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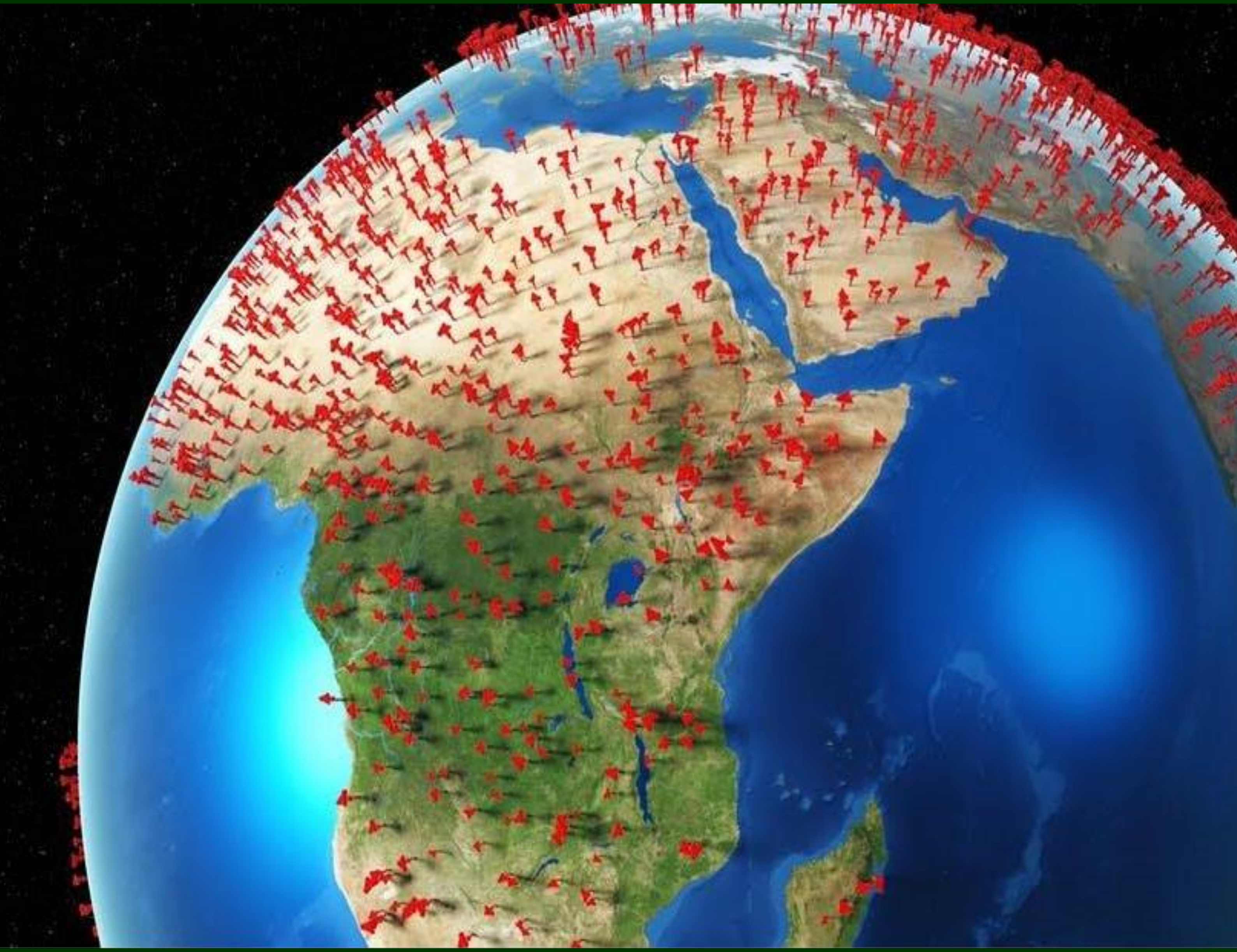

Nigeria H2'20 Outlook

The viral shock

June 2020

NIGERIA OUTLOOK
The viral shock

30 June 2020

The year 2020 has been a struggle. A global pandemic is in full swing and is poised to upend lives and livelihoods, obliterating any optimism for growth. In addition to disruption to social interaction, the outbreak is saddled with economic consequences in both the short and long run. The economic damages associated with the pandemic are already kicking in, particularly in developed economies, with unprecedented momentum and severity. The sharp drop in economic activity, the collapse of trade and a surge in unemployment to record levels are indications of what is to come, should the pandemic persist. This has called for concerted efforts by both fiscal and monetary authorities to limit some of the damage that could come with the pandemic.

With monetary policy limited in its capacity to mitigate the negative impact of the pandemic, fiscal policy is now in the spotlight to limit the rate of infection and also support consumption levels through financial and non-financial palliatives. Advanced economies however seem better positioned to embark on expansionary spending at this time. For developing economies, they were already mired in economic crisis before the coronavirus outbreak, but now face the triple hit from lockdowns at home, collapsing foreign demand for their exports, and the reversal of foreign capital. The economic pain from the virus could be especially severe in developing economies where swaths of the population do informal jobs for meager pay without much of a social safety net.

This is particularly true for countries in the Sub-Saharan Africa (SSA) region whose main sources of income (commodities export & tourism) have been dealt a big blow by the pandemic, while over 50% of the population rely on income from the informal sector. The fiscal stress in the region will be compounded by the inadequacy of existing public health resources, which poses as a hindrance to the ability of countries in the region to respond to the pandemic. As a result of the already tight fiscal conditions, African countries could go on a debt binge, raising fears of long term debt sustainability.

Nigeria, who has been managing the debt accumulation narrative for some time, may be pushed to its limits as a sharp drop in revenues coincides with expansionary spending. With about 60% of its GDP attributable to consumption spending, lockdowns may also have a gnashing effect on the country's aggregate output. This creates a somber expectation of things to come. However, it is not all doom and gloom as the oil and telecommunications sectors hold some promise. The seemingly low rate of infections could also give the country an investment advantage - with respect to portfolio flows – among yield chasing investors. The reliance on transient flows will, however, continue to generate liquidity concerns in the FX market and limit the firming of the naira exchange rate, but the risk of a long run FX insolvency remains low.

Against the backdrop of the pandemic, a lot of uncertainty still persists and the economic outlook is still subject to significant downside risks. Should there be a second wave of the coronavirus outbreak, with restriction measures re-introduced and economic recovery delayed, the economic performance could be a lot more bearish than anticipated. Debt service obligations may become suffocating and culminate in a global financial crisis through a contagion effect. Therefore, the speed and severity of the pandemic remains a critical piece of the global and domestic economic puzzle.

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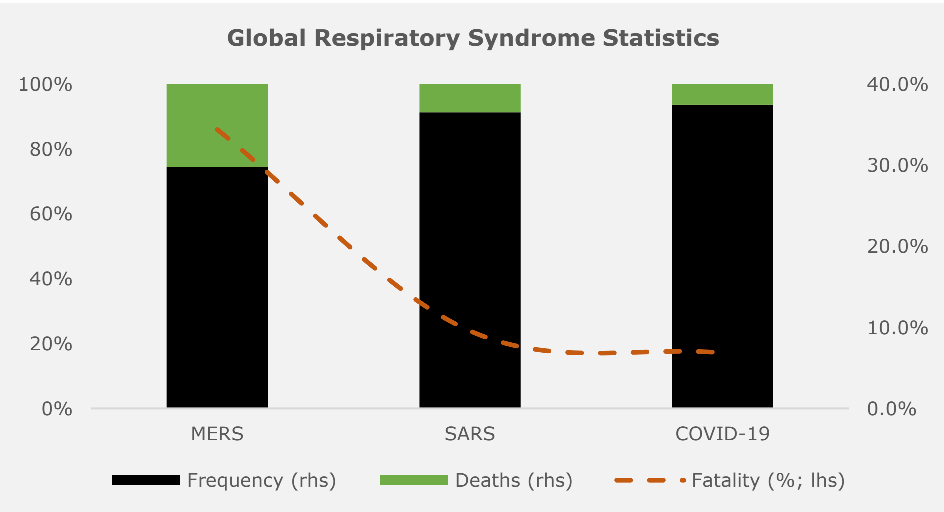
Global Economy: Clouds of uncertainty

A black swan in historical context

An unusual coronavirus outbreak ensured that the year of the metal rat (according to Chinese astrology) did not get off to the most propitious start. This pandemic, which is both a shock to demand and supply, is highly contagious and comes with economic crisis. International alarm over the coronavirus that emerged in Wuhan, China, in December 2019 was driven by its rapid spread and the fact that little was still known about the nouvelle coronavirus (SARS-CoV-2), causing the World Health Organization (WHO) to label the virus a global pandemic. The COVID-19, which has similarities to past global respiratory illnesses (SARS & MERS), is much more infectious, but less fatal. In weeks, the COVID-19 infected more people than the Severe Acute Respiratory Syndrome (SARS) did in months while it took the Middle East Respiratory Syndrome (MERS) eight years to infect almost 2,500 people. For every 50 infected persons, MERS killed 17 persons and SARS, 5 persons but the COVID-19 claims between 2-3 lives (at the time of writing).



Source: Centers for Disease Control and Prevention

With over 500,000 people dead so far, more than 10 million infected and over 180 countries affected, the raging pandemic has forced global policy makers to take various measures to contain the velocity of the virus' spread and cushion the attendant impact it may have on economic activities. Cities lockdown, travel restrictions, plant and/or business closures as well as the declaration of national emergencies in many countries have disrupted supply chains, posing a major threat to global trade, commerce, tourism and investment. Millions of workers are also at risk of losing their jobs, raising the odds of a depression in consumption demand over the coming months and weighing on global growth prospects.

A major pressure point on the global economy stems from economic contractions in the world's largest economies, which is an ominous sign for the global economy. The health of China's economy is critical to global growth as it accounts for 19% of global GDP, with an approximate contribution of 30% to global real GDP growth, and is an important cog in global trade. Because the Chinese economy is much more deeply intertwined with the world's economy than it was during the 2003 SARS outbreak, a sharp slowdown in

China will result in significant softening of global growth and the channels through which this slowdown will impact the world economy are weaker demand for commodities and tradeable goods, as well as disruptions to international supply chains. Also, the United States (US) – which is the current epicenter of the pandemic - constitutes 15% of global output and the Euro Area - that accounts for 11% of global GDP and 26% of global exports - was also not spared from the ravaging pandemic, with some of the region's largest economies being the worst hit (i.e. Italy, Spain and France).

Entire industries have also been shut down as the measures aimed at reducing human-to-human contact are distorting economic activity by limiting mobility and business operations. The aviation and tourism industries are being hurt by travel restriction measures and as business and leisure travelers drastically cut back on flying rather than risk infection while traveling. The hospitality and entertainment industries are also bearing the brunt of a reduction in human interaction as more people desist from going to stores, restaurants or movies. The disruption to global supply chains and the screeching halt of production activities in many countries impaired global trade while fear is also hurting businesses that are dependent on sales calls, as the epidemic is keeping its agents from visiting potential customers.

These could lead to a streak of job losses, causing a huge decrease in consumer demand - and by extension manufacturing – if the pandemic persists, as producers cut output to align supply with lower demand. Apart from applying the brakes on GDP growth, the COVID-19 pandemic affected commodities prices, especially oil. Considering that China is the world's largest oil importer, reduced oil demand from China on the back of lowered demand for jet fuel due to widespread travel restrictions, put downward pressure on commodity prices. Although there is no clear historical precedence for the scale and nature of the economic consequence of the pandemic, the heightened threat to the growth prospects in most of the world's largest economies and the adverse impact on a number of key industries suggests that global growth could take a beating similar to the impact of a historic black swan event, the Great Recession. This has raised fears of a coronavirus-led global recession in 2020, with an International Monetary Fund (IMF) global growth forecast of -3% for the year. However, the global economic outlook could deteriorate further depending on the ability of public health systems to promptly rein in the virus, as well as the effectiveness of monetary and fiscal policy responses in cushioning the economic consequences of the outbreak.

Event	Occurring date	World GDP growth rate
1907 Bankers' Panic	May'1907- Jun'1908	-22.7%
World War I End/ Spanish Flu Pandemic	Apr'1917 - Jul'1921	-28.6%
Great Depression	Sep'1929 - Mar'1933	-26.7%
World War II Demobilization/Fiscal Recession	Sep'1939 - Sep'1945	-12.7%
Great Recession	Dec'2007 - June'2009	-5.1%

Source: Wikipedia

Advanced Economies: A blizzard of woes

The coronavirus ricocheted through advanced economies in Q1’20. Although lockdown measures were introduced mostly in March, they began to bite instantly, resulting in the worst economic contractions in the advanced economies since the depth of the global financial crisis. The US has been the worst hit so far as its economy shrunk by 4.8% in Q1’20, putting an end to a nearly 11-year expansion cycle. As the level of economic activities have dropped in the country, unemployment rose to a historic high of 14.7% in Apr’20 and jobless claims have continued to rise – surpassing 43 million in 12 weeks (as at 6th Jun’20). As a result, consumer spending has recorded the largest retreat since 1980 (-13.6% m/m as of Apr’20), as many Americans cut back on spending on cars, clothes, travel, eating out and most other goods and services.

The Eurozone suffered a 3.3% y/y contraction in the first three months of the year, amid a widespread shutdown. Eurozone factories had a torrid quarter as industrial output across the bloc contracted steeply (-12.9% y/y in Mar’20) and caused unemployment to inch higher to 7.4% in Mar’20 from 7.3% in Feb’20. The gloomy Euro Area statistics are a fallout of a litany of national woes around the bloc. France recorded a staggering 5.8% contraction in Q1’20 and Spain – one of the worst affected countries by the virus – saw its GDP shrink by 5.2%. Even Germany was not left out of the grim, as the count of jobless persons soared from 2.3 million in Mar’20 to 2.6 million in Apr’20 while retail sales plunged 2.8% y/y in Mar’20 compared to Feb’20.

Elsewhere in Europe, the UK was not spared from the bloodbath as its economic output declined by 1.6% y/y in Q1’20. Its contraction was less severe, compared to the US and EU, because its lockdown was implemented a week to the end of the quarter. Economic output nosedived by a record 5.8% in Mar’20 from the previous month as the impact of the direct impacts of the lockdown kicked-in.

The question now is how quickly will these world powers recover from this contraction? We believe this is a prelude to even more massive declines in the course of the year as the full effects of the pandemic is yet to filter through the advanced economies. With only one to two weeks of lockdown in Q1’20 resulting in such steep contractions in output, the worst might be yet to come. The recession will likely gather significant pace in subsequent quarters that cover a much longer period of lockdown.

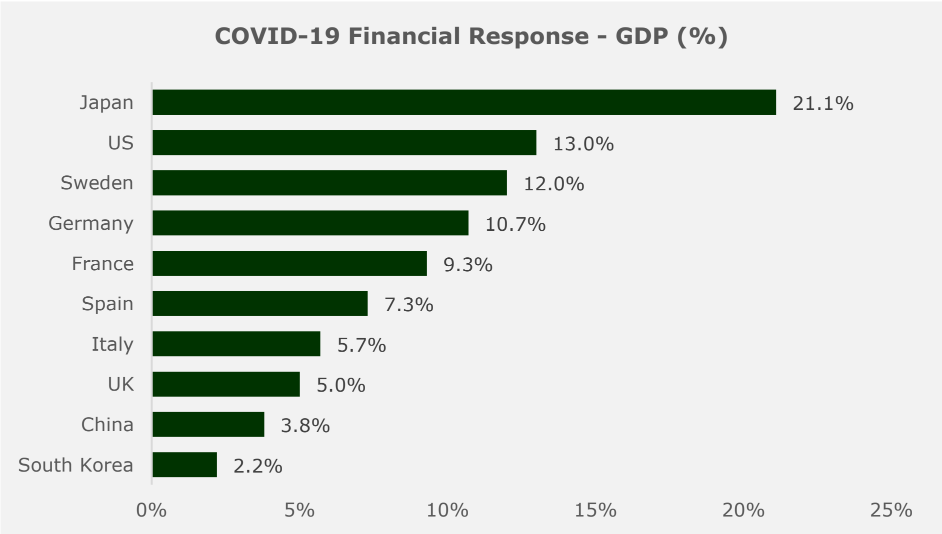
In our opinion, growth in advanced economies is likely to be weak for quite some time. We believe the economic fallout of the measures deemed necessary to contain the spread of the coronavirus could be huge, as it could shrivel consumption and investment spending and weigh on supply chains, trade and industrial output in 2020. How quickly these economies turn around and begin to grow again will depend on how well the governments limit the spread of COVID-19 and allow individuals and businesses to get back to work. Even then, lingering worries about the virus are likely to cause many citizens to continue to practice social distancing, an outcome that could harm industries such as airlines, hotels and restaurants.

The IMF projects that all three economies will fall into a recession this year, with the Euro Area expected to record the steepest contraction at -7.5% y/y. The Fund expects GDP in the UK and the US to contract by 6.5% y/y and 5.9% y/y respectively. These economic scenarios are nor far-fetched as consumption expenditure would plunge further on increasing job losses. Economic activity should, however, improve from 2021 and the expected rebound is likely to be very gradual but GDP levels at the end of 2021 will still be below where they finished 2019.

Advanced Economies' policy responses to COVID-19

To alleviate the negative effects of social restrictions on the economy and to support public welfare, governments have adopted a mix of fiscal, monetary, and financial policy measures. These economic measures are targeting households, firms, health systems and banks and they vary across countries in breadth and scope. Monetary policies adopted by countries consist of the emergency lowering of interest rates and providing liquidity support to banks while fiscal policies include transfers to households and businesses, extension of social security benefits, and funds for the healthcare system.

Although the US has committed to the largest rescue package of any country by far in financial terms, it is not the most aggressive bailout in relation to economic size. At approximately 13% of GDP, the US stimulus package is behind Japan's rescue package which is estimated to be just over 21% of GDP. In Europe, where Spain and Italy have endured devastating outbreaks of COVID-19, the size of the stimulus packages are estimated to be 7.3% and 5.7% of GDP respectively.



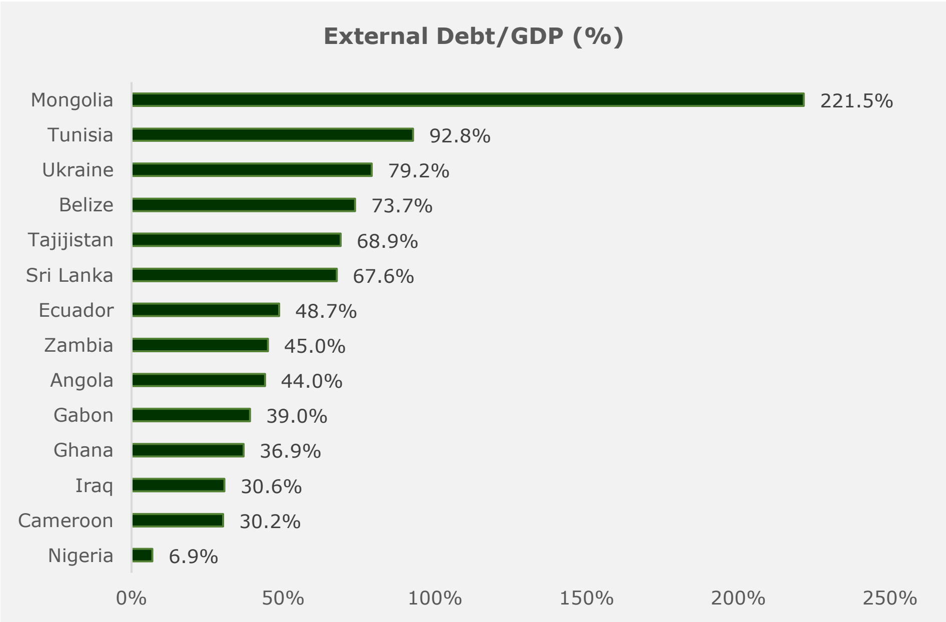
Source: Statista

Emerging Markets and Developing Economies (EMDEs): Walking tightropes

The coronavirus pandemic is taking a huge economic toll on every country in the world, but most EMDEs are being hit a little later and particularly hard. China, the biggest emerging market and the origin of the coronavirus, saw its GDP drop by 6.8% y/y in Q1'20. The dour economic performance of the Chinese economy reflects drops in retail sales, construction activity and industrial output on the back of an 11-week lockdown imposed across the country to contain the epidemic. While China is gradually re-emerging from the crisis, many EMDEs are still in the early days of the outbreak as numbers of cases are suppressed by the fact that testing capacity is still low – compared to advanced economies.

Many EMDEs were already mired in economic crisis before the coronavirus outbreak, but now they face the triple hit from lockdowns at home, collapsing foreign demand for their exports, and the reversal of foreign capital. Inadequate public health resources question the ability of developing countries to deal with the coronavirus pandemic. The economic pain from the virus could be especially severe in developing economies where swaths of the population do informal jobs for meager pay without much of a social safety net. Palliative packages are putting pressure on government finances and there is not enough aid to go around. Over a hundred of the IMF's member countries have asked for help, the highest ever.

The developing world could be on the cusp of its worst debt crisis. Ultra-loose monetary policy and unprecedented fiscal stimulus have triggered the outflow of capital from mature markets into developing ones. According to the Institute of International Finance's Capital Flows Tracker, there were inflows of an estimated $17 billion to EMDEs in Apr'20. Emerging Asia attracted twice the debt inflows as Latin America, while China secured net equity inflows - reflecting its head start on getting back to business post-COVID. Emerging economies have incurred more than $8.4 trillion in foreign debt, about 30% of the EMDE's total GDP, and many countries have put forward pleas to international creditors (including the World Bank and IMF) to delay or cancel their debt payments to enable them focus on reining the pandemic.

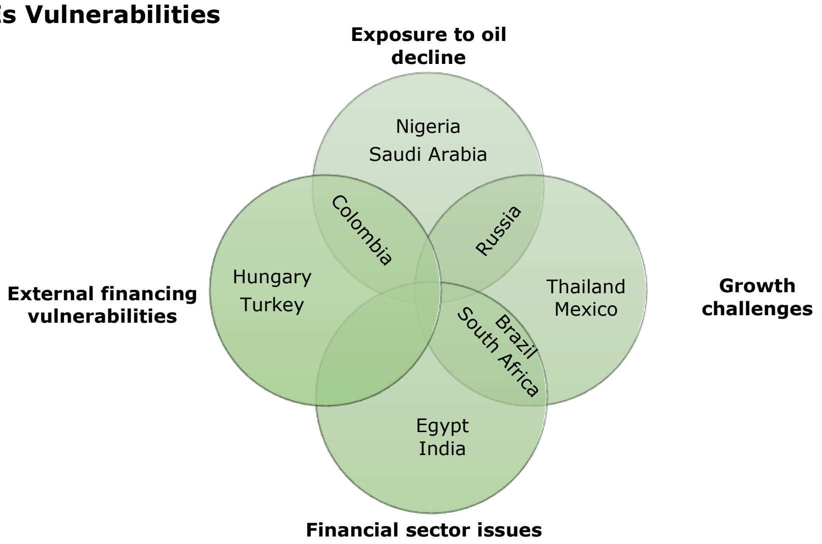


Source: CEIC, World Bank, Vetiva Research

Zambia, Ecuador and Rwanda have reported that they are grappling with their debt repayments, while Argentina is on the brink of its ninth sovereign default since its independence. However, some emerging economies (including Pakistan and Benin) have expressed concerns about renegotiating what they owe to private creditors, for fear it will damage their access to financial markets in future. The fear is that the medium-term cost in terms of market access, borrowing costs and reputational damage could be a lot higher than the short-term cash flow savings of debt restructuring. Debt restructuring or requests for repayments deferral risk triggering credit ratings downgrades in countries, which would make it more expensive for governments to borrow in future.

With global trade on course to fall by up to 32%, remittances poised to fall by an additional $100 billion this year and oil and gas revenues to developing countries projected to plunge by 85%, developing countries could be hardest hit. Higher population densities, poverty and a plague of locusts (in Africa) could accentuate the economic impacts of the coronavirus. Countries with low growth buffers, twin (fiscal & current account) deficit, less policy room to maneuver, and exposure to China via trade and commodities are the most vulnerable to downside pressure across the emerging market (EM) complex.

EMDEs Vulnerabilities



Source: IMF, Vetiva Research

Post-COVID, economic recovery in EMDEs could be uneven as countries who may have similar levels of macroeconomic stability and growth rates may differ in their crisis-management capacity. For instance, India - with limited health resources and struggling to manage the first wave of infections – may be more prone to demand-quashing outbreak relapses, until a vaccine is found. Similarly, the trend in the flow of foreign capital to EMDEs will track both the financial and non-financial (i.e. crisis management capacity) vulnerabilities of countries. Countries with a high risk of infections relapse may find themselves at the short end of the stick.

The IMF projects that emerging and developing countries would need $2.5 trillion in aid to weather the crisis. This could be revised upwards, in the course of the year, as the crisis deepens. Investors in emerging market debt - particularly dollar bonds - should exercise caution because many EMDEs are reaching the limit of their fiscal space. Discernment is required so that a fiscal problem does not degenerate to a solvency problem.

IMF Apr'20 Forecasts	GDP (%)	Inflation (%)
World	-3.0	-
Advanced Economies	-6.1	0.5
US	-5.9	0.6
Euro Area	-7.5	0.2
UK	-6.5	1.2
Japan	-5.2	0.2
EMDEs	-1.0	4.6
China	1.2	3.0
India	1.9	3.3
ASEAN-5	-0.6	1.8
Saudi Arabia	-2.3	0.9
Russia	-5.5	3.1
SSA	-1.6	9.3

Source: IMF, Vetiva Research

Macroeconomic and policy themes in H2'20

COVID-19 second wave

As countries across the world gradually roll back their stay-at-home orders, the possibility of a second - and more deadly - wave of the pandemic is increasing, without a readily available vaccine. In Seoul, South Korea's capital, a cluster tied to nightclubs emerged after restrictions were relaxed while Wuhan, China – the ground zero of the pandemic - is on alert again after a 35-day hiatus of new cases. Similarly, in Africa, the relaxation of confinement rules has led to a significant surge of coronavirus infections across the continent.

Countries are puzzling through how to restart economic activity while avoiding further waves of infections through mass testing and contact tracing - two tried and true tools to prevent new infections. Countries with limited crisis-management capacity and patchy health systems will find it nearly impossible. With optimistic estimates putting the discovery of a vaccine at 2021, at the earliest, further outbreaks are therefore likely, and with them will come a destructive cycle of re-openings and lockdowns.

Global recession

Echoes of a recession are reverberating across major global economies as the coronavirus crisis escalates. With millions of people now jobless, heightened uncertainty in financial markets, and major supply chains disruption, the world is braced for a recession even after governments and central banks have injected trillions of dollars into their economies and lowered interest rates to near zero levels. "How bad will it be?" and "How soon will we recover?" are two questions we will be hearing a lot in H2'20.

The global economic downturn could be quite deep and lengthy, with recovery limited by continued anxiety. So long as human interaction remains risky, business cannot completely return to normal and what was normal before may not be anymore. The abrupt halt of commercial activity, as governments intensify restrictions on businesses to halt the spread of the pandemic, threatens to impose economic pain so profound and enduring - simultaneously in every country - that recovery of the global economy could take a while. The timing of recovery is far from certain, and there is more uncertainty about the strength of the rebound.

U.S. Presidential election

Trump's approval ratings are their worst since the U.S. government shutdown in January 2019, amid mounting coronavirus death toll and nationwide Black-Lives-Matter protests. Americans appear to be increasingly critical of the way Trump has handled the health crisis because he initially downplayed the threat of the virus. President Trump has defended his administration's handling of the crisis and has accused China of failing to alert the world about the severity and scope of the outbreak, which has hammered the economy.

Also, a recent New York Times/Siena College poll revealed that the democratic presidential candidate, Joe Biden holds a strong lead among registered voters in six battleground states that were carried by Trump in 2016. Specifically, 42% of voters in the battleground states approve of how Trump is handling his job as president, while 54% disapprove. Voter disapproval seems to highlight deeper disagreement with Trump's prioritization of the economy over taming COVID-19 spread, and with his focus on law and order over anti-racism protests. That said, Trump's best chance of re-election is for the pandemic and the protests against criminal injustice to have faded by November and the U.S. to have made a strong economic recovery—a desire somewhat distant from current realities.

Although Biden's standing remains healthy by most measures, the dominant picture from the polls is that his wide lead reflects Trump's weaknesses rather than his own political goodwill. Notably, 55% of Biden's supporters say their vote is more a vote against Trump than a vote for Biden. Overall, while poll metrics point to Biden as the next U.S. President, a strong revival in republicans' preference for Trump could make the path to White House a contentious one in November.

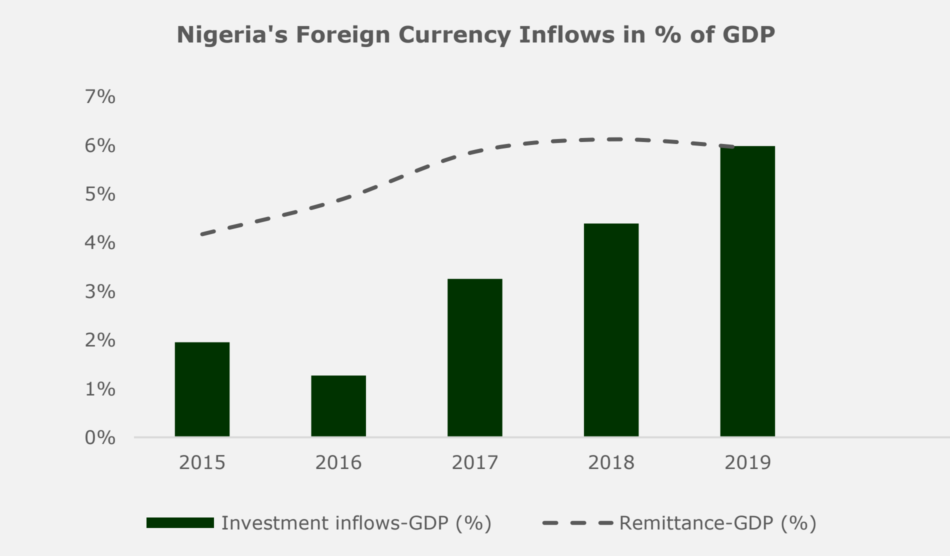
Sub-Saharan Africa: A thorny path

Although Sub-Saharan Africa (SSA) has abundant experience and expertise in managing epidemics, ongoing viral episodes as well as infestation, insecurity, climate change and several health challenges, could double down the adverse impact of the COVID-19 pandemic on the region's economy. SSA, which is home to some of the poorest and most vulnerable EMDEs, was seemingly insulated from the impact of the 2003 SARS outbreak because it was less integrated with the rest of the world. However, over the past 17 years, Sino-African ties have become extensive, including trade, investment & finance, tourism, education, and security cooperation. Therefore, if China sneezes, SSA could catch a severe cold because of its domestic macroeconomic weaknesses.

The economic constriction caused by the global coronavirus pandemic has punched holes in budgets across the region. A good number of the region's economies thrive on commodity exports and tourism, and the plunge in commodity prices as well as the social distancing measures enforced to limit the spread of the pandemic, could significantly impair revenues and FX earnings to the region's governments – amid rising pandemic bills. Also, as global demand remains weak due to a sharp drop in economic activities in China, Europe, and America - the major trading partners to SSA economies – demand for the region's exports could remain subdued, intensifying the downward pressure on revenues, and contributing to the region's fiscal stress. Just like the advanced economies, SSA countries have adopted a combination of monetary and fiscal measures to support companies and individuals - that may be affected by public health controls – who have liquidity needs. However, while richer EMDEs - like China and India - can afford to provide large palliative support to limit the adverse economic impact of the pandemic on vulnerable groups, palliatives supply by the region's governments will come at a steep cost, amid dwindling revenues and insufficient fiscal buffers.

Economic stimuli provided as a percentage of GDP is comparatively low in SSA, ranging between 0.6% - 1.1%, compared to stimuli provided in advanced economies (between 2% -21%). More aggressive social packages could end in deteriorating fiscal positions and slow the region's capacity to combat the pandemic. The apparent financial implications associated with managing an outbreak of this magnitude has led many SSA countries to seek fiscal assistance – in the form of concessional loans, debt deferment and/or forbearance – to enable them to secure some resources urgently needed to tackle the pandemic and to assist in maintaining macroeconomic stability in the region.

Furthermore, a rapidly deteriorating external environment is reducing investment flows to the region and increasing external imbalances. The IMF estimated that capital outflows from the region have surpassed $4.2 billion between the end of February and mid-April and these have continuously pressured SSA financial and currency markets. Remittances - an indirect but important channel of foreign currency inflow - have also been crimped, widening the region's foreign currency gap and putting pressure on local currencies. The COVID-19 effect on the world economy has resulted in reduced incomes to migrants in their host countries – as migrants are often the first to be laid off, leading to less money being sent to the region. In some countries, like Nigeria, remittances often surpass inflows from foreign investments (FDI & FPI) and sometimes, resource earnings.



Source: World Bank, NBS, Vetiva Research

The economic consequences of the outbreak might be more significant for the SSA region than the epidemiological impact. Consequently, multilaterals seem to agree on the very fact that a recession looms for many of the region's countries, ushering in the first recession in the region in over two decades – as forecasts range from -1.6% to -5.1%. The forecasts reflect anticipated sharp declines in aggregate output from the region's three largest economies—Nigeria, Angola, and South Africa—due to persistently weak growth and investment. With a mix of macroeconomic risks emanating from a weakened export demand, a plunge in commodity prices, reduced tourism and lower portfolio flows, it is highly unlikely for African countries to wriggle from the grasp of the looming recession. The same scenario of falling commodity prices and continuing weakness in global growth made Sub-Saharan Africa's GDP growth decelerate to an estimated 3.0% in 2015 from 4.5% in 2014.

IMF Apr'20 SSA Growth Forecasts			
Country	**Resource Dependence**	**RGDP (%)**	**Inflation (%)**
South Sudan	Crude Oil	4.9	8.1
Chad	Crude Oil	-0.2	2.2
Cameroon	Crude Oil	-1.2	2.8
Gabon	Crude Oil	-1.2	3.0
Angola	Crude Oil	-1.4	20.7
Congo, Rep. of	Crude Oil	-2.3	2.1
Nigeria	Crude Oil	-3.4	13.4
Equatorial Guinea	Crude Oil	-5.5	1.7
Tanzania	Other Resource	2.0	3.9
Ghana	Other Resource	1.5	9.7
Sierra Leone	Other Resource	-2.3	15.4
Liberia	Other Resource	-2.5	13.8
Namibia	Other Resource	-2.5	2.4
Zambia	Other Resource	-3.5	13.4
Botswana	Other Resource	-5.4	2.1
South Africa	Other Resource	-5.8	2.4
Zimbabwe	Other Resource	-7.4	319.0
Benin	Resource poor	4.5	-0.8
Rwanda	Resource poor	3.5	6.9
Uganda	Resource poor	3.5	3.9
Senegal	Resource poor	3.0	2.0
Ethiopia	Resource poor	3.2	15.4
Côte d'Ivoire	Resource poor	2.7	1.2
The Gambia	Resource poor	2.5	6.7
Mozambique	Resource poor	2.2	5.2
Kenya	Resource poor	1.0	5.1
Malawi	Resource poor	1.0	14.0
Togo	Resource poor	1.0	2.0
Madagascar	Resource poor	0.4	5.5
Eritrea	Resource poor	0.1	4.5
Burundi	Resource poor	-5.5	8.0
Sub-Saharan Africa		**-1.6**	**9.3**

The coronavirus could have a reactive impact on the economic activity of countries as well, through the disruptions caused by containment and mitigation measures imposed by the governments. Countries with stricter lockdown measures could record recessions in greater folds if the amalgamated effects of lockdowns, infections, international trade plunge and reduced portfolio flows, is large. Although a handful of SSA countries (such as Ghana & Kenya) are projected to escape the virus-recession because their domestic sources of growth are more resilient and they have some policy space to support the economy, uncertainty on the persistence of the pandemic and its economic implications, could trigger further downside revisions on the region's growth projections for 2020. Ultimately, the magnitude of country recessions will depend largely on the public's compliance with restrictions within the respective countries, the spread of the disease, the degree of every country's economic resilience, as well as the robustness of their policy response.

