FDC FINANCIAL DERIVATIVES COMPANY

MONTHLY ECONOMIC UPDATE

VOLUME 13 ISSUE 11

JUNE 27, 2023

content

THE ROLE OF INNOVATION IN THE MODERN ECONOMY: A CASE STUDY OF SINGAPORE

Innovation has been a driving force for the growth and success of modern economies, especially in Southeast Asia. Innovation is the creation and implementation of new ideas, products, and processes that bring about positive change and increase efficiency. It is not limited to technology alone but encompasses a wide range of areas such as business models, marketing strategies, and organizational structures. In today's rapidly changing world, the ability to innovate has become increasingly important for businesses and economies to thrive and stay competitive. Successful innovation can lead to increased productivity, job creation, and economic growth, making it a key driver of progress in the modern economy.

Nigeria, the largest economy in Africa with a population of over 200 million people, has not witnessed development. The country is rich in natural resources such as oil, natural gas, and solid minerals, making it an important player in the global oil market. However, the largest African economy has continued to export primary products to the international market, reducing the potential of these natural resources to increase economic development. This can be attributed to the country's inability to innovate.

The lack of innovation in Nigeria has limited economic diversification, productivity, technological advancement, and infrastructure development. Despite the country's

"...the Nigerian economy is challenged by various macroeconomic issues and performs below its peers."

immense natural resources, the Nigerian economy is challenged by various macroeconomic issues and performs below its peers. For instance, on average, Nigeria's economy has only grown 1.25% in the last five years, with unemployment at a record high (33.30% in 2020) and 133 million Nigerians multidimensionally poor. These problems make it imperative for the country to explore innovative solutions to address them.

By comparison, Singapore, a small island nation in Southeast Asia with limited natural resources, has experienced remarkable economic growth in recent years. According to the World Bank, Singapore's economy grew by 7.6% in 2021, up from 3% in 2015. [1] This growth can be attributed to the expansion of its manufacturing and financial sectors, buoyed by the promotion of innovation. Through investing in advanced technologies and embracing automation, Singapore has been able to improve productivity and efficiency, leading to higher output and lower costs. The data from the Economic Development Board revealed that Singapore's manufacturing sector contributes more than 20% of its GDP and provides employment for over 400,000 people, 7% of the total population (about 5.64 million).[2]

The financial sector is another area where innovation has played a significant role in Singapore's economic growth. The nation has emerged as a leading fintech hub in Asia, attracting numerous startups and established companies in the industry. The government implemented various initiatives to promote the development of the fintech sector, such as the Financial Sector Technology and Innovation (FSTI) scheme, which provides funding and support to fintech startups.

According to the Monetary Authority of Singapore, the country's fintech sector has grown significantly in recent years, with the number of fintech companies more than doubling from 2015 to 2020. [3] This growth has not only created new job opportunities but has also enhanced business efficiency, leading to increased economic growth.

In addition to expanding its manufacturing and financial sectors, Singapore has also focused on creating job opportunities for its citizens. Through various government initiatives, including SkillsFuture and the Adapt and Grow program, Singapore has been able to help workers acquire new skills and transition to new industries. This has helped to reduce unemployment rates and ensure that Singapore's workforce remains competitive in a rapidly changing global economy. According to data from the Ministry of Manpower, Singapore's unemployment rate stood at just 2.7% in 2021, one of the lowest in the world. [4]

1 World Bank, 2021. "World Bank Indicator" https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=SG
2 Singapore Economic Development Board (EDB), 2022. "EDB Year 2021 in Review" https://www.edb.gov.sg/en/about-edb/media-releases-publications/edb-year-2021-in-review.html

Significantly, the government of Singapore has recognized the importance of using data to enhance business efficiency and competitiveness. By investing in digital infrastructure and encouraging the adoption of new technologies, Singapore has been able to create a highly connected and data-driven economy. This has allowed businesses to optimize their operations, reduce costs, and improve customer experiences. For example, the implementation of the Smart Nation initiative has enabled Singapore to become a leader in smart city technology in Southeast Asia, with sensors and data analytics being used to improve everything from traffic flow to waste management. [5]

It follows that innovation has played a crucial role in the growth and development of Singapore's economy. As a result of increased investment in research and development, Singapore has been able to create a dynamic and resilient economy that is well-positioned to compete in the global market.

Nigeria can emulate Singapore's success through the diversification of its economy beyond the oil sector. This involves promoting and supporting other sectors, such as agriculture, manufacturing, services, and technology. With increased investment in these sectors and encouraging value addition and the export of processed goods, Nigeria can reduce its reliance on oil and create more inclusive economic opportunities.

Also, Nigeria should prioritize investments in education and skills development to build a skilled workforce capable of driving innovation and entrepreneurship. Enhancing the quality of education at all levels, aligning it with market needs, and promoting vocational training will empower individuals and enhance productivity across sectors. Similarly, a robust infrastructure is vital for fostering innovation and economic growth. Nigeria needs to focus on improving its physical infrastructure, such as transportation networks, power supply, and internet connectivity.

Furthermore, Nigeria can foster innovation by creating supportive policies and regulations, simplifying bureaucratic processes, and providing access to finance and venture capital for startups and small and medium-sized enterprises. Encouraging public-private partnerships and collaboration between the government, academia and industry can also spur innovation and entrepreneurship. In recent years, there have been some initiatives to address these challenges. The Nigerian government launched programs aimed at promoting economic diversification, such as the Agricultural Transformation Agenda and the Economic Recovery and Growth Plan. However, sustained efforts and long-term commitment are required to drive inclusive growth, reduce poverty, and create job opportunities for the growing population. Until these commitments are made and sustained, little improvement will be realized.

3Simon Mortlock, Aug 14, 2020. "Fintechs now employ far more people in Singapore than most banks do," Efinancialcareers.com,
https://www.efinancialcareers.com/news/2020/08/singapore-fintechs-employ-10000-people
4 Singapore ministry of manpower, March 15, 2023"Statement on labour market development in 2022".
https://www.mom.gov.sg/newsroom/press-releases/2023/0315-labour-market-report-2022

5 Thales. 2023 "5 ways Singapore is transforming its urban landscape."

https://www.thalesgroup.com/en/worldwide-digital-identity-and-security/iot/magazine/singapore-worlds-smartest-city

GLOBAL PERSPECTIVE: INVESTORS MUST PREPARE FOR SUSTAINED HIGHER INFLATION

CULLED FROM THE ECONOMIST

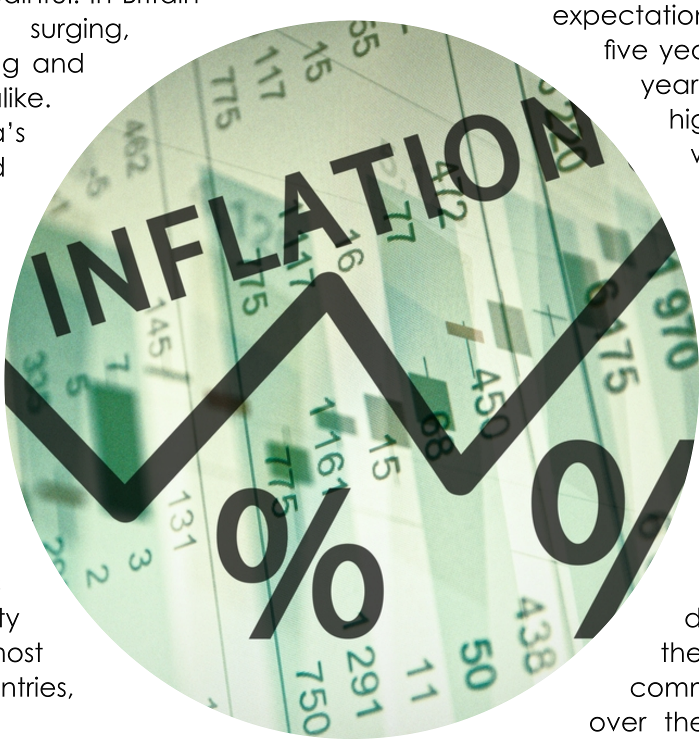
The costs of taming price rises could prove too unpalatable for central banks

At first glance the world economy appears to have escaped from a tight spot. In the United States annual inflation has fallen to 4%, having approached double digits last year. A recession is nowhere in sight and the Federal Reserve has felt able to take a break from raising interest rates. After a gruesome 2022, stockmarkets have been celebrating: the s&p 500 index of American firms has risen by 14% so far this year, propelled by a resurgence in tech stocks. Only in Britain does inflation seem to be worryingly entrenched.

