



# INVESTMENT STRATEGIES FROM MAJOR POLICY REFORMS



**JULY 2023**

## Executive Summary

Anchored by a new captain, the voyage, which is the Nigerian economy has now pointed its rudder at another direction evidenced by the series of reforms that now suggests that a favourable business environment might be in the offing. The touted outcome of this new turn over the years have included among others, attracting foreign investment, and enhancing the overall Nigerian economy. Four notable policies have emerged since the inception of this new leadership: FX liberalization, removal of PMS (Premium Motor Spirit) subsidy, the Electricity Act 2023, and the enactment of Executive Orders.

While the disconcerting fiscal state of the nation had started getting long touted reprieve in the form of subsidy removal, two of the prominent concerns which have posed as the Achilles heel of the economy in FX management and electricity have also received a new lease of life. The FX unification and the subsequent floating are expected to enhance efficiency and liquidity in the market, attract foreign investors, and eliminate the irrational arbitrage opportunity in the space. Furthermore, the removal of PMS subsidy is a crucial step towards addressing fiscal challenges and reallocating budget resources towards infrastructural development. Furthermore, the Electricity Act 2023 is expected to focus on revitalizing the power sector through private sector participation and reliable electricity supply. Finally, the Executive Orders revamp the Finance Act signed by the previous administration and improves business activity.

Although some of these policies have faced significant opposition from citizens for how they might not be enough to address Nigeria's hydra-headed macro-economic concerns, we believe that they bode well for capital market traction. Therefore, this report provides capital market strategies that investors can employ amidst the series of new economic policies being implemented.



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## Foreign Exchange

### Exchange Rate Unification: A Sharp Turn from an “Undesired” Past?

In our [H2:2023 Nigerian Strategy Report \(NSR\)](#) we had noted how the swearing in of the new administration at the federal level culminated in the implementation of series of long overdue economic reforms. One of such involved the collapse of all official FX windows into the I&E<sup>1</sup> Window. The administration sticking to its guns, considering it had earmarked these reforms in its manifesto, went at a speed of light triggering widespread market optimism in the process. We also saw the suspension of the former CBN Governor, Godwin Emefiele, leading to an extra-layer of positivity in the market as he had overtime received widespread criticism for his management of the apex bank.

This action coupled with the implementation of the willing buyer and seller’s platform resulted in a sharp devaluation of the Naira. It is expected that the new arrangement could only birth extra layer of transparency. Consequent upon this, the CBN discontinued the RT200 Rebate Scheme and the Naira4Dollar Scheme, which were initially introduced to improve inflows at the official exchange rate window.

Interestingly, while the CBN has taken the bold steps toward gradually clearing its FX backlog by prioritizing committed FX forward transactions, it has maintained status quo regarding the forty-three (43) restricted items at the I & E window. To further improve FX liquidity, the CBN granted ordinary domiciliary account holders unfettered access to their cash balances. Account holders are now allowed to access their funds of up to a USD10,000 cap per day.

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<sup>1</sup> Investors and Exporters’



We have highlighted the potential effects of the policy on each sector:

<p><b>Oil &amp; Gas Sector</b></p> <ul style="list-style-type: none"> <li>• International Oil Companies (IoC) are now allowed to sell foreign currency to commercial banks, rather than the CBN, ending a prior 3-year ban. This projects more market-reflective earnings from FX sales</li> <li>• Unhedged foreign obligations will likely lead to foreign exchange (FX) losses and increased costs of borrowing</li> <li>• Higher income in reporting currency (Nigerian Naira) resulting from foreign currency gains</li> <li>• The lower uncertainty regarding the direction of the exchange rate may lead to renewed interest in the oil and gas sector, by both local and foreign players</li> <li>• The currency devaluation could lead to higher cost of imports. This is premised on the fact that some companies previously estimated FX cost using a weighted average exchange rate which</li> </ul>	<p><b>Consumer Goods Sector</b></p> <ul style="list-style-type: none"> <li>• Sectors highly dependent on imported raw materials risk lower profitability through higher costs</li> <li>• The FX policy may boost local demand as companies switch to less expensive and locally manufactured raw materials</li> <li>• Companies have less headroom to pass on costs to final consumers due to highly competitive nature of the sector</li> <li>• Potentially higher FX obligations or foreign exchange losses underpinned by currency devaluation</li> </ul> <p><b>Banking Sector</b></p> <ul style="list-style-type: none"> <li>• We expect sustained rally in the banking sector underpinned by stronger performance of tickers arising from unrealized FX gains of large foreign currency exposures</li> </ul>
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<p>was at a discount to the prevailing parallel market rates</p>	<ul style="list-style-type: none"> <li>• The relaxation of exchange rate restrictions, reinstatement of banks as major counterparties, and higher FX inflows from IOCs (International Oil Companies) to potentially boost profit margins</li> </ul>
<p><b>Industrial Goods Sector</b></p> <ul style="list-style-type: none"> <li>• Certain players within the sector have some leeway in passing down increased costs to final consumers, we foresee some resilience underscored by higher product prices</li> <li>• We opine that firms may record increased unrealized FX losses arising from the currency devaluation which may limit bottom-line growth</li> <li>• The unification of the exchange rate may also increase the demand for locally produced raw materials as businesses grapple with surging costs</li> </ul>	<p><b>ICT Sector</b></p> <ul style="list-style-type: none"> <li>• We expect deteriorating leverage ratios in the sector, following higher FX obligations</li> <li>• The heavily regulated nature of the sector may limit pass through effect of elevated operating costs to final consumers</li> <li>• Limited competition for the Global System for Mobile Communications (GSM) operators arising from higher entry costs amid surging FX requirements</li> <li>• Built to Suit (BTS) Leases often incorporate some FX components in their cost structure, we expect elevated lease costs arising from a currency devaluation</li> </ul>



