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CONTENTS

THE NEW VAT REGIME IN NIGERIA - IMPLICATIONS FOR GOVERNMENT FISCAL BALANCES

Tax administration in Nigeria

Budget deficits have become a recurring reality in Nigeria's annual budget discourse. The question has often been asked: which is more pertinent to the Nigerian fiscal situation - to expand the tax base by bringing increasing numbers of potential taxpayers into the tax bracket, or to deepen it further by extracting more tax revenue from the existing narrow base? Questions around the size of the tax base, tax compliance rate and tax-to-GDP ratio remain topical issues in Nigeria's tax administration system.[1] Given Nigeria's recurring budget deficits, the question then is how can the government leverage its value-added tax (VAT) rate of 7.5% to boost its fiscal balances?

As a critical component of the tax revenue base, the contribution of VAT has been growing in importance over the years, recently accounting for a bigger chunk of total tax revenue. According to data from the Federal Inland Revenue Service and the National Bureau of Statistics, the government realised over N1.53trn as VAT in 2020, making it the highest and fastest growing tax line.

TAX TRENDS IN NIGERIA, 2017-2021

Tax Type	2017	2018	2019	2020	2021
PPT (N'bn)	1520.49	2467.58	2114.27	1516.99	2008.45
Non-oil (N'bn)	1262.01	1444.71	1650.80	1533.11	1939.53
VAT (N'bn)	972.35	1108.04	1189.98	1531.57	2072.85

Source: NBS, 2022[2]; FDC Think Tank

[1]Tax-to-GDP ratio refers to total tax revenues, including compulsory social security contributions as a percentage of gross domestic product (GDP). See https://data.oecd.org/tax/tax-revenue.htm
[2]National Bureau of Statistics (2022), "Value-Added tax". https://nigerianstat.gov.ng/elibrary/read/1241222

Value-added tax in Nigeria

Introduced as a replacement for the sales tax in 1993, the potential of VAT to contribute to the broadening of the tax base, and by extension, to government's fiscal balances is significant. Being a consumption tax levied on most final goods and services with in-built incentives for businesses to collect receipts from suppliers, VAT can be a very potent tool in the nation's tax arsenal if a simpler, more effective tax administration system can be put in place.

Implications of the enhanced VAT regime for government's fiscal balances

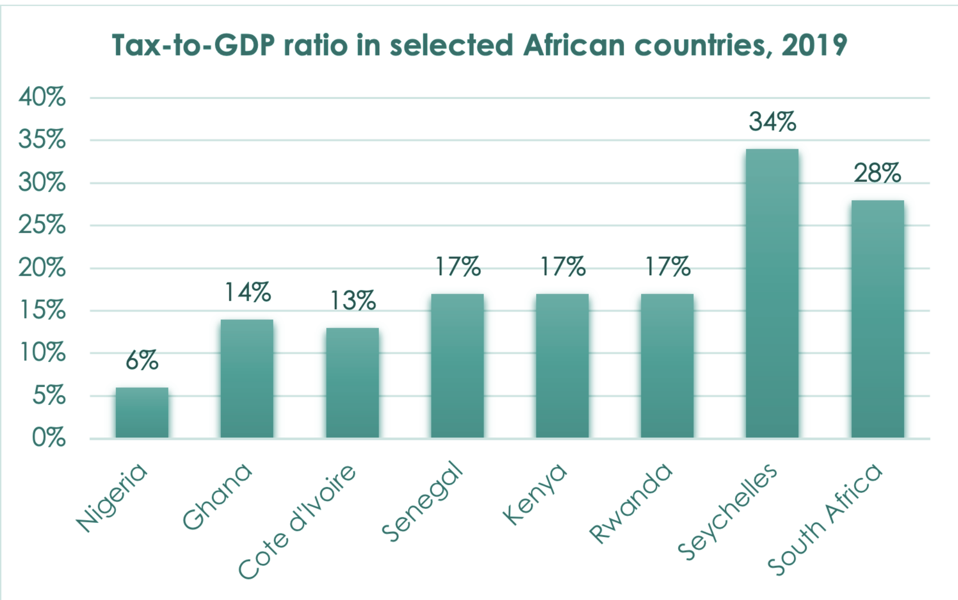
Nigeria's fiscal balances remain sub-optimal amid strong economic headwinds exacerbated by constrained crude oil output and elevated debt service obligations. According to the Ministry of Finance, debt service commitments almost surpassed government revenue in 2021. This is simply unsustainable if the country is to set aside resources for the critical investments required for the smooth take-off of the country towards sustainable economic growth and development.

Nigeria's tax-to-GDP ratio remains abysmally low (averaging 6-8%) relative to its peers in Sub-Saharan Africa, and far below the minimum desirable threshold of 15% tax-to-GDP ratio recommended by the World Bank and IMF for developing economies. Empirical evidence points to the positive correlation between access to public services and tax compliance rates. A case in point is Rwanda where significant tax policy and tax administration reforms have resulted in impressive outcomes for the country over the last decade, showcasing the capacity of effective tax administration systems to boost government revenue significantly.[3]

Sweden is another good example of where the tax compliance rate is one of the highest in the world. The reason for this state of affairs is not far-fetched: the Swedish Government provides a significant amount of social safety benefits to the citizenry compared to the rest of the western world. These include, but are not limited to state-funded healthcare and education through university, generous cash assistance for those who lose their jobs and up to 480 days of parental leave between couples who have a new child.[4] Given the foregoing scenario, the Swedish taxpayer is therefore incentivized to be tax compliant and this has far-reaching implications for the relatively low incidence of tax avoidance and tax evasion in the country.

In light of the significant potential of the enhanced VAT regime to contribute to government revenue more robustly, what lessons can Nigeria draw from the experiences of Rwanda and Sweden? It is noteworthy that payment of taxes is still largely the exception rather than the rule in Nigeria, even among the enlightened elite class. The reasons are quite varied – from low levels of awareness among the citizenry to deliberate tax evasion. With questions around the judicious application of tax proceeds towards societal development, tax administration in Nigeria still largely underperforms its potential.

FIGURE 2. TAX-TO-GDP RATIO IN SSA



Source: OECD; FDC Think Tank

[3]Mascagni, G and Nell, C (2021). Tax Compliance in Rwanda: Evidence from a Message Field Experiment. Economic Development and cultural change. https://doi.org/10.1086/713929
[4]Jenny Jannson (2018). "Creating Tax-Compliant Citizens in Sweden: The Role of Social Democracy". https://doi.org/10.1093/oso/9780198796817.003.0003

Policy implications and recommendations

A good first step is for the government to win the trust of Nigerians by raising the awareness level regarding the benefits that accrue from the payment of taxes. Government should also embark on projects that impact the well-being of the citizenry more directly. Government must not only be more prudent in the use of public resources, but must be seen to be truly transparent and accountable to the citizens. In this regard, it is imperative for the nation's tax system to continue to leverage the power of digital not only as a veritable frontier for opening up new or under-utilized sources of taxation, but also for improving the credibility of the tax system generally in Nigeria.

In a similar vein, an enabling environment that supports the competitiveness of Nigerian businesses must be pursued with all the seriousness it deserves. This calls for streamlining the current tax system to reduce the incidence of multiple taxation which constitutes a huge burden on tax-compliant businesses in the country and serves as a disincentive to potential taxpayers, especially among the informal sector of the economy where the vast majority of Nigerian businesses are domiciled.

The way forward

Given the huge gap between Nigeria's current fiscal position and where it ought to be If it must meet the Sustainable Development Goals (SDG 2030), the need for the government to ramp up its tax revenue cannot be over-emphasized. To this end, every step should be taken by the government to not only broaden the current tax base, but also be intentional about justifying the social contract entered into with Nigerians by ensuring the judicious application of tax resources towards the consistent improvement of Nigeria's Human Development Index (HDI) going into the future.

