

Nigeria Strategy Report – H1 2017 Excerpts

Review of Global Economy and Markets

Economic Snapshot

November 2016 Inflation Data/Indices			
	MoM	YoY	Prev YoY
Headline	0.78%	18.5%	18.5%
Food	0.88%	17.2%	17.1%
All Items Less Farm	0.71%	18.2%	18.1%
Imported food	0.86%	21.2%	21.2%
Energy	0.15%	31.4%	32.1%
Currency Markets			
	Latest	Daily Chg	YTD
USDNGN	305.0	0.0%	0.0%
EURNGN	333.7	0.2%	3.0%
GBPNGN	387.1	0.3%	2.0%
JPYNGN	272.0	0.4%	4.0%
Monetary Aggregates – October 2016			
	(₦bn)	MoM	YoY
M2	22,276	0.7%	22.4%
CPS	23,070	1.9%	20.9%
NCG	3,705	1.2%	63.8%
NFA	7,742	-1.7%	64.7%
NDC	26,775	1.8%	25.4%
External Position			
	Latest	QoQ	YoY
Trade Balance (\$'mn)	-235.07	-21.5%	N/A
External Reserves (\$'mn)	26,659	-3.5%	-19.2%
Foreign Debt (\$'mn)	10,718	0.9%	10.4%
Growth Data – Q3 2016			
	(₦bn)	%of total	YoY
Real GDP	17,574	100%	-2.2%
Agriculture	5,035	28.7%	4.5%
Oil	1,439	8.2%	-22.0%
Services	5,950	33.9%	-1.1%
Wholesale and Trade	2,880	16.4%	-1.4%
Manufacturing	1,700	9.7%	-4.3%

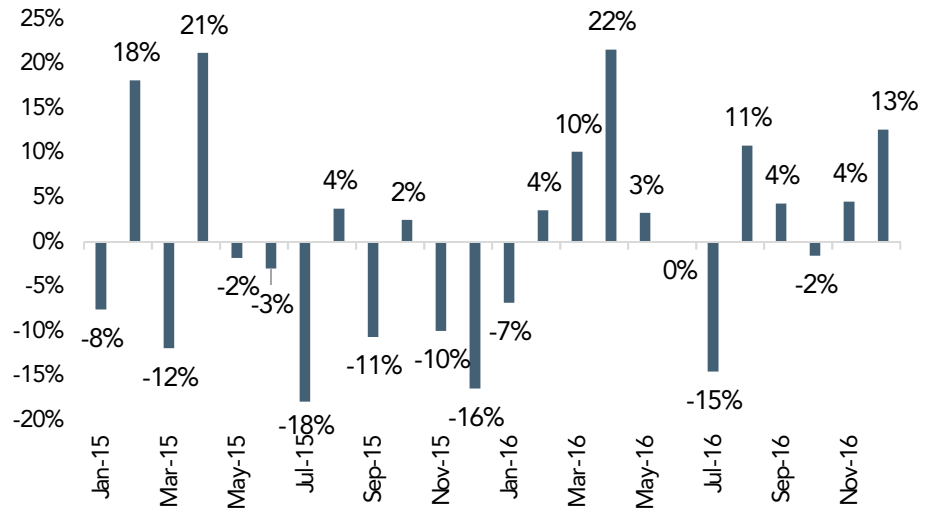
CRUDE OIL PRICES ON VERGE OF A BREAKOUT?

Prospect of market rebalancing propels best oil price rally since 2009

Crude oil prices have had some sharp swings over 2016, but the trend since hitting multi-year lows in January has clearly been up as talk of market rebalancing by conventional oil producers gained ground. On the heels of a bull run in H1 16 (+33% to \$49.68/bbl), Brent crude started off H2 16 on a bearish note in July (-14.5% MoM to \$42.46/bbl) as talk of an output freeze ahead of OPEC's April 2016 meeting which fueled the rally in H1 16 waned. However, as production shut-ins in Canada and Nigeria remained over August, oil prices recovered 10.8% MoM to \$47.04/bbl as fresh talks of possible production freeze at the informal OPEC meeting slated for September received Russia's support. Ahead of the talks in Qatar, which eventually culminated in a draft agreement by OPEC to cut production to a target of 32.5-33.0mbpd, prices climbed further 3.3% to \$48.6/bbl. in September. Nonetheless, prices receded in October (-1.5% MoM to \$48.3/bbl) as oil fundamentals weakened sharply—with oversupply more extensive than it had been believed before—as OPEC production increased by 179kbpd and 237kbpd in September and October to 33.4mbpd and 33.6mbpd respectively. That said, in the aftermath of the OPEC production cut of November 30, Brent tracked higher 8.8% pushing the MoM return to 4.5%. Gains extended through December (+12.6% MoM) given market expectations for rebalancing across global oil markets.