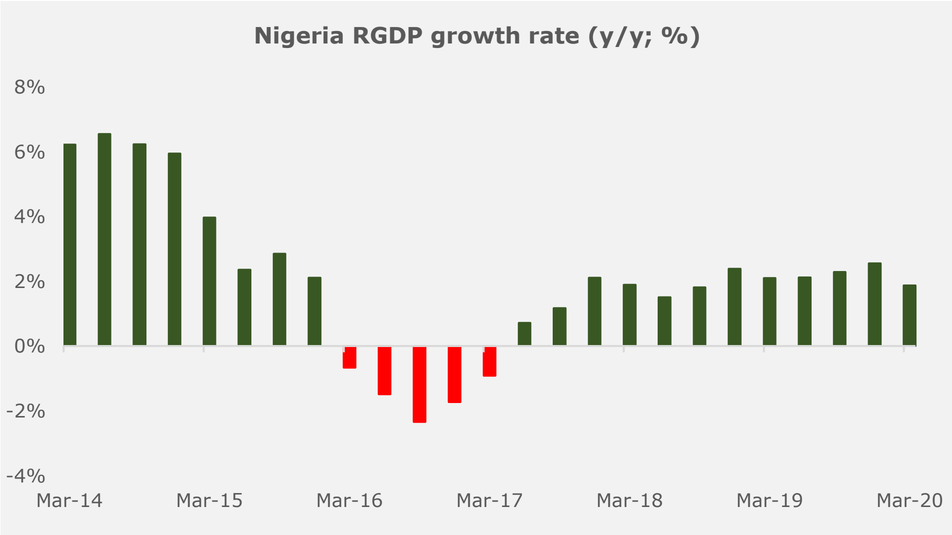
The COVID-19 outbreak could also result in a food security crisis in the region if a possible contraction in agricultural output coincides with a considerable decline in food imports (due to a mix of higher transaction costs and reduced domestic demand). In addition to managing the outbreak, East African countries are dealing with huge locust swarms that pose a threat to food security and livelihood in the sub-region. This might put pressure on food prices and pass through to headline consumer prices because the average weighting for the food price index in sub-Saharan Africa is put at approximately 40%, by the IMF.

Depreciations of local currencies could also contribute to increasing inflationary pressures in the region, on the back of higher import prices. All these lend credence to the IMF's expectation of an uptick in the region's inflation to 9.3% from 8.4% in 2019. Higher inflation expectations, amid heightened economic uncertainty should stay the hand of most central banks in the region from further monetary policy accommodation. However, countries with properly anchored inflation expectations (Ghana, Kenya & South Africa) can take advantage of existing monetary policy space to compliment fiscal policy and support economic growth, by further relaxing monetary policy.

Domestic Economy: Walking a tight rope

Economic growth and welfare linkages

Nigeria's recovery from 2016's oil-induced recession was U-shaped as the economy endured five consecutive quarters of contraction. This pushed the economy into its first recession since 1991, recording a growth of -1.5% y/y in 2016 as oil production shortages exacerbated the decline in the oil price. Since the country exited recession in 2017, economic growth is yet to return to pre-recession levels. Post-recession, economic growth has remained sluggish at sub-2% y/y growth rate. This has been due largely to slow growth in the output of tangibles (which include agriculture, manufacturing, mining and construction) which account for about 47% of total real output.



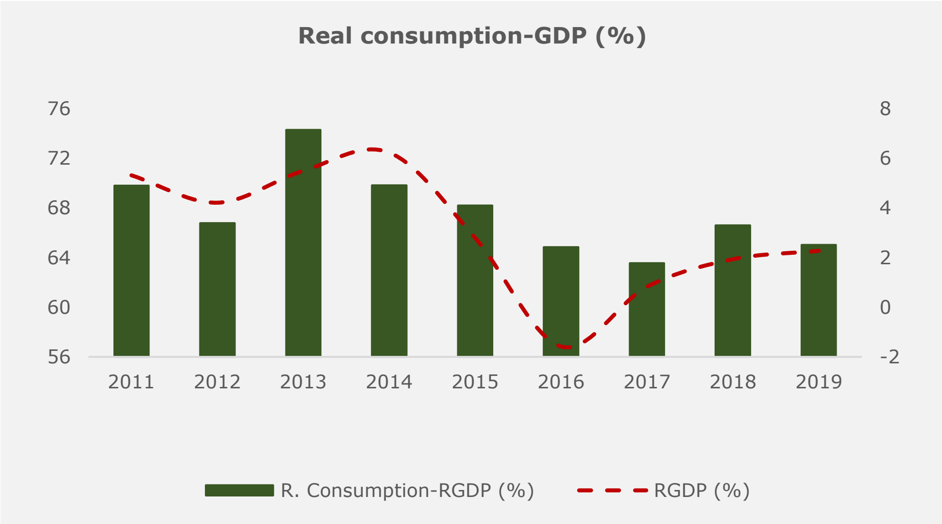
Source: NBS, Vetiva Research

Growth in the agriculture sector has slowed from a record high of 6.70% y/y in 2012 to 2.36% y/y in 2019. Growth in the sector has slowed on the back of age-long challenges, including low yielding seedlings, underinvestment by the private sector, land ownership and tenure rigidities, poor infrastructure, restricted access to credit, ageing farming population, persistent rural-urban population drift among other daunting limitations.

Role of consumption and investment in industry

Industrial sector growth has mainly reflected the volatility in the oil sector, in the midst of weakness in the manufacturing and construction sectors. Oil sector growth continued to be sluggish, post-recession, as a dearth in policies exacerbated the impact of oil price swings and production uncertainties on the sector's overall performance. Post-recession, capital imports to the oil and gas sector have declined by an average of 17.24% over the last three years (2017-2019). This has been largely due to the impasse of the Petroleum Industry Governance Bill (PIGB) which holds uncertainties for the sector and continued to weigh on the sector's investment outlook.

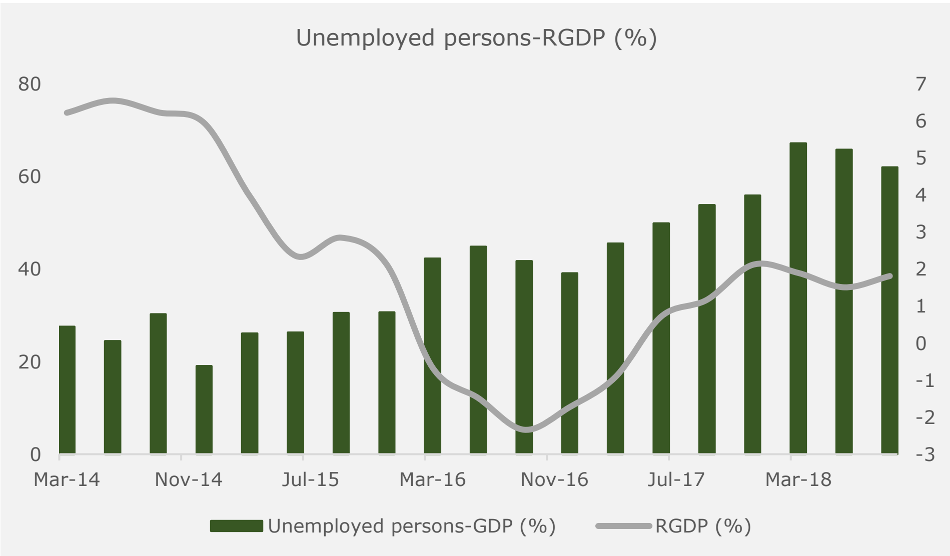
The manufacturing sector is yet to recover from the downturn in consumption spending that occasioned the 2016 recession (2019: 2.31% y/y). Prior to the recession, consumption contributed an average of 70.6% to real GDP in the six years before the recession (2010-2015). However, since the recession, consumption's contribution to real GDP has dropped to an average of 65%, and it reached a decade low of 63.5% in 2017. As a result, growth in the manufacturing sector has slowed from pre-recession levels as demand for the sector's weighty components (i.e. food, textile and cement) has declined. Similarly, output from the construction sector has also lagged its pre-recession performance, due to the underperformance of oil revenues, as oil prices remain shy of pre-recession levels.



Source: NBS, Vetiva Research

Services sector linkage to unemployment

According to the World Bank, the services sector accounted for 52.67% of employment in 2019. Post-recession recovery in the services sector has remained weak (2019: 2.22% y/y), in spite of a strong recovery in the information and communications sub-sector (2019: 9.17% y/y). Contractions in trade and real estate continue to weigh on the overall performance of the services sector. The decline in oil price and the rise in global protectionism continue to limit trade performance (2019: -0.38% y/y) while the delayed recovery in income levels – amid rising price pressures - is limiting consumption, particularly for big ticket items like real estate (2019: -2.36% y/y) and motor vehicles (2019: 2.31% y/y). The sub-optimal performance of the services sector has had an overbearing impact on unemployment, as the latter has been on an upward trajectory post-recession.



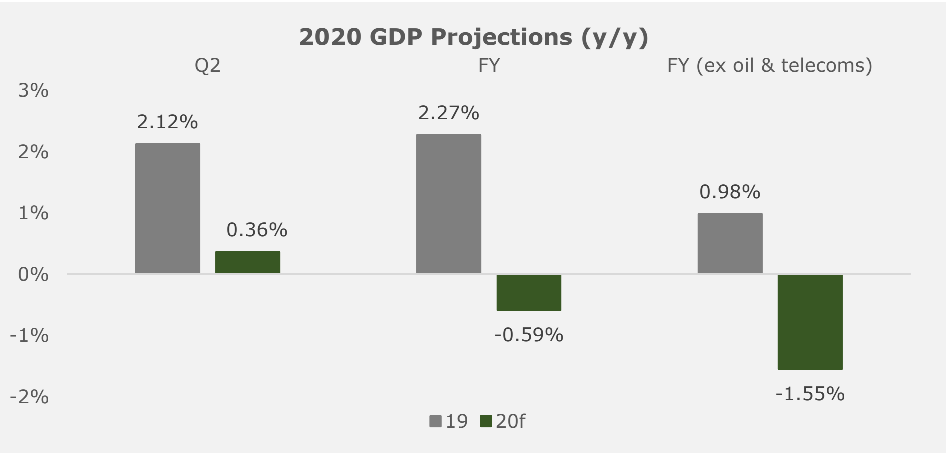
Source: NBS, Vetiva Research

Technical recession looms

In 2020, partial lockdowns implemented across many states to contain the spread of the pandemic is expected to weigh on overall economic activity. The lockdowns which lasted for more than a month, will weigh on operations across many sectors and limit their contributing output to growth. Social distancing measures, such as reduction in the number of employees working onsite, are also expected to persist for as long as a coronavirus vaccine is yet to be found. As the earliest date for discovering a viable vaccine is put at 2021, we expect social distancing measure to weigh on many sectors for the rest of the year including the transportation, agriculture, manufacturing and construction sectors.

We believe that remote work operations will reduce the demand for road transport, particularly in Q2’20 when partial lockdowns are still in place in many states across the country. In addition, mandatory limits on vehicle passengers will also weigh on output from the sector while fear of contracting the virus from human interaction – in the absence of a vaccine – could weaken the overall demand for road transport through 2020. The same expectations apply to air and water travel, especially as inter-state lockdowns appear to be more stringent than commuting within states. Consequently, we expect transport sector output to contract by 0.36% y/y in 2020, from 10.73% y/y in 2019.

Restrictions on the transport sector are likely to weigh on activities across other key sectors of the economy. In the agriculture sector, the distribution of fertilizers and viable seedlings may be hampered while output from the manufacturing sector may be limited by delays associated with clearing imported inputs at the ports due to a reduction in port officials. The construction sector could also feel the impact of the delayed budget revision and underperformance of revenue targets while a limit on onsite employee concentration can slow the progress of construction projects.



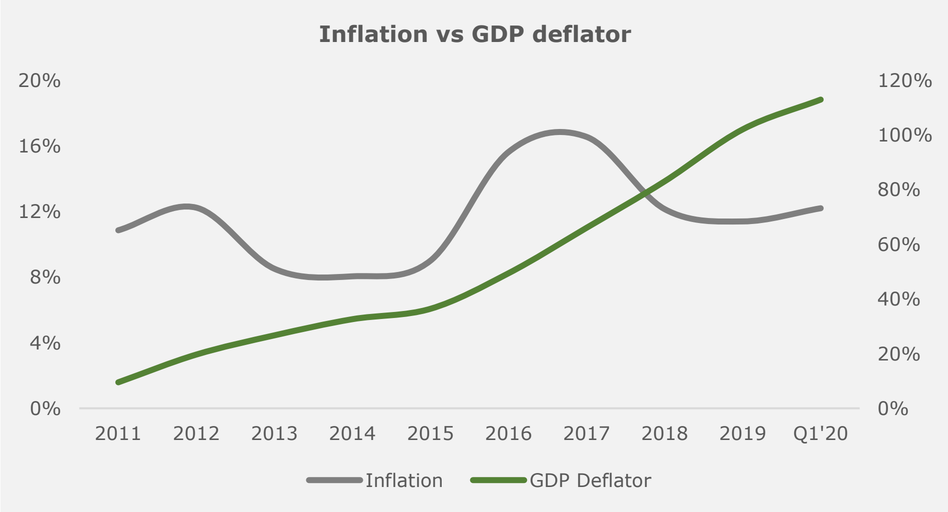
Source: NBS, Vetiva Research

Overall, most sectors are expected to record a slower growth in FY’20 compared to FY’19. However, contractions are expected in H2’20 due to the unfavourable high base from H2’19. H2 output contributes over 50% to total output, as such a decline in H2 output is sufficient to plunge the Nigerian economy into a recession. Consequently, we expect the Nigerian economy to contract by -0.59% y/y in FY’20 - compared to a growth rate of 2.27% y/y recorded in FY’19 – as the impact of partial lockdowns and social distancing measures begin to bite.

The slight contraction in the economy is due largely to an anticipated 1.22% y/y growth in real output from the oil sector, and continued growth in the telecommunications sub-sector. Ex-oil and telecommunications, real output could contract by as much as 1.55% y/y in FY’20. While we believe the new normal of reduced face-to-face interaction could bode well for the telecommunications sub-sector, a disruption to oil production in the course of the year could widen the recessionary gap, significantly contributing to an increase in poverty and unemployment.

Domestic price pressures persist

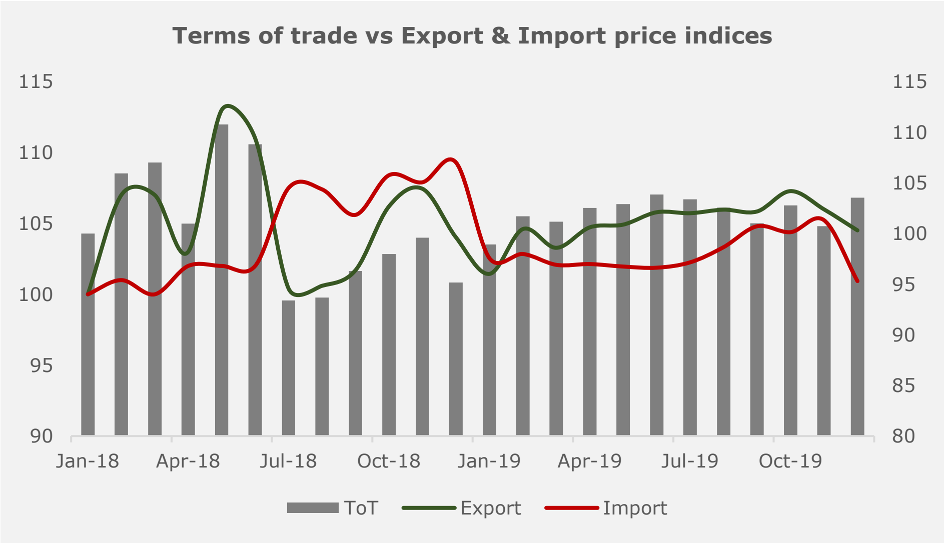
Consumer prices have been on a slow, but steady, upward trend since the start of the year. While the impact of the land-border closure has been abating, pressure from the upward review of the Value Added Tax (VAT) as well as the mounting pressure on the naira exchange rate have passed through to consumer prices, supporting the upward trajectory. In Q1'20, inflation averaged 12.20% y/y - compared to an average of 11.39% recorded in FY'19 – as food prices bottomed out and the new VAT took effect. In May'20, consumer inflation reached a two-year high of 12.40% y/y. This was due largely to restrictive transport arrangements that is putting pressure on both food and core prices.



Source: NBS, Vetiva Research

Lending credence to the pressure on domestic prices is the implicit price deflator (or GDP deflator) that measures the price level of all new, domestically produced, final goods and services in an economy. Unlike the consumer price index (CPI) basket that is static, the basket of the GDP deflator changes annually with people's consumption and investment patterns. While domestic prices have doubled in 2019 relative to a 2010 base, implicit prices in Q1'20 were firmer by 5.4% than FY'19 prices. This means the average price of all goods and services included in GDP has risen compared to the 2019 level.

The persistence of domestic price pressures continues to undermine the competitiveness of the country's exports in the global market. Expensive power sources and costly logistics are among the price pressures that have been inflating export prices. As such, the average price of imports was less than the average price of exports all through 2019. This basically made imports cheaper than exports. Although both prices moderated towards the end of 2019, the average import price fell faster than the average export price. Stickier export prices compared to import prices reflects domestic price pressures that feed into the export price of local goods. This is the fundamental issue that drives the country's preference for imports and also discourages local production.

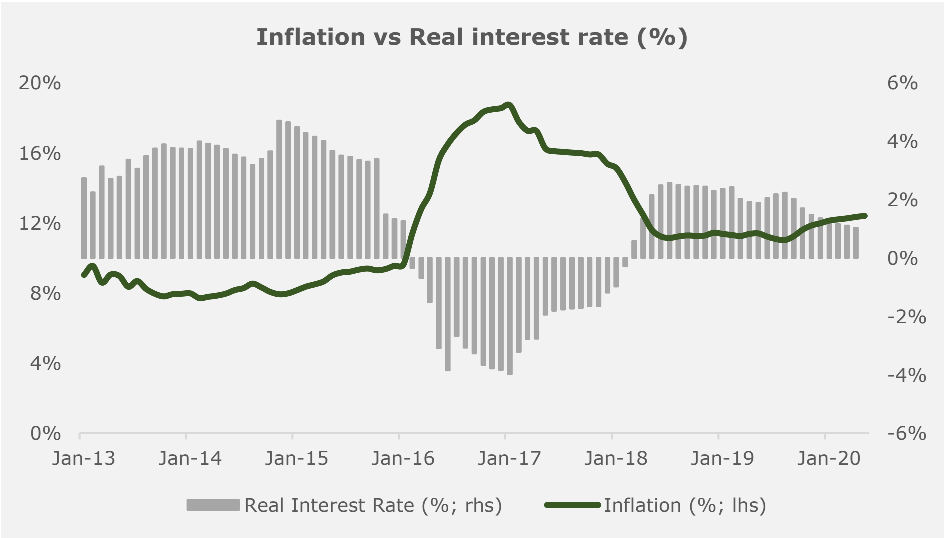


Source: NBS, Vetiva Research

Monetary policy: Stabilizing prices and economic growth

Due to Nigeria's growth-inflation dynamic (i.e. sluggish growth amid rising inflation), the Central Bank previously erred on the side of caution and held the policy rate constant at the first two meetings of the year. However, at the May'20 policy decision meeting, members of the Monetary Policy Committee (MPC) signaled a pro-growth bias by unanimously voting to lower the Monetary Policy Rate (MPR). The decision to lower the policy rate came against the backdrop of a coronavirus trilemma: a looming pandemic-led recession, rising inflation (Apr'20:12.34% y/y) and a fragile external position.

The rate cut is aimed at consolidating ongoing fiscal policy measures to revive animal spirits in the economy, amid the global easing cycle. 7 out of the 10 members in attendance voted for a 100bps reduction in the MPR to 12.5%, to stave off a pandemic-induced recession. However, a lower benchmark interest rate pushes the economy closer to a negative real interest rate environment as domestic inflation continues to tick higher.



Source: NBS, Vetiva Research

Upward inflationary pressure is expected to persist through H1'20 on the back of persistently higher food prices and transport costs. We expect that disruption to local supply chains, as well as a festivity-induced demand surge, would put pressure on food prices. In addition, the upward review of the VAT and the technical adjustment to the naira exchange rate would be contributory to the inflationary pressures in the first half of the year. The impact of the various pressure points would be exacerbated by the low base from the corresponding period in 2019. Consequently, we expect inflation in H1’20 to inch higher to average of 12.29% y/y from an average of 11.32% y/y in H1’19.

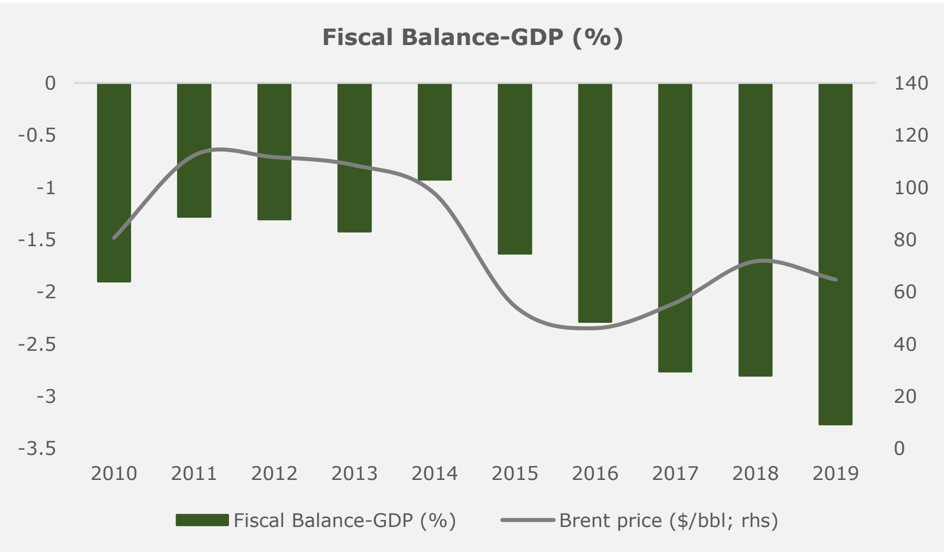
In the second half of the year, we expect pressure on consumer prices to be more intense, despite an anticipated seasonality-induced softening in food inflation and a favourable base from H2’19. The pressure on consumer prices would emanate from the partial removal of electricity subsidy, which is scheduled to take effect in Jul’20. Consequently, we expect inflation in H2’20 to average 12.41% y/y, higher than the average of 11.43% y/y recorded in H2’19. For the full year, we expect average inflation to tick higher at 12.35% y/y, from 11.39% y/y in 2019, as the highlighted demand and supply pressure points concertedly inflate consumer prices.

In response to the anticipated uptick in inflation, we see limited scope for monetary policy action going forward. While a rate hike is very unlikely because it will be counterproductive for economic growth, further accommodation could lead to more severe external imbalances. The latter would have an adverse impact on foreign exchange and domestic inflation. As such, we believe the CBN will be more focused on the transmission of its unconventional policies to the economy rather than opting to lower the benchmark interest rate to stave off a coronavirus-induced recession.

Fiscal policy: The web of lower oil prices

Pro-cyclicality of fiscal policy

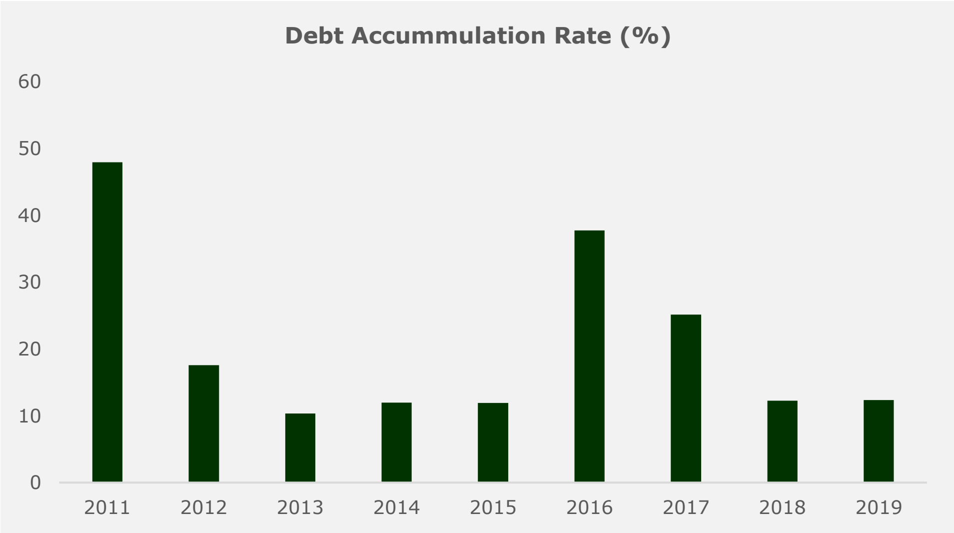
Given the limitations of monetary policy response to the economic consequences of the pandemic, fiscal policy is now in the spotlight to stave off a coronavirus-led recession. However, Nigeria has precedents of cyclical fiscal exuberance that can lead to unsustainable debt expansion – in light of the looser monetary stance - if budget assumptions are not properly anchored. In the last decade, the Nigeria government’s fiscal policy (revenue & expenditure) moved in the same direction as oil prices. Revenues have however been more strongly correlated with oil price cycles than expenditure. This has resulted in a widening of the fiscal deficit, with oil price down cycles, as the government continued its expansionary spending plans.



Source: CBN; Bloomberg; Vetiva Research

Debt sustainability fears mount

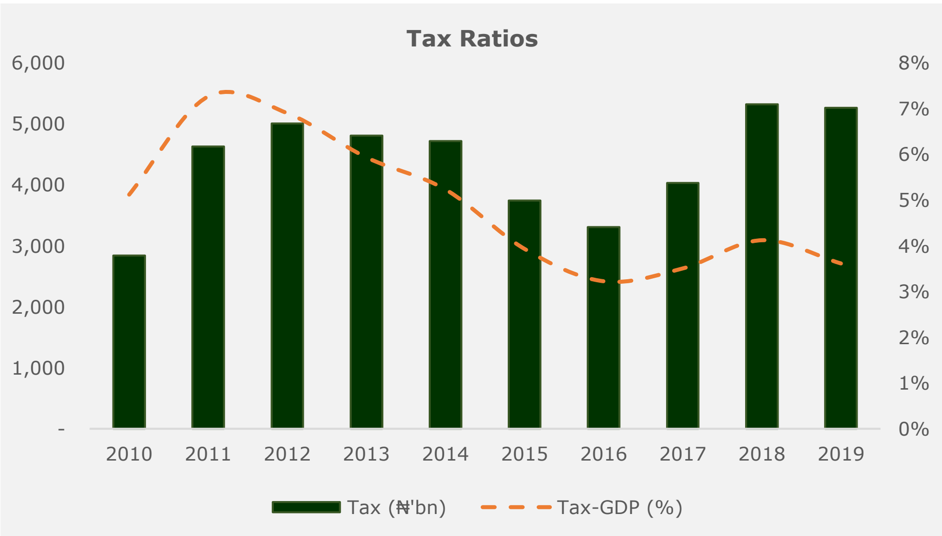
To finance the widening fiscal deficits and meet a significant fraction of expenditure targets, the government had embarked on aggressive borrowing. Borrowing during a recession and periods of weak recovery appear to be more aggressive than other years as the rate of debt accumulation in those years was much stronger. This suggests that a similar pattern of debt accumulation may play out in 2020, in view of the fact that projections for the economy's performance in the year already trend downward.



Source: CBN; DMO; Vetiva Research

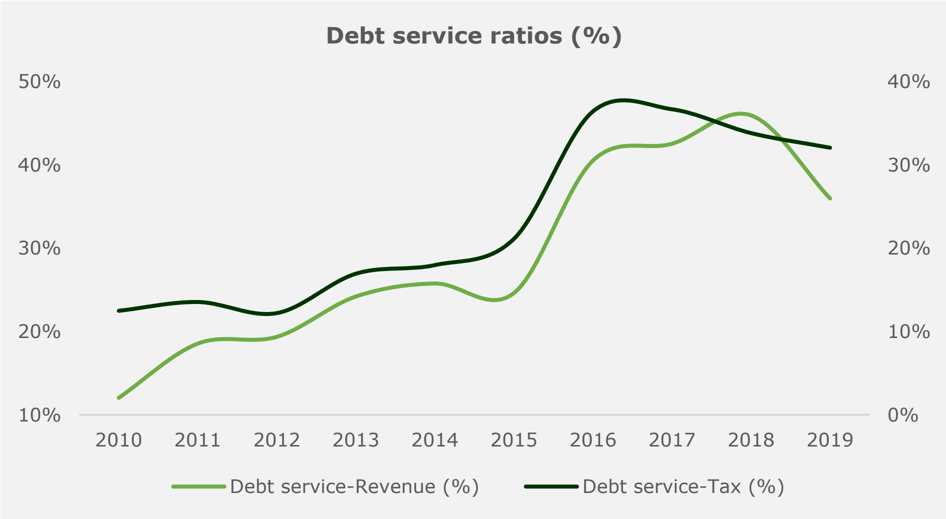
In a bid to trail the lead of governments around the world by pursuing counter-cyclical fiscal policy to manage the devastating economic effects of the 2020 coronavirus pandemic, the country's weak public finances make it particularly vulnerable. This could limit the country's policy flexibility during the crisis and complicate its ability to support post-crisis economic recovery, as more adverse public debt dynamics could pose harder policy trade-offs.

Due to weak tax receipts, the country's tax-GDP ratio is among the least in SSA – indicative of inefficiencies in Nigeria's tax system. These inefficiencies include unorganized informal sector (that contributes approximately 60%-65% of GDP), narrow tax base, tax exemption and subsidy policies as well as loopholes in tax laws. Although tax receipts have improved in absolute terms over the past few years following the government's renewed focus on shoring up revenues, the recent debt binge has overshadowed the mild improvements recorded as debt obligations have an overbearing impact on tax receipts.



Source: FIRS; NBS; Vetiva Research

An underutilized tax space results in the weak contribution of tax earnings to the government's revenue coffers (at a three-year average of 45%) compared to oil earnings and reflects reliance on volatile oil receipts - which still account for between 55%-60% of total revenue when oil trades at decent levels. As such, excessive government spending - especially for non-investment purposes such as wages and salaries – has increased the government's fiscal stress despite improvements in oil sector fundamentals and/or tax collection.



Source: DMO; FIRS; CBN; Vetiva Research

As a result of the country's deteriorating fiscal position and slow reforms, credit rating agencies have downgraded the country's long-term rating for both foreign and local currency obligations. In Mar'20, Standard & Poor's (S&P) downgraded both Nigeria's long-term foreign and local currency ratings to B- from B, where it had been since Sep'16. In similar fashion, Fitch ratings downgraded the country's long-term ratings to B in Apr'20, from a B+ rating that had been in place since Jul'16. While Moody's is yet to review its rating on Nigeria's credit worthiness in 2020, it downgraded its outlook for the economy from stable to negative in Dec'20.

Fiscal reforms on track

In response to fiscal sustainability concerns that is being raised by both local and foreign stakeholders, the Nigerian government has set in motion a number of reforms that are aimed at increasing fiscal space in the long run. In Mar'20, the upward review of the VAT from 5% to 7.5% - which is aimed at increasing tax receipts - took effect in spite of the public push back. Going forward, tax reviews will be contained in the Finance Act that will accompany the budget every year. In addition, the government is taking steps to free up encumbered revenues by reducing subsidy payments and tending towards market-determined energy (i.e. petroleum & electricity) prices.

In the short term, however, the major reforms have been centered on adjusting the budget assumptions to reflect current economic realities. A major modification to the budget benchmarks is the adjustment of the official naira exchange rate from ₦306/$ to ₦360/$. This is positive for government revenue flows in naira terms as government at all levels get to exchange their dollar allocations for more in naira terms than they would have gotten if the official exchange rate was still pegged at ₦306/$. Other assumptions such as the oil price and production benchmarks and the Real GDP growth rate have also been adjusted to $20/bbl, 1.7 mb/d and -2.93% y/y respectively.

Despite the adjustments, we envisage a 52.7% underperformance in aggregate revenue. The underperformance of total revenue will ride on shortfalls in oil (50%) and non-oil (41%) revenue targets. As a result of the revenue shortfalls, we expect budget implementation to fall short by 24% in spite of an accompanying deficit of ₦4.08tn – almost double the ₦2.18tn deficit that was initially approved for the 2020 budget In view of a firmer recovery in oil price and demand in H2'20 and barring a second wave of the pandemic in Nigeria, accompanied by the 20% underperformance of the capital expenditure target, we expect the fiscal deficit to narrow to -2.67% of GDP in FY'20 (FY'19: -3.27% of GDP). However, the fiscal deficit could widen to as much as -3.5% of GDP, depending on the strength of the oil market recovery as well as the prevalence of the COVID-19 pandemic in Nigeria- which can impair the generation of non-oil revenues.

Budget Aggregates	Approved 2020 Appropriation Bill (as at Dec'19)	Vetiva Projections	Projected Variance (%)
Assumptions			
Oil price ($/bbl)	55.00	44.00	-20%
Oil production (mbpd)	2.18	1.70	-22%
Exchange Rate (₦/$)	305.00	360.00	-18%
Real GDP Growth rate (%)	2.93	(0.59)	-120%
Inflation (%)	10.81	12.35	-14%
Aggregate Revenue (₦'mn)	**8,419,164.48**	**3,980,352.99**	-52.7%
Oil revenue (₦'mn)	2,637,609.31	1,318,804.66	-50.0%
Non-oil revenue (₦'mn)	1,805,115.82	1,064,852.73	-41.0%
Independent recoveries (₦'mn)	849,968.44	254,990.53	-70.0%
Aggregate Expenditure (₦'mn)	**10,594,362.36**	**8,056,489.55**	-24.0%
Recurrent (₦'mn)	7,568,473.53	5,676,355.15	-25.0%
Capex (₦'mn)	2,465,418.01	1,972,334.41	-20.0%
Statutory Transfers (₦'mn)	560,470.83	407,800.00	-27.2%
Deficit Financing			
Fiscal Deficit (₦'mn)	(2,175,197.89)	(4,076,136.57)	87.4%
Nominal GDP (₦'mn)	142,960,529.37	152,472,311.16	6.7%
Deficit-GDP (%)	(1.52)	(2.67)	75.7%
Expenditure Ratios (%)			
Recurrent -Total Expenditure	71.44	70.46	-1.4%
CAPEX-Total Expenditure	23.27	24.48	5.2%
Revenue Ratios (%)			
Recurrent Expenditure-Revenue	89.90	142.61	58.6%
CAPEX-Revenue	29.28	49.55	69.2%
Deficit-Revenue	(25.84)	(102.41)	296.4%

The slump in international oil prices would have a dual impact on Nigeria's fiscal policy. While the country could save on its oil import bill if the prices remain at the current levels, the impact of the savings could be wiped out by the decline in oil earnings. The steep fall in oil revenues, in the absence of sufficient fiscal buffers, could undermine macroeconomic stability as economic output is likely to decline.

Much like the rest of the world, Nigeria will have to contend with a slowing economy. Therefore, fiscal policy may take up some of the lifting work as growth prospects are looking less optimistic. Nigeria does not have the fiscal space to deal with the COVID-19 pandemic or to enact the necessary responses to prevent economic collapse. As such, we may need to borrow to finance emergency budgetary support in order to mitigate revenue shortfalls and fund fiscal stimuli - such as consumer demand support and direct support to vulnerable sectors (such as health, tourism and hospitality).

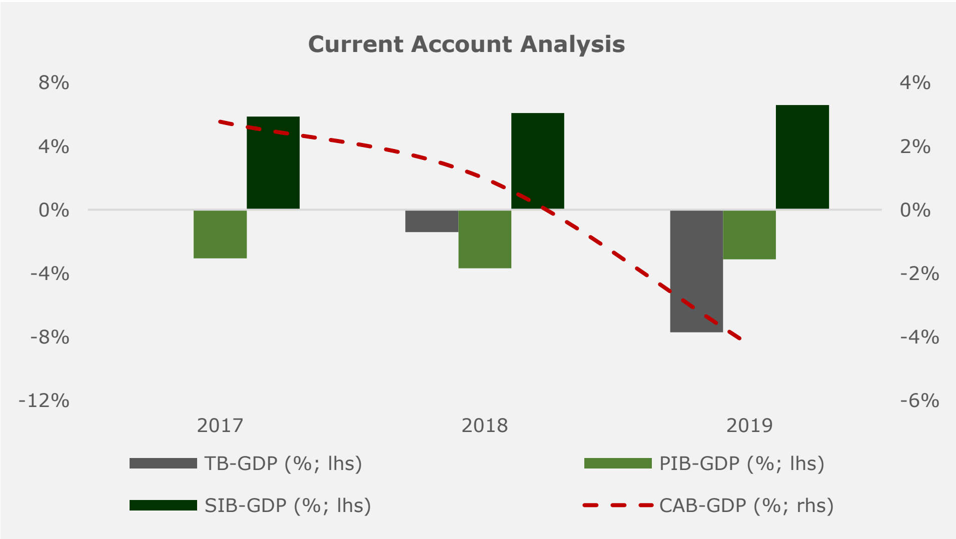
However, fiscal prudence is equally required to avoid excessive borrowing for non-investment purposes because of the parlous state of the country's current fiscal situation. Fiscal prudence involves ensuring that efficiency and equity are at the core of fiscal policy. While efficient spending will require doing more with fewer resources, equitable spending involves targeting spending towards the poor and vulnerable. Although Nigeria's total debt-GDP ratio is below the suggested prudential upper bound of 40% for developing economies, a higher than projected fiscal deficit, high costs of borrowing, and weaker naira may further limit Nigeria's fiscal space and reduce the country's capacity to respond to the crisis.