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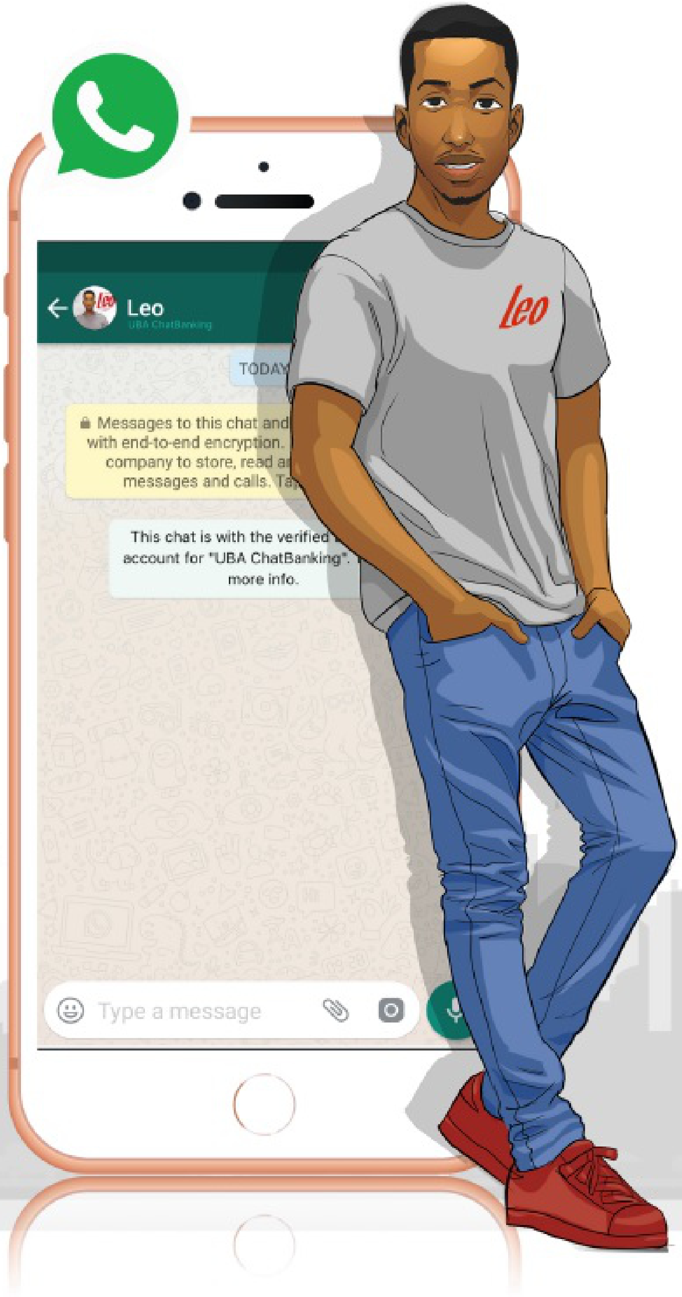

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DEVELOPING THE WHEAT VALUE CHAIN

Nigeria imports about 4.7 million tonnes of wheat annually to fill its demand gap. As wheat imports have become scarce, due to the global economic crisis, flour millers in Abuja have been increasing wheat flour prices and most bakeries in the North and Southwest, have either temporarily shut down or laid off some workers, further increasing unemployment and buoying inflation. It is imperative to note that Nigeria has the appropriate land to become wheat self-sufficient, but to achieve this, local farmers must be trained and educated on modern irrigation methods and Improved seeds. Farmers must have access to credit facilities, and extension services, such as regular training, and facilitation must be provided.

Nigeria's wheat demand is about 1.29 trillion tonnes in 2021 from 756.92 billion tonnes in 2020. Yet, it only produces 60,000 tonnes of wheat from 60,000 hectares of cultivated land. South Korea, by comparison, which is one of the world's smallest wheat producers, with a total acreage of 5,224 hectares, produces 32,513 hectogramS of wheat per hectare and 16,985 tonnes in total.[5] Thus, with 8.71% less cultivated land, it yields 3,251.3% more per hectare than Nigeria. These figures depict inefficient land use and under production in Nigeria, as local farmers are limited to natural seedlings, despite frequent development of improved seedlings in the United States.

Also, Nigeria uses little or no fertilizers, insecticides and herbicides which are necessary inputs for the agricultural sector. In addition, the rising insecurity and terrorism in Nigeria has rendered several hectares of cultivatedfarmlands unavailable; farmers have abandoned their farms because of fear of attacks from herdsmen, Boko Haram, ethnic group

[5]Food and Agricultural Organization of United States. https://www.fao.org/faostat/en/#country/159

clashes, and kidnappings. These farmers are unable to produce adequate quantities to fill the supply gap, therefore creating wheat shortages and increasing the need for importation.

Training programs for local farmers

Intervention programs should be established with the purpose of educating farmers on variety seedlings and irrigation techniques to boost productivity. Egypt consumes 21 million tonnes of wheat per year, and about 15 million tonnes are imported from Kyiv and Moscow. In a bid to curb wheat import dependency, the Egyptian government has begun supplying farmers with genetically modified soybeans and maize at subsidized rates to boost production. The goal of this initiative is to increase cultivated area by two million hectares in the next three years. So far, Egypt has succeeded in planting an additional 250,00 hectares. Production average per hectare has already increased from 2,700 to 3,000 kilograms, and crop wastage has been reduced by 15% using silos.[6]

Likewise, in Turkey which is currently facing drought problems, some farmers have been advised to turn to less water reliant crops like corn and beans, while some are being trained on modern irrigation methods such as drip or sprinkle irrigation. Others are using underground dams which have better water-use efficiency to support wheat production. In 2021, the Turkish government paid $150 million to farmers who lost yields due to water challenges. Also, under the European Union of Pre-Accession Assistance Rural Development (IPARD), the Turkish government is funneling funds worth 15 million euro for construction of underground dams in areas with adequate topography.

This modern irrigation training has helped expand the country's cultivated land to 642,00 acres. 25.5% water has been saved, electricity costs have been reduced by 23.2%, and half of the 41 dam projects have been completed.[7] This will incentivize farmers to consider wheat farming, as there is now a lower cost of production, sufficient water resources and skills training available.

Access to credit facilities

Loans and other credit facilities should be accessible to farmers, to allow them to invest in their businesses for growth and expansion. The agricultural sector of Pakistan contributes significantly to the national economy and employs half of the labor force. The government implemented its Credit Guarantee scheme for small and marginalized farmers in the federal budget 2015, with the aim of including local farmers who did not have sufficient collateral, in the credit market. Since 2016, over 114,000 borrowers have secured about Rs 19.4 billion loans, which has prompted adaptation to technology and increased yield in important crops.