Overall, though crude oil prices returned 52.4% in 2016, mean prices at \$45/bbl. are 15.7% lower relative to 2015 on account of the collapse in January.

Figure 1: Brent Crude Monthly returns



Source: Bloomberg, ARM Research

Record high OPEC output and recovering Canadian output bolsters supply

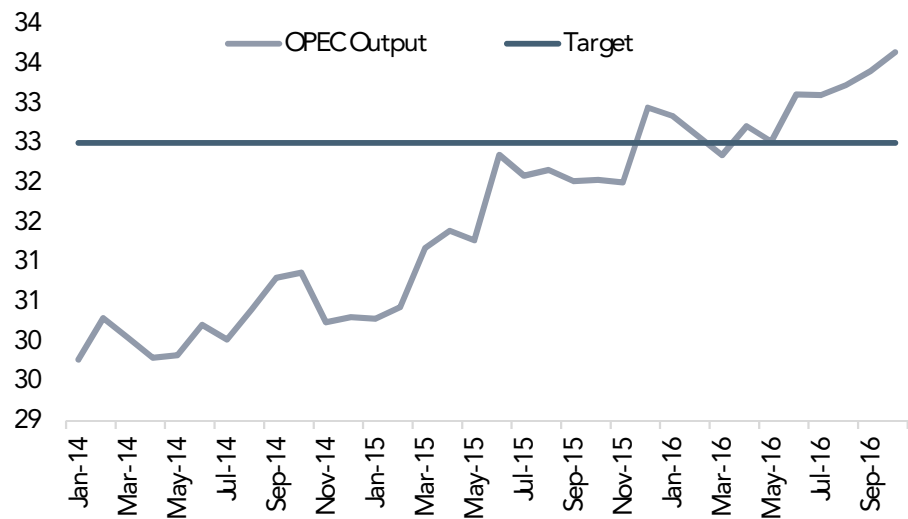
In terms of fundamentals, global oil supply rose 1.0% QoQ in Q3 16 to 96.2mbpd buoyed by higher production by OPEC and non-OPEC producers triggered by return of disrupted Canadian oil supply¹ and OPEC crude production at its highest level since 2008. OPEC supply increased by 400kbpd during the period to 39.6mbpd (including NGLs) while non-OPEC supply increased by 500kbpd to 56.6mbpd. The production decline from the troika of Nigeria, Venezuela and Libya was offset by an increase in output by Iraq, Iran and Saudi Arabia (Saudi Arabia, Iraq and Iran’s production averaged 10.25mbpd, 4.27mbpd and 3.37mbpd respectively).

Based on the most recent report, total OPEC oil production in October grew to a new record high of 34.02mbpd with the largest contributor to the increase being Nigeria (+170kbpd), Libya (+180kbpd), Iran (+50kbpd) and Iraq (+50kbpd), while

¹ The drop on the non-OPEC leg was led by cyclical reductions in the US (-310kbpd) from independent producers as well as unprecedented outages in Canada due to wildfires (-340kbpd).

Saudi Arabia, Qatar and Venezuela slightly reduced output by 20kbpd each. Angola marked the most noticeable change to its production, decreasing output by 230kbpd. On YoY basis, OPEC ramped up its total output by 6.2%. Further down, non-OPEC supply which expanded 500kbpd to 56.6mbpd in Q3 16 inched further +466kbpd MoM in October buoyed by increase in US supply (+137kbpd) and Russia (+123kbpd) while supply from UK, Malaysia and China dipped 27kbpd, 25kbpd and 21kbpd accordingly from preceding month.

Figure 2: Oil Production OPEC (mbpd)