In addition to lower oil receipts, already weak tax receipts could also be worsened by slowing business activity and increasing job losses. This would further pressure the government's purse and limit its ability to stimulate domestic consumption, amid emergency spending to manage the economic and social consequences of the pandemic. Therefore, it is imperative that the government arrives at a sweet spot between financing needs and revenue constraints because an already high debt level - amid volatile revenues - limits the capacity of the government to undertake out-of-budget-emergency spending without undermining fiscal and external sustainability.

External sector imbalances

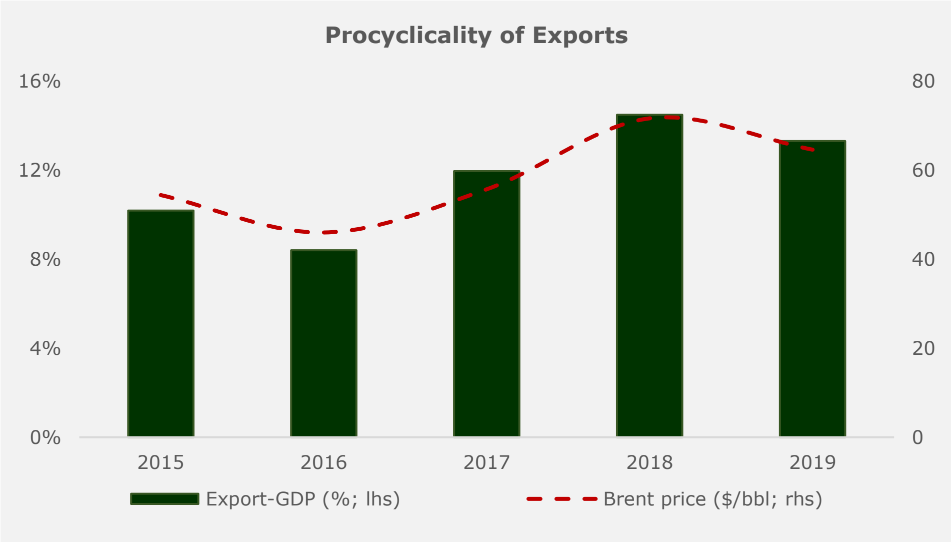
Balance of payment (BoP) analysis

The current account, which is made up of balances from trade, primary income and secondary income, has seen a constant deterioration in its position since 2017. The deterioration in the current account balance (CAB) has been largely driven by the trade balance (TB) – which accounts for a significant fraction of the current account – and supported by declines in the primary income balance (PIB).



Source: World Bank; CBN; Vetiva Research

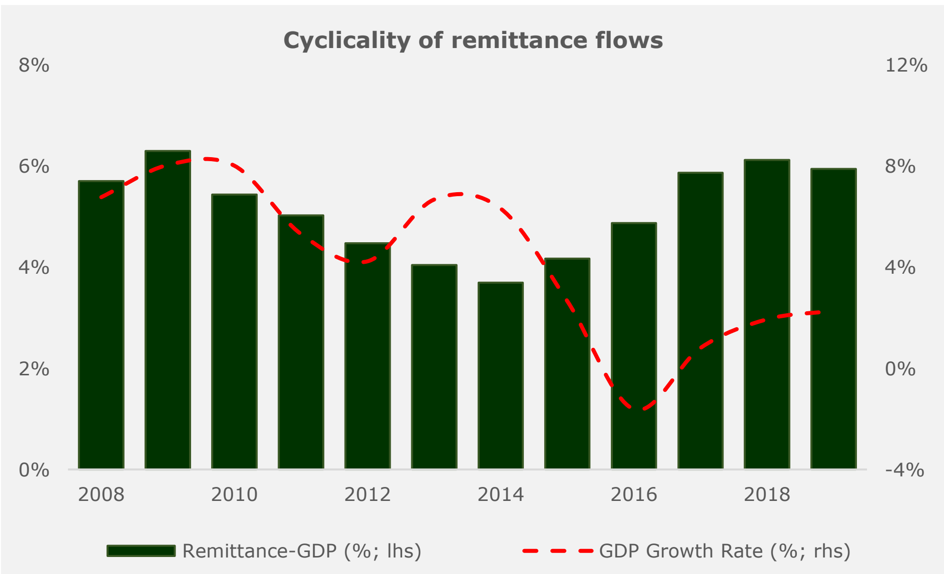
TB performance has a strong correlation with developments in the oil market because oil is the single most important contributor to the country's trade. In 2019, the petroleum sector contributed 52% to total trade and 84% of merchandise exports. As a result, Nigeria's exports tend to be pro-cyclical with commodity price cycles. Unlike the balance of goods trade that fluctuates with oil market trends, the balance from services trade has been in perpetual deficit. The deficit in services is fueled by the country's insatiable thirst for foreign-related services, especially other business services that constituted 41% of dollar liabilities in service payments in 2019.



Source: Bloomberg; CBN; Vetiva Research

Similar to the balance for services payment, the PIB – which captures international payments to factors of production, such as investment income and compensation to employees – has also been in perpetual deficit. Nigeria's economic relevance in the emerging market space fuels the demand for the country's assets by foreign investors. However, due to the low-income status of the country, foreign investment by local residents is limited - resulting in the deficit in investment income balance and by extension, the PIB deficit. Also, the demand for high-earning expats by resident multinationals contributes, albeit marginally, to the PIB deficit.

The secondary income balance (SIB), on the other hand, has remained resilient. The SIB has been supported mostly by remittance flows, which tend to exhibit a countercyclical pattern during recessions and sluggish growth. This time around however, they may be pro-cyclical with respect to GDP growth and might worsen Nigeria's already precarious current account position. According to the World Bank, Nigeria remained the largest recipient of remittances in the SSA region and was the sixth-largest recipient among low and middle-income countries (LMICs), with an estimated amount of $23.8 billion received in 2019. However, immediate and long-term economic adjustments in host countries will certainly have cascading effects on labour markets, and subsequently on migrant remittances because they are often the first victims of economic adjustments during a downturn.



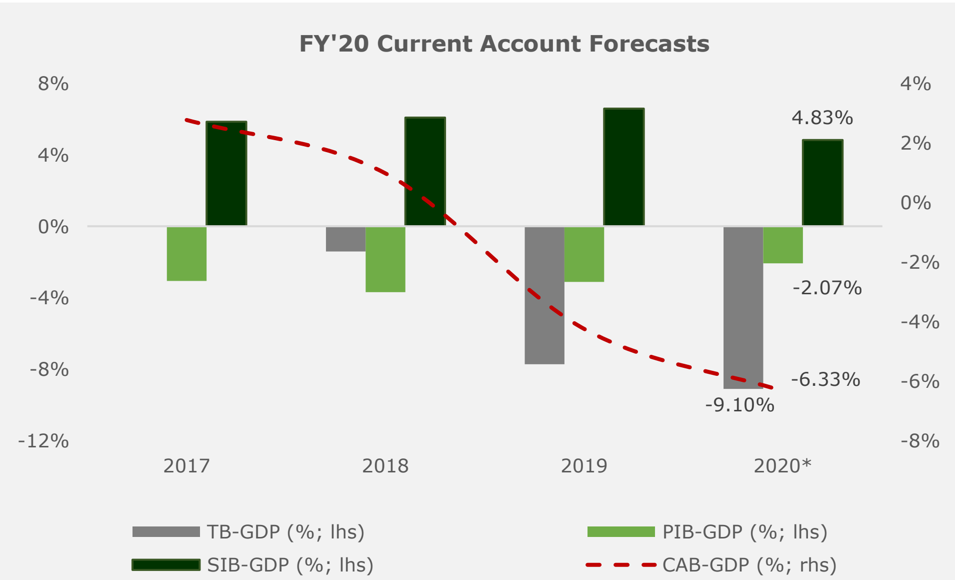
Source: World Bank; CBN; Vetiva Research

The second component of the BoP, the financial account, typically shows how the surplus/deficit in the current account is spent or financed. While the CAB reflects whether a country's income and savings are enough to fund its imports, a deficit CAB typically has to be financed by borrowing while a surplus CAB may be lent to foreigners. The financial account shows how net lending to or borrowing from non-residents is financed. In 2019, Nigeria's $17.02 billion current account deficit was financed by an $18.09 billion net incurrence in liabilities. The borrowing was channeled predominantly through short-term debt securities from the Central Bank of Nigeria (47.58%) and the general government (41.78%) i.e. OMO and Treasury bill securities.

Balance of payment (BoP) Outlook

In 2020, the negative shocks to the global economy will be channeled to Nigeria's external sector through trade, factor flows and financial flows. Pandemic-induced shutdowns will weigh on external demand and is likely to worsen Nigeria's merchandise trade deficit. The assumption of benign oil prices, under an oil production quota of 1.4 mb/d and the re-introduction of non-tariff trade barriers could exacerbate the widening of the trade deficit. Consequently, we envisage a widening of the trade deficit to -9.10% of GDP (FY'19: -7.71% of GDP).

In addition, cautious investing by foreign investors as well as cuts on expatriate remuneration would support the narrowing of the PIB to -2.07% of GDP (FY'19: -3.12% of GDP) while a projected 24% drop in remittance flows – amid hard pressed trade and primary balances - will be a double whammy for the current account balance. In view of the aforementioned, we expect the CAB-GDP ratio to widen to as much as -6.33% in FY'20 (FY'19: -4.25% of GDP).



Source: World Bank; CBN; Vetiva Research

Nigeria's BoP outlook reveals that it will not have sufficient income and savings to pay for its goods, services and capital imports. The country's projected financing needs in FY'20 - on the back of an expected CAB deficit of $25.41 billion - will definitely be met by borrowing or drawing down reserves, in the face of headwinds to trade and economic growth. Already, the country is on course to take advantage of concessionary loans from international financial institutions (IFIs) to the tune of $5.4 billion in order to prop up reserves.

While we note that Nigeria's current economic fundamentals may not support foreign borrowing at this time, the resulting glut in global liquidity from monetary policy and quantitative easing operations of advanced economies provides some scope for reasonable pricing on foreign debt. As such, the government might need to meet the balance of its financing needs through commercial borrowing in the international capital market, if oil extends its price recovery. This will be necessary to avoid an aggressive drawdown on dwindling reserves assets.

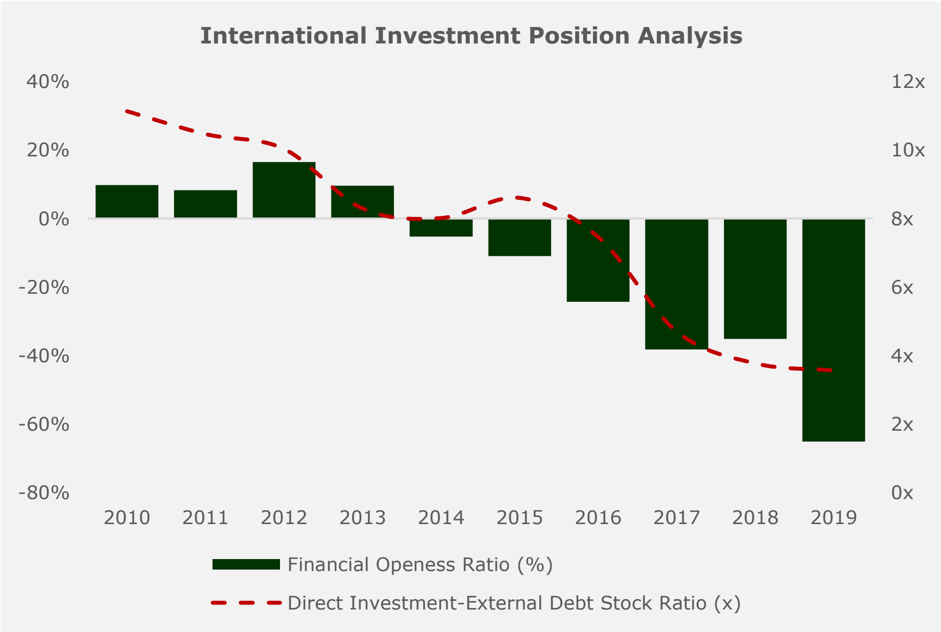
For now, we believe the financing source will be bias in favour of domestic borrowing to limit exposure to currency risk as global volatility persists. However, it is not unlikely to see a switch in government preference to foreign borrowing when macroeconomic conditions improve in the not-so-distant future, while its proceeds will be used to redeem domestic debt. This will enable the economy to reap the benefits of borrowing in foreign currency on the stock of reserves assets and the cost of financing to both the government and the private sector. We also believe financing preferences remain skewed to the short-term and medium term via short tenured bonds, where the CBN can offer slightly more attractive rates than what is obtainable in advanced economies.

International Investment Position (IIP) analysis

Drilling down to Nigeria's financing needs that are international (i.e. foreign) in nature is the International Investment Position (IIP). In addition to cross-border debt and investment flows that are captured in the financial account, the IIP also takes into consideration the stock of reserve assets to assess the sustainability of dollar financing. The net IIP reflects the difference between the value of external financial assets (i.e. claims on foreigners) and the value of external financial liabilities (i.e. liabilities to foreigners), including foreign assets and liabilities held by a nation's government, the private sector, and its citizens.

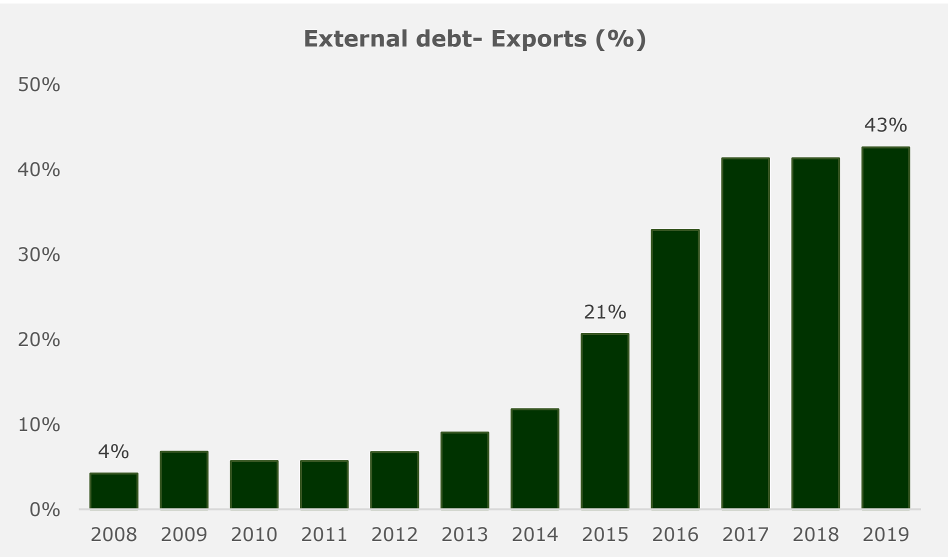
Due to the perpetual deficit in Nigeria's current account, the country has accumulated a negative net international investment position (NIIP) of $70.8 billion (-65.08 % of GDP) as at December 31, 2019, the highest level ever recorded. Unfortunately, a continued deterioration in Nigeria's financial openness (i.e. net IIP-GDP ratio) since 2014 has led to a recourse to external borrowing to finance the deficits in the current account - amid souring investor sentiment towards Nigerian assets. The country's ratio of financial openness has halved in the last three years from 7.46x in FY'16 to 3.56x in FY'19, indicative of a lower penetration of foreign capital in the economy.

Consequently, the ratio of direct investment to external debt stock has been nosediving. The ratio of direct investment-external debt is a measure of a country's capacity to attract stable external financing (FDI). Therefore, the smaller the amount of direct investment received in proportion to external debt, the higher the risk of a foreign exchange crisis. A continued decline in Nigeria's ratio reflects a buildup in foreign debt accompanied by a continued decline in non-liquid foreign flows, reinforcing the downward spiral in Nigeria's external health.



Source: World Bank; CBN; DMO; Vetiva Research

As at the end of 2019, Nigeria owed $27.68 to the rest of the world – 60% of which are owed to IFIs while the other 40% are commercial borrowings. The low interest environment that was prevalent in the last decade gave the country room to pile up its foreign debt. The down cycle in commodity prices in the past decade also pressured the country's revenues as resource earnings contribute about 60% of total government revenues. Both factors have undermined Nigeria's external debt sustainability with increased exposure to currency risk. For instance, the ratio of Nigeria's external debt to its export earnings rose from 6% in 2010 to about 43% in 2019. This reflects changes in the country's stock of external debt and a drop in oil revenues that is mounting pressure on Nigeria's capacity to organically service its external obligations.



Source: CBN; DMO; Vetiva Research

International Investment Position (IIP) Outlook

In the ongoing year, we expect a 25% increase in external debt to $34.70 billion at year end. The increase will be driven by the need to ramp up health sector spending in response to the COVID-19 pandemic, finance the twin deficits (i.e. fiscal and current account deficits) and provide fiscal stimuli to support economic growth.

In addition, we expect growth in net direct flows to slow to 1.73% in the current year, resulting in a net flow of $100.32 billion from $98.62 billion in FY'19. As a result, we envisage a further moderation in the ratio of Nigeria's direct investment flows-external debt to 2.89x from 3.56x in FY'19. This implies that anticipated non-liquid foreign financial flows will be sufficient to cover the expected external debt stock 2.89 times. A lower direct investment-external debt ratio suggests that Nigeria's IIP will remain under pressure in the near term as external factors continue to weigh on the country's economic attractiveness to foreign investors. However, at 2.89x, the risk of a short-term FX liquidity crunch and long run insolvency remains low.

Although increasing Nigeria's external debt stock to meet its dollar financing needs could result in further external profile deterioration, it seems to be the most feasible action plan in the short term that could have positive implications for the naira exchange rate. Due to the C BILLION's need for reserves asset to maintain the naira's quasi-peg, a reserves draw-down to meet external financing needs is unlikely, hence the recourse to external borrowing. Our expectation is reinforced by a projected drop in remittances - which most times is the largest source of external financing (ahead of ODA and FDI) in Nigeria.

FX Outlook

In response to weaker oil market fundamentals, on the back of the COVID-19 pandemic, the CBN embraced some pending FX reforms in a bid to ease the pressure on reserves asset. The petro-currency status of the naira made it particularly vulnerable to the slump in oil prices. In addition to adjusting the naira exchange rate downwards by about 5% to ₦380/$ on the I&E window, the apex bank halved the exchange rate gap that existed between the official and market rates prior to the currency adjustment. The CBN also momentarily reined in its supply of FX through its various sales channels, a development deposit money banks (DMBs) responded to by reducing their clients' international spending limits.

A projected further deterioration in external sector indicators is a pointer to the fact that we are not out of the woods with respect to currency risk. A sharp drop in resource earnings, cross-border flows (i.e. investment and remittances) and limited global ODA capacity lends credence to our expectation of further pressure on the naira in the near term. However, the gradual recovery in oil prices - as economies re-open – and non-tariff barriers to trade could stem the tide of FX outflows, easing the tight dollar liquidity situation.

Contrary to market expectation of a CBN-induced further devaluation of the naira before the end of the year, we believe the repricing of the naira will be more market determined – barring a second wave of the coronavirus that could truncate oil market recovery. As such, we expect the naira to have appreciated by the end of the year from current levels, at both the I&E window and parallel market to ₦383.99/$ and ₦438.00/$ respectively.

Our call is supported by our expectation of a continued recovery in oil prices and the extension of the upward momentum in global risk appetite through the second half of the year. The latter would support the expected slow growth in net direct flows as most advanced economies could still be reeling under the impact of higher COVID-19 fatalities. However, the further moderation in the ratio of the country's direct investment flows-external debt to 2.89x, - on the back of an external debt pile-up – is suggestive of higher sustainability concerns that may limit the firming of the naira.

Vetiva Exchange Rate Forecasts (₦/$)

Period	Indicator	Forecast		
		Worst	Base	Best
Jun-20	Reserves ($'mn)	35,258.40	35,258.40	36,525.60
	I&E (₦/$)	384.07	384.07	383.20
	Official (₦/$)	361	361	358.11
	Parallel (₦/$)	439	439	426.50
Sep-20	Reserves ($'mn)	33,970.39	35,970.39	37,475.19
	I&E (₦/$)	385.00	383.58	382.57
	Official (₦/$)	372	361	353.30
	Parallel (₦/$)	453	432	417.42
Dec-20	Reserves ($'mn)	33,382.03	35,382.03	37,084.83
	I&E (₦/$)	385.43	383.99	382.82
	Official (₦/$)	376	364	355.25
	Parallel (₦/$)	460	438	421.10

Forecast Assumptions

	Worst	Base	Best
Jun-20	Brent (avg.): $33/bbl	**Brent (avg.): $33/bbl**	Brent (avg.): $34/bbl
	Crude oil sales: low	**Crude oil sales: low**	Crude oil sales: low
	IMF flow: $3.4 billion	**IMF flow: $3.4 billion**	IMF flow: $3.4 billion
	Imports restriction: Yes	**Imports restriction: Yes**	Imports restriction: Yes
	Spending limits relaxed: No	**Spending limits relaxed: No**	Spending limits relaxed: No
	COVID-19 Transmission slows: No	**COVID-19 Transmission slows: No**	COVID-19 Transmission slows: Yes
	Risk-off sentiment	**Risk-off sentiment**	Risk-off sentiment
Sep-20	Brent (avg.): $33/bbl	**Brent (avg.): $44/bbl**	Brent (avg.): $48/bbl
	Crude oil sales: low	**Crude oil sales: moderate recovery**	Crude oil sales: strong recovery
	Imports restriction: Yes	**Imports restriction: Yes**	Imports restriction: Yes
	Spending limits relaxed: Yes	**Spending limits relaxed: No**	Spending limits relaxed: No
	Domestic COVID-19 Transmission slows: No	**Domestic COVID-19 Transmission slows: Yes**	Domestic COVID-19 Transmission slows: Yes
	Risk-off sentiment	**Risk-on sentiment**	Risk-on sentiment
		WB flow: $1.5 billion	WB flow: $1.5 billion
		AfDB flow: $0.5 billion	AfDB flow: $0.5 billion
Dec-20	Brent (avg.): $33/bbl	**Brent (avg.): $47/bbl**	Brent (avg.): $49/bbl
	Crude oil sales: low	**Crude oil sales: moderate recovery**	Crude oil sales: strong recovery
	Imports restriction: Yes	**Imports restriction: Yes**	Imports restriction: Yes
	Spending limits relaxed: Yes	**Spending limits relaxed: Yes**	Spending limits relaxed: No
	Wave 2 COVID-19: Yes	**Wave 2 COVID-19: No**	Wave 2 COVID-19: No
	Risk-off sentiment	**Risk-on sentiment**	Risk-on sentiment

Risks to outlook

With a pandemic-risk in full swing, the outlook for growth in 2020 is not particularly sunny side up. As economies are riding out the health risks associated with the outbreak of the coronavirus, politics, corporate insolvency and already high debt levels, also pose key sources of risk to the already downbeat global economic outlook.

Health Risks

The outbreak of the coronavirus pandemic is currently straining health systems globally and progress on the virus is still uncertain. There are concerns about under-reporting of confirmed cases in many countries, raising fears of a dramatic escalation in confirmed cases. Fears over the timing and severity of containment measures are also fueling concerns about the actual impact of the outbreak on economic growth, supporting the possibility of an extension of the recession beyond Q3'20. Likewise, the continued absence of a vaccine or a medication also increases the possibility of a COVID-19 second wave as many countries implement a phased re-opening of their economies. Therefore, the bearish outlook for global growth and individual economies may become negligible or more severe, depending on how the impending health risks evolve.

Politics and Geo-politics

Confrontations, both within and between countries, is a major source of upside risk to global economic outlook. Frictions between global powers could quicken the pace of de-globalization and intensify trade policy uncertainty. In addition to altercations between the US and China, focus could shift back to the EU's trade surplus with the US while the EU's position may become more assertive with a new leadership at the EU Commission in place. Therefore, a further escalation in tariffs involving the US and EU auto industries cannot be ruled out. Brexit uncertainties and tensions within the EU could also bubble over, further depressing outlook.

Although seemingly extreme, an unintended military conflict between the US and Iran can also not be ruled out. This poses a risk to the Strait of Hormuz (SoH), through which about 20% of global oil supplies transit. While a direct conventional war between Washington and Tehran would have devastating consequences for the global economy, disruptions in and around the SoH will support a spike in oil prices.

National politics in many countries, which have resulted in divisiveness and pushbacks, will likely persist through the year. This will be especially true in the 60 countries and territories scheduled to hold elections and referendums before the end of the year. The resulting domestic political polarization, coupled with increasingly fractious international relations, will challenge cooperation on key priorities as the pandemic persists.

Economic Risks

The global economic impact of the coronavirus outbreak is set to be more profound than that of severe acute respiratory syndrome (SARS), owing to the much larger role that China plays in the global economy today. Over the past two decades, China has become a critical cog in the mechanism of the global economy as both a consumer and producer of a vast range of commodities.

The ongoing public health crisis could be a threat to political and financial stability within China, the origin of the pandemic. This has raised the odds of a recession in China and could have a cataclysmic impact on global growth.

Also, containment measures aimed at containing the virus spread has dislodged global supply chains, contributing to trade policy uncertainty as more countries could try to reduce their exposure to China-led trade shocks. Disruption of international trade may become entrenched as supply chains are diverted from China. This could result in increased trade and investment protectionism, escalating the risk of de-globalization in the near term. US-China trade tensions are also likely to re-escalate, particularly if China proves unwilling or unable to deliver the import commitments agreed under the recent first-phase limited trade deal.

There is evidence that labour markets have already been damaged, and the shock to consumer and business confidence could generate a self-sustaining economic downturn. A high Eurozone public debt and a protracted stagnation in developed economies are also imperiling to the health of the global economy. A sharp deterioration in these fundamentals could accelerate the downturn in the global economy that is already showing signs of a concerted slowdown.

Financial Risks

A growing number of international exporters might experience financial distress, as a shortfall in global demand would weigh on commodity prices and export revenues. Firms are grappling with lower business investment & external demand and higher import & labour costs, both cutting into profits. Exacerbating all of these are the high levels of corporate debt, as businesses have been eagerly taking advantage of the past few years of low interest rates - increasing their vulnerability to economic and financial shocks. This could lead to rising defaults and liquidity issues, which in turn creates fears of a 2008-style downturn. All this uncertainty means business insolvencies will continue to rise. When businesses become insolvent, their trading partners suffer, creating a ripple effect of risk—a contagion. Crises could spread from country to country through investment flows as well as interbank links.

Environmental Risks

Amid the pandemic, how people and systems would cope if a major natural hazard occurs is an important source of concern. At this time, environmental risks remain a potential double whammy that governments may have to deal with over the next few months. Extreme weather conditions and natural disasters (floods, earthquakes, wildfires, etc.) could intensify the damaging impact of the pandemic, whose response is already taking up the bulk of resources, expertise, time and effort. A pandemic-natural disaster hybrid would be an economic curse at this time, as it could reinforce a symbiotic downward pressure on economic activities. On one hand, COVID-19 counter measures can hamper the emergency response to natural disasters. Then on the other hand, the disruption to social distancing – in the event of a natural disaster - can increase the potential for infection.

Security Risks

Pockets of unrest across a number of countries are an important source risk to the global economy, should the disturbances escalate. Already, the Black Lives

Matter protests that started in the US have been replicated in some countries in Europe. Hong Kong does not also seem to be relenting on its anti-government protests, which started last year. These protests may result in disruptions to business operations and infrastructure, and depending on their intensities, may cause an exodus of investments from the affected regions. This would double down on the already somber global – and individual – economic outlook.

Fixed Income

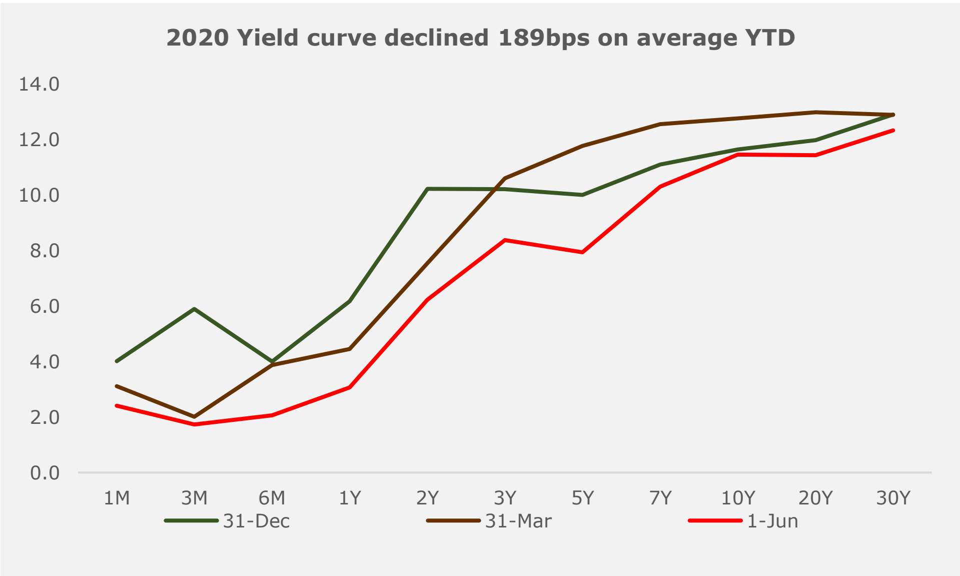
Fixed Income

Global Monetary Policy alignment to support existing yield differential

A change in the outlook for global growth (GDP) has seen monetary policy exert additional influence on the yield environment, occasioned by the overwhelming need to prioritize growth to cushion the adverse economic impact from the COVID-19 pandemic. As such, yield levels remained depressed in most developed (DM) and emerging (EM) markets in H1’20, buoyed by rate cuts across central banks and stimulus packages from nations with sufficient reserves and trade balances. That said, a global risk-off sentiment was also seen between DMs, EMs and frontier (FM) markets, as global demand flowed to markets with less perceived risk in terms of debt-repayment, growth recovery and currency stability.

In H2’20, we expect EM countries like China to attract significant flows to its debt markets, given its timely management of the pandemic impact on economic activity and swift return to growth; however, escalating trade tensions with the U.S could taper these flows and alter the countries yield outlook dynamic in the short term. Fiscal and monetary responses by DMs led to a surge in QE Bonds and other liquidity instruments to purchase assets across U.S, EU and UK markets, with global fiscal stimulus in excess of $8 trillion as of May 2020. Thus, yields have remained at historical lows across these markets with the yield on the 10-yr U.S. treasury bill relatively flat at 0.65% in May. We see yields staying depressed in DMs for H2’20, as policy makers maintain accommodative market conditions through the year in order to mitigate the pandemic impact.

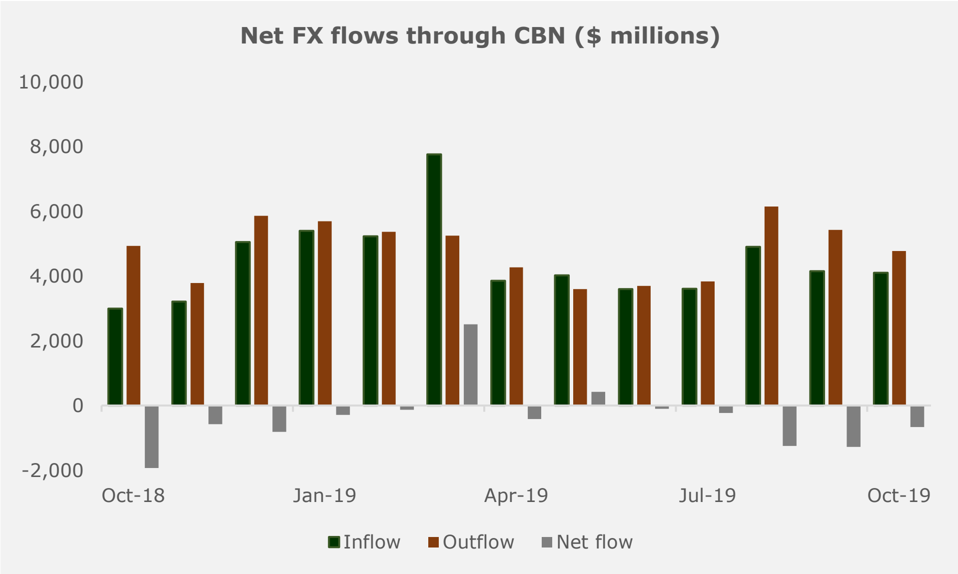
Nonetheless our expectations for a staggered recovery and a possible contraction in Global growth support our view for a low yield environment in 2020 for most DMs and EMs. Thus, flows seeking higher returns(yield) will continue to seek EM and FM opportunities that offer attractive yield differentials and show positive signs of a speedy recovery.



Source: FMDQ, Vetiva Research

Stronger Brent prices to drive sustained Nigerian Eurobond demand

Nigeria dollar debt saw significant volatility during the review period with Eurobond yields moving north by 2.0% YTD on average across maturity buckets as at June 3, 2020. Current yield levels are buoyed by slight improvements in global economic outlook from April's viewpoint, when a crash in commodity prices triggered a kneejerk reaction by investors to sell off Nigerian Eurobonds with yields reaching highs of 16.5% on the Jan 2021 and 13.1% on the Nov 2027 Eurobonds. A steady recovery in Brent crude price in May saw Nigerian Eurobond yields ease to the 6% - 8% region on the short to medium term maturities (3 to 7-year notes) and 8% - 10% at the long tenured notes (10 to 30-year notes). We expect Eurobond yields to ease further in H2'20 by c1.5%, supported by firmer Brent crude prices during the quarter and Nigeria's move to borrow domestic instead of the Eurobond route in H2'20.



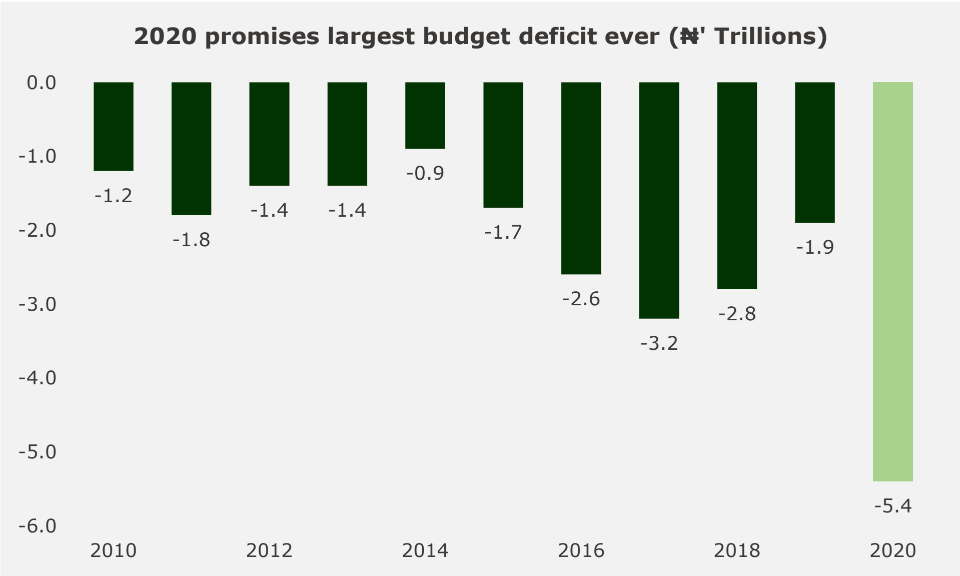
Source: CBN, Vetiva Research

Increasing Domestic Debt will prop FGN bond yields in Q4'20

Given Nigeria's current weak fiscal position due to a prolonged period of debt financing for recurrent expenditure, its influence on yield and debt instrument pricing has largely been limited to the domestic treasury bills market where yields have remained at low single digits in H1'20 due to a stranglehold in supply of short tenured risk free instruments. Short to mid tenor FGN bonds (3 to 7-year notes) have also seen significant yield moderations during the review period due to unmet demand at the money and treasury bills markets. During the six-month period ending June 3, 2020, yields moderated by 115 bps on average across the sovereign yield curve with greater demand for short to mind tenor notes versus longer date paper.