Wheat yield grew to 27.293 million tonnes in 2021 from 25.248 million tonnes in 2020, wheat cultivated area increased to 9.178 hectares. Furthermore, the loan repayment relief initiative, which focused on

[6]Mohammad Hanafi. 2022. "Egypt may plant 2 million acres of wheat to compensate for Russian-Ukraine war". AL-Monitor. https://www.al-monitor.com/originals/2022/03/egypt-may-plant-2-million-acres-wheat-compensate-ukraine-war
[7]Daily Sabah. 2022. "Turkey sets out road map for climate friendly agriculture". https://www.dailysabah.com/turkey/turkey-sets-out-road-map-for-climate-friendly-agriculture/news

deferring the principal amount of agricultural loans for one year and facilitating banks who could not meet the deferment, has helped ease the aftereffects of the COVID-19 pandemic.[8]

Providing extension services

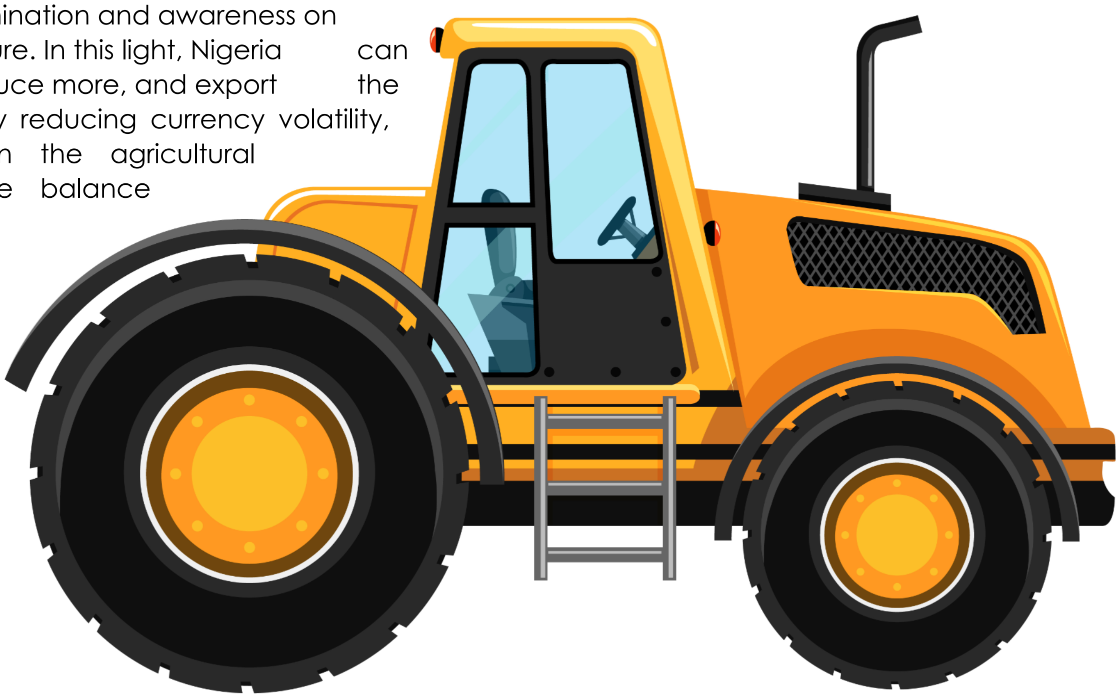
Agricultural extension services (AES) are crucial for growth and improvement in the agricultural sector, as they encourage adaptation to new technologies and increase productivity, especially for developing nations. Although some challenges exist, Ethiopia's AES is commendable, given the recent trends in production, yields and income of farmers. The Growth and Transformation Plan is a five-year national plan, aimed at expanding Ethiopia's agricultural extension services, by providing market-oriented and context specific AES. Ethiopia has one of the most extensive AES, with over 72,000 development agents serving 16.7 million farmers, through 15,000 farmer training centers.

In May 2016, the second Growth and Transformation plan (GTP-II) was released with an objective of increasing total AES beneficiaries, to 18.237 million in 2019 from 13.95 million in 2014/15, after it met 95% of its previous target of 14.6 million beneficiaries in 2015.[9] This objective will be achieved by improving the quality of AES - a major shortcoming of the first plan, mainstreaming approaches to agroecology and climate change, and organizing learning groups for more interactive sessions. This training will provide Ethiopian wheat farmers with knowledge of modernized inputs, for faster and easier production.

It is imperative to note that AES does not directly improve output, it only increases adoption of modern inputs that speed up productivity, reduce cost of production, multiply yields, and generate more income for the farmers and the nation at large.

A developed wheat value chain

Nigeria can attain self-sufficiency in wheat production through aggressive implementation of these strategies, following the lead of these countries. Addressing the agricultural sector by providing easy access to credit facilities for farmers for rapid technological advancements, training the farmers on modern irrigation methods and improved seeds for increased productivity, and promoting extension services, for proper information dissemination and awareness on developments in agriculture. In this light, Nigeria can begin to import less, produce more, and export the available surplus, thereby reducing currency volatility, attracting investment in the agricultural sector, and reducing trade balance deficit.



[8]Agriculture. https://www.finance.gov.pk/survey/chapters_21/02-Agriculture.pdf
[9]Guush Berhane et al. 2018. "The state of agricultural extension services in Ethiopia and their contribution to agricultural productivity". Ethiopian Development Research Institute (EDRI). https://www.exemplars.health/-/media/files/egh/resources/stunting/ethiopia/the-state-of-agricultural extension-services-in-ethiopia-and-theri-contribution-to-agriculture-prod.pdf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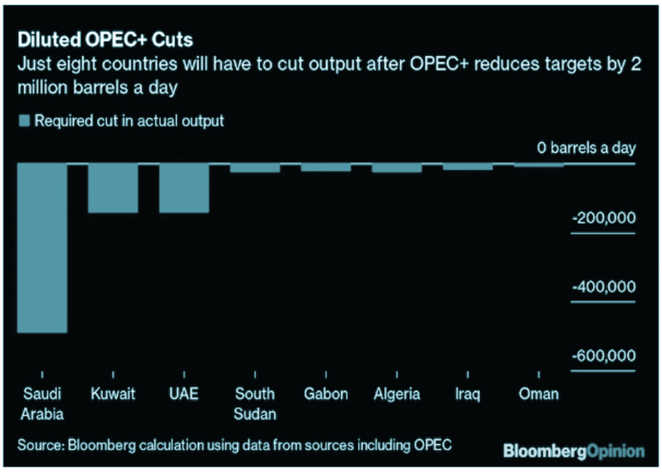
GLOBAL PERSPECTIVE: OIL PRODUCTION CUT COULD BE 10% REAL, 90% ILLUSION

– CULLED FROM BLOOMBERG

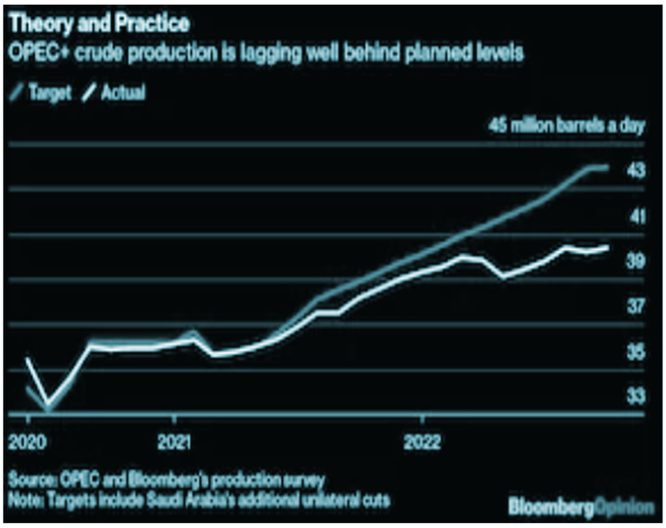
Ministers from the OPEC+ group of oil-producing countries agreed to cut their collective output target by 2 million barrels a day from November when they met on Wednesday. How much their actual production falls could be as little as one-tenth of the headline figure. Although the group comprises 23 countries, the burden of the latest cut will be shared by just three — Saudi Arabia, the United Arab Emirates and Kuwait. Most of the others are already pumping so far below their quota levels that their output will still fall short of their new allocations.

Estimates of OPEC+'s September production suggest that, collectively, it's lagging the planned level by about 3.6 million barrels a day. When the new targets come into effect on Nov. 1, only eight countries will be required to pump less crude. In addition to the three Gulf Arab neighbors, small reductions should also come from South Sudan, Algeria, Gabon, Iraq and Oman.



The total reduction required of them is just 890,000 barrels a day. That's still a significant cut, but a long way from the headline figure. However, don't expect the cut to be even that much. You can forget about South Sudan, Gabon and probably even Iraq.