**Outlook**

In our H2:2023 NSR report, our exchange rate forecast for the Naira at the official window is within a range of **NGN780/USD to NGN830/USD** in 2023. We expect banking sectors to outperform given potentially strong FX gains, and we opine that increased cost of business may encourage some M&A<sup>2</sup> activity as businesses grapple with higher costs of business.

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<sup>2</sup> Mergers and Acquisitions



## PMS Subsidy Removal: The Wait is Over

Fuel subsidy has remained a contentious issue in Nigeria for several decades. The country heavily relies on petroleum products to meet its energy needs. To make fuel more affordable for its citizens, the Nigerian government commenced subsidy regime in the 1970's. It became institutionalized in 1977 following the promulgation of the Price Control Act which aimed to bridge the gap between the market price and the cost of production. However, the fuel subsidy program has faced numerous challenges, including corruption, and inefficiency which has caused the economy significant fiscal strain.

While the initial goal for PMS subsidy was to alleviate the burden of high fuel prices on the average Nigerian and improve living standards, the Nigerian government has overtime opined that the program has created economic distortions, hindered investment, and contributed to fiscal deficits. Hence, the need to discontinue the program. By removing fuel subsidy, the government posited that it would create a more transparent and market-driven pricing mechanism that reflects the actual cost of petroleum products. We note that this alone is not enough to encourage investment, innovation, and competition within the downstream sector, considering there are still issues of vandalism.

### Impacts Of Fuel Subsidy Removal on the Nigerian Economy

<ul style="list-style-type: none"> <li>• Upward pressures on Inflation due to rising cost of transportation, and the trickledown effect on other CPI<sup>3</sup> sub-indexes</li> <li>• Competitive pricing would incentivize downstream companies to improve efficiency</li> </ul>	<ul style="list-style-type: none"> <li>• Fiscal stability and reduced budget deficits</li> <li>• Enhance the fiscal ability to grow critical sectors such as healthcare, education, infrastructure, agriculture, and technology</li> </ul>
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<sup>3</sup> Consumer Price Index





### Impact Of Fuel Subsidy Removal on the Capital Market

<ul style="list-style-type: none"> <li>The deregulation of the downstream sector has so far indicated the likelihood of wholesale fiscal reform and has improved market outlook. We expect the positive sentiment this has created to impact general fiscal outlook positively while also driving traction to oil and gas tickers</li> </ul>	<ul style="list-style-type: none"> <li>The deregulation of the downstream sector is likely to attract a significant influx of foreign investors, hunting for the oil and gas companies on the Nigerian equities market</li> </ul>
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### On a Balance of Factors

We expect a prolonged bullish trend in the equities market driven by both local and foreign participation and advise investors to invest in companies in the oil and gas sector with robust fundamentals.



## Electricity Act 2023: The Fight for Light

Nigeria's power supply has long suffered from chronic instability, despite numerous attempts at structural reforms and investments in the electricity sector. The Electricity Act was enacted on the 8<sup>th</sup> of June 2023. This Act is aimed at establishing a fully privatized and competitive electricity market in Nigeria, with tariffs that accurately reflect the costs involved. Consequently, the Act repeals the Electric Power Sector Reform Act, 2005.

The primary objective of the Act is to stimulate private sector investments in the power sector, establish a robust post-privatization framework, promote the integration of renewable energy sources, and implement cost-reflective tariffs.

We anticipate several positive outcomes for the Nigerian economy if the Act is properly implemented.

