FDC Bi-Monthly Update

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In This Issue …

IEFX rate crosses N400/$ amid gentleman's disagreement between the IMF and FGN on naira devaluation

The exchange rate at the Investor and Exporter window (IEFX rate) crossed the N400/$ threshold again after a one-day spell on December 31, 2020. In the last one week, the IEFX rate has been gradually shifting towards N400 after hovering around N393-N394/$ for almost five weeks. The average turnover at this window has declined by 0.8% to $56.85mn in the first eight trading days in February, compared to $57.31mn in January. Meanwhile, the parallel market appears stuck at N478-N480/$.

The IMF has released its Article IV review on Nigeria reiterating its position on the need for another devaluation of the naira, which is overvalued by at least 18% and by as much as 27%. According to the IMF, this would ease external imbalances and clear the dollar backlog. The federal government on the other hand is of the view that another naira devaluation will further stoke inflationary pressures. Bear in mind that in 2020, the CBN adjusted the official exchange rate twice from N306/$ to N360/$ and then N380/$.

Nigeria's macroeconomic challenges compounded by policy uncertainty

The Nigerian economy is challenged by rising inflation (last reported at 15.75% in December 2020), negative growth of 3.62% and high unemployment (27.1% as of Q2'20) and poverty. These have been compounded by exchange rate pressures, which have contributed to the rise in headline inflation through an increase in the import bill and an erosion of the real purchasing power of consumers. The real income of the average Nigerian has depleted by at least 25% in the last one year.

There have been calls for the adoption of a flexible exchange rate and a unification of the multiple exchange rates in the Nigerian forex market. But so far, what has been done is to ensure more convergence, with the premium between the parallel and IEFX rate reduced to N78 from as much as N110(November 2020). The CBN has had to ration its forex supply due to reduced forex inflows exacerbated by the impact of the covid pandemic on diaspora remittances and export earnings.

What next?

It is clear that the CBN is more inclined to address the issue of price and exchange rate stability with the use of more orthodox means and controls. The plethora of circulars released by the CBN ranging from the repatriation of export proceeds, to diaspora remittances and more recently cryptocurrency transactions, may be rubbing off negatively on international investors who are uncertain of the policy environment in the country and what circular may be released next. Foreign portfolio inflows into Nigeria have declined sharply partly because of covid but maybe more importantly because of policy ambiguity.

We expect the CBN to reduce its forex rationing especially with oil prices trading at $60pb. Also with money market interest rates trading above 10% for the first time in about five months, it means that liquidity in the banking system is reducing and the demand for dollars can be curtailed.

The CBN may give in to a managed depreciation rather than a one-off devaluation, i.e. a crawling peg that would effectively allow the naira to trade within a band. The crawling peg could be based on the Nigeria-US inflation differential, currently around 14.35%. This will increase transparency for investors and reduce uncertainty. It should also help bring inflation under control.

In addition, it will lead to an appreciation of the parallel market rate towards N440/$, especially if the apex bank increases its forex supply at the IEFX and retail and wholesale forex markets. The costs of imported goods sold in the supermarkets are already priced at the current parallel market rate. As forex supply improves and manufacturers can access dollars and increase their output, we should see a correction in consumer goods prices in the medium to long term.

Higher interest rates –necessary but not sufficient to curb inflation

It appears the era of low interest rates has finally come to an end. Nominal interest rates are gradually increasing in the Nigerian money markets on tighter liquidity. So far in 2021, the average opening position of banks has fallen by 12.6% to N479.68bn, relative to December's average of N548.85bn. This is on the back of the CBN's increased mopping up activities.

The CBN is seen to be using more of its traditional monetary policy tools such as OMO bills, CRR debits, etc to address price and exchange rate stability while keeping its benchmark interest rate unchanged. The outcome has been an increase in the yields of secondary market OMO bills from as low as 1.5% to a range of 7% to 10.1%[1]. Also, short term money market rates of OBB and ON have increased to above 10% for the first time since a brief stint in September 2020.

Implications

There is an inverse relationship between interest rates and stock prices. As returns on investment (yields) start to increase, there will be a gradual shift from equities to the fixed income market. This is also occurring at a time when corporate earnings are being released. A combination of weak corporate results and a rise in interest rates could be the pin that finally bursts the stock market bubble.

The reduction in naira liquidity and resultant increase in interest rates will reduce the demand for dollars. This is positive for exchange rate stability and should lead to an appreciation of the naira and reduction in imported inflation.

[1]As at February 4's OMO auction


STAY
safe

Multidimensional poverty and insecurity are inextricably linked

Growing insecurity in Nigeria in recent years has coincided with rising poverty levels as Nigeria now has an estimated 91 million people (43% of its population) living in extreme poverty (less than $2 a day)[2]. This is up 29% from 70 million in 2016 and this is projected to reach 106.6 million by 2030. Nigeria is now regarded as the world's poverty capital. The twin shocks of the coronavirus pandemic and the oil price collapse triggered another economic crisis. Like most oil shocks in the past, it was followed by worsening external imbalances and a devaluation of the naira. Every naira devaluation has pushed more and more Nigerians into poverty as the country's import dependency for its consumables means the average consumer can afford less than he used to. The poor got poorer while inequality widened. The poverty of today is as a result of low investment in the education sector of 10 years ago. This is evident in the number of out of schoolchildren (41mn according to the UNICEF). This implies that one in every five of the world's out of school children is in Nigeria.

[2]https://worldpoverty.io/map

Insecurity pushes Nigeria on the Brink

Nigeria is currently grappling with security challenges ranging from farmer/herder clashes, cattle rustling, banditry, kidnapping and the Boko Haram insurgency. The situation has deteriorated significantly since 2017 with most of the incidents occurring in northern Nigeria and the middle belt. The disruption to lives and livelihoods and the surge in the number of internally displaced people is on the verge of triggering a humanitarian crisis. Many displaced people are being prevented from accessing vital services such as healthcare, and farmers are unable to plant or harvest crops. In some cases, armed bandits insist on payments before farmers can have access to farmlands in the planting season. They return during the harvest season and extort farmers for further payments before any access is granted. This has led to scarcity and a surge in the prices of certain food commodities. According to ReliefWeb, as much as 5.1 million Nigerians are at high risk of being critically food insecure between June-August 2021. This situation is exacerbated by a second wave of COVID-19 in which Borno, Adamawa, Yobe states (Boko Haram hotspots) have recorded new cases.

