OUTLOOK 2020

FINDING ALPHA
AMIDST THE HAZE

Content Highlights

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Recovery in Key EMDEs to Support Global Growth in 2020

Against a backdrop of persistent trade tensions and dwindling demand, global output slowed further in 2019 and is expected to remain pressured in 2020, but recoveries in a few bright spots amongst EMDEs could drive growth higher on a base case.

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Economic Output to Remain Lacklustre Despite Improving Real Sector Credit

Economic Growth remains considerably below potential despite dovish monetary policy stance and enhanced credit to the private sector. Strained reserves, heightened inflationary pressures and an increasingly compelling case for currency devaluation, alongside dwindling revenue from crude oil set to hurt growth prospects in 2020.

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The Hunt for Yields to Temper Weak Sentiment

Weak macro conditions, political and policy uncertainties, higher yield in the fixed income space impaired sentiment towards equities in 2019. While some of these risks persist, attractive dividend yields, excess liquidity from OMO maturities should provide some offset.

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The fixed income market told a tale of two halves in 2019, largely influenced by regulations and market forces. Although yields in the market fell to low and unattractive points, investors remained in the market, for a lack of alternatives. Our projection is that yields will remain depressed in 2020, driving an increase in supply side activities.

2020 Strategy ……………………………………………………………………………88

Play for Dividends, Go Long on Fixed Income, and Alternative investments

Hunt for dividend in the first half of the year, go long on Treasuries and take advantage of alternative investments, although with the risks of lower liquidity.

Overview

Global and Domestic Economy

Global growth is set to remain fragile in 2020 as the trade tension between the two largest economies in the world weighs on demand, manufacturing, and private investments across the major economies. Monetary policies across these economies have become accommodative amidst low inflation rate and weaker economic output levels. Quantitative easing programmes have also been resumed in the U.S and the Euro to stimulate growth. The softness in global growth also impacted Emerging Markets and Developing Economies (EMDEs), although country specific risks also contributed to the growth outcomes in these economies. Political upheavals in Hong Kong and Venezuela, and sustained tensions in the Middle East hurt the fortunes of EMDEs, with commodity prices also depressed by lower global demand and oversupply.

The outlook for 2020 highlights some broad-based recovery to be driven by easing of the trade war and a clearer sky over Britain's exit from the EU. Country-specific recoveries previously beleaguered economies including Brazil, Turkey and other EMDEs is also expected to drive growth to 3.5%, although this is figure is lower than the initial expectation of 3.6%.

On the domestic front, 2019 commenced with a flurry of unconventional policies instituted by the Government to sustain the economic progress made in 2018. On the year, growth firmed up gradually from 2.10% in Q1:2019, to a moderate expansion of 2.12% in Q2 on the back of robust oil sector growth. The third quarter of the year was similarly propped up by sustained output in the oil sector and GDP growth pitched in higher at 2.28%. Some of the standout policies introduced include a review of the required Loan to Deposit Ratio of Banks, an adjustment of the Standing Deposit Facility accessible to banks and restricting accessibility to the OMO market. Clearly, the monetary end of the policy space was quite active during the year.

In the fiscal space, the 2020 budget of continuity was passed before the end of 2019, returning the budget cycle to a standard calendar year although, with rather ambitious revenue and expenditure targets. Lawmakers worked in tandem with the executive arm to expand the revenue base of the government for the 2020 fiscal year, which included an increase in the VAT, an amendment of the PSC Act, amongst other legislation.

In 2020, our expectations of consumer spending include a consistent rise in inflation and imposition of a myriad of taxes, which affirm the possibility of an erosion in consumers purchasing power during the fiscal year. Alongside this, there is a real prospect that the land borders will remain shut for the better part of 2020, further exerting pressure on food prices. In response to this, we expect a rejuvenation of activities in the agricultural sector, as domestic players work to meet the never-ending demand of foreign goods stuck at the land borders.

Mirroring the sluggish growth of the economy, the Nigerian bourse remained downbeat for the most part of 2019, save for short periods of bullish bouts triggered by corporate actions and most recently, depressing yields in the fixed income market. A review of the players allowed to partake in OMO market activities dragged primary market yields lower and in the secondary market, investors' scramble for available instruments pressured yields further. With inflation on the high on an upward trajectory, the real rate of return sank further into the negative territory, exaggerating the unattractiveness of these markets to domestic investors.

In 2020, we expect the CBN to keep up with unorthodox policies to drive its objectives. We expect inflation to remain on the high side while GDP growth stays moderate. We also project relative stability in exchange rate and do not foresee a cut in the Monetary Policy Rate (MPR) in the year.

Global Economy and Growth

Monetary Stimulus to Support Growth in Advanced Economies

Global economic growth weakened considerably, from 3.7% in 2018 to c. 3.2% in 2019 (IMF), as geopolitical tensions heightened risks and decelerated interest in long-term business investment. Contractionary fiscal policies aimed at pegging debt levels and protectionist trade policies emerging across nations dampened growth prospects for major economies, further limiting the effectiveness of monetary policy.

In a bid to provide some extra layer of protection for the US economy in a chaotic global economy, sustain economic expansion and trigger an uptick in stubbornly low inflation rates, the US Federal Open Market Committee (FOMC) cut benchmark rates three times in 2019. Rates are now in the range of 1.5 to 1.75 percentage points. After leaving rates unchanged in December, the Committee indicated that its outlook for rates are likely to remain around current levels until the end of 2020 – an indication that the time is perhaps ripe to watch the impact of the cuts and direction of the global economy.

In the Euro Area, growth in countries like Italy, Germany and France remain subdued as data from the European Central Bank (ECB) expects a longer period of economic slowdown as against the previous estimate. Growth in the economy, especially the manufacturing sector, continues to suffer from the decline in international trade and extended global uncertainties. Also, declining economic activity continue to weigh on inflation numbers, which has been crawling below the ECB target of 2%. Consequently, the ECB has intensified its stimulus programmes, re-introducing the EUR20bn per month bond-buying programme in September to drive up inflationary pressures and support growth in the Euro Area. As at November 2019, the E.U annual inflation had inched up to 1.30%, up from 1.10% in October.

Also, in the UK, Brexit uncertainty lingered, weakening private investment and growth. In November, the Monetary Policy Committee voted 7-2 to keep the rate on hold at 0.75%, despite signs of weakness in the economy. The MPC also expects inflation to remain below its 2% target in the medium term as household spending remains tepid and business investment is kept on hold amidst Brexit uncertainties. Although the MPC held its benchmark rate at 0.75%

all through 2019, we expect the stance to remain accommodative in 2020, notwithstanding the recent positive developments regarding Brexit and the elections. This would be necessary to spur recovery and growth in the near-term.

The growth outlook remains weak across major advanced countries, hence, most Central Banks have become dovish, keeping interest rates low and resuming stimulus programmes to drive economic growth. However, some measure of recovery is expected on the year, and with 2019 as a base, global growth for 2020 is projected at 3.5% by the IMF.

…How far can Monetary Policies Go?

In 2019, with weak economic growth across nations, the need for expansionary monetary policies to drive economic activities amid the rising geopolitical and trade tension was dominant. From the advanced economies, to emerging markets, Central Banks cut their interest rates at least once in the year. Yet, global economic growth slowed with the fear of a possible global recession on the horizon.

Going into 2020, the effectiveness of expansionary monetary policy in driving growth is getting weaker, especially in advanced economies. The ECB currently has its benchmark rate close to 0% while the Fed also cut rates three times this year to stimulate growth.

While accommodative monetary policy remains a key monetary tool to propel demand and employment; there is a need for fiscal stimuli to complement these policies.

This then begs the question; is there enough fiscal space left? The high debt profile in countries like Japan and the US could limit the size of fiscal stimulus while the European Union is still recovering from the sovereign debt crisis.

Global Credit Conditions Remain Weak

Globally, expansionary monetary policies continue to support economic growth in the near term. However, the accommodative stance has increased the financial risk-taking appetite across different markets, increasing the vulnerabilities of economies to financial stress in the future. As further rate-cuts emerge, the allure of sub-prime investment increases as portfolio managers seek a higher return.

Quite a number of debt issuers with weak credit quality have seized this opportunity to raise debt instruments and to refinance earlier issued instruments in a bid to lower finance costs. Hence, the level of leveraged finance has increased significantly since the global crisis. If low rates linger for longer, the influx of leveraged debt will weaken global credit conditions further which would pose further risk to the global economy.

For the banks, the interest rate decline on investment, are affecting profitability, and in turn, the capital buffers for the bank in the face of rising macroeconomic tensions.

In the US, the economy is in its longest streak of expansion and the possibility of a cyclical recession is increasing. Given this, the US Federal Reserve has reduced the benchmark rates three (3) times in 2019 to bolster growth. However, this has lowered the borrowing cost and if it remains low for a long time, it could distress the Interest Income of lenders and insurance companies, affecting their long-run profitability. To shore up returns, some banks may take more risks which could lead to deterioration in asset quality. Also, we expect insurance firms to respond to the lower yield environment by demanding higher premiums to insure risks.

In Europe, the risks created by low monetary policy rates, Brexit, and slowing manufacturing output lingers. Concerns remain about the effectiveness of expansionary monetary policies, especially in Germany, as slow growth persist in the face of low inflation and high employment levels.

Credit risk also remains elevated in Asia, with China’s debt crisis standing out. As the economy hits its slowest growth rate in over two (2) decades, its huge debt cannot be ignored. In Q1:2019, China’s debt-to-GDP rose to 300%, on the back of huge corporate and household debt over the years. With China accounting for almost a third of global GDP growth, its growth performance alongside its poor credit conditions remains significant to the global credit and financial conditions.

Investment continues to slump in Latin America as the lack of broad economic reforms in key countries like Brazil, as well as political uncertainties in Mexico and Argentina continues to pull down investors’ confidence in the region. Although rate cuts in advanced economies make debt instruments in emerging economies more appealing, the appetite of global investors in low-rated issuers remains subdued. Credit conditions in the region remain weak and banks' asset quality remains at risk.

In Sub-Saharan Africa, weak macroeconomic conditions pressure the credit ratings across regions. Also, most nations remain exposed to their high sovereign credit risk while the weak economic environment still pose risks to asset quality, especially in countries where policy directives and geopolitical tensions exists.

Global credit conditions are expected to remain weak in 2020, in the face of increased risk of a global economic downturn, high debt levels, high private-sector leverage, and geopolitical tensions which could impact global supply chains, and investment decisions. We expect the uncertainty around trade and geopolitics to continue to impact the financial market in 2020. To moderate its effect, there will be a need to intensify the credit risk assessment for financial institutions, increase the oversight on investments made by non-financial entities and enhance the debt management practice and framework for emerging and frontier markets.

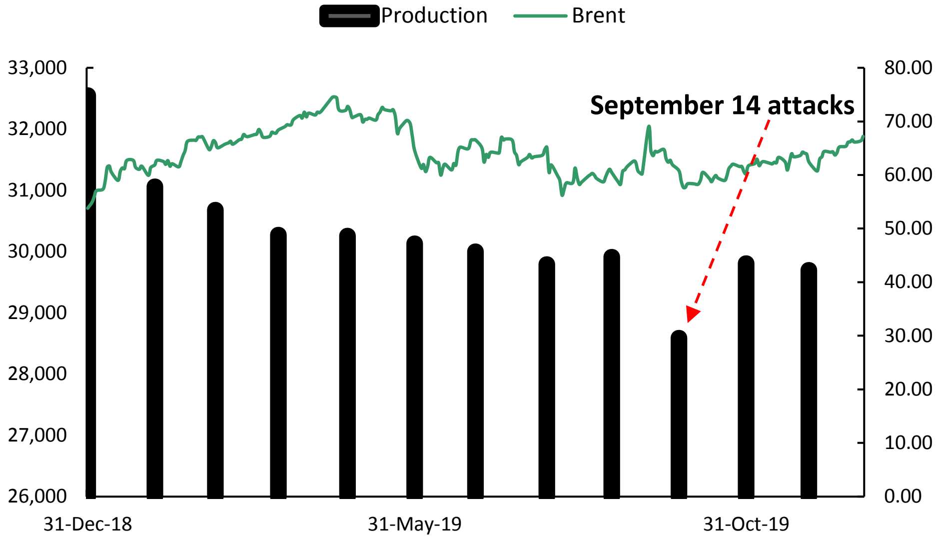
Crude Oil

The Decade Finale Points to a Bumpier Ride Ahead

After the testy end to 2018, the oil markets showed signs of recovery in January as Brent Crude gained c. 15%, buoyed by the escalating wave of economic and political unrest in Venezuela, and the extension of production cuts by OPEC+ aimed at moderating supply. Winter-induced inventory drawdowns in the US, alongside lower rig counts (an oil and gas industry leading indicator for reduced output) also aided the rally. During the year, oil prices were also supported by a variety of geopolitical events across Libya and Venezuela, removal of waivers on crude exports from Iran by the Trump administration and the major attack on Saudi Aramco's Abqaiq and Khurais oil fields, which removed 5.7% of oil from global supply. These factors drove Brent to a year-high of USD74.57pb on the 24th of April. Meanwhile, OPEC continued cutting aggressively, with OPEC-14 (comprising all current members of OPEC) production reaching a 9-year low of 28.72MMbpd in September 2019, albeit tempered by the September attacks on Aramco's oil installations. After the attacks, oil markets responded with a 20% surge in prices to USD71.95pb. Speculation was rife that Aramco might be unable to restore output as quickly as possible, and the implication for short-term global supply seemed depressing. More importantly, market participants bared concerns about the sanctity of Saudi's defence structure for oil installations, despite controlling the world's largest military budget. Saudi Arabia recovered impressively, achieving 8.56MMbpd and 9.89MMbpd output in September and October respectively, relative to a January – August average output of 9.90MMbpd. The implication of the attacks was that overall OPEC (Organization of Petroleum Exporting Countries) output initially dipped by 3.70%, but recovered by 3.28% in October, effectively restoring output back to pre-attack levels.

Historical precedents tell us that geopolitical meltdowns of this scale are enough to drive oil prices on an extended rally, to new highs before climaxing. However, it appears that oil traders have now discounted the staying power of geopolitical risk on oil prices, given the relative ease with which Saudi recovered from the coordinated attacks – prices now take a far shorter time to correct after disruptions. We must keep in mind the fact that 2019 was the year when the US finally achieved the status of net oil exporter. The realization that there was a 13MMbpd behemoth that could pick up the gauntlet in the event of a large-scale disruption in the Middle East, is enough reason to conclude that there will always be enough oil supply to meet demand, regardless of the scale of disruption. Expectedly, oil prices came back down to earth after the Aramco restoration efforts – by October 2nd, Brent was sub-USD58pb, the lowest since August 7th as the market focus shifted back to waning global demand.

Chart 1: OPEC Output vs. Brent Crude Prices (2019)

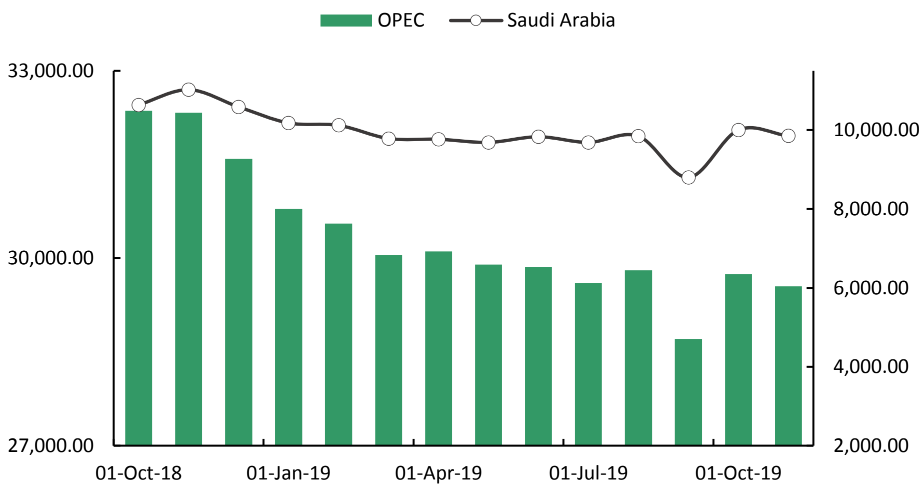


Source: Bloomberg, OPEC, Meristem Research

Does the Revised OPEC+ Deal Offer a Glimmer of Hope?

In our outlook on commodities, we highlighted OPEC's sustained supply management efforts as the key to stable oil prices in 2020. On December 6th, 2019, OPEC and its partners committed to removing a further 500kbpd from supply throughout Q1:2020. This is in addition to the existing 1.2MMbpd voluntary cuts and brings official cuts to 1.7MMbpd. It is important to highlight the very critical role Saudi Arabia has played so far in maintaining compliance, as the de-facto leader of OPEC. In addition to the agreed cuts, the Gulf nation has voluntarily withheld some additional 400kbpd from the market throughout the deal period – and has agreed to sustain this, provided other members of the alliance comply with the revised quotas.

Chart 2: Saudi Arabia is the driver of OPEC+ cuts



Source: Bloomberg, OPEC, Meristem Research

When the Saudi's additional voluntary cuts are factored in, OPEC+ could effectively be withholding 2.1MMbpd from the market in 2020. To the casual observer, this deal appears just enough to counterbalance non-OPEC-led supply growth (+2.20MMbpd) in 2020. However, there is an air of scepticism about the adequacy of the new cuts to support prices – even if full compliance is achieved, the IEA (even OPEC) see potential for a build-up in global inventories in the first half of 2020, to the tune of c. 700kbpd. There is the sense that to achieve the objective of price support, the quantum of further cuts should have been larger, given that current efforts have been largely invalidated by US shale growth. At best, we envisage that the modified deal, as it is presently structured, will only place a floor under prices and might be insufficient to elevate prices.

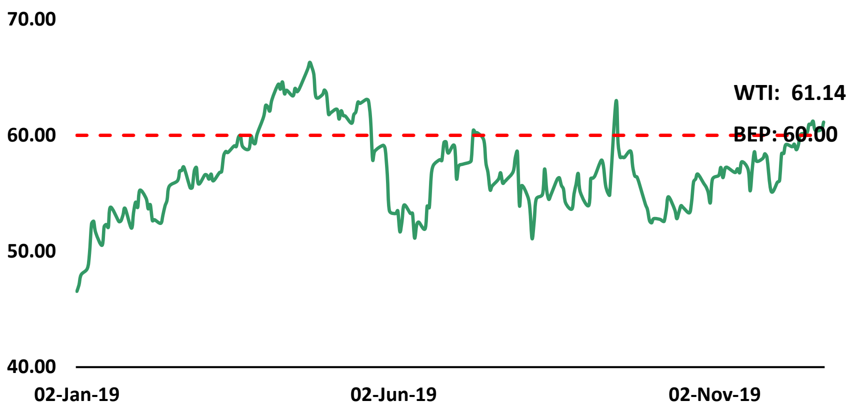
Given the insipid historical compliance amongst non-OPEC partners to the deal, we remain pessimistic about the chances of the new one recording a decent level of success. For the new pact to go through, several sweeteners had to be introduced (such as allowing Russia to pump more condensates and shortening the deal period to 3 months to allow for flexibility). In 2020, Saudi Arabia requires oil prices at a minimum of USD60.00pb for its fiscal balance, and to support the share prices of newly-listed Saudi Aramco. On the other side of the divide, Russia (leader of the Non-OPEC sub-group) has its oil producing firms grumpy about the output constraints. In a sharp contrast to Riyadh's 243% compliance, Russia and Kazakhstan (the biggest producers in Non-OPEC) only achieved compliance rates of 73% and 38% respectively in November 2019.

Moreso, the modified accord inadvertently offers US Shale a lifeline of sorts in 2020. We have already emphasized that shale growth is "only" expected at 1.02MMbpd in 2020 (vs. the 1.20MMbpd in 2019E), due in large part to evacuation bottlenecks and natural declines from the Permian basin (the most prolific shale play in the US) cum other major shale plays. However, a key driver of slower supply growth is not apparent to non-industry insiders – funding for shale exploration is drying up because financiers are increasingly worried about colossal costs and almost non-existent profits.

West Texas Intermediate (WTI) crude has averaged USD56.97pb in 2019, while the Break-Even Price (BEP) for majority of shale plays is north of USD60.00pb. If the OPEC+ deal succeeds at lifting prices, it could serve as an enabler for US output that has already hurt OPEC market share badly (currently 12.80MMbpd and forecast to print at c. 14.00MMbpd in 2020).

The near-term challenges notwithstanding, shale remains a potent long-term threat to OPEC's dominance and will keep eating into market share.

Chart 3: West Texas Intermediate Prices (2019) vs. Break-Even Price



Source: Bloomberg, EIA, Meristem Research

To prop up oil prices perpetually and guarantee a decade of prosperity for its members, OPEC will have to address all posers from the last two years. For now, the most important question is long term sustainability of its key tool: the production cut strategy, particularly given that its share of the market continues to shrink.

The Sino-US Trade Breakthrough Solidifies the Bullish Case for 2020

The phase-one trade deal announced by the US and China on December 15th guaranteed that, yet another Christmas season was not spent in the throes of a trade war. The announcement was particularly positive for oil markets in dire need of cheery news for the new decade. It is important to understand this war within the context of oil prices, to appreciate just how much damage it has caused. Up until April, prices were significantly buffered by the OPEC+'s efforts, albeit with the aid of other market wildcards including the sanctions on Iran and Venezuela. However, as the US-China trade rift escalated, concerns about demand matching supply and global economic growth resurfaced, sending prices to an 8-month low of USD56.23pb on 7th August. Prices have since slightly recovered but continue to oscillate around a new support level of USD60pb, even after the announcement of the partial trade deal.

If the implementation of this deal goes through as planned, demand numbers are expected to pick up in US, China and others. Elevated demand should expand energy consumption and trigger a bull run for oil prices.

… but IMO 2020 Rules could upset market balance

From January 1, 2020 new regulations in the maritime industry will have far-reaching implications for the global oil and gas value chain. In fulfilment of its climate change obligations, the International Maritime Organization (IMO) has stipulated that all marine bunkers and vessels are powered by only Low Sulphur Fuel Oil (LSFO), which hold sulphur content of 0.5% or below. To circumvent the new rule, vessels can rather install an expensive *scrubber* system which removes sulphur content from exhaust before discharge into the atmosphere. This new rule directly impacts *sour* oil (sulphur content >0.5%) producing nations, as we expect to see a rapid shift towards sweet crude types, which contain lower levels of impurities. To corroborate this, the International Energy Agency (IEA) projects that demand for High Sulphur Fuel Oil (HSFO) will drop by 60% from 3.5MMbpd to 1.4MMbpd in just one year before sea-going vessels modify their exhaust systems to include scrubbers.

It immediately appears that large producers of Low Sulphur Fuel Oil (LSFO), such as the USA and Brazil (although its own variety is heavy-sweet) are the biggest winners of the potential switch. These are non-OPEC sources which pose a further threat to market demand-supply balance.

With respect to oil prices, the IEA envisages that the regulations could put some upward pressure of c. USD2.50pb on Brent Crude prices – which also augurs well for Brent-linked grades such as Bonny Light. However, sour grades such as Mexico's Maya, Dubai and Canadian grades might see some price depreciation. Russia, Saudi Arabia and Iraq could also see demand for their grades slightly diminish, only propped up by sustained sanctions on other heavy-sour producers – Iran and Venezuela.

The bottomline for all market participants is clear; for shippers it is imperative to switch crude grades or install scrubbers. For the rest of the industry however, it is time to reconfigure refineries, prepare for wider price differentials (between sweet and heavy crude) and a possible demand-supply balance reset.

Our commodities outlook underscored the overarching influence of weakening global demand on oil prices – soft demand growth will dictate a negative direction for oil prices in the new decade. Similarly, prices will be further hurt by the United States' new status as a net crude exporter (albeit with dwindling growth in shale output). Moreso, 2019 was the year of heightened social consciousness about climate change and the contribution of fossil fuels to a less-sustainable world. Therefore, intensified renewables adoption and a growing disappointment over the contribution of oil to the climate debacle will also dominate conversations.

Given all relevant factors, we have effected a downward revision to our previous 2020 oil price forecast of USD67.60pb. We now expect oil prices to range between a lower limit of USD58.00pb and a ceiling of USD66.55pb in 2020. Occasional geopolitical wildcards still pose risks, but demand-supply fundamentals will always win the day.

Advanced Economies

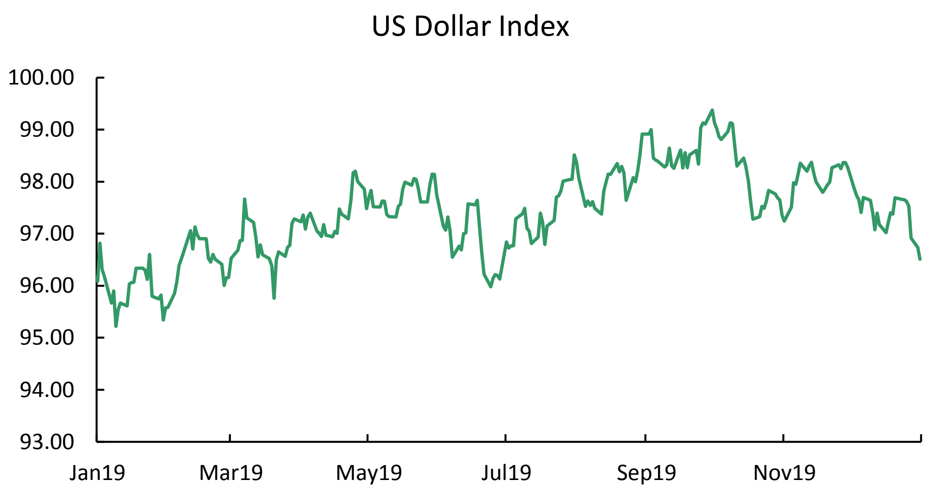
US: Prosperity in Global Chaos?

The American economy remained defiant in 2019, despite fears of a recession- there were concerns about the health of the economy with the inversion of the yield curve (a predictor of previous recessions in the American economy) occurring late in 2018. The long-winding trade spat with China also added an extra layer of gloom to the outlook for the economy in 2019. However, the economy expanded by 3.10% in Q1:2019, surpassing expectations. Higher net exports, domestic consumption and investment spending drove the economy during the period. Although the growth rate cooled in subsequent quarters (2% and 2.1% in Q2:2019 and Q3:2019 respectively), as the trade war took its toll. Net exports declined, along with private investment and manufacturing. Nevertheless, the American economy is on its longest streak of expansion streak, its 126th month of growth.

However, fears that a recession is imminent are still in place and the recent drop in the rate of growth, as well as an inflation rate that has remained below target for a long period of time has nudged the FOMC into an accommodative stance, with the Committee cutting rate three (3) times in 2019 to sustain the economic expansion. The Fed has also resuscitated its Quantitative Easing program (the Fed Chair insists we do not call it QE) to boost liquidity and demand.

On the currency front, relatively weaker growth in other developed markets has helped boost the strength of the Dollar, which gained 2.18% against a basket of other currencies as at the end of November 2019, although weakening to just 0.35% as at December 2019.

Chart 4: U.S Dollar against a basket of other currencies



Source: Bloomberg, Meristem Research

Ahead of 2020, more attention will be devoted to the U.S general election and its influence on the temperament of President Trump, as well as his stance towards major issues like the Trade war, geopolitical tensions in the Middle

East, amongst others. The tendency to score political gains on these points should dictate his actions in 2020, with significant consequences for the rest of the world. The performance of the economy, trade policies, health care policies, immigration policies, and security are some of the factors we also expect to drive the conversations leading up to the polls. The performance of President Trump on these issues are critical determinants in convincing the American electorate to give him another term of four years.

Hence, we expect the President to be less aggressive over the trade dispute and push through with the Phase-1 deal agreement with China which was announced in December. This prevented tariffs on Chinese goods from kicking in and in turn an agreement by China to purchase American agricultural products. We are less optimistic about an agreement on Phase 2, which will border on intellectual property rights and technology transfer. We might however see increased geopolitical tension in the Middle East as a result, a strong man stance will raise his popularity among his political base.

A de-escalation of the trade war between the two economic giants will boost global demand and support global trade. This should support growth across the different regions of the world economy, especially commodity exporters in emerging and frontier markets.

JAPAN: Weak Export and VAT Hike Keeps Growth Subdued

The Japanese economy was burdened by the weight of slowing foreign demand for manufactured goods, following the trade tension between the USA and China. In Q3:2019, the economy grew by 0.20%, as soft global demand for the country's export impacted growth. Notably, domestic demand was strong but attributable to anticipatory purchases ahead of the second stage of its consumption tax, which took effect on the 1st of October 2019. The two-staged increase in consumption tax was implemented in 2014, VAT rate was increased from 5% to 8%. The second and final stage will raise consumption tax on goods and services (excluding most food items) from 8% to 10%. The Government plans to utilize the additional revenue to pay down public debt and implement welfare programmes.

To minimize the blow of the VAT hike on consumer spending, the Japanese Government introduced rebates for some purchases made using electronic payments. The initiative is expected to fast-track the adoption of e-payments system in Japan, as the volume of transaction is currently low.

Although the recent consumption tax hike alongside weak export is purported to lower demand in the third-largest economy in the world, we expect the palliative measures put in place by the Government to minimize the effect. Also, we project that domestic demand will improve in 2020 as anticipatory purchases fizzle out and consumers loosen their purse strings again. Lastly, the recovery in domestic demand is expected to be strong due to the influx of tourists into Japan as they host the Olympics. However, the demand for Japan's export is dependent on the outcome of the trade tension between the US and China which is currently unclear but expected to improve in 2020.

EURO-AREA: Germany Remains Weak, Euro Activities Subdued.

Following the decline in domestic demand, reduction in exports and shortfall in manufacturing activities in EU's major economies, the region registered slower economic growth in 2019. At the end of the third quarter, the Euro Area GDP expanded by 1.1% YoY, printing the lowest growth since Q4:2013. Escalation of trade tensions depressed the external sector and manufacturing activities in the Euro area during the year. As a result, the IHS Markit Eurozone Manufacturing PMI printed 46.9pts in November, marking the contraction of business activities in the region's manufacturing sector for the 10th consecutive month in 2019. Uncertainties around Brexit talks, and reduction in demand for industrial goods and automotive, particularly from China, have also been a significant headwind for the economic expansion of the region.