The trouble is that the inflation monster has not truly been tamed. Britain's problem is the most acute. There, wages and "core" prices, which exclude energy and food, are rising by around 7%, year on year. But even as headline rates elsewhere have dropped as the energy shock has faded, core inflation has been frustratingly stubborn. In both America and the euro area it exceeds 5%, and has been high over the past year. Across the rich world many governments are adding fuel to the fire by running budget deficits of a scale typically seen during deep economic slumps.

As a result, central banks face agonising choices. What they do next will reverberate across financial markets, threatening uncertainty and upheaval for workers, bosses and pensioners.

Equity investors are hoping that central banks can return inflation to their 2% targets without inducing a recession. But history suggests that bringing inflation down will be painful. In Britain mortgage rates are surging, causing pain to aspiring and existing homeowners alike. Rarely has America's economy escaped unscathed as the Fed has raised rates. By one reckoning, the unemployment rate would have to rise to 6.5% for inflation to come down to the Fed's target, the equivalent of another 5m people being out of work. Rising interest rates imperil financial stability in the euro area's most indebted member countries, notably Italy.



Moreover, the secular forces pushing up inflation are likely to gather strength. Sabre-rattling between America and China is leading companies to replace efficient multinational supply chains with costlier local ones. The demands on the public purse to spend on everything from decarbonisation to defence will only intensify.

Central bankers vow that they are determined to meet their targets. They could, by raising rates, destroy enough demand to bring inflation down. Were they to keep their word, a recession would seem likelier than a painless disinflation. But the costs of inducing a recession, together with the longer term pressures on inflation, suggest another scenario: that central banks seek to evade their nightmarish trade-off, by raising rates less than is needed to hit their targets and instead living with higher inflation of, say, 3% or 4%.

This approach would resemble the "opportunistic disinflation" espoused by some Fed governors in the late 1980s. Rather than deliberately inducing recessions to bring inflation down, they sought to do so passively, from cycle to cycle. Yet today's markets are not prepared for such tactics. The pricing of inflation-linked Treasuries, for instance, is consistent with average inflation expectations of 2.1% over the next five years, and 2.3% in the five years thereafter. A world of higher sustained inflation would therefore involve an epochal shift for financial markets. Unfortunately, it would be volatile, wrong-foot investors and pit winners against losers.

One source of volatility could stem from the damage to central banks' reputations. In the decades since the 1980s they have trumpeted their commitment to targets. Yet over the past two years they have failed to anticipate the persistence of inflation. Should they then pay lip service to their unmet targets, they might no longer be taken at their word. In time they could lose the ability to guide the expectations of businesses and their workers. Those expectations could become unmoored and cause lurches in prices, inducing inflation to spiral.

Volatile inflation would hurt companies, and their shares, by making it harder for them to manage their costs and set prices. It would hurt virtually every asset class by raising the likelihood that central banks would have to rush to adjust rates after an unexpected flare-up. That could bring large swings in real yields, prompting investors to demand a discount in compensation for the uncertainty, forcing asset prices down.

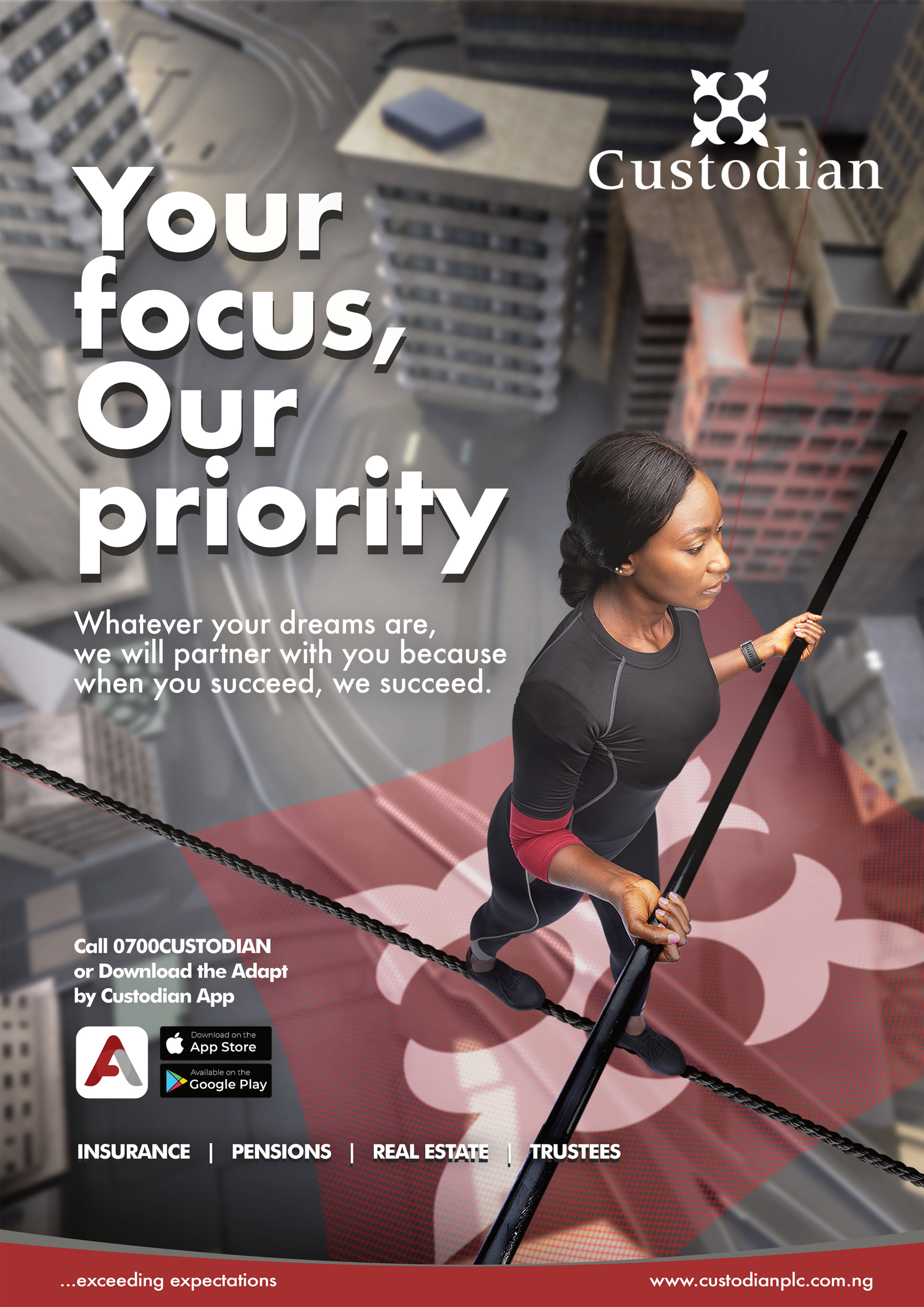
The new regime could wrong-foot investors in other ways, too. Were central banks more lax, it would initially flatter the prices of short-term bonds and push down their yields. In time, as the system adjusted to higher inflation, nominal rates would rise to keep real interest rates constant; in anticipation, the price of long-term bonds would fall. Investors could rush into commodities, an inflation hedge. Yet a stampede into the tiny market for futures, which are easier to trade than physical barrels of oil, would risk a bubble.