What began as localized clashes between farmers and herders over access to land has degenerated into a major conflict and loss of lives across the north. In late 2020, dozens of rice farmers were massacred in Borno state – their crime was cooperating with the military. Boko Haram extremists have claimed responsibility for the attacks. According to the Global Terrorism Index (GTI), Nigeria is the third most terrorized country in the world, after Afghanistan and Iraq. Total terror-related deaths were estimated at 1,245 in 2019 and 1,606 in 2020. Total deaths are estimated at 22,441 since 2001.[3]

Perverse Incentive

Many have pointed to rising poverty, inequality and a lack of opportunity, especially among the youth, as the major cause of insecurity. Others have also emphasized the part played by Nigeria's weak security infrastructure to tackle the menace of terrorism, banditry and kidnapping. Successful bandits and kidnappers embolden even more bandits and kidnappers. In addition, the perverse incentive system (amnesty) that seemingly rewards repentant terrorists disproportionately creates an attraction for many youths who have been conditioned by poverty and destitution to think that they have little to lose and, on the face of it, everything to gain.

[3]https://visionofhumanity.org/wp-content/uploads/2020/11/GTI-2020-web-1.pdf

Both Cause and Consequence

Poverty has both been a cause and consequence of insecurity. In times of heightened insecurity and instability, the danger to lives and property means increased uncertainty as businesses stay closed or offer skeletal services, consumer and investor confidence fall and business expansion is almost non-existent. Foreign direct investment (FDI) flows into Nigeria fell by 21% to $2.61bn in 2020 due to the coronavirus pandemic. This figure is expected to rise in 2021 but will be held back by rising insecurity. Insecurity also delays the construction of critical transport infrastructure, which should, ordinarily, improve logistics and bolster economic growth. It is also noteworthy that insecurity has risen sharply in northern Nigeria, where populations are poorer and state governments get less revenue for sharing.

The resolution of multidimensional poverty remains one of the biggest challenges facing Nigerian policymakers today. It is one that an entrenched system that promotes sharing rather than production has so far failed to tackle. Nigeria's weak economy is a consequence of its over-reliance on oil & gas and its failure to strengthen its institutions and invest in infrastructure. Empirical evidence from countries with success stories in pulling millions of people out of poverty, like China, points to sustained economic growth over extended periods as the barest minimum required. China achieved double-digit GDP growth rate over two decades through economic reform and policies that created jobs and alleviated poverty in rural China, and the provision of social welfare. It never had to face issues bordering on insecurity – at least not on the scale being witnessed in Nigeria.

Ticking time bomb

Nigeria's high unemployment (27.1%), large youth population and poverty rates mean it is effectively seating on a massive keg of gun powder. Plans to combat insecurity without tackling poverty and its root causes would be dead on arrival. Both plans must reinforce each other. The incentive to commit acts of terror and banditry must be outweighed by the threat and consequence of being caught. Pro-poor growth strategies and social welfare are crucial to alleviating poverty, but the government also needs to strongly expand its anti-terror capabilities and create a strong disincentive to the perpetrators.

A change of guard at the top of the military does in fact signal that the FG acknowledges that it could have done more in the past to end the stalemate with Boko Haram and it now intends to. Its success is critical to achieving sustainable economic growth in Nigeria.

Global Perspective- culled from the FT

African countries look beyond west for vaccines

Continent turns to China and Russia to supplement WHO-backed Covax initiative for developing nations

African countries are looking beyond the west in the global vaccine race dominated by Europe and the US, with policymakers across the continent seeking jabs from the likes of Russia and China. Officials in countries from Kenya to Guinea are in talks with China and Russia to procure vaccines to supplement the global WHO-backed Covax facility that aims to provide developing countries with enough jabs for at least 20% of their populations.

Nigeria's drugs regulator has received dossiers for two vaccines, from Russia and India, as Africa's most populous country seeks to work around the global shortage, health minister Osagie Ehanire told reporters on Monday night. It has been hard for African countries to buy western-developed jabs as most have been pre-ordered by wealthier countries. "We have been keeping a strict eye on. . . the scramble for vaccines, which has pitched some countries against each other in Europe, as wealthy, high-income countries have pre-paid to allocate vaccines to themselves," he said. The WHO had estimated that 95% of vaccines produced thus far have gone to 10 wealthy countries.

Mr Ehanire did not name the vaccines the National Agency for Food and Drug Administration and Control was considering. But Russia has heavily promoted its flagship Sputnik V vaccine, which has shown 91.6% efficacy against symptomatic Covid-19 in clinical trials, according to a Lancet peer review released on Tuesday. Guinea and Algeria have already approved Sputnik for use.

China has made vaccine diplomacy a key aspect of its outreach to Africa over the past year, with President Xi Jinping promising in August that vaccinations for Africans would be a "priority". But while its leading Sinopharm vaccine has been approved for domestic use in China, it has yet to be delivered to the continent.

Boss Mustapha, head of Nigeria's presidential task force on Covid-19, warned that the rapid pace of vaccinations in other parts of the world could leave Nigerians unable to travel freely. "So we must try as much as possible to get ourselves on course with vaccination," he told reporters. Officials said Nigeria would receive an initial batch of 16mn doses starting this month through Covax. They expect an additional 41mn doses at the end of April via an African Union initiative that has secured 400mn doses of the AstraZeneca vaccine and 270mn additional doses for the continent.

This week, South Africa took delivery of its first batch of Covishield, the Indian name for the Oxford-AstraZeneca vaccine made by the Serum Institute of India. Pretoria ordered 1.5mn doses to immunize health workers after domestic criticism that it was relying too heavily on deliveries from Covax.

Richard Mihigo, coordinator of immunization and vaccine development at the WHO regional office for Africa, said that between Covax deliveries and their own bilateral purchases, African nations could realistically aim to immunize 30-35% of their populations by the end of the year.

Patrick Amoth, director-general for health at Kenya's health ministry, said Nairobi was working with Covax to secure some 20mn free doses this year. However, he said the country was in talks with China, Russia, and India about other vaccines. "We will end up with a hybrid system where we have a variety of vaccines," he said.

There have been concerns about Africa's cold-chain capacity but the AU, along with both national and state governments, has said that local refrigeration capacity had been boosted in recent months.