OPEC's own data show that South Sudan not only exceeded its quota every month since the current deal came into effect in May 2020, but that it never cut a single barrel of production. It would be surprising if it began now.



Gabon has shown a similar lack of resolve. Its output has been below its cap in just one month out of the agreement's 29-month history, OPEC's data show. As for Iraq, the nation's oil minister wasted no time after Wednesday's deal was finalized to assure oil buyers that the agreement would not affect his country's exports. With little room to tweak domestic use, that really means no cut in production either.

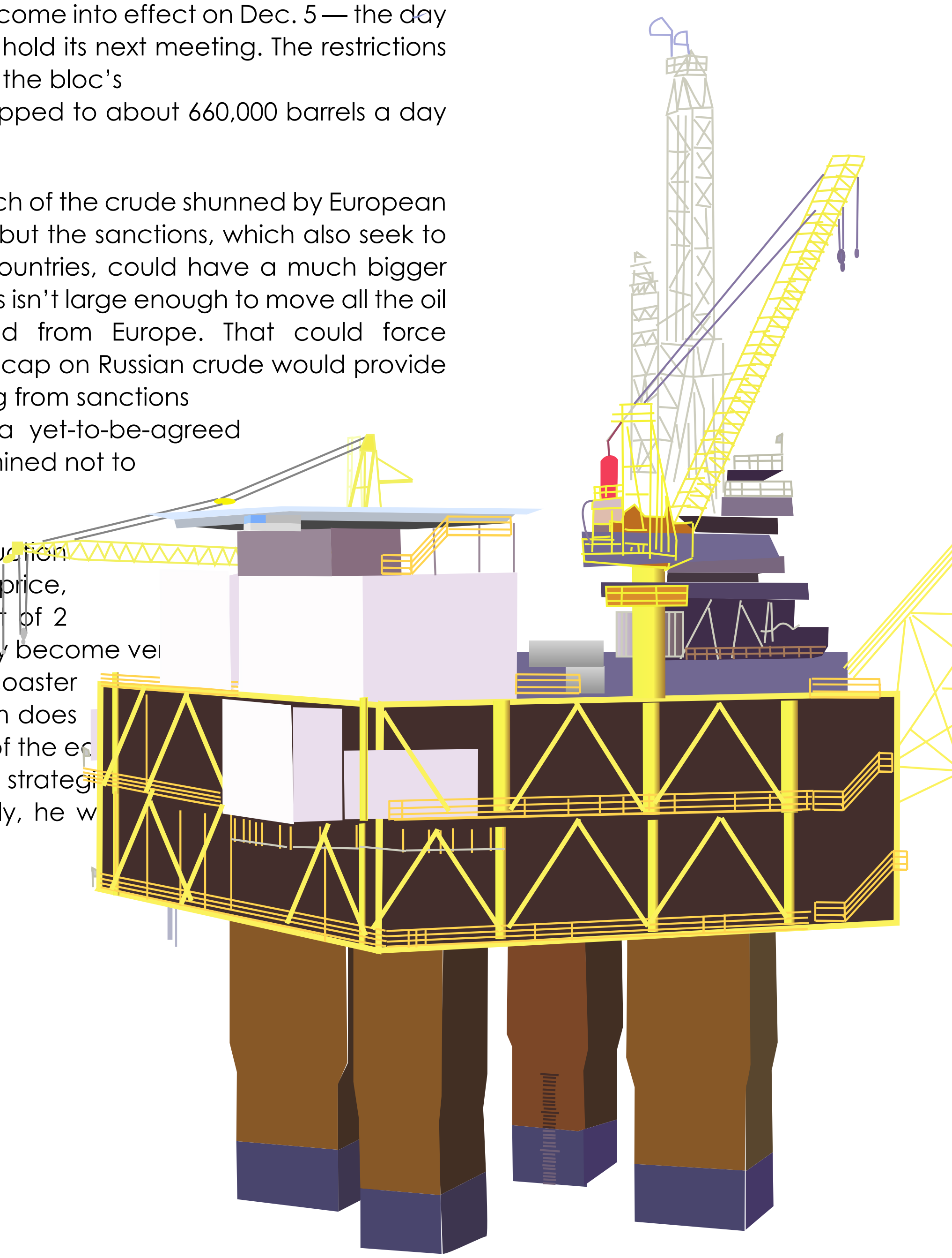
That whittles the list down to five. The reductions required from Algeria and Oman total 32,000 barrels a day; that's little more than a rounding error in the assessment of the group's overall production. The cuts required of Saudi Arabia and its neighbours amount to 790,000 barrels a day, but even that could be offset by increasing output from some other members of the group. Nigeria, Angola and Malaysia are all contending with dwindling production capacity and have been pumping below their targets for many months. That's not likely to change. Russia, too, is struggling. It was already finding it difficult to keep pace with its rising allocation before President Vladimir Putin ordered his troops into Ukraine, and the situation has only gotten worse in the months since the invasion.

But Kazakhstan is different. Output is running more than 560,000 barrels a day below target on a combination of planned maintenance at one of its biggest fields and a gas leak at another. The completion of the maintenance this weekend should allow the return of about 260,000 barrels a day. The rest will take longer, but the country's energy minister says it should be back before the end of the month — just in time to offset the planned cut. If he's right, the effective output cut, measured from current production, could be reduced to as little as 230,000 barrels a day — hardly worth getting worked up about.

But a month later, the situation may look very different. European Union sanctions on Russian crude exports come into effect on Dec. 5 — the day after the producer group is due to hold its next meeting. The restrictions target most seaborne shipments to the bloc's
members, which have already dropped to about 660,000 barrels a day from 1.6 million barrels in January.

Russia has successfully diverted much of the crude shunned by European buyers to India, Turkey and China; but the sanctions, which also seek to limit shipments to non-European countries, could have a much bigger impact. Russia's own fleet of tankers isn't large enough to move all the oil that would need to be diverted from Europe. That could force production cuts. A proposed price cap on Russian crude would provide the Kremlin a way out — exempting from sanctions those cargoes sold at or below a yet-to-be-agreed price — but Moscow seems determined not to take it.

If the Kremlin decides to halt production instead of accepting a capped price, which seems likely, the OPEC+ cut of 2 million barrels a day could suddenly become ver thing's sure, crude's on a roller coaster ride for the rest of 2022. This column does not necessarily reflect the opinion of the ed and its owners. Julian Lee is an oil strategi for Bloomberg First Word. Previously, he w Centre for Global Energy Studies.



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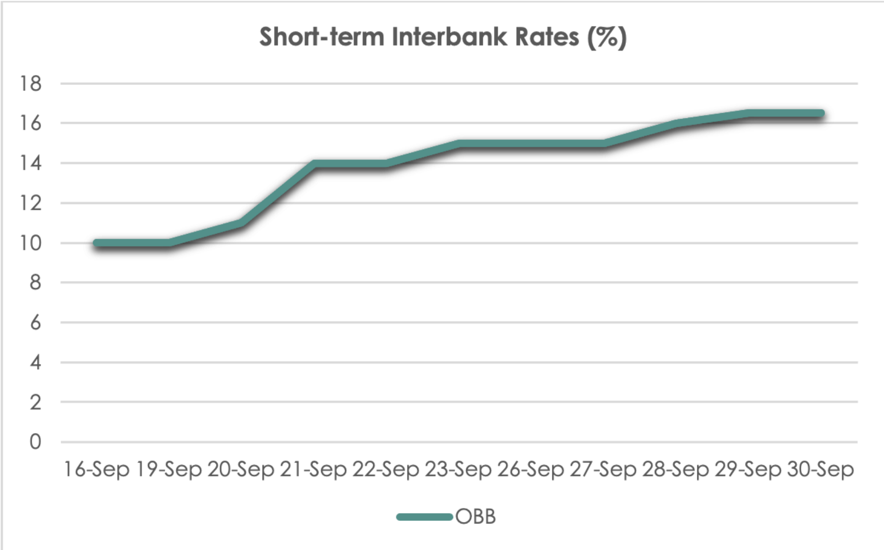
MACROECONOMIC INDICATORS 16TH- 30TH SEPT

Money Market

In the second half of September, the average bank position opened at N179.81bn. This was an increase from the corresponding period in August by 59.76%, with the average being N112.55bn. The increase was fueled by the soaring inflation rate despite the recent hike in CRR. During the review period, the money market recorded a two-day negative opening position on the 22nd and 23rd of the month as a result of an increase in the sales of bonds.