With fiscal authorities revising their debt strategy in favor of domestic issuances for the rest of 2020, we expect Nigeria's debt management office (DMO) to supply between ₦3 – ₦4 trillion in FGN bonds to fund budgetary deficits. We expect the DMO to increase debt supply between September into Q4'20, due to the larger volume of maturities in Q4'20 (₦4.7 trillion) vs Q3'20 (₦2.9 trillion). That said, these maturities are largely short tenured funds, so the DMO will have to concentrate issuances around the 3 to 7-year range, as long tenors could require additional returns from current yield levels. Two auctions on an FGN vanilla bond and a Sukuk bond were both oversubscribed in Q2'20, with the DMO issuing a very modest offering volume pre-auction but deciding to sell far more than offered in a "tip of the iceberg" approach.

Despite our improved outlook for commodity prices in H2'20, we do not see any significant moderation in yields, particularly at the long end of the curve due to the need for additional borrowing to support capital expenditure and our expectations of higher inflationary forces for the rest of the year.



Source: CBN, NBS, DMO, Vetiva Research

Yield environment to sustain corporate issuances for commercial papers/bond

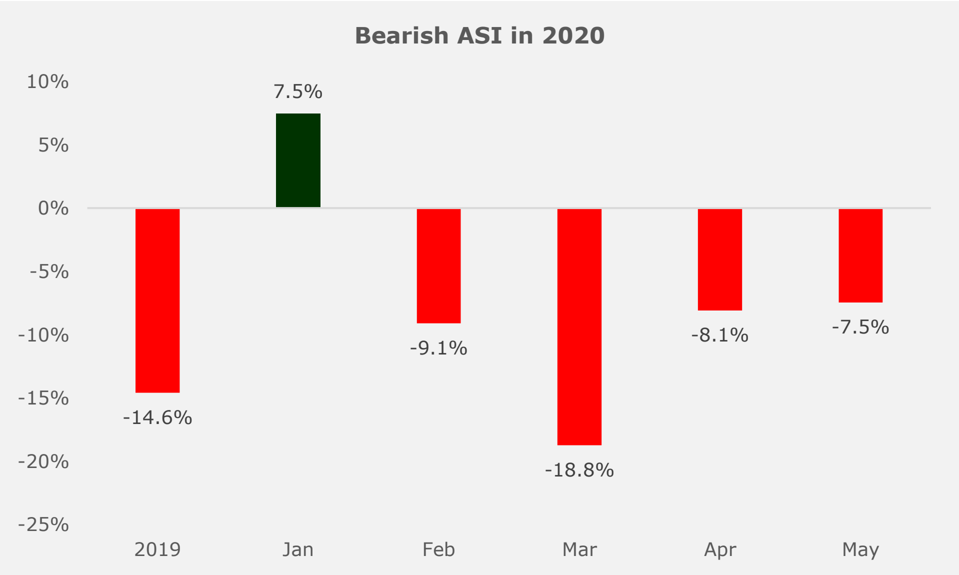
Domestic corporates continued to supply debt instruments to the market (CPs and bonds) given the low yield environment. Corporate CP issuances surged in H1'20 with the largest offerings issued by Dangote and MTN in May and June respectively that both account for C.60% of total CP outstanding value of ₦444 billion as at June 12, 2020, 2.4 times more than the outstanding value as of December 2019. Corporate bond issuances were low during the period, with Flour Mills tapping the market in February before domestic markets were faced with COVID-19 pandemic realities. We expect a similar flurry of issuances in H2'20 given the low yield environment with emphasis on the CP market or short tenor bonds.

Equity

Equity Market

A pandemic-induced panic

Despite the early optimism of the first month of 2020, a steep decline in crude prices caused by the spread of the coronavirus led to a generally bearish H1. The sell-offs from international and local investors dragged the bourse to a low of -23% on April 7, before bargain hunting from mainly local investors pushed the ASI to single-digit losses by May. While we expected a more attractive market for investors in 2020, the poor macro environment, currency devaluation and general uncertainty over crude prices have dampened investors' view of the Nigerian market. In the second half of the year, we expect the recovery in equity prices seen in Q2 to continue -albeit at a slower pace- with local investors continuing to drive majority of the activity on the bourse. We expect the market to close the year in mildly negative territory (-5%), driven by the current economic outlook.



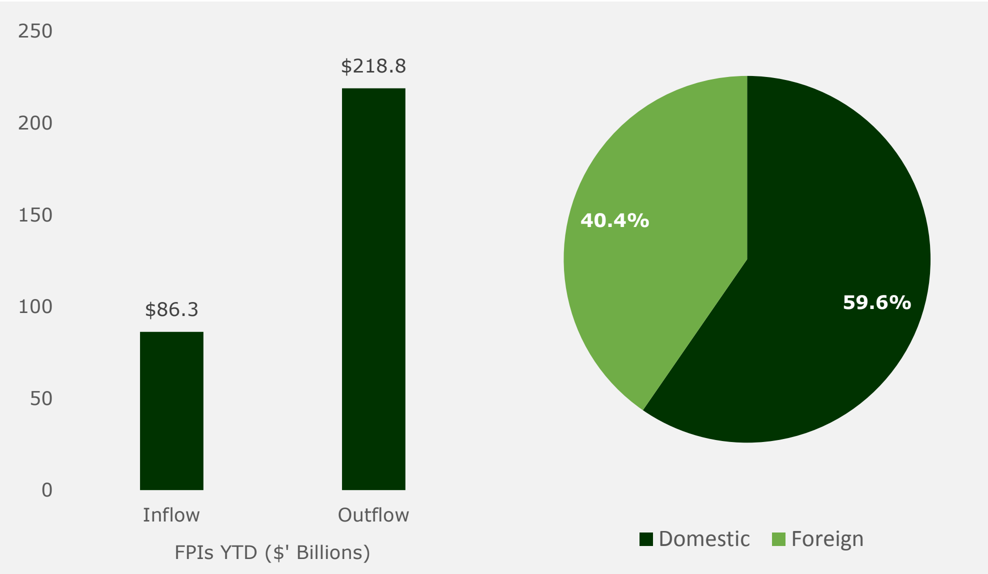
Source: NSE, Vetiva Research

FPIs unlikely to return in the near-term

Following the steep decline in crude price, foreign portfolio investors (FPIs) who feared an economic crash began exiting the Nigerian market. This had the double effect of dragging equity prices and pressuring Nigeria's foreign reserves, with the official reserves dipping to a three-year low of $33.43 billion in April. As a result of this, the CBN adjusted the rate in the Investors' and Exporters' Foreign exchange window to ₦380/$1 to alleviate some of the pressure.

International participation in the Nigerian Equity space has been understandably weak, as foreign investors seek safer investments in more stable economies and commodities such as Gold. This has created a favourable environment for long-term, local investors, with the average proportion of domestic transactions standing at 59.6% as of April 2020, compared to 48.1% in the corresponding period in 2019.

Looking forward, we expect Nigeria's currency position to remain fairly stable in H2'20, supported by the $3.5 billion IMF facility and the $2.8 billion concessionary loans from the World Bank. However, we do not foresee a full rebound in FPI activity in the near-term, as the economic outlook for the country remains weak. Additionally, the recent move by MSCI Inc. to add Nigeria to the list of frontier markets with accessibility issues will further drain FPIs' appetite for the Nigerian equity market in the near term. In our view, domestic investors are likely to remain the most active participants in the local market for the rest of the year. However, a stronger-than-anticipated recovery in oil prices in Q4, coupled with an unconstrained flow of liquidity at the NAFEX window, could somewhat rekindle FPIs' interest in the equity market.



Source: NSE, Vetiva Research

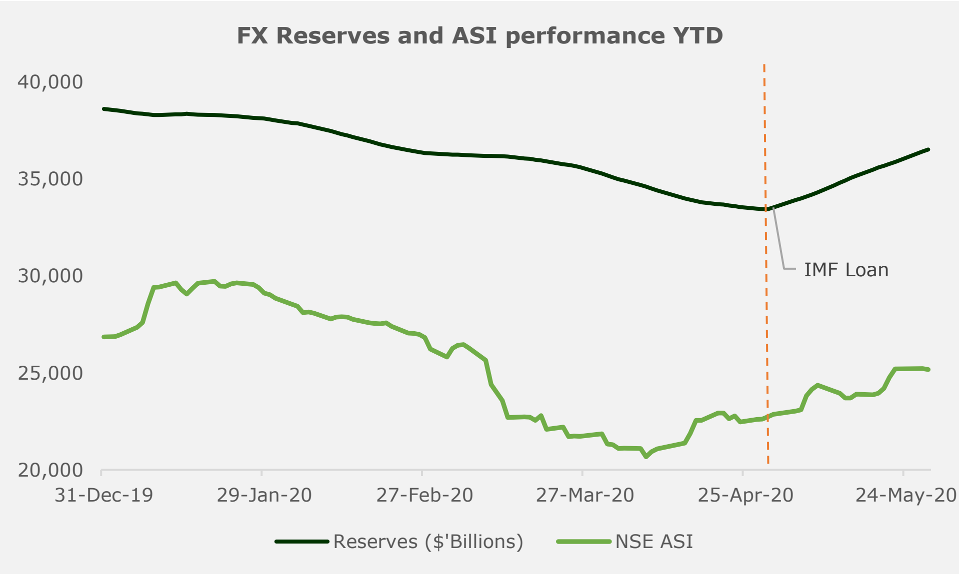
Weak sentiment to delay primary activity until 2021

2020 was meant to be the year in which the NSE took further steps to expand its appeal. The demutualization and eventual listing of the bourse on the exchange would have attracted further FPIs and expanded the NSE's market capitalization. However, the current economic environment has necessitated a pause in any further actions on demutualization. Furthermore, the current poor sentiment, which we believe will persist for the rest of the year, has made equity capital raising unattractive to all companies. Due to the decline in yields across the curve in the Fixed Income market since the start of the year, we have seen many companies raising capital through the issuances of commercial papers (Union Bank, MTN and Nigerian Breweries to name a few). Given the sharp drop in equity prices, we do not expect to see any primary activity, whether new listings or rights issues in H2'20.

Company earnings, like the economy, unlikely to grow

Early optimism about economic growth and strong earnings at the start of the year has all but gone. Q1 results, while not entirely negative, were evidently affected by the global pandemic and the shutdown of various states (Q1 GDP growth came in at 1.87%). We expect Q2 and H1 results to more accurately reflect the impact of COVID-19 and its effect on crude prices and economic activity. In the Banking sector, we expect a decrease in Interest Income, caused by lower repayment rates and an increase in loan deferrals and extensions. Furthermore, we expect the Consumer and Industrial Goods companies to report lower revenues, due to the weak economic activity and diminished spending power of consumers. Meanwhile, the lower crude prices and reduced pump price of PMS will affect upstream and downstream revenues; however, margins in the downstream sector may improve slightly due to cheaper landing costs. Overall, we believe that earnings are unlikely to outperform 2019 figures for H2, with major recovery or growth likely to come in 2021.

Nevertheless, it is important to note that investors will likely begin to take positions ahead of any such recovery in the coming quarters, with some savvy investors already taking positions at the tail-end of Q2 (the ASI gained 8.1% in April and 9.8% in May). Should the trend continue, the market could re-enter positive territory some time in H2, although general sentiment means this recovery is unlikely to hold until the end of the year.



Source: NSE, CBN, Vetiva Research

Regulatory bodies and their roles in driving market recovery

The importance of regulatory bodies in driving reforms to encourage investments and boost investor confidence cannot be overstated, especially during the current economic uncertainty. Notably, we highlight the recent appointment of a new DG of the Securities and Exchange Commission by the President, which has been passed to the National Assembly for approval. The appointment of a permanent head is expected to also boost investor confidence after two years of interim leadership. The expectation is that the appointment will precede the reinvigoration of the Nigerian equity market by expanding the market through diversification, enacting growth strategies and broadening the appeal of the Nigerian equities to attract new entrants.

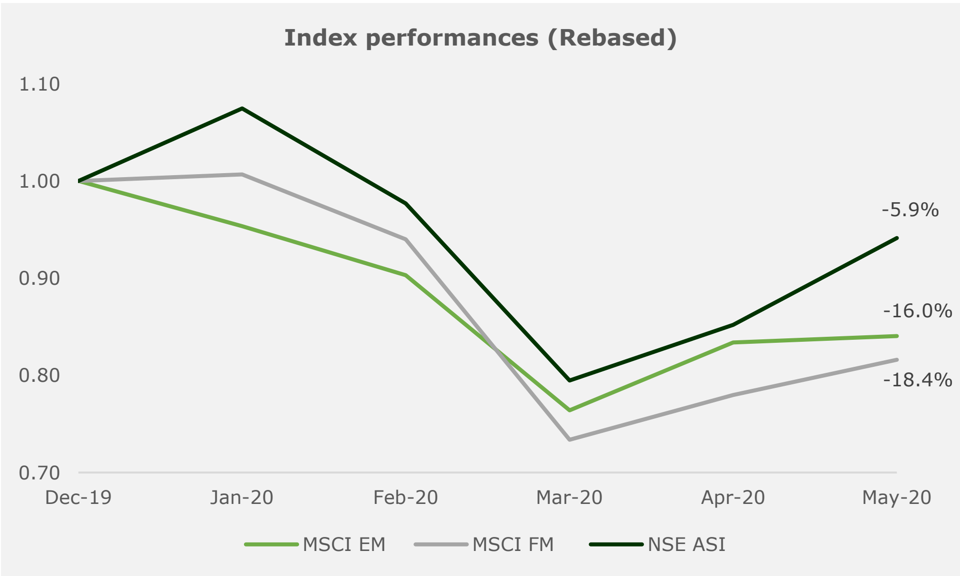
Meanwhile, the new regulation on crowdfunding for SMEs could increase capital investment by creating a new segment for smaller companies unable to meet the requirements to list on the stock exchange. However, the lack of clarity on the mechanics behind the regulation make it difficult to predict its effectiveness and whether it will work to expand the capital market.

The main role of the CBN in driving market recovery centers on the activity in the I&E FX window. Despite the positive reaction following the convergence of the official and I&E rates, activity in the window was noticeably lower following the suspension of currency sales by the apex bank during the lockdown period. Although investors continued to trade, the absence of liquidity in the market had a negative effect. While we have noted the increase in outflows from the Nigerian market in H1, we expect that the resumption of Fx sales by the CBN will serve to ease some of the pressure on the market, with foreign investors more likely to resume trading in a stable Fx regime. Going forward, a more stable currency would provide the foundation for investors to return to the market for equities. However, previously highlighted factors may dampen said recovery.

Recovery for Frontier Markets, a concerted rebound?

The level of recovery in the Frontier economies is likely to vary depending on the tactics employed by individual governments. As at May 29, the MSCI Frontier Markets index had lost 18.4%, compared to -5.9% for the NSE ASI and -16.0% for Emerging Markets. International investors remain wary of frontier markets, especially commodity-reliant economies. While Nigeria's currency is likely to be kept stable following the strategic devaluation by the CBN, other economies running more liberal exchange rate regimes could increase the uncertainty among investors for the rest of 2020. Also, the levels of economic activity in these economies are likely to remain somewhat depressed in the near term, further dampening investor sentiment. Even after partial or complete easing of lockdowns across the continent, the likelihood of a U-shaped rebound will probably lead to a negative return for equities in these economies.

However, should businesses rebound at a faster rate in the third quarter, international investors may begin to dip their toes into these markets at a higher pace. Although, the fact that Nigeria's currency devaluation was one of the highest (-6.5% YTD) compared to other economies (Egypt's currency appreciated by 1.3% against the US Dollar) could discourage investors who believe the currency to still be overvalued. In the short-term, we do expect any recovery in Frontier equities to slightly favour the Nigerian market.



Source: MSCI, NSE, Vetiva Research

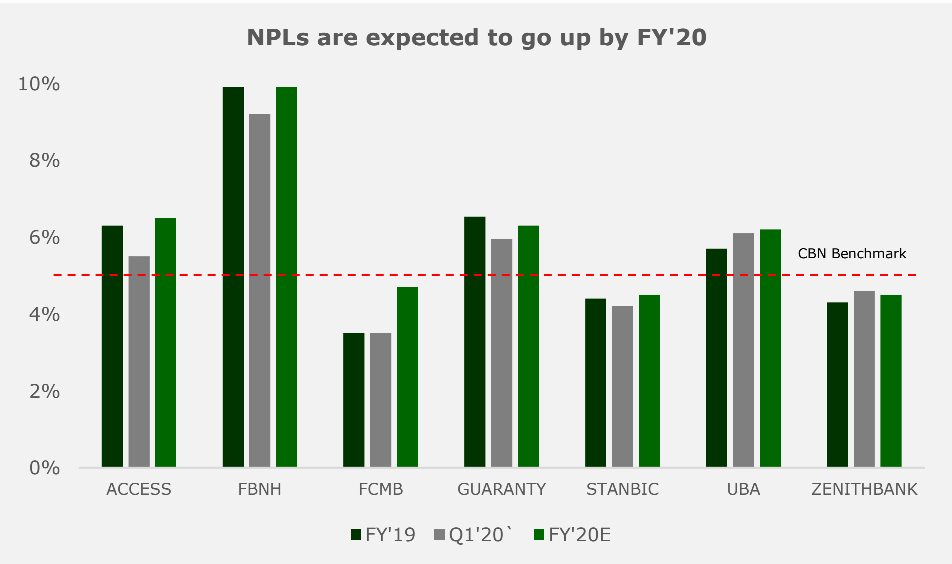
Financial Services

Banking: A minor bump in the road?

Pandemic disrupts banks' momentum

The COVID-19 pandemic led to a steep decline in crude prices, translating to weaker domestic currency with adverse impact on the general economy and local businesses. Weak economic activity has consequently put a strain on loan obligors, threatening banks' interest income. Rising inflation, lower disposable income and weaker government revenue/spending, coupled with lower GDP growth have all served to weaken demand, lowering output in the consumer and industrial sectors. Our coverage banks reported positive growth in Gross earnings in Q1, mainly due to the delayed impact of the economic slowdown and surprisingly strong yield on assets (YoA), as much of Q1 Interest Income from consumer loans was booked before the shutdown came into effect. Therefore, we expect the full impact of the pandemic to be more accurately reflected in Q2 and H2 results. Meanwhile, although industry NPL was around 6.0% as of FY'19 and our coverage banks were at an average of 5.6% as of Q1'20-slightly above the CBN's 5% benchmark- the increased risk of default will likely raise the average in the near-term. However, due to the unique nature of this economic downturn, banks remain fairly optimistic of a swift V-shaped recovery and have deferred some of their income rather than writing them off completely as bad loans.

Consequently, we expect Interest Income to suffer in the near-term, as we do not anticipate a greatly improved macro environment in H2. Furthermore, we estimate a modest uptick in NPL ratio of our coverage banks, tempered by the increased repayment periods and moratoriums granted to maintain asset quality. Therefore, amidst the challenging operating environment, we remain positive about the near-term asset quality of Tier-I banks and estimate an average NPL ratio of 6.1% for FY'20 for our coverage, with FBNH, GUARANTY and ACCESS carrying the most impact and weighting on our forecast.



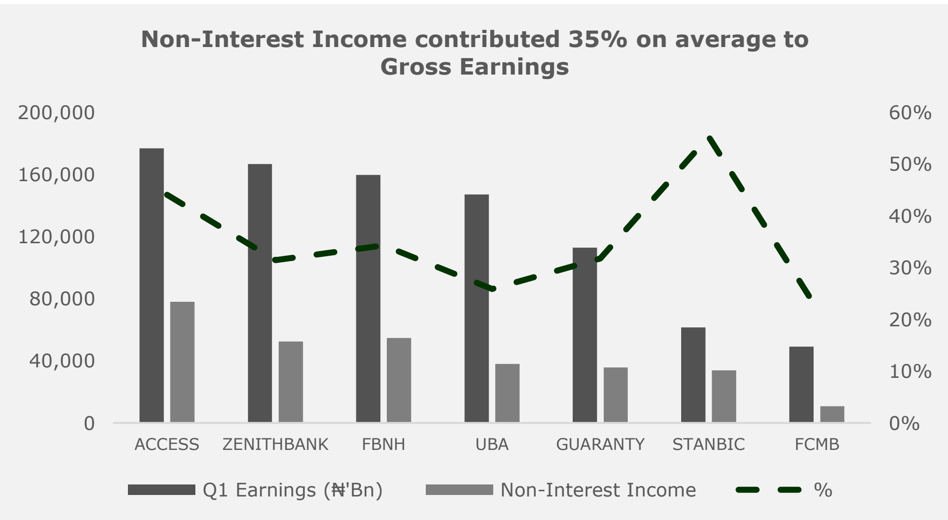
Source: Company filings, Vetiva Research

Loan growth to slow down in H2

Due to the outbreak, we expect only modest, single-digit loan growth across our coverage banks for FY'20 due to the increased risk of default and currency devaluation. Given the recessionary impact, it is unlikely that banks will be able to repeat the aggressive loan growth seen in 2019 (20% across our coverage), even though the primary incentive for the significant climb in loans (the minimum LDR requirement) remains in place. We expect banks to err on the side of caution, given the level of economic uncertainty in the near-term. Thus far, the CBN has mainly used CRR debits to control excess liquidity and limit activity in the OMO and FX markets, with little attention paid to the LDR. That said, evidence suggests that prior to the outbreak, the minimum LDR was having a significant effect on bank's lending strategies. Our coverage banks achieved loan-growth of 5.8% in Q1'20, as the drive to meet up with LDR regulations pushed banks to issue short term-loans, with campaigns that were set in motion before the economic reality of the pandemic became clear. Therefore, we have scaled back our loan-book growth forecast for the rest of the year, with only a 48bps increased in loan book expected for the rest of the year.

Non-interest Income to support top-line in near term

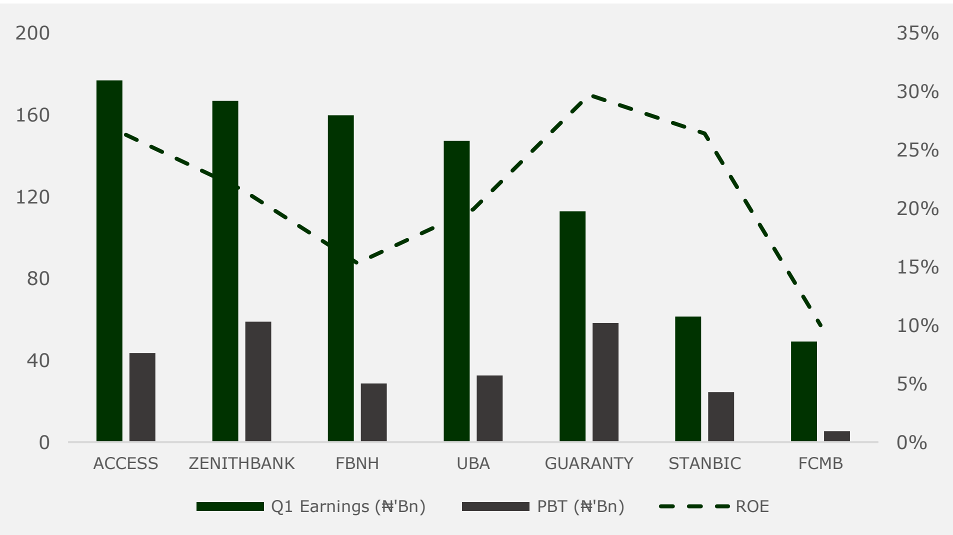
Coming into 2020, we had anticipated an uptick in Non-Interest Income due to increased economic activity and a revamp of the charges and payment structures by the CBN. As expected, Q1 results showed Tier-1 banks grew Non-Interest Income by 38.1% y/y, while our coverage universe managed a 32.9% y/y growth. This helped to support the 13.0% y/y growth in PAT reported by our coverage banks, while Net Interest Income only managed a 6.0% y/y growth. Due to the increased reliance on electronic and mobile banking platforms to drive banking activity, coupled with the reduction in in-person banking necessitated by the COVID-19 pandemic, we expect this growth in Non-Interest Income, specifically fees and commissions to hold for the remander of 2020. Further to that, we expect banks with significant long-positions in foreign currency to reap the benefits of the Naira devaluation, as was evident in Q1 from the likes of GUARANTY and ZENITHBANK. However, trading of fixed income securities has been quite a mixed bag for our coverage banks, with some reporting heavy losses (ACCESS, UBA) while others reported significant gains (GUARANTY, ZENITHBANK). While we do not expect the trend to reverse, we do foresee slightly better performances from some of the banks with Q1'20 trade losses, due to the banks going long ont eh dollar in hope of further currency devaluations.



Source: Company filings, Vetiva Research

The weak macro economy and the challenging operating environment have negatively impacted corporate earnings across most sectors. In the Banking sector, the key pressure points remain the possibility of weaker top line growth and increased loan loss provisions. Whilst Interest Income came in 2.8% stronger y/y on average across our coverage in Q1 due to lower yield on assets (YoA) which capped the impact of relatively strong (5.8% y/y) loan growth, Net Interest Income actually grew 6.0% y/y thanks to a 2.9% y/y decline in Interest Expense. The lower cost of funds was particularly beneficial to GUARANTY, which saw a 21.6% decline in Interest Expense, while other Tier-1 names (ex UBA) also saw significant declines. Going forward, we expect the favourable interest rate environment to significantly reduce banks' interest expense, with many banks already announcing revisions of interest payment on savings accounts, as well as borrowing short-term funds at significantly lower rates through commercial papers. However, whilst we forecast a 4.2% moderation in Interest Expense, we also expect weak (0.6% y/y/) growth in Interest Income, giving a 2.1% y/y growth in Net Interest Income.

Meanwhile, in terms of Operating expenses, we observed an 18.9% y/y average growth in Opex across our coverage. Although a large portion of this could be attributed to the softer base of ACCESS' pre-merger, other banks also recorded significant increases in costs such as AMCON charges and personnel compensation- Opex growth across our coverage averaged 11.1% (ex-ACCESS). However, we do not expect this trend to persist in the remaining quarters, mainly due to the expected slowdown in economic activity, which has necessitated some cost-saving measures across the various banks. We foresee some moderations in branch costs, as many bank branches remain closed, or only operate at semi-capacity. The savings on expenses such as diesel and electricity costs may not be as significant to the bottom line as other efficiency costs, but they will contribute somewhat to the overall moderation in Opex we expect. Therefore, we expect only a 5.7% y/y Opex growth (FY'19: 10.7% y/y). However, we must highlight that this moderation in Opex growth is unlikely to reflect equally across the sector, with the largest banks in the best positions to take advantage of economies of scale. Therefore, we expect the banks to report weak PBT gains, mainly lifted by FX revaluation gains and overall Non-Interest Income. Hence, we estimate average Cost to Income Ratio (CIR) of 56.1% for FY'20. Overall, we anticipate a modest PAT growth of 0.6% for FY'20 – largely dragged by the weaker expected earnings.

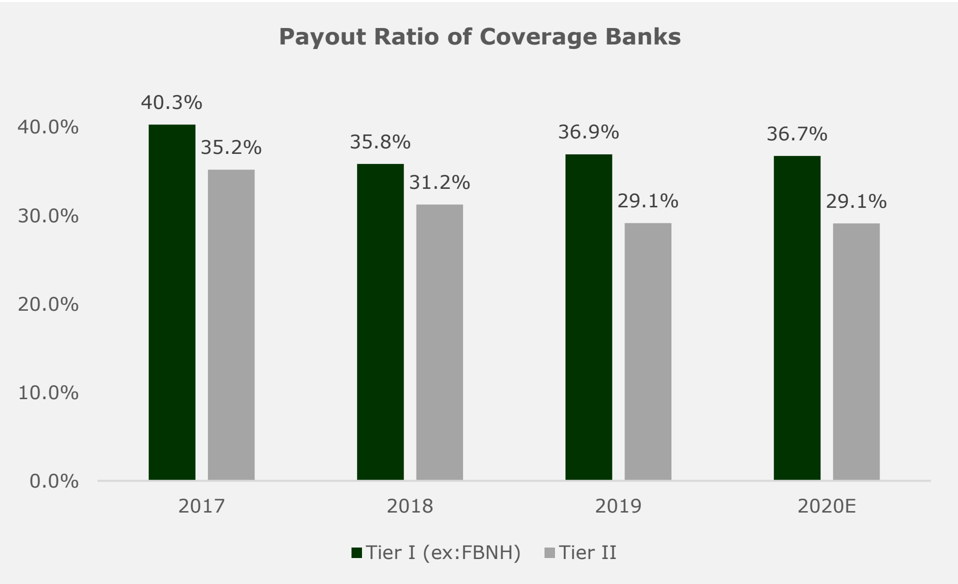


Source: Company filings, Vetiva Research

Tier I dividend to remain flat y/y

The banking sector has historically been a dividend paying sector, with the Tier I names (ex FBNH) paying as high as 40% of earnings as dividends, translating to an average dividend yield in the range of 9% to 15%. Although, in recent fiscal years, we have seen moderations in dividend payments, especially due to the impact of the tougher operating environment and as banks have sought to retain more earnings in a bid the maintain adequate capital buffers. That said, we expect dividend payout to remain relatively strong, particularly across the Tier I names.

The IMF has advised banks to cut back on dividend payments in order to build up their capital base. However, due to the nature of the local equity space, any significant reduction in dividend payout would likely dampen investor sentiment and spur exits from the sector. Therefore, while we do not expect a y/y increase in dividend payout, we do foresee, at least, flat dividend payout for FY'20, with interim dividends likely to remain flat also.



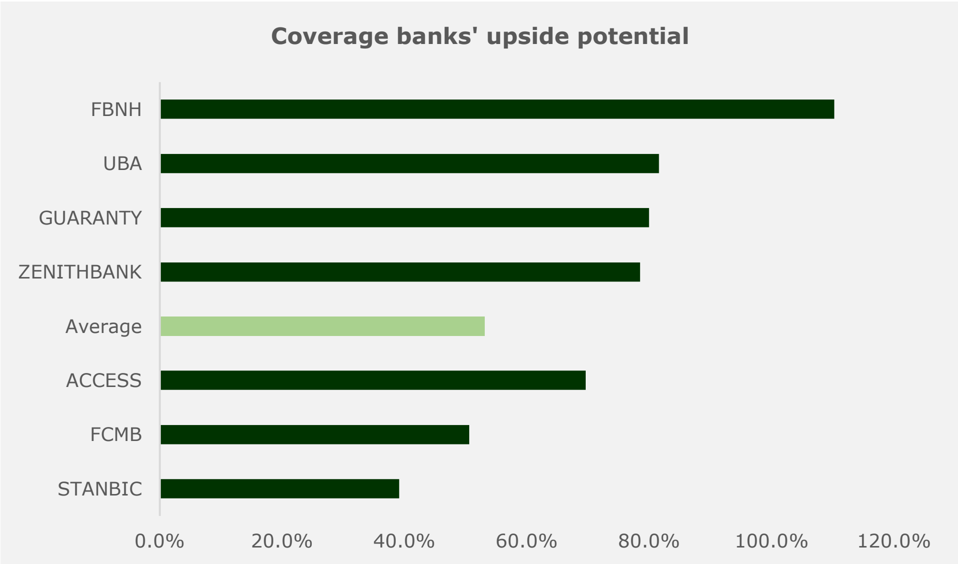
Source: Company filings, Vetiva Research

Capital raising still on the horizon

While all the banks within our coverage have maintained Capital Adequacy ratios above the regulatory minimums (Tier I: 15%; Tier II: 10%), average CAR deteriorated from FY'19 (20.8%) to Q1'20 (19.4%). Although we expect most banks to cut back on loan growth due to the current economic environment while maintaining current dividend payout, the impact of the current macro economy on business operation, coupled with the low yield environment has brought the capital raising need back to the fore. Although most of our coverage banks have indicated little interest in the raising of capital, especially due to the tepid sentiment in the equity space, our discussions with managements have led us to expect bond raising plans in the near-term. The low interest rate environment makes this the most appealing step for any bank seeking to boost short to medium term Tier-2 capital. However, we do not expect significant capital raises within the year from the major players, rather we expect Tier -II banks not within our coverage to engage in commercial paper and bond raises to take advantage of the current interest rate environment.

Nigerian bank valuation still attractive after adjusting for risk

The Nigerian banking sector has consistently appeared significantly undervalued, priced at an average P/Bv of 0.6x compared to Frontier Market average P/Bv of 2.5x. Despite improvements in earnings visibility and much stronger asset quality, the persistently low valuation is difficult to justify. Currently, the banking sector is trading at a YTD loss of 16.1% vs NSE ASI -5.70% and we believe the sector remains largely undervalued, presenting an average 91.2% upside to our target prices. We believe that the banking sector remains the most attractive sector for investors both in the short and long-term, with strong profitability and dividend payouts sure to attract both foreign and domestic investors to the attractively priced stocks in the coming months.



Source: Company filings, Vetiva Research

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Equity Research

GUARANTY TRUST BANK PLC

Efficiency to prop earnings for FY'20

GUARANTY's Q1 performance was mildly positive, with the 2% y/y growth in Gross Earnings coming as a result of stronger than expected Interest Income of ₦77.0 billion. This 3% y/y growth was driven by higher income from customer loans. However, the bank did report a remarkable growth in Net Interest Income, thanks to a 21% y/y drop in Interest paid on customer deposits—a result of the favourable interest rate environment in Q1. Meanwhile, Non-Interest Income remained flat y/y at ₦35.8 billion. This disappointing performance was due to a 22% y/y decline in Fee income (mostly credit related fees), which cancelled out a 50% jump in foreign exchange trading gains. Also, the bank's Opex grew 12% y/y to ₦40.7 billion, while provisions jumped 88% y/y to ₦1.2 billion. Overall, PAT grew 2% y/y to ₦50.1 billion, producing an ROAE of 29.7%.

Going forward, we anticipate a slight (2%) decline in Net Interest Income, driven by a 4% drop in Interest Income. However, we do expect Non-Interest Income to improve by 7% y/y, driven by increased transaction volumes and continued Fx revaluation gains. Meanwhile, we expect loan loss provisions to increase by 64% y/y to ₦8.1 billion due to the weaker macro environment. More so, we expect the bank to maintain its best-in-class efficiency, with Operating Expenses forecast to grow by 1% y/y, while cost-to-income ratio is expected to remain at 36% levels. We anticipate a significantly weaker second quarter, with a mild recovery coming in Q3 before a more robust growth in Q4. Thus, we forecast a FY'20 PAT of ₦197.3 billion (FY'19: ₦196.9 billion) and an ROAE projection of 28.3% and EPS of ₦6.70. GUARANTY currently trades at P/B and P/E ratios of 1.1x and 3.7x vs. Tier I averages of 0.5x and 2.9x respectively.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Gross Earnings	434,699	435,407	432,916	470,844
Net Interest Income	222,434	231,363	225,958	230,678
Loan Loss Expense	(4,906)	(4,912)	(8,061)	(4,849)
Non-Interest Income	127,735	139,202	148,807	162,200
Operating Expenses	(129,676)	(133,946)	(135,070)	(144,190)
Profit After Tax	184,640	196,866	197,311	207,708
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Net Loans and Advances	1,362,073	1,569,339	1,663,499	1,696,769
Deposits	2,356,706	2,640,059	2,930,465	3,223,512
Total Assets	3,287,343	3,758,919	4,326,494	4,567,168
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Cost to Income Ratio	-37%	-36%	-36%	-37%
Loan to Deposit Ratio	58%	59%	54%	50%
ROAE	32%	31%	26%	27%
ROAA	6%	6%	5%	5%
EPS	6.27	6.64	6.70	7.06
DPS	2.75	2.80	2.80	3.00

BUY

Target price	₦43.28

Company Statistics

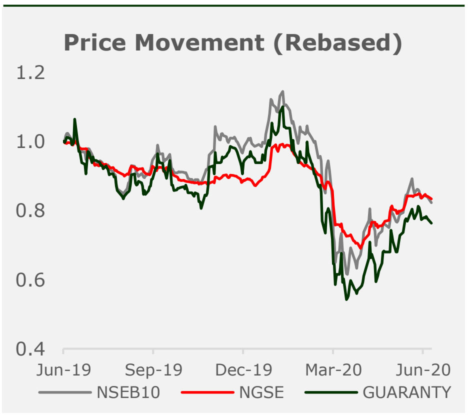
Price (₦)	22.35
Market Cap (₦'Mn)	657,786
Shares Outstanding (Mn)	29,431
NSE	GUARANTY
P/B (FY'20)	1.0x
P/E (FY'20)	3.4x
Bloomberg	GUARANTY.NL
Reuters	GUARANTY.LG

Ownership Structure

FMR LLC	1.75%
BMO Investments	1.36%
Others	96.89%

Share Price Performance

30 days	4.89%
Ytd	-20.54%
365 days	76.38%



Business Description

Guaranty Trust Bank PLC (GUARANTY) is the fifth largest bank in Nigeria by total assets. The bank focuses on corporate banking with presence in Nigeria, Gambia, Sierra Leone, Ghana, UK, Liberia, Cote D'Ivoire, Kenya, Uganda and Rwanda. The bank has its primary listing on the Nigerian Stock Exchange and secondary listing as GDRs on the London Stock Exchange.