- Improvement in power infrastructure
- Increased supply and efficiency in business operations
- The introduction of new market players is expected to foster a more competitive environment
- Improved service quality for consumers

Though, the Act encourages an increase in electricity tariffs (about 40%) which may deplete consumers' disposable income, it provides a Power Consumer Assistance Fund (PCAF) which provides subsidized tariffs for consumers who are not able to afford the full costs of the electricity tariffs. Furthermore, the Act provides incentives such as tax relief to promote the generation and consumption of energy from renewable energy sources. On the back of this, we expect the emergence of companies specializing in renewable energy sources.



## Equities Market: A Promising Outlook

The enactment of the Electricity Act 2023 is expected to have a positive impact on the Nigerian equities market, particularly in relation to the privatization, investment, and overall efficiency of the power sector. Consequently, we anticipate an increase in the number of power companies listed on the Nigerian Exchange (NGX). Currently, GREGU and TRANSCORP are the two listed firms, highlighting the limited presence of the power industry on the NGX. The influx of private-owned power companies is likely to attract foreign investors, leading to increased liquidity and attractiveness in the equity market.

Furthermore, the introduction of cost-reflective tariffs is expected to drive consumer preference towards companies involved in renewable energy sources. In addition, the Act provides tax incentives and easy licensing for renewable energy service companies, encouraging investment in these service companies. Consequently, we anticipate a rise in the number of renewable energy companies listed on the NGX.

However, the Consumer Goods sector may face challenges due to anticipated inflationary pressures driven by structural factors, including the increase in electricity tariffs. This could affect consumer purchasing power and negatively affect the profitability of companies in this sector. Similarly, the Industrial Goods sector is expected to record surging cost, but the sector's price making advantage puts it in a place to transfer it to customers and maintain decent profit levels. Nonetheless, companies in these sectors can explore energy-efficient alternatives such as solar power to mitigate the impact of rising electricity costs. The Industrial Goods sector for one are big on optimising energy mix, and we would expect a replication of such energy strategy across board.

Overall, assuming proper implementation, the Electricity Act 2023 is expected to address one of the challenges of doing business in Nigeria, which is insufficient power supply. Notably, it could also usher in a period of improved investment that bodes well for the overall capital market.



### Fixed Income Market: Possibility of the Bears

The Electricity Act's provision for privatization is expected to attract investments in the power sector, leading to the emergence of privately owned power companies. As these companies seek to expand and develop, they are likely to issue fixed income instruments such as corporate bonds, presenting opportunities for investors to diversify their portfolios. This increased issuance of bonds by power companies may contribute to an uptrend in yields in the fixed income space, especially considering the potential impact of inflation caused by higher electricity tariffs. Additionally, the credit risk associated with electricity-dependent companies could prompt investors to demand higher yields on the bonds they issue.

However, considering the overall factors at play, we maintain our stance from our [H2:2023 Outlook Report](#), that yields in the fixed income market will taper. This projection is based on the high system liquidity expected during this period.



## Executive Orders: A New Tax Regime

In July 2023, President Bola Ahmed Tinubu demonstrated his commitment to economic reform by enacting four (4) executive orders that have profound implications for the tax landscape in Nigeria. These orders aim to streamline the tax system, alleviate concerns surrounding multiple taxations, and tackle local anti-business practices. By signing these executive orders, the President has set in motion a series of measures designed to create a more favourable environment for businesses operating in Nigeria.

### Finance Act (Effective Date Variation) 2023

The Federal Government of Nigeria has issued an executive order deferring the commencement date of the changes contained in the Finance Act 2023 from May 23, 2023, to September 1, 2023. The Finance Act 2023 introduced several changes to the tax regime in Nigeria, including:

- An increase in tertiary education tax rate from 2.5% to 3%.
- Elimination of double VAT (Value Added Tax) on goods purchased from a non-resident supplier.
- A 0.5% levy on goods imported outside of Africa into Nigeria.
- Removal of investment allowance on plant and equipment.
- Deduction of life insurance premiums.

The executive order defers the commencement date of these changes for a period of 90 days. This is in accordance with the 2017 National Tax Policy, which allows the government to defer the commencement date of tax changes to give businesses and other stakeholders more time to adjust. The deferral of the commencement date of the Finance Act 2023 is a positive development for businesses in Nigeria. It will give them more time to prepare for the changes and to ensure that they are compliant with the new tax regime. The deferral is also a sign that the government is committed to working



with businesses to ensure that the tax system is fair and efficient. This is important for attracting investment and stimulating economic growth.

### **Suspension of Customs Excise Tax Amendment Order, 2023**

The Federal Government of Nigeria has suspended the commencement of tax changes on consumer goods, such as water, tobacco, and alcohol. The changes were originally scheduled to take effect on March 27, 2023, but have now been deferred to August 1, 2023. The suspension of the tax changes is a positive development for consumers, as it will lead to lower prices for these goods. The tax changes would have imposed a 5% levy on the sale of these goods, which would have been passed on to consumers in the form of higher prices. The suspension of the tax changes is a welcome relief for consumers and businesses alike.