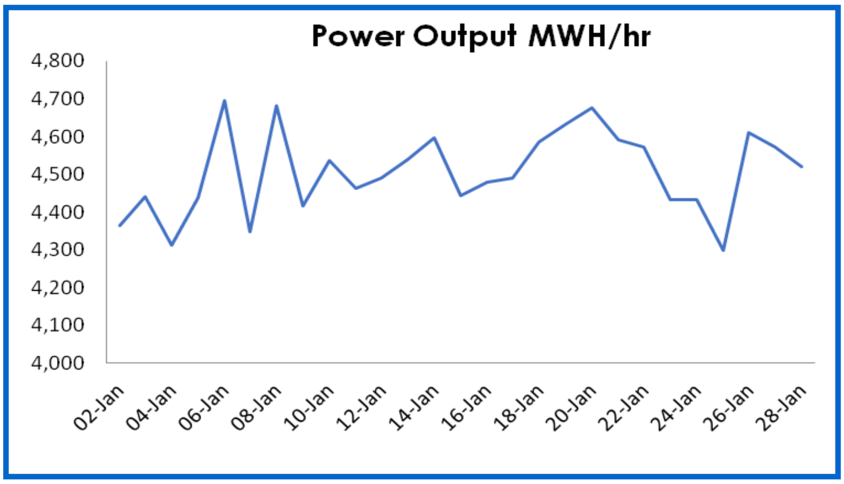
Ethiopian Airlines, Africa's largest carrier, which has funneled medical equipment to countries across Africa and Latin America, has established an air bridge to transport cold vaccines from Shenzhen in China to Addis Ababa. From there, the jabs could be distributed across Africa, the airline said.

Africa has so far escaped the worst of the pandemic, recording just 4% of global deaths for 17% of the global population, according to official figures. However, it is currently experiencing a second wave worse than the first.

Macroeconomic Indicators
Jan 2nd – 28th

Power Sector

Average power output was flat at 4,502MWh/h, 0.04% lower than the average of 4,504 MWh/h in the corresponding period in December 2020. During the review period, the major constraint to the sector was gas supply, which restrained the ability of many thermal power stations to generate power optimally.



[4]

Outlook

As the dry season continues, we expect a decline in hydropower generation. Gas constraints will continue to limit total power output from the grid. We expect average power supply to remain within the range of 4,500MW to 5,000MW.

Impact

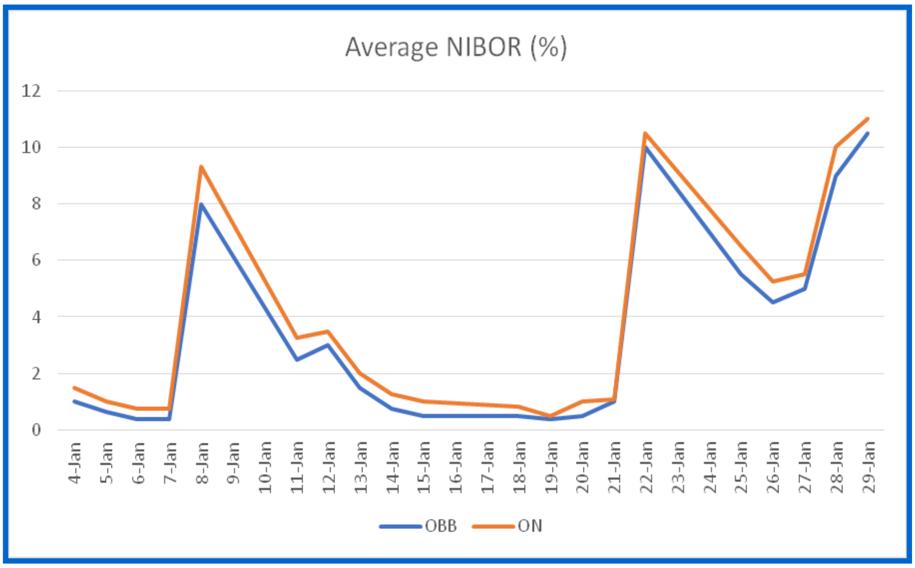
Epileptic power supply remains a bane to the productivity and output of manufacturers and SMEs. A decrease in power supply will increase the cost of production for firms and households. It will also increase the use of alternative energy, which is more costly.

Money Market

Average money market interest rates (OBB and ON) increased by 237bps to 3.55% in January 2021 from 1.18% in December 2020. This was due to reduced liquidity in the system as the average opening position of banks fell by 0.2% to N547.77bn from N548.85bn in December.

[4]FGN

So far in February, short-term interbank rates have gradually increased to 12.5% (OBB) and 13.5% (ON)[5] due to increased mopping up by the CBN. The apex bank has issued a sum of N353.41bn in OMO bills cumulatively this year.[6] Secondary market treasury bills (OMO) are also higher in comparison to their December levels. The yields at the last OMO auction of February 5 ranged between 7.5% and 10.1%.



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Outlook

The CBN has been using its traditional tools of monetary policy to tighten liquidity in the money markets (OMO bills, forex sales, CRR debits etc). We expect this trend to continue, leading to reduced system wide liquidity and a further rise in interest rates.

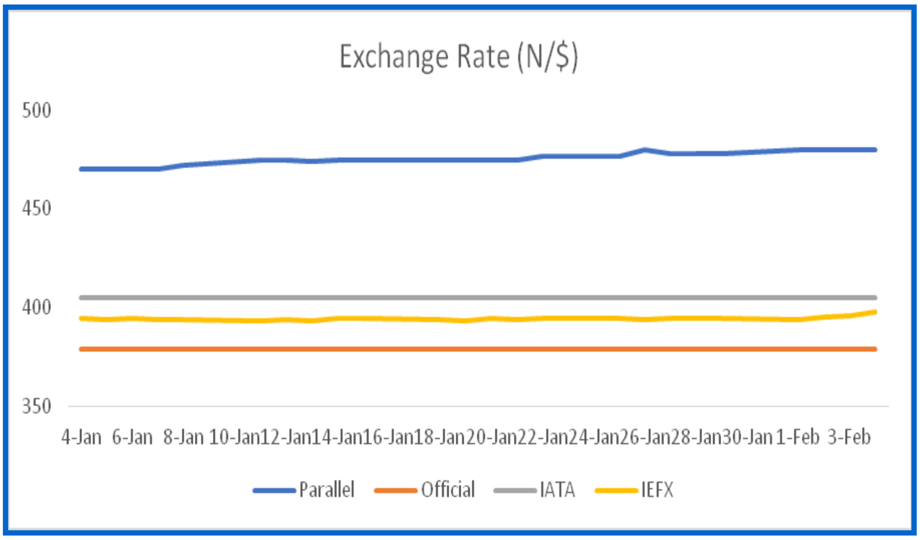
Impact

The gradual increase in interest rates may be an indication that the low interest rate era has finally ended. This will trigger an outflow from the Nigerian equities market that had been a major beneficiary of the era. In addition, there is an inverse relationship between higher interest rates and stock prices. The government, who also benefitted from low interest rates, will begin to face a higher debt service problem as servicing the domestic debt in a rising interest rate environment becomes more expensive. The impact of our projection is also expected to mitigate the demand-pull inflationary pressure as money supply falls.