However, the combined effect of an improvement in the services sector across the continent and resilient private consumption provided a fair balance for the economy amidst subdued manufacturing activities. Private consumption was buoyed by an increase in minimum wages across Central Europe and the falling unemployment rate in the economic region. In addition, the inflation rate remained downbeat for the most part of 2019, albeit reading 1.9% in April. Although the decline in energy prices helps improve profitability for the firm, the rising employment level and wage firms have also impacted the profit levels negatively. However, firms have been reluctant to pass on costs to customers to avoid hurting domestic demand. Hence, the inflation figure was muted during the year as it settled at 1.1% in October 2019. According to Eurostat, the highest annual rates were registered in Hungary (3.0%), Romania (3.2%), and Slovakia (2.9%) while Greece (-0.3%), Cyprus (-0.5%) and Portugal (-0.1%) had the lowest inflation figures in the region.

GERMANY: On the Verge of a Recession?

The economic performance of Germany was lacklustre in 2019 as economic activities contracted in the second and third quarters of the year. Germany barely scaled through a technical recession after reporting a 0.1% QoQ GDP growth in Q3:2019 (vs. -0.2% QoQ in Q2:2019). Although the growth rate was slightly higher than expected (-0.1%), the Q3:2019 figure signals a weak economy and bleak growth outlook for the European giant. The marginal expansion recorded was mainly induced by tax breaks, intensified government transfers and private spending during the year. However, the refinancing rate, which pegged at 0% across all European countries did little to support the German economic growth as credit to the private sector was up by only 0.31%.

Prevalent economic issues such as weak demand for capital goods, the slowdown in manufacturing activities, and political uncertainties continue to pose downside risks to the growth prospect of the German economy. The absence of promising expectations for the global industrial activities in the next financial year, anemic external sector, and weak domestic demand, all paint a fragile outlook for the largest economy in Europe.

The possibility of an economic recession in Germany remains of utmost concern, as the avenues open for monetary policies to propel growth wanes off. So, despite the monetary measures such as low-interest rate, there is a growing need for fiscal stimuli to boost economic growth in the near term.

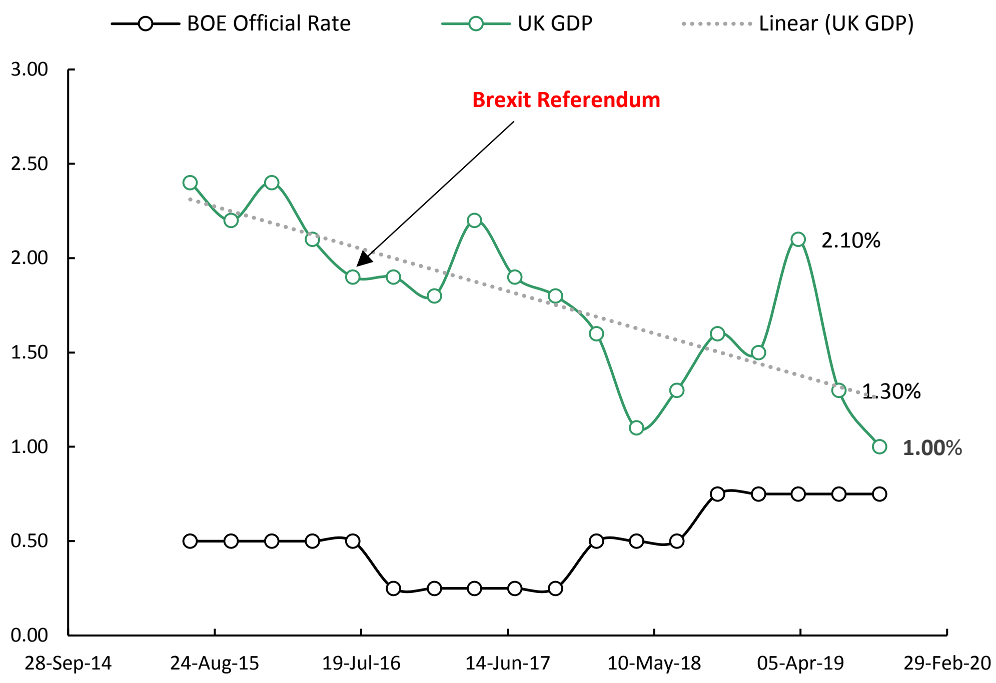
UK: Another BREXIT Extension on the Horizon?

The due date for Brexit did not materialize, as Theresa May failed to get her Brexit deal ratified by parliament. After the third time of trying to push through the deal, May eventually resigned her position as Prime Minister in July 2019. Her successor, Prime Minister Boris Johnson similarly failed to get his version of the exit deal across the line, and the revised Brexit deadline of October 31st was also breached. Earlier, Members of Parliament (MPs) had acted proactively by voting to block a no-deal Brexit under any circumstances, thereby forcing Johnson to request a second extension from the EU. A new *flexible extension* was settled for January 31st, 2019, which implies that the UK could leave on or before the date, if a deal was finalized before then. It is important to note that the lack of unanimity has stalled progress on previous Brexit deals. Hence, the success of the Conservative party at the December elections, the Party now has the majority required to get Brexit over the line. Less than 50 days separate the elections of new Members of Parliament (MPs) from the new Brexit deadline and MPs must either expedite action on the deal or risk a further extension. Nevertheless, given the fact that Boris Johnson's deal had already been previously accepted by the EU and the Tories now have their majority, there is enough reason to believe that the UK will finally leave the EU by January 2020. At best, the deal will only require a few modifications to appeal to certain minority interests (such as Scotland).

While this confirmation significantly dispels the cloud of uncertainty that has held over Britain's economy for 3 years, there remain major obstacles ahead. The post-exit trade negotiations are expected to be gruelling, while the UK's economy is forecast by the Office of National Statistics to record contraction in the aftermath of the exit.

In 2019, the Bank of England has had to maintain official rates below 1.00% (0.75%), to manage a flailing economy, given the direction of economic growth. However, declining inflation has also been pivotal at keeping the rate constant (November 2019: 1.50%). The UK's Office of National Statistics (ONS) forecasts GDP growth at 1.30% in 2019 and 1.00% in 2020, before a rebound to 1.50% in 2021.To drive this growth, the Bank of England has adopted a dovish stance in its interest rates outlook for 2020, highlighting a willingness to cut rates if global growth continues to weaken and the contagion effects are felt on the UK economy.

Chart 5: **Economy on a tailspin**



Source: UK Office of National Statistics, Bank of England, Meristem Research

Meanwhile, the UK must also grapple with the possibility of a push for Scottish independence, given the voting direction of Scots in the just concluded elections, a development that may stoke uncertainty in the year.

Emerging Markets and Developing Economies (EMDEs)

The Economic Mood in EMDEs

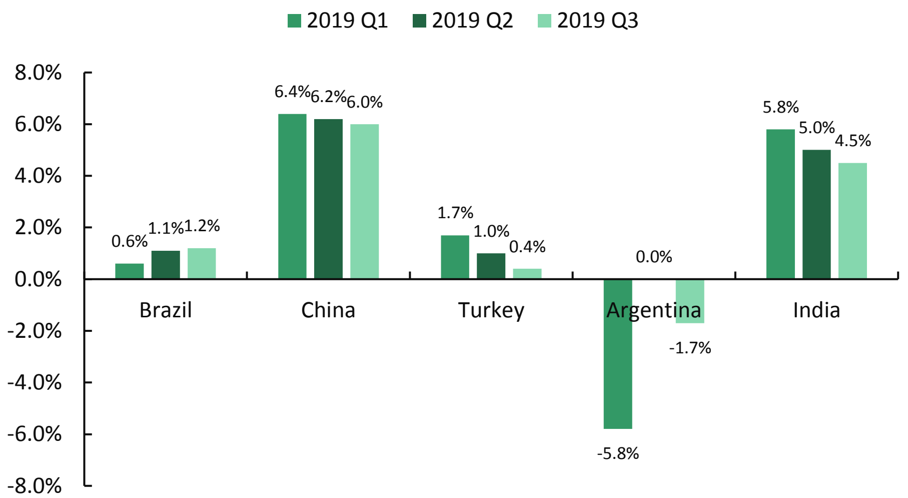
The economic performance in the Emerging market and Developing economies was modest in 2019 as countries within the sect registered slower than expected growth, due to rising economic and monetary issues. Consequently, the IMF downgraded the outlook for growth in the economies to 4.1% in September 2019 (lower than 4.4% projected earlier in March 2019). The figure reflects growing concerns about the downturn in economic activities across most developing economies. While inflationary pressures, and currency depreciation, were relatively mute in 2019, headwinds such as pressured external sector, weak global demand, escalating trade tensions, high debt burden, and distressed consumer spending linger across countries.

The emerging economies are yet to recover from the headwinds that affected the economies in 2019 and growth may come in at a slower pace in 2020. Mounting pressures on global demands, a product of the prolonged trade talks between US and China, should continue to weigh down the external sector of most emerging economies. As a result, exports should be kept at a low level for the first half of 2020, thereby dragging manufacturing activities and negatively impacting on their trade balances.

While the unrest in Brazil, Hongkong, Spain, and France have moderated in recent months, business activities have not fully recuperated in these countries, posing a threat to the extent at which the economies would expand. Nevertheless, China should sustain its resilience in 2020, given the increase in government spending, high wage rate, and reduction in tax level, which should strengthen domestic demands in the economy.

Elsewhere, the Fed's dovish stance and softer rate hikes in emerging economies should continue to trim down the interest rate differentials with the US. Accordingly, there should be an improvement in liquidity inflows to the developing economies, and currencies should perform better in 2020. Downside risk to the anticipated liquidity flows is the economic crisis in Argentina, Turkey, and India, which could prompt a complicated monetary policy decision.

Chart 6: GDP Growth in Emerging Economies



BRAZIL: Economic Activities Pick Up as Business Confidence Improves

The Brazilian economy recorded stronger growth by Q3:2019 as domestic demand and consumer confidence improved in the country. Q3:2019 GDP stood at 1.2% YoY, stronger than Q2:2019 figure (1.1%).

Earlier in Q1:2019, GDP had moderated to 0.5% (from 1.1% in Q4:2018) – a two year low, as the adverse consequences of the trade war infiltrated the Brazilian economy. A reduction in demand from major trading partners US (-4.70%), China (-11.00%), Argentina (-25.50%) and the EU (-41.40%) weighed heavily on export numbers which hit their lowest since 2017. The nation trailed its path to cyclical recovery after a severe economic crunch in 2014 and 2016. To stimulate economic growth, the Federal Government introduced several fiscal measures including pegging Government recurrent expenses to limit the pressure on a weakened revenue base, while allowing workers to profit from unemployment benefit funds, to boost household spending. In addition, the Brazilian Government proposed a new tax system to reduce tax burdens on firms and households and resolve conflicting jurisdiction issues between the three tiers of government.

The Brazilian Central Bank also maintained a dovish stance, cutting the monetary policy rate for the fourth consecutive time to 4.5% in December 2019. This action sought to ease borrowing costs for businesses and increasing the chances of growth in the largest economy in Latin America. The IHS Markit Brazil Manufacturing PMI stood at 52.9pts in November 2019, well above the 50pt mark (an indication of expansion) in ten (10) out of the eleven (11) months through till November 2019, signaling consistent expansion in the manufacturing sector.

The reduction in unemployment rates, tax cuts, and access to unemployment benefits fund should support household spending in 2020, which will in turn boost economic activities. The accommodative monetary policy stance should also continue to buoy private investment, especially in the manufacturing sector, in the process, bolstering economic growth. However, downside risks such as increasing inflationary pressures, a weak external sector, and the effects of trade tensions serve as downside risks to our outlook for growth in 2020.

RUSSIA: Robust Local Demand outpaces External Demand

The Russian economy showed some resilience in the face of US tariffs on its steel and aluminum products in 2019. The economy sustained its growth momentum and in Q3:2019 outperformed expectations, recording an expansion of 1.7% YoY, almost twice the Q2:2019 number (0.9%). Intensified activity in the manufacturing sector (2.5%), coupled with the expansion recorded in agriculture, fishing and forestry sectors emerged the key drivers. Similarly, robust private sector and domestic demand triggered an improvement in retail and wholesale trading. Despite the advancement in domestic demand, weak foreign demand continued to pressure merchandise exports and affect gross revenue.

In Q1:2019, a pronounced dip in the mining sector alongside sluggish growth in electricity, air conditioning gas and steam output had resulted in a slump in industrial output growth; which in turn moderated economic expansion to 0.5% (vs. 2.7% in Q4:2018).

We sense that the economy has greater scope for growth, as the elevated tax rate (13% personal income tax and 20% company tax) continue to hurt business confidence in the economy, softening growth. However, the efforts of the Russian Government in intensifying expenditure public projects as part of its effort to enhance consumer spending and in turn, strengthen economic activities are commendable.

Inflationary pressures in 2019 were rather subdued with Consumer Price Index moving southwards after touching 5.3% in March 2019 to settle at 3% in December 2019. The December reading was the lowest figure since July 2018, signaling improved price stability in the economy, although the Bank of Russia projects annual inflation around the 4% band in short-term.

Given the propitious price environment and to provide support for Government's fiscal measures at stimulating growth, the Russian Central Bank sustained its dovish stance, cutting benchmark rate to 6.25% at its December meeting. The recent rate cut marks the fifth consecutive cut since June 2019 (7.75%), pegging the rate at its lowest level since 2014. Clearly, lower yields on the country's sovereign debt has also played a significant role in the streak of rate cuts. As a result, credit to private sector climbed higher in 2019, printing at USD750.92bn in September 2019, compared to USD648bn during the same period in 2018.

Economic performance in 2020 is expected stronger, given the moderation in inflation rate which is expected to encourage consumer spending, thereby triggering domestic demand. Provision of RUB1trn for development of domestic infrastructure and loans to foreign companies to purchase Russian goods should similarly buffer economic growth. The higher tax regime, rising unemployment rates, and weak external demand remains lingering issues that serve as drags on the economic performance of the country.

INDIA: Credit Crunch Poses Threats on Private Sector Performance

About three years ago, India was one of the world's fastest growing emerging markets. However, economic growth has slowed considerably despite efforts by the Government to propel economic activities. By the quarter ending September 2019, the rate of growth had slowed for the sixth consecutive quarter, at 4.5% (vs. 5% in the previous quarter and 8.1% as at the start of 2018).

The Government on its part has implemented strategies aimed at propelling growth in the economy, yet, efforts seem to be failing. The Reserve Bank of India held its rate in December 2019, after five (5) consecutive rate cuts earlier this year. Yet, growth and credit flow to the private sector failed to improve, while the declining rate did little to moderate rising inflationary pressures. Hence, headline inflation rate stood at 5.54% in November 2019, the highest figure in the last two years.

For the financial system, the declining rates failed to encourage loan growth as the risks inherent in the economy were stronger deterrents. The crisis in the Indian financial system lingered in 2019, a year after the sudden default of the Infrastructure Leasing & Financial services (IL&FS), one of the leading non-bank lenders. With most of the banks invested in the fraudulent investment products of the non-bank financial institutions, the default of these firms led to a loss of funds.

The 2020 outlook for the Indian economy remains bleak as we expect these major economic challenges to persist, with key sectors in the economy still depressed due to weak consumer spending. Although the revised Goods and Services Tax and the prevailing monetary policies, aims at stimulating consumer spending, the economy requires a lot more. There is the need for land and labour reforms to bolster productivity in the agricultural sector, more initiatives from monetary policies to foster lending to the private sector, and the creation of an enabling environment to support the growth of the private businesses.

CHINA: A Decelerating Economy and Debt Concerns

The Chinese economy remains subject to headwinds from the trade spat with the USA and lower demand has called for policy support for the economy. The economy recorded slower GDP growth of 6% in Q3:2019 (versus 6.20% in Q2:2019); the slowest rate in twenty-seven (27) years as the global economic slowdown and weakening domestic demand set in. The trade spat with the USA weighed in on the growth, impacting exports and causing imports from the US and some other countries to plunge.

Chart 7: Gross Capital Formation Contribution to GDP Growth

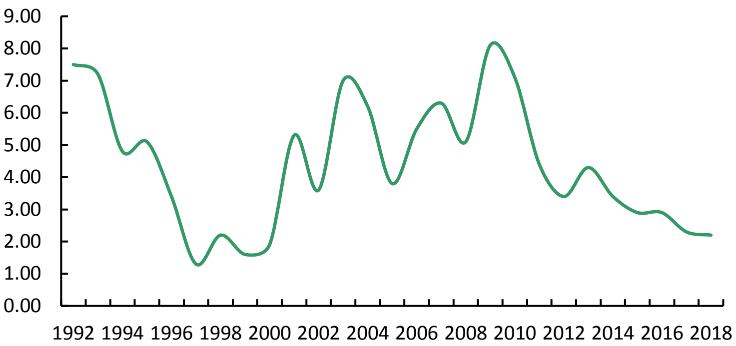
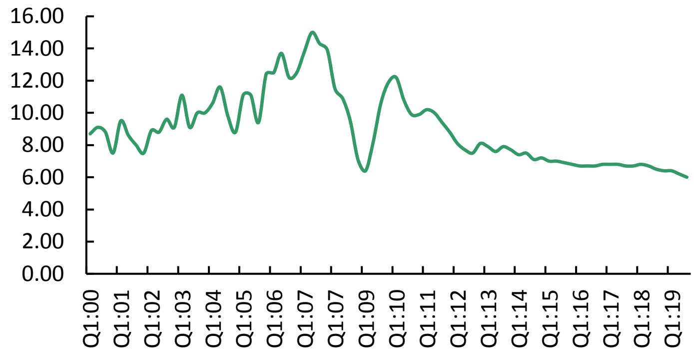


Chart 8: GDP Quarterly Growth Rate (YoY)



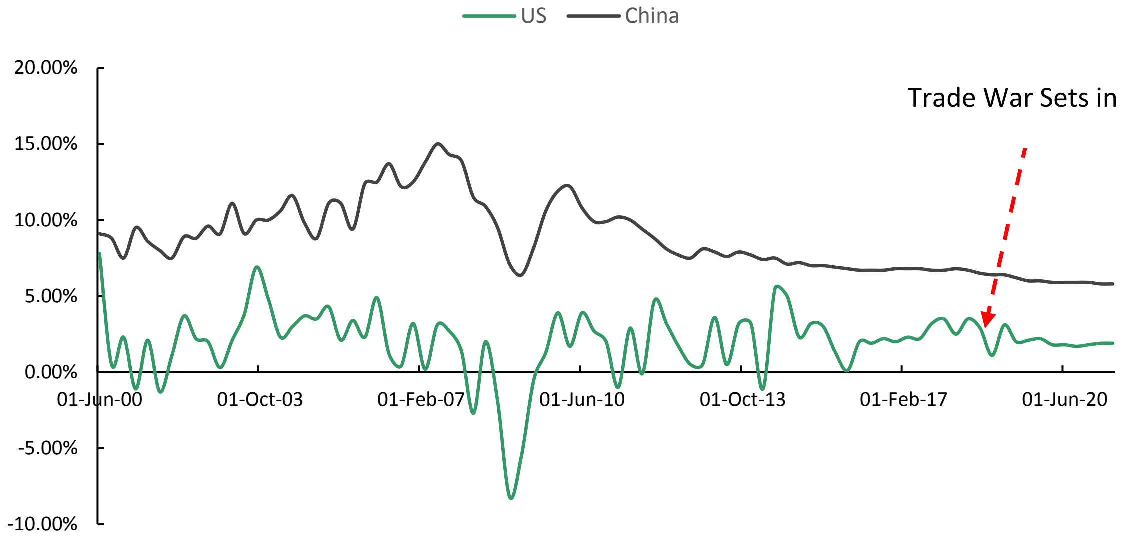
Source: Bloomberg, Meristem Research

Also, annual inflation rose to 4.5% in November 2019 from 3.8% in October, the fastest pace since 2012, driven strongly by a 110% rise in pork prices as the African swine fever which affected hog herds in China persists.

The manufacturing sector in November showed appreciable signs of improvement as PMI printed at 52.6pts after dipping to 49.8pts and 49.3pts in September and October respectively. The November reading was only the third month above the 50pts threshold in 2019. In 2020, we expect to see a consolidation of the progress made in the trade truce with the USA, and this is likely to keep domestic and global demand on the upward trajectory. To further support the economy, we expect fiscal policies to be focused on tax relief and infrastructure spending. We also expect monetary policy to provide further support to growth and the subdued core inflation and weakening producer prices.

Economic growth rate in China now appears to be on the path of long-run, slow growth economy after decades characterized by impressive double-digit growth. In 2020, we expect to see stimulus geared at achieving a long-term sustainable growth rate of around 6%, even though the World Bank and IMF see growth around 5.5% and 5.9% respectively in 2020.

Chart 9: Decelerating Growth Across Economic Superpowers



Source: Bloomberg, Meristem Research

Beyond decelerating growth, trade tensions and decimation in the agricultural sector, the Chinese economy is also under the stress of overheating debt levels. The economy's growth in the early part of its growth phase was supported by shadow-banking activities, which reduced the capacity of the monetary authorities to adequately control debt levels. However, with Debt to GDP ratio at c. 300% there is an urgent need to deleverage as the government strives to support growth and moderate the risks inherent in the economy.

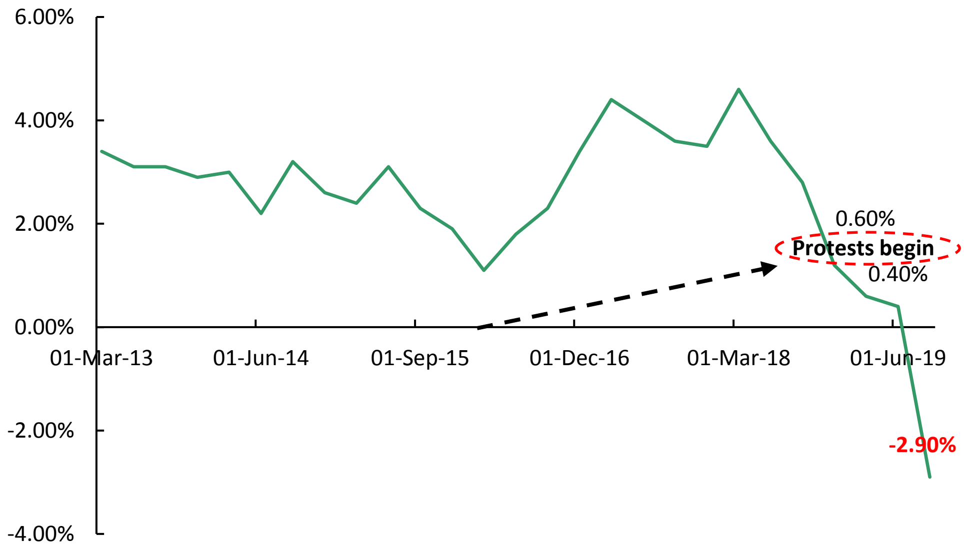
HONG KONG: Political Unrest Hurts Economic Growth Prospects

Hong Kong presented one of the major geopolitical challenges of the year 2019. In April, the Hong Kong Parliament proposed a bill to allow extradition of criminal suspects to countries Hong Kong did not previously have an extradition treaty with. For citizens of Hong Kong, the implication of this bill becoming an Act of Parliament was obvious – journalists and activists could now be extradited to places like Macau, Taiwan and mainland China, based on the slightest perception of opposition to the government of China.

The introduction of this Extradition Bill sparked peaceful protests across Hong Kong, with citizens initially demanding that it be withdrawn. With time, the protests grew violent and featured regular sparring between Hong Kong police and demonstrators. There were also a few targeted attacks on pro-China lawmakers, until the Government decided to suspend the bill indefinitely in July. Protests persisted unabated, and a complete withdrawal was announced by Parliament in September. However, this proved a little too late, as the protesters expanded their demands to include a separation from China, an investigation into alleged police brutality and other matters.

Economic data is hard evidence that these demonstrations have crippled the Hong Kong economy – GDP growth has declined consistently since the start of the year, from 0.60% in Q1 to 0.40% in Q2:2019. For the first time in 10 years, the otherwise stable Asian country's economy contracted by 2.90% in Q3 and is on course for negative growth in 2019FY (-1.30%) according to official government forecasts.

Chart 10: Hong Kong on a Downward Spiral



Source: Census and Statistics Department Hong Kong, Meristem Research

The instability is also hurting investment flows, FPI flows weakened by 125.50% between Q2 and Q3:2019. This sense of insecurity is also hurting the South East Asian nation's perception as an emerging market destination of choice and even a prompt resolution of the conflicts will do little to repair the sullied reputation in the short-term. It was initially a front-runner for Saudi Aramco's offshore IPO, but the plans were cancelled due to considerations that the protests could hurt performance of the highly anticipated IPO. Economic growth is expected at between -1.8% and -2.2% by FY2019, further evidence that it will take some time for the economic consequences of the protests to fade off.

SUB-SAHARAN AFRICA: Weak Consumer Spending Precipitates Sluggish Economic Growth

Economic growth in Sub-Saharan Africa remained rather lethargic in 2019. Beyond pressures from the external environment, the tepid performance in the region came in on the back of weak consumer spending and slow expansion in the leading economies – South Africa and Nigeria.

Economic growth was unevenly spread – nations with less dependence on natural resources including Senegal, Rwanda, and Cote d'Ivoire, sustained a strong growth momentum, thanks to the intensified productivity in agricultural sector (Rwanda) and improved private investments in Rwanda and Mauritius. Meanwhile, larger economies in the region such as South Africa and Nigeria registered slower growth due to low private investments, waning business confidence and weak consumer spending.

Inflation rate in the region remained elevated in 2019, soaring from 12.80% in September 2019 to 14.10% in October 2019. The rise in inflation was due to the combined effect of the trade policies in Nigeria which induced increase in food prices and intensified inflationary pressures from Zimbabwe. While the effects of the above factors linger, inflationary pressures are expected to moderate in the near term, given the expectation of tighter monetary policies in most economies across the region.

SOUTH AFRICA: Power Shortages Pressure Business Activities

For most of 2019, productive activity in South Africa was impeded by the breakdown of the Eskom Power plant; which triggered significant deficits in power supply. The power shortages impaired business activities during the period especially in the mining, manufacturing, transport and communication sectors. As a result, the economy grew at a much slower pace in the third quarter of the year after narrowly escaping a technical recession in Q2:2019. In Q3:2019, the South African economy expanded by only 0.1% (vs. 0.9% in Q2:2019 and 0.0% in Q1:2019), lower than the forecast of 0.4%.

Manufacturing output improved in September 2019 as the IHS Markit South Africa PMI printed at 41.6pts, much higher than the 25.7pts reported for August 2019. Through to November, PMI maintained its place above 40pts, yet remains lower than the 50pts threshold, signaling the low manufacturing levels and sustained contraction. The contraction in private sector activities was put down to low investment levels and weaker domestic demand which impaired production levels. Elevated cost levels also pressured profit margins levels for firms as the weaker Rand, higher fuel and precious metal prices raised input prices. As a result, unemployment rate climbed higher as firms resorted to downsizing to support profit margins.

Meanwhile, government services and the agricultural sector recorded some modest improvement, thereby lending support to economic expansion in Q3:2019 and moderating inflationary pressures seeping in from the private sector. Consequently, inflation rate moved few notches lower to 3.6% in November 2019 (vs. 4.0% in January 2019), brought about by a slowdown in food prices and non-alcoholic beverages.

RWANDA: The Next African Giant?

While other economies in Sub-Saharan Africa grappled for scrappy growth in the first three quarters of 2019, Rwanda enjoyed heightened economic activities during the period. In October 2019, the IMF revised its growth forecast for the economy upward to 8.5% from its initial estimate of 7.8%. Remarkably, in Q3:2019, Rwanda’s GDP expanded by 11.9% YoY, slightly lower than the Q2:2019 level (12.20%). Faster expansion in the manufacturing and services sector was the major growth catalyst during the review period. In its quest for a stronger economy, the government intensified its spending and pegged the monetary policy rate at 5% to facilitate a moderation in borrowing costs and encourage credit availability to the private sector. Other policies such as the “Made in Rwanda” policy which entails boosting local production, efforts at raising consciousness of Rwanda as a tourist destination of choice in Africa, and infrastructural development (the construction of Bugesera Airport and roads) have also rightly positioned the economy for expansion. These measures proved effective in driving both private and public investment, as well as increasing exports and trading activities.

Inflationary pressures were also kept in check, as the spate of increases in consumer prices slowed. By October 2019, headline inflation rate stood at 1.4% as against 2.2% in February 2019, amplifying the effect of growth on real GDP. Increased exports also supported foreign exchange stability as the Rwandan Franc remained strong.

The economic outlook for Rwanda in 2020 is promising, premised on elevated government spending, a robust manufacturing sector, and a calm political environment. The government has also fastened its belt by reducing grants and augmenting its tax collection measures, in a bid to ensure increased revenue, thereby improving its fiscal deficit run.

Overall, the IMF expects SSA economy to expand by 1.2% in 2019, lower than the 1.4% initially estimated. Fewer growth triggers exist mainly because of policy uncertainties, weak global demands, and muted consumer confidence. Unresolved contemporary issues such as weak domestic demand, the downturn in private sector activities, and depressed external sector, are other downside risks to the growth of the economy in 2020. However, we anticipate softer tensions from trade spat, improved global commodity prices, and a more stable power supply in the later part of 2020, thereby bolstering economic growth.

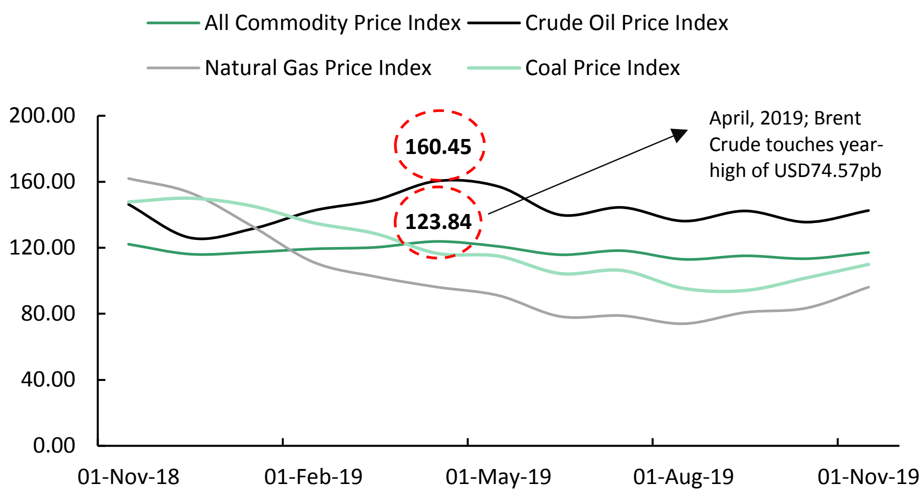
The Global Commodity Market

Will Commodity Prices See A Recovery in 2020?