Source: Bloomberg, Vetiva Research

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Equity Research

ZENITH BANK PLC

Profitability to remain best in class in 2020

ZENITHBANK's Q1'20 earnings were impressive, as the bank reported an 8% y/y growth in Gross Earnings. This came despite a 7% y/y decline in Interest Income to ₦114.3 billion. The earnings improvement was driven by a 61% y/y increase in Non-Interest Income to ₦52.5 billion, the result of a 339% spike in FX revaluation gains to ₦14.7 billion. We note that similar gains were recorded across the industry in the aftermath of the Naira devaluation. Also, despite an 89% y/y rise in Provisions to ₦3.9 billion and Opex growth of 20% y/y to ₦71.2 billion, the bank was able to maintain bottom line at ₦50.5 billion.

Despite the bank recording a 16% y/y improvement in income from loans, these gains were offset by a 64% y/y decline in Income from T-Bills. Going forward, we expect further declines in Interest Income, especially in the latter half of H2'20, due to the expected increase in loan defaults and persistently weak yield environment. On the other hand, the bank's impressive Non-Interest Income growth of 61% y/y provides a potential upside for Gross earnings, as FX revaluation gains and trading income are expected to significantly boost the bank's performance in FY'20. Also, we expect the bank's Opex growth to be contained at 10% y/y. This gives us a lower PAT projection of ₦199.6 billion (FY'19: ₦208.84), yielding an ROAE of 20% and an expected EPS of ₦6.36 and DPS of ₦2.80.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Gross Earnings	630,344	662,251	677,858	707,922
Net Interest Income	295,594	267,031	292,310	302,496
Loan Loss Expense	(18,372)	(24,032)	(37,674)	(39,085)
Non-Interest Income	190,292	246,688	249,155	256,630
Operating Expenses	(235,829)	(246,393)	(271,143)	(261,931)
Profit After Tax	193,424	208,843	199,612	221,458
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Net Loans and Advances	2,016,520	2,462,359	2,560,853	2,650,483
Deposits	3,690,295	4,262,289	4,590,485	4,911,819
Total Assets	5,955,710	6,346,879	6,790,396	7,241,724
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Cost to Income Ratio	-49%	-49%	-50%	-47%
Loan to Deposit Ratio	39%	43%	56%	54%
ROAE	24%	24%	20%	20%
ROAA	3%	3%	3%	3%
EPS	6.16	6.65	6.36	7.05
DPS	2.80	2.80	2.75	2.82

BUY

Target price	₦30.17

Company Statistics

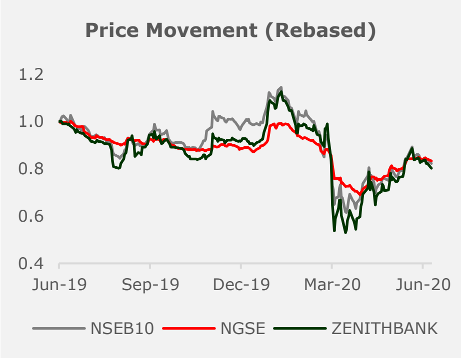
Price (₦)	16.20
Market Cap (₦'Mn)	508,615
Shares Outstanding (Mn)	31,396
P/B (FY'20)	0.6x
P/E (FY'20)	2.1x
NSE	ZENITHBANK
Bloomberg	ZENITHBA:NL
Reuters	ZENITHBANK: LG

Ownership Structure

Ovia Jim	9.38%
Others	90.62%

Share Price Performance

30 days	4.85%
Ytd	-12.90%
365 days	80.20%



Source: NSE, Vetiva Research

Business Description

Zenith Bank PLC (ZENITHBANK) is one of Nigeria's largest lenders. The bank offers its clients wide range of corporate, investment, business and personal banking products and solutions across 500+ branches, predominantly in Nigeria, with subsidiaries in the UK, Ghana, Sierra Leone and Gambia, as well as representative offices in South Africa and China.

Source: Bloomberg, Vetiva Research

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ACCESS BANK PLC

Macro headwinds to offset synergies

Equity Research

ACCESS' Q1'20 results showed an impressive 31% y/y growth in Gross Earnings. The significant increase was mainly due to a low base from Q1'19, as the bank was yet to complete its merger with the defunct Diamond bank at the time; however, the bank's interest income growth (19% y/y to ₦131.9 billion) and Non-Interest Income (58% higher y/y at ₦77.9 billion) were nonetheless noteworthy. Most notably, the bank reported a 320% y/y spike in gains from investment securities to ₦82.9 billion. This helped to offset a ₦54.7 billion loss on foreign exchange trading and revaluations. On the other hand, the bank recorded a 153% y/y increase in loan loss provisions to ₦8.5 billion (Vetiva Estimate: ₦5.5 billion), a result of the bank's expanded Loan book. Furthermore, the bank also recorded a spike (65% y/y) in Opex to ₦95.3 billion, driven by a weaker base in Q1'19, as well as a higher wage bill and a 55% jump in AMCON charges to ₦17.5 billion. As a result of this, the bank reported a 3% y/y growth in PBT to ₦46.3 billion (Vetiva Estimate: ₦43.5 billion) and flat PAT of ₦41.0 billion, giving an ROAE of 26.3% (Q1'19: 30.9%).

Amidst the prospect of further moderations in earnings occasioned by the weak economic outlook for 2020 and the poor yield environment, the bank's cost to income ratio has risen from 53.2% in Q1'19 to 62.2% in Q1'20 (FY'19: 65.0%). Looking ahead, we expect a slight moderation in Opex y/y to ₦268.8 billion (Previous: ₦272.6 billion), driven by cost synergies that the bank will continue to realize over the course of the year, with regard to branch rationalization and lower subscription fees and charges and other overhead costs. As a result of this, our FY'20 PAT is set at ₦90.4 billion, yielding an ROAE of 14.2% and EPS/DPS projections of ₦2.50 and ₦0.60.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Gross Earnings	528,745	666,754	651,953	761,768
Net Interest Income	173,578	277,229	226,752	284,302
Loan Loss Expense	(14,657)	(20,189)	(37,608)	(15,904)
Non-Interest Income	147,830	129,907	194,860	210,449
Operating Expenses	(203,563)	(271,568)	(277,080)	(309,257)
Profit After Tax	94,981	97,510	91,955	145,847
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Net Loans and Advances	1,993,606	2,894,552	2,947,965	2,945,038
Deposits	2,564,908	4,255,837	4,447,350	4,580,770
Total Assets	4,954,157	7,146,610	7,468,441	7,750,554
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Cost to Income Ratio	-63%	-67%	-66%	-63%
Loan to Deposit Ratio	83%	73%	71%	70%
ROAE	19%	18%	14%	20%
ROAA	2%	2%	1%	2%
EPS	3.25	2.74	2.59	4.10
DPS	0.50	0.65	0.62	0.79

BUY

Target price	₦11.4

Company Statistics

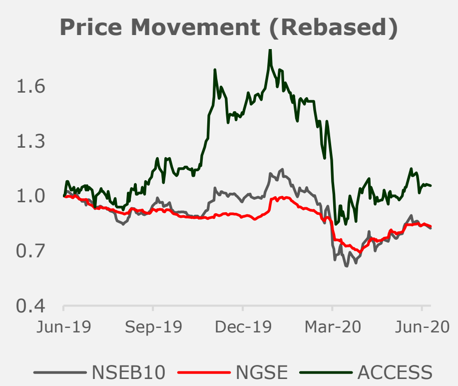
Price (₦)	6.60
Market Cap (₦'Mn)	710,641
Shares Outstanding (Mn)	35,545
NSE	ACCESS
P/B (FY'20)	0.4x
P/E (FY'20)	2.5x
Bloomberg	ACCESS.NL
Reuters	ACCESS.LG

Ownership Structure

Stanbic Nominees Ltd	13.38%
Herbert Wigwe	4.06%
Others	82.56%

Share Price Performance

30 days	8.00%
YTD	-32.50%
365 davs	5.47%



Source: NSE, Vetiva Research

Business Description

ACCESS BANK PLC (ACCESS) is a leading full-service commercial Bank with over 660 branches and service outlets, with a customer base of over 29 million spread across 12 countries. The Bank employs over 28,000 people in its operations in Nigeria and has subsidiaries in Sub-Saharan Africa and the United Kingdom. The bank has been listed on the Nigerian Stock Exchange since 1998.

Source: Bloomberg, Vetiva Research

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Equity Research

NIGERIA | EQUITY | FINANCIAL SERVICES | BANKING| UBA

UNITED BANK FOR AFRICA PLC

Profits to grow amidst tricky landscape

From UBA's Q1'20 results, we observed a 12% y/y growth in Gross Earnings to ₦147.2 billion. The bank's Q1 performance was solid across most line items, driven by the 15% y/y rise in Non-Interest Income to ₦38.1 billion and an 11% increase in Net Interest Income to ₦65.4 billion. Interestingly, UBA achieved this increase in Net-Interest Income despite recording an 8% rise in Interest Expense driven by an 11% y/y growth in Interest Income (II) to ₦109.1 billion. Also, the bank reported a 15% y/y jump in Non-Interest Income to ₦38.1 billion. However, Opex also jumped 15% y/y to ₦68.2 billion, bringing PBT to ₦32.6 billion (8% y/y), while PAT grew by 8% y/y to ₦32.6 billion. This resulted in an annualized ROAE of 19.9% (FY'19 ROAE: 16.2%).

Although NPLs were initially expected to continue to improve, the downturn in the economy is expected to slow loan growth in Q2 and beyond, while the rate of defaults will rise in H2; thus raising impairments, though this will be tapered by loan tenure extensions as well as extended moratoriums to maintain the quality of some assets. Thus, we expect NPLs to worsen to 6.5% levels (FY'19: 5.3%), while impairments will likely match 2019 levels at ₦18.1 billion. However, our expectation of higher income from term loans to corporates and overdrafts to individuals, boosted by the bank's pan-African footprint with operations in over 23 countries, gives a slight upside to the bearish industry outlook. Going forward, whilst we expect the bank to continue to outperform peers in this regard, the unfavourable economic outlook and weaker yield environment are likely to drag earnings growth in the coming quarters. Therefore, we project FY'20 PAT of ₦96.9 billion, which gives an ROAE of 16% and an expected EPS of ₦2.75 and DPS of ₦1.00.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Gross Earnings	465,913	560,218	576,822	630,027
Net Interest Income	205,646	221,875	231,000	221,440
Loan Loss Expense	(4,529)	(18,252)	(18,123)	(12,513)
Non-Interest Income	102,991	155,388	170,927	186,310
Operating Expenses	(197,342)	(247,724)	(259,570)	(264,611)
Profit After Tax	78,607	89,089	96,902	102,541
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Net Loans and Advances	1,807,393	2,147,283	2,383,484	2,621,833
Deposits	3,349,120	3,832,884	4,139,515	4,553,466
Total Assets	4,869,738	5,604,052	5,961,269	6,501,222
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Cost to Income Ratio	0%	0%	0%	0%
Loan to Deposit Ratio	2%	2%	2%	2%
ROAE	-64%	-66%	-65%	-65%
ROAA	15%	16%	16%	14%
EPS	0.54	0.56	0.58	0.58
DPS	2.20	2.52	2.75	2.91

BUY

Target price	₦12.45

Company Statistics

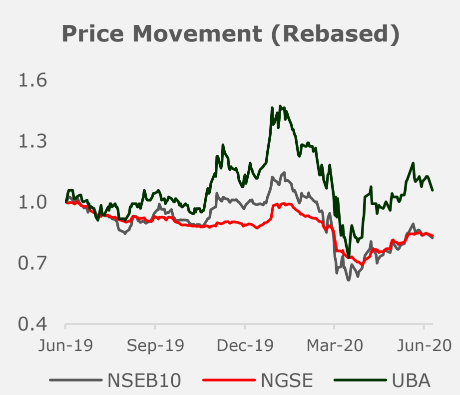
Price (₦)	6.25
Market Cap (₦'Mn)	213,750
Shares Outstanding (Mn)	34,200
NSE	UBA
P/B (FY'20)	0.4x
P/E (FY'20)	2.8x
Bloomberg	UBA.NL
Reuters	UBA.LG

Ownership Structure

Heirs Holdings	5.09%
Others	94.90%

Share Price Performance

30 days	2.40%
90 days	-10.49%
365 days	5.79%



Source: Bloomberg, Vetiva Research

Business Description

UBA is one of the largest banks in Nigeria with a vision to building strong banking businesses across the African continent. The bank offers a wide range of corporate, investment, business and personal banking products and solutions across 700 branches in 19 African countries with presence in New York, London and Paris.

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FBN HOLDINGS PLC

Finding success from solid balance sheet

Equity Research

FBNH reported a 9% y/y growth in Gross earnings in Q1 to ₦159.7 billion despite a 6% y/y drop in Interest Income; a result of the weaker yield environment during the quarter. The earnings beat came as a result of a 57% y/y jump in Non-Interest Income to ₦54.8 billion. This was due to a 748% spike in income from sales of investment securities during the quarter, as well as milder, 12% y/y gains on fees and commissions. Added to this, the bank also reported only a 1% y/y increase in Opex to ₦76.6 billion and a 30% y/y decline in loan loss provisions to ₦9.7 billion. The decline in provisions and tame Opex growth indicate that the bank's strategy of improving efficiency and managing risk is starting to yield results. However, the onset of the COVID-19 pandemic is likely to test management's strategy further in the coming quarter. Overall, the bank reported a 47% y/y rise in PAT to ₦23.1 billion, ahead of our estimate of ₦20.6 billion, the highest Q1 profits since Q1'13 (₦24.7 billion). This gives the bank an ROAE of 15.3%, up from FY'19 (12.4%).

Given the bank's focus on improving asset quality- NPLs also improved 7bps q/q to 9.2%- we do not expect the bank to place much focus on meeting minimum LDR requirements in the near term. We also expect the apex bank to grant some leeway to banks with regards to the regulation, while continuing to use the CRR debits as a form of liquidity control. Ultimately, the current economic climate does not favour further loan growth, with contractions likely to come in subsequent quarters, as default rates are also likely to increase. Overall, our PAT estimate is set at ₦74.5 billion for FY'20 – translating to an ROAE of 10.6% and EPS/DPS of ₦2.07 and ₦0.23 respectively. The bank currently trades at P/B and P/E ratios of 0.3x and 2.8x vs. Tier I averages of 0.5x and 2.9x respectively.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Gross Earnings	589,083	614,545	637,771	669,683
Net Interest Income	284,168	286,388	238,692	235,677
Loan Loss Expense	(86,911)	(41,711)	(35,459)	(26,373)
Non-Interest Income	154,673	173,923	220,882	242,970
Operating Expenses	(286,665)	(345,058)	(338,018)	(351,583)
Profit After Tax	59,744	62,094	74,474	87,098
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Net Loans and Advances	1,683,813	1,877,350	1,891,048	1,947,120
Deposits	3,486,691	4,004,664	4,284,990	4,584,940
Total Assets	5,568,316	6,181,773	6,662,082	7,193,054
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Cost to Income Ratio	-65%	-75%	-74%	-73%
Loan to Deposit Ratio	59%	48%	47%	45%
ROAE	10%	10%	11%	11%
ROAA	1.1%	1.0%	1.1%	1.2%
EPS	1.66	1.73	2.07	2.43
DPS	0.20	0.20	0.23	0.28

BUY

Target price	₦11.37

Company Statistics

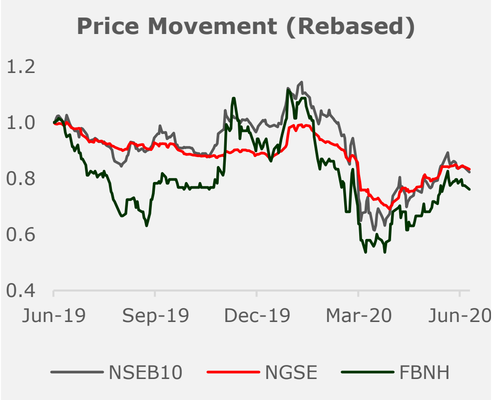
Price (₦)	5.30
Market Cap (₦'Mn)	190,248
Shares Outstanding (Mn)	35,895
NSE	FBNH
P/B (FY'20)	0.3x
P/E (FY'20)	2.8x
Bloomberg	FBN.NL
Reuters	FBN.LG

Ownership Structure

Otudeko Oba	1.50%
T Rowe Price Group Inc.	1.24%
Others	97.26%

Share Price Performance

30 days	6.06%
YTD	-14.63%
365 days	-23.91%



Source: Bloomberg, Vetiva Research

Business Description

First Bank of Nigeria Holdings (FBNH) PLC is one of the largest financial services groups in Nigeria. FBNH is structured under four business groups, namely: Commercial Banking, Investment Banking and Asset Management, Insurance, and Other Financial Services. FBNH's principal bank subsidiary is First Bank of Nigeria (FirstBank), Nigeria's largest commercial bank with operations in 7 countries.

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STANBIC IBTC HOLDING PLC

Non-core banking to boost FY profits

Equity Research

STANBIC posted a 5% y/y increase in Gross Earnings in Q1 to ₦61.4 billion. Interest Income worsened by 12% y/y to ₦27.5 billion. This was the result of a 31% y/y decline in interest from investment securities to ₦9.9 billion. However, Interest Expense also declined 18% y/y to ₦8.9 billion, mainly due to a decline in interest paid on term deposits and current accounts. This led to an 8% y/y decline in Net Interest Income to ₦18.5 billion. Meanwhile, the bank reported a 23% y/y growth in Non-Interest Income to ₦33.9 billion, thanks to a 47% jump in fixed income trading revenue to ₦14.5 billion. On the other hand, the bank recorded loan loss provisions of ₦1.9 billion, indicating a U-turn from the previous year's write-backs of ₦1.4 billion. This, along with a modest rise (4% y/y) in Opex to ₦26.1 billion, led to a 4% y/y growth in PBT to ₦24.4 billion and a PAT of ₦20.6 billion, 8% higher y/y. This yields an ROAE of 26.4% (FY'19: 27.3%).

Going forward, we expect the non-core aspects of the bank's operations to contribute a greater proportion of FY'20 profits (53% of Gross Earnings), as the interest rate environment is expected to remain unfavourable through the majority of 2020. Therefore, we have raised our FY'20 Non-Interest income forecast to ₦130.4 billion. We also raised our loan loss expectation to ₦8.1 billion. In addition, we lowered our PBT estimate to ₦97.9 billion and our PAT forecast to ₦80.8 billion, giving an ROAE of 25.3% and EPS of ₦7.69 and DPS of ₦2.50.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Gross Earnings	220,986	233,808	243,134	265,155
Net Interest Income	78,209	77,831	72,801	80,927
Loan Loss Expense	2,940	(1,632)	(8,081)	(3,660)
Non-Interest Income	102,604	113,396	130,405	136,926
Operating Expenses	(95,601)	(94,029)	(97,254)	(106,062)
Profit After Tax	74,440	75,035	80,768	89,233
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Net Loans and Advances	432,713	532,124	581,361	607,037
Deposits	807,692	637,840	656,975	689,824
Total Assets	1,663,661	1,876,456	1,896,075	1,948,117
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Cost to Income Ratio	-53%	-50%	-48%	-49%
Loan to Deposit Ratio	47%	63%	65%	65%
ROAE	34%	27%	25%	27%
ROAA	5%	4%	4%	5%
EPS	7.27	7.14	7.69	8.50
DPS	2.50	2.50	2.53	2.90

BUY

Target price	₦46.23

Company Statistics

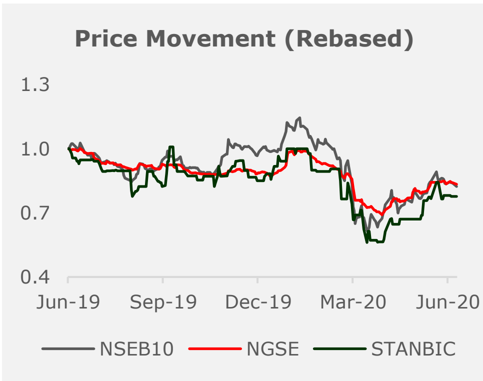
Price (₦)	30.25
Market Cap (₦'Mn)	349,928
Shares Outstanding (Mn)	10,540
NSE	STANBIC
P/B (FY'20)	1.2x
P/E (FY'20)	4.0x
Bloomberg	STANBIC.NL
Reuters	IBTC.LG

Ownership Structure

Stanbic Africa Holdings	63.2%
Others	36.8%

Share Price Performance

30 days	2.64%
YTD	-19.51%
52 weeks	-22.35%



Source: Bloomberg, Vetiva Research

Business Description

Stanbic IBTC Holdings is a member of Standard Bank Group. Standard Bank Group is Africa's largest banking group ranked by assets and earnings and has been in business for over 150 years. With a controlling stake of 64% in Stanbic IBTC Holdings PLC, Standard Bank employs over 52,000 people worldwide; operates in 18 African countries including South Africa and 12 countries outside Africa including key financial centres like Europe, United States and Asia.

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FCMB GROUP PLC

Earnings to moderate in FY'20

FCMB's Q1 performance showed a 12% y/y increase in Gross Earnings to ₦49.2 billion. This was thanks to an 11% y/y gain in Interest Income to ₦38.3 billion, driven majorly by a 10% y/y increase in interest from loans to ₦25.9 billion. With Interest Expense declining 4% y/y to ₦15.2 billion, Net Interest Income came in higher at ₦23.1 billion. Meanwhile, the bank also posted 14% y/y growth in Non-Interest Income to ₦10.9 billion, thanks to a 9% y/y increase in Fees and Commissions to ₦7.3 billion as well as a 195% y/y jump in FX revaluation gains to ₦1.4 billion. However, as expected the bank reported a 61% rise in net loan loss provisions to ₦3.7, mainly due to a 69% y/y decline in write-backs. Meanwhile the bank's Operating Expenses climbed 16% y/y to ₦24.9 billion, although this was generally due to increases in general admin and regulatory expenses. Ultimately, these led to a 26% y/y growth in PBT to ₦5.4 billion and a PAT of ₦4.73 billion, a 31% y/y growth, giving an EPS of ₦0.24.

Importantly, the bank's 7% q/q growth in Loan book should support somewhat stable interest income in the coming quarters; however, this will likely be offset by an increase in defaults and write-offs due to poor economic activity. Furthermore, given Q1'20 run rate, we expect Opex to track higher in 2020, unless management discloses plans for a cost saving in the coming quarters; therefore, we raise our FY'20 Opex projection to ₦88.4 billion (FY'19: ₦85.901 billion). Overall, our expectations for FCMB's FY'20 performance have led to a FY'20 PAT projection of ₦16.6 billion (FY'19: ₦17.34 billion), yielding an ROAE of 8.0% (FY'19: 9.0%). This gives an EPS of ₦0.84 and DPS of ₦0.14.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Gross Earnings	177,249	181,250	180,461	186,832
Net Interest Income	72,573	75,976	76,459	75,343
Loan Loss Expense	(14,113)	(13,748)	(15,163)	(14,839)
Non-Interest Income	45,586	43,803	45,993	48,384
Operating Expenses	(85,604)	(85,901)	(88,426)	(86,877)
Profit After Tax	14,972	17,337	16,599	19,591
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Net Loans and Advances	633,035	715,881	718,451	749,793
Deposits	821,747	943,086	1,095,135	1,138,941
Total Assets	1,431,298	1,668,506	1,867,677	1,959,974
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Cost to Income Ratio	-72%	-72%	-72%	-70%
Loan to Deposit Ratio	68%	69%	64%	65%
ROAE	8%	9%	8%	9%
ROAA	1%	1%	1%	1%
EPS	0.75	0.87	0.84	0.99
DPS	0.14	0.14	0.14	0.15

Equity Research

BUY

Target price	₦2.59

Company Statistics

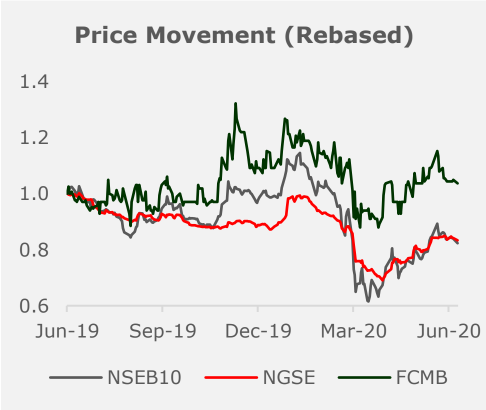
Price (₦)	1.90
Market Cap (₦'Mn)	37,625
Shares Outstanding (Mn)	19,803
NSE	FCMB
P/B (FY'20)	0.2x
P/E (FY'20)	2.0x
Bloomberg	FCMB.NL
Reuters	FCMB.LG

Ownership Structure

CAPITAL IRG TRUSTEES	8.54%
AMCON	5.62%
Others	85.84%

Share Statistics

30 days	-0.58%
Ytd	-7.57%
365 days	3.64%



Source: Bloomberg, Vetiva Research

Business Description

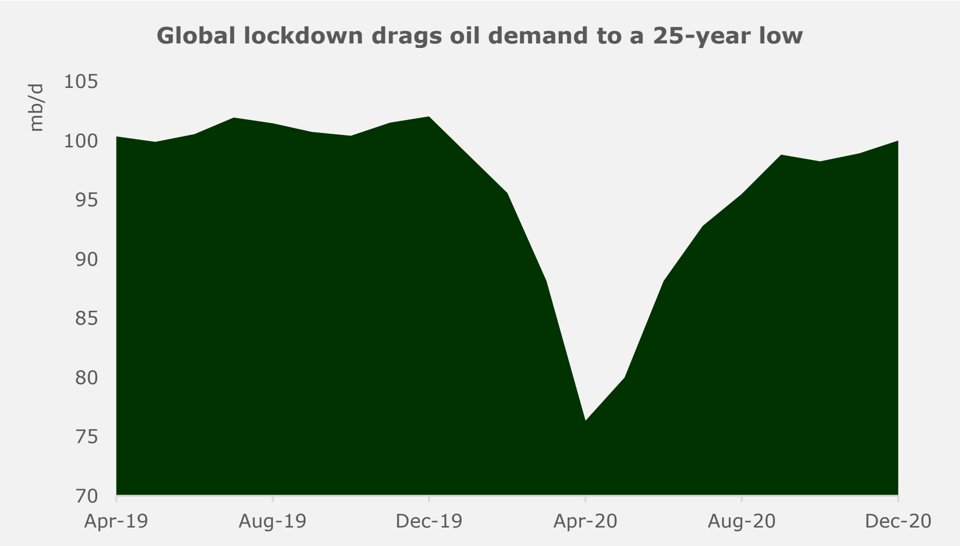
FCMB Group Plc is a non-operating financial holding company, regulated by the Central Bank of Nigeria ("CBN"). FCMB Group Plc was formed in response to the CBN's regulation on the scope of banking activities and ancillary matters ("Regulation 3"), which requires banks to divest their non-banking businesses, or retain them under a holding company ("Hold Co.") structure approved by the CBN.

Oil & Gas

Oil & Gas

Oil demand: a windy, bumpy trip to recovery

Global oil demand was hit hard early this year, following the outbreak of the novel coronavirus (COVID-19) in China and the widespread shutdown of the country's economy. China, which accounted for 14% of world oil demand in 2019, saw its oil consumption reach its decade low in February, as factories shut down and large-scale containment measures limited transportation. As a result, China's oil demand declined by 1.8 mb/d y/y in the first quarter, leading to the first contraction in world oil demand since the 2009 financial crisis. Demand dipped further in April, as the spread COVID-19 was recognized as a global pandemic in late March, with countries across the globe implementing lockdown measures. According to the International Energy Agency (IEA), world oil demand fell 30 mb/d y/y in April, hitting a 25-year low. This was followed by a brief stint of negative WTI prices in the oil futures market, almost reaching minus $40/bbl.

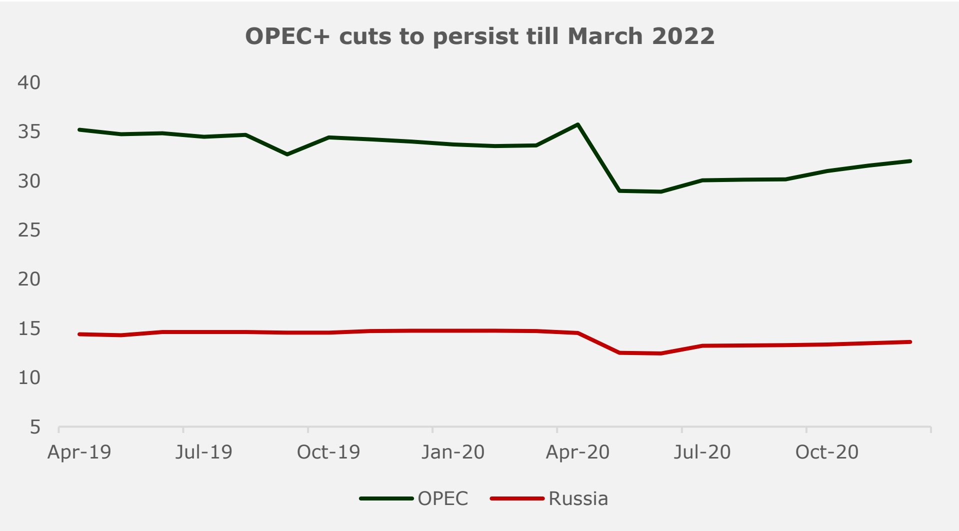


Source: U.S. Energy Information Administration

Interestingly, the plunge in oil demand bottomed out in late April, as most affected countries began to ease lockdown measures in order to revive stifled business activities. For instance, in early April, China lifted the lockdown in Wuhan, the epicentre of the virus in the country, though domestic flights are still partly grounded; subsequently in late April, economic giants in the Euro Area began to take similar steps, with Germany being the first to resume business activities, followed by the reopening of Italy's and France's economies in May. As business activities continue to restart across the world, we foresee considerable recoveries in oil consumption through the second half of the year, though not enough to lift demand to the 2019 levels of roughly 100 mb/d. In our view, we believe demand will remain shy of pre-pandemic levels in the medium term, as many services firms structurally adjust to embrace work-from-home as the new normal, while the airline industry is starting the long trudge to recovery. Although revised projections from the IEA point to a lower demand contraction of 8.6 mb/d (previous: 9.4 mb/d) in 2020, we note that a resurgence of COVID-19 is a major risk factor that could potentially reverse the expected upticks in oil demand in H2'20.

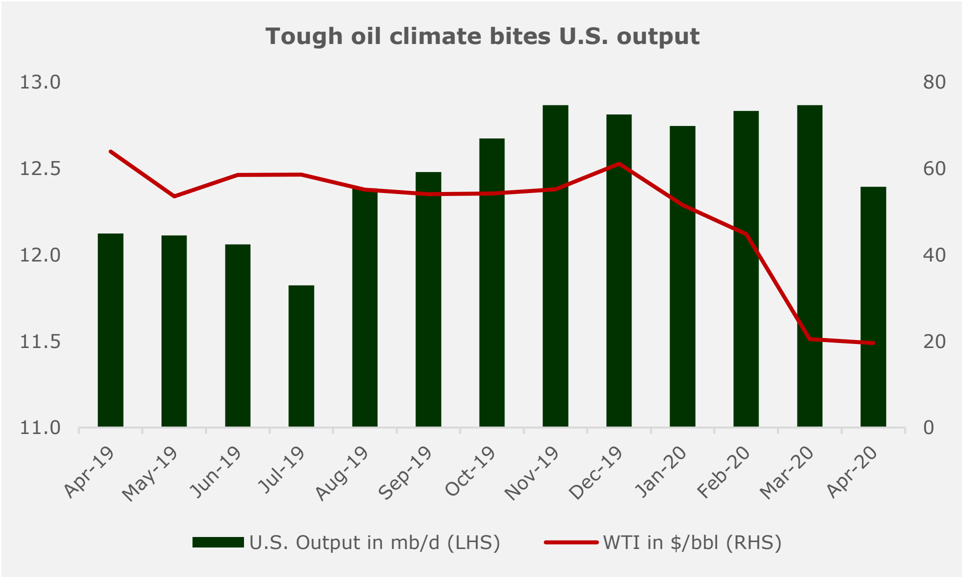
Oil supply: historic cuts to rebalance oil market

World oil supply fell 815 kb/d m/m in January to 100.5 mb/d, as OPEC supply tumbled to its lowest level since the 2009 global recession. A blockade to Libyan flows saw OPEC output drop 710 kb/d m/m to 28.9 mb/d in January. With a 1.2 mb/d cut still in effect, members of the OPEC+ alliance saw the need to implement deeper cuts in March, in a bid to tame the impact of COVID-19 on oil demand. However, a rift between Saudi Arabia and Russia at their March meeting led to both parties increasing production, with Saudi offering its crude at a discount relative to spot prices. As oil prices continued to hit record lows amidst an oversupplied market, OPEC+ convened again in April, where the members forged a deal to tighten their supply tap by a historic 9.7 mb/d in May and June, 7.7 mb/d in H2'20 and 5.8 mb/d from January 2021 till March 2022. Following this development, global oil supply fell to a nine-year low of 88 mb/d in May, with Brent price advancing 22% m/m. In addition to the agreed cuts, Saudi Arabia, the UAE and Kuwait have stated plans to voluntarily deepen output adjustments from June, by 1 mb/d, 100 kb/d and 80 kb/d respectively, in an effort to accelerate rebalancing the oil market.



Source: U.S. Energy Information Administration

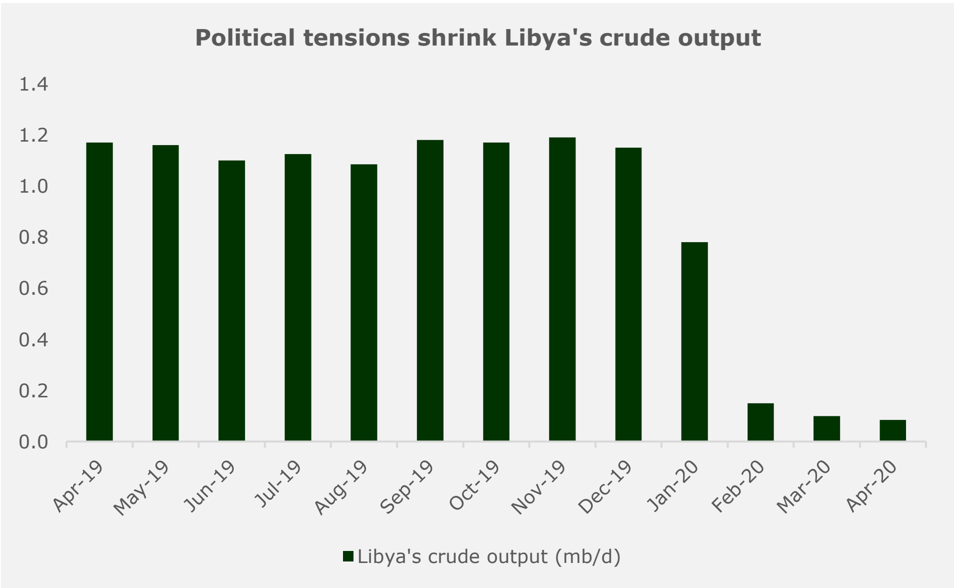
We also note that output from other prominent producers, such as the U.S., Canada and Brazil, has been on a downtrend since the coronavirus-induced shock to global oil demand. Specifically, U.S. crude output has shed 20% from its 2020 peak of 13.1 mb/d, amidst harsh business economics for Permian shale frackers. With the expectation of rapidly shrinking investments in the U.S. oil industry, evidenced by the slowing number of active rigs, we foresee further declines in U.S. output in the coming months. Having mentioned all this, we expect Brent prices to average $44/bbl and $47/bbl in Q3'20 and Q4'20 respectively, bringing our 2020 average estimate to $44/bbl (2019: $64/bbl). However, it suffices to say that if crude prices hold steady above the breakeven shale price in subsequent quarters, U.S. shale producers would be enticed to reopen idle fields and ramp up output, which could, in turn, result in a drag on oil prices.