[5]As at February 4
[6]As at February 4
[7]FMDQ

Exchange Rate

The naira continued to trade range bound between N393/$ and N395/$ at the IEFX window. Average daily turnover in January was $57.31mn, 80.74% lower than the corresponding period in 2020 ($297.49mn) and 63.36% lower than December ($156.41mn).[8] The parallel market rate oscillated between N470 and N480 against the dollar. The CBN has maintained its forex sales at the retail and wholesale forex markets. In addition, the CBN's forex rationing has forced manufacturers to use a blended rate of the parallel and IEFX rates, which is estimated at an average of N420-N430/$.



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Outlook

The full resumption of business and economic activities has led to a resurgence in forex demand pressures. This is expected to build up especially with the recent depletion in external reserves.

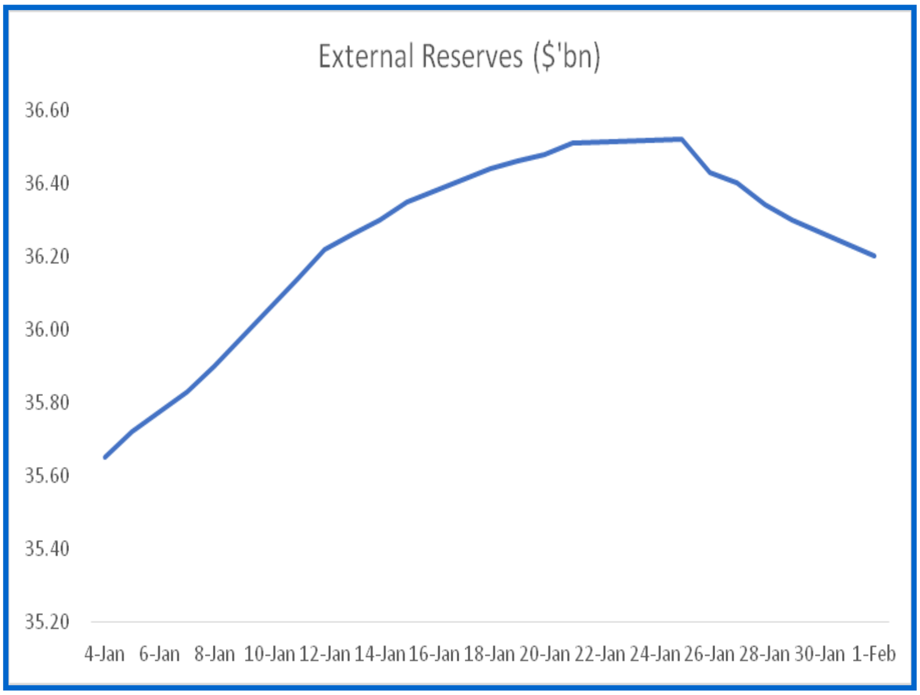
Impact

The impact of a weaker currency will be felt in the cost of imported goods.

External Reserves

Nigeria's gross external reserves maintained an increasing trend in the month of January before easing marginally towards the end to $36.3bn (December 31 2020: $35.37bn). Higher oil prices have supported the accretion in the external reserves level. However, as forex demand pressures resurface, we expect to see the impact on the external reserves level. The imports and payments cover increased to 9.04 months from 8.81 months at the end of December.

[8] FMDQ
[9] FMDQ, Aboki FX



[10]

Outlook

Oil prices are trading close to $60pb. This will support the reserves level. However, the Eurobond repayment of $500mn when deducted will limit the pace of accretion. In addition, the degree to which the CBN addresses the forex backlog amid lower forex inflows will determine the trajectory of the external reserves.

Impact

The external reserves is one of the many economic indicators used to determine the macroeconomic performance of a country. If the reserves level continue to decline amid rising dollar pressures and limited forex inflows, this could raise some eyebrows and lead to uncertainty about the Nigerian market.

[10] CBN, FDC Think Tank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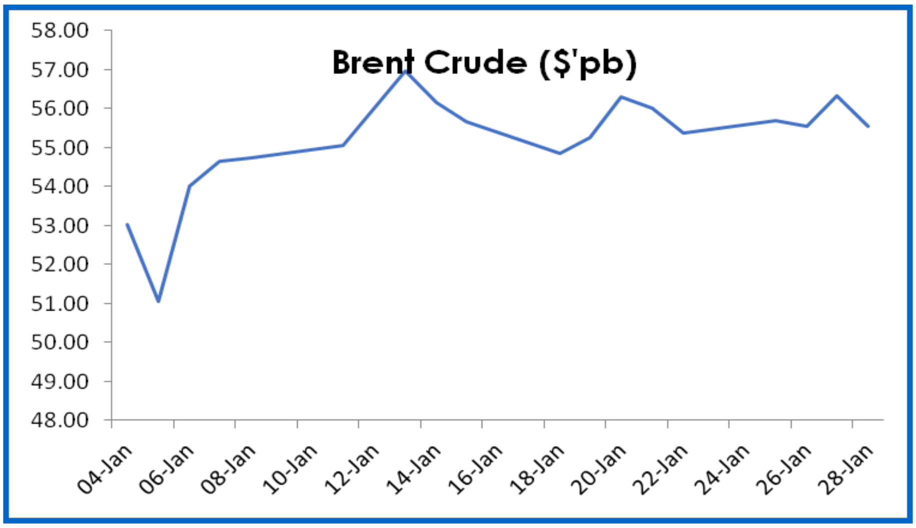
Commodities Market - Exports

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

Oil Prices

On average, oil prices have increased by 9.77% to $55.17pb in January from $50.26pb recorded in the corresponding period in December 2020. So far in February, oil prices have traded close to $60pb, on supply tightening. OPEC members' compliance to the output cuts is almost 100% and major OPEC members (Saudi Arabia and Iraq) have pledged to reduce their production levels. This is in spite of the cartel and its allies' agreement to ease production by a total of 150,000bpd in February and March.