Across the spectrum of global commodity instruments, sentiment has been mixed in 2019. As expected, this has prevailed even within commodity sub-groups, with diverging returns premised on variables ranging from commodity-specific fundamentals, geopolitical events and monetary policy decisions.

For much of 2019, the IMF All Commodity Price Index has been depressed, and had softened by 4.10% as at November 2019, with the most evident culprit being energy commodity prices – crude oil, coal and natural gas which have weakened consistently since April but picked up again in November.

Chart 11: All Commodity Price Index vs. Energy Commodity Indices



Source: IMF, Meristem Research

It was not a story of gloom throughout though – in April 2019, Brent rose to as much as c. USD74.57pb, coinciding with the index high of 123.84 points.

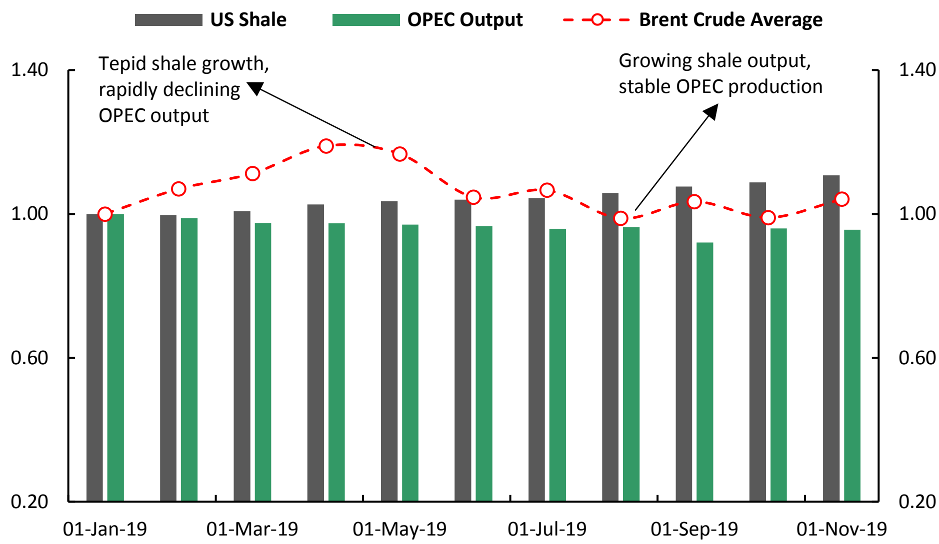
Energy: Supply-Side Management Provides a Hint of Stability

Several events during the year in review fuelled optimism for oil prices, despite the resoundingly bearish outlook posited by several international agencies. In the year, there was a steady escalation of conflicts in the Middle East and matters got to a head with the September 14 attacks on Saudi Aramco's Abqaiq processing facility and Khurais oil field which removed c. 5.7MMbpd from global supply. Oil markets responded immediately with a 20% surge in prices to USD271.95pb on September 16. Speculation was rife that Aramco might be unable to restore output as quickly as possible, and the implication for short-term global supply seemed depressing. However, the oil giant worked extra time on its restoration efforts such that full production was restored barely two (2) weeks after the incident. Expectedly, oil prices fell back to earth – by October 2nd, Brent was sub-USD58pbUS. More so, the US tightened its sanctions on the governments of Iran and Venezuela, causing a steep decline in supply from both countries to 2.1MMbpd (-0.83MMbpd; -28.21% y-o-y) and 0.70MMbpd (-

0.48MMbpd; -40.98% y-o-y) respectively. OPEC+ also sustained its production cuts, which saw OPEC output levels fall below 30.00MMbpd for the first time since May 2014 and currently at 29.55MMbpd (November 2019).

Nevertheless, the demand side has dictated the direction of markets for the better part of 2019 as global economic growth buckled under the immense weight of the protracted trade war. While oil demand growth for 2019 was initially expected at 1.5MMbpd in January, OPEC's most recent revision (November 2019) slashed that expectation to 0.98MMbpd for 2019 – an indication that even OPEC's supply management efforts might fall short in averting a glut in 2020. This glut will be driven by sustained output levels from the US and other Non-OPEC, combined with tepid oil demand growth, regardless, of the quantum of the coalition's efforts. It appears that there are enough factors to counteract the effect of supply-side management.

Chart 12: 2019 – A Tale of Two Halves



Source: OPEC, Bloomberg, Meristem Research

Perhaps the most decisive pressure point for oil prices during the year was the relentless growth in US Shale production, which aside nicking market share from OPEC, capped Brent prices around the USD65pb – USD70pb region throughout 2019. For context, shale output accounted for 62.92% (7.67MMbpd of 12.19MMbpd) of total US Crude production and 96.67% (1.16MMbpd of 1.20MMbpd) of US supply growth in 2019. Expectedly, US has just achieved the status of crude oil net-exporter.

There are several positive indications that oil prices will maintain stability around current levels in 2020. This assertion stands in stark contrast to the production, expectations and supply/demand balance. Global oil demand is expected to expand by only 1.08MMbpd (to reach 100.88MMbpd) in 2020, while supply growth will more than double (+2.20MMbpd) – evidence of an impending supply glut. Non-OPEC sources such as US (+1.02MMbpd), Brazil

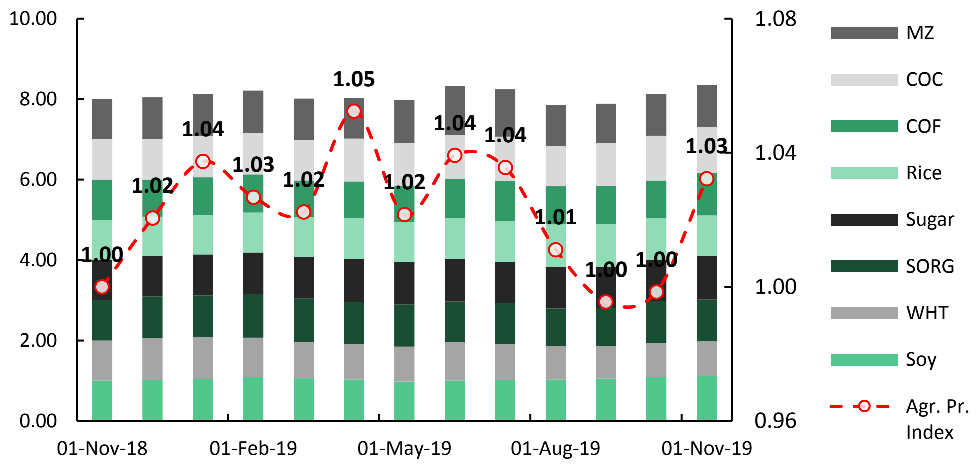
(+0.29MMbpd), Canada (+0.10MMbpd) and Norway (+0.21MMbpd) are the biggest drivers of this supply growth.

However, OPEC+, in its final meeting of 2019 unanimously decided in favour of an extended production cut – the coalition has received commitment from its members to remove an additional 500kbpd from the market in Q1:2020, thereby increasing its baseline to 1.7MMbpd. We believe this will maintain the firm floor under Brent crude around the USD60pb mark.

Similarly, the US and China have announced a mini-truce after at least 18 months of bickering over trade. In exchange for purchase of agricultural goods from the US and a stronger commitment to intellectual property protection for US companies, China will enjoy a rollback on existing tariffs to the tune of 50% and cancellation of planned further tariffs. The deal suggests that the global trade slowdown has likely bottomed out and the negative trend in industrial production experienced in 2019 will likely reverse and trigger firmer oil demand growth in Asia and America.

Agricultural Commodities: Demand Growth Rests on Resolution of Trade Spat

Chart 13: Agricultural Commodities are poised for a rebound in 2020



Source: IMF, Meristem Research

Prices of most agricultural commodities have stabilized since the start of Q4:2019 as trade tensions, high inventory levels and other factors that exerted downward pressure on them begin to lose hold. Compared to the same period last year, the IMF Agricultural Price Index had gained 3.23% as at November 2019, driven by significant increases in the prices of Cocoa (+15.31%) and Soybeans (+11.80%) – on the back of softer supply from the US. These advances masked losses in Wheat (-13.23%) and a tepid rise in rice prices due to the multi-year high inventory levels.

Strong dollar levels mean that there is limited room for currency upside in 2020. This is positive for agricultural commodities, as they tend to see increased demand when the dollar is cheaper. Meanwhile, the first phase of a trade agreement has been signed between the US and China and features a 50% rollback of tariffs on critical agricultural commodities such as soybeans, and a commitment to better trade balance. This key event sets the stage for stronger demand from China and improved supply from US farms. However, some of the factors that precipitated lower prices subsist, including low energy costs and weak demand for some commodities. While agricultural commodity prices are on course to lose c. 4.00% in 2019, the stronger demand outlook should drive prices higher.

Precious Metals: Dovish Monetary Stance Supports "Flight to Safety"

Precious metals have enjoyed positive sentiment in 2019 reflecting robust demand, monetary easing stance and heightened global uncertainties. In line with these, the World Bank projects that prices will tick up by 5.60% in 2020 respectively, owing to the signs of weakness in global growth prospects which has led to a broad-based dovish monetary stance across emerging and developed economies.

Gold has experienced three (3) consecutive quarters of gains which is supported by increased physical demand, global uncertainty and the pursuit of safety in the face of three (3) interest rate cuts by the US Federal Reserve. Notably, central banks in emerging economies especially have been aggressive in their acquisition of gold in a bid to diversify their reserves from the US Dollar in the face of global trade tension. Robust demand for physical gold fueled by the expansionary monetary policies is expected to keep gold up by 5.80% in 2020.

Platinum prices showed signs of weakness earlier in the year, but in the third quarter, prices rose by 4.70% with support from lower supply from South Africa following a labour strike at South African mines. The steep discount of the metal to gold also made it an attractive haven of safety for investments. The World Bank projects platinum prices to advance by 3.50% in 2020. The weak optimism is hinged on the expectation of lower demand for diesel engines implying weak demand in China and Europe on the back of strengthened environmental regulations and broad-based manufacturing slowdown.

The trajectory of silver has been in line with gold, as prices rose by 14.30% in the third quarter of the year. The discount of the precious metal to gold boosted its demand as an alternative safe asset. Also, in India, purchases increased significantly in the first half of the year ahead of the new tariff on silver which kicked off in August 2019. The World Bank projects that demand will continue to mirror gold, with prices expected to advance by 4.90% in 2020.

Due to the weak growth prospect of the global economy and uncertainties between major economies, we expect positive sentiment in favour of precious metals in 2020. In October, the ratio of Gold (a haven asset) and Copper (an industrial asset), a measure of uncertainty reached a three-year high, an indication of heightened uncertainty. If the present uncertainties linger for long, we expect apex banks in emerging economies to diversify their reserve in favour of gold, however, if uncertainties are steered to the clear in 2020, and the dollar becomes stronger, investors are likely to rotate away from

precious metals. On a balance of factors, our projection remains that dovish monetary stance of apex banks will remain in 2020, hence, we expect appreciable positive sentiment on precious metals in the year.

Base Metals: Weak Global Demand to Persist into 2020

Activities on this end of the commodities market were downbeat in 2019, as base metals traded at relatively low prices compared to 2018. As at the end of 9M:2019, World Bank's Metal & Mineral Price Index was down by 7.01% to 80.02pts (vs 86.05pts in 9M:2018). The low-price levels reflect the backdrop of the trade tensions between US and its trade partners, most especially China. The trade spat and the uncertainties around it, have impaired global trade and manufacturing activities, and in turn weaken global demand for base metals.

The combined effect of less stringent environmental measures on aluminum production in China and resumed operations in the world's largest Alumina refinery (Alunorte, Brazil) spawned stronger supply for aluminum, thereby pressuring alumina prices. US Tariffs on China also hampered the demand for copper by the Chinese economy which is the largest consumer of copper, hence prices plunged for most part of the year. Other base metals such as Lead, Zinc, Tin and Iron ore were affected by the subdued activities in the global automobile industry and solder sector of electronics in manufacturing countries, and in turn, negatively impacted prices.

The outlook for base metal prices in 2020 remains bleak, given the persistence of the existing drags to global metal prices. The fiscal stimulus strategy in China does not seem promising as the Chinese government prioritize tax cuts over government spending, hence, demand for metals from the economy should remain downbeat. Prolonged trade negotiations between US and its trade partners is also expected to further weaken metal prices. However, strict pollution control measures and restrictions on tin ore exports in Indonesia, should be helpful in production cuts, thereby providing a buffer for metal prices.

The Biggest Winners of our Commodities Outlook

The synchronized slowdown in global growth implies an expectation that the accommodative stance adopted by major central banks will likely continue into the new decade. Expansionary monetary policy infers lower yields for longer, and in a dispensation where investors sustain their pivots towards risk free assets, it will become increasingly difficult to generate superior alpha.

The relentlessly strong US Dollar will limit the upside potential on agricultural commodities, while energy prices are expected to remain stable as positive fundamentals counterbalance existing bearish sentiment. Similarly, tepid demand growth is expected to peg back a rally in the prices of base metals. Meanwhile, widespread global uncertainty and fears of a possible recession might limit investor participation in emerging and frontier market equities.

Precious metals are the obvious winners of our outlook for 2020. Gold's status as a store of real value in uncertainty should swell demand and cause prices to surge, providing a source of solid returns.

Domestic Economy

Gross Domestic Product (GDP)

Economic Growth Remains Lacklustre

Nigeria's domestic output sustained its slow march towards recovery in 2019, against the backdrop of political and policy uncertainties, volatile oil prices and disruptions to oil supply that beset the economy at various times during the year. At an average of 2.17% for the first three quarters in 2019, the real GDP growth is on course to surpass our forecast of 2.14% for the year. Much of the economic growth this year can be attributed to the slow but steady improvement in the non-oil sector and the resurgence in domestic oil output in June when daily product increased to 2.08mbdp (despite notable Force Majeures in the earlier part year).

Chart 1: Trend in Real GDP Growth

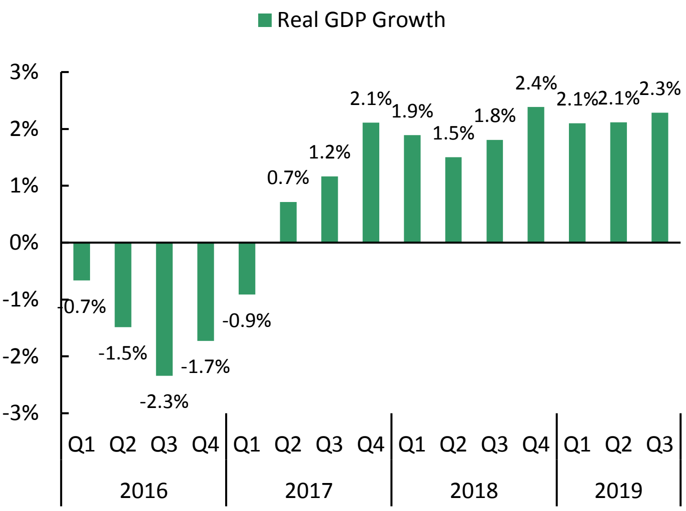
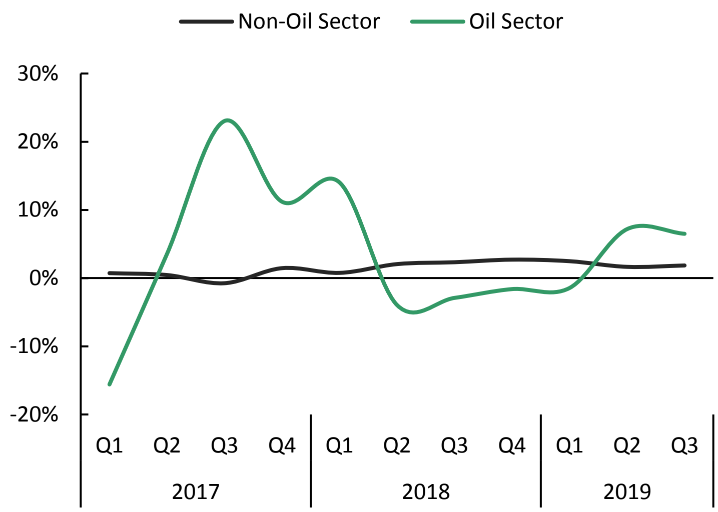


Chart 2: Trend in Sectoral Growth



Source: Nigerian Bureau of Statistics (NBS), Meristem Research

In line with the recovery highlighted above, the oil sector recovered after four consecutive quarters of contraction (between Q2:2018 to Q1:2019). The revival triggered notable levels of growth – 7.17% and 6.49% in Q2:2019 and Q3:2019 respectively0. Coupled with the relatively high crude oil prices in Q2 (averaging USD68.47pb), Nigeria's oil output also benefitted from a relatively uneventful period, with minimal disruptions to oil production leading to an average output of 1.88MMbpd in Q2:2019 and 1.92MMbpd in Q3:2019, despite the *Force Majeure* on the Nembe Creek Trunk Line (NCTL) in September due to leakages. However, Brent Crude price moderated to its lowest range for the year in Q4:2019, at an average of USD62.42pb (vs. an average of USD68.60pd in Q4:2018), although output has been relatively sturdier at 1.9MMbpd (up to c. 2.1MMbpd when condensates are included), which supports our expectation of modest y-o-y growth in the oil sector for Q4:2019.

We have revised our growth expectations for the economy in 2019 slightly upwards to 2.21% YoY (prev. 2.14% YoY) as we expect crude oil output to remain stable around the 1.9MMbpd mark. However, we acknowledge that oil prices for Q4 have been below prices for Q4 last year and the preceding quarters of the year which might weaken oil GDP growth.

Yet, we expect improved credit conditions to the real sector to provide further support to domestic output, delivering an overall GDP growth of 2.30% YoY in the final quarter of 2019.

Improved Credit to the Non-Oil Sector Buoys Performance

The non-oil sector recorded an expansion of 2.47% in the first quarter and maintained this growth trajectory in subsequent quarters, although at a slower pace (Q2:2019 - 1.64%, Q3:2019 - 1.80%). The CBN intensified its intervention in the agricultural sector, while the herdsmen and farmers' crises which plagued the sector for much of 2018 ebbed in 2019, contributing to the growth recorded in the sector. As at Q3:2019, the sector grew by 2.28% year on year. In the same vein, the services sector strengthened in 2019, with the expansion in the sector now stretching back for six (6) successive quarters.

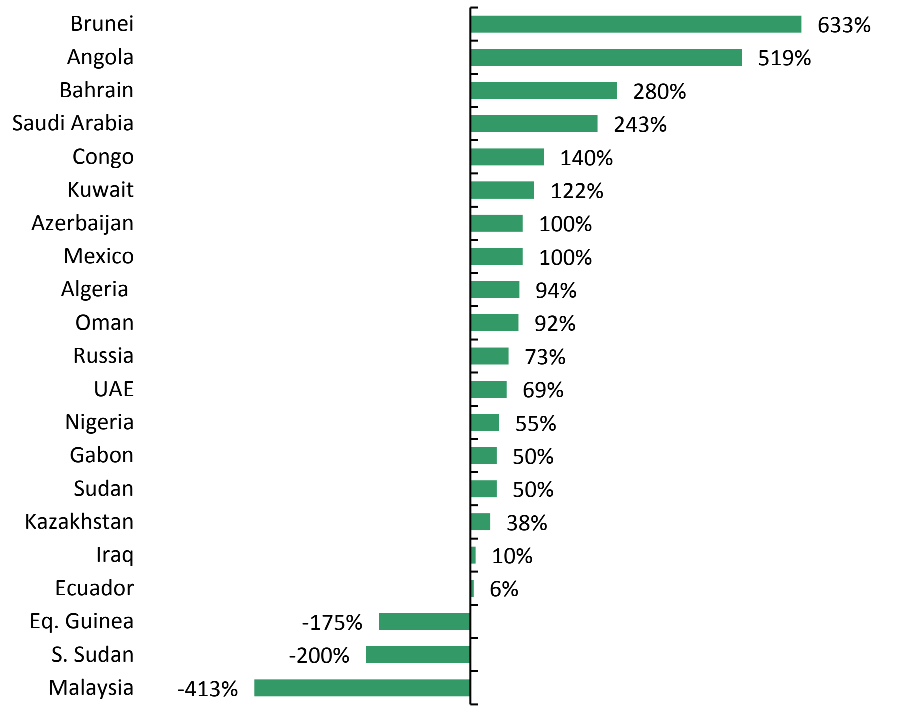
Growth in the non-oil sector was bolstered by a stable FX environment, sustained moderation in headline inflation (prior to the border closure in Auguste) as well as an accommodative monetary policy. Overall, the sector also benefited from the CBN's revised Loan to Deposit Ratio (LDR) policy, which resulted in improved credit delivery to various sectors of the real economy. The manufacturing, general services and ICT sectors were the largest recipients of bank credit, which was a positive driver of their performance. However, the chronically poor transportation infrastructure and inefficiencies at the sea ports took their toll on the trade numbers, which contracted in Q2 and Q3:2019.

Policies to deepen incentives available to businesses (such as improved access to cheap credit and fiscal policy concessions) are in progress, we expect to see local production gradually fill the supply gap created by the land border closure, especially for agricultural goods Meanwhile, enhanced private investment and activities ploughed into boosting local production capacity should support economic growth. We also envisage that improved credit to the manufacturing sector will spur improved output. However, until the required infrastructural reforms needed to improve power, transportation and port efficiency are set in motion, the non-oil sector will continue to perform below potential.

Real GDP to grow by 2.47% in 2020

In 2020, we envisage that the oil sector GDP growth will moderate to 3.89% YoY from our average projections of 9.98% in 2019. Our assumptions are hinged on the fact that for much of 2019, Saudi Arabia has had to constrain production far above its production cut quota, in order to maintain the crude oil price floor at USD60.00bpd as Nigeria and Iraq, two of OPEC's largest producers, consistently with their production quota (*Nigeria's average daily* *production for 2019 stood at c. 1.88MMbpd as at December, as opposed to its quota of 1.69MMbpd*).

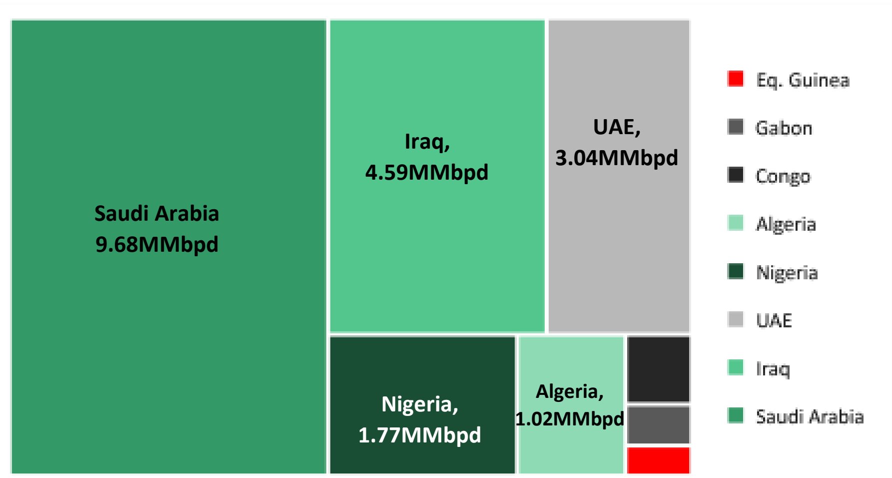
Chart 3: OPEC+ Compliance Rates (2019, November)



Source: Bloomberg, OPEC, IEA, Meristem Research

For 2020, Nigeria's production cap has been revised to 1.75MMbpd, based on October 2019 production baseline of 1.77MMbpd. With the oil glut in view and oil prices grasping for support, OPEC+ might put in measures to extract maximum compliance from members. The direct impact of this would mean that Nigeria's production numbers are likely to drop in 2020.

Chart 4: 2020 OPEC Production Quota* (Mbpd)



Source: Bloomberg, OPEC, IEA, Meristem Research

**Under the revised agreement, Libya, Iran and Venezuela remain sidelined, Angola has no new quota and Ecuador exits the OPEC coalition effective 1st January 2020.*

Barring any significant disruptions to supply, and given other factors highlighted in our commodities outlook, we expect Brent Crude prices to be relatively lower in 2020. When combined with lower output, this creates the perfect recipe for lower oil revenue. Nevertheless, because condensates do not fall within the purview of the production cuts, a window of opportunity to ramp up production of condensates (currently estimated at c. 200kbpd) exists and might provide comfort for the shortfall.

Are We Throwing Money at the Problem?

Access to credit is undoubtedly important to stimulate economic activity, which ultimately leads to economic growth. Hence, we view the increase in credit to the real sector as a laudable development. Loan growth flowed from the CBN's unorthodox approaches, which improved the affordability and availability of loans. However, while this approach might accelerate economic growth in the short term, we maintain the view that without appropriate risk management frameworks and guidelines in place, the initiative might lead to a gradual build-up of vulnerabilities in the financial sector in the medium to long term.

Will the Protectionist Policy Deliver Stronger Agricultural Output?

The Agriculture sector has received a lot of attention by the current administration in its efforts to diversify the economy. The sector currently contributes 23.71% to GDP and is also pertinent to the economy owing to; the number of jobs it creates and the need for self-sufficiency in food production. Hence, during the year we saw a pronounced mix of interventionism and protectionism adopted towards the sector by both the CBN and the federal government to drive growth. The CBN continued to intervene in the agriculture sector via the Anchor Borrower's Program (ABP), now in its fourth year, while also declaring its intention to add milk and other dairy products to the list of 41 items banned from receiving FX for imports.

To check the impact of smuggling on the domestic economy, the Federal Government ordered the complete closure of the land borders. The move created a demand gap in the agricultural value chain, given that the country is yet to achieve self-sufficiency in most food items, particularly in rice. Thus, we expect to see more investments in the agricultural value chain which will boost local capacity and support growth in the sector.

Several state governments including Kano and Edo, have kickstarted various initiatives geared at increasing agricultural production, while the CBN is also expected to continue its intervention schemes to the sector. However, downside risks such as insecurity in some food-producing states, flooding, irregular rain patterns and poor infrastructure may limit the extent of growth we are likely to observe. Also, it is unclear how long the border closure will persist in 2020 as the move goes against Nigeria's assent to the African Continental Free Trade Agreement (AfCFTA) and its membership of the World Trade Organization. We posit that the benefits of the land border closure on the agricultural space would only be sustainable if the country can

find lasting ways to control her porous borders in collaboration with her neighbours.

Non-Oil Sector Growth to Remain Modest

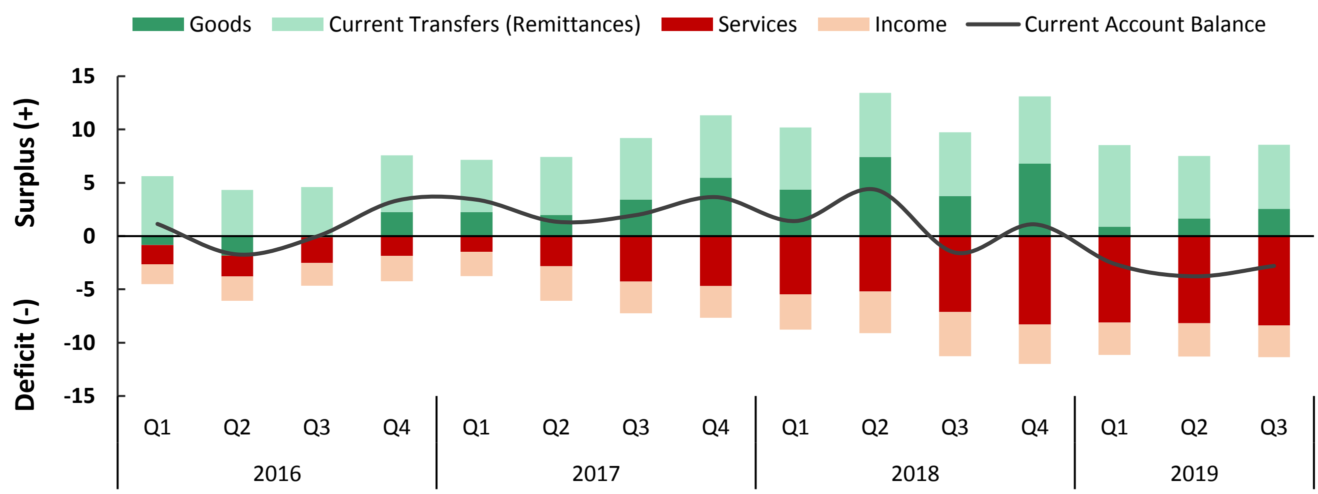
We are encouraged by the improved credit levels extended to the real sector and are optimistic about the level of growth obtainable by this initiative. However, our optimism is tempered by the earlier highlighted operational challenges besetting the economy. Thus, we have modelled a relatively conservative growth of 2.32% for the non-oil sector in 2020. We expect stronger performance from the agricultural sector due to the increased investments in boosting local capacity. We also expect the Telecommunication sector to maintain its trend of double-digit growth fuelled by growing smartphone penetration and increased foray by Mobile Network Operators (MNOs) into mobile financial services. Growth in the manufacturing and trade sector is expected to remain weak due to the challenges with poor road infrastructure, inefficiencies from the Apapa Port and an unreliable power sector.

Current Account

2019 Ends in Deficit

As at Q3:2019, Nigeria's current account deficit was USD9.17bn, from a surplus of USD4.23bn over the same period last year, representing 2.31% of our GDP in 2018. While a sharp decline in the trade balance for goods (-79.66% YoY) alongside a widened deficit in the trade balance for services (-47.96% YoY) accounted for much of the deficit in the first quarter, the trade balance for goods improved in Q2 and Q3, with the deficit for services as the main driver of the widening deficit.