Furthermore, short-term interbank rates (OBB, O/N) traded in double digits throughout the period with 10% being its lowest and reaching an all-year high of 16.5% as a result of the rise in the MPR. On average, the short-term interbaln the review period (Sep 16st- 31st), two auctions were conducted while a total of N408.5 was sold. This was 17.65% lower than the N496.07bn sold in the second half of August.

The primary markets experienced an increase in the rate of treasury bills across all maturities. The 91-day bill interest rate increased by 114bps, the 182-day bill by 150 bps and the 364-day bill by 225 bps. In the secondary markets, yields on most of the benchmark maturities increased from its previous level with the long-term maturity being an exception after falling by 50bps to 10.43% from the preceding level.



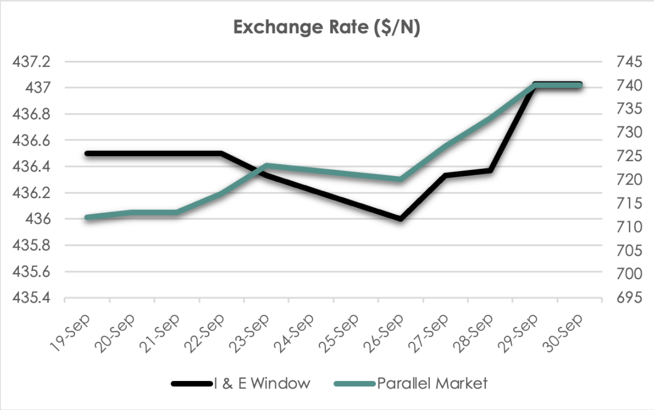
Source: FDC Think Tank

Tenor	Primary market (Sep 14th, 2022) (%)	Primary market (Sep 28th, 2022) (%)	Secondary market (Sep 15th, 2022) (%)	Secondary market (Sep 30th, 2022) (%)
91-day	5.50	▲ 6.64	3.90	▲ 5.91
182-day	6.00	▲ 7.50	8.90	▲ 10.90
364-day	9.75	▲ 12.00	10.90	▼ 10.43

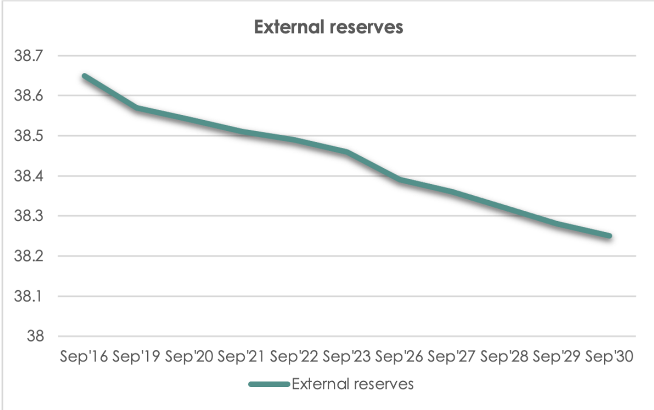
Source: FMDQ, FDC Think Tank

OUTLOOK

Short-term interbank rates are expected to maintain its bullish trend and keep trading in double digits due to the recent increase in the MPR. As a result, money supply would continue to deplete in accordance with the CBN's contractionary policy as well as an increase in the number of non-performing loans.



Source: FMDQ, FDC Think Tank



Source: CBN, FDC Think Tank

Forex Market

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

Exchange Rate

In the IEFX market, naira remained relatively stable but depreciated by 0.54% to N437.03/$ on September 30th from N434.67/$ at the beginning of the review period (September 16th). At the parallel market, the naira maintained a firm depreciation trend and reached its minimum value of N740/$ at the end of the month due to growing limited forex supply and increasing speculations.

OUTLOOK

As liquidity tightens in the economy, demand pressure is likely to ease in the parallel market leading to a slight appreciation of the naira. This is achievable given an increase in foreign earnings as oil prices rise and the CBN's firm efforts to defend the domestic currency.

External Reserves

The nation's foreign exchange reserves decreased by 1.03% to $38.25bn (as of September 30) from $38.65bn at the start of the review period (September 16th). This was brought about by the CBN's efforts to support the naira

OUTLOOK

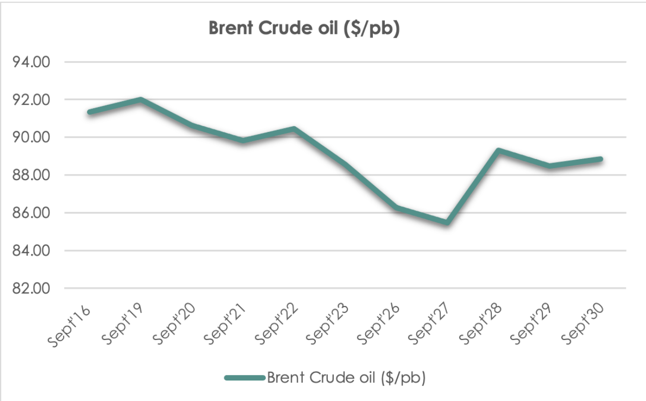
The volatility of oil price and the crippling fall in the level of oil production in the country could be held responsible for this drop in the external reserves. However, with the current slash in oil production by OPEC+, oil price is expected to increase. Therefore, it is very likely that the country's external reserves will start to rise in the upcoming month.

IMPACT

The CBN's willingness to offer foreign currency in the external market is likely to be encouraged by an increase in the external reserves.

COMMODITIES EXPORTS

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



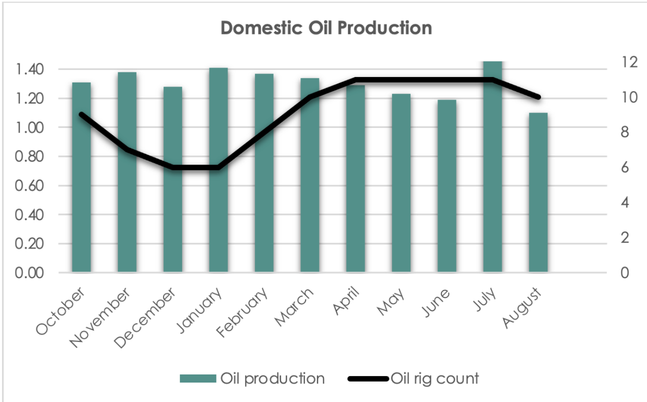
Source: Bloomberg, FDC Think Tank

Oil Prices

The price of oil was largely bearish in the review period and traded below the $90pb threshold for most of the period. It fell to a low of $84.06pb on September 26th from $92pb on September 19th on recession concerns and the strengthening of the US dollar in the market. The oil market witnessed an increase in oil price on the 28th of September as a result of a decrease in crude stockpiles but this rise was short-lived. On average, oil price fell by 9.46% to $88.99pb in the second half of the month from $98.29pb in the corresponding period in August.