[11]

Outlook

We expect oil prices to remain around an average of $55 and $60pb in the next six to 8 weeks on supply tightening and hopes of a recovery in global oil demand as more countries get the COVID-19 vaccines.

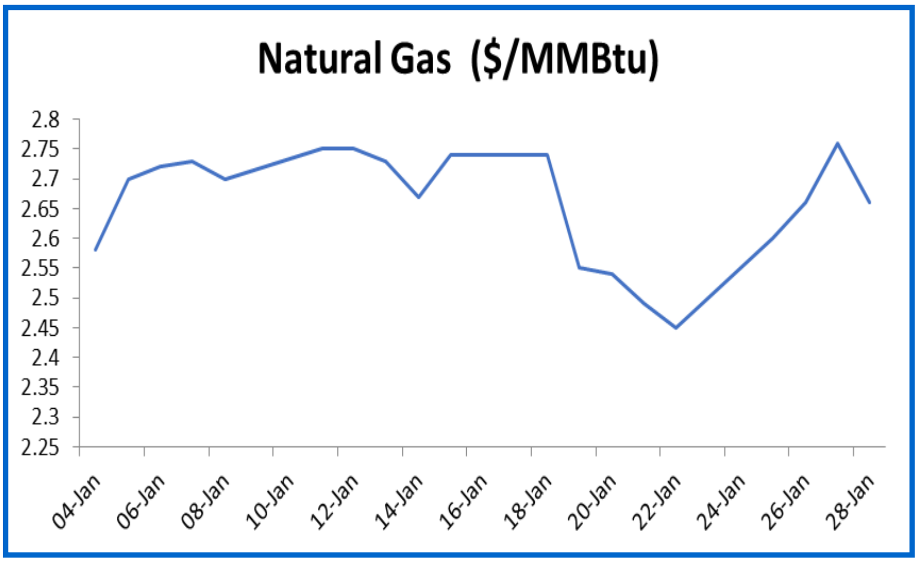
Impact

While higher oil prices are positive for the country with respect to increased fiscal and external revenues, it has a more dire impact for the average Nigerian. This is because higher oil prices imply a possible increase in petrol prices. Nigeria's refining capacity is almost nonexistent and the country imports all its refined products. Thus, higher oil prices coupled with a weaker currency will increase the landing costs of fuel and ultimately the pump price of petrol. This means that transport fares could increase further.

[11]Bloomberg, FDC Think Tank

Natural Gas

In tandem with global oil prices, the average price of natural gas increased by 2.32% to $2.65/mmbtu in January from $2.59/mmbtu in the corresponding period in December. So far in February, the average price of natural gas has climbed 7.92% to $2.86/mmbtu. The rally in LNG price has been largely supported by increased demand for heating due to the winter season in Europe, US and Canada.



[12]

Outlook

The price of natural gas could maintain the upward trend on the rising demand for heating and signs of possible supply shortages from Canada and the US.

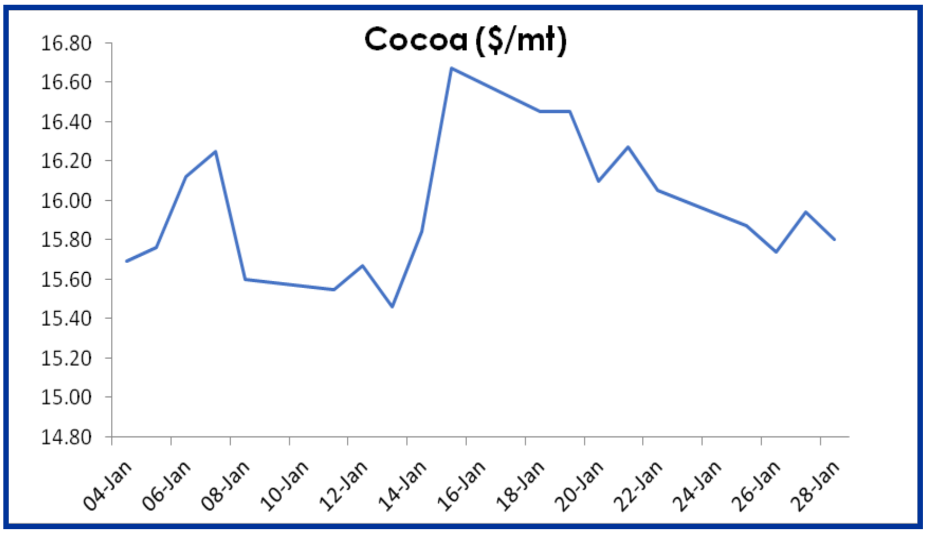
Impact

The rise in the global price of LNG will positively affect Nigeria's LNG export earnings.

Cocoa

The average price of cocoa fell by 1.67% to $2,529/mt during the review period from an average of $2,572/mt in December. The price fall was primarily due to the pandemic despite unfavorable weather conditions in Ivory Coast (largest cocoa producer globally) that affected global supply.

[12]Bloomberg, FDC Think Tank



[13]

Outlook

Low demand for chocolates, as major cocoa importing countries remain in strict lockdowns, will continue to dampen the price of the commodity.

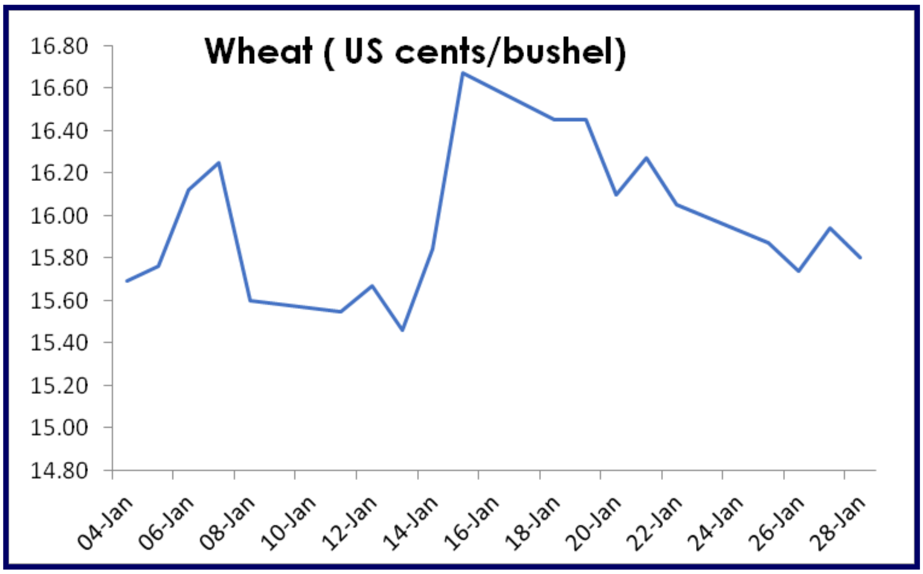
Impact

A fall in global cocoa prices will negatively affect Nigeria's cocoa export earnings.