Chart 5: Current Account Balance



Source: CBN, Meristem Research

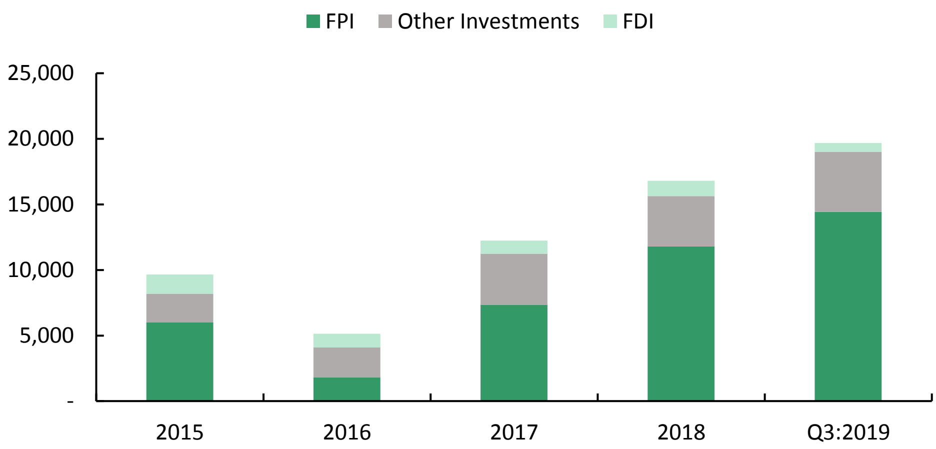
Weak Oil Receipts Pressure Trade Surplus Position

Nigeria's trade surplus has gradually risen since the poor start in Q1:2019 to reach USD5.11bn in the third quarter, although this is much lower (-67.10% Y-o-Y) than its corresponding cumulative balance of USD15.54bn as at Q3:2018. The trade balance has been dragged by the fall in global oil prices relative to last year and weaker export volumes, in the face of stronger total imports. Examining figures from the NBS, total exports as at Q3:2019 stood at NGN14.42trn, representing a growth of just 2.65% over Q3:2018 figures, with the country's oil exports declining by 3.78% YoY. On the other hand, total imports have surged by 27.71% YoY driven largely by increased imports of machineries and appliances even though oil imports continue to moderate (-29.62% YoY).

Nigeria Remains Attractive to Foreign Portfolio Investors

The CBN has sought to cushion the effect of the current account deficit on the country's reserves and support the naira by keeping interest rates attractive enough to foreign investors. Thus, capital inflows into the country continued to improve in 2019 and by the end of Q3:2019, the cumulative capital inflows had already surpassed capital inflows for 2018 by 22.34%, at USD14.44bn. Foreign portfolio investments (FPI) continue to account for the bulk of inflows into the country, of which over 80% have been destined for the money market space, while Foreign Direct investments (FDI) continue to underperform, standing at an aggregate of just USD666.34mn (4.62% of total inflows) as at Q3:2019. **The low level of FDI inflows reflect the weak confidence on the economy; the lack of structural and market reforms, and the yawning infrastructural gap are some of the main factors spooking foreign direct investors.**

Chart 6: Capital Inflows into Nigeria



Source: NBS, Meristem Research

Current Account Deficit to Widen in 2020

For our outlook, we expect supply side factors, chiefly, our lower oil price expectations and the OPEC's cap on Nigeria's oil production, to limit the upside attainable on the country's export growth. Also, we are encouraged by the growth in non-oil exports albeit, we do not expect it to significantly impact export volumes given that crude oil still accounts for over 87% of total exports. On the demand side, the CBN has sought to curb the country's import by indicating its intention to add more goods to the list of items restricted from receiving FX. In addition, the border closure has resulted in a drop in PMS imports which should eventually see oil imports normalize to the levels required by the country.

Going forward, we expect the services deficit to widen by 16.63% to -NGNG39.30bn in 2020 given growing demand for services. Current transfers into the economy have remained consistent over the years and we do not expect any deviation on this item. Hence, we expect the surplus position in current transfers to improve by 6.98% in 2020 to USD28.10bn. Income outflows to foreign providers of capital should persist in 2020, fueled largely by payments to foreign direct investors. Thus, after careful consideration of these factors, we expect the current account deficit to widen by 12.79% to USD9.99bn in 2020.

Fiscal Policy

National Budget Gyrates to Familiar Tunes

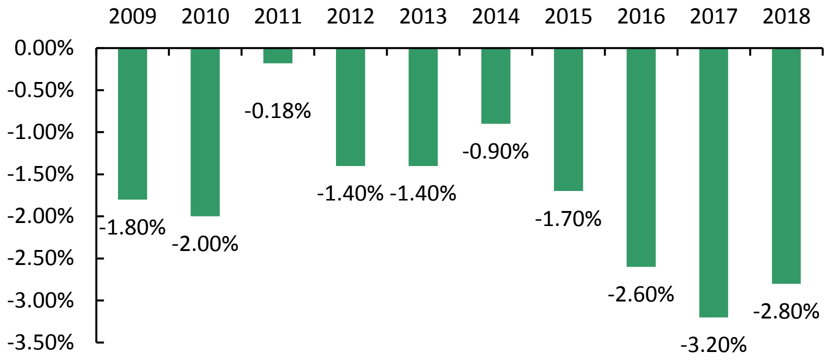
The National Assembly finally passed the 2019 Budget of Continuity, five months after it was presented by the President. With a proposed expenditure of NGN8.83trn, the Budget was premised on the assumptions that oil price will remain at *or above* USD60 per barrel, daily oil production will average 2.3 million barrels and Interbank exchange rate of NGN305/$1. The Budget also accommodates an ambitious revenue projection of NGN6.97trn, which implies a budget deficit of NGN1.86trn. **The penchant to spend way in excess of revenue generation over the years continues to drive the country's increasing debt burden.**

The 2019 budget deficit was to be financed by privatization proceeds and borrowings from domestic and foreign sources. Unsurprisingly, there have been major shortfalls across different segments of the Budget. According to the most recent figures (H1:2019), total expenditure was 23.96% shy of budgeted spending while there was a 42% shortfall in projected revenue, reaffirming the need for more borrowings to finance the deficit.

Unrealized One-Off Revenue Targets Impedes Budget Performance

Budgeted revenue pro-rated for the first half of the year amounted to NGN3.50trn out of which NGN2.04trn was realized, indicating a revenue performance of 58.39% for the six-month period. As expected, oil proceeds contributed the lion share, contributing 44.14% (NGN900.42bn) to the bulk of revenue, although still 51% short of its target for the half year. Non-oil revenue target for the period was 87.22% achieved. Projected income from one-off activities continued to drag actualization of the revenue target. Revenues from FGN's share of signature bonus, joint ventures, domestic recoveries, earmarked funds, grants and donor funding amongst others remained unrealized by the end of the first half of the year.

Chart 7: Budget Deficit as a Percentage of GDP



Source: Budget Office, Meristem Research

Capital expenditure as at the third quarter stood at NGN294.63bn, 18.77% of planned expenditure (Budget Office of the Federation).

…What Holds for 2020?

Tagged as the Budget of Sustaining Growth and Job Creation, the 2020 Budget was presented in October 2019, breaking a 10-year record of delayed budgets, a demonstration of the FG's resolve to normalize the budget cycle. The key assumptions of the 2020 Budget include an average crude oil production of 2.18 million barrels per day, oil price of USD57 per barrel, an exchange rate of NGN305 per USD, inflation rate of 10.81%, and a GDP growth rate of 2.93%.

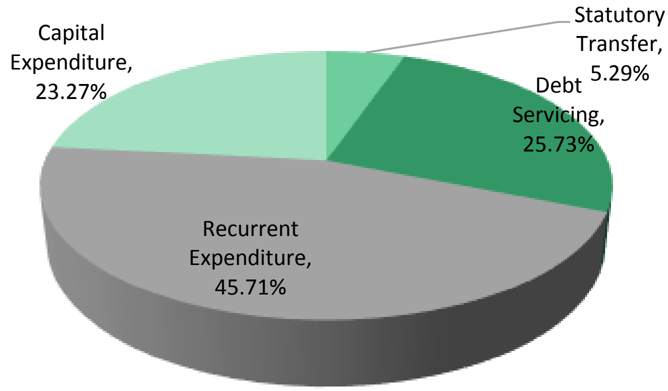
In our opinion, the assumptions on economic growth and crude oil production are overly optimistic, given the current economic realities and the oil production caps by OPEC+ (which pegs the crude output of the country at 1.75MMbpd). This already indicates that the chance of attaining the projected 2020 revenue of NGN8.16trn is low, which itself is 7.44% higher than the 2019 revenue projection of NGN7.59trn. Oil revenue is projected at NGN2.46trn (or 34.70% of total), non-oil revenue of NGN1.81trn (21.55% of total), while proceeds from independent sources, exchange rate differentials and sundry income are expected to make up NGN3.75trn. The budget shortfall of NGN2.43trn is expected to be financed primarily by borrowings, representing 33% of the total revenue and 3.78% of the Gross Domestic Product (GDP) (versus the 4.46% ERGP revenue projection for 2020).

Capital Expenditure Takes a Cut in the 2020 Budget

The 2020 budget expenditure is pegged at NGN10.59trn, indicating a 5.16% increase from the 2019 budget size of NGN10.07trn. Despite the increase in the budget size, capital expenditure unfortunately went under the knife, taking an 18.72% cut from NGN2.93trn in 2019 to NGN2.47trn in 2020. CAPEX was pressured by the rising cost of debt financing and provisions for the upward review of the minimum wage. **The lower capital spending underscores the**

need for reforms and fiscal discipline; the need to cut the cost of governance cannot be more obvious, in the face of rising debt service charges (which accounts for more than half of revenue).

Chart 8: 2020 Budget Components



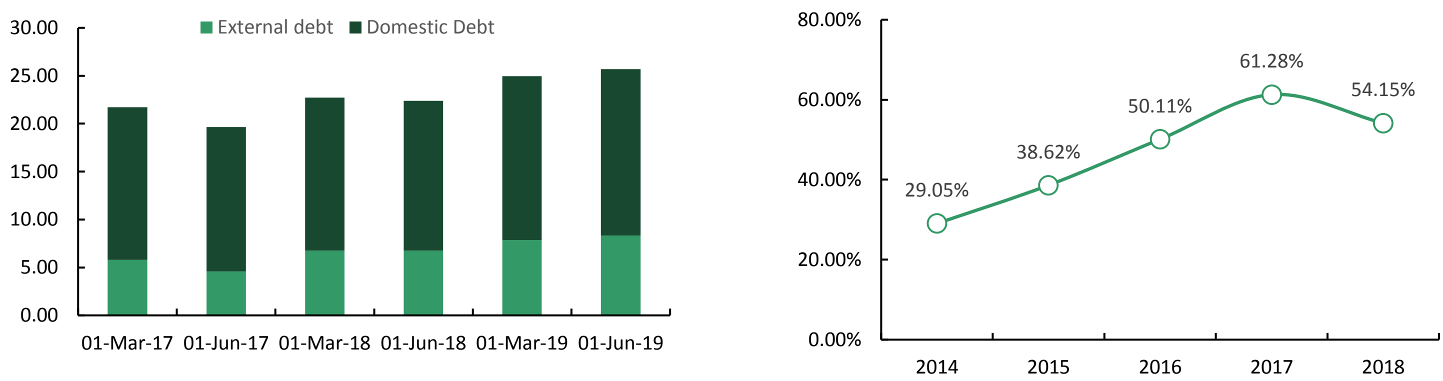
Source: Budget Office, Meristem Research

Debt Profile

Debt Sustainability Remains a Concern

The issue of Nigeria's rising debt profile has always generated concerns about the nation's economy and governance. As at June 2019, public debt stood at NGN25.70trn, increasing year-on-year by 14.84%. Domestic debt accounts for 67.62% of the total debt stock, while external debt make up the remainder at NGN8.32trn (32.38%). Debt to GDP stood at 19.09% as at December 2018, well within the 25% ceiling according to the Fiscal Responsibility Act, and below the World Bank/IMF threshold of 56% for Nigeria's peer group countries. However, the more disturbing metric for the nation remains the debt service to revenue ratio of 54.15% as at 2018. The ratio reflects the unsustainability of the country's increasing debt profile, and rising vulnerability to default in the event of a significant underperformance of projected revenue.

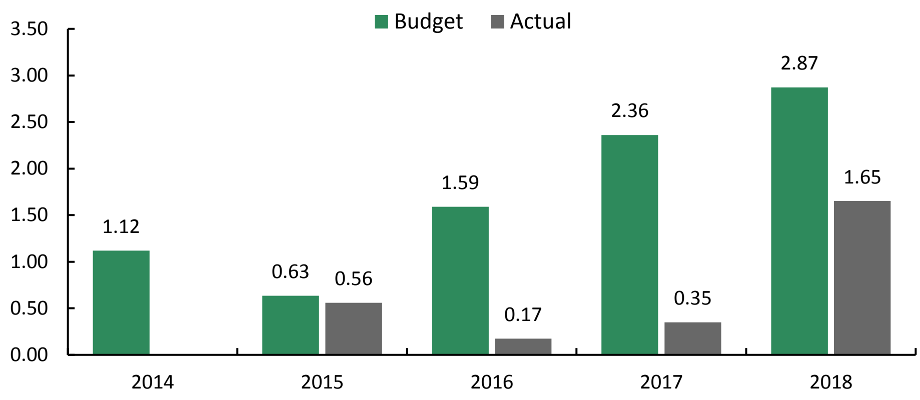
Chart 9: Total Public Debt Profile (NGN'trn) and Actual Debt Service-to-Revenue Trend



Source: Budget Office, BudgIT, Meristem Research

Previous borrowings are purported to have been channelled towards infrastructural development which should drive economic growth and improve revenue accruable to the Government through increased taxes. However, analysis of budget performance reveals the underperformance of planned capital expenditure. In 2016, only NGN173.01bn was released according to the budget implementation report and as at September 2019, NGN350bn was released for capital expenditure according to the Minister of Budget and National Planning. With the low performance of capital expenditure, revenue growth from non-oil sources cannot be effectively exploited.

Chart 10: Capital Expenditure (NGN'trn) Performance



Source: Budget office, BudgiT, Meristem Research

The Government continues to drive initiatives aimed at shoring up the revenue from non-oil sources, through the review of extant tax laws. Yet, revenue challenges for Nigeria remain, given inadequate infrastructural development and low diversification of the economy. The high dependence on oil receipts continues to pressure the economy's outlook in 2020 given the forecast for oil revenue in 2020.

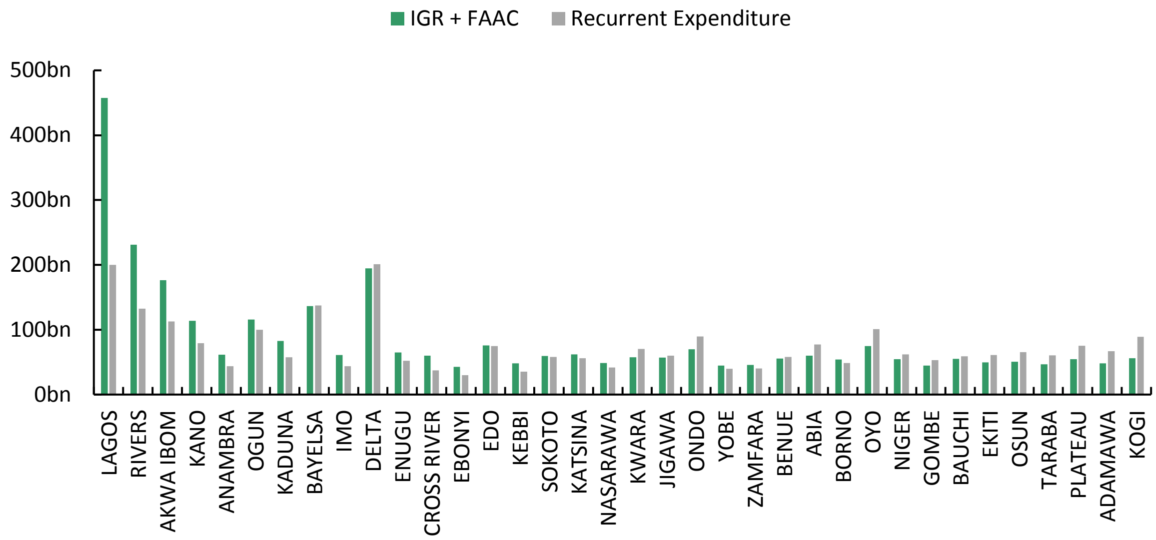
Hence, with a budget deficit of NGN2.18trn in 2020 to be financed mainly by borrowings, and the historical underperformance of budgeted revenue, we hold that the FG's expected debt service to revenue ratio of 31% in 2020 may be understated.

We expect the country's debt stock to trend upwards in 2020; already the World Bank has approved a USD3bn credit facility to expand transmission and distribution infrastructure in the power sector. The FG has also requested approval for a USD29.96bn loan for infrastructural development**. The cost of debt servicing is therefore set to surge, as the recent credit downgrades by Moody's and Fitch highlight the preference of investors for higher premia. This may prompt the Government to raise more domestic debt in 2020 at lower costs**.

Review in Minimum Wage Weighs on Recurrent Expenditure

The National Minimum Wage was last revised in 2011 and has been long overdue for another review since 2016, according to the Nigerian labour law, which mandates a re-assessment every five (5) years. Following prolonged negotiations between the Trade Union and the Federal Government, an agreement was reached to raise the minimum wage from NGN18,000 to NGN30,000. The implementation of the wage structure will result in a 24.97% spike in personnel expenditure in 2020.

Chart 11: Juxtaposing Total Revenue with Revenue Expenditure across States



Source: Budget of States, Meristem Research

Provisions for the new minimum wage were duly incorporated in the 2020 budget, contributing to the 24.97% surge in personnel expenditure (excluding pension, gratuities and retiree benefits) from NGN2.45trn to NGN3.06trn. To put this in perspective, the portion of personnel expenditure to total expenditure in the 2020 budget stood at 23.12%, slightly lower than the budgeted amount for capital expenditure (24%). The opportunity cost of increasing salaries appears to be the investment in critical infrastructure and social programs that could set the stage for long term economic development and poverty alleviation.

Finance Bill to Provide Concession to MSMEs

The Finance Bill successfully passed its second reading at the Senate in November 2019. Its objectives include to promote fiscal equity, raise revenue to support the Government's Budget, reform domestic tax laws, support MSMEs and introduce tax incentives. The Bill proposes to offer palliative measures to the ailing business environment, enhance financial inclusion while providing support for the budget shortfall. Riddled with several outdated references, the Finance Bill proposes an amendment to the Stamp Duty Act, one of the oldest laws in Nigeria. The amendment is intended to facilitate cashless transactions, raising the minimum threshold for the NGN50 charge on Point of Sale (PoS) transaction from NGN1,000 to NGN10,000. In a similar vein, the Bill proposes to amend the Customs Excise Tariff Act, by subjecting the importation of excisable products to excise duties at the same charges that apply to local manufacturers.

In Nigeria, there are over forty (40) million Small and Medium Scale enterprises, employing over sixty million people, which represents eighty per cent of the entire labour force. In a bid to stimulate the economic environment, the Finance Bill makes provisions to ease the financial burden on MSMEs (Micro Small and Medium Scale Enterprises) in their early years of operation. Concessions are provided to exempt businesses with revenue less than NGN25mn from the payment of Company Income Tax (CIT) and Value Added Tax registration (VAT). In addition, a lower CIT rate of 20% will apply to medium-sized firms with revenues between NGN25mn and NGN100mn. **The passage of the bill should boost the growth of the MSME sector and the economy in general and attract private investment in the country.**

VAT Rate to Rise to 7.5%

One of the major provisions of the Finance bill is the proposed increase in the Value Added Tax (VAT) rate by fifty per cent (50%). In its quest to prop-up non-oil revenue and adjust tax rates in line with global practice, the Federal Government created the 2020 budget on an assumption of a 7.5% VAT rate. Nigeria's VAT unarguably ranks amongst the lowest worldwide and in 2018, VAT collection reached a record high of NGN1.1trn, which was just 0.9% of GDP. In other Commonwealth and ECOWAS countries, VAT to GDP rate averaged 3.8%, according to the International Monetary Fund (IMF).

The fifty per cent (50%) hike in VAT is set to push prices of Vatable goods and services northwards, especially at a time when there are existing pressures on inflation resulting from the closure of land borders. This may weaken consumer spending and contract the growth of the economy as spending on discretionary products and services such as tourism and non-essential food items declines. According to the 2019 Multidimensional Poverty Index, over ninety-eight million Nigerians live in extreme poverty and as such, increase in prices, even though marginal, coupled with the persistent rise in inflation will inevitably shrink the purchasing income of consumers further.

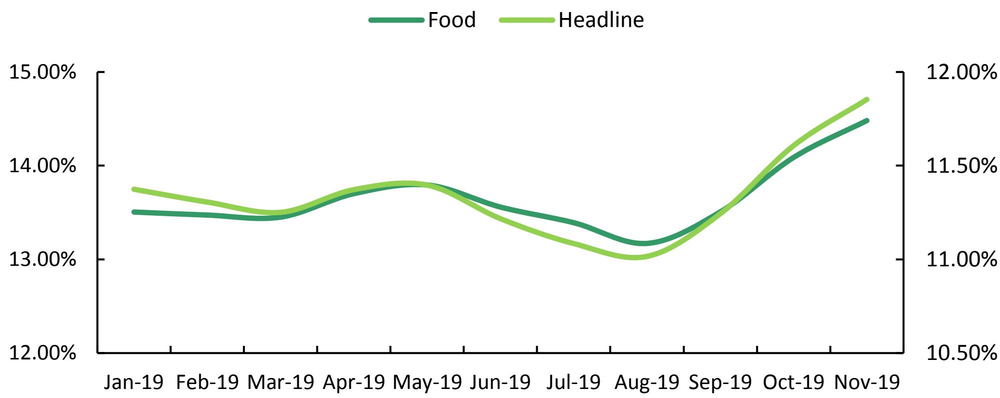
While the increase will allow the Government to fund its higher wage bill, we believe widening the tax net and reducing the cost of governance would have been a better alternative given the tough business conditions. Also, the fact that the current VAT Act does not allow for deductions on overhead, services and general expenses will only raise costs for businesses.

Inflation

Rise in Food Prices Drives Inflation Higher

The downward trajectory in the inflation rate held up till the first quarter of the year, dropping by 19 basis points to 11.25% by the end of the quarter. The general price level however picked up, following an uptick in food prices in response to lower inventory levels and weather-driven supply side factors like erratic rainfall which disrupted agricultural output on one hand, and higher demand due to the festivities during the period on the other. Subsequently, the Food Index rose briefly to 13.79% YoY in May (the highest level since May 2018), driving headline inflation higher to 11.40% as Core inflation continued to ease. The inflationary pressures however eased up, and headline inflation resumed its downward trajectory, reaching a 43-month low of 11.02% in August. This did not last as the Federal Government shut all land borders to curb smuggling, improve border security, and force her neighbours to comply with ECOWAS guidelines with respect to the rules of origin. Headline inflation rate promptly rose sharply by 0.84% to 11.85% as at November as the prices of staples like rice, vegetable oil, sugar, and others spiked.

Chart 12: Headline and Food Inflation



Source: National Bureau of Statistics, Meristem Research

Inflation Risks Tilted to the Upside

The outlook for inflation is tilted to the upside in 2020; the effect of the continued closure of the border on food prices, implementation of the new minimum wage, revision of electricity tariffs and the increase in Value Added Tax (VAT) are some of the factors driving our outlook.

Sustained Pressure on the Food Index

The recent rise in food prices due to the land border closure remains a significant risk to food inflation. We expect continued pressure on the Food Index to last through the first quarter, and this may be extended depending on the FG’s stance on the closure of the border. Although a joint task force of security agencies in Nigeria and her neighbours had been formed to enforce compliance of the ECOWAS trade protocols, the posturing of the Nigerian Government suggests the closure will extend beyond Nigeria. In addition, the cyclical depletion of food inventories should keep food inflation high until the first half of the year when agricultural produce hits the market.

Effect of New Minimum Wage Expected to be Minimal

The implementation of the new minimum wage will also commence in 2020 at the Federal level and across many states (about 15 States are yet to conclude negotiations with their workers' unions). This injection of liquidity poses further risks for inflation, although its impact on purchasing power should be muted by higher prices of goods as manufacturers and service providers pass on the hike in VAT rates to consumers.

Electricity Tariff Reviews will cause a jolt in prices

The Nigerian Electricity Regulatory Commission (NERC) has revised the Multi Year Tariff Order (MYTO) in alignment with current economic realities. Hence, effective from January 2020, residential, commercial, and industrial customers will pay about an average of 55%, 67%, and 57% more in electricity bills respectively. This will pressure core inflation higher, especially given the non-discretionary nature of electricity consumption.

We expect these risks to keep inflation elevated during the year. Hence, we project year end headline inflation at 11.89% with an average of 12.28% in 2020.

Monetary Policy

Unorthodox Methods to Force Lending

The Monetary Policy Committee (MPC) in March 2019 voted to cut the Monetary Policy Rate by 50bps to 13.50%, to signal its pro-growth stance. The Committee cited improvements in the performance of the non-oil sector, moderation in inflation, accreting foreign reserves, and stability in the exchange rate as bases for the decision. Lending to the private sector however did not improve in response to the rate cut.

The Central Bank, running out of patience with the low rate of lending to the private sector, took bolder measures to force the matter. Consequently, the Loan-to-Deposit Ratio (LDR) for commercial banks was reviewed from a cap of 80% to a minimum of first 60%, and then 65% at the end of September 2019, with a deadline of December 2019, with penalties for defaulting banks. **While this has improved credit to the manufacturing and agricultural sectors, we are cautious to buy the hype of the apex bank over the reduction in NPLs over the period as a sign of progress. The drop in NPLs is the result of an expansion in gross loans, the denominator in the ratio. Constraining banks to grow their loan books without de-risking the lending environment will potentially increase the stock and the ratio of NPLs down the line. This will only increase the vulnerabilities in the financial system, a development we doubt the economy can bear at this time.**

MPC to Hold Rates Despite Heightened Inflationary Pressures

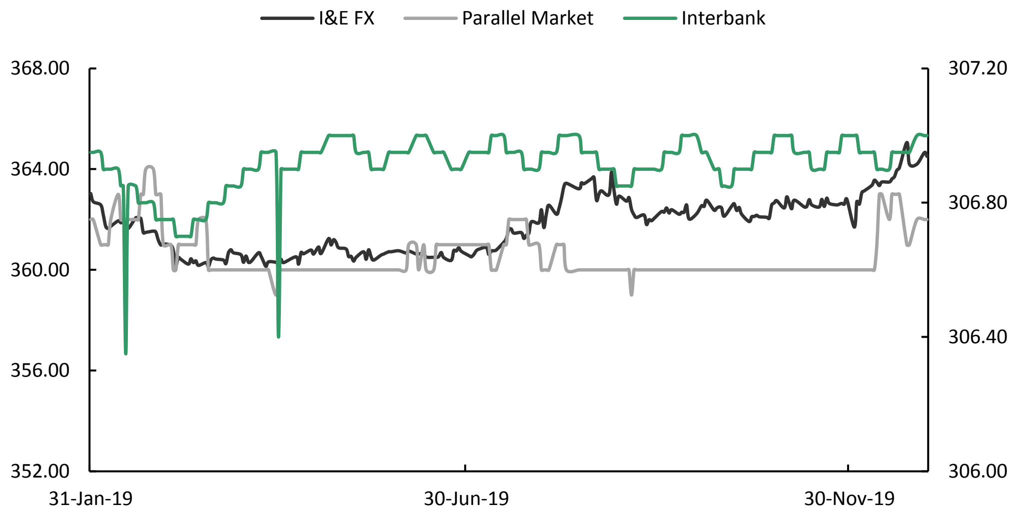
The Committee, since the cut in MPR to 13.50% in March maintained the policy rate, along with other policy variables at their current levels for the remainder of 2019. In what we hope was a recognition of the limits of monetary policy in stimulating growth, it called for fiscal measures to strengthen the growth of the economy and reduce its vulnerability to shocks through reforms. The *stay of execution* was also to allow for the evolution of inflationary pressures and some of the policies in play, especially in the banking sector and the closure of the country's land borders. **Our outlook on inflation shows that risks are tilted to the upside and maintaining price stability will be the overarching objective of the Committee. These risks should restrain the MPC from further reducing the rate. Should the inflation rate breach the 13% level, we expect the MPC will act to stem the tide by reviewing the rate upwards. We see this happening only in a bear case.**

Exchange Rate

CBN Sustains Naira Defence as Currency Risks Mount

The Naira remained relatively stable through 2019, averaging NGN361.90/USD at the I & E FX market. Despite the sustained pressure on Nigeria's external reserves due to foreign portfolio outflows, the Naira remained steady at NGN362.00/USD at the parallel FX market and similarly maintained stability at NGN307.00/USD at the Interbank market as at 31st December 2019. The relative stability in the currency is reflective of the efforts of the CBN at defending the Naira. The spate of interventions in the forex market however dwindled in Q4:2019, evidenced by a marginal depreciation of the Naira by 54bps to NGN364.51/USD.

Chart 13: Exchange Rate (NGN/USD)



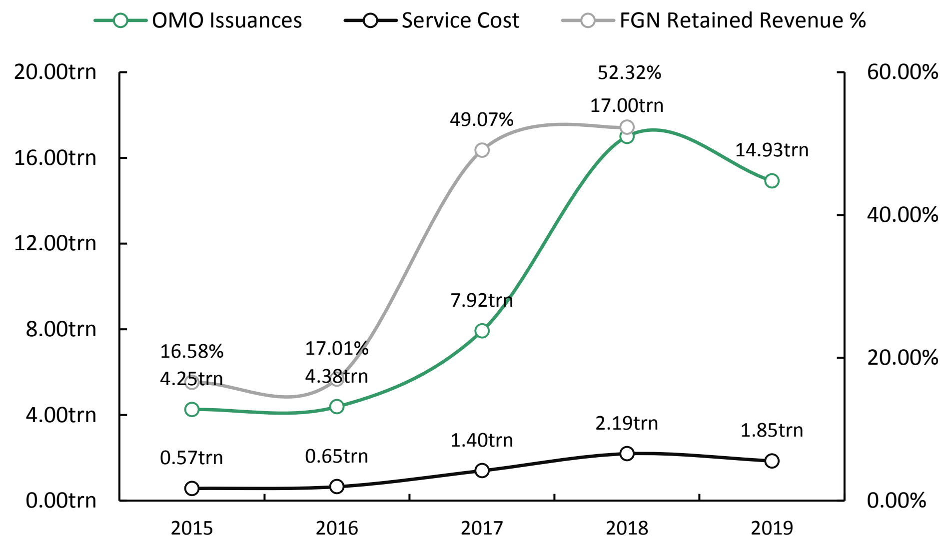
Source: CBN, Meristem Research

How Long Before Reserves Position Trigger a Devaluation?

At the start of 2019, Nigeria's external reserves witnessed stable accretion, triggered by progressively positive oil prices and relatively stable production, peaking at the tail end of the first half to USD45.18bn (10th June 2019) from USD43.08bn at the start. Reserves however began a free fall in the second half of the year, reaching a low point of NGN38.82bn as at the 23rd of December 2019 due to declining oil receipts, increased capital flight and the aggressive FX interventions by the CBN to defend the currency. In the final quarter of 2019 alone, the reserve position lost at least USD3.17bn.

