointestinal, antiretroviral, antimalaria, cardiovascular, analgesic, hamematinics and supplements. The company generates revenue from three major sources namely: sale of prescription medicines, over-the-counter products (non-prescribed drugs); and production of household items within the consumer segment.

In 2017, Fidson commissioned a World Health Organization (WHO) compliant manufacturing facility in Sango Ota, Ogun state. This ultramodern plant is the largest manufacturing facility among its peers in West Africa. This facility has enabled the company position itself for nongovernmental organization relief programs aimed at tackling diseases such as malaria, tuberculosis, typhoid, and hepatitis among other health issues.

In a bid to improve its financial structure, the company raised additional capital of N3billion through a right issue in 2019 which was used to support its expansion plans and boost the company's working capital which had been negatively affected by the depreciation of the naira. The company's performance in 2019 also benefited from its strategic partnership with Ohara Pharmaceutical, a big pharmaceutical company in Japan which grew its shares in Fidson Healthcare to 21.75% through the right issue.

GlaxoSmithKline (GSK), a British giant in the industry has partnered with Fidson Healthcare as its local contract manufacturing partner. In the third quarter of 2021, GSK will transfer the manufacturing of its respiratory and wellness products to Fidson Healthcare. This partnership is expected to help the company experience more financial growth which will spur business expansion in the company's activities.

In determining Fidson pharmaceutical's intrinsic valuation, we considered historical and current financial performance, growth prospects, expansion plans, competitive positioning, and its macroeconomic fundamentals. The company has reported significant volatility in the financial performance with its best year in 2017. The company recorded an increase of 83.64% in revenue to N14bn from N7.66bn the previous year. Profit after Tax (PAT) grew by 235% to N1bn. These remarkable figures were achieved due to the commencement of operations in its ultra modern manufacturing facility in Sango Ota which doubled its former production capacity in 2017. Prior to this significant growth in 2017's revenue, the company's revenue growth rate averaged -0.8%. However in 2018, the company recorded an unimpressive bottom-line performance as PAT declined by 109% to a loss of N97mn. The loss after tax was due to a 43% increase in cost of sales which was inflated by the devaluation of the naira, high cost of active pharmaceutical ingredients (APIs) and port congestion. In 2019, the company recovered from its previous year's loss by 520% to N407mn in PAT amid declining sales which was because of reduced purchasing power of consumers.

Fidson's financial performance so far in 2020 has been impressive. In its H1'2020 result, the company recorded a 12% growth in revenue to N8.2bn from N7.3bn, Gross profit also grew by 8% to N3.57bn from N3.3bn, due to a 12% growth in revenue. Operating profit increased by 10% to N1.4bn from N1.27bn due to a 20% decline in administrative expenses to N1.2bn from N1.5bn. PAT grew by 81% to N500mn from N275.9mn due to a 23% decline in finance cost from N896.9mn to N690.5mn and a 20% decline in administrative expenses.

We expect the company to record a better performance in FY'2020. We project a 10% growth in revenue in 2020 as we expect that the company's growing capacity will enable it to meet the growing demand for healthcare products amid an increase in population and the spread of the coronavirus pandemic.

Effective cost management drives bottom-line growth

The company in its 2019 financial year put an effective cost management strategy in place to reduce cost of sales to N8.19bn to ensure profitability. The company's high cost of sales in 2018 of N9.9bn was driven by increased logistical costs for imported materials due to congestions at the seaports.

The company, however, recorded a 258% growth in PBT, while PAT grew by 520% from a loss of N97mn despite declining revenue in FY'2019. This is attributable to a 17.3% decline in cost of sales to N8.19bn from N9.9bn in 2018 and a 17% decline in operating expenses to N4bn from N4.8bn in FY'2019. A 34.8% decline in income tax expense to N168mn also contributed to the bottom-line growth.

De-leverage exercise keeps finance cost down

Sequel to the construction of its manufacturing plant in 2017, Fidson's current interest bearing debts increased in FY'2018 to N4.7bn from N1.7bn in 2017 with a corresponding rise in finance cost to N1.9bn from N1bn in 2017.