Imports

Wheat

On the average, wheat prices increased by 9.59% to $655.47/bushel during the review period from $598.13/bushel in the corresponding period in December 2020. Russia, one of the largest producers of wheat, is imposing a tax on its wheat exports. This coupled with increased stockpiling by countries, as a result of the lockdown, has contributed to the price increase.



[13]Bloomberg, FDC Think Tank

Outlook

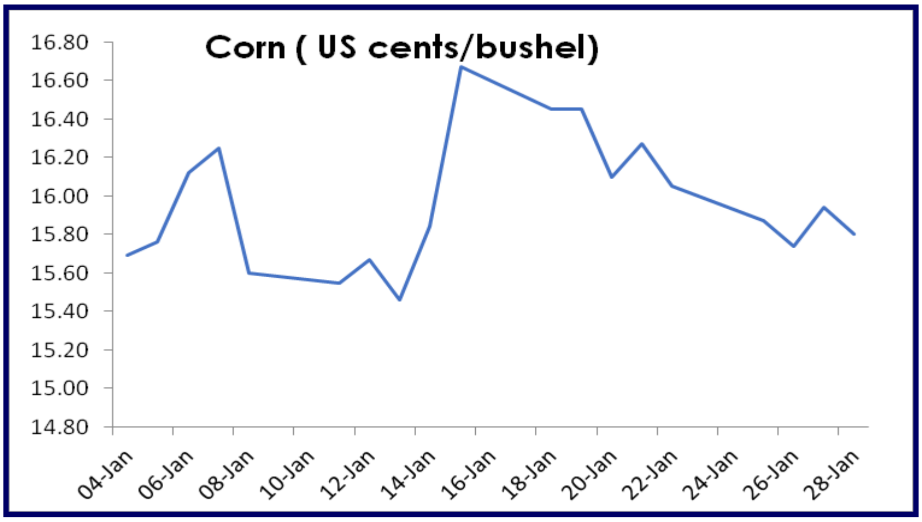
Wheat prices will remain elevated as a result of Russia's wheat export tax and growing demand for the commodity.

Impact

Wheat is one of Nigeria's major agricultural imports and a key ingredient in making flour. This means that the cost of a bag of flour, priced at N14,500 per 50kg bag, could increase. More so, flour millers are forced to use a blended rate of the IEFX and parallel market due to the dollar dearth. The prices of end products such as bread will either increase as a result, or the size and quality reduced to reflect the increase in the cost of wheat and other raw materials.

Corn

Corn prices averaged $513.61/bushel during the review period, 19.39% higher than the average of $430.20/bushel recorded in the corresponding period in December. The increase in price was as a result of high demand for ethanol by China.



[14]

Outlook

Panic buying by consumers in a bid to stock up basic staples could cause an increase in corn prices in Q1.

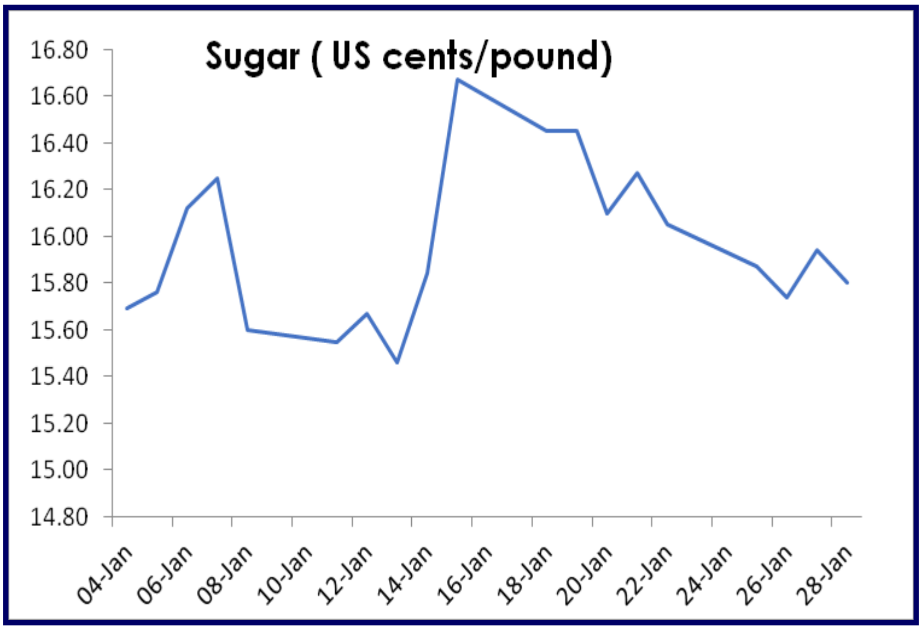
Impact

An increase in the price of corn will increase the import bill of the country. It will also increase the cost of production of firms who depend on grains for their production.

[14]Bloomberg, FDC Think Tank

Sugar

Like the other commodities, the average price of sugar gained 9.69% to $15.96/pound in the review period compared to the average of $14.55/pound in the corresponding period in December. This was due to a fall in Brazil's sugar production level. Brazil is the world's largest producer of sugar.



[15]

Outlook

Lingering supply shortages in Brazil will keep sugar prices high in the short term barring a pick up in demand.