The resolve of the CBN to continue its policy of interventions in the FX market and hence, the stability of the Naira is anchored on the external reserves position of the country. The Central Bank Governor had guided in the past that this policy stance will not change unless the external reserves and crude oil price fall below USD30bn and USD30pb. Making the OMO market the exclusive preserve of foreign investors has been touted as a further step to maintain FX liquidity and the stability of the exchange rate. This is however at a huge cost – currently, the debt service costs (interest portion only) of the CBN on OMO is at least 52.32% of the retained revenue of the Federal Government. In 2019, the CBN issued NGN14.93trn in OMO bills. In 2018 and 2017 respectively, the numbers were NGN17.00trn and NGN7.92trn. Overall, the CBN has issued OMO bills of NGN48.48trn since 2015 at an average stop rate of 14.23%, translating to total interest cost of c. NGN6.90trn on OMO alone since 2015.

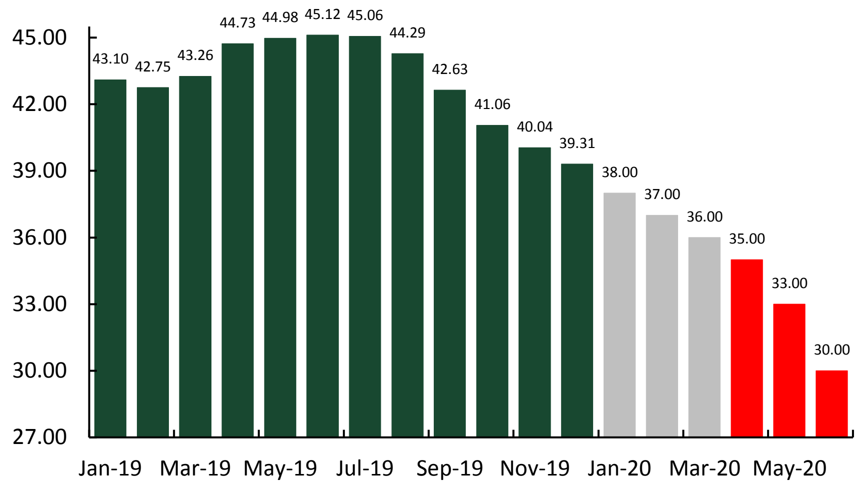
Chart 14: OMO Issuances come at a Huge Cost



Source: CBN, Meristem Research

The sustainability of this policy has therefore come under intense scrutiny, and rightly so. Apart from the depletion of the reserves and its impact on the sovereign risk rating of the Government, the policy makes the economy more susceptible to external shocks which may trigger sudden capital flight.

Chart 15: Foreign Reserves Movement and Forecast



Source: CBN, Meristem Research

While the CBN has offered to play in the secondary market to assuage the liquidity concerns of foreign portfolio investors, the unconventional measure is certain to spook foreign portfolio investors, which in itself may trigger further outflows, making the CBN's stance counterproductive, although this risk should be tempered by high crude oil prices in the year.

Nonetheless, the question of currency devaluation continues to simmer. This was one of the dominant questions at this time last year and our view has not changed much. We hold that exchange rate stability was one of the main achievements of the CBN Governor and given the impact of this variable on inflation and the performance of the real sector, we get the sense that he will do whatever it takes to achieve this. Evidence of this lies in the unconventional measures to sustain liquidity in the FX markets. As long as the external reserve adequacy ratios remain healthy, we expect the Bank to continue pursuing its FX strategy. From January 2020, the reserves will cover at least c. 9 months of imports (based on an average monthly import bill of NGN1.29trn as at Q3:2019, and the official exchange rate of NGN307/USD) which is adequate. At 4.37x, the Reserves to Short-Term-Debt ratio also appears enough. However, amid declining foreign investor confidence in the capital market and other weak macroeconomic variables, a currency devaluation could be in the offing. A sharp devaluation of the exchange rate under current economic realities could incite further economic volatility and weaken the recent currency devaluation in 2016. This could, in turn, ruin the progress made by the Monetary Policy Committee in terms of forex and price stability.

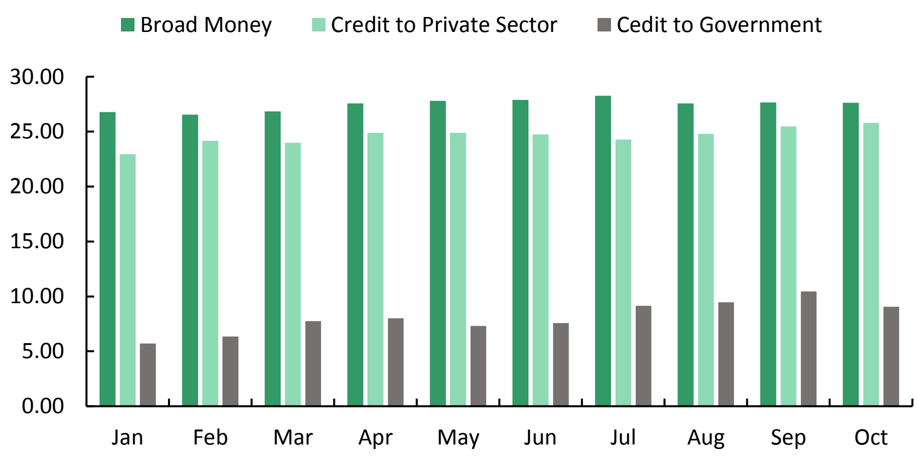
We therefore expect the FX intervention to continue at least till H1:2020, after which the state of crude oil prices and the external reserve position will test the resolve of the bank to continue its defence of the naira. If these hold true to the stated thresholds, the strategy will continue. We expect FX inflows in the form of foreign borrowings, grants and other infrastructure support facilities from multilateral institutions to plug budget deficit to boost the foreign reserves and ease the pressure on the currency. Hence, the exchange rate should hover around NGN360-NGN365/USD by FY2020.

Money and Credit

Appreciable Growth in Credit to the Private Sector

M2 (Broad money) grew by 6.12% YoY in October 2019, while base money inched up by 1.63%, based on the 0.94% increase in bank reserves and the significant growth (5.11%) in currency in circulation. During the year, the CBN issued regulatory directives to Deposit Money Banks to improve lending to the real sector. The Apex bank reviewed the Standing Deposit Facility (SDF) downwards to NGN2bn and changed the Loan-to-Deposit ratio from a maximum of 80% to a minimum of 65%, while giving priority to SMEs, Retail, Mortgage and Consumers in terms of lending. Consequently, net domestic credit spiked by 29.57%, hinged on improved lending to the private sector (11.49%) and credit to the government (141%). It is important to note that the private sector grew for the third consecutive month in November (1.30%) while credit to government declined by 13.41% in November (the first in five months).

Chart 16: Trend in Money and Credit



Source: Central Bank of Nigeria, Meristem Research

The recent policies by the CBN which includes the upward revision of LDR for banks from 60% to 65%, highlights the apex bank's push for more lending to the real sector of the economy. So far, there has been appreciable progress in this regard and the possibility of further review of the LDR for banks cannot be ruled out in 2020. We envisage that these initiatives at boosting private sector lending will be integral to driving growth in the real sector of the economy, however, the banks must ensure the quality of these risk assets.

Trade Policy

AFCFTA…Ready to take on the Challenge?

In 2019, President Buhari finally assented to the African Continental Free Trade Agreement (AfCFTA) in Niger Republic; a move that could serve to drive multilateral trade and grow the economy. The agreement aims to promote intra-African trade by establishing a single continental market for goods and services, provide business opportunities that will enhance industrialization while enhancing competitiveness and diversifying Africa's trade. Sequel to the signing of this agreement, the President has since inaugurated the National Action Committee for the Implementation of the agreement.

The AfCFTA is divided into two phases. The first phase encompasses the framework of the agreement, protocols for trade in goods and trade in services and the mechanism for dispute resolution. The other phase however focuses on investment, competition policy and intellectual property rights. Although, the operational (first) phase was initially scheduled to commence on July 1, 2020, negotiations on rules of origin and schedules of tariff concessions are still ongoing and this is expected to continue through to the end of 2020.

The AfCFTA agreement offers opportunities for sustainable development and economic growth in the African economies, yet, the extent of these benefits will differ on a country-by-country basis. More so, a few of the benefits of the trade integration which includes production efficiency, are expected to materialize in the long term. Concerns remain about the full scope of this agreement and the availability of institutional capacity to effectively implement these policies. Likewise, the fear that the agreement could render Nigerian manufacturers less competitive and promote some dumping if the rules of origin are not adhered to, remains a bone of contention. Nonetheless, we expect the Federal Government to put in place regulations that will aid trade and enhance the ease of doing business, while ensuring that the full benefits of this agreement accrue to Nigerians.

Polity and Security

Tensions Cool in Aftermath of General Election

Since the conclusion of the general elections, the polity has been relatively calm. Aggrieved candidates took their cases to the election tribunals, with some dramatic outcomes. Tension however rose when the Presidency communicated its intention to establish a Rural Grazing Area (RUGA) Settlement Scheme across the country, as part of efforts to put the perennial herdsmen and farmers' conflict in the bud. The RUGA initiative however met with widespread criticism, with fears that it is a ploy for land grabbing. The initiative has since been suspended.

In 2020, we expect rerun elections (28 of them) across several regions while gubernatorial elections in Edo and Ondo States will draw fireworks that we expect to remain local.

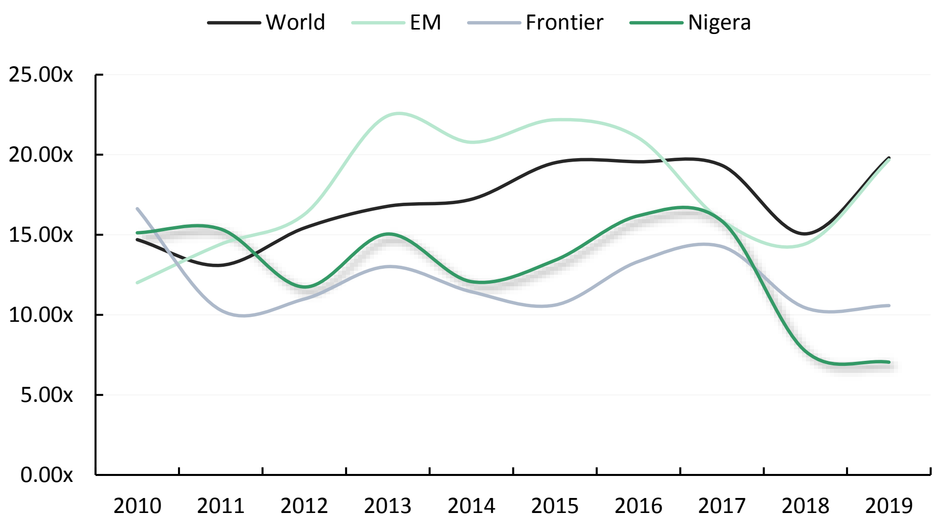
The continued war against insurgency in the North East and the fight against corruption should also continue to dominate the political landscape. Overall, we expect the political space to remain calm, although that sector is hardly unexciting.

Domestic Equities Market

Market Valuation Slumps to a Decade Low

The mood in the Nigerian equities market was largely bearish throughout the year, laced with short bursts of excitement at different times. Early trading sessions in the year were dominated by pre-election jitters, which prompted caution on the side of investors. The All Share Index (ASI) thus continued its bearish run from the previous year to settle below 30,000 points in January – the first time since May 2017. The market gradually rallied in the three (3) weeks leading up to the elections, in hopes of a win for the main opposition candidate (who was perceived as being pro market). The gains however quickly receded following the reelection of the incumbent, a signal that much was not going to change in the economic policy for the next four years; continued intervention in the currency market, retention of fuel subsidy and a seeming disinterest in implementing required structural reforms. These impaired sentiment towards the equity market, worsened by the unimpressive earnings performance across different sectors of the market. This ensured the bears dominated the market for much of 2019, driving valuations levels to historical lows.

Chart 1: P/E Ratios Over the Last Decade



Source: Bloomberg, Meristem Research

Enter the Knight in Yellow Armor

The long-awaited introduction of **MTNN** to the Bourse in May altered the course of the market, following successive months in the red since the conclusion of the general elections. The shares of the company were listed on the NSE by introduction and the ensuing frenzy to own the stock resulted in a five-day surge, during which it helped to trim the loss in the NSEASI by 10.27%. The market eventually reverted to its bearish trend with the local bourse shedding 4.06% over the next couple of sessions as investors took their profit on the stock and sold off across other large caps stocks in the banking, consumer goods, industrial and oil and gas sectors.

Similarly, in early July, **AIRTELAFRI** completed its dual listing on both the London Stock Exchange (LSE) and Nigerian Stock Exchange. At a market cap of NGN1.36trn, **AIRTELAFRI** instantly became the third largest capitalized stock on the Exchange, behind **DANGCEM** and **MTNN**, and increased the presence of telecommunications companies on the Exchange. However, its listing price was considerably higher than the share price of **MTNN** and failed to spur the same kind of rally as **MTNN** did as the bears stripped off 18.98% of its share price, after the first three days of trading.

CBN Policies Looms Large Over the Markets

The Central Bank of Nigeria (CBN) kickstarted the second half of the year by serving a series of circulars aimed at improving lending to the real sector, the sixty per cent (60%) minimum Loan to Deposit Ratio (LDR) requirement for banks and a review of the remunerable daily placements by banks at its Standing Deposit Facility. This roiled the market and resulted in the **NSEB10** index losing 9.19% in July. Furthermore, upon failure to meet the minimum LDR requirement, **ZENITH**, **GUARANTY**, **UBA** and six other banks were fined NGN499bn. The penalty dampened investors' confidence on these counters, resulting in further share price losses of 7.61%, 14.73% and 5.69% respectively in October.

With the persistence of the market downtrend, for much of the second half, the NSE reviewed its pricing rules regarding the minimum trade quantity required to change the prices of a stock. This was aimed at ensuring market stability and pricing efficiency. Under the new regime the minimum quantity of a stock that must be traded in order to change its price was reviewed to one hundred thousand (100,000) units for all categories of stocks.

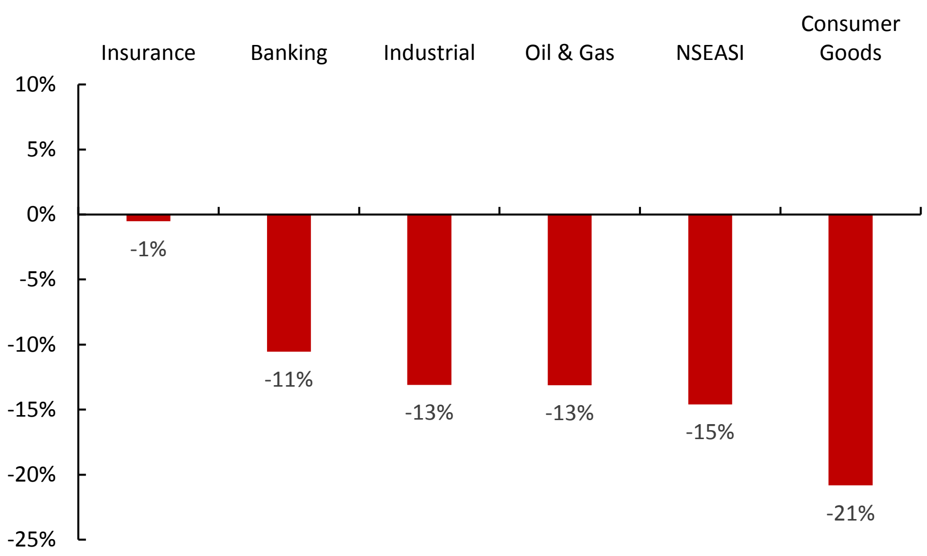
The market showed some resilience in November, as the market recorded a rare four consecutive weeks of gains. The announcement by the CBN to restrict domestic investors and non-banking institutions from participating in the OMO market sent investors scouring for attractive yields on other asset classes. With yields subsequently falling in the Treasury Bills Market, there were some inflows into the equities market, which lifted the **NSEASI** by 2.45% to 27,002.15pts.

However, by December, the bulls began exiting the market, putting a halt to the nine-year streak of positive December returns. The market recorded losses on four consecutive weeks, worsening the year to date return to -14.60%.

Consumer Goods Sector, the Poorest of them All

All the NSE sectoral indices closed the year in the red zone with the **NSEFB10** (which tracks the consumer goods sector) ending the year as the worst performer (-21%). Most consumer goods companies have had to endure major headwinds such as weak consumer spending, smuggling, worsening infrastructure and inefficiencies at the Apapa port. The effect on their performance has been telling, with most consumer goods companies recording weaker earnings during the year. However, news of the border closure along with CBN's OMO directive, spurred positive sentiment on the sector during the fourth quarter, with the **NSEFB10** gaining 4.48% over the period, it was too little, and too late.

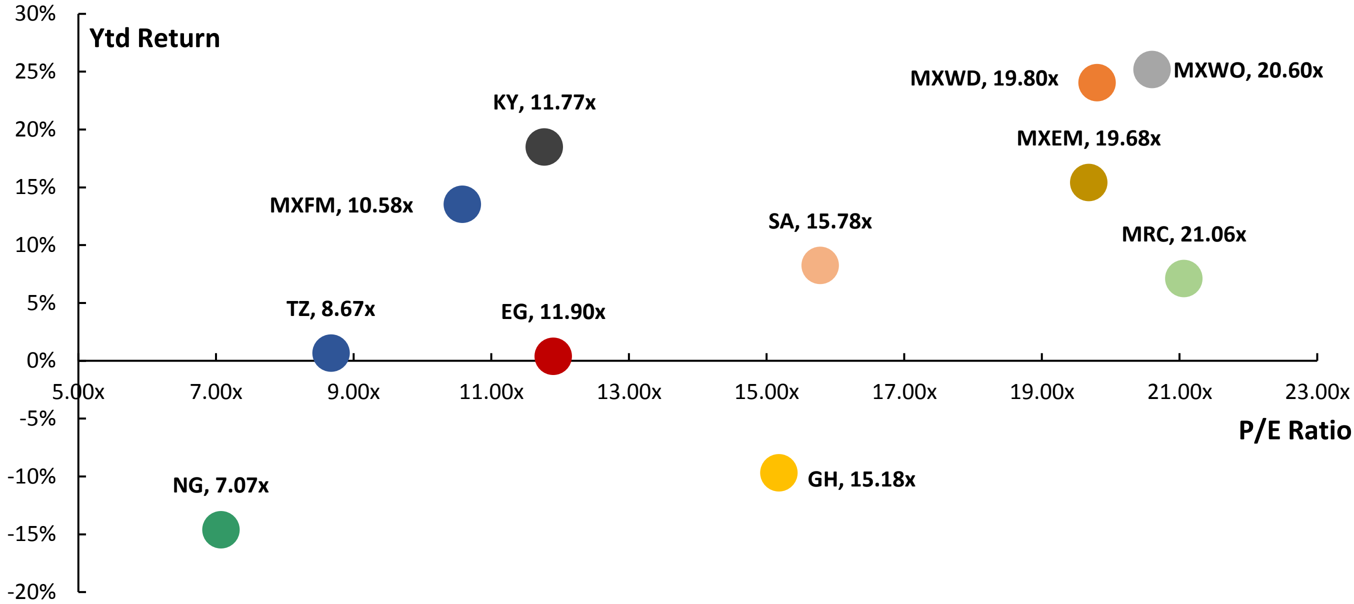
Chart 2: 2019 Return of Sectoral Indices



Source: Bloomberg, NSE, Meristem Research

The performance of the market for the year contrasted that of its peers in Africa and emerging markets. The major concern for investors lies in the uncertainty of macroeconomic policies and the lack of reforms to strengthen the country's weakening fiscal position.

Chart 3: P/E Ratio and 2019 Return of the NSEASI and Other Selected Market Indices



NG = Nigeria, TZ = Tanzania, GH = Ghana, EG = Egypt, SA = South Africa, KY = Kenya, MRC = Morocco, MXEM = MSCI Emerging Market Index, MXFM = MSCI Frontier Markets Index, MXWO = MSCI Developed Markets Index, MXWD = MSCI World Index

**P/E Ratio as at 31st December 2019*

Source: Bloomberg, Meristem Research

Outlook

As we pointed out in our last outlook, the market performance during the first half of the 2019 was defined by political uncertainty in the build-up to the general elections. However, post-election, it was replaced by uncertainty in the policy space and weak economic growth, which dampened investor sentiment as most investors opted for the haven provided by fixed income assets. In 2020, we expect the following to drive market activities:

- **Excess Liquidity from the Money Market:** With the CBN policies in the money market sending rates crashing, the equities market is expected to see some inflows in 2020. Hence, we expect gains in the market to be driven by excess liquidity from OMO maturities, some of which should end up in the equities in search of the attractive dividend yields and potential capital gains.
- **Depressed valuation has not been enough and that will not change:** Emerging market equities have become very cheap, relative to advanced markets, making them attractive for global portfolio managers. With the accommodative stance by many Central banks in advanced economies, rates are set to remain low for longer. However, country specific risks will direct the flow of these funds; in Nigeria's case, low growth and persistent Government intervention in the market are factors which have dampened

investors' interest. Nevertheless, we expect cherry-picking of fundamentally sound counters to drive activities in the market.

- **Hunt for Dividends:** Lower equities prices has made dividend yields very attractive. We expect many of the dividend paying tickers to sustain distributions in 2020 and investors angling for a slice portends an improvement in market activities.
- **Foreign Participation**: Foreign investors mostly stood on the sidelines in 2019, with net FPI outflows from the equities market totaling NGN84.53bn as at November 2019. With OMO yields still proving attractive to foreign investors, their appetite for the equities market will most likely mirror the trend observed in 2019.
- **Corporate Earnings**: Our outlook for full year earnings is weak; dampened by the weak performance of most consumer goods, industrials and downstream oil and gas companies as at 9M:2019.

Table 1: Corporate Earnings Outlook

Sectors	Earnings Growth Expectation				Remarks
	Strong	Moderate	Low	Negative	
Banking		✓			Growth in loan volumes will support interest earnings while interest expense should trend downwards
Insurance		✓			We expect the growth in premium income to persist however, high claims payments may be a drag on earnings
Flour milling		✓			Earnings are expected to remain modest given the constraint on consumer spending although their performance has been boosted by the border closure
Brewery			✓		We are not optimistic about performance given the prevailing industry headwinds.
Industrial Goods			✓		The sector is in a low growth phase hence, we expect volume sales and price growth to remain modest
Healthcare		✓			We expect the improvement in top line and cost efficiency to boost earnings performance in 2020
Oil and Gas			✓		We expect moderate growth in earnings for upstream players, but margins will be depressed for downstream operators due to the high landing cost environment

The risks to the market outlook appear balanced, we are therefore not particularly bullish about the equities market this year, even if we do not rule out that more clarity in the policy space and introduction of desired reforms may spur the market.

Banking

2019 proved to be another challenging year for the banking industry, with the financial performance of banks coming under pressure from major headwinds which include weak economic growth, a declining yield environment and volatile regulatory landscape. Nonetheless, the banks remained resilient amidst these challenges, as majority recorded growth in revenue and earnings, while only a few witnessed marginal dips in performance.

Earnings Improve Amid Lower Yield Environment

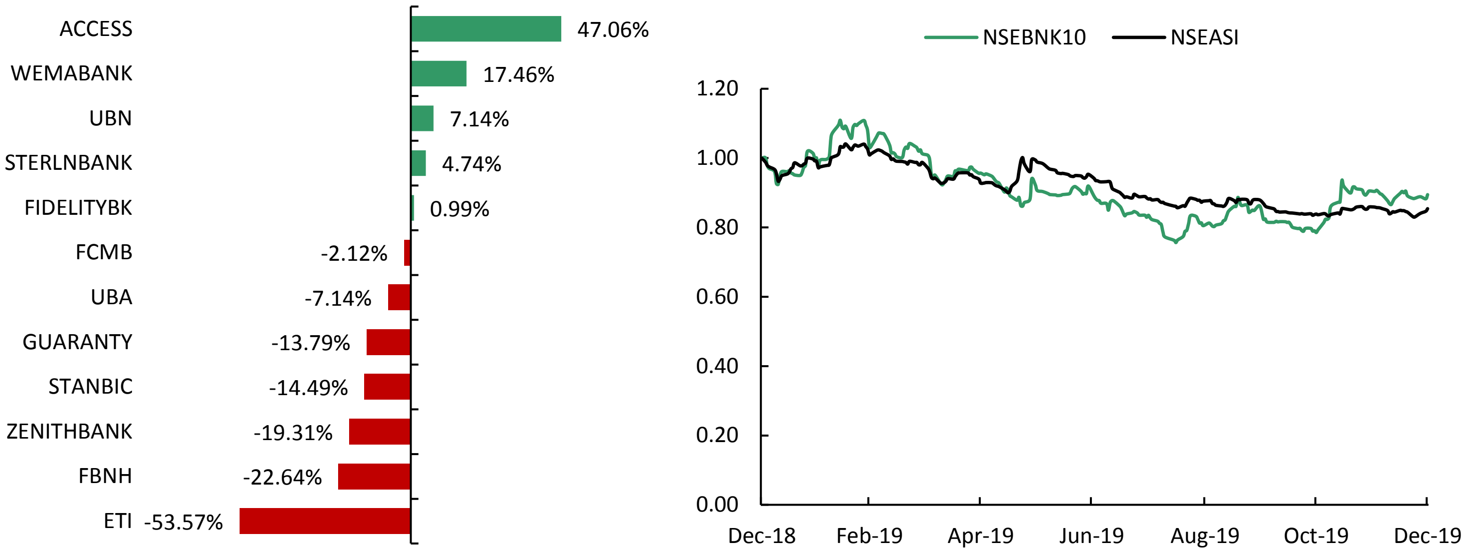
As at 9M:2019, the 12 banks under our coverage grew aggregate gross earnings by 3.82% to NGN3.58trn, from NGN3.45trn in the corresponding period in the previous year. Lower interest income performance was a recurring theme across most banks during the year, a trend which was largely driven by a general decline in loans and advances to customers across banks, prior to the introduction of the minimum LDR regulation in July. The quandary was further compounded by a lower yield environment relative to last year, although to a lesser degree. Asides Access Bank, which was an outlier due to its merger with Diamond Bank, only Wema Bank (+26.10%), UBA (+10.77%) and Fidelity Bank (+12.56%) grew their interest earnings substantially during the period as interest income remained relatively flat across the other banks. On the other hand, interest expenses were on the upswing (+2.88%), with a more marked growth than interest income (+2.57%), despite the lower cost of funding environment compared to last year, leading to a contraction of average net margins across our coverage banks (6.72% in 9M:2019 vs 7.05% in 9M:2018).

The non-interest line across our coverage banks witnessed further expansion in 2019, fueled largely by higher fees and commission income which stemmed from an increase in transaction volumes. This compensated for lower trading income and one-off revaluation gains recognized in 2018 due to the transition to IFRS 9 reporting. In addition, the relative stability of the Naira meant that the banks were unable to record significant FX related gains. There was a general decline in impairment charges across the banks (-42.81%) due to an improvement in asset quality, although operating costs grew by 2.88%. Overall, there was a double-digit expansion (+10.32%) in net profit across our coverage banks to NGN715.42bn as at 9M:2019, while the average Return on Equity (ROE) improved by 50bps to 17.02%.

CBN's Policies Weigh Heavily on Sector Share Performance

The banking sector index closed the year as the second-best performing sectoral index in 2019, although just like the **NSEASI**, the **NSEBNK10** index also closed in the red for the year at -10.55%. Most of the gyrations in the share price of the banks were largely influenced by adverse investor reactions to CBN's policy pronouncements on the banks despite their decent earnings performance. The selloffs reached a peak in August when the **NSEBNK10** index plunged to its year low of 301.72pts (-24.37%), with several banking heavyweights touching their year lows. However, shortly after, **ACCESS** began a remarkable bullish run after successfully completing its merger with Diamond Bank and announcing yet another acquisition, this time in Kenya. This spurred renewed investor appetite for banking stocks, with the index gaining 3.74% in the fourth quarter. However, except for **ACCESS**, other Tier 1 banks never fully recovered from the shock of CBN's policies which led to a negative close for the year for these counters. Expectedly, the sector remains undervalued relative to the broader market, with a P/E ratio of 3.39x compared with 7.10x for the NSEASI.

Chart 4: Share Price Performance of Banking Universe



Source: NSE, Bloomberg, Meristem Research

Financial System is Stronger but Still Vulnerable to Shocks

The health of banking sector has gradually improved since the credit distress of 2016, with the industry NPL ratio dropping to 6.67% in Q3:2019, from 11.67% as at 2018FY. On this backdrop, the CBN has hinted at a possibility of further raising the minimum LDR limit to 65% at some point in the 2020 due to the appreciable growth in bank credit and the decline in NPLs. While this provides support for CBN's policy directive, we would like to highlight that the health of the financial system is not yet out of the woods.

Considering the figures from the CBN's banking sector stress test as at December 2018, the results indicate that the banking sector could withstand up to 75% growth in non-performing loans (NPLs) and with any NPL growth above the 100% threshold, the industry Capital Adequacy Ratio (CAR) would fall below 10%. This easily suggests that the banking system is relatively stable, given that 100% growth in NPLs from its level as at Q4:2018 would be mean an additional NGN1.79trn which might seem improbable. However, we would like to point out that in just one quarter between the end of Q4:2015 and the end of Q1:2016, industry NPLs grew by 100.50% and by the end of 2016, industry NPLs had grown by over 200% from 2015. This implies that another scenario where we have a 100% growth in NPLs is very possible, given the short timeframe the banks have to provide credit to the private sector which will have dire consequences for the industry, considering the fact that CAR of some banks are still reeling from the effect of the transition to IFRS 9. Thus, we reiterate that it is important for the CBN to adopt a cautious approach towards credit growth to avoid building up vulnerabilities in the financial system.

Banking Ecosystem Set to Welcome New Players

The banking ecosystem has gradually witnessed the influx of new entities necessitated by CBN's desire to increase financial inclusion amongst the unbanked population. In 2019, MTN Nigeria was granted a Super-agent license, while Flutterwave (a payments solution company) was granted an approval in principle by the CBN. Similarly, MTN and Airtel are in the process of securing an approval from the CBN for the Payment Service Bank (PSB) license, which would further increase the number of players in the financial system. Also, the CBN issued new licenses to two commercial banks (Globus Bank and Titan Bank) and a non-interest bank (Taj Bank) with a likelihood of more players entering the space in coming years.

