

January 25, 2021



Nigeria Strategy Report

H1 2021

Domestic Economy and Policy Environment

Equity: Volatility set to persist...

Executive Summary

In 2020, the Nigerian equity market was a major recipient of global risk-off sentiments as the pandemic weighed negatively on macroeconomic indicators. This caused heavy selloffs especially in the month of February and March, and a 20.6% contraction in the NSEASI performance at the end of Q1 20. In Q2 20, the market rebounded by 14.9% QoQ, supporting a reduction in the H1 20 contraction in NSEASI to 8.8%. This was supported by lower net foreign outflows relative to Q1 20 levels, which combined with continued moderation in yields in the fixed income space buoyed the QoQ gains witnessed in the equities market over this period. The NSEASI returned to a positive terrain in October 2020 following a bullish run in Q3 20 as yields in the fixed income space continued to trend southwards amidst robust system liquidity. In addition, optimism surrounding the COVID-19 vaccine and improved global crude oil prices also supported the gains recorded in the remaining part of the year. By the end of FY20, the market had gained 50.0% largely due to strong performance in Q4 20 (up 50.1% QoQ).

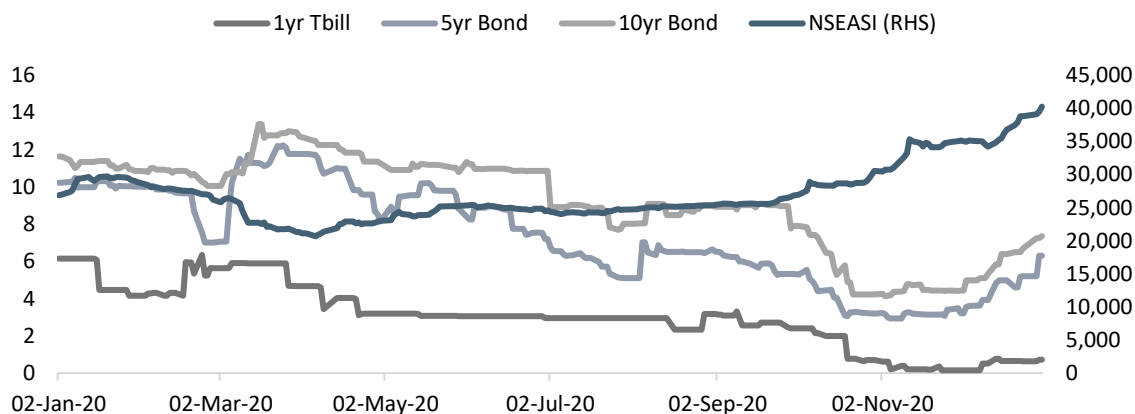
Looking ahead to 2021, we anticipate a flattish performance in H1 21 and also recognize the possibility of a slightly positive gain at the end of FY21. Given that Telecoms (+108%) and Cement (+106%) were majorly responsible for the strong gains posted on the NSE in FY 20, we do not rule out the possibility of investors booking profits on some of these names. Also, we expect to see increased flow of funds to other segments of the market that either underperformed or posted slight gains in 2020 as investors may decide to switch from sectors that may have met threshold gains to sectors that are perceived to be undervalued or recovering. As such, given our expectations on some of these blue-chip names, we expect a flattish performance in H121. In H221, we see scope for a better performance in the equity space largely due to higher system liquidity during the period which may further suppress yields.

In this report, we look at the major themes that dominated the equity market space in 2020 and delineate our outlook for 2021.

Volatility set to persist...

In 2019, the CBN gave a directive that limited participation in the OMO market to banks and foreign investors both in the primary and secondary market. This narrowed the investment options available to individuals and local corporates to instruments such as T-Bills and FGN bonds, thus leading to a material decline in yields across the fixed income space in 2019 to levels not seen since 2016. Average yield on the 1yr, 5yr and 10yr bond instrument fell by 39% YoY to 9.51%, with yields on the 1yr T-Bill also declining by 64% YoY to 6.16% as at the end of 2019. We had hoped that the unattractive yields in the fixed income space was going to rekindle local investors’ interest in the equities market, which informed our optimism towards the equity market performance in 2020. Our expectations were reflected in the equities market’s performance in the early part of the year, with the ASI up by 10.69% as of 20th January 2020. This was however short-lived as heavy profit taking set in on the back of the COVID-19 pandemic global outbreak.