Source: U.S. Energy Information Administration

Possible recoveries in Libya's output may weigh on oil prices

Following lesser political distractions in the country, Libya's crude output averaged 1.1 mb/d in 2019, an improvement from an average of 951 kb/d recorded in 2018. However, the impressive output trend witnessed in 2019 was swiftly reversed at the start of 2020, after Khalifa Haftar, leader of the Libyan National Army (LNA) seized Libya's export terminals and several pipelines in mid-January, over claims that oil export earnings solely go to the UN-backed Government of National Accord (GNA). As a result, Libya's crude output dropped to an unprecedented low of 348 kb/d in Q1'20 before sinking further in April to 82 kb/d—the lowest output in almost a decade.



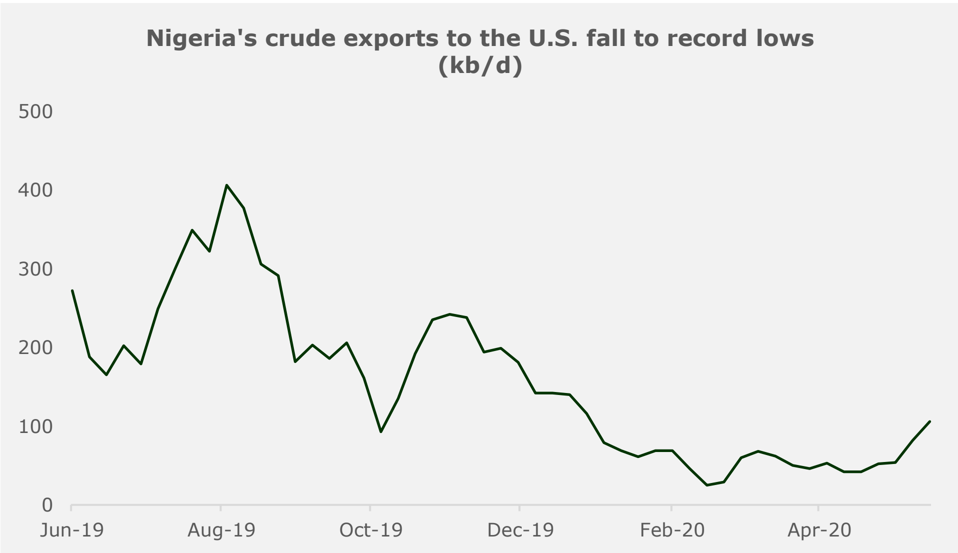
Source: U.S. Energy Information Administration

The blockade to the Libya's crude output could stretch on for months as ongoing peace talks miserably fail to yield results. Though a ceasefire is seeming unlikely in the interim, an eventual truce between the two warring factions of government in H2'20 could re-introduce an additional supply of 1 mb/d to the oil market, thereby reducing the effect of OPEC+ cuts. This in turn could result in lower-than-anticipated crude prices in H2'20.

Domestic strains leave Nigeria with an OPEC Pinocchio problem

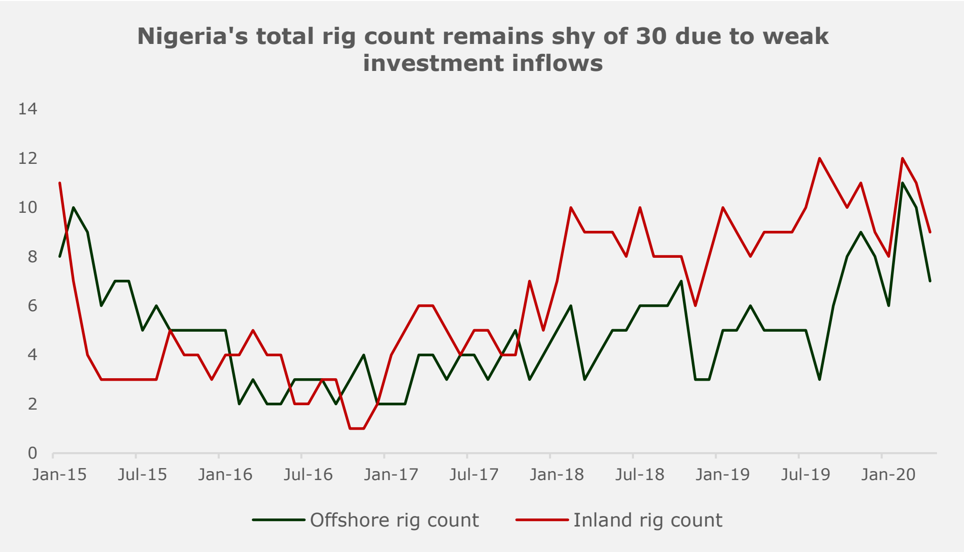
Q1'20 GDP data released by the National Bureau of Statistics (NBS) showed that Nigeria's crude output advanced 4% q/q to 2.07 mb/d, largely supported by improved production uptime across the upstream sphere. However, we believe output might have slowed in the second quarter following the plunge in oil demand in April – stemming from the coronavirus-induced global lockdown. Evidently, preliminary data from OPEC revealed that Nigeria's oil production (ex. condensates) dropped to 1.78 mb/d in April from 1.84 mb/d in March. With the expectation that oil demand would gain higher grounds in subsequent quarters - on the backdrop of looser lockdown measures, we envisage that Nigeria's crude output will inch higher in the coming months, barring any major downtime at export terminals.

Although the Nigerian government gave a nod to the OPEC+ accord reached in April - requiring the country to reduce its output (ex. condensates) to 1.41 mb/d, a confluence of domestic factors such as expanded budget deficit, plunging tax receipts and weaker oil revenue will deter the government from actual compliance. Notwithstanding, Nigeria's average crude output (including condensates) is expected to fall below 2 mb/d this year, largely due to a pandemic-driven lower demand from the country's oil trading customers. For context, latest data from the U.S. Energy Information Administration (EIA) showed that Nigeria's crude exports to the U.S. dropped by 63% y/y in the first quarter. Though Q2 data is yet to be released, we expect to see a similar y/y drop - as the pandemic hit the U.S. economy more in the second quarter.



Source: U.S. EIA

As per investment inflows to the oil sector, the recent plunge in oil prices has further drained the appetite for new investments at a time when potential investors are still wary of the uncertainty surrounding the passage of the Petroleum Industry Governance Bill (PIGB). With the two chambers of the legislature likely to be distracted with ongoing fiscal reforms to stave off a looming pandemic-driven recession, we believe the passage of the PIGB will be delayed till next year - the earliest possible time for the bill's passage, in our view.



Source: Baker Hughes International Rotary Rig Count

Downstream: market-based price adjustments to boost margins

Prior to March this year, Nigeria's downstream industry had remained shackled with thin margins since the 2016-naira devaluation. This resulted in earnings downtrend over the last three years, despite surging sales volumes. For context, gross margin from sales of premium motor spirit (PMS), which accounted for the bulk of aggregate downstream revenue, averaged 5% in 2019, contracting from 8% in 2017. While the slump in oil prices connotes pains for the upstream players, it has emerged as a source of respite for the struggling oil marketers. Remarkably, the steep drop in PMS landing costs led to the downward revision of PMS pump price from ₦145/litre to ₦125/litre in March, which was further reduced to a price band of ₦121.50 - ₦123.50/litre in June, alongside a cut in ex-depot collection price to ₦109.78 – ₦111.78/litre. These new price adjustments leave downstream players with a much higher gross margin of 10% (2019: 5%) from PMS sales in 2020, consequently leading to a spike in earnings growth.

As the improvement in margins is expected to trigger earnings surge in 2020, some marketers could seize this opportunity to reduce their exposure to financial leverage, which was one of the factors that led to weaker earnings last year. For others, it could be a time to expand their retail presence in order to gain more market share in a relatively static market.

VETIVA RESEARCH

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SEPLAT PETROLEUM DEVELOPMENT COMPANY PLC

Q1 impairment loss to mask future earnings

Equity Research

In its Q1'20 results, SEPLAT reported a 36% q/q drop in turnover to $130 million, as the company lifted smaller crude in the quarter amidst weaker oil prices (average realised oil price- Q1'20: $50/bbl, Q4'19: $65/bbl). Although the company recorded higher production at 3.1 mbbls in Q1'20 – thanks to Eland consolidation, it only lifted 2.2 mbbls (down 19% q/q) for its crude sales. As a result, Q1 oil revenue fell 38% q/q to $107 million, while the 0.9 mbbl shortfall in lifted oil, which is in effect a sale to the NPDC, was included in Other Income ($48 million). Like its oil business, SEPLAT's gas operations posted an underwhelming performance in Q1, revealing a contraction in turnover for the third consecutive quarter. Due to a two-week maintenance downtime at the Oben gas plant, gas output declined 22% q/q and 38% y/y to 8.0 Bscf in Q1'20, bringing gas revenue to a multi-quarter low of $23 million (down 25% q/q).

Looking ahead, we expect daily output to remain largely stable at current levels for the rest of the year, resulting in a total lifted volume of 11.3 mbbls (2019: 7.7 mbbls). As per realised oil prices, we reiterate that the coronavirus-induced slump in oil demand will leave prices in a low terrain over the course of the year. That said, we expect oil revenue to come in lower at $431 million (2019: $495 million), partly reflecting the Q1 revenue miss stemming from an underlift of $47 million. For the gas business, we see output reverting to pre-maintenance levels in subsequent quarters, bringing our full year expectation for gas output to 38.7 Bscf (2019: 47.8 Bscf). With average gas price expected to remain relatively unchanged at $2.89/Mscf, we see gas revenue dropping 17% y/y to $112 million, taking the Group's revenue to $567 million (2019: $698 million). Having booked an impairment loss of $146 million in Q1, we see SEPLAT recording a loss after tax of $20 million (2019 PAT: $264 million) for the full year. However, bearing in mind that the Q1 impairment charge was a non-cash and unusual expense, SEPLAT's normalized profit after tax might come in at $86 million in 2020.

Income Stat. ($'000)	2018A	2019A	2020E	2021F
Revenue	746	698	567	650
Gross Profit	391	396	203	306
Operating Profit	310	312	50	197
Profit Before Tax	263	293	(22)	129
Profit After Tax	147	264	(20)	97

Balance Sheet ($'000)	2018A	2019A	2020E	2021F
Total Assets	2,497	3,271	3,119	3,116
Total Liabilities	896	1,467	1,335	1,265
Shareholders' Funds	1,601	1,804	1,784	1,852

Margins & Ratios	2018A	2019A	2020E	2021F
Gross Profit Margin	52%	57%	36%	47%
Operating Profit Margin	42%	45%	9%	30%
Net Profit Margin	20%	38%	-3%	15%
ROAE	9%	15%	-1%	5%
ROAA	6%	9%	-1%	3%

BUY

Target price	**₦698.46**

Company Statistics

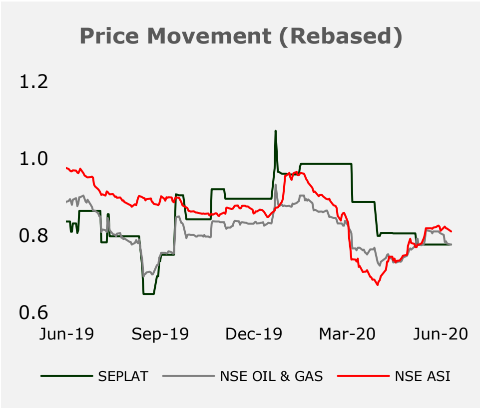
Price (₦)	476.40
Market Cap (₦'Mn)	280,335
Total Assets (₦'Mn)	1,109,038
Debt to Assets	25.84%
Shares Outstanding (Mn):	588
NSE	SEPLAT
Bloomberg	SEPLAT.NL

Ownership Structure

MPI	20.32%
Petrolin	13.69%
Others	65.97%

Share Price Performance

30 days	0.00%
ytd	-27.58%
365 days	-7.21%



Source: NSE, Vetiva Research

Business Description

SEPLAT is an independent Oil and Gas Exploration and Production (E&P) company in the Niger Delta region of Nigeria. The company has a 45% in OMLs 4, 38, 41 and 40% stake in OML 53 and OPL 283. The company's focus is on maximizing hydrocarbon output from its existing assets and exploring new opportunities in the energy industry.

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ARDOVA PLC

Regulatory PMS price adjustments to drive earnings growth

Equity Research

ARDOVA's Q1 financial performance was largely dragged by the 200 basis-point decline in gross margin, which was strong enough to subdue the effect of improved operational efficiency witnessed in the quarter. Although the company grew its turnover 22% y/y to ₦52.1 billion in Q1, gross profit slid 9% y/y to ₦2.8 billion as margins from PMS sales compressed during the quarter. The company however recorded better operational efficiency in Q1'20, as operating expenses/sales ratio came in lower at 5.0% from 5.4% in Q1'19. This improvement was in line with comments from management on ARDOVA's 2020 cost containment strategy at our last corporate visit in March. However, operating profit showed a significant climbdown to ₦736 million (down 81% y/y), as a gain of ₦2.6 billion from asset disposal in Q1'19 created a high comparison base. Meanwhile, finance costs slid 69% y/y to ₦263 million, driven by the balance sheet deleveraging witnessed last year. Notably, ARDOVA's debt sharply dropped to ₦5.5 billion in Q1'20 from ₦19.8 billion in Q1'19.

Given recent price adjustments along the PMS supply chain, we foresee a spike in ARDOVA's earnings in the coming quarters. Following the reduction in PMS pump and ex-depot prices to ₦123.50/litre and ₦111.78/litre respectively, we anticipate that gross margin from ARDOVA's fuel business will improve to 10% in 2020 from 4% in 2019, thereby resulting in a gross profit of ₦18.0 billion (2019: ₦6.9 billion) from the fuel business. Taking a cue from Q1 outcome, coupled with anticipated weaker economic activity in subsequent quarters, we see ARDOVA's lubricant operations growing by 2% in 2020 to ₦17.5 billion, lifting the Group's revenue to ₦197.7 billion (2019: ₦176.6 billion). Our projections equate to a gross profit of ₦23.1 billion (2019: ₦11.3 billion), double the figure recorded last year. With our estimate for finance costs remaining relatively unchanged at ₦1.1 billion (2019: ₦4.8 billion), we expect profit after tax to surge to ₦8.5 billion (2019: ₦3.9 billion), yielding an ROAE of 43% (2019: 26%).

Income Stat. (₦'mil)	2018A	2019A	2020E	2021F
Revenue	134,706	176,551	197,740	208,142
Gross profit	11,330	11,282	23,115	24,435
Operating profit	2,949	4,924	13,738	14,892
Profit before tax	1,029	4,654	13,076	14,570
Profit after tax	631	3,915	8,499	9,471

Balance Sheet (₦'mil)	2018A	2019A	2020E	2021F
Total assets	61,198	47,019	62,010	66,092
Total liabilities	47,449	30,856	38,649	34,564
Shareholders' funds	13,749	16,163	23,360	31,528

Margins & Ratios	2018A	2019A	2020E	2021F
Gross profit margin	8%	6%	12%	12%
Operating profit margin	2%	3%	7%	7%
Net profit margin	0%	2%	4%	5%
ROAE	5%	26%	43%	35%
ROAA	1%	7%	16%	15%

BUY

Target price	₦34.34

Company Statistics

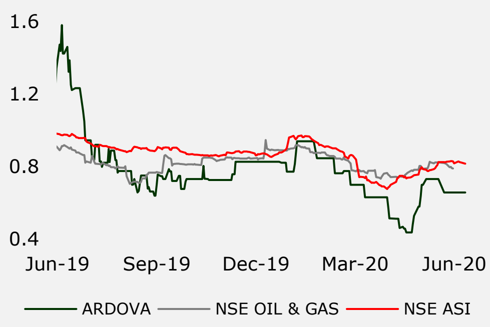
Price (₦)	14.40
Market Cap (₦'Mn)	18,756
Total Assets (₦'Mn)	56,493
Debt to Assets	9.67%
Shares Outstanding (Mn):	1,302
NSE	ARDOVA
Bloomberg	ARDOVA.NL

Ownership Structure

Ignite Investments and Commodities Ltd	74.06%
Others	25.94%

Share Price Performance

30 days	-10.00%
ytd	-20.44%
365 days	-44.08%



Source: NSE, Vetiva Research

Business Description

Ardova PLC. (ARDOVA) is a foremost Nigerian integrated energy group. The Company changed its name to Ardova Plc in 2019 upon restructuring and rebranding, with Ignite Investments and Commodities Limited as its major shareholder. Headquartered in Lagos, Nigeria, Ardova's products mix includes refined white products and synthetic

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NIGERIA | EQUITY | OIL & GAS | EXPLORATION & PRODUCTION | TOTAL

TOTAL NIGERIA PLC

Margin improvement offers a rescue from high leverage

Equity Research

Unsurprisingly, TOTAL's fuel revenue declined 11% y/y to ₦57.2 billion in Q1, as the firm continued to lose market share to other aggressive players in the downstream sector. Similarly, lubricant operations contracted 3% y/y to ₦13.1 billion, bringing total revenue to ₦70.2 billion (down 9% y/y). With gross margin staying flat at 11%, gross profit dipped 5% y/y to ₦7.8 billion. The effect of the smaller gross profit trickled down the income and consequently dragged Q1 bottom line to the red zone.

While we expect growth in lubricant operations to slow to 2% (2019: 4%) in 2020, we see sales of petroleum products falling 15% to ₦203.9 billion, largely a reflection of the cut in PMS pump price to ₦123.50/litre (formerly ₦145/litre). Similar to our expectation for other oil marketers, we see a jump in TOTAL'S gross margin in 2020, as the cut in PMS ex-depot price to ₦111.78/litre is expected to lift gross margin from PMS sales to 10% from 5% in 2019. As a result, we expect the company's gross profit to surge to ₦50.0 billion (up 43%) for the full year, which, in turn, will lift TOTAL's operating cash flows to ₦23.6 billion (2019: ₦15.1 billion). Given this, we see TOTAL seizing this green opportunity to reduce its exposure to bank overdrafts, which have been weighing on the company's earnings since 2018. In our view, we see TOTAL's debt dropping to ₦30.4 billion (2019: ₦39.9 billion) by year end, driving finance expenses lower to ₦5.8 billion in 2020 from ₦7.9 billion in 2019. Going by our projections, we expect a five-fold increase in after-tax profit to ₦11.8 billion and a spike in ROAE to 39% (2019: 8%).

Income Stat. (₦'mil)	2018A	2019A	2020E	2021F
Revenue	307,988	292,177	256,315	258,296
Gross profit	34,785	35,051	49,981	49,076
Operating profit	9,812	9,822	23,177	26,995
Profit before tax	12,098	3,071	17,746	22,847
Profit after tax	7,961	2,279	11,819	15,239

Balance Sheet (₦'mil)	2018A	2019A	2020E	2021F
Total assets	132,521	133,788	124,574	124,901
Total liabilities	101,790	105,468	92,944	86,414
Shareholders' funds	30,731	28,320	31,629	38,487

Margins & Ratios	2018A	2019A	2020E	2021F
Gross profit margin	11%	12%	20%	19%
Operating profit margin	3%	3%	9%	10%
Net profit margin	3%	1%	5%	6%
ROAE	27%	8%	39%	43%
ROAA	7%	2%	9%	12%

BUY

Target price **₦203.48**

Company Statistics

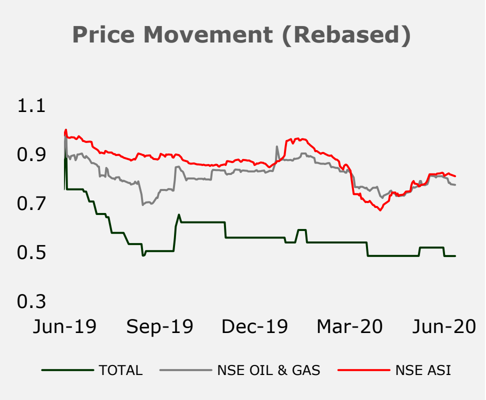
Price (₦)	96.10
Market Cap (₦'Mn)	32,628
Total Assets (₦'Mn)	130,699
Debt to Assets	29.39%
Shares Outstanding (Mn):	340
NSE	TOTAL
Bloomberg	TOTAL.NL

Ownership Structure

Total Marketing Services	61.72%
Others	38.28%

Share Price Performance

30 days	-6.52%
ytd	-13.35%
365 days	-35.93%



Source: NSE, Vetiva Research

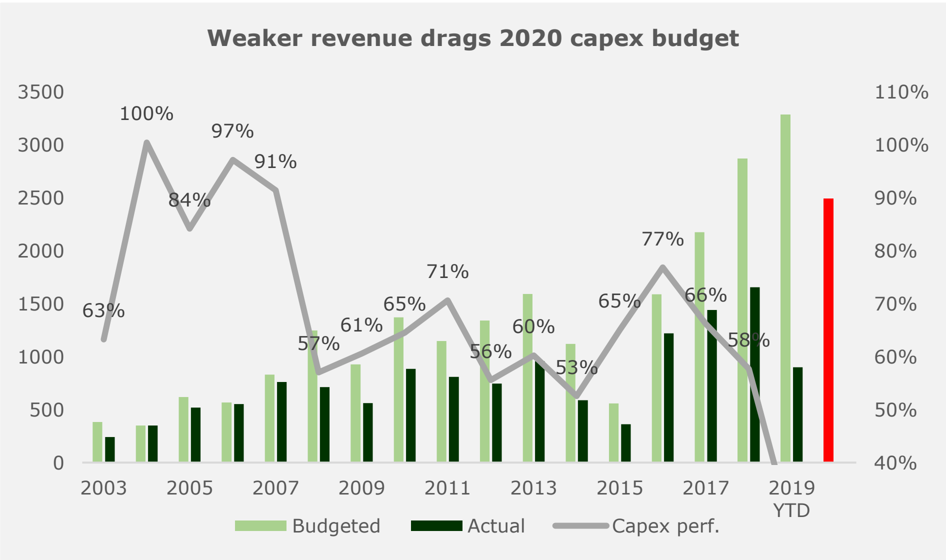
Business Description

TOTAL is one of the largest marketers and distributors of petroleum products in Nigeria. TOTAL offers various fuel products, including petrol, diesel, and kerosene. TOTAL operates 550 service stations, 5 LPG bottling plants, 3 lubricants blending plants; and 5 aviation storage facilities.

Industrial Goods

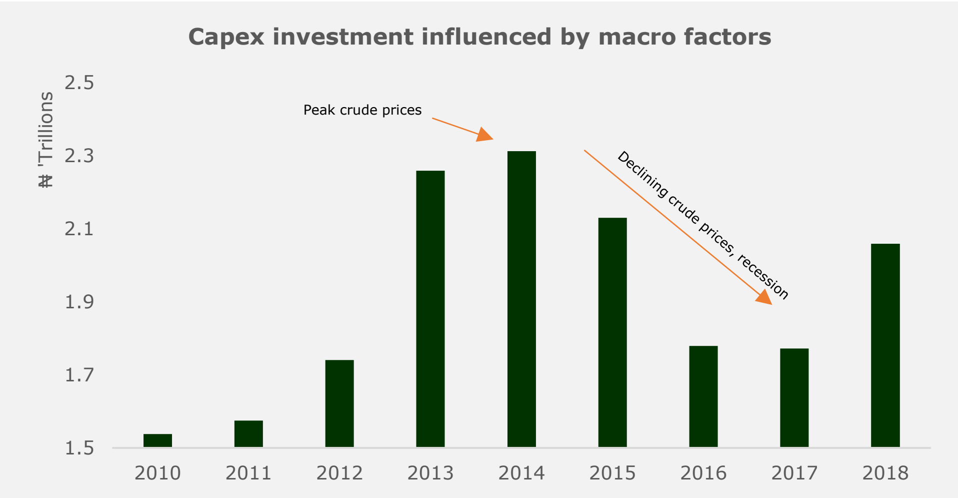
Cement and Construction

Capital expenditure to bear the brunt of slowing government revenues
Given the weak capex implementation in 2019 (estimated at 22% implementation), Consensus expectation at the start of the year was for a resurgence in public capital spend in 2020, especially given the absence of similar political distractions this year. Supporting this, the National Assembly and Presidency both passed and assented to the 2020 budget in record time, indicating stronger harmony between the key spending arm (executive) and the key approving arm (executive). Expectations of continued economic growth also supported stronger private sector capital spend in 2020. Overall, this had positive implications for cement sales, with domestic cement sales expected to expand by 5% y/y in 2020. While we estimate that the sector expanded by the projected figure in the first quarter, this outlook has dimmed due to the onslaught of the COVID-19 pandemic as the economic impacts of the virus hits public and private sector spending outlook. Interestingly, the largest impact of the pandemic on the sector is likely to come from an indirect source. Crude prices have fallen 42% YTD, dragged by the slowing of activity across the globe. With Nigeria largely dependent on crude earnings for a chunk of Revenue and Foreign exchange, the drop in crude prices has tempered the outlook for an already ambitious Revenue budget. Notably, the Federal government has adjusted crude oil price benchmark from $57/bbl to $28/bbl and is actively reviewing the feasibility of its non-oil revenue figures. With additional revenue shortfalls compounding historical budget deficits, the Federal Government of Nigeria has announced some revisions to its expenditure budget, cutting 25% of previously budgeted recurrent expenditure and 20% of budgeted capital expenditure in an effort to rein in an oversized deficit. Despite these cuts, we believe that the FG has been conservative in deficit expectations and see the possibility of weaker capex performance in 2020 as external and domestic financing environments continue to reel from the direct and indirect effects of the pandemic. On the positive side, Nigeria has been able to secure critical concessionary loans from multilateral organizations ($3.4 billion from the IMF, $2.2 billion from the World Bank and $0.5 billion from the AFDB) and recover yet another $311 million from the Abacha loot, our "ever-present rainy-day fund". That said, we still expect a slowdown in public capital expenditure in 2020 as FG deprioritizes its capex budget in favor of recurrent spend.



Source: Budget office, Vetiva Research

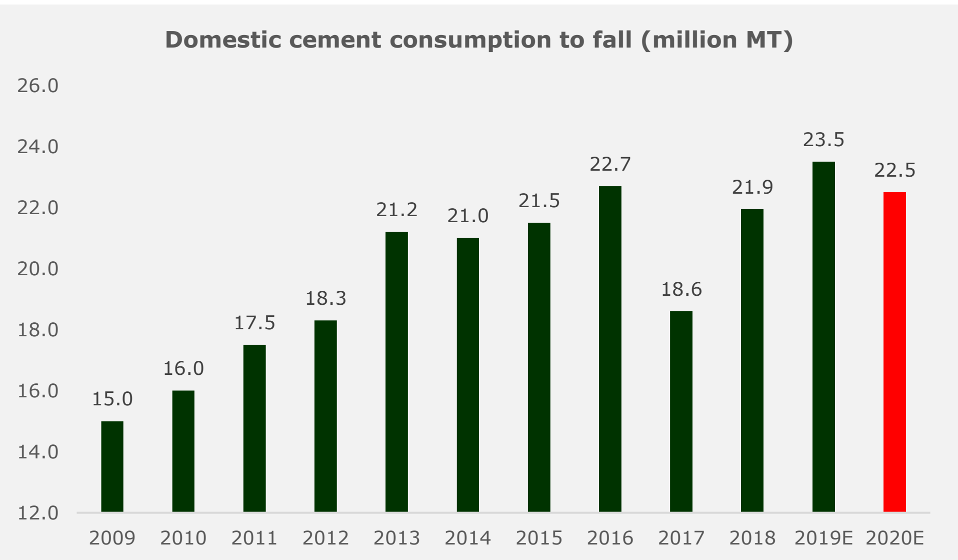
Similar to the public sector, we expect private sector capital spend to dovetail in 2020, driven by a combination of weak business activity and slower economic outlook. Driven by the pandemic, our economic growth estimate has moderated from 2.5% at the start of the year to -0.6%. The IMF predicts an even stronger contraction at 3.4%. With private capital spend usually supported by macroeconomic growth outlooks, we foresee a slide in cement consumption from the private sector. Using Julius Berger's Q1'20 results as a proxy for the construction sector, we note that revenue from the private sector dropped in the quarter, the first drop in many quarters.



Source: Bloomberg, Vetiva Research

The real estate segment in Nigeria is also expected to contract further by 8.47% y/y in 2020. While demand for reasonably priced residential real estate properties will continue to grow in urban centers such as Lagos, we expect the contraction to be most highlighted in the demand for commercial and luxury real estate spaces as they are most correlated with economic growth outlook. Notably, with pre-pandemic optimism in commercial real estate leading to an increase in supply of rental and lease units in the past 12 months, we also foresee a moderation in prices amidst demand constraints.

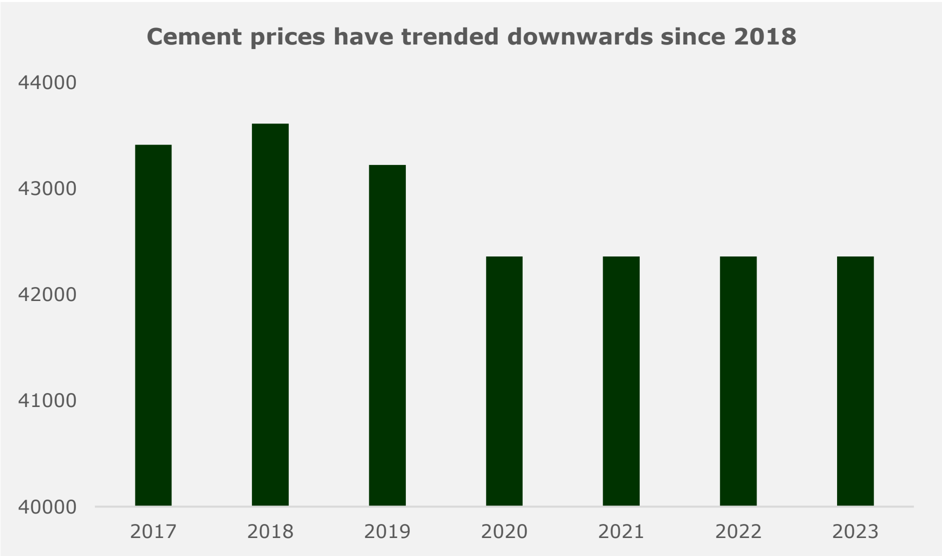
Driven by the expectations of reduced capital spend from the public and private sectors, we foresee a 4% y/y contraction in domestic cement demand to 22.5 million MT.



Source: Dangote cement, Vetiva Research

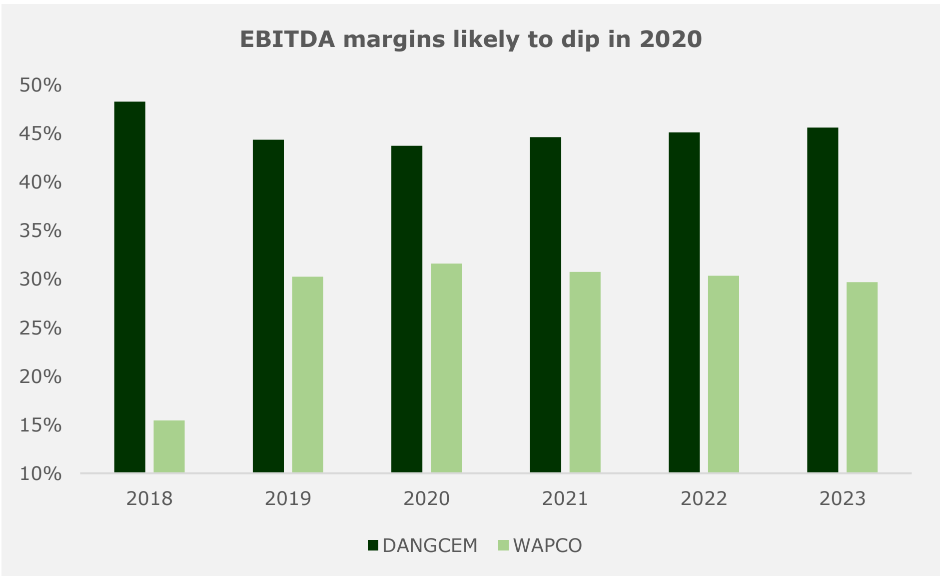
Cement, Construction revenues will be impacted

We expect industry revenues to fall in 2020 as slower capital spend from the public and private sector impacts cement sales across the sector. We also expect this slower demand to further stoke the price competition in the cement sector. We anticipate a 2% y/y moderation in average cement prices and a 7% y/y drop in the combined revenues of our coverage companies.



Source: Company filings, Vetiva Research

While the reduction in fuel costs is expected to support lower haulage costs, the increased competition amidst lower demand should put further pressure on marketing and promotion costs. The depreciation of the naira versus the USD will also put pressure on gas costs which account for a significant portion of production costs and are typically priced in USD. All these combined with the expected reduction in cement prices will drive an 18bps moderation in EBITDA margins to an average of 41% across our coverage companies.



Source: Company filings, Vetiva Research

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Equity Research

JULIUS BERGER NIGERIA PLC

Smaller Interest expense will drive earnings

BUY

Target price	₦39.57

Revenue should come in weaker

In line with the broader cement, real estate and construction sectors, JBERGER's FY'20 topline is expected to fall c.5% y/y to ₦253.1 billion, weakened by slower infrastructure spend from both the public and the private sector. Notably, we expect revenue from civil works (mainly dominated by government contracts) to be impacted the most, falling 8% y/y to ₦139.4 billion amidst an expected revenue and financing shortfall from the government. We also project lower revenue from already existing projects as we expect the lockdown and social distancing protocols to affect contract completion rates this year. Furthermore, driven by the drop in revenue as well as inflationary impacts, we forecast a 10% y/y fall in operating profit to ₦18.2 billion, with EBIT margin moderating 20bps y/y.

With a base expectation of an economic rebound and stronger business optimism post-2020, we expect a pickup in capital spend by both the public and private sectors, driving a 3-year revenue CAGR of 10% beyond 2020.

Outlying risk of losses due to FX acquisitions

While the operating margin is expected to shrink y/y, we expect net profit margin to expand by 1 ppt y/y to 4.4%, driven by a reduction in net interest expense. Specifically, driven by a 45% y/y moderation in debt balances, JBERGER's FY'20 net interest expense is expected to moderate by a whopping 69% y/y to ₦1.9 billion. Overall, both the PBT and PAT are expected to grow by 17% to ₦16.3 billion and ₦10.3 billion in FY'20. Post-2020, we project a 3-year PAT CAGR of 12% to ₦14.4 billion in 2023.

While we recognize an outlying risk of FX losses due to the recent c.7% currency depreciation, we have however chosen not to reflect this in our model as the impact on operations is not clear. That said, we recall that a similar currency depreciation led to an ₦14.2 billion FX acquisition loss in 2016 and could lead to a similar impact on 2020 numbers.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue	194,618	266,430	253,109	278,420
Gross profit	52,009	60,119	56,949	62,644
Operating profit	14,852	20,241	18,227	20,860
Profit before tax	10,198	13,919	16,299	18,917
Profit after tax	6,102	8,760	10,268	11,917
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Total assets	288,430	313,661	325,748	333,143
Total liabilities	253,012	273,333	278,779	279,186
Shareholders' funds	35,418	40,328	46,968	53,957
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Gross profit margin	27%	23%	23%	23%
Operating profit margin	8%	8%	7%	7%
Net profit margin	3%	3%	4%	4%
ROAE	19%	23%	24%	24%
ROAA	2%	3%	3%	4%

Company Statistics

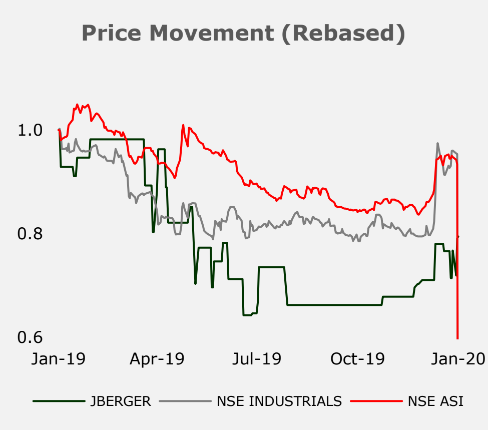
Price (₦)	22.25
Market Cap (₦'Mn)	29,370
Enterprise Value (₦'Mn)	32,223
Net Cash (₦'Mn)	18,676
Shares Outstanding (Mn)	1,320
NSE	JBERGER
Bloomberg	JBERGER.NL
Reuters	JBERGER.LG

Ownership Structure

Goldstone Estates Limited	19.87%
Neptune Hill	16.50%
Watertown Energy Ltd	10.00%
Others	53.63%

Share Price Performance

30 days	-11.78%
YTD	19.70%
365 days	-8.31%



Source: NSE, Vetiva Research

Business Description

Julius Berger Nigeria PLC (JBERGER) is a leading construction company engaged in the planning and construction of civil engineering works in Nigeria and a foremost contractor to Nigerian Governments. It operates through three segments: Civil Works, Building Works, and Services. The company was founded in 1965 and is headquartered in Abuja, Nigeria.