Given that Nigeria's target of 70% inclusion in formal financial services and 10% inclusion in the informal sector, as contained in the 2020 National Financial Inclusion Strategy (NFIS) will likely not be met, we are likely to see the CBN intensify its efforts to achieve this objective in the coming years. For one, we expect the CBN to finally grant the PSB license to MTN and Airtel in 2020 seeing that the process dragged on for a while and no significant activity has taken place in that space since its introduction in 2018. This would finally allow the Telcos roll out their mobile money strategies which has a greater potential of improving the financial inclusion rate faster than has occurred so far.

What More Policies Should We Expect in 2020?

Much of the developments in the banking sector in 2019 were shaped by the CBN's policies and this heightens regulatory risk for the coming year. The CBN adopted a much tougher stance towards the banks during the year by releasing various circulars aimed at improving credit to the real sector. This has yielded appreciable growth in industry credit and the CBN has hinted at a possibility of raising the minimum LDR to 70% at some point in 2020. Also, the CBN made a number of reviews to its cashless policy initiative (See our September Monthly Banking Sector Update), while also reviewing most of banks' charges downwards, which we believe will be a net positive in boosting further growth in electronic transactions.

After analyzing the CBN governor's policy thrust for his second tenure, it is easy to understand that most of the policies introduced in 2019 are consistent with his agenda for the financial system. So far, most of the policies have been geared towards improving credit delivery to the real sector, while the BVN 2.0 initiative speaks towards easing KYC burdens and improving financial inclusion. In his speech, the CBN governor also indicated the need for the banks to maintain a higher level of capital in order to withstand potential economic shocks, which we are yet to see any policy directive geared towards achieving this. We anticipate that this might be a focus for the CBN in 2020, given that the recent directives aimed at more risk asset creation by the banks would require that they hold a higher level of capital in order to withstand economic shocks. Also, we expect to see more policies aimed at de-risking lending to the real sector which would encourage banks to lend to the real sector and ultimately assist in achieving an all-inclusive economic growth.

Sector Outlook

Higher Loan Volumes to Support Interest Income Growth

Our outlook for interest income growth is slightly bullish, hinged on the renewed growth in the aggregate loan portfolio across the banks since the implementation of CBN's minimum LDR policy. We acknowledge that the yield on earning assets in 2020 will be further depressed due to high system liquidity, in the aftermath of CBN's restriction of local non-banking institutions from participation in the OMO market, while the rush to grow loan volumes will see lending rates fall. However, we expect the overall growth in loan volumes to compensate for the lower asset yield which should result in an expansion of average net interest margin across our coverage banks. In the same vein, we expect a reduction in interest expenses due to our modest growth expectations for customer deposits as banks seek to comply with the minimum LDR policy. In addition, most banks have already begun repricing their funding base in line with the current yield environment which lends further credence to our expectation for lower interest expenses in 2020.

Revised Bank Charges to Drag Non-interest Income

For the non-interest income line, we expect the growth in E-business income across the banks to continue in the near to mid-term, fueled by greater adoption of alternative banking channels in the country. Furthermore, we believe CBN's recent cashless policy initiative will be a net positive on growing e-transaction volumes. Although, we view the proposed implementation of VAT on local online purchases as a potential drag on electronic transaction volumes when it becomes implemented. In the same vein, we expect CBN's downward review of bank's charges to pressure non-interest income in 2020. However, the reduced bank charges will likely result in the commercial banks eating into the market share of fintech companies and increase transaction volumes on the banks' platforms.

Table 2: Key Highlights of New Bank Charges

Service	New Charges	Previous Charges
Electronic Funds Transfer		
Below NGN5,000	NGN10	NGN50
NGN5,000 – NGN50,000	NGN25	
Above NGN50,000	NGN50	
Bills Payment (Including Bills Payment through other E-channels)	Negotiable subject to a maximum of NGN500 per beneficiary payable by the sender	0.75% of transaction value but not more than NGN1,200
Card Maintenance Fees		
Foreign Currency debit/ credit cards	USD10 per annum	USD20 per annum
Naira debit/credit card	• Cards linked to current account – No charge • Cards linked to savings account – NGN50 quarterly	NGN50 monthly
Debit Card Charges		
Remote-On-Us (from another bank's ATM) in Nigeria.	Maximum of N35 after the third withdrawal within the same month	NGN65 after the third withdrawal within the same month
Transaction Alerts	• Cost recovery (on customer-induced transactions) • No charge (for bank-induced transactions)	Not more than NGN4 per SMS.

Source: CBN, Meristem Research

Table 3: Valuations and Ratings

	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target PE	Exp. EPS	TP	CP	UPP	RT
ACCESS	0.10	18.4%	20.0%	1.9%	10.7	3.46	17.30	2.8x	0.6x	2.7x	4.24	11.24	10.80	4%	HOLD
ETI	0.10	12.9%	15.9%	1.3%	12.4	3.40	21.35	1.9x	0.3x	1.90	3.57	6.78	7.40	-8%	HOLD
FBNH	0.10	11.5%	11.0%	1.2%	9.5	1.86	16.85	3.5x	0.4x	3.4x	2.31	7.85	6.95	+ 13%	BUY
FCMB	0.12	8.00%	7.67%	1.0%	8.1	0.73	9.49	2.6x	0.2x	2.0x	0.89	1.78	2.09	- 23%	SELL
FIDELITYBK	0.11	12.6%	12.0%	1.3%	8.9	0.92	7.65	2.3x	0.3x	2.4x	0.95	2.28	2.23	4%	HOLD
GUARANTY	0.12	44.7%	29.7%	5.4%	5.5	6.44	21.64	4.6x	1.4x	5.2x	7.21	37.47	31.00	+ 21%	BUY
STANBIC	0.13	30.6%	24.0%	3.8%	6.3	6.86	28.53	5.5x	1.3x	5.8x	7.47	43.33	40.00	8%	HOLD
STERLNBANK	0.13	5.70%	7.84%	0.7%	11.0	0.30	3.80	6.4x	0.5x	5.8x	0.35	2.06	2.04	1%	HOLD
UBA	0.11	18.0%	17.7%	2.0%	8.9	2.88	16.24	2.4x	0.4x	2.8x	3.37	9.44	8.05	+ 17%	BUY
UBN	0.08	13.3%	7.69%	1.0%	7.4	0.64	8.31	10.6x	0.8x	10.2x	0.69	7.04	5.70	+ 23%	BUY
WEMABANK	2.14	7.36%	27.9%	15.7%	1.8	0.12	0.44	5.7x	1.6x	5.2x	0.14	0.73	0.74	-2%	HOLD
ZENITHBANK	0.11	30.9%	22.9%	3.3%	6.9	6.37	27.77	2.9x	0.7x	3.5x	6.98	24.43	20.00	+ 22%	BUY

TP = Target Price, CP=Current Price as at 31st December 2019, UPP= Upside Potential, RT = Rating, Exp. EPS = 2020 Expected EPS, BVP = Book Value Per Share, P/E= Price to Earnings Ratio, P/BV = Price to Book, EPS = Earnings Per Share, AT= Asset Turnover, NM=Net Margin, Lev= Leverage.* ***Data in the Fundamental columns are based on trailing performance*

Consumer Staples and Discretionary

The Brewery Industry

Increasingly competitive, tightly held and dynamic are words that best describe the Nigerian brewery industry. The industry has grown by leaps and bounds, registering good prospects in years past given the existence of a large market and foreign investments. However, in recent times, the Nigerian brewery industry has experienced a downturn, due to weaker sales posed by weak consumer spending, changes in consumer preferences, government regulations and other company-specific operating challenges. More so, the tussle for market share amongst players in the industry has led to an unhealthy competition between the foremost brands. As at 2017FY, Nigerian Breweries and Guinness who were the top rivals controlled the most significant share of the market (c.90%), while other regional brewers who had carved a niche for themselves at the value end of the market held the remaining 10%. However, the entry of AB-InBev into Nigeria through INTBREW, has threatened the market dominance of both NB and Guinness, whose market shares have declined consequently. INTBREW has also leveraged on its increased production capacity, having completed work and commenced operations at its new plants in Sagamu, which ranks as the second largest in Africa. Currently, NB now controls about 54.29% of the market share, Guinness (21.97%), International breweries (22.68%) while Champion breweries (CHAMPION) accounts for a meagre 1.06%. The struggles of the dominant players in the sector is underscored by their market valuation: market capitalization for NB and Guinness are NGN471.81bn and NGN65.82bn respectively, compared to four-year highs of NGN1.53trillion and NGN263.39bn respectively.

Performance So Far in 2019…

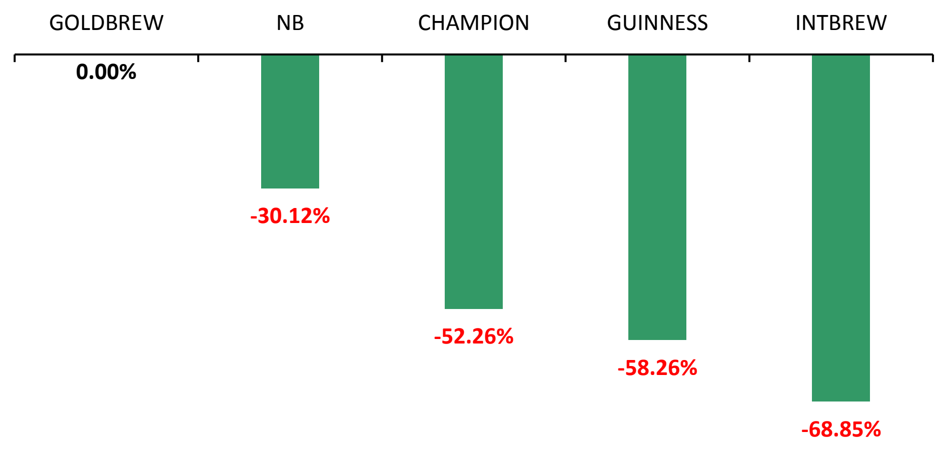
A few key themes headlined industry news this year, these are; increased excise duties on alcoholic beverages, brewers' upward price adjustment, and the prevailing weak operating conditions of industry players.

The second phase of the excise duty regime took effect in June 2019, which includes a charge of NGN35/litre (c.17%) for beer and this is expected to carry on through to 2020. Likewise, for wines and spirits, excise charges increased by 20% and 17% respectively. In response to this, industry players announced in November that prices of selected brands will be revised upwards to ease cost pressures at this time. While it is yet too early to estimate the impact of these price adjustments on overall sales, we expect that it will help alleviate some of the top-line pressures faced by the brewers as well as aid margins.

As consumer spending remains pressured, industry players have also grappled with weak sales, which in combination with rising cost of production and finance costs have led to an underwhelming performance this year. Across board, brewers have recorded declines in revenue, with the exception of INTBREW (which continues to derive post-merger benefits combined with improved operating capacity). NB's revenue declined marginally (-1.00%) in 9M:2019, and so did its bottom-line, which declined even more by 17.00% to NGN12.24bn (vs. NGN14.76bn in 9M:2018). The spike in finance cost (140.24%) precipitated a quarterly loss of NGN1.05bn in Q3:2019 alone - the second time the brewer is making a loss in the past twelve months, having posted consecutive quarterly profits for more than a decade. GUINNESS also suffered the same fate, with its performance worsened by the firm's dip in export sales (-75.17%), resulting in a 4.25% decline in revenue in Q1:2020. This drop in export sales is set to continue in the near term due to the discontinued production of Malta Guinness to its sister company, Guinness Ghana Breweries Ltd, which now produces locally**.** This, coupled with increased finance costs, gobbled up the firm's meagre profit, with the brewer reporting a quarterly loss (-144.33%) of NGN0.37bn in Q1:2020 - the first time it is doing so since Q2:2017. INTBREW, on the other hand, continues to ride on its improved capacity, recording a 16.69% jump in topline to NGN97.26bn in 9M:2019. However, cost pressures continue to weigh performance with the firm recording consecutive quarterly losses, which worsened to NGN16.45bn in 9M:2019.

These poor performances are not lost on investors and have been reflected on the share prices of these companies with NB, GUINNESS and INTBREW reaching all year lows of NGN46.00, NGN23.30 and NGN8.94 respectively.

Chart 5: Year-to-Date Share Price Performance of Listed Brewers



Source: NSE, Meristem Research

Sector Outlook: Navigating Through the Tough Times

Across the sector, performances were largely unfavourable this year, as reflected in the declines at both top and bottom lines of the brewers' financial scorecards. Weaker sales, cost of additional excise duty charges and rise in prices of raw materials remain growth constraints. To ease cost pressures, industry players guided about an upward revision at various price points. While, we believe that the current economic realities do not favour this move considering consumers' strained purse, we expect this upward review of prices to attenuate some of the cost pressures faced by the brewers.

Given the industry headwinds, brewers have in the meantime embraced cost management strategies to mitigate slow growth. This has gained traction especially with Guinness, which has recorded some success in terms of reduction in overhead costs in recent times. Likewise, NB's transformation agenda and reorganization exercise which entails strategies to drive down costs are poised to crystallize in the near term.

While downside risks remain, we expect the brewers to continue their cost management strategies to ease pressures while consolidating on their brand portfolio with high demand and impressive margins. Although, we are not upbeat about this significantly bolstering earnings, we envisage moderation in topline growth, which if combined with effective cost-cutting initiatives should spur improvement in margins.

Flourmillers

Top line Pressured by Subdued Consumer Spending

The strain on consumers' wallets precipitated by the consistent rise in prices of goods, increasing rate of unemployment and the slow growth of the economy weighed in on the performance of the consumer staples industry. The major players in the sector – Dangote Flour Mills (DFM) Flour Mills of Nigeria Plc. (FMN) and Honeywell Flour Mills Plc. (HFM) - struggled to grow top-line, the result of weakened consumer spending and the competition for market share within the industry.

The lack of improvement in local wheat production and its unsuitability for contemporary flour-based products continued to fuel the need to look beyond the borders for wheat and other raw materials. The poor state of infrastructure also persisted as a major headwind for activities in the sector, with emphasis on the congestion at the port in Apapa and the gridlock on the roads around it contributing to the woes of flour millers in sourcing for raw materials from international markets and distribution across the country. The blend of a high cost of raw materials and inflated logistics cost resulted pushed cost to sales to record-high levels. During the 2019 financial year, **FLOURMILL** recorded a cost-to-sales ratio of 89.88%, the highest in six years. The trend was similar for **HONYFLOUR** with a cost to sales of 84.53%, from 77.54% in 2018FY. The increase in cost to sales continued to threaten margins, even as top line settled at sub-par levels by 2019FY (**FLOURMILL**: NGN527bn and **HONYFLOUR**: NGN74bn). With all of these in perspective, there was little room for improvement in bottom-line, as both firms recorded net margins of 0.76% and 0.09% (down from **FLOURMILL**: 2.40%, **HONYFLOUR:** 6.19%).

Olam cements Leadership Status with Flurry of Acquisitions

Following on its acquisition of BUA Flour Mills and Crown Flour Mills, Olam's management announced its intention to acquire Dangote Flour Mills, in a move which brought its total installed capacity to 11,140Mtpd. The acquisition, worth

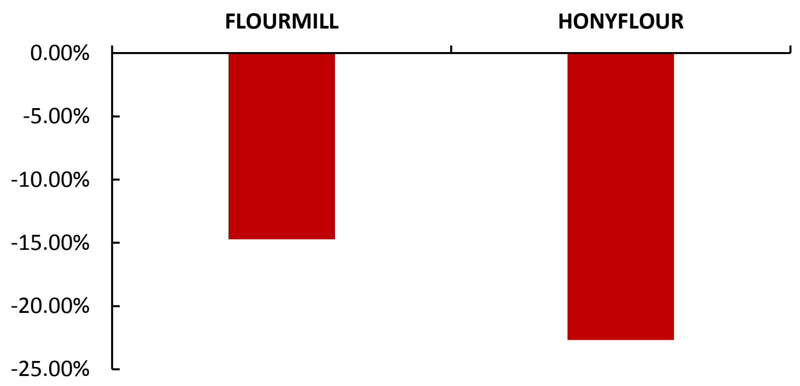
NGN120bn, cements the leadership position of Olam in the flour milling industry, significantly surpassing Flour Mills' 8000Mtpd capacity.

Also, the Honeywell Group expanded its existing capacity, completing the construction of its ultra-modern pasta factory in Sagamu. The firm restructured its production arrangement, transferring pasta production from the Ikeja to Sagamu factory.

Improvement in Domestic Capacity to Fuel Growth

We expect the Government's effort at boosting domestic production by shutting the borders in August 2019 to be matched with commensurate efforts to improve the domestic capacity for a suitable wheat variety. Nigeria currently produces about sixty thousand metric tons (60,000MT), a paltry amount, compared to the current levels of demand, estimated at about five million tons. While the excessive levels of temperature in the wheat growing areas in the North-East remain a fundamental challenge, the deficient state of mechanized farming coupled with the uncompetitive pricing continue to drag the performance of domestic wheat production. Investment in wheat production research, availability of cheap credit to wheat farmers and the improvement of capacity to produce the variety of wheat suitable to produce local staples has never been more expedient.

Chart 6: Share Price Performance



Source: NSE, Meristem Research

Sector Outlook

While the revision of the national minimum wage aims to improve the disposable income of the average citizen, the introduction of varying types of indirect taxes and tariffs in 2020 (electricity tariff, VAT, communication tax and excise duties) is set to dampen its impact. However, shutting the land borders has significantly reduced the activities of smugglers, thereby increasing patronage of locally produced items. Pasta has benefited greatly as the unavailability of foreign rice and the hike in prices of its local variants, has triggered an increase in the domestic substitute for rice- Pasta. Hence, local producers of Pasta- **FLOURMILL** and **HONYFLOUR** amongst others, have recorded considerable gains on their pasta and noodles product lines. Should the border closure be prolonged in 2020, growth from the pasta and noodles product lines should support growth in top-line.

Table 4: Valuations and Ratings

	Valuation and Fundamental Metrics														
	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target PE	Exp. EPS	TP	CP	UPP	RT
CADBURY	1.31	3.4%	10.1%	4.5%	1.3	0.69	6.84	15.3x	1.5x	18.5x	0.61	11.33	10.55	7.37%	HOLD
NESTLE	1.52	17.0%	82.7%	25.8%	1.5	58.96	71.29	24.9x	20.6x	25.0x	61.94	1,548.59	1,469.90	5.35%	HOLD
DANGSUGAR	0.89	13.2%	19.9%	11.8%	0.9	1.66	8.37	8.2x	1.6x	8.3x	1.58	13.11	15.05	- 12.91%	SELL
NASCON	0.92	9.5%	23.5%	8.7%	0.9	1.00	4.25	12.9x	3.0x	10.0x	1.36	13.63	13.95	-2.33%	HOLD
HONYFLOUR	0.58	0.1%	0.1%	0.0%	0.6	0.00	7.17	212.2x	0.1x	2.5x	0.38	0.95	1.01	-5.94%	HOLD
FLOURMILL	1.36	0.9%	3.2%	1.2%	1.4	1.18	37.06	16.7x	0.5x	8.5x	2.51	21.30	19.70	8.12%	SELL
NB	0.86	5.1%	10.3%	4.4%	0.9	2.12	20.54	27.9x	2.9x	25.0x	2.05	51.25	59.00	-13%	SELL
GUINNESS	0.83	3.0%	4.8%	2.5%	0.8	1.95	40.49	15.4x	0.7x	17.0x	1.87	31.79	30.05	6%	HOLD

TP = Target Price, CP=Current Price as at 31st December 2019, UPP= Upside Potential, RT = Rating, Exp. EPS = 2020 Expected EPS, BVP = Book Value Per Share, P/E= Price to Earnings Ratio, P/BV = Price to Book, EPS = Earnings Per Share, AT= Asset Turnover, NM=Net Margin, Lev= Leverage.* ***Data in the Fundamental columns are based on trailing performance*

Energy

Upstream

Tumultuous year ends on a High for Upstream Players

After the market downturn of Q4:2018, which saw oil prices reach multi-year lows, the recovery in Q1:2019 was very much welcome for Nigeria's upstream operators. Production had commenced at Total's newly-minted Egina Floating Production Storage and Offloading (FPSO) unit – a new, rich source of light sweet crude, favored by European refiners. However, output was constrained by the OPEC+ production caps and only averaged 1.86MMbpd as at H1:2019. Beyond OPEC quotas, producers were also inhibited by outages on key evacuation redundancies. While militancy in the oil producing area appear to be in check, outages reared their heads in the shape of a new monster – oil theft. In April, Shell, Aiteo and Total, in separate incidents, declared *Force Majeures* on exports of crude, following attacks on key pipelines, fields and pumps; the Nembe Creek Trunk Line and Amenam field inclusive. Government efforts to check militancy over the years appears to have enabled oil theft as a safer and more lucrative industry; creating budding integrated energy companies with crude siphoned from pipelines, sent to illicit makeshift refineries and refined fuel sold in the black market. The second half of the year was relatively incident-free, and OPEC increased Nigeria's production quota to 1.77Mbpd (from 1.69MMbpd). Average production growth was rather tepid though – at 1.91MMbpd, it was only 2.69% higher than that recorded in H1:2019.

OPEC has capped Nigeria's production at 1.75MMbpd for Q1:2020 based on the most recent voluntary production cut agreement. There is a sense that the group might have to extend those cuts throughout 2020. Hence, the outlook for crude oil output from Nigeria in 2020 is weaker. In 2019, Nigeria was one of the poorest conformists to the OPEC Accord and might face firmer resistance to that stance in 2020, with OPEC desperately needing to contain a glut in H1:2020. The consequence of this is negligible for small independents like SEPLAT, but more pronounced for larger majors, including Shell and Chevron who must turn off the spigots to control output. Ultimately, NNPC and IOCs will have to maximize condensate output (currently c. 200kbpd) to meet up with their revenue projections.

Moreover, Nigeria's gas production remains robust at 7.94MMscfd and should remain a key source of revenue for upstream players in 2020, given that the low gas price environment will sustain high demand levels. Operators such as SEPLAT have had to support toplines with gas offtake revenues in 2019 – oil revenue has disappointed badly due to relatively weaker prices (which should continue into 2020) and output challenges.

Revised PSC Unlocks Near-term Revenue but Impairs Long-term Investment

In November 2019, the amended Deep Offshore and Inland Basin Production Sharing Contract Act (DOIBPSCA) was signed into law by President Buhari. The Act amends the PSC Act of 1999 by making changes to Section 5, which relates to the royalty rates currently paid by Upstream Oil Companies operating under the PSC Regime. The Act specifies two bases for calculating royalties – field location and price.

The price basis recognizes the ever-dynamic oil & gas price environment and makes a provision for higher royalties to the Government at oil prices above USD20pb. As it were, this provision already invalidates the clause in Section 16 of the Act, which requires a periodic review of royalty rates. We have included the graduated royalty table based on prices.

Table 5: Additional Royalty Rates under the PSC Amendment

Oil Price Band (USD pb)	Additional Royalty Rate (%)
0 – 20	0.00
20 – 60	2.50
60 – 100	4.00
100 – 150	8.00

Source: PSC Act, Meristem Research

Several issues are immediately obvious. First, the 4th band may be irrelevant due to the outlook on oil prices in the new decade. Furthermore, the amendment stands in contrast to the proposed royalty rates under the Petroleum Industry Fiscal Bill (PIFB) of the PIB which proposes an additional 0.5% payment for every additional USD1 above USD60pb for crude oil (capped at 60%). Standard royalty rates under the proposed PIFB are also based on field location and volume of oil produced but have greater detail.

Table 6: Proposed Royalty Rates Under the Petroleum Industry Fiscal Bill (PIFB)

Onshore		Shallow Water		Deep Offshore	
Output (kbpd)	***Royalty***	***Output (kbpd)***	***Royalty***	***Output (kbpd)***	***Royalty***
First 2.5	2.5%	First 10.0	5.0%	First 50	5.0%
Next 7.5	7.5%	Next 10.0	10.0%	Next 50.0	7.5%
Next 10.0	15.0%	Next 10.0	15.0%	Above 100	10.0%
Above 20.0	20.0%	Above 30.0	20.0%		

Source: Petroleumindustrybill.com, Meristem Research

Undoubtedly, rates under the PIB favour a shift to Deepwater exploration, while they are higher under the PSC Act. A key source of uncertainty is therefore brewing for oil majors – will the royalty rates provided by the DOIBPSCA be suspended when the PIB is finally passed in its entirety? These are some of the expectations for 2020; to expedite passage of all sections of the PIB and clear the operating environment of the haze of uncertainty impeding investment.

The Nigerian Government claims that the additional royalty payments will add c. USD1.5bn per annum to revenue in the near term – which is good news for the fiscal balance, since revenue growth is stagnating. However, we maintain that this increase will hurt long term revenue potential by stalling further investment into Nigeria's upstream. It is not hard to see that other jurisdictions are sweetening fiscal terms for the oil and gas business, while Nigeria's is becoming increasingly uncertain and challenging.

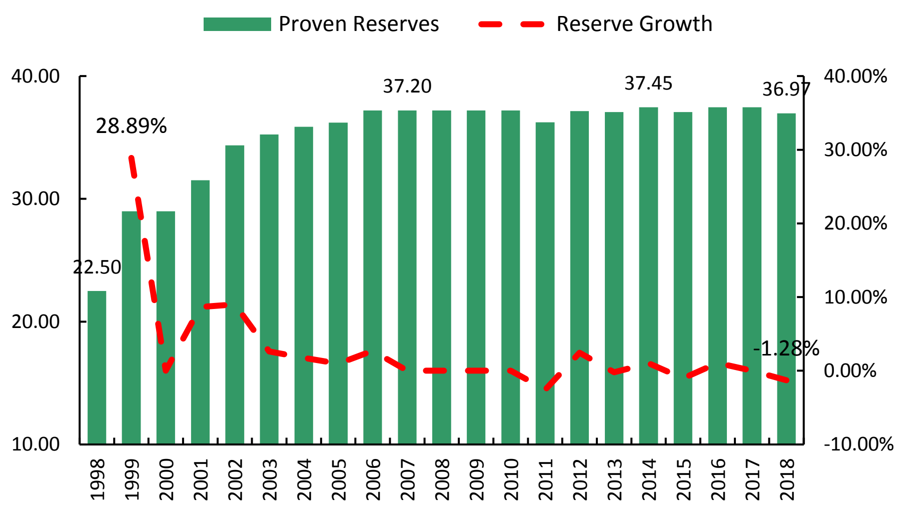
2019: New Discoveries as IOCs Sustain Divestment Drive

In 2019, ExxonMobil (OMLs 66, 68, 70 & 104) joined a growing list of International Oil Companies divesting their equity in onshore oil and gas assets in Nigeria to move further into the Deepwater region – providing scope for indigenous players to take advantage. Petrobras (OML 27 and OML 130; Deepwater) and Chevron (OML 86 and OML 88, Shallow water) are only a few of the big names that sold off oil blocs, to focus on burgeoning development in new frontiers such as Guyana, Mozambique and Brazil. Besides, fiscal terms for the oil business in other parts of the world are improving, even in Africa (Egypt, Angola and Gabon are cases in point), making them more exciting investment destinations against the backdrop of a weakening oil price environment. Moreover, Nigeria's onshore has long been prone to the activities of oil thieves and pipeline vandals, making business difficult for majors and pushing them offshore.

The spate of divestments provides strategic opportunities for independents such as Seplat, Oando and Aiteo to take on value-accretive acreages and grow their reserve base. Seplat's interest in OML 4, 38 & 41 was purchased from a consortium of IOCs in 2010 and served as the foundation for the company's leap into upstream dominance amongst independents. Oando similarly completed its acquisition of ConocoPhillips assets for USD1.5bn in 2014. However, the divestment drive by IOCs potentially births key challenges in the near term. Quite a few indigenous companies are yet to build the financial and technical muscle to acquire large onshore assets, and this might stall sale processes and operations on those blocs which does not augur well for Nigeria's production profile.

Recent oil finds in 2019 such as the Kolmani II River (Gongola, North-Eastern Nigeria) and Obiafu-Obrikom (Rivers, Southern Nigeria) are good signs, but it is important to highlight that reserve growth has stalled and is now negative.

Chart 7: Nigeria's Oil Reserves Growth



Source: OPEC, Meristem Research

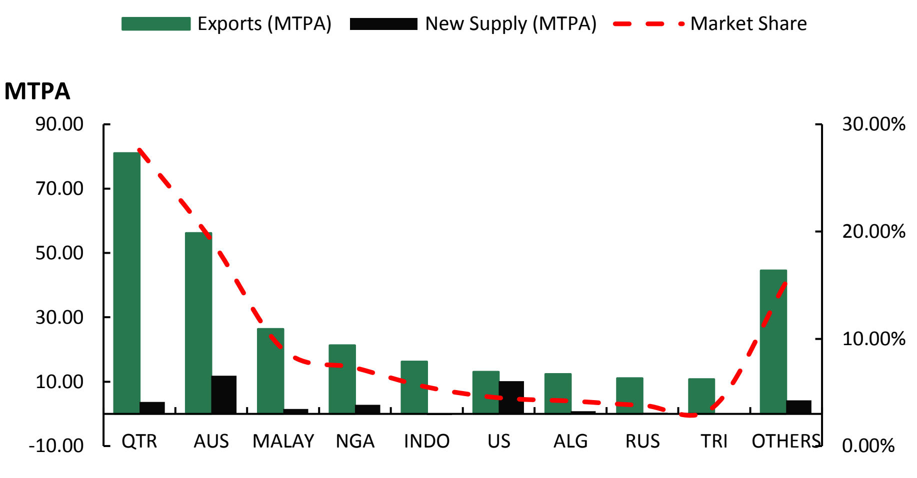
At the current production pace (1.88MMbpd), Nigeria has, at best, only 54 years until existing reserves run out.

We opine that the NNPC's output target of 3.0MMbpd by 2023 is unrealistic (to achieve this, NNPC plans a fresh oil licensing round for mid-2020) while Nigeria remains a signatory to OPEC. Then again, softer global demand and new oil finds elsewhere in the world further corroborate the impracticability of that output level. **Finally, the growing shift towards renewable energy probably dampens the urgency of reserve growth anyway, therefore, we recommend that fewer resources be dissipated in discovering new oil reserves, while the focus should be on maximizing existing oil resources and locating new gas reserves for the burgeoning international gas market.**

… as NLNG's Train 7 Gets 2024 Completion Date

The global shift from non-renewable energy and burgeoning global gas market imposes a necessity to invest in the requisite infrastructure to capture and process gas for countries that own significant gas reserves. Liquefied Natural Gas (LNG), Liquefied Petroleum Gas (LPG) or Compressed Natural Gas (CNG) could be utilized for domestic consumption, sold in the export market or used as feedstock for powering gas plants. As at 2018, Nigeria had 7.3% of the global LNG export market, with annual export of 21.3MTPA. In December 2019, the Nigerian Liquefied Natural Gas (NLNG) took Final Investment Decision (FID) on "Train-7", its 7th LNG processing unit, exactly 12 years after Train 6 became operational in December 2007. The project is worth an additional 8MTPA and will bring total export capacity to 30MTPA on completion (maintaining Nigeria's position as 5th largest LNG export country in the world).