Higher inflation would also create new winners and losers. Most obviously, inflation involves an arbitrary transfer of wealth from lenders to borrowers, as the real value of debt falls. Heavily indebted borrowers, including governments around the world, may feel like rejoicing. But as bond investors realised they were being stiffed, they could punish recklessness with higher borrowing costs, including in rich countries.

Sticker shock

Other financial relationships could also become strained. If inflation was gobbling up four percentage points of returns each year, investors might start to look askance at fund managers' fees. Rising yields would improve the financial health of many defined-benefit pension schemes, by reducing the present value of their future liabilities. But benefits in retirement are not always fully protected from inflation, meaning that the purchasing power of some pensions will eventually be lower than expected. That would fuel voters' ire.

Such is the excruciating situation that central banks now find themselves in. They are likely to steer a course between high inflation and recession. Investors seem to believe that this can still end well, but the chances are that it won't.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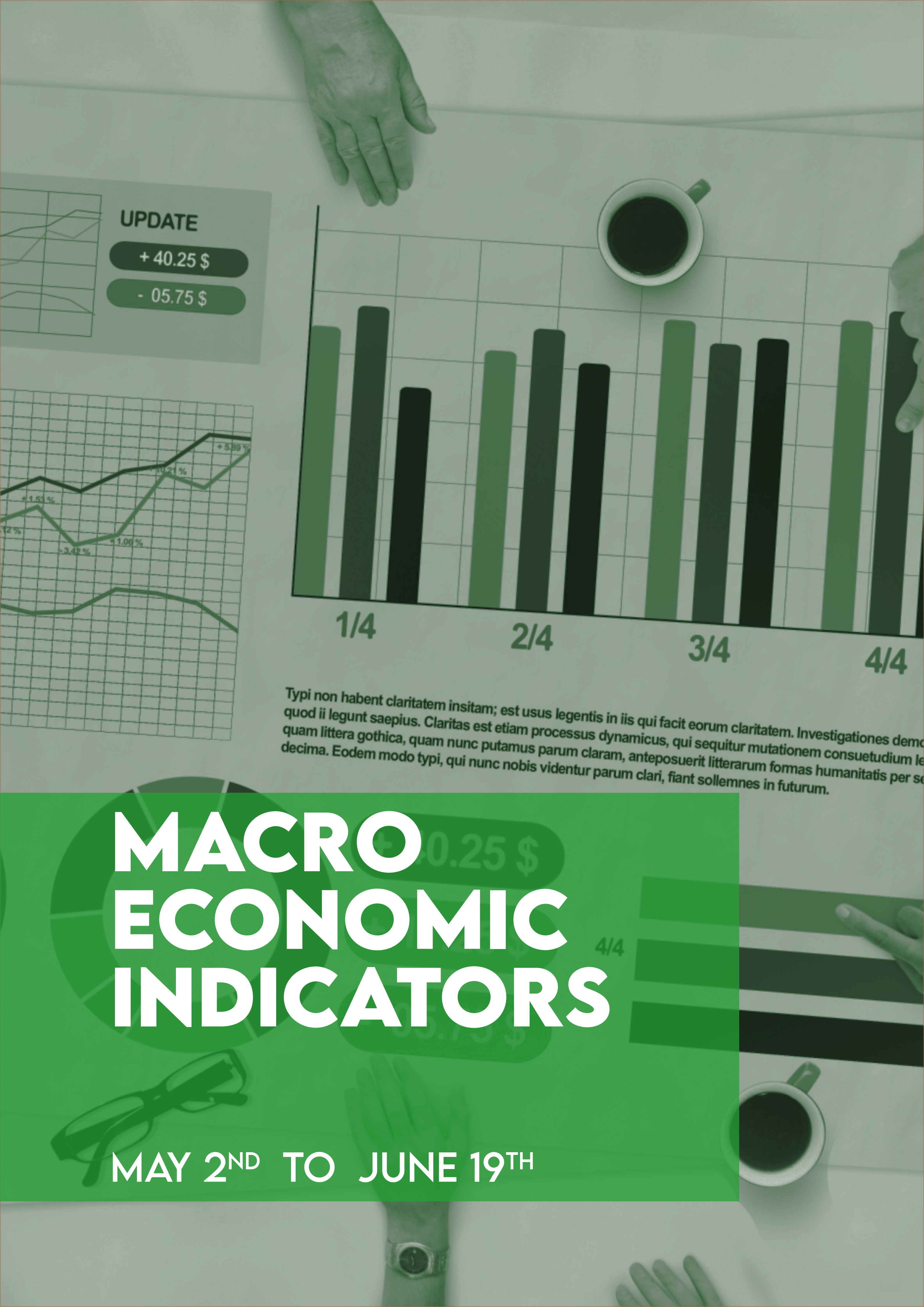


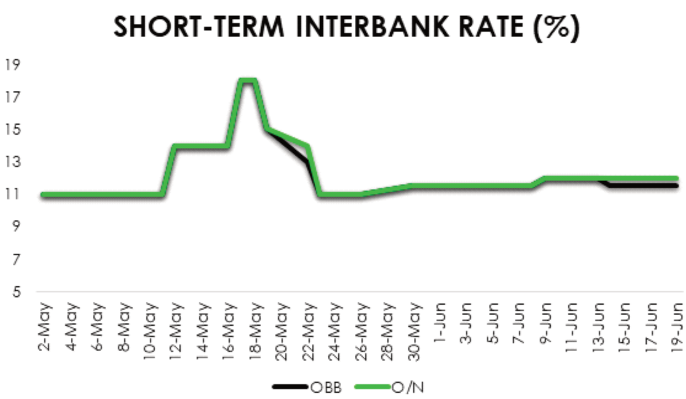
MACRO ECONOMIC INDICATORS

MAY 2ND TO JUNE 19TH

MONEY MARKET

Banks' opening positions averaged N319.39bn in May. Liquidity spiked by 1522.04% when compared to the average negative position of N22.46bn in April. The increase in liquidity was partly due to the OMO repayment of N60bn. However, there were no OMO bills sold in May. So far in June, liquidity rose by 337.26% from N162.63bn to close June 19th at a positive balance of N711.13bn. In the month of May, short-term interbank rates (OPR, O/N) averaged 12.45% p.a in the review period, 461bps down from the average of 17.06% p.a. in April due to the improvement in liquidity. Interbank rates have so far remained unchanged from the beginning of June to the close of the review period (June 19th).