However, the additional capital raised through the right issue in 2019 has deleveraged the balance sheet position of the company. The right issue action increased the share capital of the company to N1.04bn from N750mn. The debt to total capitalization declined by 11.35% to 39.8% from 44.9% in 2018 financial year. In addition, we also saw a decline in finance cost to N1.7bn from N1.9bn in 2019 financial year.

We project a further reduction in finance cost to N1.5bn in 2020 from N1.7bn in FY'2020.

Fidson Healthcare Plc										
Pre-forecast Vs forecast		Pre-forecast	Pre-forecast	Pre-forecast	Pre-forecast	Pre-forecast	Forecast	Forecast	Forecast	Forecast
Financial year ending		31 Dec 15	31 Dec 16	31 Dec 17	31 Dec 18	31 Dec 19	31 Dec 20	31 Dec 21	31 Dec 22	31 Dec 23
Statement Of Comprehensive Income										
Revenue	N'000	8,210,760	7,655,029	14,057,394	16,229,903	14,062,015	15,468,217	17,015,038	18,716,542	20,588,196
Cost of sales		(3,858,896)	(3,599,666)	(6,902,227)	(9,910,219)	(8,186,458)	(8,117,727)	(8,929,499)	(9,822,449)	(10,804,694)
Gross Profit	N'000	4,351,864	4,055,363	7,155,167	6,319,684	5,875,557	7,350,490	8,085,539	8,894,093	9,783,502
Other operating income		94,264	105,110	103,145	247,790	296,642	422,408	601,494	856,507	1,219,637
Operating Income	N'000	**4,446,128**	**4,160,473**	**7,258,312**	**6,567,474**	**6,172,199**	**7,772,898**	**8,687,033**	**9,750,600**	**11,003,139**
Administration expenses		(2,060,962)	(2,096,585)	(2,360,681)	(2,614,355)	(2,520,319)	(3,196,148)	(3,515,763)	(3,867,339)	(4,254,073)
Selling and distribution expenses		(868,844)	(973,574)	(2,348,506)	(1,905,330)	(1,398,476)	(1,908,503)	(2,099,353)	(2,309,289)	(2,540,217)
Operating Profit	N'000	**1,516,322**	**1,090,314**	**2,549,125**	**2,047,789**	**2,253,404**	**2,668,247**	**3,071,918**	**3,573,973**	**4,208,849**
Finance income		38,675	44,249	31,072	38,080	57,360	65,651	75,140	86,002	98,433
EBIT	N'000	**1,554,997**	**1,134,563**	**2,580,197**	**2,085,869**	**2,310,764**	**2,733,898**	**3,147,058**	**3,659,974**	**4,307,281**
Finance cost		(716,958)	(690,776)	(1,001,650)	(1,925,002)	(1,735,098)	(1,563,101)	(1,172,325)	(781,550)	(390,775)
Profit Before Tax	N'000	**838,039**	**443,787**	**1,578,547**	**160,867**	**575,666**	**1,170,798**	**1,974,733**	**2,878,424**	**3,916,506**
Tax credit/(Tax expense)		(93,661)	(127,025)	(517,758)	(258,314)	(168,478)	(351,239)	(592,420)	(863,527)	(1,174,952)
Profit After Tax	N'000	**744,378**	**316,762**	**1,060,789**	**(97,447)**	**407,188**	**819,558**	**1,382,313**	**2,014,897**	**2,741,554**
Dividend Paid		**225,000**	**75,000**	**75,000**	**300,000**	**225,000**	**238,164**	**401,700**	**585,529**	**796,696**
Earnings Per Share		**0.5**	**0.21**	**0.71**	**-0.06**	**0.2**	**0.4**	**0.7**	**1.0**	**1.3**
Dividend Per share		**0.05**	**0.05**	**0.2**	**0.15**	**0.15**	**0.1**	**0.2**	**0.3**	**0.4**

Industry Overview

Nigeria is a significant market for pharmaceutical products as the most populous country in Africa. It has a high demand for efficient healthcare services due to the high prevalence of diseases such as malaria, HIV/AIDS, tuberculosis, among others.