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Equity Research

DANGOTE CEMENT PLC

Earnings slowdown does not detract from value

Lockdown, Revenue shortfalls will drag topline

Largely in line with expectations, Dangote Cement kicked off 2020 with a decent performance, reporting 4% and 1% y/y growths in Q1 Revenue and profit lines to ₦249.2 billion and ₦60.6 billion. Notably, in spite of the border closure (accounts for c.5% of volumes), cement volumes from the Nigerian operation still rose c.1% y/y to 4.02 million MT, reflecting gains from the strong marketing push started in H2'19. That said, dragged by the estimated impact of the pandemic on corporate and government spending, we forecast a 6% y/y drop in FY'20 volumes to 13.3 million MT in Nigeria. Furthermore, while average realized prices in Q1 jumped 5% y/y, we forecast a 2% y/y moderation in average revenue/tonne to ₦42,357 in FY'20, dragged by increased competition due to the expected drop in FY'20 cement demand. Overall, we expect an 8% y/y moderation in FY'20 revenue for the Nigerian business to ₦561.7 billion, its lowest revenue since FY'17.

Revenue from pan African operations is also expected to moderate due to the pandemic. Cement sales are expected to fall 3% y/y to 9.2 million MT, with pressure particularly from South Africa, Tanzania, Zambia and Cameroon. Prices are also expected to remain depressed in SA and Zambia, taking overall pan African revenue 3% lower y/y to ₦273.2 billion. Overall, we expect Group cement sales to fall 5% y/y to 22.4 million MT, taking topline 6% lower y/y to ₦834.9 billion.

Still a BUY despite 2020 pressure

While the c.14% y/y reduction in average PMS prices should have a positive impact on fuel costs for haulage and transportation, we expect the reduced scale and general inflationary pressures to drive operating margins lower in FY'20. Specifically, we foresee a 60bps moderation in EBITDA margin to 44% in FY'20, taking EBITDA 8% lower y/y to ₦365 billion. Furthermore, driven by an expectation of a higher effective tax rate in 2020, we forecast a 24% y/y drop in PAT to ₦152.2 billion. We value DANGCEM at ₦183.91 and place a BUY rating on the stock.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue	901,213	891,671	834,900	910,946
Gross profit	517,902	511,682	475,893	523,794
Operating profit	338,698	299,893	265,137	301,402
Profit before tax	300,806	250,479	211,417	247,201
Profit after tax	390,325	200,521	152,220	177,985
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Total assets	1,694,463	1,741,351	1,640,309	1,652,689
Total liabilities	707,850	843,414	1,001,313	977,739
Shareholders' funds	986,613	897,937	638,997	674,950
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Gross profit margin	57%	57%	57%	58%
Operating profit margin	38%	34%	32%	33%
Net profit margin	43%	22%	18%	20%
ROAE	45%	22%	20%	28%
ROAA	23%	12%	9%	11%

BUY

Target price	**₦183.91**

Company Statistics

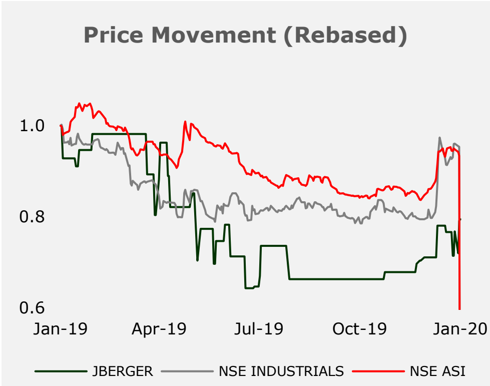
Price (₦)	170.00
Market Cap (₦'Mn)	2,896.88
Enterprise Value (₦'Mn)	3,124.33
Net Cash (₦'Mn)	227.53
Shares Outstanding (Mn)	17,040.5
NSE	DANGCEM
Bloomberg	DANGCEM.NL
	DANGCEM.LG

Ownership Structure

Dangote Industries Ltd	85.1%
Others	14.9%

Share Price Performance

30 days	-3.14%
YTD	-2.11%
365 days	-23.63%



Source: NSE, Vetiva Research

Business Description

Dangote Cement PLC is Nigeria's leading cement producer with three plants in Nigeria and expansions in 15 other African countries. The Group is a fully integrated quarry-to-depot producer with production capacity of 45.6 million tonnes as at 2015.

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Equity Research

LAFARGE AFRICA PLC

Lower finance costs will drive profit growth

Revenue to fall on account of pandemic

Like most cement producers, we expect Lafarge Africa's FY'20 revenue to fall on account of the pandemic. The cement producer kicked off the year in fine fashion, reporting an 8% y/y increase in cement sales to 1.4 million MT in Q1'20, taking revenue 10% higher y/y to ₦63.7 billion. The expansion was attributed to a combination of economic growth and renewed focus on driving the Nigerian business post LSAH divestment. However, with the pandemic impacting bot FG revenue and business activity, public and private sector cement demand will likely fall in FY'20. We expect Lafarge Africa's to be most hit by this and project an 8% y/y drop in FY'20 volume to 4.5 million MT, with particular pressure from the Southwest operations. With the drop in demand also likely to fuel price competition, we expect the average realized price to fall in FY'20, driving Group revenue 9% lower y/y to ₦193.8 billion. Post pandemic however, we foresee a strong rebound in cement demand and forecast a 3-year Revenue CAGR of 12% for Lafarge Africa to ₦275.1 billion in 2023.

Similar to other cement producers, we also expect Lafarge Africa's operating margin to moderate, driven by price pressure, smaller scale and general inflationary pressures. Overall, we forecast a 5% moderation in EBITDA to ₦61.2 billion, translating to a 500bps reduction in EBITDA margin.

PAT will still grow due to reduced finance costs

In July 2019, Lafarge Africa divested LSAH, its South African production arm, to Lafarge Holcim (parent company) in exchange for a consideration equivalent to a related party loan owed to the same parent company. Following the divestment, Lafarge's net debt balance fell by ₦154 billion. Driven by the lower debt balance, the cement giant is expected to record a 54% y/y reduction in Net finance costs to ₦7.9 billion, taking PBT 57% higher y/y to ₦28.1 billion and PAT 30% higher to ₦20.2 billion. Beyond 2020, we forecast a 3-year PAT CAGR of 22% for Lafarge Africa and value the stock at ₦33.03 (Buy recommendation).

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue	308,425	212,999	193,823	222,789
Gross profit	69,683	55,952	54,792	64,094
Operating profit	24,811	34,910	35,989	42,505
Profit before tax	(19,509)	17,892	28,073	33,137
Profit after tax	(8,803)	15,518	20,213	23,858

Balance sheet (₦'mil)	2018A	2019A	2020E	2021F
Total assets	540,737	497,152	514,472	526,251
Total liabilities	406,196	152,238	164,833	168,924
Shareholders' funds	134,541	344,914	349,638	357,327

Margins & Ratios	2018A	2019A	2020E	2021F
Gross profit margin	23%	26%	28%	29%
Operating profit margin	8%	16%	19%	19%
Net profit margin	-3%	7%	10%	11%
ROAE	-6%	48%	6%	7%
ROAA	-2%	22%	4%	5%

BUY

Target price	₦33.03

Company Statistics

Price (₦)	21.00
Market Cap (₦'Mn)	182,142
Enterprise Value (₦'Mn)	449,127
Net Cash (₦'Mn)	266,985
Shares Outstanding (Mn)	8,673
NSE	WAPCO
Bloomberg	WAPCO.NL WAPCO.LG

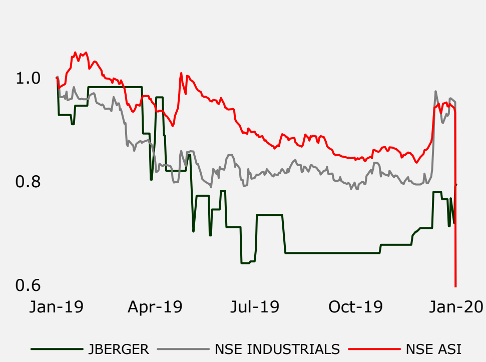
Ownership Structure

Lafarge SA	76%
Others	24%

Share Price Performance

30 days	-3.08%
YTD	-28.10%
365 days	15.18%

Price Movement (Rebased)



Source: NSE, Vetiva Research

Business Description

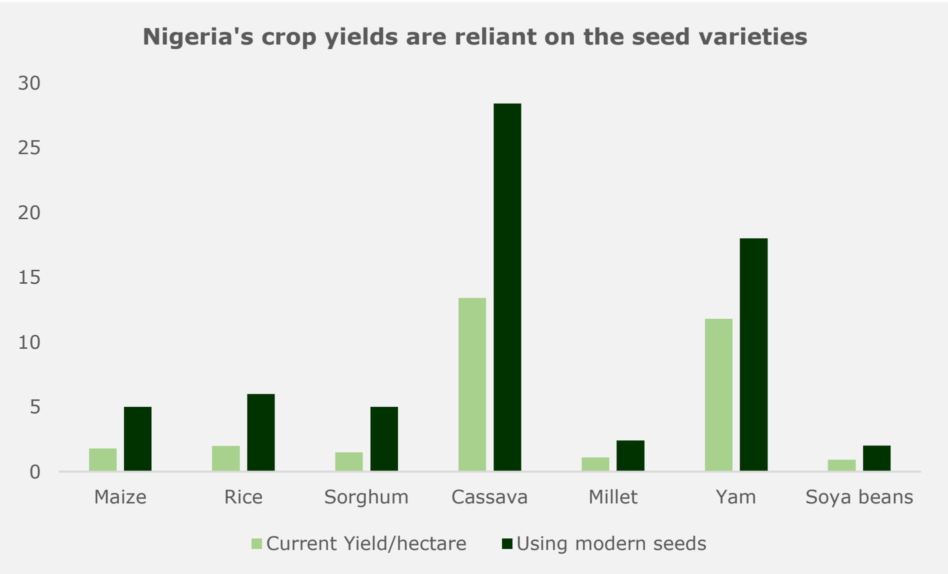
Lafarge Africa PLC is a subsidiary of LafargeHolcim, a world leader in building materials. The company has operations in Nigeria - Ewekoro and Sagamu plants in Ogun State, Ashakacem in Gombe State, Mfamosing in Cross Rivers State, Atlas cement in Rivers State and Ready-Mix Nigeria and varied operations in South Africa and Ghana with total group capacity of around 14 million MT.

Agriculture

Agriculture sector

Disruptions to input distribution could slow crop production yield

The Agriculture sector, long labelled as Nigeria's route to revenue diversification, expanded 2.2% y/y in Q1'20, accounting for 22% of economic activity and 48% of employment (Q3'17 data) in the Nigerian economy. However, the sector expansion came in slower than the previous year (Q1'20: 3.2%) and indeed below the 5-year average growth rate of 3.2% as the sector is still bedeviled by infrastructure challenges and security issues. The onset of the pandemic further threatens to slow the expansion of the sector in 2020, with our 2020 real GDP growth estimate falling to 1.10% y/y from 2.36% y/y in 2019. While no restrictions have been placed on farming activity, general mobility restrictions threaten to disrupt supply of quality seeds, fertilizers and other key agro-inputs across major food producing regions. This is important because the rate of certified seed use in Nigeria has historically been low and is just beginning to catch up to regional peers. Most recent data (2012) puts certified seed use between 5 and 10% during planting seasons. The commercial seed industry supplies around 2-5% of seeds to farmers (20,000 to 50,000 tons of an estimated 1 million tonnes demand) while government agencies supply another 50,000 to 80,000 tons. This could potentially lead to reduced yields in an already low-yield agriculture environment.



Source: Media reports, Vetiva Research

The disruptions to mobility of inputs could put pressure on input prices, potentially impacting food prices. According to the seed council of Nigeria, prices of seeds and transport for farmers have tripled this planting season. This could put pressure on food prices as farmers attempt to compensate for the increase in input prices. In addition, we see the impending upward review of electricity tariffs intensifying the upwards pressure on food prices. As a result, we forecast a 14.30% y/y average food inflation for H2'20, a 42bps increase over the same period last year.

Finally, the next planting cycle in 2021 could also be impacted by the delayed production of Early Generation seeds by the National Agriculture Research institutes (NARIs) – especially for cross-pollinated crop species and key grains such as Rice.

CBN initiatives should help to bridge the agric financing shortfall

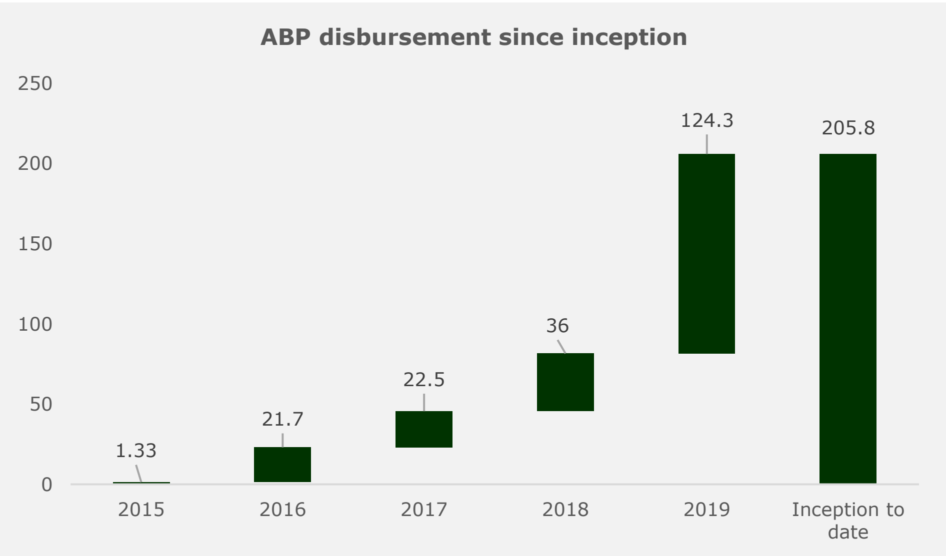
With the pandemic negatively affecting the overall risk environment and outlook of the domestic economy, we foresee a drop in bank lending, with particular bias towards riskier sectors such as agriculture. Notably, banking credit to the sector has been on the rise, with credit growing by c.₦100 billion (15%) to ₦772 billion in Q4'19, supported by pro-growth fiscal and monetary policies. We therefore expect the drop in lending in Q2, the major planting season, to impact agriculture financing and output in 2020. That said, we expect the financing shortfall to be partially mitigated by CBN initiatives designed to support the sector. We recall that the CBN announced the creation of a ₦1.15 trillion COVID-19 pandemic intervention fund at the start of the lockdown, with ₦100 billion targeted at the healthcare sector, ₦1 trillion at agriculture and manufacturing firms and a ₦50 billion targeted credit facility for MSMEs. Notably, all the loans are to be disbursed at single digit rates. According to the apex bank, almost 6,000 beneficiaries have accessed up to ₦114 billion from the fund, with a bias towards the agriculture sector.

CBN's COVID-19 interventions

	Total Size ₦'million	Disbursement ₦'million	Number of Recipients
Healthcare fund	100,000	10,150	NA
Agric & Manufacturing	1,000,000	93,200	44 projects
MSME fund	50,000	10,900	14,331

Source: Media reports, Vetiva Research

Furthermore, these funds are being disbursed alongside already running CBN agriculture initiatives such as the Anchor Borrowers' programme. The central bank has pledged to fund up to 1.6 million farmers under the ABP this 2020, with c.256,000 engaged in cotton farming. Driven by these initiatives, we foresee a minimal impact of the pandemic on the financing of the agriculture sector.



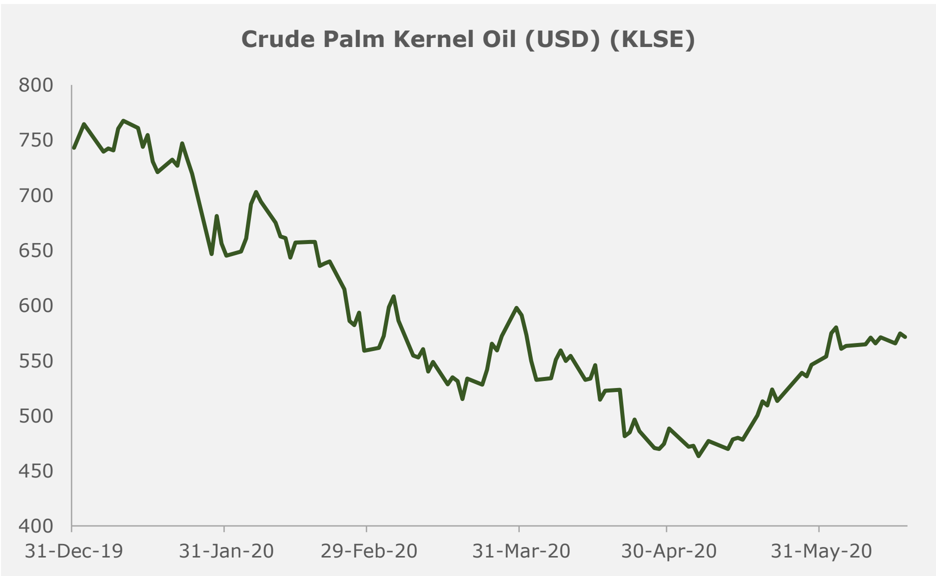
Source: Media reports, CBN, Vetiva Research

Sector Focus – Palm oil

Global CPO prices will remain depressed in 2020 amidst pandemic

With crude prices falling significantly since the start of the year, the value proposition for biofuels (chiefly oil palm) has begun to slide as biofuels now trade at a premium to crude. With global demand also slowing and global supply chains being disrupted due to the pandemic, CPO prices have begun a freefall, triggering a downward re-rating of major oil palm producers by fitch. CPO prices have consequently dropped by as much as 30% YTD.

The outlook for global CPO prices is relatively mixed. On one hand, demand is expected to improve as India ramps up purchases from Malaysia due to a reduction in tensions between both countries. June and July orders from India are currently at its highest levels this year and are expected to increase. Also, the gradual rebound in crude oil prices amidst measured re-openings of key global economies have begun to reduce the spread between both fuel types, strengthening the value proposition for biofuels like CPO. However, with economic activity unlikely to make a full rebound in the second half of the year, global CPO prices will remain depressed in 2020.



Source: Bloomberg, Vetiva Research

Local CPO prices should be partly insulated

Local players should be partially shielded from the global price onslaught for a number of reasons. While 2019 was characterized by low domestic CPO prices (c.14% down) due to a surge in smuggled palm oil across porous borders, H2'20 promises to see a reversal amidst a total lockdown of land borders and an increasing spread between official USD rates and parallel market rates (Official USDNGN: ₦387.08, Parallel market: ₦444.00). The exchange rate spread matters as importers of oil palm have to rely on parallel market liquidity to fund supply due to the restrictions placed by the CBN. With USD largely scarce and more expensive at the parallel market, we foresee a reduction in importation of palm oil, leading to increased bargaining power for local producers. Furthermore, CPO in Nigeria is largely consumed as food and not as biofuel. With demand for food holding steady despite the pandemic, we estimate that demand for CPO has been relatively constant. The relatively constant demand as well as improved bargaining power of the producers should see local CPO prices mildly improve in H2’20, taking average 2020 prices 5% higher y/y.

While this will positively impact revenue lines for key local producers in our coverage such as Okomu Oil Palm Company PLC and Presco PLC, the impact on the bottom line could be tempered by a negative revaluation of the biological assets (the palm plantations) due to the weakening of global CPO prices.

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OKOMU OIL PALM COMPANY PLC

A rebound on the horizon

SELL

Target price	₦53.80

Company Statistics

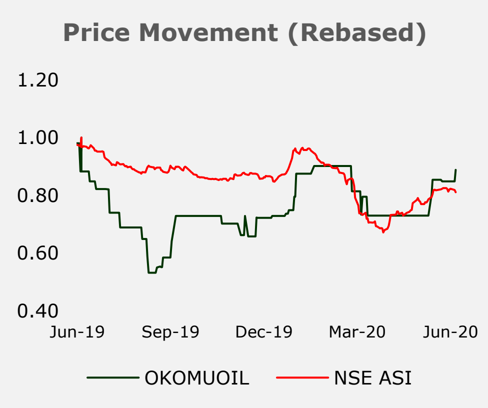
Price (₦)	54.95
Market Cap (₦'Mn)	74,786
Enterprise Value (₦'Mn)	68,647
Net Cash (₦'Mn)	6,139
Shares Outstanding (Mn)	954
NSE	OKOMUOIL.NL
Bloomberg	OKOMUOIL.LG
	OKOMUOIL.LG

Ownership Structure

SOCFIN	62.7%
Others	37.3%

Share Price Performance

30 days	10.65%
YTD	20.50%
365 davs	0.60%



Source: NSE, Vetiva Research

Business Description

Okomu Oil Palm Company PLC. is an indigenous agro-allied company engaged in the cultivation of oil palm, processing of fresh fruit bunches into crude palm oil for resale, rubber plantation and processing of rubber lumps into rubber cake for export. The company was established in 1976 as a Federal Government pilot project covering an area of 15,580 hectares and was incorporated as a

Stronger CPO prices will drive topline growth

Okomu oil palm company's revenue moderated once again in 2019, declining 7% y/y to ₦18.9 billion in 2019. Notably, the drop in revenue was driven solely by the oil palm business, with the segment losing 8% of revenue in 2019. According to management, oil palm revenue was negatively impacted by lower CPO pricing as illegal imports of Olein (a form of refined CPO) flooded the market, even as demand remained relatively stable. Thus, in spite of higher CPO production (6% higher y/y), CPO revenue moderated, dragged by a 14% y/y drop in average selling prices. That said, Okomu's management has confirmed a sharp drop in illegal smuggling since the FG took the decision to close the land borders (a key source of smuggling). Thus, we now expect CPO revenue to jump 9% y/y to ₦17.3 billion, driven by a 4% increase in CPO production and a 5% increase in average prices.

Furthermore, with rubber prices expected to remain stable in FY'20 and production forecast to rise by 11%, we project a 10% y/y jump in rubber revenue to ₦3.3 billion. Overall, Okomu oil is set to record a 9% y/y rise in overall topline to ₦20.6 billion this year.

Earnings to pick up after two years of decline

After steadily declining between 2017 and 2019, we expect Okomu oil to report higher profits in 2020. First, operating profit is expected to jump by 24% y/y to ₦9.2 billion, driven by an expected reduction in FY operating expenses. PBT will also come in 14% higher y/y, with growth tempered by rising finance costs. Overall, we forecast a 15% y/y jump in PAT to ₦5.8 billion and a 12-month target price of ₦53.80. We place a SELL on OKOMUOIL.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue	20,258	21,420	20,589	21,697
Gross profit	14,899	15,534	14,322	14,947
Operating profit	10,260	7,354	8,488	8,690
Profit before tax	10,337	7,523	7,920	8,136
Profit after tax	8,502	5,050	5,386	5,533
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Total assets	38,417	43,596	43,719	44,478
Total liabilities	9,903	14,416	12,968	12,011
Shareholders' funds	28,514	29,180	30,750	32,467
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Gross profit margin	74%	73%	70%	69%
Operating profit margin	51%	34%	41%	40%
Net profit margin	42%	24%	26%	25%
ROAE	33%	18%	18%	18%
ROAA	24%	12%	12%	13%

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PRESCO PLC

Looking to bounce back from a poor 2019

Following a surge in illegal imports of Olein (a CPO-based product) in 2019, average domestic CPO prices fell c.14% y/y in 2019, hitting the topline of key oil palm producers. Notably, Presco's topline dropped 8% y/y to ₦19.7 billion in 2019. However, with the government taking a drastic decision to close all land borders in order to stem the smuggling tide, prices have steadily risen. Supported by the border closure, we foresee a rebound in CPO prices and conservatively expect a 5% y/y increase in the average domestic CPO price. Combined with an expected increase in CPO production and extraction, we forecast a 16% y/y jump in Presco's FY'20 revenue to ₦22.8 billion in FY'20, the first topline expansion since 2017.

With prices rebounding, operating margins are also expected to improve. We have projected a 29% y/y improvement in EBIT to ₦8.1 billion, taking the EBIT margin 300bps higher to 35%. That said, we forecast an 8% y/y growth in PBT to ₦4.6 billion after accounting for a 71% y/y increase in net finance costs. Overall, PAT is expected to grow by 16% y/y to ₦3.1 billion. We value Presco at ₦37.40 and place a SELL recommendation on the stock.

Risk of loss on biological assets

While Presco looks set to record a growth in PAT in 2020, the negative outlook to global CPO prices could potentially drive a negative revaluation of biological assets, impairing net earnings.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue	21,345	19,724	22,811	26,018
Gross profit	16,591	12,722	15,210	17,476
Operating profit	10,230	6,294	8,095	9,313
Profit before tax	8,953	4,228	4,558	5,160
Profit after tax	6,068	2,678	3,099	3,508
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Total assets	58,679	70,733	71,252	79,176
Total liabilities	34,504	42,845	42,265	48,681
Shareholders' funds	24,174	27,888	28,987	30,496
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Gross profit margin	78%	65%	67%	67%
Operating profit margin	48%	32%	35%	36%
Net profit margin	28%	14%	14%	13%
ROAE	19%	15%	11%	12%
ROAA	8%	6%	4%	5%

SELL

Target price	₦37.40

Company Statistics

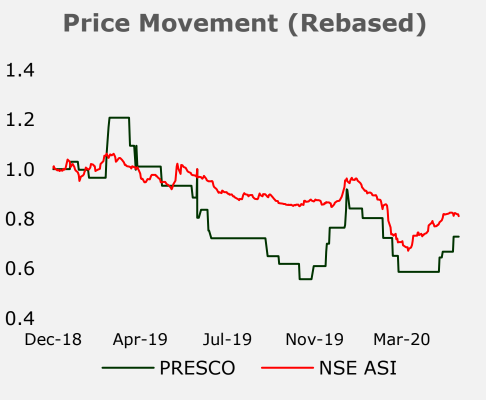
Price (₦)	75.60
Market Cap (₦'Mn)	75,600
Enterprise Value (₦'Mn)	81,370
Net Cash (₦'Mn)	5,770
Shares Outstanding (Mn)	1,000
NSE	PRESCO.NL
Bloomberg	PRESCO.LG
	PRESCO.LG

Ownership Structure

SA Siat NV	76%
Others	24%

Share Price Performance

30 days	12.98%
YTD	-4.74%
365 davs	-9.50%



Source: NSE, Vetiva Research

Business Description

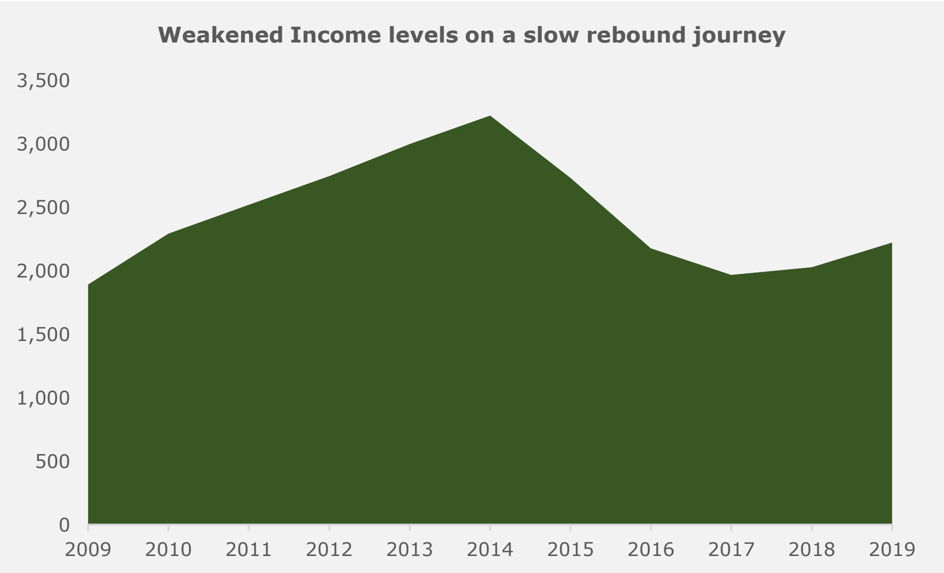
PRESCO is the only fully integrated player in the Nigerian oil palm industry, specialized in the cultivation of oil palms and in the extraction, refining and fractioning of crude palm oil (CPO) into refined products. The Siat Group currently own 60% of the company with the remaining held by Nigerian institutions and individuals.

NIGERIA | EQUITY | AGRICULTURE | CROP PRODUCTION | PRESCO

Consumer Goods

Consumer wallets to remain pressured in the coming half-year

A major win for consumers in 2019 had been the implementation of the c.67% minimum wage increase, a move expected to support consumer spending post-recession. However, amidst steadily rising inflation due to the pandemic (Average Inflation rate: 12.23%) and a c.7% currency depreciation, consumer wallets remain strained. The anticipated contraction in Real GDP (2020 estimate: -0.59% y/y) is also likely to drive a moderation in aggregate income levels, supporting a reduction in consumer purchasing power and possibly driving a decline in the middle class population. While we expect government incentives such as; the decline in pump prices, MSME grants and the CBN's directives to banks to suspend layoffs, among others, to temper the impact of the pressure on aggregate disposable income, we still expect consumer wallets to shrink in 2020, effectively affecting demand levels.



Source: Capitaliq, Vetiva Research

Producers have little scope to raise prices

With consumer wallets likely to depreciate amid an expected slowdown in the broader economy and a rise in unemployment levels, demand across most consumer products is forecast to contract, with pressure particularly on luxury goods and products that are driven by social interaction. Even within essential products such as food, consumers are likely to down-tier or downsize purchases of premium brands in favour of value brands or even cheaply available local substitutes. While we expect companies to explore partnerships with more digital platforms to continue to drive volumes amidst social distancing measures and to use discounted promos to maintain its customer base, we do not expect this to compensate for the fall in income levels. Notably, we saw this in the consumer reaction to the 2016 recession.

However, unlike the 2016 recession, we see little scope for non-food producers to compensate for weaker demand with higher prices. Given the adjusted income earning capacity of consumers due to the pandemic and still pressured wallets, we do not see a price dynamic favourable to FMCG producers (ex-food). The steady rise in food prices is also expected to crowd out non-essential purchases, as consumers prioritize food over other spend. Thus, producers will likely be constrained in their pricing ability, leading to a hit in margins.

Furthermore, as demand shrinks without a quid pro quo in supply, competition will likely intensify among producers, with a potential negative impact on pricing as producers fight to maintain market share.

Mixed revenue bag for subsectors

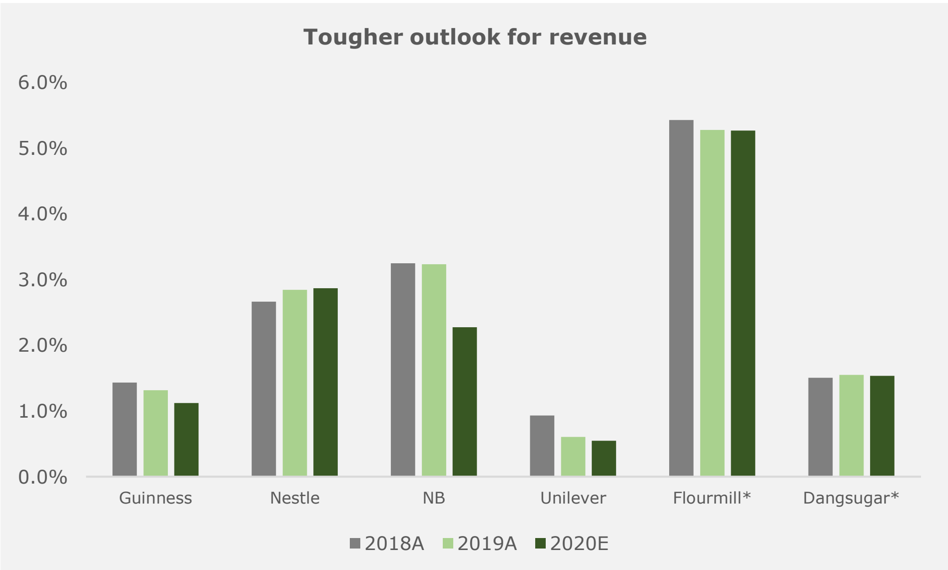
The limited scope for pricing available to products in several subsectors in the consumer goods sphere poses a headwind to revenue growth in the next half, ahead of the effect of social distancing and safety measures on consumers' patronage of physical stores and supermarkets. We do not however rule out the possibility of increased online sales promotion to drive volume amidst the pandemic. That said, we expect the effect of these blows to affect the subsectors in varying degrees depending on flexibility and necessity.

Even as food prices have steadily risen through the pandemic (Average food inflation from March to May: 15.01% y/y), we do not see a significant slowdown in food demand as it is a necessity. That said, although we note that consumers have usually favoured staple foods, such as pasta, noodles, rice and ball foods, we expect the pressure on consumer pockets to force consumers to switch to cheaper un-packaged staples. While this would be a positive for the larger group of producers not represented on the stock market, we believe that the food players on the NSE - who majorly operate in the mainstream/premium segment of the market - would be left with the leftover demand from consumers who can afford to stay on brand. We maintain the same sentiment toward non-alcoholic beverages as consumers seek cheaper substitutes.

The problem becomes much tougher for brewers. While there are not a lot of local manufacturers for consumers to down-tier to, the restrictions on bars, clubs and lounges pose a strong opposing factor to volume roll-out for these producers. This added to the stiff competition in the beer segment of the market – which is the larger segment of the market – is setting the brewers up to be the most affected segment of the consumer goods sector in terms of revenue. However, we hold out an expectation for increased push of promotions and discounts through possible strategic partnerships with online merchants as well as more focus on the non-reusable can-strategy.

Coming off 2019, after being disadvantaged to cheaper smuggled sugar, this may have been a more positive year for local sugar producers especially given the restrictions placed on FX sourcing for refined sugar importation. We expect sugar sales to thrive on its affordability and for local manufacturers to maintain a stable stream in revenue.

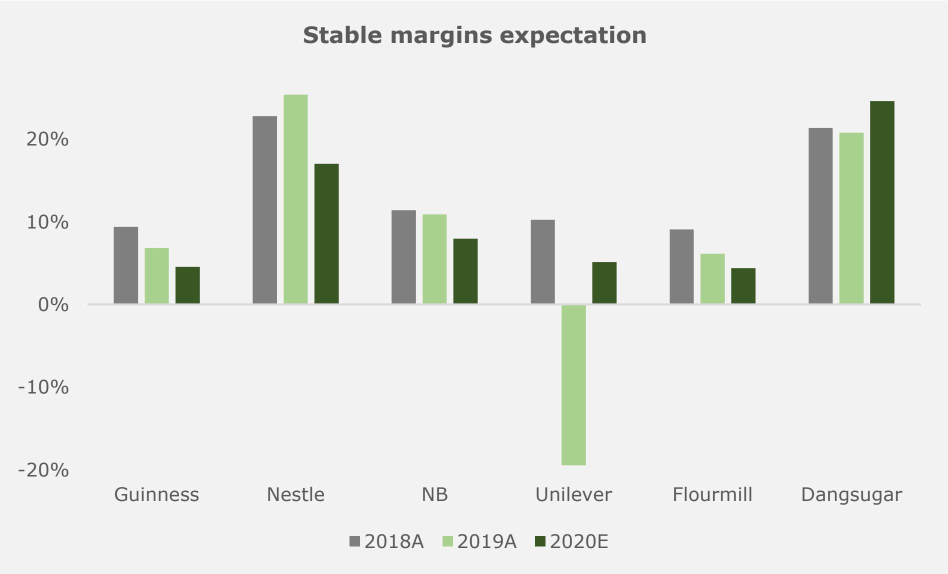
We expect the most stable performer in terms of revenue to be the Home and Personal Care segment. This is based on the increased drive for disinfectants and cleaning agents. With the greatest insurance against the pandemic the ability to wash off the virus, we expect to see a stable rise in the demand for cleaning agents, although we note that major players in the segment are not represented on the Stock exchange.