OUTLOOK

Oil price is expected to increase in the near term and trade between the $90bp benchmark as OPEC has taking new strides to cut down oil production again. OPEC's inclination towards higher oil prices will continue to limit it from further raising its monthly oil production quota, while Nigeria will continue to produce below its OPEC quota due to oil theft and operational issues. Although, the possible return of Venezuela to the oil market might serve as a threat to this price increase and push it downwards in the coming month.



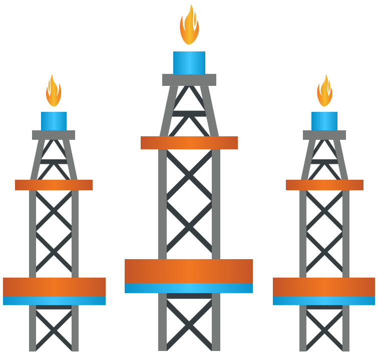
Source: OPEC, FDC Think Tank

Oil production

OPEC+ total oil production increased in most countries with the exceptions being Iran, Iraq and Venezuela. Specifically, oil production increased by 0.51% to 29.77mbpd in September from 29.62mbpd in the previous month. This growth could be attributed to the huge increase in oil production in Saudi Arabia and Libya which is currently recovering from the blockage of its ports. The shortage of oil supply in Russia has given rise to the new monthly oil production slash by OPEC+ in which the organization is set to cut its production by 2 million barrels by November to increase oil price. On the other hand, the oil rig count fell to 10, breaking the constant trend of it being 11 since April.

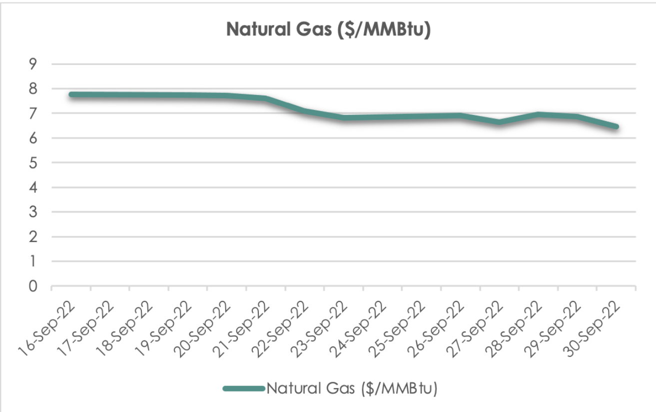
IMPACT

The rise in oil price will increase the country's oil revenue and its foreign exchange earnings. As a result, FAAC allocation to the three tiers of government will increase making government borrowings in the capital market to reduce as well as its debt burden.



Natural Gas

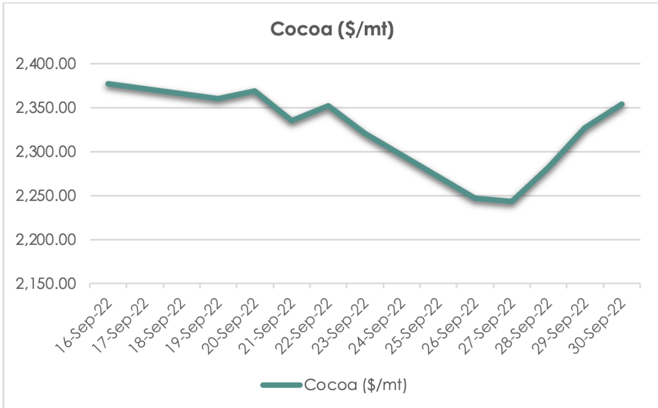
The price of gas fell in September reaching a low of $6.47/mmbtu to end the month despite the effect of the hurricane Ian in the US. The steady drop in its price is as a result of increasing inventories of the commodity in Europe and the EU's decision to curb its soaring power costs. On an average, the price of gas fell by 23.04% to $7.15/mmbtu in the second half of September from $9.29/mmbu in the second half of August.



Source: Bloomberg, FDC Think Tank

Cocoa

Cocoa prices recorded choppy movements during the review period as a result of the fears of the EU ban on the commodity. Owing to this, cocoa prices reached a low of $2243/mt towards the ending of the month but later improved to close the review period at $2354/mt (September 30th), an effect brought about by low fertilizer use in the top producing country (Ghana). On average, the cocoa price fell by 2.79% to $2324.27/mt in the second half of September from $2,391/mt in the second half of the previous month.



Source: Bloomberg, FDC Think Tank

OUTLOOK

Gas price is expected to elevate as demand increases for gas in the US due to hot weather conditions and shortening supply from Russia. Also, the cut in oil production by OPEC+ is likely to support this rise in gas price.

IMPACT

Higher gas price will raise the country's external revenue as well as its fiscal revenue through higher FAAC remittances. This would aid the implementation of salient policies in the country.

OUTLOOK

The Ghanaian government has taken strides to increase its production of cocoa by 21% as the fears of the EU bans are being quelled. Furthermore, good soil moisture content in Ivory Coast's cocoa regions is expected to aid October to March main crop cocoa harvest. The improved supply by Ivory Coast and Ghana will continue to support lower cocoa prices.

IMPACT

Reduced cocoa prices will reduce the country's foreign exchange profits, limiting government revenue.

omni PLUS

CYNTHIA IS A SMART CFO

She relies on **OmniPlus** for reliable salary payments to over 50,000 staff in over 33 African countries and other bill payments.

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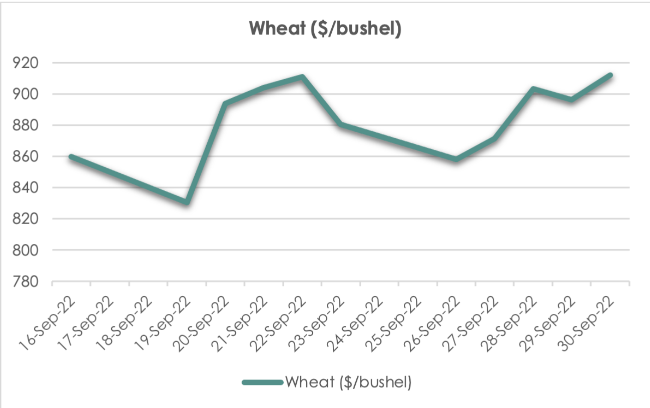
The Pan African Bank

COMMODITIES IMPORTS



Source: Bloomberg, FDC Think Tank

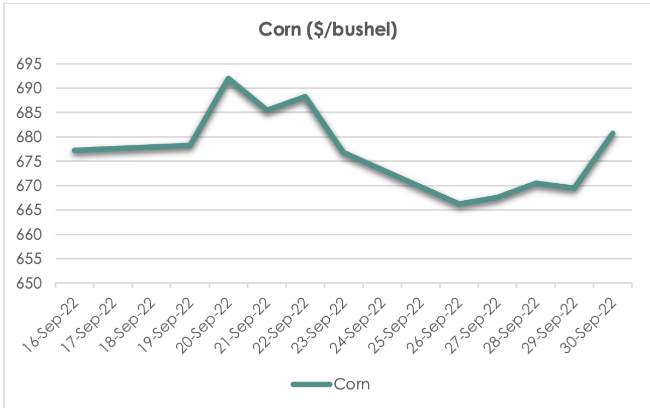
Wheat

The wheat market experienced high levels of price volatility trading mostly between a $800/bushel benchmark during the review period. Factors such as increased supply from Ukraine, tightening Russia supply and the risk of global economic slowdown can be held responsible this price volatility. Wheat price fell to a low of $830.5/bushel on the 19th of September before rising to $912/bushel to end the month due to adverse weather conditions in key production areas at this period. On average, wheat price significantly increased by 10.39% to $883.64/bushel within the review period from the average of $800.46/bushel in the second half of August.

OUTLOOK

The price of wheat is expected to rise in the coming month as Ukraine and Russia continue to rage war thereby limiting global supply. The adverse weather condition in Argentina, one of the commodity's key exporters, is also a factor contributing to this spike.