The healthcare industry in Nigerian is largely fragmented and includes some dominant household names. The industry can be broadly categorized into consumer healthcare and pharmaceutical categories. Consumer healthcare centers on drugs administered over-the-counter, without prescriptions while pharmaceuticals include prescription drugs and vaccines.

There are over 130 pharmaceutical companies in Nigeria. The key players in the industry include multinational pharmaceutical companies, such as GSK, Pfizer, Novartis, and Sanofi, while local players include Fidson, May and Baker, Neimeth, Swipha and Evans Pharmaceutical Industries.

The industry is plagued with economic uncertainties as it faces stiff competition from unregulated and unbranded drugs, as well as cheaper imported variants. Multinational suppliers of pharmaceutical products are faced with the long regulatory process of registering products in Nigeria which makes them miss out on market opportunities. However, new policies and guidelines, issued by the regulatory authorities and the Nigerian Custom Service, have helped industry players remain competitive.

The impact of COVID-19 on the industry has been mixed. The country is overly dependent on imported drugs from China and India with 70% of the drugs consumed in Nigeria imported from these two countries. The sudden pandemic, however, has put pressure on government and other regulatory bodies to increase their efforts to ensure local manufacturing of pharmaceutical products in Nigeria. In Q1'2020, the healthcare sector contributed 1.06% to the country's GDP compared to -0.56% decline in Q4'2019. This is attributed to the consumers' quest for healthcare service to prevent the contraction of the COVID-19 virus.

Governance Structure

The management of Fidson healthcare plc has over the years built and cultured an organizational framework that has helped the company gain a competitive position in the industry and recognition as a household name in the healthcare space.

Fidson Healthcare is led by a highly talented and experienced team that has helped the company maintain a strategic position in the industry. The company is chaired by Mr. Segun Adebanji an experienced chartered accountant and auditor in the manufacturing industry who has worked both within and outside Africa.

Dr. Fidelis Ayebae is the Managing Director of Fidson Healthcare. He is an experienced industrialist with both banking and engineering background.

Over the years, the management team has delivered enormous value for the company through the implementation of several strategic initiatives. The team has done a great job in terms of increasing the volume of locally manufactured products available to customers on the back of its ultra modern manufacturing plant.

The management team has been able to drive the company to be the first pharmaceutical company in Nigeria and the entire Sub-Saharan Africa to locally manufacture anti-retroviral drugs for HIV-AIDS patients which became a great achievement for the company.

Managing Director
Dr. Fidelis Ayebae

Chairman
Mr. Segun Adebanji

The team consistently seeks partnership with foreign companies to ensure improved management, sound corporate governance among others. The company's recent partnership with Ohara pharmaceutical company is expected to support Fidson Healthcare in fulfilling its commitment to provide standard healthcare products for its customers.

It is the vision of the management that the company will be the first full-fledged research and development based manufacturing company in Nigeria.

Risk and outlook

The business operation of Fidson Healthcare has been a steady journey towards expansion. The company put some strategic measures in place to cut cost and ensure profitability in its 2019 financial year as a result of its unimpressive performance in 2018.

However, there is a likely risk that an increase in its product pricing will lead to further reductions in revenue and that customers may shift to purchase products with lower prices.

Due to the import-dependent nature of the company for some of its raw materials, the operations of the company will likely be affected by naira devaluation which may lead to a problem of product availability and consequently increase the operating expenses of the company.

However the ever increasing demand for drugs and healthcare services provides an opportunity for continuous growth for the company. It is expected that Fidson Healthcare Plc will continue to deliver substantial value for investors based on the company's growth platform through its ultramodern factory, robust product offerings and its partnership with Glaxosmithkline Plc as its preferred local manufacturing partner.