Source: OPEC MOMR, IEA, ARM Research

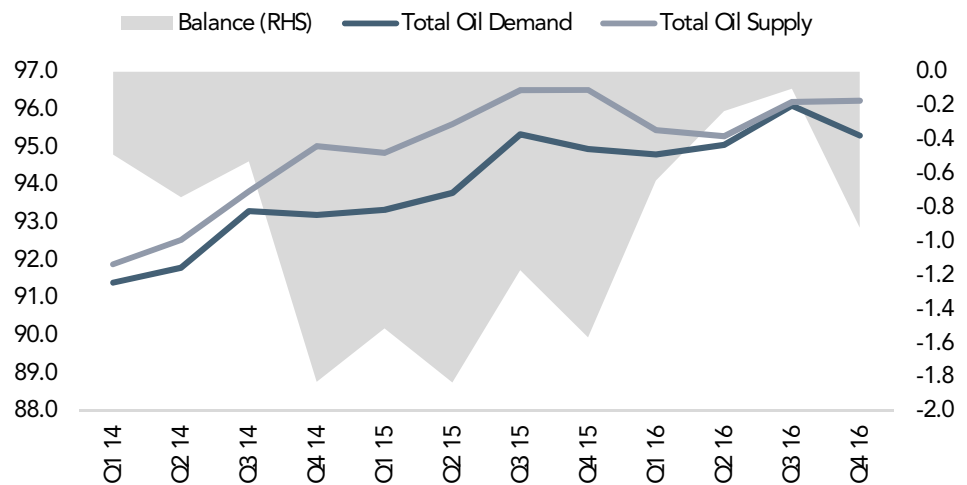
Demand stays upbeat, buoyed by India and China

On the demand side, global crude oil consumption climbed in Q3 16 to 96.1mbpd (+1.1% QoQ) driven by growth in OECD (+1.6% QoQ) and non-OECD (+0.6% QoQ). The growth recorded in the OECD region was primarily due to strong demand in the Europe and USA. Demand in the US (21% of global demand) reflected seasonal rise in gasoline consumption during the summer driving season. Also, seasonal factors buoyed Q3 16 oil demand in Europe (14% of global demand)—higher consumption of road transportation fuels and an improvement in vehicle sales resulted in higher demand. Elsewhere, increased consumption in Asia, particularly in India (+400kbpd) and China (+300kbpd) underpinned expansion in non-OECD

demand. For China, (12% of global demand) consumption was buoyed by rise of its small independent refiners (teapot refineries)²—which contributed circa.90% to China's crude oil import growth over 2016 (+18% YoY) to 7.87mbpd. For India, robust vehicle sales—with double digit growth in gasoline and diesel consumption—infrastructure push and government’s LPG penetration scheme were the key drivers for the sturdy growth in India consumption. India now consumes 4mbpd due to a massive road-building program, a booming refining industry and a government-led push to increase manufacturing activity to 25% of domestic output by 2022 (currently 15%).

Overall, while supply glut persisted over 2016 at 1.13mbpd based on latest numbers for November, the glut moderated pointedly from 1.4mbpd in H2 15 to 640kbpd, 230kbpd and 100kbpd for Q1 16, Q2 16 and Q3 16 respectively. Perhaps, increased production by OPEC and Russia ahead of the agreed production cut drove the swing in supply glut to cross the 1mbpd levels.

Figure 3: Crude oil Supply/Demand vs. Balance (in mbpd)



Source: IEA, ARM Research

² The Chinese government granted crude import quotas to teapot refineries at the end of 2015 in a bid to reform the refining industry, boost competition and attract private investment.

OPEC finally cuts...triggering the long-awaited supply rebalancing

At the end of its second bi-annual meeting, OPEC announced its intention to cut group oil production by 1.2mbpd from current levels of 33.6mbpd—the first cut by the cartel since 2008. The agreement, which is scheduled to start January 2017 and hold for six months would involve output cuts across all member countries with some special considerations for Iran, Libya, and Nigeria while Indonesia suspended its membership temporarily. From the details released, the core of the cut came from the two largest producers, Saudi Arabia, and Iraq, who agreed to reduce output by 486kbpd and 210kbpd respectively—Iraq had previously pushed for special consideration hinged on the urgency of its offensive against ISIS. Furthermore, UAE and Kuwait agreed to cut production by 139kbpd and 131kbpd accordingly. For Iran, pre-sanction output of 3.97mbpd was used which represents an output freeze after Iran ramp up in production by 90kbpd from 3.69mbpd reported in October. For Indonesia, due to its net import status, the country was allowed to suspend its membership—implying no production cut. Further, Libya and Nigeria were granted exemption from output cut due to severe supply disruption.