Two primary market Treasury bill auctions were conducted in May. A total of N311.89bn was allotted in May, up 10.96% from the total allotment of N281.09bn in April. So far in June, two primary market auctions were conducted, of which a total of N217.39bn was allotted. Primary market rates fell across the 91-day, 182-day, and 364-day t/bill tenors by an average of 174bps from the April auction. Meanwhile, at the secondary market, the 91-day t/bill rate decreased to 5.09%p.a. while the 181-day and 364-day yields fell by 51bps and 89bps respectively, from their individual levels in April. NTB Auction (April 26 to June 19)



Source: FMDQ, FDC Think Tank

Tenor	Primary market (April 26th 2023) (%)	Primary market (June 15th 2023) (%)	Secondary market May 2nd 2023) (%)	Secondary market (December 30th 2023) (%)
91-day	5.30	4.89 ▼	5.40	5.09 ▼
182-day	8.00	5.12 ▼	6.80	6.29 ▼
364-day	10.17	8.24 ▼	8.20	7.31 ▼

Source: FMDQ, FDC Think Tank

▲ 337.26%

N711.13B

BANK OPENING POSITION

OUTLOOK

Given the high level of inflation in the economy and the unification of the exchange rate, short-term interest rates are likely to rise as demand for naira increases. Also. Persist inflationary pressure could embolden the CBN to remain hawkish. More so, borrowing costs for corporates & the government will increase in tandem with interest rate hike. The increase in interest expense for businesses could lead to high default rates on loans, which is likely to result in increased impairment charges for banks.

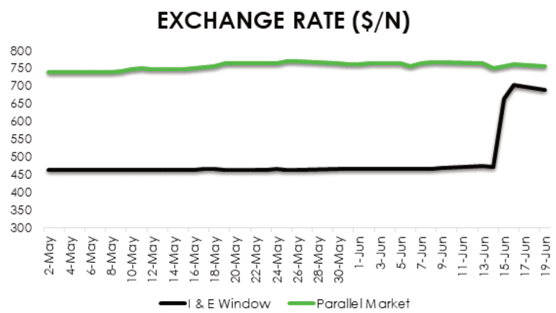
FOREX MARKET

The Nigerian forex market is currently being reformed. The CBN has unified the exchange rate and significantly reduced the restrictions on access to forex, including domiciliary accounts. Although the adoption of the "willing buyer, willing seller" model signals a deregulation of the forex market, the CBN has yet to make a categorical statement on whether it intends to operate a managed or free-floating system.

EXCHANGE RATE

The exchange rate of the naira oscillated between N462.13/$ and N465.13/$ at the I & E window in May. On average, it stood at N463.27/$, a 0.05% depreciation from April's average of N463.06/$. On the parallel market, naira depreciated by 2.63% to N760/$ at the end of May from N740/$ at the beginning of the month.

Meanwhile, the IEFX rate has depreciated by an average of 41% following the adoption of the willing-buyer-willing-seller model on June 14. The rate further depreciated to close the review period (June 19th) at N770/$, 1.72% higher than the black-market rate (N757/$). This is the first time in 15 years that the official rate has exceeded the parallel market rate.



Source: FDC Think Tank

▲ 2.30%

N757.00/$

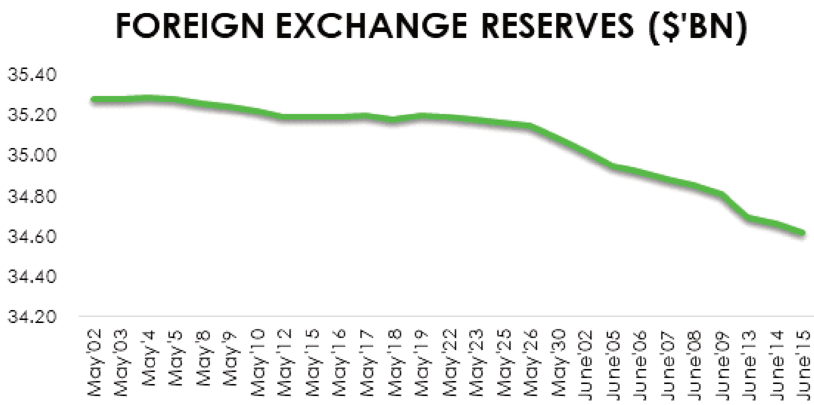
PARALLEL MARKET RATE

OUTLOOK

The foreign exchange market will remain volatile in the short term as market expectations continue to drive the demand & supply dynamics. The naira is likely to trade within the band of N656/$ - N795/$ on the I & E window in the short term to medium term.

EXTERNAL RESERVES

In the month of May, Nigeria's Foreign exchange reserves maintained its downward trajectory. It fell by 0.54% to close the month at \$35.09bn on May 30th from \$35.28bn at the start of the month. The decline in foreign external reserves was mainly due to lower oil prices. So far in June, the foreign exchange reserves lost 1.14% (\$400mn) to close at \$34.62bn on June 15th from \$35.02bn at the beginning of June.