### **Suspension of Excise Tax on Telecommunication Services Order, 2023**

The Federal Government of Nigeria has suspended the implementation of the 5% excise tax on telecommunication services. The excise tax was introduced in the Finance Act 2023 but has been met with widespread opposition from businesses and consumers. The order suspends the implementation of this tax for a period of six months. This will give the government time to review the tax and to consider alternative ways to raise revenue. With this suspension, there will be reduced tax burden on consumers and businesses.

### **Suspension of Green Tax on Single-Use Plastics Order and Import Tax Adjustment Levy on Certain Vehicles Order, 2023**

This order suspends the implementation of the 10% green tax on single-use plastics. The green tax on single-use plastics was also introduced in the Finance Act 2023 and was aimed at preventing errant dumping of plastic waste products. However, it was criticized for being too harsh on businesses and consumers.



Like the other orders, the tax has been suspended for a period of six months. This will give the government time to review the tax and to consider alternative ways to promote environmental sustainability. Though, the suspension of the tax bodes well for consumer pricing, it could undermine efforts aimed at reducing Single-Use Plastics (SUPs) in Nigeria. Furthermore, the import tax adjustment levy was introduced in the Finance Act 2023. It was criticized for being too high and for disproportionately affecting low-income consumers. The order suspends the implementation of this tax for a period of six months. This should reduce the tax burden on consumers. However, it is likely that we would see an increase in the importation of vehicles in the coming months. For context, according to the Nigeria Bureau of Statistics, the importation of Vehicles, aircraft, and parts thereof; vessels etc. fell by 13.00% YoY to NGN396.99bn in Q1:2023 (vs. NGN456.32bn in Q1:2022). However, this might be the reverse in the remaining part of the year, following the suspension of the import tax.

### **Equities Market: Respite for Consumer Goods and Telecommunications Sectors**

The temporary suspension of excise taxes on domestically manufactured goods, telecommunication services, Single Use Plastics (SUPs), and the lifting of import taxes on select vehicles are poised to generate positive outcomes for the Consumer Goods and Telecommunications sectors from a financial perspective. These tax breaks directly result in lower production costs for companies, leading to improved profitability. Additionally, the suspension of these taxes will have a direct impact on the prices of goods and services. Consequently, businesses operating in these sectors are likely to sustain decent revenue performance, an indication of sustained positivity for bottom-line performance.

Given the suspension of the various taxes through the executive order, we expect consumption to remain modest especially in the Consumer Goods and Telecommunications sectors.



Overall, as stated in our H2:2023 outlook report, our sector recommendation are the **Banking, Oil and Gas and Industrial Goods sector.**

CONSUMER GOODS	Closing Price as of 21st July		Upside/Downside	RECOMMENDATION
	2023	TP		
DANGOTE SUGAR REFINERY PLC	29.00	23.7	-18.28%	SELL
FLOUR MILLS NIG. PLC.	31.90	38.37	20.28%	STRONG BUY
GUINNESS NIG PLC	73.00	144.71	98.23%	STRONG BUY
NIGERIAN BREW. PLC.	43.65	39.22	-10.15%	SELL
<b>FINANCIAL SERVICES</b>				
ACCESS HOLDINGS PLC	18.35	20.86	13.68%	OVERWEIGHT
FBN HOLDINGS PLC	19.85	20.53	3.43%	NEUTRAL
GUARANTY TRUST HOLDING COMPANY PL	38.50	38.13	-0.96%	UNDERWEIGHT
UNITED BANK FOR AFRICA PLC	14.90	17.67	18.59%	OVERWEIGHT
ZENITH BANK PLC	35.15	39.58	12.60%	OVERWEIGHT
<b>ICT</b>				
AIRTEL AFRICA PLC	1319.90	915.11	-30.67%	SELL
MTN NIGERIA COMMUNICATIONS PLC	270.00	352.96	30.73%	STRONG BUY
<b>INDUSTRIAL GOODS</b>				
BUA CEMENT PLC	98.95	110.81	11.99%	OVERWEIGHT
DANGOTE CEMENT PLC	352.00	348.34	-1.04%	UNDERWEIGHT
LAFARGE AFRICA PLC (WAPCO)	28.60	45.01	57.38%	STRONG BUY
<b>OIL AND GAS</b>				
SEPLAT ENERGY PLC	1399.80	1,483.90	6.01%	NEUTRAL
TOTALENERGIES MARKETING NIGERIA PLC	370.00	437.35	18.20%	OVERWEIGHT

RECOMMENDATION	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding – i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio





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