Table 1: Proposed production cut for individual OPEC members in Vienna accord

	Jul-16	Aug-16	Sep-16	Oct-16	Adjustment	Production from Jan 2017
Algeria	1,087	1,088	1,086	1,089	(50)	1,039
Angola	1,782	1,786	1,751	1,751	(78)	1,673
Ecuador	548	543	550	548	(26)	522
Gabon	230	221	212	202	(9)	193
Indonesia	737	726	724	722	-	722
Iran	3,629	3,647	3,663	3,690	90	3,780
Iraq	4,320	4,375	4,472	4,561	(210)	4,351
Kuwait	2,783	2,810	2,825	2,838	(131)	2,707
Libya	304	270	360	528	-	528
Nigeria	1,508	1,419	1,458	1,628	-	1,628
Qatar	662	657	640	648	(30)	618
Saudi Arabia	10,477	10,603	10,583	10,544	(486)	10,058
U.A.E.	2,943	2,976	2,993	3,013	(139)	2,874
Venezuela	2,095	2,107	2,090	2,067	(95)	1,972
	33,105	33,228	33,407	33,829	(1,164)	32,665

Source: OPEC, ARM Research

Another relevant theme in the context of the negotiations is the role that will be played by non-OPEC producers—a production cut of 600kbpd led by Russia, the largest Non-OPEC producer, which agreed to cut output by circa.300kbpd, while some other members agreed to cut production as follows—Mexico (100kbpd), Azerbaijan (35kbpd), Oman (40kbpd) and Kazakhstan (20kbpd). Overall OPEC and non-OPEC members slashed total production by circa 1.8mbpd.

Can OPEC cohesiveness hold off rebound in shale production?

Supported by production cut, the crude oil market is headed for rebalancing in 2017, as rising demand is expected to slightly outpace supply. On the demand side, the EIA estimates that the demand for crude oil should rise by 1.2mbpd over 2016 and 2017 a view shared by OPEC's whose own analysis projects YoY oil demand growth of 1.3mbpd in 2016 and 1.2mbpd in 2017. More strikingly, China and India are expected to support the global demand growth over the period. For China, its teapot refineries are expected to add around 200kbpd – 400kbpd to China's overall crude oil import growth over 2017. The foregoing combined with lower retail pump prices, rising vehicle sales and ongoing efforts to raise strategic and commercial crude oil stocks is expected to support Chinese demand. The increase in diesel and gasoline

consumption in India buoyed by robust car sales as well as structural changes to the economy³ will keep demand growth elevated.

On the supply side, we see a gradual balancing in the oil market over 2017 with an expected deficit in H2 17, which aligns with the EIA⁴ and OPEC outlook. However, this will be possible only if OPEC sticks to its commitment of achieving its production target (32.7mbpd) and non-OPEC members agree to reduce their oil output by 558kbpd. For OPEC members exempted from the arrangement, we see upside to supply from Nigeria and Libya in 2017. For Nigeria, the fiscal challenges caused by militant attacks seems to have forced the government to initiate conciliatory moves with militants with ₦65 billion provided for in the 2017 budget. While we remain conservative about the ramp up in production, we think a steady improvement is likely and could see about 200-300kbpd increase from current 1.6mbpd. Elsewhere in Libya, the Petroleum facilities guard (PFG) recently re-opened a pipeline with access to two major oil producing fields—the government has guided for oil production to average 975kbpd in 2017. While we think this is optimistic given the as yet unclear political situation in Libya, we are of the view that recent reopening of pipeline and export terminals should push Libya's production in 2017 to around 650kbpd.

For non-OPEC leg, given the resilience of the US production, as oil prices edge northwards, there are increased prospects of shale oil rebound as higher oil prices bodes well for shale producers in terms of renewed hedging, debt restructuring and bringing on-line of drilled uncompleted (DUCs) wells. Supporting this view is the rebound in US oil rig count which has risen 50.9% from a low of 316 in H1 16 to 477 in December. (YTD: -11%). Importantly, the backlog of drilled but uncompleted (DUCs) shale oil wells represent a new phenomenon in the oil industry. Akin to a form of storage, wells represent a large source of production that has yet to come online, but will likely hit the market as oil prices rebound.