Source: CBN, FDC Think Tank

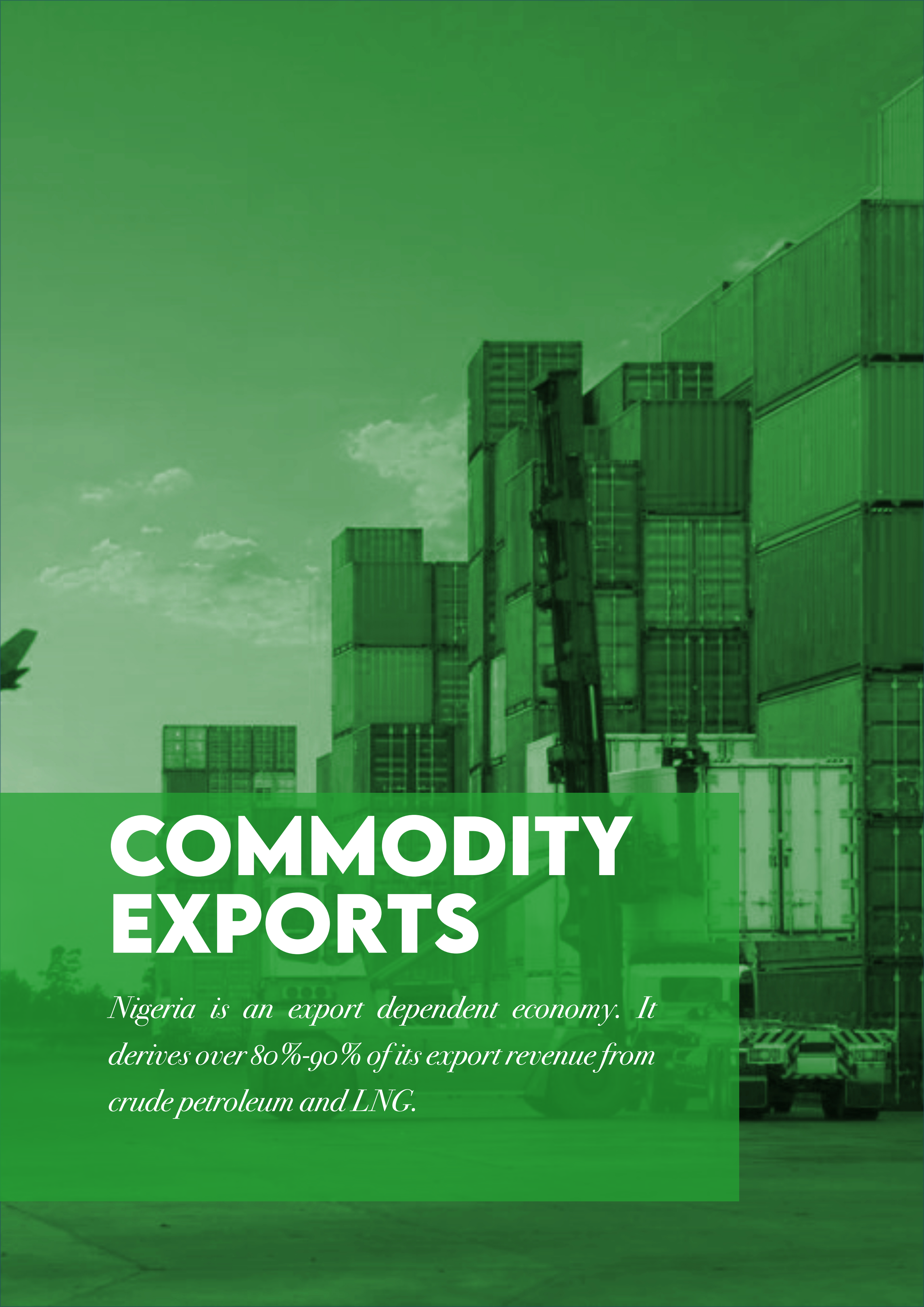
▼ 1.14%

\$34.62BN

NIGERIA'S EXTERNAL RESERVES

OUTLOOK

In the short term, the external reserve is likely to sustain its depletion as oil prices sustain its losses on fears of weak global demand. However, in the medium term, the reduction in forex restrictions and administrative controls will increase foreign investment inflows as lower currency & convertibility risks improve foreign investor confidence. This will lead to reduced depletion of the foreign exchange reserves.



COMMODITY EXPORTS

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

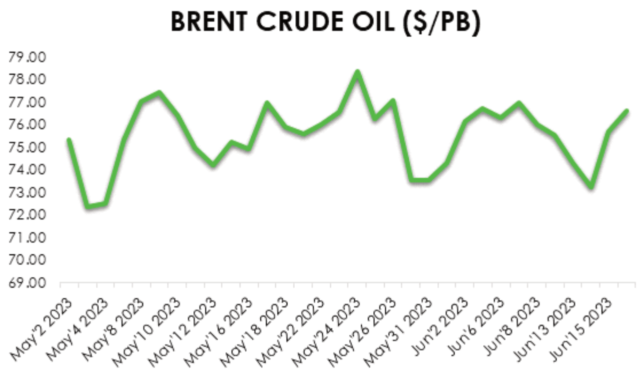
OIL PRICES

In May, the price of oil traded lower compared to April. On average, the price of Brent crude dropped by 6.16% to \$75.49/bp in May from \$83.66/bp in April. Also, oil prices fell by 6% to close at \$73.54 on May 31st after touching a high of \$78.36/bp on May 24th. The decline can be attributed to the uncertainty that surrounded the US debt ceiling talks and Chinese demand concerns.

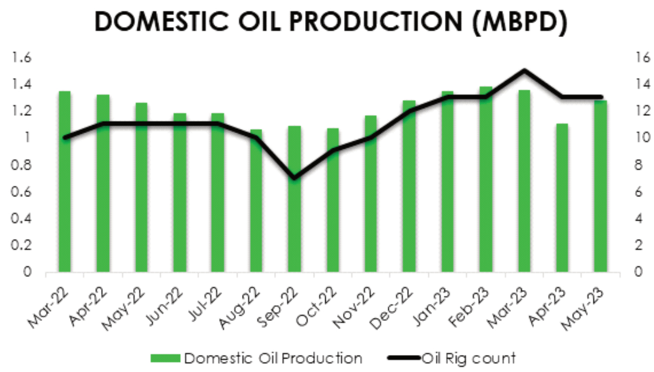
On the other hand, oil prices rose by 3.14% from \$74.28pb at the beginning of June to \$76.61pb on June 19th owing to further oil supply cut (1mbpd) by Saudi Arabia coupled with a pause in US Fed monetary tightening. However, this gain has been wiped in sustained weeklong losses between June 19 and June 23.

OIL PRODUCTION

OPEC's average oil production fell by 2.57% (74,000bpd) to 28.06mbpd in May from 28.80mbpd in April. Oil production increased majorly in Nigeria, Iran and Angola while it declined in Saudi Arabia, the UAE and Kuwait. Domestic oil production increased sharply by 15.45% to 1.27mbpd in May from 1.10mbpd in the previous month. Meanwhile, its oil rig count remained unchanged at 13 for the month of May.



Source: Bloomberg, FDC Think Tank



Source: OPEC, FDC Think Tank

▲ 15.45%

1.27 mbpd

DOMESTIC OIL PRODUCTION

OUTLOOK

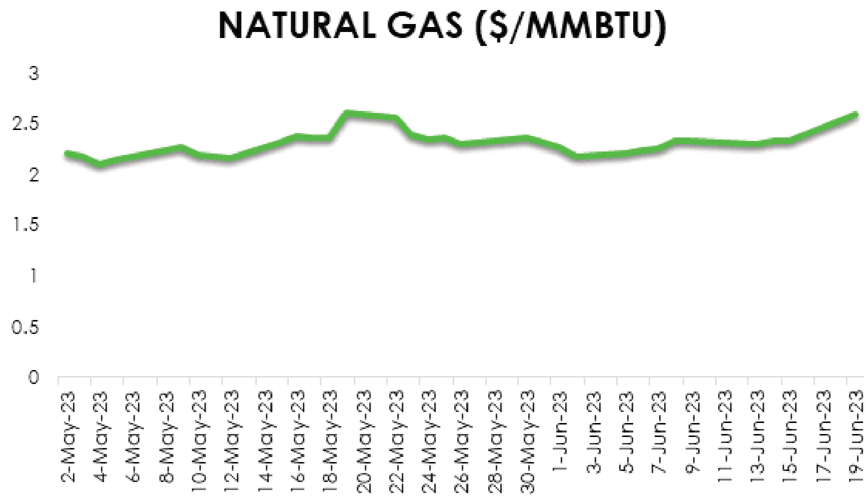
Oil prices are likely to trade lower in the near term. Lower oil prices will be supported by weak global demand as central banks remain aggressive towards inflation and a weaker Chinese post-covid economic recovery. China is the second-largest importer of crude oil. Its weak economic recovery can be linked to less aggressive policy measures to support growth.

IMPACT

Lower oil prices would reduce export earnings, decrease government revenue, and worsen the country's trade balance. Crude oil accounts for 89.5% of total exports. Also, the country's inability to meet its production quota could further weigh on fiscal revenue and decrease the allocation of funds from the federal government to states.

NATURAL GAS

Gas prices rose in the month of May despite subdued demand and high gas stockpiles in Europe. LNG increased by 4.52% to close May at $2.31/mmbtu, up from $2.21/mmbtu at the beginning of the month. On average, it rose by 4.07% to $2.30/mmbtu compared to $2.21/mmbtu in April. Similarly, gas price climbed by 13.66% to close June 19th at $2.58/mmbtu from $2.27/mmbtu. This was primarily due to supply outages in Norway and the planned shutdown of a key production site in Netherlands.



Source: Bloomberg, FDC Think Tank

▲ 4.07%

$2.30/MMBtu

AVG NATURAL GAS PRICE

OUTLOOK

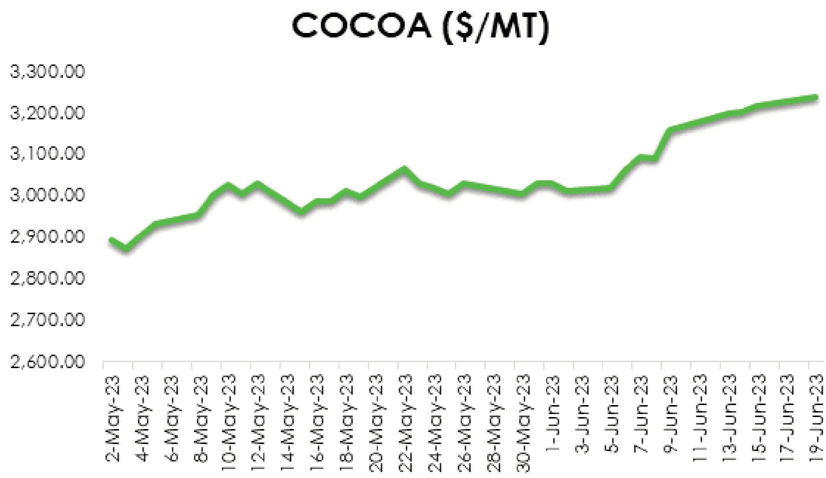
In the coming month, gas prices are expected to remain high due to forecasts of a warmer weather condition in Europe, which could increase the demand for gas for cooling.