What the Bulls and the Bears Say:

Bulls say;

- Leading player in the healthcare sector
- First manufacturer of antiretroviral drugs in Sub-Saharan Africa
- World class pharmaceutical manufacturing facility
- Large market share
- World Health Organization's Good Manufacturing Practice (GMP) Certification
- Improved regulatory support
- Increased government patronage

Bear s say

- Prevalence of counterfeit drugs
- Harsh economic conditions
- Epileptic power supply
- Scarcity of skilled workers

Valuation summary

- Fidson Healthcare Plc's valuation was derived from using the Discounted Cash Flow (DCF) methodology. We estimate a stock price of ₦4.81, which is a 30% upside on the current stock price of ₦3.70 per share as at August 14, 2020. With a discount rate (Weighted Average Cost of Capital (WACC)) of 20.1% derived using a 12.50% risk free rate (FGN 5-year Bond as at 17th July 2020, a Beta of 1.26, after-tax cost of debt of 16.1%, and a market risk premium of 8.09%, long-term cash flow growth rate to perpetuity (4.5%) was derived by multiplying the average return on invested capital of 7% by the retention rate of 64%.

- Based on the analysis above, and current market happenings, Fidson Healthcare's current stock price is undervalued, coupled with positive performance prospect in the long run if well managed. Thus, we place a **BUY** rating on the stock.

DCF Valuation for Fidson Plc						
Naira '000'	**2020E**	**2021E**	**2022E**	**2023E**		
EBIT	2,668,247	3,071,918	3,573,973	4,208,849	**WACC**	
Less: Taxes	(351,239)	(592,420)	(863,527)	(1,174,952)	Debt-to-Total Capitalization	39.8%
EBIAT	2,317,008	2,479,498	2,710,446	3,033,897	Equity-to-Total Capitalization	60.2%
Plus: depreciation expense	665,840	665,840	624,269	610,827	Interest Expense as a % of debt	23.00%
Less: CAPEX	(946,967)	(1,060,602)	(395,122)	(442,537)	Cost of Debt	23.00%
Less: Change in working capital	(3,231,199)	(557,064)	144,786	159,264	Tax Rate	30.00%
Free Cash Flow (FCF)	(1,195,318)	1,527,671	3,084,378	3,361,451	**After-tax Cost of Debt**	16.1%
WACC	20.1%	20.1%	20.1%	20.1%		
Present value (PV) of FCF	(1,195,318)	1,272,336	2,139,494	1,941,968	Risk-free Rate	12.50%
					Market Risk Premium (Rm-Rf)	8.09%
					Beta	1.26
Terminal value @ perpetual growth rate (2020)	**2020**	**2021**	**2022**	**2023**	**Cost of Equity**	22.7%
Terminal value as of 2020	-	-	-	22,530,049	**WACC**	20.1%
Present value of terminal value	13,015,995					
2020					Infinite growth rate	4.5%
DCF Calculation	**Valuation**				Payout ratio	36.0%
PV of explicit period	4,158,480				Retention rate	64.0%
PV of terminal value	13,015,995				Return on Invested capital	7%
Enterprise Value	17,174,475				Total Capital	15,830,440
+ Cash	303,919				EBIT	2,253,404
- Borrowings	(7,443,336)					
Equity value	10,035,058					
Share Price ₦	**4.81**					
Shares outstanding ('000)	2,086,360.00					

Economic Outlook for the Next Month

In the coming month, we expect a further boost in economic activities as more businesses and companies re-open. Notwithstanding, companies will continue to battle with the lingering impact of the pandemic. Consumer spending pattern would remain tilted in favour of necessities as income levels remain squeezed. The upward adjustment in PMS price to N148.7/litre will further put a strain on consumer's disposable income, reducing aggregate consumption. Investors will also remain jittery and would thread cautiously as the fear of a second wave of the virus increases uncertainty in the economy.

As more companies re-open, we expect a build-up in forex demand pressures. Yet, the CBN will continue its forex rationing strategy to conserve the external reserves especially with the delayed disbursement of the World Bank loan.

Inflationary pressures will also persist in spite of the commencement of the harvest season, crossing the 13% in August. The closure of the Third Mainland Bridge will disrupt the commodity supply chain while the exchange rate adjustment will keep import costs elevated.