Impact

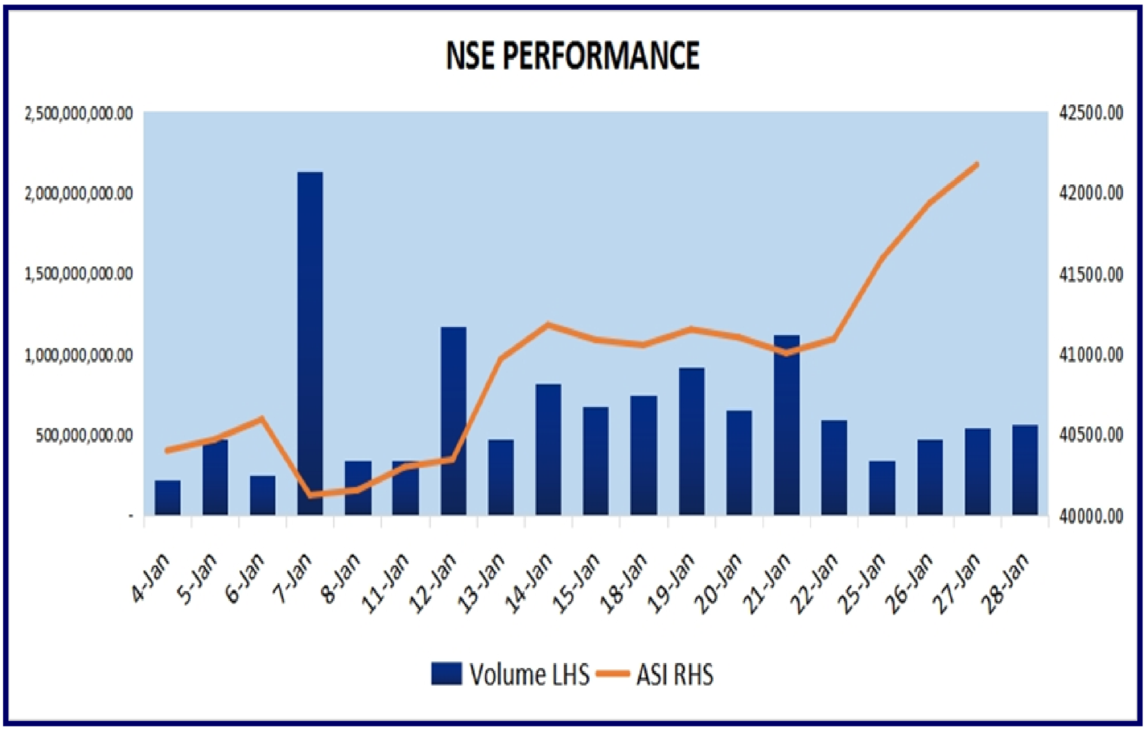
Nigeria imports sugar. Higher sugar prices increases the cost of imported sugar such as St Louis. This will lead to a shift to cheaper local brands such as Dangote and Flour Mills of Nigeria.

[15]Bloomberg, FDC Think Tank

Stock Market Review

The Nigerian bourse continued its positive performance in January as it gained 4.71% to close at 42,169.41 points on January 28th from 40,270.72 points on December 31st. Similarly, market capitalization was up 4.70% (N990bn) to N22.05trn relative to its close of N21.06trn on December 31st. The market gained 4.71% during the month. In the 19 trading days of the review period, the market gained in 13 days and lost in 6 days.

The NSE traded at a price to earnings (P/E) ratio of 16.05x as of January 28th, 5.66% higher than the close of December 31st (15.19x). The market breadth was positive at 3.29x as 79 stocks gained, 24 lost while 58 stocks remained unchanged.



[16]

Market activity level was mixed in the review period. The average volume traded rose by 41.26% to 671.26mn units from 475.19mn units in the previous month. Meanwhile, the average value of trades declined by 12.23% to N5.24bn from N5.97bn in the review period.

[16] NSE and FDC Think tank

[17]

The sector indices were broadly positive during the review period. The insurance sector gained the most (28.60%), followed by the oil & gas (11.73%), banking (7.34%), consumer goods (6.70%) and industrial (1.49%).

Champion Breweries Plc topped the gainers' list with a 229.07% increase in its share price. This was followed by Livestock Feeds Plc (79.14%), Linkage Assurance Plc (73.08%), Mutual Benefits Assurance Plc (70.37%) and NCR Nigeria Plc (59.18%).

TOP 5 GAINERS

Company	Dec-31 (N)	Jan-28 (N)	Absolute Change	Change (%)
Champion Breweries Plc	0.86	2.83	1.97	229.07
Livestock Feeds Plc	1.39	2.49	1.10	79.14
Linkage Assurance Plc	0.52	0.90	0.38	73.08
Mutual Benefits Assurance Plc	0.27	0.46	0.19	70.37
NCR Nigeria Plc	1.96	3.12	1.16	59.18

The laggards were led by Deap Capital Management and Trust Plc (-20%), FTN Cocoa Processors Plc (-16.67%), Oando Plc (-13.51%), John Holt Plc (-11.76%) and Neimeth International Pharmaceuticals Plc (-11.21%).

[17] NSE and FDC Think tank

TOP 5 LOSERS				
Company	**Dec-31 (N)**	**Jan-28 (N)**	**Absolute Change**	**Change (%)**
Deap Capital Management and Trust Plc	0.25	0.20	0.05	-20.00
FTN Cocoa Processors Plc	0.66	0.55	0.11	-16.67
Oando Plc	3.70	3.20	0.50	-13.51
John Holt Plc	0.51	0.45	0.06	-11.76
Neimeth International Pharmaceuticals Plc	2.23	1.98	0.25	-11.21

Company	Topline	PBT	PAT	EPS
Airtel Africa Plc	\$2.85 billion (13.10%) ↑	(\$501 million) (3.79%) ↓	(\$261 million) (21.15%) ↓	5.5 cents (36.05%) ↓
Ecobank Transnational Incorporated Plc	N828.96 billion (1.61%) ↓	N65.46 billion (55.33%) ↓	N35.88 billion (63.93%) ↓	0.778 kobo (99.72%) ↓
Stanbic IBTC Holdings Plc	N234.45 billion (0.27%) ↑	N94.72 billion (4.17%) ↑	N83.21 billion (10.90%) ↑	N7.29 (5.35%) ↑
FBN Holdings Plc	N386.58 billion (10.50%) ↓	N78.11 billion (3.75%) ↑	N65.94 billion (0.15%) ↓	N2.18 (11.79%) ↑
Coronation Insurance Plc	N17.45 billion (9.75%) ↑	N918.76 million (3788.11%) ↑	N759.27 million (254.25%) ↑	3.16 kobo (58%) ↑
Unilever Nigeria Plc	N61.57 billion (1.34%) ↑	-N1.96 billion (77.36%) ↑	-N1.59 billion (62.32%) ↑	N0.28 (62.16%) ↑

Outlook

We expect the NSE performance to be influenced by the release of more corporate earnings in the coming months.