IMPACT

LNG is the second-largest export commodity in Nigeria, accounting for 10.4% of total exports. Higher gas prices will help to compensate for the shortfall caused by lower oil prices.

COCOA

The price of cocoa fluctuated in May. It touched a high of $3,064/mt on May 22nd, due to supply tightness in the top grower, Ivory Coast, before falling to close the review period at $3,027/mt. The price of cocoa averaged $2,987/mt in the month of May, up 2.54% from the average price of $2,913/mt in April. Also, cocoa price rose by 6.80% to $3,236/mt in June (June 19th) when compared to $3,030/mt at the beginning of June. This was driven by unfavourable weather conditions in Ivory Coast, Ghana, Nigeria and Cameroon.



Source: Bloomberg, FDC Think Tank

▲ 2.54%

$2,987/mt

AVG COCOA PRICE

OUTLOOK

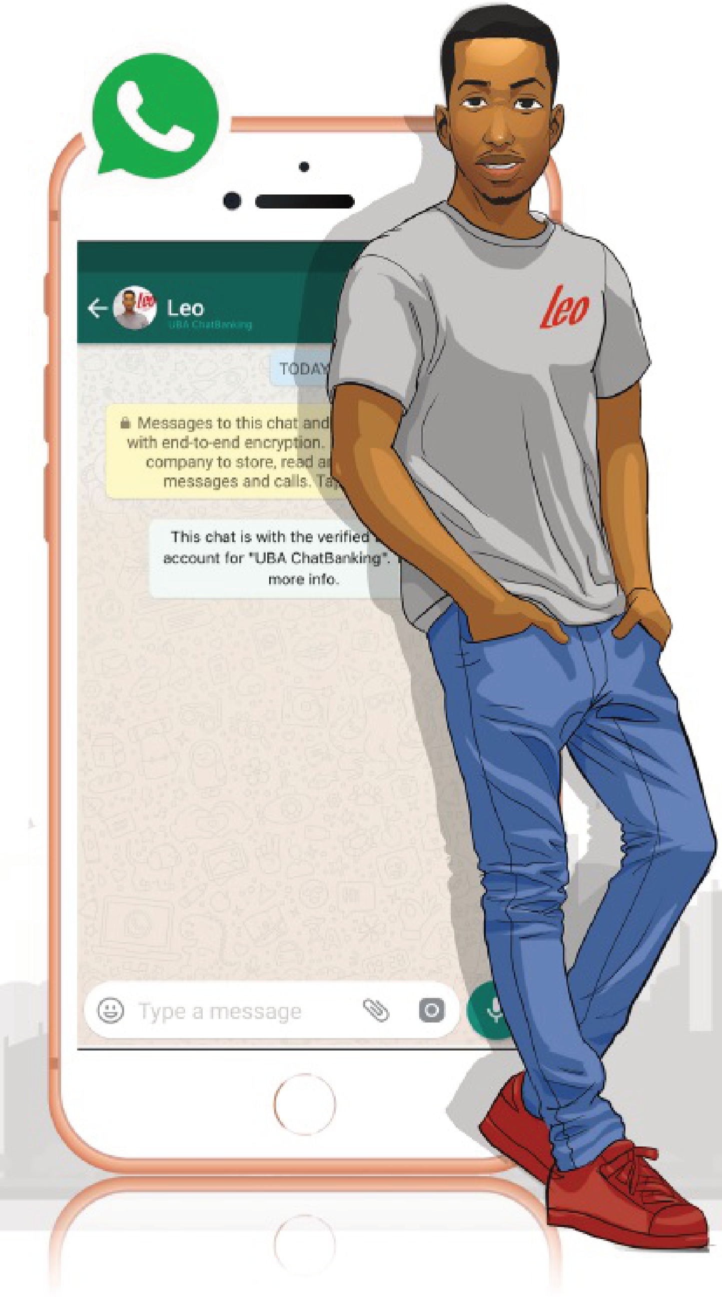
Cocoa prices are expected to maintain an upward trend in the near term as heavy rainfall and floods in West-African cocoa-producing countries (Ivory-coast, Ghana, Cameroon & Nigeria) threaten the quality of mid-crop cocoa and lower supply prospects.

IMPACT

Cocoa is one of the major non-oil export commodities in Nigeria. The rise in the price of cocoa will increase cocoa farmers' income in Nigeria as well as the country’s exchange earnings. The increase in the income of farmers will be supported by the adjustment of the exchange rate at the official windows.

UBA

United Bank for Africa



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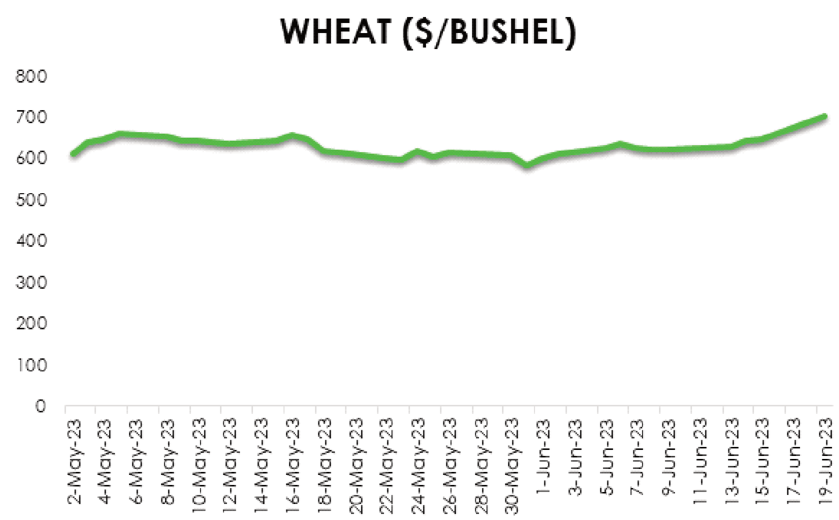
COMMODITY IMPORTS

WHEAT

The average price of wheat fell by 3.08% to $626.81/bushel in May when compared to $674.89/bushel in April, driven by the extension of the Black Sea export deal. Similarly, wheat price decreased by 4.43% to close the month of May at $582.27/bushel from $609.25/bushel at the beginning of May. On the other hand, wheat price surged by 16.72% to close the review period (June 19th) at $701.50/bushel from $601/bushel at the beginning of June. Higher wheat prices were buoyed by Russia's refusal to extend the Black Sea export agreement, which allows Ukraine to export grains to other countries, past the July 17th deadline.