Source: Capitaliq, Vetiva Research

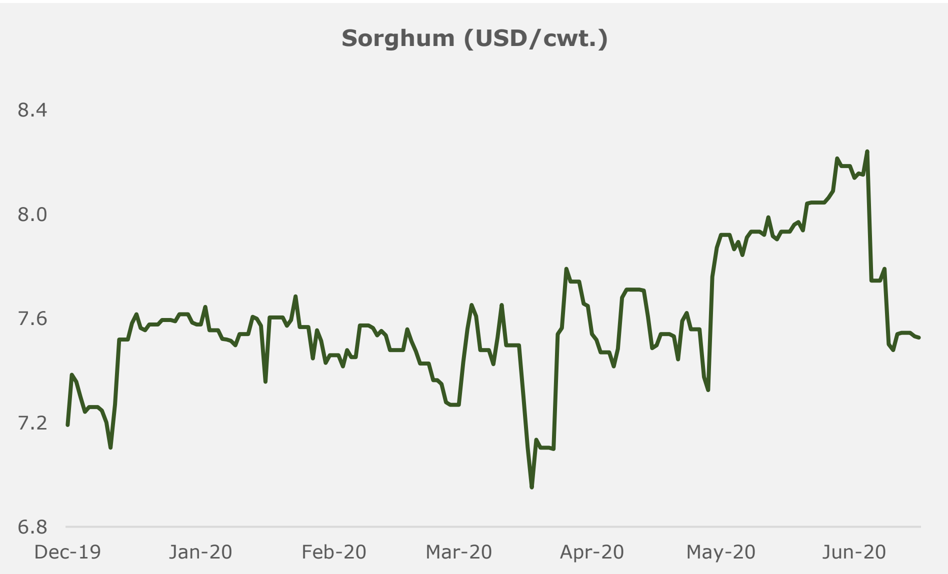
The pandemic-led decline in demand for raw materials as factories shut down at the early phase of the contagion across the globe, occasioned a fall in food prices amidst largely favourable supply factors.

Global maize production is forecast to come in at an all-time high of 1.2 billion tonnes - a 5.6% increase from the peak in 2019, buoyed by stable production in Russia and the EU and favourable weather conditions supporting a projected 3% increase in Ukraine's production. Combined with the dampening effect of the COVID-19 pandemic on demand, maize prices will face downward pressure in 2020.



Source: Capitaliq, Vetiva Research

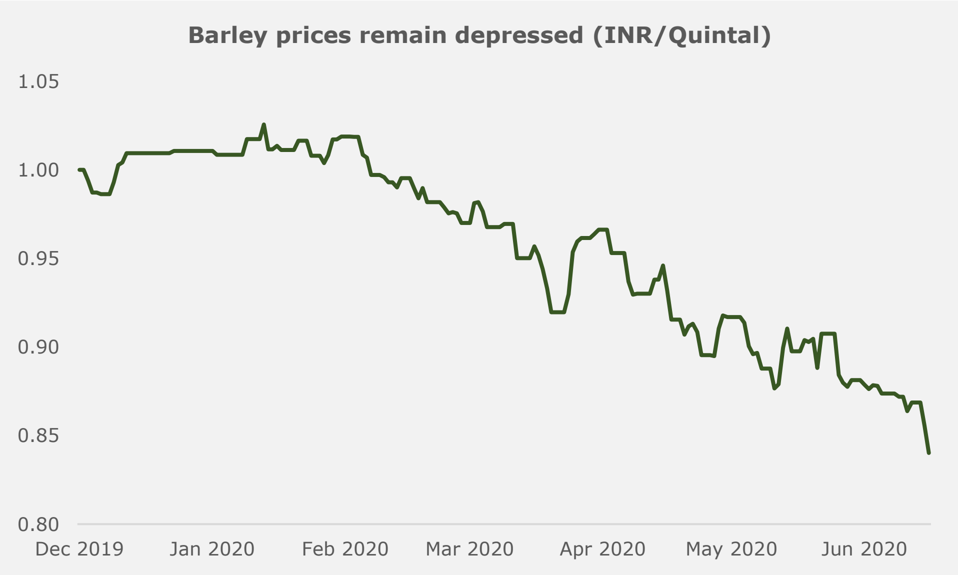
Global output levels for sorghum is expected to remain unchanged due to a mix of unfavourable weather conditions in Australia and a rebound in India's output levels. Also, following favourable trade policy from China – the largest importer of sorghum, demand for sorghum from the USA is expected to improve and maintain stable sorghum prices.



Source: Capitaliq, Vetiva Research

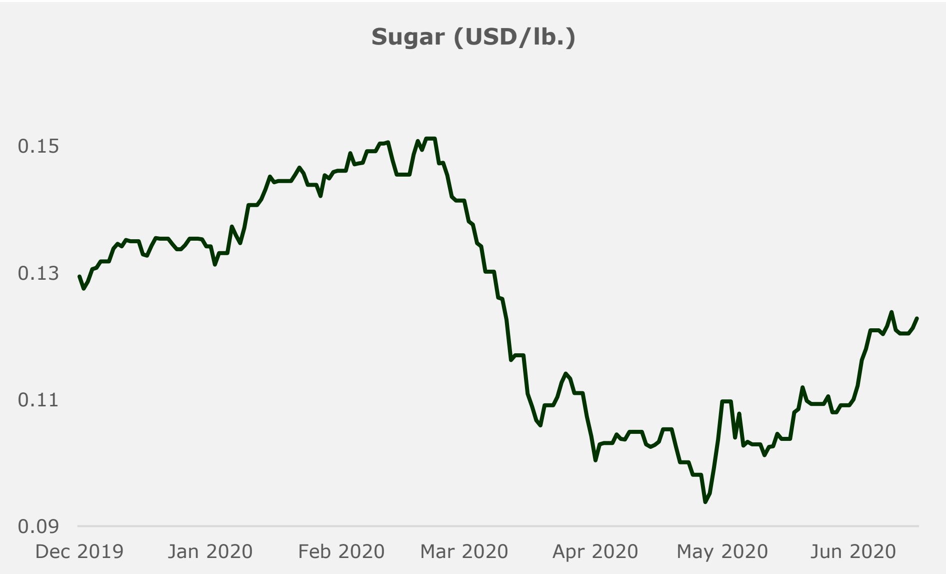
Despite expectations of reduced global production of barley (-2.4%) underpinned by a decline in output from Russia and Canada due to lower pricing, the impact of expected significant reduction in imports from Saudi

Arabia and China – the two largest importers should see prices trend lower for the rest of the year.



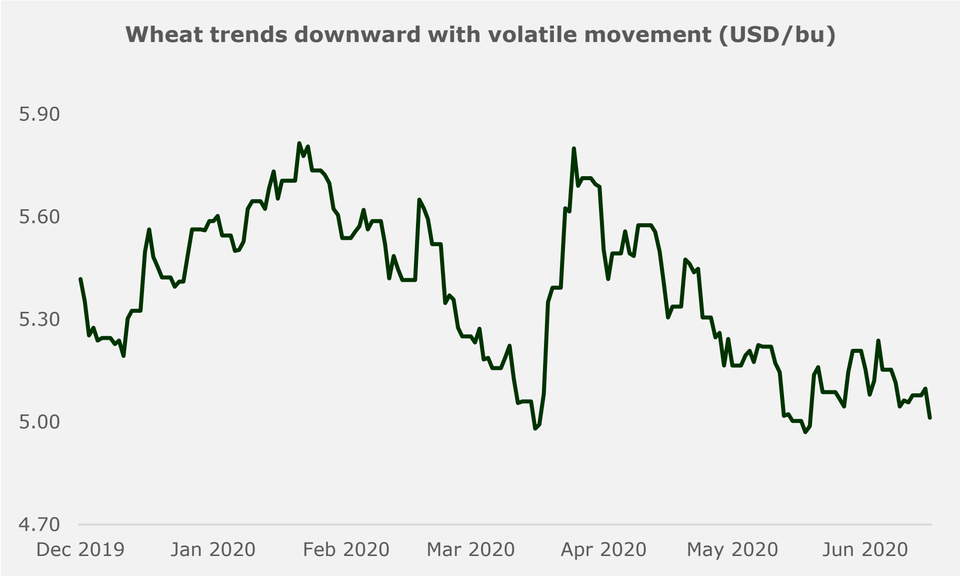
Source: CapitalIQ, Vetiva Research

The softening in sugar prices have extended into the first half of the year, evidenced by the 3% y/y decline in the period and driven by a mix of reduced demand for sugar and products that require sugar (Food and Beverages) as well as the diversion of sugar from ethanol production given the falling in price of the substitute, crude oil. However, sugar prices are now below production costs for many world producers and may see a shift in supply quantities. If this happens, sugar prices may rebound although, given that sugar is perennial in nature, the rebound may not happen this year.



Source: CapitalIQ, Vetiva Research

According to the Food and Agricultural Organisation, across the global wheat market, expectations of a slight rise in production levels in Australia, Canada and Russia is expected to be dampened by a weightier decline in production from the European Union, Ukraine and the U.S. This coupled with a projection of declining consumption levels as the COVID-19 pandemic depresses demand, should ordinarily see international wheat prices trend lower. However, given a possibility for major wheat exporting countries to prioritize domestic food security amidst fears of disruption to production, declining levels of export would support an upward sway in international wheat prices.



Source: CapitalIQ, Vetiva Research

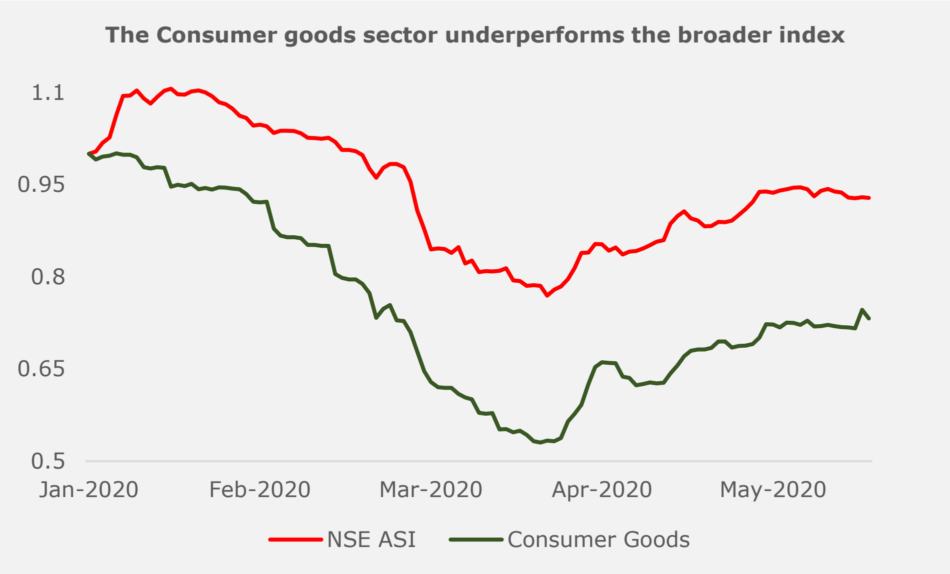
Increased backward integration focus amidst sustained FX pressure
Although global prices of raw materials may appear to be softening overall, the naira devaluation (-7% to ₦380/$) and limited international trade will prove vital to local manufacturers in this period as imported raw materials become more expensive. Furthermore, with the tight liquidity in the FX market, raw materials import will likely become more difficult and could impede logistics efficiency. In a bid to overcome this, we foresee many companies intensifying the drive to source raw materials locally. We see this transition easier for some than others given the varying statuses of their ongoing backward integration (Guinness for example has achieved c.75% local sourcing while Nestle has achieved c.80%). Albeit going by the industry average of 60%, we daresay this would foster major investment in farmers and local agriculture. Whilst the strain on local farming and transportation activities have turned pricing favourable as farmers try to offload excess supply amidst declining demand, the potential re-focus on the backward strategy may swing prices around once more.

Pressure on margins remain subtle amidst lower energy costs
The negative outlook for revenue and limited scope for pricing amid rising inflationary pressures is expected to create a cocktail for slower margins. While we see the reduction in fuel prices giving support to operating costs, we however expect the pressure on operating margins to remain, intensified by the reduced production scale across the industry.

Source: CapitalIQ, Vetiva Research

The consumer goods index on the upswing

By the end of the first quarter, the NSE Consumer Goods index had emerged the worst performing sector for the season, recording a loss of 47.01%, 2x greater than the overall market loss. The performance was a broad reflection of pessimism surrounding the macro space, with selloffs largely driven by foreign investors. The pandemic worsened the sentiment towards the industry. In Q2’20 however, the index is set to have recovered by c.32%, feeding off the prevailing general market sentiment. That said, our expectation is that the index would sustain losses as far as the pandemic continues, given the still weak fundamentals of the economy and the headwinds to growth in the sector.



Source: CapitalIQ, Vetiva Research

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FLOUR MILLS OF NIGERIA PLC

Diverse brand portfolio to prop revenue

The full border closure implemented towards the end of Q3'19 has supported sales in almost all segments of the company. The agro-allied segment for example has shown impressive growth presumably due to a ramp up in local agricultural activities to meet increased demand. Likewise, the difficulties with sugar imports, first from the closed borders, and now from pandemic-led constraints, continues to provide an avenue for growth. Although the company is yet to release its FY'20 results, we expect the revenue performance to remain largely in line with our forecast (₦526.5 billion, -0.2% y/y). This is despite the lockdown witnessed in the quarter and is premised on the panic buying spree experienced in the period. However, we expect the food sector to remain afloat, being a necessity. That said, we see a possible scale down in consumer preferences to cheaper staple food products.

Many farmers have bemoaned the effect of the pandemic on their crops, citing logistic as well as demand constraints in selling their produce. This creates a bleak outlook for the fertilizer business and even the entire agro-allied value chain as the pandemic may also adversely affect the livestock feeds. However, we maintain that our expectation of intensified backward integration program would lend a stabilizing hand to the agricultural sector and by extension, the agro-allied business.

On the flip side, with imported wheat comprising a significant portion of their flour milling activities, the company currently imports c.90% of raw materials. Wheat prices are expected to drop, owing to increased global wheat stock and reduced consumption. However, the devaluation of the naira should increase cost of raw materials. Given the huge gap between local wheat output (c.60,000 MT) and wheat consumption (c. 6 million MT and growing), there is a potential problem here, depending on the action taken by the major wheat exporting countries and whether another devaluation is likely. Overall, we expect a rise in input costs and forecast a 0.1ppt y/y drop in gross margin to 10.0%.

Interest expense to remain subdued

With a series of bond and commercial paper issuances, the company has managed to finance its overdraft liabilities as well as shore up a strong cash position. Given the favourable yield environment, we expect finance costs to fall in 2020, taking interest cover from 1.4x to 1.6x. Overall, we forecast a 38% y/y growth in PAT to ₦5.7 billion mainly buoyed by favourable interest expense. We project a target price of ₦24.43 and issue a BUY rating.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue	542,670	527,405	526,512	498,669
Gross profit	68,775	53,348	52,651	54,854
Operating profit	49,115	32,297	23,113	17,099
Profit before tax	17,234	10,174	9,359	5,768
Profit after tax	14,308	4,000	6,084	3,922
Balance sheet (₦'mil)	**2018A**	**2019A**	**2020E**	**2021F**
Total assets	408,348	416,822	392,868	334,115
Total liabilities	257,731	265,849	267,687	230,492
Shareholders' funds	150,617	150,972	154,446	157,472
Margins & Ratios	**2018A**	**2019A**	**2020E**	**2021F**
Gross profit margin	13%	10%	10%	11%
Operating profit margin	9%	6%	4%	3%
Net profit margin	3%	1%	1%	1%
ROAE	9%	3%	5%	4%
ROAA	4%	1%	2%	1%

BUY

Target price	₦24.43

Company Statistics

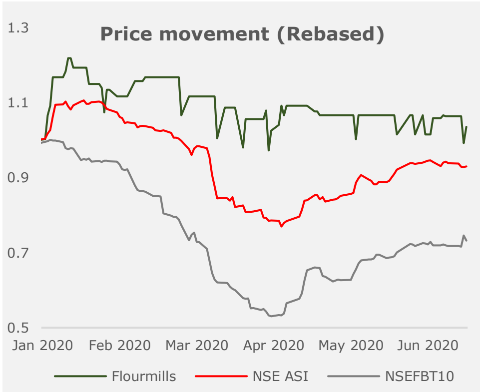
Price (₦)	19.60
Market Cap (₦'Mn)	80,368
Enterprise Value (₦'Mn)	197,406
Net Cash (₦'Mn)	109,730
Shares Outstanding (Mn)	4,100
NSE	FLOURMILL
Bloomberg	FLOURMILL.NL
Reuters	FLOURMILL.LG

Ownership Structure

Excelsior Shipping Co. Limited	62.7%
Others	37.3%

Share Price Performance

30 days	-6.90%
YTD	-0.76%
365 davs	40.14%



Source: NSE, Vetiva Research

Business Description

Flour Mills of Nigeria Plc is primarily engaged in flour milling, production of pasta, noodles, edible oil and livestock feeds, farming and other agro-allied activities, distribution and sales of fertilizer, manufacturing and marketing of laminated woven polypropylene sacks and flexible packaging materials, operating terminals A and B at the Apapa Port, customs clearing, forwarding agents, shipping agents and logistics and management of third party mills. The Group derives over 90% of

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Equity Research

DANGOTE SUGAR REFINERY PLC

Trade policies support growth outlook

While the company is yet to release its results for the last two quarters, we forecast an impressive growth in H2'19 and 2020 revenue as the border closure restricts the influx of unlicensed sugar. Notably, amidst a surge of illegal sugar imports over the previous year, sugar prices had moderated, dragging DANGSUGAR revenue. We expect the sugar refiner to have taken advantage of the border closure to normalize sugar prices across the country. The contraction in income levels driven by the pandemic is also expected to have a negligible impact on the demand for sugar, giving refiners some pricing leeway. Overall, we forecast an 15.5% y/y growth in revenue to ₦186.0 billion in 2020.

Meanwhile, we expect operating margins to remain stable in 2020 as the anticipated decline in global raw sugar prices (given expectations of favourable yields in the top sugar producing countries) is offset by the c.7% Naira devaluation. We forecast an 2.7% y/y growth in EBIT to ₦31.4 billion in 2020. Also, given the company's FX exposure, we expect a 1.77x jump in finance costs driven by the dip in the naira against the dollar.

Driven by the aforementioned factors, we forecast a 9.2% y/y decline in PAT to ₦20.3 billion and value DANGSUGAR at a 12-month target price of ₦16.04. We place a BUY recommendation on the stock.

A backwards integration plan in play

In line with the National Sugar Master Plan, we note the company's efforts to transform from a pure port-based refining play to a fully integrated sugar production within Nigeria. Dangote sugar has successfully introduced a number of sugar cane farms and mills into the group. While the sugarcane farms and mills are not 100% operational, we believe that a gradual pay-off from these investments would begin to show at this time as the company relies more on local sugar amidst tightened FX liquidity and currency devaluations.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue	150,373	161,086	177,597	192,879
Gross profit	(110,688)	(122,801)	(138,526)	(150,446)
Operating profit	39,685	38,285	39,071	42,433
Profit before tax	34,802	29,820	29,859	33,584
Profit after tax	(12,625)	(7,459)	(9,555)	(10,747)

Balance sheet (₦'mil)	2018A	2019A	2020E	2021F
Total assets	175,117	182,928	190,367	199,149
Total liabilities	76,141	117,796	118,549	116,575
Shareholders' funds	98,975	108,136	116,258	125,165

Margins & Ratios	2018A	2019A	2020E	2021F
Gross profit margin	26%	24%	22%	22%
Operating profit margin	21%	21%	25%	24%
Net profit margin	15%	14%	17%	17%
ROAE	22%	21%	22%	20%
ROAA	13%	12%	14%	13%

BUY

Target price	₦16.04

Company Statistics

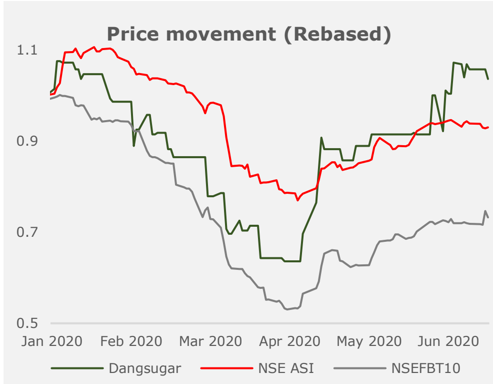
Price (₦)	11.90
Market Cap (₦'Mn)	142,800
Enterprise Value (₦'Mn)	132,782
Net Cash (₦'Mn)	19,524
Shares Outstanding (Mn)	12,000
NSE	DANGSUGAR
Bloomberg	DANGSUGAR.NL
	DANGSUG.LG

Ownership Structure

Dangote Industries Ltd	62.7%
Others	37.3%

Share Price Performance

30 days	-6.25%
YTD	-14.29%
365 days	3.08%



Source: NSE, Vetiva Research

Business Description

Dangote Sugar Refinery PLC (DANGSUGAR) is the largest sugar refinery in Sub- Saharan Africa with installed capacity of 1.44 million MT. DANGSUGAR is listed under the Consumer Goods sector, in the Food Products subsector on the Nigerian Stock Exchange. Following the acquisition of Savannah Sugar in Q1 2013, the group's operations now comprise of three key areas which include: i) Planting and milling of sugar cane ii) Refining of granulated white sugar; iii) Marketing and

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UNILEVER NIGERIA PLC

The road to redemption has many bumps

Coming from a loss-making position in the past year, Unilever has kicked off 2020 on a much stronger foot, reporting a 45.9% q/q growth in first-quarter topline. While the competitive landscape of its largest revenue segment (bouillon cubes) has not slowed, the company made a slow return to profit in the past quarter with 26.1% of its revenue coming from the segment (Q4'19:16.4%). Going forward, we believe that the FMCG giant is approaching a new sales baseline after abandoning the problematic receivables policy it had employed in the past. Thus, we expect the company to conservatively maintain this run rate for the rest of the year. That said, the super-premium positioning of its flagship seasoning brand, Knorr, places Unilever in an awkward position as the expected reduction in consumer wallets could lead to a broad-based down-tiering of consumer purchases across the FMCG spectrum.

On a brighter note, we expect the company's Home and Personal Care segment to thrive in this period, given the increasing need/awareness for personal and environmental hygiene.

Earnings outlook: Given our expectation for a more stable outlook on revenue in line with its Q1 run rate and normalized credit stance, we expect revenue from its seasoning segment to decline by 11% y/y to ₦28.4 billion. Similarly, we forecast a 9.6% y/y decline in revenue to ₦54.7 billion (Previous: ₦60.5 billion). We also expect operating margins to come in greatly improved at 19.0%, FY'19: -27.1%. All in, we forecast a target price of ₦8.55 and issue a SELL rating.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue	92,900	60,487	54,703	60,215
Gross profit	28,225	4,750	13,129	14,452
Operating profit	9,509	(11,763)	2,795	1,867
Profit before tax	12,933	(9,754)	4,420	3,165
Profit after tax	9,444	(7,420)	3,006	2,152

Balance sheet (₦'mil)	2018A	2019A	2020E	2021F
Total assets	131,843	103,678	95,893	110,426
Total liabilities	49,054	37,149	26,359	38,739
Shareholders' funds	82,790	66,528	69,534	71,687

Margins & Ratios	2018A	2019A	2020E	2021F
Gross profit margin	30%	8%	24%	24%
Operating profit margin	10%	-19%	5%	3%
Net profit margin	10%	-12%	5%	4%
ROAE	11%	-11%	4%	3%
ROAA	7%	-7%	3%	2%

SELL

Target price	**₦8.55**

Company Statistics

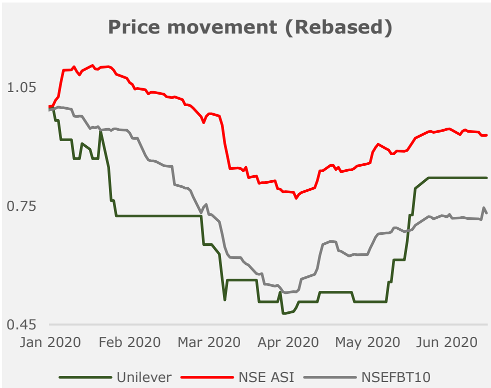
Price (₦)	17.00
Market Cap (₦'Mn)	97,665
Net Cash (₦'Mn)	35,459
Shares Outstanding (Mn)	5,745
NSE	UNILEVER
Bloomberg	UNILEVER.NL
Reuters	UNILEVER.LG

Ownership Structure

Unilever Plc	72.3%
Others	27.7%

Share Price Performance

30 days	20.47%
YTD	-14.50%
365 davs	-10.44%



Source: NSE, Vetiva Research

Business Description

Unilever Nigeria PLC (UNILEVER) is Nigeria's largest Home and Personal Care (HPC) manufacturing company. The company's operations span across the HPC and Food segments. Parent company, Unilever Overseas Holding B.V. owns a 60.04% share in Unilever Nigeria.

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NIGERIAN BREWERIES PLC

Pandemic headwinds to pressure earnings

Given the challenging impact of the coronavirus on demand through restriction to major physical sales outlets (bars and clubs), we see a substantial dip in sales for the company. We however remain optimistic on this company, given its current strong cash position which we believe will support operations in the coming half year. We note that the company has largely held on to its share of the beer market despite the intense competition from International Breweries. Thus, we expect to see an increase in advertising and marketing costs to ensure that it sustains its share of the market through the pandemic. However, we do not rule out the possibility of increased borrowing given the increasing importance of maintaining healthy liquidity levels and the prevailing low rates in the fixed income market.

Earnings Outlook: In line with expectations of further depressed consumption levels and harsh competitive terrain, we expect revenue to decline 29% y/y to ₦227.0 billion for the full year. We also adjust our full year cost estimates in line with the current and expected realities and expect the significant contraction in sales volume to drive a 113bps decline in gross margin to 39.5%. This translates to a full year gross profit forecast of ₦89.7 billion. Furthermore, we estimate a 50.2% y/y decrease in operating profit to ₦17.0 billion driven by a 300bps reduction in operating margin. We adjust our finance cost estimate to reflect the series 7 and 8 commercial papers and project a PBT of ₦8.6 billion and a PAT of ₦5.8 billion, (a 20.6% y/y and 17.1% y/y decline respectively). We estimate a target price of ₦39.25 and issue a HOLD recommendation.

Income Statement (N'mil)	2018A	2019A	2020E	2021F
Revenue	324,389	323,007	227,084	329,271
Gross profit	126,904	131,251	89,698	135,001
Operating profit	36,952	35,206	18,016	34,551
Profit before tax	29,422	23,352	8,283	29,578
Profit after tax	19,438	16,106	5,632	20,113

Balance sheet (N'mil)	2018A	2019A	2020E	2021F
Total assets	388,263	382,778	364,578	392,067
Total liabilities	221,434	215,028	196,828	224,317
Shareholders' funds	166,828	167,750	167,750	167,750

Margins & Ratios	2018A	2019A	2020E	2021F
Gross profit margin	39%	41%	40%	41%
Operating profit margin	11%	11%	8%	10%
Net profit margin	6%	5%	2%	6%
ROAE	12%	10%	3%	12%
ROAA	5%	4%	2%	5%

HOLD

Target price	₦39.25

Company Statistics

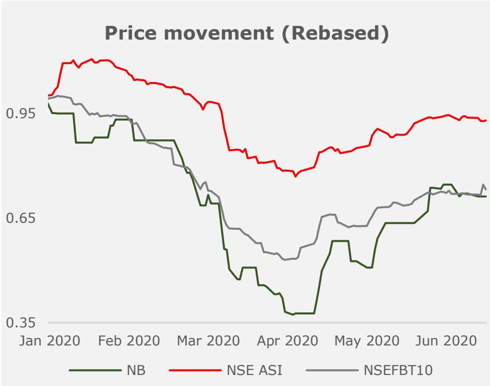
Current Price (₦)	35.00
Market Cap (₦'Mn)	279,892
Enterprise Value (₦'Mn)	314,626
Net Debt (₦'Mn)	49,358
Shares Outstanding (Mn)	7,997
NSE	NB
Bloomberg	NB.NL
Reuters	NB.LG

Ownership Structure

Heineken N.V	37.8%
Distilled Trading	15.5%
Others	46.7%

Share Price Performance

30 days	-6.67%
YTD	-40.68%
365 days	-41.43%



Source: NSE, Vetiva Research

Business Description

Nigerian Breweries Plc (NB) is the largest brewer in Nigeria and the eleventh largest listed company on the Nigerian Stock Exchange. Following the merger with Consolidated Breweries effective December 2014, parent company, Heineken maintains a 52% controlling stake in the larger entity. NB dominates Nigeria's brewery market with a c.60% market share and a brand portfolio that includes lager beer, stout beer, non-alcoholic malt drinks,

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NESTLE NIGERIA PLC

Depressed income will bite turnover

Income contraction will shrink revenues

While the bouillon cube sector (Nestle's major revenue segment) continues to face stiff competition from value brands, we believe that the consistent innovation from the FMCG giant in that space and its relatively medium pricing level has largely helped retain market share. Thus, in spite of the expected drop in aggregate income levels, we expect the company to hold on to its market leading position in 2020. That said, we foresee some reduction in demand for the other food segments as consumers down-tier or defer pricier food purchases for cheaper ones. Nestle's range of Stock-keeping units (SKUs) across major brands will mitigate the exodus to value brands but is unlikely to completely stem the flow. Thus, we forecast a slight 0.9%y/y growth in FY'20 revenue to ₦286.7 billion.

Local substitution a blessing to margins

Meanwhile, given that the company's inputs are largely local based (80% local and 20% imports), we foresee only a mild increase in operating efficiency amid the disruption to global supply chains. We forecast a gross margin of 43.0% for FY'20 (Q1'20: 45.0%, -2.1% y/y). That said, keeping with the competitive space, we foresee NESTLE maintaining its operating expense run rate and operating margins at 19.6% with PBT printing at ₦49.8billion and PAT at ₦33.8 billion for the year. We value the company at ₦964.49 and place a HOLD recommendation on the stock.

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue	266,275	284,035	286,711	293,587
Gross profit	113,920	128,147	123,286	124,569
Operating profit	60,641	72,062	48,741	48,236
Profit before tax	59,751	71,124	49,813	49,993
Profit after tax	43,008	45,683	33,873	33,995

Balance sheet (₦'mil)	2018A	2019A	2020E	2021F
Total assets	162,334	193,374	190,607	200,264
Total liabilities	112,114	147,817	139,968	146,226
Shareholders' funds	50,220	45,558	50,639	54,038

Margins & Ratios	2018A	2019A	2020E	2021F
Gross profit margin	43%	45%	43%	42%
Operating profit margin	23%	25%	17%	16%
Net profit margin	16%	16%	12%	12%
ROAE	86%	100%	67%	63%
ROAA	26%	24%	18%	17%

SELL

Target price	₦964.49

Company Statistics

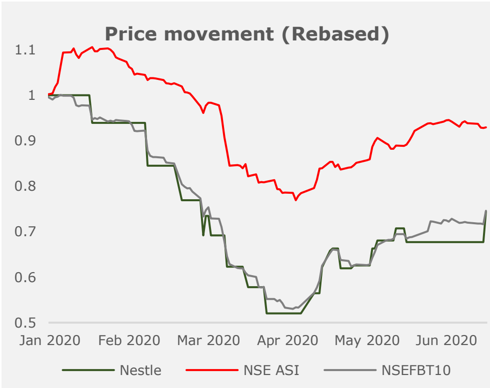
Current Price (₦)	1,200.00
Market Cap (₦'Mn)	951,192
Enterprise Value (₦'Mn)	568,431
Net Debt (₦'Mn)	6,233
Shares Outstanding (Mn)	793
NSE	NESTLE
Bloomberg	NESTLE.NL

Ownership Structure

Nestle S.A. Switzerland	63.5%
Others	36.5%

Share Price Performance

30 days	20.85%
YTD	-14.50%
365 days	-10.44%



Source: NSE, Vetiva Research

Business Description

Nestle Nigeria PLC, a subsidiary of Nestle S.A., is one of Nigeria's largest food and beverage companies. Nestle has been in operation in Nigeria since 1961 in the Food and Beverage Segments. The company produces and markets global brands including market leading Maggi seasoning cube. Milo and Nestle Pure Life Water.

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GUINNESS NIGERIA PLC

A long-term Spirits play

The revenue outlook for Guinness is not positive in the short term, given the social and economic restrictions influenced by the pandemic. We believe that the social distancing, having already affected restaurants, bars and nighttime activity will cause a significant decline in beer and spirits demand even as the company may try to engage more online stores and use discount strategies to push an e-commerce strategy. That said, we still see support for the mainstream spirits, Guinness lager and malt segments. Specifically, we still see the spirits play by Guinness to be a decent long-term strategy, given the opportunities presented by the country's current low consumption/capita. We also expect loyalists of the Guinness and malt brands to continue to push sales over the long term, even as we are more pessimistic of the other lager segments.

A potential downside however is its current foreign exchange exposure and the current volatility in the Nigerian FX market. We believe that the company may be exposed to more FX losses amidst constrained FX liquidity and a c.7% currency depreciation.

Earnings outlook: Looking forward we expect the company's revenue to decline 13% y/y to ₦102.1 billion for the full year. Given the strain on revenues, we also expect operating margins to shrink by 2.3% y/y. All in, we expect the company's PBT and PAT to come in at ₦2.3 billion and ₦1.5 billion respectively. Thus, we estimate a target price of ₦26.85 and issue a BUY rating

Income Statement (₦'mil)	2018A	2019A	2020E	2021F
Revenue		131,498	112,249	102,998
Gross profit	48,625	40,129	29,473	31,029
Operating profit	12,718	8,185	4,390	5,672
Profit before tax	9,943	7,104	2,256	6,016
Profit after tax	6,718	5,484	1,534	4,091

Balance sheet (₦'mil)	2018A	2019A	2020E	2021F
Total assets	153,255	160,793	159,276	158,878
Total liabilities	65,667	71,732	69,525	67,286
Shareholders' funds	87,588	89,060	89,751	91,592

Margins & Ratios	2018A	2019A	2020E	2021F
Gross profit margin	34%	28%	24%	26%
Operating profit margin	9%	7%	5%	6%
Net profit margin	5%	4%	1%	4%
ROAE	8%	6%	2%	4%
ROAA	4%	3%	1%	3%

BUY

Target price	₦26.85

Company Statistics

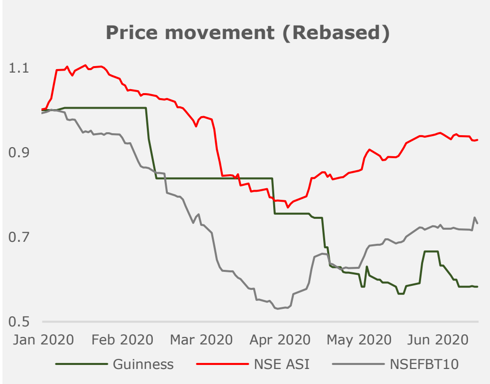
Current Price (₦)	15.00
Market Cap (₦'Mn)	32,856
Enterprise Value (₦'Mn)	64,965
Net Debt (₦'Mn)	15,170
Shares Outstanding (Mn)	2,190
NSE	GUINNESS
Bloomberg	GUINNESS.NL
Reuters	

Ownership Structure

Guinness Overseas Limited	50.18%
Atalantaf Limited	5.39%
Others	44.43%

Share Price Performance

30 days	-14.29%
YTD	-50.08%
365 days	-68.88%



Source: NSE, Vetiva Research

Business Description

Guinness Nigeria PLC (GUINNESS) is Nigeria's third largest brewer. GUINNESS' brand portfolio includes premium Guinness Foreign Extra Stout, mainstream Harp Lager, Malta Guinness and Orijin. Parent company, Diageo owns a 54% stake in GUINNESS. GUINNESS in 2016, acquired exclusive rights to distribute Diageo's International Premium Spirits brands in Nigeria and brands from United Spirits Limited (Diageo's

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