The price of corn is expected to rise in the near term as adverse weather condition in the US and an expected damaging drought in Argentina, the fourth largest producer of corn offset the effect of the increasing supply of Ukraine. This cause is also aided by the robust defense Ukraine has been mounting against Russia in the war.



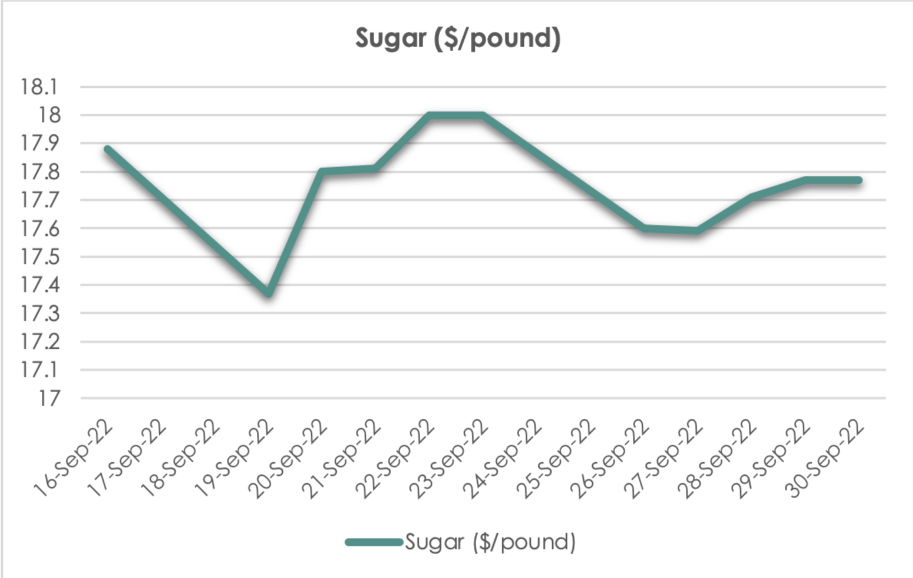
Source: Bloomberg, FDC Think Tank

Corn

Average corn price jumped to $677.5/bushel in the second half of September from $646.15/bushel in the corresponding period in August due to prolonged drought in Argentina. Although this rise was threatened by the fear of global economic recession, increased supply in Ukraine and the forecast of stable corn supply in the US. Ultimately, corn price dropped to a low of $666.25/bushel on September 26th from $692/bushel on September 20th.

IMPACT

The increase in grain prices will increase the country's import bill. Manufacturers will pass on costs to consumers in form of higher prices, thereby raising inflation risk.



Source: Bloomberg, FDC Think Tank

Sugar

The price of sugar remained relatively stable during the period of review. It rose to a high of $18/pound on September 22nd from $17.37/pound on the 19th of the month due to tight supplies in Europe. Sugar prices also experienced steady growth towards the end of the month as Brazil, the then world largest sugar exporter, suffers a shortage in its supply and the price of coffee increases. Overall, the price of sugar averaged $17.75/pound in the review period, 1.44% lower than the average of $18.01/pound in the second half of August.

OUTLOOK

As the price of oil increases, supply of sugar might reduce in Brazil as the government may focus its resources on the production of ethanol. This would have a significant effect on sugar prices as Brazil is the second top world exporter of the commodity.

IMPACT

Higher sugar prices have an adverse effect on the country's terms of trade. The cost of producing confections will go up due to the rising price of sugar, which will also raise the risk of inflation and reduce real income for consumers.

OUTLOOK FOR TERMS OF TRADE

The country's terms of trade are expected to remain negative as the prices of its imports rise relative to its exports.

STOCK MARKET REVIEW

16TH -30TH SEPTEMBER

The NGX closed on a negative note from September 16th – 30th. It lost 1.04% to close at 49,024.16 points on September 30th from 49,540.48 points on September 15th. Also, the market capitalization decreased by 1.01% to N26.45trn relative to its close of N26.72trn on September 15th. The market YTD return decreased to 14.77% from 15.98% in the review period. The market breadth was negative at 0.49x as 23 stocks gained, 86 stocks remained unchanged while 47 lost.

Market activity level was negative in the review period. The average volume traded decreased by 18.89% to 152.27mn units from 187.74mn. Similarly, the average value of trades fell by 34.75% to N1.84bn from N2.82bn in the review period.

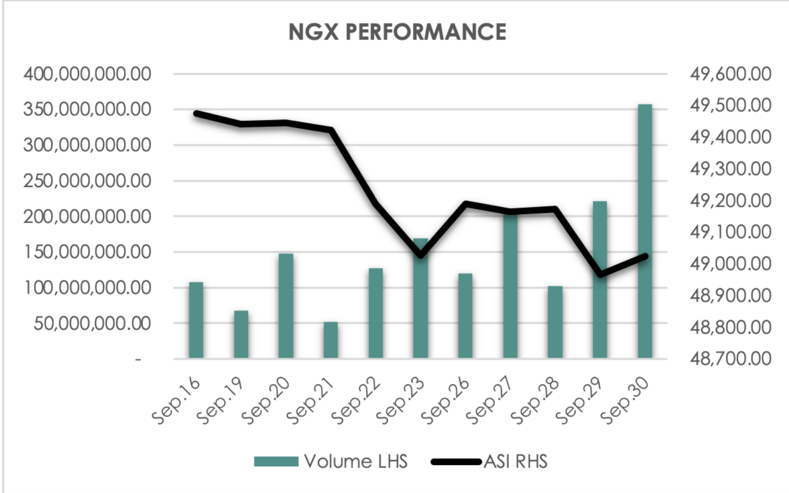
The performance of the sectors was negative from September 16th – September 23rd, as four sectors lost while only one gained. The oil and gas sector recorded the highest loss (-4.68%). This was followed by the industrial sector (-3.92%), the insurance sector (-1.44%) and the consumer goods sector (-0.14%). Meanwhile, the banking sector gained 0.85%.

Multiverse Mining and Exploration Plc topped the gainers' list with a 31.79% increase in its share price. This was followed by E-Tranzact International Plc (9.97%), Trans- Nationwide Express Plc (8.70%), UPDC Plc (8.42%) and Fidelity Bank Plc (7.92%).

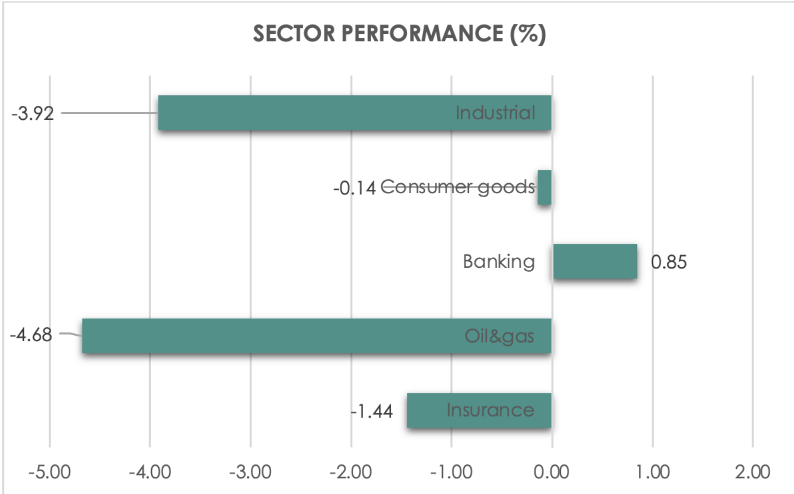
The laggards were led by Academy Press Plc (-22.33%), Livestock Feeds Plc (-11.30%), Cornerstone Insurance Plc (-11.11%), Neimeth International Pharmaceuticals Plc (-10.26%) and Nestle Nigeria Plc (-10.00%).