Source: Bloomberg, FDC Think Tank

▼ 3.08%

$626.81/b

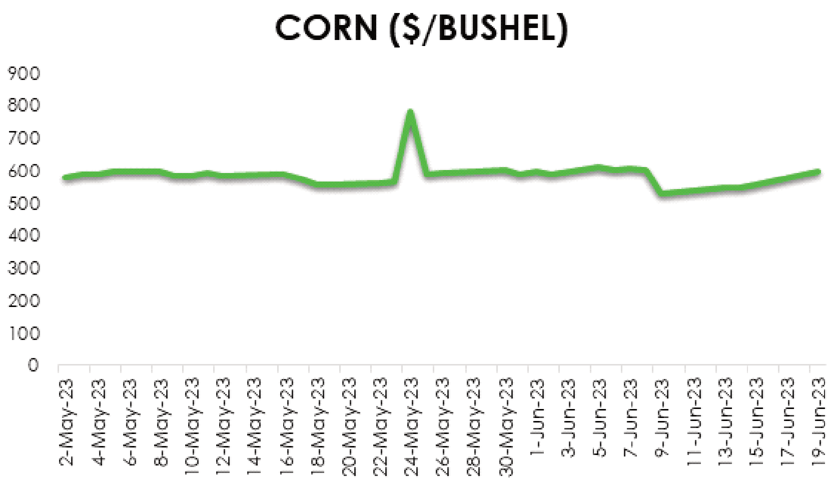
AVG WHEAT PRICE

OUTLOOK - GRAINS

Grain prices are expected to be bullish in the near term due to supply concerns aggravated by the non-extension of the Black Sea port export deal as well as extreme drought conditions in the US (world largest corn exporter).

CORN

Corn price rose by 1.55% to close at $589.00/bushel on May 31st from $580.00 at the start of the month despite increased global supplies. However, the average corn price fell by 5.59% to $592.49/bushel in May from $627.55/bushel the previous month. Corn price declined marginally by 0.21% to $597.50/bushel on June 19th from $598.75/bushel at the beginning of June due to waning export demand for US supplies.



Source: Bloomberg, FDC Think Tank

▲ 5.59%

$589.00 /b

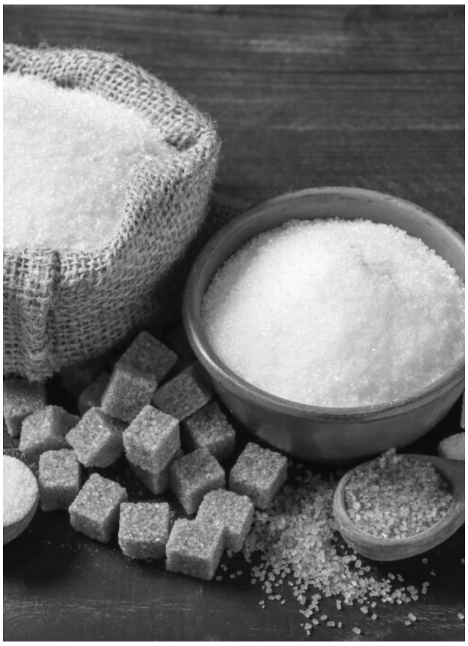
AVG CORN PRICE

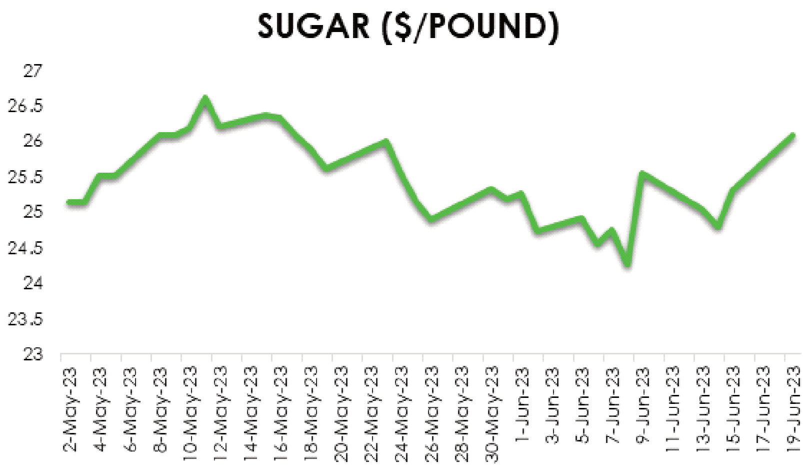
IMPACT - GRAINS

High grain price could shrink the country's trade surplus as its import bill increases. The increase in grain prices will also raise production costs for confectioners, resulting in an uptick in the price of processed foods as they pass their costs to consumers, while also stoking inflationary pressures.

SUGAR

The price of sugar increased consecutively in the month of May. It rose by 0.16% from $25.14/pound to $25.18/pound on May 31st. Sugar price averaged $25.75/pound, 6.94% higher than the average of $24.08/pound in April. This increase was driven by a decline in global market supplies. Sugar prices increased by 3.29% in June, rising from $25.26/pound at the start of the month to $26.09/pound at the end of the review period (June 19th). In India, (second largest exporter) the government has extended its ban on sugar exports till mid-2024 in the expectation of a lower supply.





Source: Bloomberg, FDC Think Tank

▲ 6.94%

$25.75/lb

AVG SUGAR PRICE

OUTLOOK

Sugar prices are expected to remain elevated, as El Nino (unusual warming of surface waters in the eastern tropical Pacific Ocean) weather pattern in India heighten global supply concern.

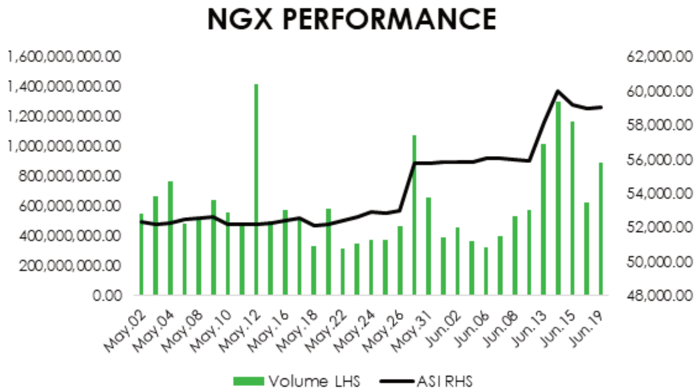
IMPACT

With higher sugar prices, the country's import bill is expected to increase, worsening trade imbalances and straining reserves. This would also result in a rise in confectioners' production costs.

STOCK MARKET REVIEW

MAY 2ND - JUNE 19TH

Trading activities on the NGX closed on a positive note from May 2nd – June 19th. It gained 12.62% to close at 59,016.12 points on June 19th, up from 52,403.51 points on April 28th. Also, the market capitalization increased by 12.62% to N32.13 trillion (trn) relative to its close of N28.53trn on April 28th. The market YTD return increased to 15.15% from 2.25% in the review period. The market breadth was positive at 6.25x as 100 stocks gained, 40 stocks remained unchanged, and 16 lost. The positive performance of the bourse could be mainly attributed to renewed market optimism due to policy changes, institutional reforms and clarity of goals from the new administration.



Source: NGX, FDC Think Tank

The market activity level was mixed in the review period. The average volume traded decreased by 54.53% to 613.90mn units from 1.35bn. Meanwhile, the average value of trades rose by 43.72% to N8.58bn from N5.97bn in the review period.

SECTOR PERFORMANCE

Industrial	FMCG	Banking	Oil &Gas	Insurance
0.71%	20.12%	39.11%	43.23%	44.57%

The performance of the sectors was positive in the review period as four sectors gained while one lost. The Insurance sector recorded a gain of 44.57% in the review period. This was followed by the Oil & Gas sector (43.23%), the Banking sector (39.11%) and the Consumer Goods sector (20.12%). Meanwhile, the Industrial sector recorded a loss of 0.71%.