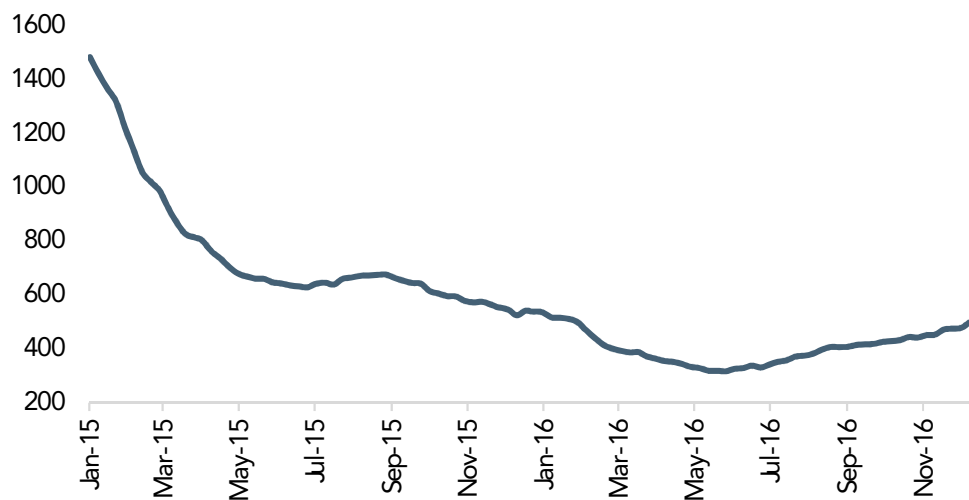
Another dynamic we believe markets should track over 2017 is the energy policies of the incoming US president Donald Trump. During the testy electoral campaign, the US president-elect pledged to remove all regulations on US energy production and

³ India government plans to increase the share of manufacturing in GDP from 16% to 25% in six years

⁴ According to the EIA, the markets will move into a supply deficit by H1 2017 and the global crude oil glut will disappear.

promised ‘no action’ on climate change. Thus, given the backdrop there are increased prospects for removal of regulatory/environment roadblocks which should allow for opening of more onshore and offshore leasing on US federal lands and waters to oil exploration. Furthermore, we think the Trump administration should continue the Obama era relaxation of restraints on US energy exports. Tying it all together we think a renaissance of US shale production could cap the OPEC-induced crude oil price rally with the EIA forecasting that U.S. oil production should rise 3.5% YoY to 8.8mbpd in 2017—an occurrence which could postpone the projected withdrawals in oil inventories, pushing drawdowns off until 2018. Overall, non-OPEC production is forecasted at 56.8mbpd in 2017 (+175kbpd YoY), majorly due to increased production from US (+300kbpd).

Figure 4: US Rig Counts



Source: Baker Hughes, ARM Research

Largely reflecting OPEC’s return to a managed market as well as the expected rebalancing, we are positive on oil over 2017. However, we note the possibility of near-term supply side disruptions from US, Libya and Nigeria remains downside risk to our outlook, majorly responsiveness of US shale and a lingering inventory overhang. In the interim, proposed OPEC and non-OPEC cut set the scene for a return to a balanced market. However, things can be quite different after H1 17 because the proposed cuts (by OPEC and non-OPEC members) are only applicable

for six months and these will be again reviewed during OPEC's ministerial meeting at the end of May 17. Based on the foregoing dynamics, we envisage the steady rebalancing of the crude markets should lead prices to trend higher in H1 17. Brent crude prices averaged \$49/bbl. in H2 16, we see the sustained rally keeping crude oil prices at \$50 - \$55/bbl. in H1 17.

Copyright © 2017 Asset & Resource Management Company Limited (“ARM”).

All rights reserved. Unauthorised use, reproduction, distribution or disclosure of this document is strictly prohibited.

This material has been issued by Asset & Resource Management Company Limited (“ARM”), a Company regulated by the Nigerian Securities and Exchange Commission. The analyst(s) primarily responsible for preparing this research report, in whole or in part, certifies that with respect to each security or issuer covered; all of the views expressed accurately reflect his/her personal views about the subject securities and issuers and no part of his/her compensation was, is, or will be, directly or indirectly, related to the inclusion of specific recommendations or views in the report.

This research report is based on information from sources that ARM and its analysts believe to be reliable. Neither ARM nor any of its research analysts, nor any member of the ARM Group, gives any representation or warranty, express or implied, or undertaking of any kind or assumes responsibility or liability of any kind with respect to the accuracy or completeness of the information set out in this report or any third party’s use (or the results of such use) of such information. This report is provided solely for informational purposes and is not to be construed as providing advice, recommendations, or endorsements of any kind whatsoever. The investments and strategies discussed here may not be suitable for all investors; counsel of investment advisor should be obtained with regard to such investments and or strategies. This research report is not a replacement for advice from an accountant, lawyer, personal finance advisor or other category of investment advisor. The investments discussed in this report may oscillate in price or value. Opinions and information provided are made as of the date of the report issue and are subject to change without notice. This research report is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Reference herein to any specific security or financial instrument does not necessarily constitute or imply its endorsement or recommendation by ARM, its directors, officers, employees or designated agents. Members of ARM may act as broker, advisor or lender, or make a market in any investments or issuers referenced in this report. Further information on any of the securities discussed herein may be obtained upon request to ARM. By accepting this document, you agree to be bound by the foregoing limitations.