Chart 8: Global LNG Export Powerhouses (2018)



Source: International Gas Union, Meristem Research

Train 7 is set to unlock additional tax revenues and dividend income to the Federal Government, and 2020 is such a pivotal year, as majority of the EPC contracts and commercial agreements are set to be awarded during the year.

The project also opens further gas production and monetization for Nigeria's oil majors, as 20-year Gas Supply Agreements were signed with NNPC's JV partners (SPDC, TEPNG and NAOC) as a prerequisite for signing the FID.

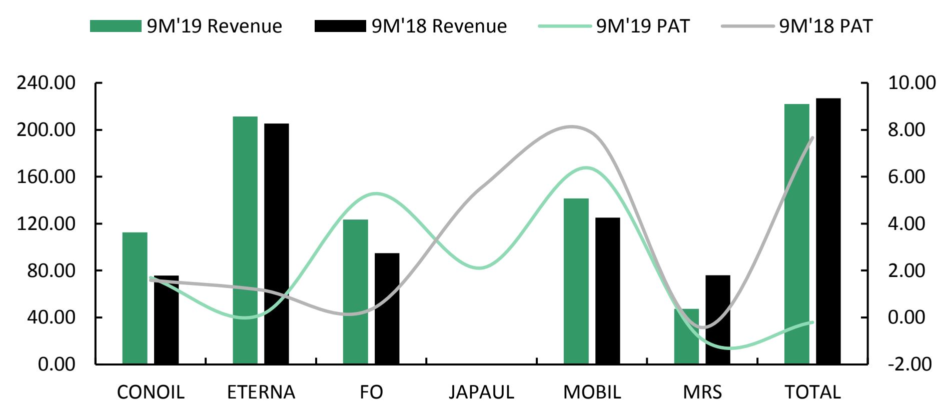
We maintain a stable outlook for listed upstream players in 2020, given the revenue opportunities from gas monetization and the minimal impact from OPEC output restrictions on OANDO and SEPLAT. Besides, SEPLAT's recent acquisition of ELAND bodes well for its oil reserves and oil production profile in 2020.

Downstream

Grim Outlook on the Downstream Segment

The narrative in Nigeria's downstream sector remained largely unchanged from 2018, although with a further shift in fortunes to the downside. In the period to 9M:2019, overall topline for listed players (ex-OANDO) ticked up by 6.69% to NGN858.66bn (vs. NGN804.82bn in 9M:2018), as industry players intensified their efforts to push products in the face of mounting competition. For TOTAL (-2.24%; NGN221.84bn), MRS (-37.85%; NGN47.28bn) and its ilk, extensive retail networks have proven inadequate in the quest for topline growth. While TOTAL shut down some of its retail outlets during the period for renovation/upgrades, MRS shifted emphasis from serving its Bulk/Industrial customers (which historically are receivables-laden) to a retail-driven strategy, a shift which has impacted its revenues in the short-term but is certain to deliver better efficiency in asset-use in the long-term. After a hiatus resulting in suspension by the NSE, CONOIL finally turned in its 2018FY, Q1:2019 and H1:2019 results in July. While its governance issues remain a critical red flag, the company is staking a claim to the crown of "downstream darling" after posting a NGN112.72bn topline (+48.64%) in 9M:2019 and significant bottomline growth, despite the prevailing environment. Bottomline growth across the segment significantly declined by 39.45% (NGN23.7bn to NGN14.39bn), albeit propped by FO's NGN5.26bn (+1,408.23%) and CONOIL's NGN1.70bn (+7.10%), as all other players recorded earnings declines. Then again, FO's result was purely a one-off income booked on the back of outstanding subsidy payments.

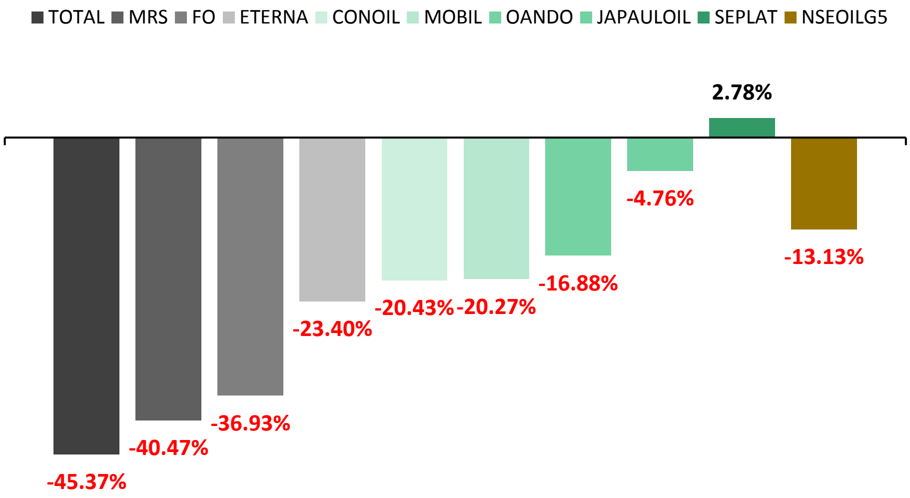
Chart 9: Downstream Revenue and Earnings (9M'2019)



Source: NNPC, Meristem Research

Share prices have reflected sentiment on the segment; the NSEOILG5 lost 13.30% in 2019, with the likes of TOTAL, MRS and FO testing new lows. The consensus is clear – the risks in Nigeria's downstream are as diverse as they are knotty. Our assessment of the downstream segment therefore remains downbeat – at least until a permanent answer to the question of high landing costs (from importation) is available. Not even lower oil prices will force down landing costs in the near-term, as freight costs for oil tankers have also gone over the roof due to higher "war premiums", in reference to tensions in the Middle East. To resolve these deep-seated issues as soon as possible, two policy cum infrastructural imperatives are urgent – developing refinery capacity and passing the PIGB.

Chart 10: 2019 Oil and Gas Sector Market Returns



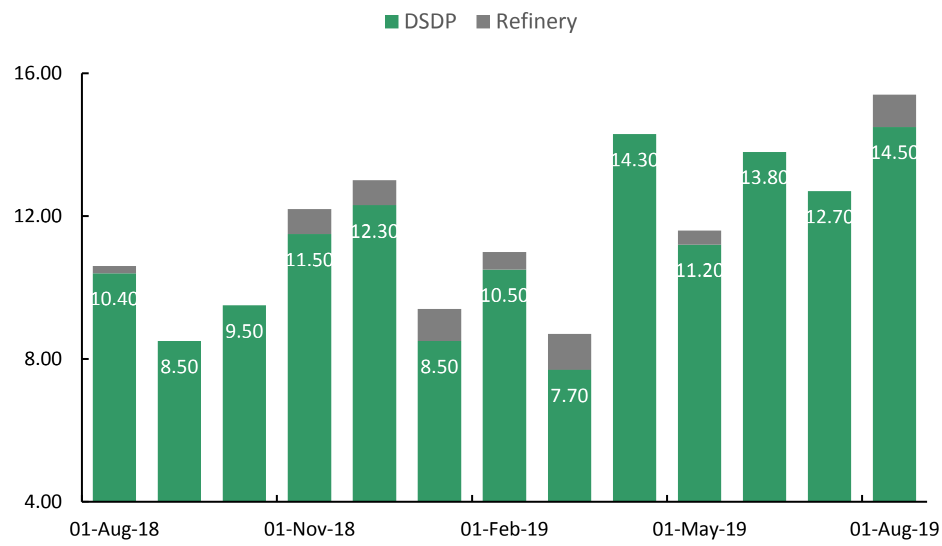
Source: *NSE, Bloomberg, Meristem Research*

Sector Outlook

Develop Refining Capacity and Improve Capacity Utilization

Domestic sufficiency in refined products is the only sustainable solution to the conundrum of high landing costs in Nigeria, otherwise, the status quo for industry players will be maintained in 2020. Nigeria's national refining capacity (including Port-Harcourt 1 & 2, Warri, Kaduna and NPDC modular refinery) is currently 446,000bpsd. Ongoing rehabilitation/renovation work at the refineries means that consolidated capacity utilization at the refineries dropped to 0.00% for July, August and September 2019 (the most recent month for which data is available). However, the highest utilization achieved in the one-year period between September 2018 and September 2019 was 13.18% in February – a poor return by any metric. To fulfil its refined product supply mandate, the NNPC had to sustain the Direct Sales Direct Purchase (DSDP) programme – a crude-for-products swap arrangement with oil traders. Between August 2018 and August 2019, 96.48% of NNPC's crude was applied to the DSDP programme, with only c. 3.52% going for processing at the local refineries. On completion of Dangote Refinery (+650,000bpsd), Other Modular Refineries (+689,000bpsd) and Other Complex Refineries (+700,000bpsd), overall refining capacity should be at c. 2.49MMbpsd. NNPC's new leadership has set a revised 2023 date for a complete overhaul of the nation's 4 existing refineries. Until then, the DSDP will remain what it is – an expensive stopgap.

Chart 11: Down the DSDP Channel



Source: NNPC, Meristem Research

Back to Basics: The PIGB should become an Act in 2020

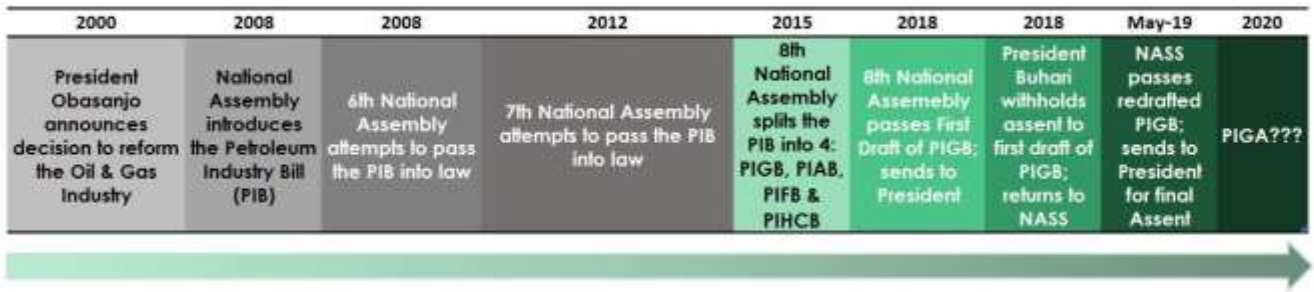
After 19 years of back and forth over Nigeria's Petroleum Industry Bill (PIB), both chambers of Nigeria's National Assembly finally passed a major component of the Bill in May 2019. Earlier in September 2018, President Buhari had refused assent to the Petroleum Industry Governance Bill (PIGB), due to concerns including:

- a disagreement with expansion of scope for the Petroleum Equalization Fund (PEF)
- Some legislative drafting concerns which, if assented to in the form presented, will create ambiguity and conflict in interpretation
- the provision of the bill permitting the Petroleum Regulatory Commission to retain as much as 10 percent of the revenue generated which could adversely impact FAAC allocations

To address these concerns, the PIGB had to be re-drafted and re-introduced at the Senate and House of Representatives and eventually passed at both Chambers. As the fears had been addressed, we envisaged speedy assent by the President, but this did not come through.

In 2020, we retain the hope that this critical piece of legislation will finally become an Act of Parliament in 2020 for a few reasons. The PIGB will be an effective catalyst for the discussion about liberalizing prices of petroleum products, and institute a proper regulatory framework for all segments of the industry. Presently, there are only two regulators in the industry (the Department of Petroleum Resources; DPR and Petroleum Products Pricing and Regulatory Authority; PPPRA) and these do not have the capacity to police the entire industry effectively.

Chart 12: Timeline of the Petroleum Industry (Governance) Bill



Source: NNPC, Meristem Research

Our outlook on the downstream segment remains downbeat, as the challenges that constrained growth of the segment in 2019 remain at the fore of conversations. High landing cost pressures and poor margins will subsist till products import is replaced with fully functional refineries. Fortunately, the Federal Government has included a provision of NGN450bn in the 2020 budget to cater for under-recovery (subsidy) expenses, which should ensure year-round products supply and maintain revenues at existing levels. However, operators' efforts at optimizing their revenue mix to favor high-margin and deregulated products (including AGO and Lubricants) are the keys to improved performance.

Table 7: Valuation and Ratings

	Valuation and Fundamental Metrics														
	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target PE	Exp. EPS	TP	CP	UPP	RT
CONOIL	2.95	1.2%	10.2%	3.5%	3.0	2.75	26.82	6.9x	0.7x	5.6x	4.53	25.37	19.00	34%	BUY
ETERNA	5.01	0.0%	-0.2%	0.0%	5.0	-0.02	9.74	-223.5x	0.4x	5.5x	0.70	3.85	3.60	7%	HOLD
FO	3.05	8.1%	75.7%	24.7%	3.0	10.18	13.44	1.8x	1.3x	8.0x	2.13	17.08	18.00	-5%	HOLD
MOBIL	2.31	4.3%	21.0%	10.0%	2.3	21.64	103.00	6.8x	1.4x	6.5x	24.88	161.72	147.90	9%	HOLD
MRS	1.43	-3.2%	-10.0%	-4.6%	1.4	-6.43	64.27	-2.4x	0.2x	498.0x	0.03	14.94	15.30	-2%	HOLD
SEPLAT	0.26	35.6%	13.6%	9.4%	0.3	124.99	921.34	4.7x	0.6x	5.5x	127.68	698.41	589.50	18%	BUY
TOTAL	2.09	0.0%	0.4%	0.1%	2.1	0.27	76.01	416.7x	1.5x	21.1x	6.17	130.19	110.90	17%	BUY

TP = Target Price, CP=Current Price as at 31st December 2019, UPP= Upside Potential, RT = Rating, Exp. EPS = 2020 Expected EPS, BVP = Book Value Per Share, P/E= Price to Earnings Ratio, P/BV = Price to Book, EPS = Earnings Per Share, AT= Asset Turnover, NM=Net Margin, Lev= Leverage.* ***Data in the Fundamental columns are based on trailing performance*

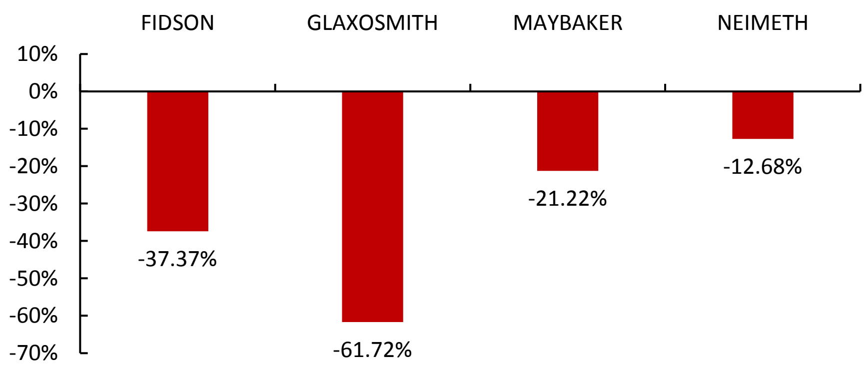
Healthcare

A Tale of Mixed Fortunes

Amidst the sluggish economic growth recorded as at 9M:2019, the healthcare sector has shown considerable level of resilience. The non-discretionary nature of the sector's products provided buffer to the industry players even in the face of constrained disposable income. In line with the steady growth in the overall market size of about USD1.50bn, total revenue of listed pharmaceutical firms inched upwards slightly by 1.82% to NGN34.45bn in 9M:2019, from NGN33.84bn in the corresponding period. The increasing adoption of alternative medicines coupled with the abundance of substitutes makes demand in the sector highly elastic (revenue becomes highly sensitive to price changes in price). As at 9M:2019, **GLAXOSMITH** and **NEIMETH** reported top-line growth of 13.90% and 14.38% respectively, driven by improved sales volume. **FIDSON** and **MAYBAKER,** however, recorded declines in revenue, which dropped by 8.48% and 9.57% respectively. Nonetheless, all the listed pharma firms recorded earnings growth over the nine-month period, except **FIDSON**. Finance costs has been a drag on the company's earnings, and this came to a head in 9M:2019 when it rose to NGN413mn and wiping off operating profit for the quarter.

In the course of the year, there were some strategic partnerships in the industry, with the potential improving productivity and efficiency in the sector in future. **GLAXOSMITH** restructured its supply chain model by transferring the manufacturing of its wellness and respiratory products to **FIDSON,** effective from Q3:2021. We expect this to translate into lower cost of sales and reduced administrative expenses for **GLAXOSMITH**. In a similar vein, **MAYBAKER** signed a contract manufacturing agreement with Sanofi Nigeria Limited to use Sanofi's World Health Organization (WHO) certified manufacturing facility to produce four products of the Sanofi brand in Nigeria and the West African market. Essentially, affiliation with an internationally recognized organization is expected to improve the brand reputation of **MAYBAKER** while also expanding its product portfolio. **FIDSON** also partnered with Ohara Pharmaceutical, a Japanese pharma firm. The deal evolved from the increase in Ohara's share in **FIDSON** to 21.75% during the rights issue. Ohara is expected to bring to the table, its cutting-edge technology, expertise and knowledge sharing to enhance FIDSON's excellence and efficiency in the Nigerian pharmaceutical industry.

Chart 13: Share Price Performance



Source: Bloomberg, Meristem Research

Sector Outlook

In 2020, we expect to see more strategic alliances as Nigerian pharmaceutical firms continue to scout for means to increase their market reach and brand presence in the most cost-efficient way. We also expect decent improvement in top-line across board driven by increased sales volume and improved public-private partnerships. In line with the aforementioned, costs are expected to hover around current levels. To spur growth in the sector, regulators will need to solidify their stance on drug counterfeiting to give more room for market players to improve top-line and bottom-line.

Table 8: Valuation and Ratings

	Valuation and Fundamental Metrics															
	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target PE	Exp. EPS	TP	CP	UPP	RT
FIDSON	0.71	-4.0%	-6.5%	-2.8%	0.7	-0.27	4.20	-9.4x	0.6x	7.5x	0.53	3.98	2.55	+56%	BUY
GLAXOSMITH	1.23	3.4%	8.0%	4.2%	1.2	0.58	7.24	9.1x	0.7x	8.0x	0.95	7.60	5.25	+45%	BUY
MAYBAKER	0.83	4.1%	5.8%	3.4%	0.8	0.19	3.21	10.7x	0.6x	10.5x	0.23	2.42	2.00	+21%	BUY
NEIMETH	0.86	9.3%	20.6%	8.0%	0.9	0.12	0.56	4.8x	1.0x	4.3x	0.18	0.77	0.56	+38%	BUY

TP = Target Price, CP=Current Price as at 31st December 2019, UPP= Upside Potential, RT = Rating, Exp. EPS = 2020 Expected EPS, BVP = Book Value Per Share, P/E= Price to Earnings Ratio, P/BV = Price to Book, EPS = Earnings Per Share, AT= Asset Turnover, NM=Net Margin, Lev= Leverage.* ***Data in the Fundamental columns are based on trailing performance*

Insurance

The growth of the Nigerian insurance industry remains weak; estimates by the National Bureau of Statistics showed that the industry grew marginally by 7.14% (in nominal terms, 3.96% in real terms) as at the third quarter of 2019. Our estimates (based on financials of 21 insurance firms that accounts for 87% of total gross premium income in the industry) showed that gross premium written rose by 13.89% YoY in nominal terms, from NGN318.87bn to NGN377.09bn over the same period. When adjusted for inflation, gross premium income grew in real terms by 3.27%. The top-line growth is consequent on the increased premiums from nonlife business (18.40%) especially in the oil and gas space, fast growth in annuity portfolio (17.46%), and stricter enforcement of the compulsory insurance policies. In addition, prompt claims payment as mandated by NAICOM have also been helpful in restoring confidence in the underwriting industry, and in turn, contributing to the growth of the industry. However, still reflective of the low insurance demand and underperformance of the industry, the insurance penetration level remains pegged at 0.36% (ratio of premiums to GDP).

Most of the underwriters reported improved topline performance in 2019, with double-digit growth in premium income over the period. However, higher claims payment offset the support provided by investment income, thereby subduing earnings performance in 2019. Inappropriate policy pricing, weak underwriting capacity, and low insurance market remain perennial issues dragging the development of the industry.

Race to Recapitalize - Charting a new course

In May 2019, NAICOM revisited its plans to shore-up the capital base of the insurance sector, having cancelled the previously proposed Tier Based Minimum Solvency Capital structure. In the new recapitalization plan, life, general and composite insurers are expected to increase their paid-up share capital from NGN2bn, NGN3bn, and NGN5bn respectively to NGN8bn, NGN10bn and NGN18bn. According to the regulator, underwriters are expected to comply with the new capital requirement on or before June 2020, after which defaulters risk withdrawal of their operating licenses. The recapitalization exercise is expected to bring about increased insurance penetration and density level, stronger underwriting capacity, bolster industrial performance and intensify the contribution of the sector to the nation's GDP.

In the quest to comply, underwriters have resorted to raising capital through rights issue, private placement and mergers & acquisition proposals. However, raising funds through rights issue and private placement has been an enormous task, given the low profitability of underwriters as most of them struggle with marginal or no earnings growth. Also, the sentiment on insurance stocks has been rather negative with seventeen (17) out of the twenty-six (26) listed insurance stocks trading below their nominal value of NGN0.50.

With this new development, we expect a boost in local underwriting capacity and a reduction in *premium flight* and consequently driving top-line growth across business segments.

Driving Insurance Inclusion

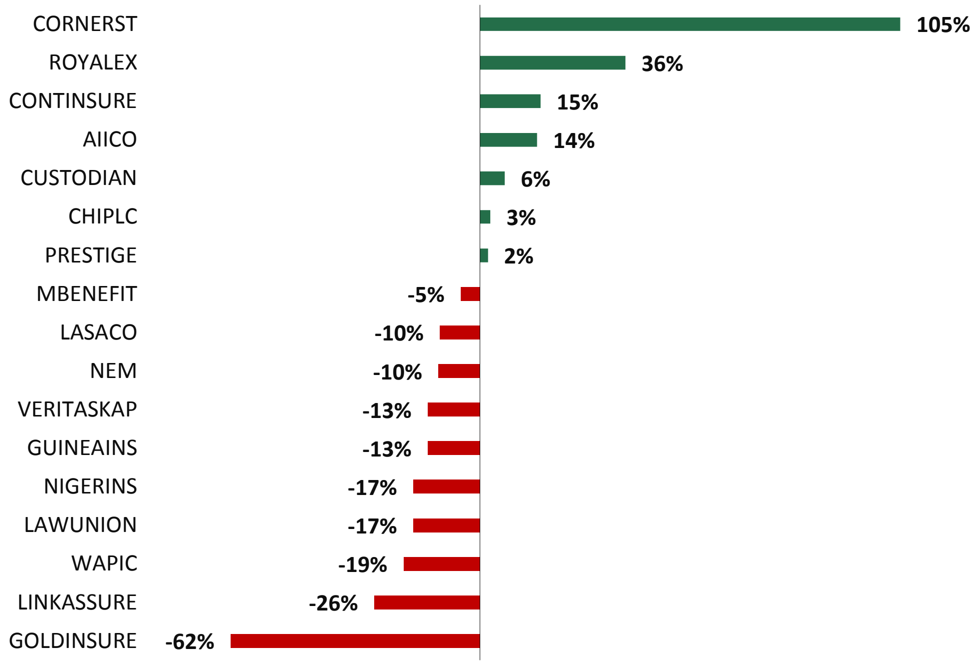
Aside the traditional insurance classes, Microinsurance, Takaful, and Agro insurance in Nigeria recorded some progress in 2019. During the year, NAICOM approved the applications of two new composite micro insurers; *Goxi Microinsurance Company* and *Cassava Microinsurance Company*, making them the pioneer insurance firms to operate as full-fledged Microinsurance firms in Nigeria. The two microinsurance firms are State micro insurers, with the operating license to transact both life and nonlife insurance businesses in Lagos State alone. The license allows the firms to sell insurance policies to the low-income demographic thus deepening the reach of the insurance sector and strengthening the resilience of the Nigerian economy. However, other than the emergence of microinsurance firms, the growth of microinsurance and other insurance classes requires deep insurance awareness that cuts across all roots. This will eliminate the negative bias against insurance policies, in that way, contributing to the overall development of the industry.

Also, the number of Takaful insurance firms increased to four (4) with the birth of two (2) more takaful insurance firms; Halal Takaful Insurance Company Limited (A subsidiary of Cornerstone Insurance Company), and Salam Takaful Insurance Company Limited. **Although the contribution of Takaful Insurance to the industry is marginal (NGN0.46bn as at FY2018) the business segment has a huge potential, given its ethical appeal to Muslims who constitute a sizeable share of Nigeria's population (53.7%), its inherent wealth creation features (share of residual profit after deductions for claims settlement among policyholders) and the accessibility to non-Muslims.**

Share Performance

The investors' sentiment on insurance stocks was largely bearish as the average YtD return on the counter was -3.58% as at the last trading day of the year. **GOLDINSURE** was the worst performing stock after losing -62.26% YtD while **CORNERSTONE** recorded the highest gains (105%) for the year, owing to the rally on the stock after meeting the new minimum capital requirement. In all, thirteen (13) counters closed the year in the negative territory while seven (7) recorded gains by the close of the year.

Chart 14: Top Gainers and Losers



Source: NSE, Meristem Research

Sector Outlook

Market players have taken further steps in pursuance for premium growth as the hunt for the hidden potential of the industry continues. Part of the moves include the introduction of new products by insurance firms, diversification of business segments including the launch of agricultural insurance business arms by underwriters and stronger partnership with insurance brokers and agents. From the regulators' end, the release of relevant guidelines necessary for the development of the microinsurance and bancassurance business should support the overall business growth in the industry. The apex regulator has also extended the deadline for the recapitalization exercise by six months till December 31st, 2020, allaying fears of possible instability in the industry structure as underwriters have enough room to buffer their capital base.

The decision of the Central Bank of Nigeria (CBN) to restrict foreign investors and banks from subscribing to OMO bills is expected to trigger a high level of liquidity in the succeeding year within the economy. In our observation**, we envisage that the liquidity glut would drive yields downward causing a decline in investment income. Since, the investment income is an important part of the industry's earnings (evidenced by the estimated NGN65.15bn posted in the 2018FY), we expect this burden to reflect in the firms' bottom-line.**

Furthermore, NAICOM proposed to commence the stringent enforcement of approved premium rates come January 2020, a measure put in place to eliminate inappropriate pricing of insurance policies by market players due to the competitive nature of the industry. **We expect this new initiative to usher in higher growth in premium earned as well as a wider profit margin for underwriters. However, low insurance awareness and weak consumer spending are poised to limit the sales of insurance policies should prices be pegged at higher levels. Also, we reiterate the need to embrace the use of mobile technology for the distribution of insurance products, considering the increasing level of mobile phone penetration (87%) in Nigeria. This will help in reducing the operating costs of underwriters, in that way, boosting the profitability of market players.**

Table 9: Valuation and Ratings

	Valuation and Fundamental Metrics														
	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target PE	Exp. EPS	TP	CP	UPP	RT
AIICO	0.33	12.9%	32.3%	4.2%	0.3	0.87	2.69	0.8x	0.3x	1.1x	0.85	0.94	0.73	+ 28%	BUY
CONTINSURE	0.68	11.6%	16.3%	7.9%	0.7	0.40	2.48	5.4x	0.9x	6.0x	0.36	2.13	2.20	-3%	HOLD
CORNERST	0.43	41.7%	50.7%	18.0%	0.4	0.35	0.69	1.7x	0.8x	3.5x	0.21	0.74	0.58	+ 28%	BUY
CUSTODIAN	0.41	16.0%	16.7%	6.6%	0.4	1.26	7.55	4.8x	0.8x	4.9x	1.45	7.11	6.00	+ 18%	BUY
LAWUNION	0.51	-12.9%	-10.7%	-6.5%	0.5	-0.17	1.55	-3.1x	0.3x	4.0x	0.18	0.73	0.51	+ 43%	BUY
LINKASSURE	0.24	3.7%	1.2%	0.9%	0.2	0.03	2.31	17.7x	0.2x	5.0x	0.12	0.60	0.48	+ 25%	BUY
MANSARD	0.45	7.3%	9.6%	3.2%	0.4	0.24	2.53	8.2x	0.8x	9.3x	0.31	2.88	2.00	+ 44%	BUY
NEM	0.69	13.7%	17.2%	9.5%	0.7	0.40	2.35	6.0x	1.0x	5.4x	0.57	3.05	2.42	+ 26%	BUY
WAPIC	0.51	0.1%	0.1%	0.1%	0.5	0.00	1.28	248.8x	0.3x	2.5x	0.23	0.58	0.36	+ 60%	BUY

TP = Target Price, CP=Current Price as at 31st December 2019, UPP= Upside Potential, RT = Rating, Exp. EPS = 2020 Expected EPS, BVP = Book Value Per Share, P/E= Price to Earnings Ratio, P/BV = Price to Book, EPS = Earnings Per Share, AT= Asset Turnover, NM=Net Margin, Lev= Leverage.* ***Data in the Fundamental columns are based on trailing performance*

Materials and Industrials

New Growth Era Following Corporate Restructuring

Activity in the manufacturing space was upbeat for the greater part of 2019 as the purchasing manager's index (PMI) was consistently stable above the 50 points mark. The manufacturing sector thrived on the diversification efforts of the Federal Government, which saw modest improvement in credit to the private sector (up by 4.54%) between Q1:2019 and Q3:2019 and contributed to the uptick in non-oil GDP. However, cement companies suffered some setbacks arising from the delayed capital spending due to the general elections. This was exacerbated by price cuts in the jostle for market share as industry capacity expanded. The slight changes in rain patterns also weighed on the cement industry as cement demand was erratic during the year. The Central Bank of Nigeria's PMI sub-index for new cement orders indicated that new orders for cement peaked in May and August at 75pts apiece and mostly decreasing on a month-on-month basis.
Turnover in the cement industry largely reflected the series of corporate restructuring that took place within the year and late 2018 as volumes adjusted to the divestment and mergers; (**DANGCEM**-0.80%, **LAFARGE**-30.41%, **CCNN**+117%).