TOP 5 GAINERS

FTN Cocoa Processors Plc topped the gainers' list with a 393.33% increase in its share price. This was followed by Ikeja Hotel Plc (150.00%), MRS Nigeria Plc (145.97%), Eterna Plc (135.90%) and Unity Bank Plc (115.38%).

TOP 5 LOSERS

The laggards were led by John Holt Plc (-40.23%), Chellarams Plc (-26.52%), The Initiates Plc. (-19.23%), Ellah Lakes Plc (-18.18%) and McNichols Plc (-17.72%).

Company	Apr-28(N)	Jun-19 (N)	Absolute Change	Change (%)
FTNCOCOA	0.30	1.48	1.18	393.33
IKEJAHOTEL	1.46	3.65	2.19	150.00
MRS	27.95	68.75	40.80	145.97
ETERNA	5.85	13.80	7.95	135.90
UNITYBNK	0.52	1.12	0.60	115.38

Company	Apr-28 (N)	Jun-19 (N)	Absolute Change	Change (%)
JOHNHOLT	1.74	1.04	-0.70	-40.23
CHELLARAM	1.81	1.33	-0.48	-26.52
TIP	0.52	0.42	-0.10	-19.23
ELLAHLAKES	3.96	3.24	-0.72	-18.18
MCNICHOLS	0.79	0.65	-0.14	-17.72

OUTLOOK

We expect investors to remain tentative as Nigeria's headline inflation rose to 22.41% in May from 22.22% in April. The rise in inflation and the expectation that prices will be higher in June due to the effect of the PMS subsidy reduction are likely to prompt further interest rate hikes at the next MPC meeting.

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Corporate Focus

NESTLE

CONSUMER GOODS

INDUSTRY

N1,148

CURRENT PRICE

N909.96bn

MARKET CAP

Analyst's Note

In the first quarter of the year, Nestle Nigeria Plc was put under increased pressure due to mounting interest expenses. Despite the growth in revenue, currency depreciation and stubbornly high inflation increased the company's operating costs and margins. Nestle Nigeria Plc's stock is currently trading at N1,148 at the NGX, representing a YTD growth of 13.6%. Over the years, the company has shown its dedication to creating value and improving margins for the benefit of its shareholders in spite of macroeconomic challenges.

Revenue growth bolstered by improved performance in the food business segment

Nestle Nigeria Plc's turnover rose by 16.09% to N127 billion in Q1'23 from N110 billion in Q1'22. This uptick was largely supported by the food business segment, which grew by 22.7% (year-on-year) to N81.17 billion, compared to the 6.13% growth in the beverage product business segment to N46.79 billion. During the review period, the company's domestic sales increased by 18%, offsetting the 87% decline in export sales.

The company's food business segment was largely supported by increased sales of brands like Maggi, Cerelac, Nan, Lactogen, and Golden Morn as similar price increases by competitors limited the down trading impact.

Nonetheless, the beverage segment also remains competitive, especially with its Milo and Nescafe products, as the company's brands remain largely popular among consumers.

Uptick in cost of sales and operating expenses dampens margins

Nestlé Nigeria Plc.'s cost of sales increased by 13.9% to 76.32 billion in the first quarter ended March 31st, 2023. Meanwhile, gross profit was up 19.44% to 51.65 billion compared to 43.24 billion in Q1'22 due to strong revenue growth. Nestlé Nigeria Plc.'s marketing and distribution expenses grew more than twice ahead of sales revenue at 35.9% to N19.3 billion at the end of the quarter. This, coupled with the 40% increase in administrative expenses to N3.66 billion, resulted in a 36.5% uptick in operating costs to N23 billion. This exerted downward pressure on the company's operating margin, declining to 22.39% from 23.95% in Q1'22. Nevertheless, operating profit remained strong at 28.65 billion, 8.52% higher compared to the corresponding period in 2022.

High interest expense depressed bottom line performance

In the first quarter ended March 20, 2023. Nestle Nigeria Plc recorded a profit after tax of N16.2 billion, a 9.8% decline compared to N17.9 billion in the corresponding period in 2022. The decrease in the company's profit was largely driven by higher finance costs, which were up 125% due to the increase in interest expense on financial liabilities. Included in interest expense on financial liabilities is interest expense on intercompany loans, which amounted to 5.52 billion, 200% higher than 1.84 billion in 2022. Despite the 70.5% increase in interest on bank deposits, the zero net foreign exchange gain led to a reduction in finance income, which resulted in a net finance cost of N3.7 billion compared to a N1.45 billion net finance income in Q1'22.

Company Overview

Nestlé Nigeria Plc, is a household name in fast-moving consumer goods in Nigeria, especially in the food and beverage industry. Just like its parent company, Nestlé S.A., a Switzerland-based consumer goods company, it is known for delivering high-quality, nutritious food. Since inception, the FMCG giant has retained its market share through extensive innovations, a varied product line, product rebranding, and the adoption of a local substitution strategy in sourcing some of its raw materials (including soy beans, cocoa, palm oil, and sorghum, among others).

Nestle Nigeria Plc seeks to promote local sourcing of raw materials as it leverages the use of local raw materials in manufacturing its goods to hedge against the foreign exchange issues plaguing the Nigerian economy. In partnership with the International Fertilizer Development Centre (IFDC), the company started a Sorghum and Millet in the Sahel (SMS) project to strengthen the resilience of sorghum and millet farming systems in north-western Nigeria. There was also the launch of the "feed the future Nestlé Maize Quality Improvement Program (M-QIP)" in collaboration with USAID and VEGA as well as the promotion of small-scale agricultural businesses in Kaduna state. All of which are aimed at increasing the quality and quantity of maize and soybean by at least 17,000 metric tonnes annually. Nestle Nigeria manufactures, markets, and distributes food products, including purified bottle water, and exports consumer goods to markets within and outside Africa. The brand's distinctive-tasting cereal, Golden Morn, is made from locally sourced grains and fortified with other vitamins. It has been providing delicious nourishment to families for over 35 years. Its milo product continues to promote sports development at the grass-root level through competitions like basketball championships. Nestle Nigeria Plc has made impressive strides over the years as seen in increases in its assets and revenue.

Outlook

Nestle Nigeria Plc has played a significant role in the Nigerian FMCG industry buoyed by investment in backward integration and a well-diversified brand portfolio. The company has continued to invest in strategies for manufacturing products that match consumers' expectations and benefitted from several government opportunities related to local content production and trade deals. This indicates that the company is well positioned to capitalize on a window of opportunities within the industry and immune from potential headwinds that could impair future business operations.

While major economic headwinds persist and weigh on profit margins through increased finance costs, Nestle Nigeria Plc faces the risk of currency devaluation due to its significant exposure to foreign debt as well as risk of inflated interest expense particularly as interest rates have been on the rise. We expect a moderation in the company's capital structure in a bid to reduce exposure to debt and interest expense on intercompany loans. Notwithstanding, Nestle Nigeria's operations will continue to leverage on its strong business model, brand recognition, and good product quality.

Bulls say:

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

Bears say:

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

OUTLOOK FOR NEXT MONTH

It is expected that the ongoing reforms will begin to crystallise in the coming months. Although the exchange rate seems to be volatile at the IEFX window, it is expected that it will become more stable in the coming months while converging to the parallel market rate. However, external reserves will remain constrained as oil prices sustain their bearish outlook. Headline inflation is expected to rise in June due to the impact of fuel subsidy removal on transport and food prices. As inflation continues to trend upward, the MPC is likely to hike interest rates at its next meeting in July.

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