Corporate Focus- Okomu Oil Palm Plc

Analyst Note

Okomu oil palm plc, one of the two local oil palm processing companies in Nigeria released its unaudited financial statement for FY'20 in January. The company's turnover rose by 24.06% to N23.41bn in FY'20 from N18.87bn in the corresponding period in 2019. This reflects the company's resilience despite the challenges posed by the coronavirus pandemic.

Market Capitalization: N88.71bn

Current Price: N93.0 per share

Industry: Consumer Goods

Sustained top and bottom-line growth despite higher operating costs

Okomu oil palm Plc was able to sustain a positive performance, in terms of revenue and profit after tax, despite the pandemic-induced increase in its operating costs. The company's net operating expenses increased by 28.16% to N7.19bn in FY'20 from N5.61bn in FY'19 while the cost of sales margin remained above 65%. In 2020, the gross profit margin was 67.11% compared to 68.8% in FY'19. The decline in the gross profit margin in FY'20 despite a 30.73% increase in the cost of sales can be largely attributed to the higher turnover during the period.

Okomu oil palm Plc's profit before tax rose by 12.37% to N8.45bn in FY'20 from N7.52bn in FY'19. In the same vein, profit after tax was 46.34% higher at N7.39bn from N5.05bn in FY'19 as lower tax deductions in FY'20 bolstered earnings.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Industry Overview

Nigeria used to be the biggest oil palm producer in 1990 before Indonesia took over in recent years. Currently, it is the fifth largest producer of palm oil globally, supplying less than 2% (1.45%) of the global production. However, the country is the largest producer in Africa (1.02mmt in 2019).

Crude palm oil (CPO) exports were also one of Nigeria's major exports and forex earner. Domestic demand of CPO is about ₦9.88bn, far in excess of the domestic supply. Hence Nigeria is still a net importer of crude palm oil. The Nigerian palm oil industry has been a major beneficiary of the government's protectionist policy, particularly as it is featured among the list of items banned from accessing foreign exchange from official sources. This is consistent with the government's policy to discourage the importation of products that can be produced locally.

However, the border closure which lasted for 16 months, favoured domestic production of commodities. This boosted the company's performance and sustained its positive double-digit growth on solvency.

The oil palm industry can provide both unskilled and skilled employment for millions of Nigerians if there is increased focus on commercial large-scale production. Most companies in this industry are currently focused on their expansion projects, and have been investing to increase their arable land area and milling facilities over the last three years to meet up with rising domestic demand amidst several business challenges.

The major business challenges remain unlevelled playing fields, illegal importation of crude palm oil through Nigeria's porous borders. Others include illegal taxes and tolls, insecurity and poor infrastructure in terms of road network, port delays and epileptic power supply. These have resulted in higher operating costs mainly from maintenance costs for generators and vehicles. The most recent challenge, which is also affecting the global market, is the COVID-19 pandemic that has led to supply disruptions and low demand.

The Nigerian Agricultural industry is highly fragmented with several small scale farmers. However, the oil palm space is dominated by three main players - Okomu, Presco and PZ Wilmar. The industry is categorized by hectares into: large estate plantations, medium and small-scale plantations and semi natural groves. Both Presco plc and Okomu Oil palm plc are classified as large estates plantations, and are the only two palm oil companies listed on the Nigerian Stock Exchange.

The global demand for palm oil has declined sharply due to the impact of the pandemic on the commodities market. The two largest producers of the commodity, Indonesia and Malaysia, were forced to impose lockdowns as a result of the pandemic. The global oil palm market is expected to remain weak in the short term. This is subject to a quick recovery of economies.

Company Overview

Okomu oil palm plc, is an integrated agricultural company with oil palm plantations, mills, crushing plants and oil refining plants. Its major sources of revenue are income from sales of palm oil and rubber production, while revenue from services remains insignificant. The company started out as a federal government pilot project in 1976, before becoming incorporated in 1979 as a limited liability company. It began infrastructural developments at the end of 1989, when its 5,055 hectares (ha) land was planted. Okomu has grown to become a leading oil palm company in Nigeria. Okomu is a subsidiary of the Socfina Group, and benefits from its main shareholder Socfinaf S.A. This is a company based in Luxemburg that brings almost a century of sound technical industry knowledge in the cultivation of oil palm and rubber plantation.

Governance Structure

The Board is chaired by Mr. Gbenga Oyebode, while the Managing Director (MD) is Dr. G.D. Hefer. Most of Okomu's directors have long years of service to the company, and also serve concurrently as members of other companies, but not companies that operate similar businesses to Okomu that could possibly create conflict of interest.

Chairman

Mr. Gbenga Oyebode

Managing Director

Mr. Graham Hefer

Risk and outlook

We have identified the business operation of this company to be a volume- led business model, which is synonymous with businesses of its kind in the consumer goods space. It is worth noting that prices in the international market greatly define the price direction of the two products the company produces (palm oil and rubber), which can significantly affect the overall performance of the company. Illegal importers of these products will continue to benefit from lower international prices of CPO and a weak local currency, which would be a potential threat to Okomu oil palm plc. In addition, heightened insecurity risk could affect production of palm oil. One of the palm oil producing states in Nigeria is Ondo and it has been rife with clashes between herdsmen and farmers.

Bulls and Bears

Bulls Say:

- Leading player in the Nigerian oil palm market
- Diversified revenue stream (addition of service revenue stream and increased investment in the rubber market)
- The growing demand for crude palm oil and its derivative products
- Favorable government policies towards the agricultural sector
- Strong market presence
- Multiple entry points and appeal to the market
- Land expansion initiatives to broaden the revenue base

Bears Say:

- Declining commodity prices particularly rubber
- High operating cost (Epileptic power supply)
- High rate of smuggling
- Dilapidated infrastructure
- Intense competition from leading players such as Presco, PZ Wilmar, as well as international players like Olam
- Change in government policies could affect the competitiveness of companies in the agricultural sector, particularly the palm oil sector
- Persistent macroeconomic headwinds could dampen consumer demand for palm oil products
- Insecurity in palm oil producing states

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Economic Outlook for the next six to eight weeks

The Q4'20 GDP growth numbers are scheduled to be released on February 22, while the inflation numbers are expected much earlier. We are estimating a negative growth rate of 4.6%, which will bring full year 2020 growth to -3.1%. Inflation numbers for January are also expected to increase further crossing the 16% threshold on base year effects, supply shortages and higher imported inflation.

The gradual increase in interest rates are expected to continue and this coupled with the release of more weak corporate earnings, will impact negatively on the performance of the Nigerian stock market.