Dangote Cement Proposes Share Buy-Back

In October 2019, the board of directors of Dangote Cement Plc. declared its intention to consolidate the share capital of the company through a share buy-back program. This was against the backdrop of a bearish equities market, with the company's stock having lost 38.26% since the end of December 2018. As at 9M:2019, the total shares outstanding of Dangote cement stood at 17bn units and the paid-up share capital at NGN8.5bn. Upon approval, the share buy-back would see a reduction in total shares outstanding and an expansion in earnings per share.

BUA Consolidates Footprint

As further evidence of restructuring in the sector, the boards of the Cement Company of Northern Nigeria (CCNN) and Obu Cement have also announced a proposed merger of the two companies in a bid to further strengthen their capacity and market share in the cement industry. Following the completion of the merger, CCNN will be absorbed into Obu Cement resulting in the delisting of CCNN from the Nigerian stock exchange and the listing of the new entity– Obu Cement, on the stock exchange. The new entity will be called BUA Cement Plc, essentially a consolidation of BUA's footprint in the cement industry. The merger will also see the total share capital of CCNN cancelled and all shares previously held in respect of CCNN converted on a one for one basis (one CCNN share for one Obu Cement share).
Currently, CCNN operates a 2MTA plant which serves majorly the north-eastern region of Nigeria, while Obu Cement operates a 6MTA capacity plant in Okpella, Edo State, serving the Southern Nigeria market in competition with Dangote Cement and Lafarge Africa Plc. Upon completion of the merger, the total installed capacity of the consolidated entity will be 8MTA (vs. **LAFARGE**-10.5MTA, **DANGCEM**-29.3MTA) with footprint across Northern and Southern Nigeria.

Lafarge Africa Sells Stake in Debt-Laden Lafarge South Africa Holding (LSAH)

In July 2019, Lafarge Africa Plc concluded the sale of Lafarge South Africa Holdings to Caricement BV. The proceed from the sale which amounted to USD317mn was used in settlement of related party loan owed to Caricement BV and accrued interest amounting to the tune of USD293mn and USD23.29mn respectively. As at 2018FY total debt amounted to USD301bn and a resulting finance cost of NGN45bn. The huge finance cost burden had the effect of dragging the company to a loss position, with an after-tax loss of NGN8.8bn. However, upon completion of the divestment, total debt and finance costs stood at NGN65bn and NGN16bn respectively as at 9M:2019. **The significant reduction in finance costs should impact positively on the profitability of the company in the near term.**

Lafarge merges with Lafarge Ready-Mix Nigeria Limited

In July 2019, Lafarge Africa Plc. announced it had received the go-ahead from the court and Securities and Exchange Commission (SEC) to merge with its subsidiary Lafarge Ready Mix Nigeria Limited (LRM), which specializes in the production of aggregates and concrete. LRM will be fully absorbed into Lafarge Africa Plc. and as a result, the total share capital of Lafarge Ready-Mix Nigeria Limited amounting to the tune of NGN50bn will be cancelled. This will also have the effect of increasing the share capital and reducing the investments in subsidiary of Lafarge Africa Plc by the same amount.

Lafarge Africa re-launches SUPASET to make Inroads into Block Making Segment

In October 2019, Lafarge Africa re-launched its improved SUPASET cement. The SUPASET cement which is one of Lafarge's diverse product portfolio tailored specifically for block making was reformulated and packaged in horizontal bags. This is also an attempt to secure its market share in the block-making segment, in response to Dangote Cement's introduction of "Blockmaster" last year. We expect the battle for dominance in this segment to continue in 2020, leading to more product innovation.

Sluggish Growth in the Paints Market

Revenue growth in the paints industry was sluggish in 2019 as most leading brands grew revenue only marginally as at 9M:2019, save for Meyer paints plc which grew revenue by 14.07%. (**BERGER** +2.97%, **CAP** +5.99%, **PORTPAINT** +0.92). However, the paints industry benefitted from the stable FX environment and price moderation of some key production raw materials in 2019. This resulted in a relatively constant average cost to sales ratio of 59.15% in 9M:2019 (vs 59.46% as at 9M:2018). However, the race for market share and segment penetration saw selling and distribution expenses of major companies increase by an average of 18.14% YoY in 9M:2019.

Sector Outlook

Revenue growth of cement companies is expected to be modest in 2020, as capacity expansion in the sector will engender stiffer competition and put pressure on prices. Meanwhile, tepid economic growth might place a cap on volumes. However, prospects of increased capital expenditure are expected to drive growth in the near term.

In the event of sustained border closure in the first quarter of 2020, we expect to see year-on-year export volumes decline in Q1:2020. In the second quarter of 2020, with the African Continental Free Trade Agreement expected to have materialized, exports are expected to rebound, and in the drive to break into new exports markets spurred by the AfCFTA, we anticipate capacity expansion especially for clinker grinding facilities in hinterlands, with little or no limestone deposits.

Growth in the paints industry will continue to be supported by an expanding oil and gas sector. Growth in the auto-refinishes market is also expected to drive volumes in the industrial paints segment in the near term. In 2020, we expect more aggressive promotional activities to result in a surge in operating expenses.

Table 10: Valuation and Ratings

	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target EV/ EBITDA	Exp. EBITDA (NGN'bn)	CP	2020 TP	UPP	RT
BERGER	0.73	10%	12%	7%	1.67x	1.22	10.27	5.52x	0.69x	5.84	0.24	6.75	4.87	-28%	SELL
CAP	1.33	20%	75%	27%	2.81x	2.14	2.87	11.19x	8.37x	6.73	2.48	23.95	23.87	0%	HOLD
DANGCEM	0.54	43%	45%	24%	1.92x	22.68	50.27	6.26x	2.82x	6.3	464.56	146.00	171.66	+18%	BUY
WAPCO	0.48	10%	7%	5%	1.40x	1.42	21.72	10.76x	0.70x	4.31	36.76	13.90	18.28	+32%	BUY

Fundamentals

TP = Target Price, CP=Current Price as at 31st December 2019, UPP= Upside Potential, RT = Rating, Exp. EPS = 2020 Expected EPS, BVP = Book Value Per Share, P/E= Price to Earnings Ratio, P/BV = Price to Book, EPS = Earnings Per Share, AT= Asset Turnover, NM=Net Margin, Lev= Leverage.* ***Data in the Fundamental columns are based on trailing performance*

Agriculture

Institutional Support Should Boost Activities in the Sector

The agriculture sector grew by 2.28% YoY as at Q3:2019 (vs. 1.91% in Q3:2018 and 1.79% in Q2:2019). The sector continues to enjoy institutional support as part of the Government's policies of diversifying the economy away from oil. The CBN had disbursed NGN174.48bn as at April 2019 under the Anchors Borrowers' Programme. The closure of all land borders, although mainly aimed at curbing smuggling has boosted activities in the agricultural space, especially for producers of such staples like rice, vegetable oil and poultry products. More support also emerged in the form of restriction of access to foreign exchange for food importation in August and a fifty percent discount (50%) for equipment purchased towards the achievement of food sufficiency in Nigeria.

The major headwind in the sector has been the smuggling of goods from neighboring countries, which had impacted negatively on prices. This was duly reflected in the performance of the players in the agriculture and allied sectors: As at 9M:2019, revenue for OKOMUOIL had declined by 6.84% to NGN16.68bn as sales weakened over the period. Similarly, PRESCO's topline dropped by 5.17%. The impact of the softness in the topline and higher operating costs as earnings was telling on earnings. Net income contracted markedly by 43.23% and 30.91% respectively.

The market responded in accordance to the earnings performance as the stocks of both firms lost 27.03% and 25.78% respectively by FY2020.

In 2020, we expect the upward movement in global CPO prices to benefit the actors in the sector. In addition, the continued closure of the border should support prices. Even if the policy is reversed, we expect the Government it would be based on a policy that the country's neighbors comply with trade rules.

Table 11: Valuation and Ratings

	Valuation and Fundamental Metrics														
	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target PE	Exp. EPS	TP	CP	UPP	RT
PRESCO	0.3	12.9%	10.3%	4.0%	0.3	2.65	25.82	17.9x	1.8x	11.0x	4.50	49.37	47.50	4%	HOLD
OKOMUOIL	0.4	28.1%	18.0%	11.9%	0.4	5.63	31.20	10.0x	1.8x	9.5x	7.76	73.70	56.50	+ 30%	BUY

**TP = Target Price, CP=Current Price as at 31st December 2019, UPP= Upside Potential, RT = Rating, Exp. EPS = 2020 Expected EPS, BVP = Book Value Per Share, P/E= Price to Earnings Ratio, P/BV = Price to Book, EPS = Earnings Per Share, AT= Asset Turnover, NM=Net Margin, Lev= Leverage.*
Data in the Fundamental columns are based on trailing performance

2020 Equities Market Outlook

Fundamental Analysis

Using the fundamental approach, our expected market return for 2020 is based on the target prices of 49 stocks, which account for c.97% of the market capitalization as at December 2019.

The materials, banking and telecoms sectors are expected to be the main drivers of the market return in 2020. The poor performance of banking sector stocks in 2019 was to a large extent, influenced by the CBN's policies despite decent earnings releases and dividend pay-outs. With a median P/E and P/BV of 3.1x and 0.6x respectively, the current share prices of the banking stocks present good bargain hunting opportunities for value seeking investors due to their attractive dividend yield and our expectations for improved earnings in 2020. **DANGCEM** endured another year to forget after shedding 25.14% of its share price in 2019 after reporting slightly weaker earnings. The company intends to buy back some of its shares which would help support its share price. For the two listed telecoms companies, **MTNN** and **AIRTELAFRI**, we expect their impressive earnings growth to spur bullish sentiments on their prices, although to varying degrees. While the demand for **AIRTELAFRI** has been tepid since its listing, **MTNN** is expected to benefit from improved foreign and local demand seeing that its EV/EBITDA and P/E multiples lag most of its African and EM peers. However, its tax dispute with the Attorney General will continue to drag its performance the longer it persists.

Table 11: **Projected 2020 Equities Market Return – Fundamental Approach**

Projected 2020 Equities Market Return			
Sector	**Weight**	**Expected Return**	**Weighted Return**
Financial Services			
Banking	25.5%	20.2%	5.1%
Insurance	1.1%	21.1%	0.2%
Materials and Industrials	21.7%	19.8%	4.3%
Consumer Staples and Consumer Discretionary	18.2%	-0.1%	0.0%
Agricultural Products*	0.8%	10.1%	0.1%
Energy	4.5%	6.8%	0.3%
Healthcare	0.2%	19.6%	0.0%
Telecommunications	25.3%	10.0%	2.5%
TOTAL	**97.2%**		
Expected Return			**12.59%**

**Given our focus on agriculture, we extracted agricultural products from consumer staples and reported it as a separate item*

Based on the above, we expect the market to gain 12.59%.

Neural Networks

Artificial neural networks have been increasingly applied to predict stock market returns due to their ability to discover patterns in both linear and non-linear systems. This makes this approach superior to classical statistical models. It is therefore commonly used to forecast index values, as well as daily and weekly direction of changes in the index

Hence, we used annual time series NSEASI data from 1998 to 2019. The trained neural network was used to predict the index level for 2020 at 30,108.75 pts. ***This implies a 12.17% return from the 2019 year-end level of 26,842.07pts.***

Econometric Analysis

The NSEASI forecast was obtained using the ARIMA econometric model. The ARIMA model is one of the most widely used time series model in forecasting stock market series largely due to its integrated property, which reduces the effect of seasonality inherent in stock market variables. This approach appeals more as it applies a weight on its previous terms based on how recently they occur. This enables the model to capture recent sentiments in the equities market. Hence, we forecast the index level for 2020FY using the ARIMA (0,3) (0,1) model with lags selected based on the Akaike Information Criterion (AIC).

Using this approach, we expect the Index level to settle at 28,559.07pts, a return of 6.40% by 2020FY.

NSEASI Projection for 2020

We do not regard any of the approaches as superior to the others and therefore used an equal weighting to arrive at our 1.8% expected market return for 2020.

Table 12: Weighted 2020 Equities Market Return

	Projected Index Level	Market Return	Weight
Fundamental Approach	30,214.34	12.56%	33%
Econometric Method	28,559.07	6.40%	33%
Neural Networks	30,108.75	12.17%	33%
Forecast Return		**10.27%**	**100%**

Fixed Income Market

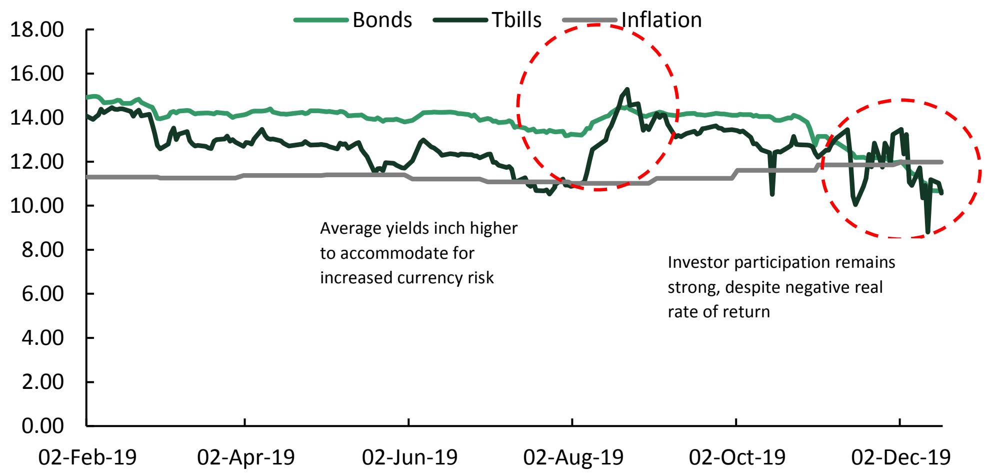
Unconventional Policies Set Yields Lower

Through 2019, the fixed income market was the preferred destination for investors, on the back of a bearish equities market, uncertainty about the general election and policy developments across financial market. This remained true even with the 50bps cut in the benchmark interest rates by the Monetary Policy Committee to 13.50%, and the thinning out of the real rate of return due to rising inflation and a drastic drop in average yields from the first quarter of the year.

Given the scarcity of more attractive alternatives, buying pressure depressed average Treasury Bills yield in the secondary market from 14.98% on January 2, 2019 to 10.93% in July 30, 2019. Average bond yield in the secondary market also followed suit, dropping by 2.19% from 15.38% in January 1, 2019 to 13.19% in July 30, 2019.

By August 2019, foreign investors began scaling down their holdings in the fixed income market due to increased concerns about the vulnerability of the reserves to FX pressure, which was influenced by the P&ID scandal and declining crude oil price. As a result, average yields in the secondary market for Treasury bills ticked upwards to a month high of 15.28% on the 22nd of August 2019 to compensate for the increased risk. Average bonds yield also trended higher, settling at a month high of 14.48% on the 22nd of August 2019.

Chart 1: Yield (%) Movement in the Secondary Market in 2019



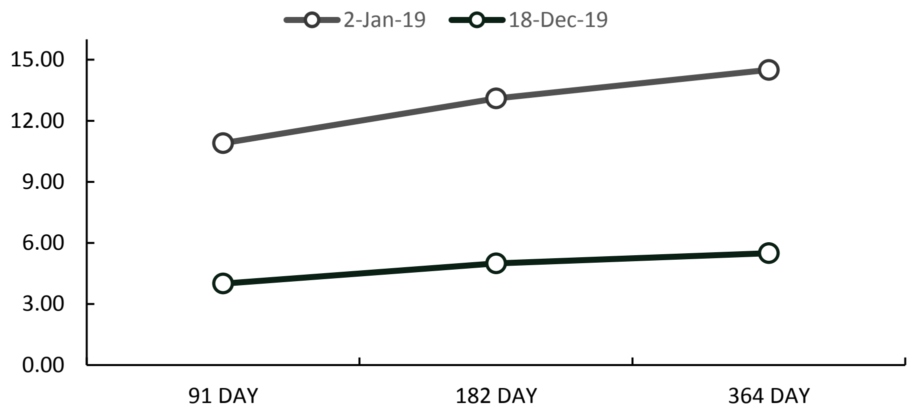
Source: FMDQ, Meristem Research

After the CBN restricted participation in the OMO market, the apex regulatory authority tapered primary market auction rates to single digit levels. With rates as low as 5.50% at the primary market and inflation rising to a year high of 11.85%, the real rate of return is deep in negative territory. On the upside, this translates to lower borrowing costs for the Government. Investors, however, are left with the short end of the stick. In the current environment, it is almost pointless investing in the Treasury Bills market or keeping fixed deposits with

DMBs who have also crashed the rates offered to the market, following the new reality in the yield environment. Nonetheless, demand has remained strong, given a lack of alternatives, as liquidity management takes top priority over excessive returns.

With increased participation and high system liquidity, yields in the secondary market for Treasury bills and bonds resumed its downward trend. Average yields in the secondary market for both Treasury bills and bonds dipped further to 10.57% and 10.68% respectively as at December 17, 2019.

Chart 2: Stop Rates (%) at the PMA for Treasury Bills



Source: CBN, Meristem Research

OMO Market Segmentation - Clear Judge of FPI Risk Perception

The CBN released a circular on the 23rd of October 2019, restricting domestic individuals and non-bank institutions from partaking in OMO activities. This move essentially created a market for foreign investors, to keep foreign inflows coming and retain the foreign capital in the market, while also reducing the borrowing cost for the Government, following the drastic reduction of primary market auction rates. Rates in the OMO market were sustained above 13% while Treasury Bills primary market auction rates declined to single digit levels (5.495% at the last auction of 2019).

Despite the attractive rates in the OMO market, we observed receding interest in exposure to the country's financial market by foreign investors, as OMO auctions recorded declines in subscriptions, even no-sale auctions for select tenors offered. The declining participation in the market is reflective of the weakening confidence in the policies put in place by the Government and thus begs the question of how long these monies will remain in the economy. While the declining yield environment has benefited the Government in terms of cheaper borrowing costs, and enticed corporates to tap into the debt capital market at lower cost, a greater concern remains the waning interest in the Nigerian market by foreign investors, the amount of OMO bills the CBN would have to redeem and its resultant impact on external reserves in 2020 given the limited market participation in that space.

Despite the expected reduction in exposure to the Nigerian economy by foreign investors, and our expectation of the Monetary Policy Committee to keep the monetary policy rate at 13.50% in 2020, we expect yields to remain pressured in the year as domestic investors grab available fixed income instruments. Furthermore, we do not rule out a gradual portfolio reallocation to the equities market as domestic investors become uncomfortable with lower returns in 2020 from holding fixed income assets, thus easing the pressure on yields.

Money Market Remains Favoured

The high yield environment of the first quarter of the year served as a deterrent to corporate bond issuers as the market suffered a dearth of supply side activities. Most of the market activity was tilted towards short term instruments as the market for commercial papers was highly active in the early parts of the year. However, following a cut in the benchmark rate in March, activities in the bonds market picked up and about six (6) companies raised debts to finance their operations.

In the commercial paper market, activities did not quite pick up until the mid and latter part of the year. In Q1:2019, only three companies tapped the market (FBN Quest Merchant Bank, Flourmills and Union bank). However, as yields began to temper, we saw increased participation with issues from companies like Sterling bank, Mixta Real Estate Plc, Coronation Merchant bank, Nigerian Breweries and Dangote Cement Plc. As at 31st December, total outstanding value of commercial papers on FMDQ pegged at NGN184.21bn.

We expect companies to take advantage of the low yield environment to refinance their debts as well as raise new issues. For as long as the CBN's stance on the OMO market stands, we anticipate strong demand for these instruments as investors continue seeking out investment alternatives that could earn them better returns than Government securities.

What Happened with Eurobonds?

Contrary to our expectation of increased activity in the Eurobond market, the market was left untapped this year. The Federal Government has instead, sought access to funding from Supranational organisations to fund its projects. In May 2019, a USD1bn loan was obtained from the China- Exim Bank, to finance the Gurara II Hydropower project. Likewise, the Presidency has made a request to the Senate in November, seeking an approval for a USD29.96bn loan from external sources to fund infrastructural plans.

While the Federal Government has shown preference for concessionary loans from external sources other than the Eurobond market, we cannot totally rule out the possibility of a Eurobond issue in 2020. Should this materialise, we envisage that it will be issued at higher rates compared to existing and previous rates given the increased risks associated with the country (*downward review of the country's outlook and gliding reserves).* Hence, we expect sell-offs on existing Eurobonds as investors look to key into the higher rates.

In the corporate Eurobond space, two instruments on issue were called by the issuers – a move that serves to reduce their exposure to foreign currency debt obligations. Access Bank Plc (**ACCESS**) and First Bank of Nigeria (**FBNH**) exercised the call options on their notes during the year. **Zenith Bank Plc.** also redeemed its 5-year tenor USD500mn Eurobond which matured April 22, 2019. The exercise of their embedded options was reflective of the strength of their balance sheets as well as their impressive FX liquidity. Currently, there are only four (4) corporate Eurobonds listed, with only one issuance in the year.

We do not envisage much participation in the corporate Eurobond space in the near term, as corporates would want to steer clear of the international debt market given the likelihood of a liquidity crunch. However, should these risk factors be mitigated, we project increased activity in that space. Nonetheless, we expect existing notes to be redeemed by the issuers as permitted by the liquidity of their balance sheet.

The Rise of Green Bonds

introduction of unconventional bonds in the capital market has not only deepened the market but also provided various investment alternatives which are suited for individual investors. In the last two years, we have seen the emergence of various alternative bonds with different structures and rule of standards. A point in case is Green bond – a bond intended to finance/refinance new projects that have been identified to have climate credentials in alignment with its Green Bond Guidelines. Following the debut Green Bond issued in December 2017, the Federal Government in June 2019, floated its second series worth NGN15bn. This 7-year Green bond was issued at a coupon rate of 14.50%, to finance sustainable development projects with positive impact on the environment and the economy.

Also, in February 2019, Access Bank Plc. (**ACCESS)** issued its debut green bond of NGN15bn at a coupon of 15.50% and a maturity of March-2024. According to the prospectus, 97.12% of the proceeds from the issue was earmarked to refinance existing green projects. This, in addition to the **NSP-SPV Powercorp Plc**. green bond brings the total outstanding value of listed corporate green bonds to NGN23.50bn.

The move towards unconventional investments is laudable especially as it addresses environmental challenges and fosters sustainable financing in Nigeria. The interest rates on these instruments also present an attractive opportunity for investors, relative to the conventional bonds. We envisage that more innovative and alternative investment products and services will emerge in the near term as focus shifts to transitioning to a low-carbon and sustainable economy.

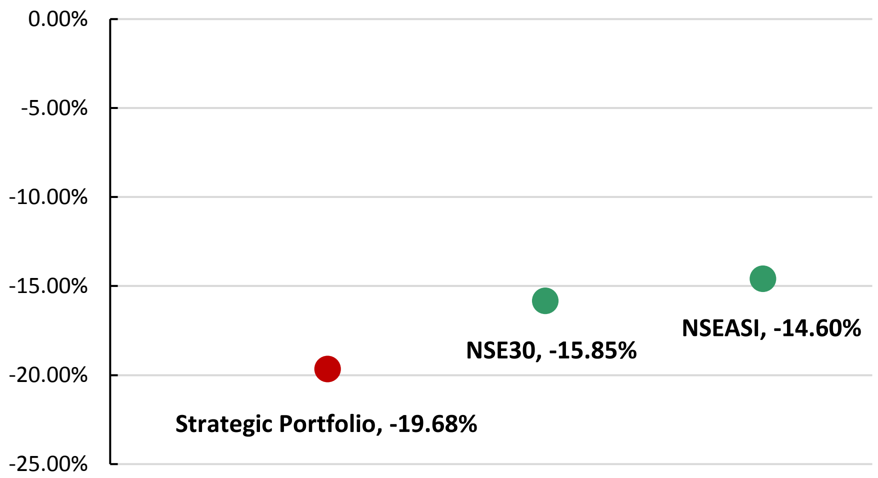
2020 Strategy

Equity Strategy

A Review of 2019 Meristem Strategy

Our recommended portfolio at the beginning of 2019 underperformed both the **NSEASI** (-14.60%) and **NSE30** (-15.85%)**,** returning -19.68% (vs. 19% projected). Asides **FIDELITYBK** which closed marginally positive (+0.99%), all other constituents of the portfolio closed negative. The major drags of the portfolio performance were concentrated on **OKOMUOIL**, **FIDSON** and **DANGCEM** which produced weighted returns of -4.33%, -4.11% and -3.27% respectively. **FIDSON's** earnings were dragged by higher than anticipated borrowing costs, while **OKOMOUOIL's** sales suffered from the influx of smuggled goods which pressured earnings. **DANGCEM** also reported slightly weaker earnings due to increased competition.

Chart 1: **2019 Strategic Portfolio Return Profile vs. Market Return**



Source: NSE, Meristem Research

2020 Strategic Portfolios

PFA Portfolio

The companies in the PFA portfolio were selected in line with **PENCOM's guidelines which are; companies which had taxable profit in three (3) out of five (5) years of operations and must have paid dividends or issued bonus shares in one (1) out of the same five (5) years.**

Given that we expect the economy to continue its growth trajectory and also considering that a major concern for PFAs about the equity market has been the erosion of share value, we have added the following factors in our inclusion criteria in addition to the above factors; At least **Three (3) years of Turnover and Earnings growths in the past five years, relatively high ROE and ROA (compared to sector average), relatively low volatility, positive historical five**

year return and an attractive upside potential for 2020 based on our target prices.

In line with the set criteria, we have carefully selected five (5) stocks from the Banking and Insurance sectors in order to generate optimal returns for this portfolio. We believe these companies should generate higher returns as compared to their peers, while also adding additional value to the portfolio by paying dividend.

Table 1: PFA Portfolio

	PFA PORTFOLIO															
	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target PE	Exp. EPS	TP	UPP	Exp. Dividend Yield	Weighted Return	Portfolio Weight
CUSTODIAN	0.4	16%	16%	67%	0.4	1.26	7.55	4.8x	0.8x	4.9x	1.45	7.11	+ 18%	8%	13%	16%
FIDELITYBK	0.1	13%	12%	1%	0.1	0.92	7.65	2.2x	0.3x	2.4x	0.95	2.32	+ 13%	10%	12%	14%
GUARANTY	0.1	45%	30%	5%	0.1	6.44	21.64	4.6x	1.4x	5.2x	7.21	37.47	+ 26%	11%	18%	23%
NEM	0.7	14%	17%	10%	0.7	0.40	2.35	6.0x	1.0x	5.4	0.57	3.05	+ 26%	5%	15%	19%
UBA	0.1	18%	18%	2%	0.1	2.88	16.24	2.5x	0.4x	2.8	3.37	9.44	+ 32%	12%	22%	27%
														Expected Return	**81%**	**100%**

Dividend Portfolio

This portfolio is skewed towards stocks which have a consistent dividend paying culture. The stocks included in this portfolio have been carefully selected using the following criteria; **fundamentally sound companies which recorded earnings growth in three of the past five years and have paid dividend at least four times in the last five years.**

In line with these criteria, we have carefully selected nine (9) stocks from Banking, Industrial goods, Insurance, Agriculture and Consumer goods sectors, with a total expected return of 89%.

Table 2: Dividend Portfolio

	DIVIDEND PORTFOLIO															
	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target PE	Exp. EPS	TP	CP	Exp. Div Yield	Weighted Return	Portfolio Weight
CONOIL	3.0	1%	10%	4%	3.0	2.75	26.82	6.7x	0.7x	5.6x	4.53	25.37	18.50	13%	14%	17%
CUSTODIAN	0.4	16%	17%	7%	0.4	1.26	7.55	4.8x	0.8x	4.9	1.45	7.11	6.00	8%	9%	10%
DANGCEM	0.5	43%	45%	24%	0.5	22.68	50.27	6.3x	2.8x	-	-	171.66	142.00	7%	8%	9%
GUARANTY	0.1	45%	30%	5%	0.1	6.44	21.64	4.6x	1.4x	5.2	7.21	37.47	29.70	9%	10%	12%
NEM	0.7	14%	17%	10%	0.7	0.40	2.35	6.0x	1.0x	5.4	0.57	3.05	2.42	5%	6%	7%
NESTLE	1.5	17%	83%	26%	1.5	58.96	71.29	24.9x	20.6x	25.0	61.94	1,548.59	1,469.90	4%	4%	5%
OKOMUOIL	0.4	28%	18%	12%	0.4	5.63	31.20	9.9x	1.8x	9.5	7.76	73.70	55.60	5%	7%	8%
UBA	0.1	18%	18%	2%	0.1	2.88	16.24	2.5x	0.4x	2.8	3.37	9.44	7.15	11%	11%	13%
ZENITHBANK	0.1	31%	23%	3%	0.1	6.37	27.77	2.9x	0.7x	3.5x	6.98	24.43	18.60	14%	15%	18%
														Expected Return	**82%**	**100%**

Fixed Income Strategy

Given the low yield environment in the fixed income space and our expectation of a tempered yield environment compared to the previous year, we recommend three strategies that will provide investors with high returns, vis-à-vis prevailing market rates, through the year.

- Concentrate exposure on mid to long tenor instruments in the Treasury Bills market. A mix of 182-Day and 364-Day instruments is expected to mitigate re-investment risk emanating from the projected lower rates, while leaving room to take advantage of a possible uptick in rates, should any risks crystallise.
- A preference for bonds with high tenor at the long end of the curve with attractive yields provides holders of the instrument a chance to earn capital gains. We therefore, recommend bonds trading at a discount to par; **8.50 20-NOV-2029** and **10.00 23-JUL-2030**.

Table 1: Bond Recommendation

Bond	Modified Duration	Coupon (%)	Offer Price	Offer Yield	Outstanding (N'bn)	Issue Date	Maturity Date
8.50 20-NOV-2029	9.89	8.50%	97.19	11.58%	200.00	20-Nov-09	20-Nov-29
10.00 23-JULY-2030	10.56	10.00%	92.30	11.61%	591.57	23-Jul-10	23-July-30

- Given the lower yields in the market, we expect companies that require short term funding to take advantage of the yield environment and raise required capital. Thus, we advise taking advantage of investment grade commercial papers that will come to the market in 2020.
- We however, do not rule out the likelihood of a CBN intervention or other externalities which could alter the course of the yield environment during the year. In which case, the advised mix of instruments will create room for investors to take advantage of the uptick in yields.

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SELL: Target Price of the stock is more than **10 percent** below the current market price.