Outlook

We expect September's inflation rate to determine market performance in the near term.



Source: NGX, FDC Think Tank



Source: NGX, FDC Think Tank

TOP 5 GAINERS

Company	Sep-15 (N)	Sep-30 (N)	Absolute Change	Change (%)
MULITVERSE	2.80	3.69	0.89	31.79
ETRANZACT	2.91	3.20	0.29	9.97
TRANSEXPR	0.69	0.75	0.06	8.70
UPDC (BLS)	0.95	1.03	0.08	8.42
FIDELITYBK	3.41	3.68	0.27	7.92

Source: NGX, FDC Think Tank

TOP 5 LOSERS

Company	Sep-15 (N)	Sep-30 (N)	Absolute Change	Change (%)
ACADEMY	2.06	1.60	-0.46	-22.33
LIVESTOCK	1.15	1.02	-0.13	-11.30
CORNESRST	0.63	0.56	-0.07	-11.11
NEIMETH	1.56	1.40	-0.16	-10.26
NESTLE	1350.00	1215.00	-135.00	-10.00

Source: NGX, FDC Think Tank

Good Food, Good Life

CORPORATE FOCUS- NESTLE NIGERIA PLC
MARKET CAP: N963 BILLION
SHARE PRICE: N1,215.00
INDUSTRY: CONSUMER GOODS

Analyst's Note

Robust top-line growth buoyed by strong performance across food and beverage business segments

Nestlé Nigeria Plc.'s revenue rose to ₦222.45 billion in H1'22, a 29.75% growth compared to ₦171.44 billion in the corresponding period in 2021. The increase in the company's revenue was largely driven by higher income from the food and beverage segments, which were up 30.94% and 28.44% respectively. The recent price increases implemented across the company's product portfolio bolstered growth in these segments. Earnings from the food and beverage segments stood at ₦132.44 billion (59.54% of H1'22 revenue) and ₦90.00 billion (40.46% of H1'22 revenue), during the period under review. Growth in sales of brands like Milo, Nescafe and Nestlé Pure Life, continues to support the company's beverage business segment. Similarly, the food business segment remains competitive, especially in the bouillon cubes and infant food businesses. Nestlé Nigeria Plc.'s product portfolio remains largely favoured among consumers even with the recent uptick in prices. This could also be attributed to other competitors raising prices in line with the broader market, limiting the down-trading impact.

Upsurge in cost of sales and operating expenses dampen margins

During the period under review, Nestlé Nigeria Plc.'s cost of sales surged by 35.46% to ₦142.25 billion in the half year ended June 30, 2022. This upsurge in cost of sales is reflective of the effects of rising cost pressures. As a result, the company's gross profit margin contracted to 36.06% in H1'22 from 38.75% in the same period in 2021. However, gross profit was up 20.73% to ₦80.21 billion compared to ₦66.43 billion in the first half of 2021 due to strong revenue growth. Meanwhile, a 20.69% growth in Nestlé Nigeria Plc.'s marketing and distribution expenses to ₦28.35 billion offset a 14.23% decline in administrative expenses, resulting in a 13.02% uptick in operating cost to ₦34.02 billion. This exerted downward pressure on the company's operating margin, declining to 20.76% from 21.19% in H1'22. Nevertheless, operating profit remained strong at ₦46.18 billion, 27.12% higher compared to the corresponding period in 2021.

Strong revenue offsets surging operating and financing costs, supports bottom-line growth

Nestle Nigeria's total loans and borrowings accelerated to ₦92.64 billion in H1'22, a 78.46% increase compared to the same period in 2021. This sharp increase fed into higher finance expense, resulting in a 105.11% increase to ₦6.96 billion. The rise in finance expense was largely driven by a 44% increase in interest expense on financial liabilities (₦4.84 billion) and a 5,886.54% upsurge in net foreign exchange loss to ₦2.13 billion. Included in interest expense on financial liabilities is interest expense on intercompany loan amounting to approximately ₦3.80 billion (2021: ₦2.30billion). A 267.53% increase in interest on bank deposits and a net foreign exchange gain of ₦2.89 billion spurred a 916.89% uptick in finance income to ₦4.52 billion. Despite the strong growth in finance income, a higher finance expense resulted in a net finance cost of ₦2.44 billion but a 17.24% decline compared to ₦2.95 billion in H1'21.

Net income however soared by 27.9% to ₦27.8billion from ₦21.7billion in H1'2021, majorly supported by strong revenue growth.

Company Overview

In the Nigerian fast-moving consumer goods sector, Nestlé Nigeria Plc, a subsidiary of Nestlé S.A, a renowned consumer products behemoth with headquarters in Switzerland, has established itself as a household name for providing high-quality, nutritious food. Nestle Nigeria manufactures, markets, distributes, and exports food products and other consumer goods to markets within and outside Africa.

The FMCG giant has retained its market share through extensive innovations, a varied line, product rebranding and the adoption of local substitution strategy in sourcing some of its raw materials (comprising, soy beans, cocoa, palm oil, and sorghum amongst others). The company uses the substitution of local raw materials in the production of goods as a hedge against prevailing foreign exchange issues plaguing the Nigerian business environment. The brand's distinctive-tasting Golden Morn cereal is made from locally sourced raw materials (Maize and Soya) fortified with other vitamins and has been providing delicious nourishment to families for over 35 years.

Nestlé S.A, recently increased its stake in Nestle Nigeria. Its ownership climbed from 67.28% to almost 70% with the purchase of shares valued at N4.9 billion. This move solidified and demonstrated Nestlé S.A.'s sway over the subsidiary's operations. The parent company's dominance somewhat influences the capital structure of the business. Nestle Nigeria is highly geared with a debt-to-equity ratio of 401% due to its significant exposure to related party loan. In its full year 2021, related party loan accounted for 99% of Nestle Nigeria's total loan portfolio.

Outlook

Nestle Nigeria's operations will continue to leverage on strong business model, brand recognition, and good product quality. While major economic headwinds persist and weigh on profit margins, we expect Nigeria's growing population to offset dwindling consumers' purchasing power.

Due to the company's backward integration strategy, Nestle Nigeria is expected to remain insulated against shocks arising from volatilities in the commodities space.

The industry giant is however vulnerable to the risk of currency devaluation due to its significant exposure to foreign debt. We therefore anticipate some moderation in Nestle Nigeria's capital structure via the issuance of additional capital to considerably reduce its exposure to debt.

Nestle Nigeria is also exposed to the risk of inflated interest expense particularly as interest rates embark on an upward trajectory. A further increase in finance cost will pose more pressure on profit margin.

The company's stock price is expected to fall in the short-term as investors sell off liquid stocks to take advantage of attractive fixed income yields. The decline in the share price will present an attractive entry opportunity for long term players.

We expect election spending, panic buying due to political uncertainties and festive spending to drive increased demand for Nestle Nigeria's products.

Bulls say:

- Strong brand name
- Notable parent company
- Diversified product portfolio
- Backward integration strategy
- Efficient distribution network

Bears say:

- Stiff competition from other players
- Weak consumers' purchasing power
- Harsh operating environment
- Heightened insecurity
- Inflationary pressures

ECONOMIC OUTLOOK FOR OCTOBER

The second half of September sets record high for a tighter monetary policy stance. The hike in rates is expected to further reduces liquidity in the system in the next first half of the next month. We anticipate a rebound in crude oil prices following the OPEC+ decision to cut down output. External reserve is expected to rise slightly owing to the positive impact of oil production cuts by the OPEC+. However, forex pressures to remain as the level of expected rise in the reserves cannot offset the supply-demand gap in the forex market. Also, we anticipate inflation rate uptick amid the aggressive monetary policy stance by the central bank since it is more structurally than monetarily induced.

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