Figure 1: NSEASI Performance VS fixed income yields



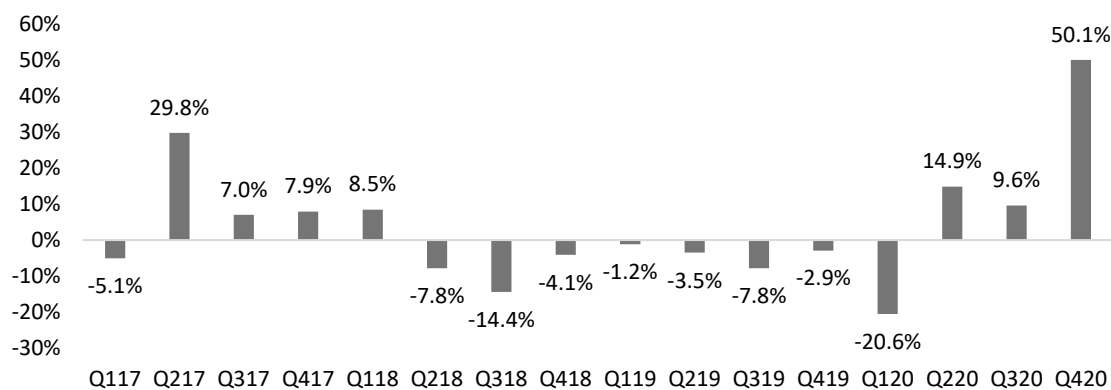
Source: NSE, FMDQ, ARM Research

One major event that impacted the local and global scene in 2020 was the global outbreak of the COVID-19 pandemic in the early part of 2020. This led countries around the globe to embark on measures such as lockdowns, flight restrictions and social distancing all of which contributed to the massive contraction in global GDP numbers especially in H120. Consequently, demand for crude oil weakened causing oil prices to trade at low levels last seen since 2016. This forced OPEC and its oil producing allies to deliver a historic cut of 9.7MMbpd to support prices.

The Nigerian equity market was a major recipient of global risk-off sentiments as the pandemic weighed negatively on macroeconomic indicators. This caused heavy selloffs especially in the month of February (-9.1% MoM) and March (-18.8% MoM), and a 20.6% contraction in the NSEASI performance at the end of Q1 20. A look at the transaction report by NSE over this period revealed

a total foreign net outflow of ₦121.3 billion – an indication of foreign investor’s bias towards the Nigerian equity space as the race to position in safe haven assets heightened. In Q2 20, the market rebounded by 14.9% QoQ, supporting a reduction in the H1 20 contraction in NSEASI to 8.8%. Compared to Q1 20, net foreign outflow in Q2 20 declined by 87.3% to ₦15.4 billion as difficulty in assessing FX led foreign investors to reinvest dividends. This coupled with the continued moderation in yields in the fixed income space buoyed the QoQ gains witnessed in the equities market over this period. The NSEASI returned to a positive terrain in October 2020 following bullish run in Q3 20 as yields in the fixed income space continued to trend southwards amidst robust system liquidity. In addition, optimism surrounding the COVID-19 vaccine and improved global crude oil prices also supported the gains recorded in the remaining part of the year. At the end of FY20, the market had gained 50.0% largely due to strong performance in Q4 20 (up 50.1% QoQ).

Figure 2: NSEASI Quarterly Returns



Source: NSE, ARM Research

Mixed sectoral performance in FY20

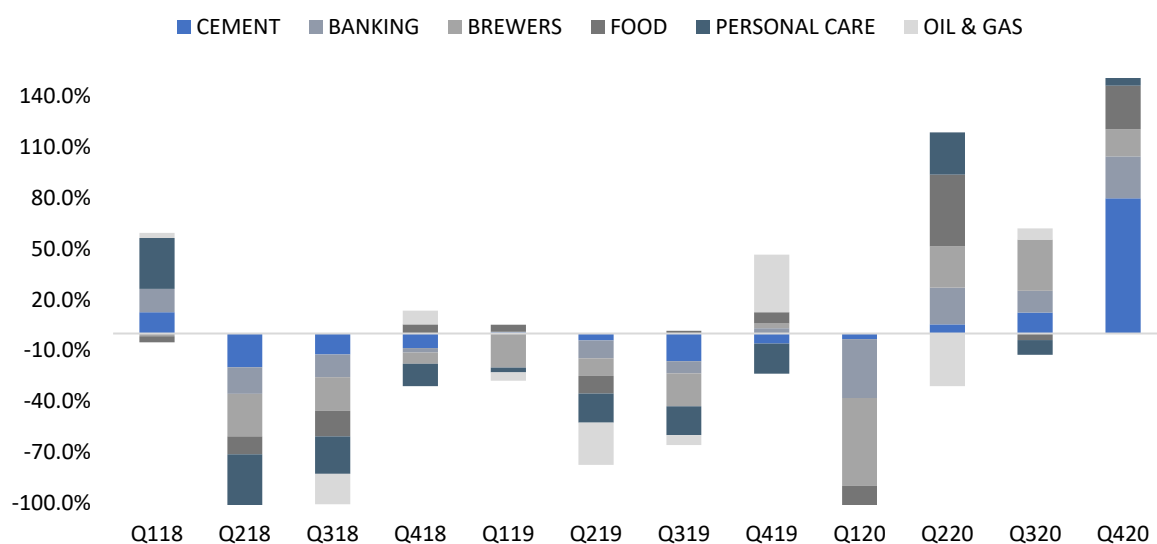
The equities market posted mixed performance across all major segments over the FY 20 period with strong gains in Telecoms (+108% YoY), Cement (+106% YoY), as well as 12% YoY and 6% YoY improvement in the Banking and Food segment. However, Oil & Gas (-42% YoY), Personal Care (-28% YoY) and Breweries (-9% YoY) were a drag on market performance.

The turnout of events following the outbreak of the COVID-19 pandemic favored the telecommunication space as shares of MTN (+62% YoY) and Airtel (185% YoY) recorded significant price appreciation. The decision to embark on lockdown measures boosted increased demand for data products as corporate entities adopted virtual mode of operations.

Similarly, the sector benefited from positive sentiments on investors’ expectations of resilient corporate earnings relative to what may be obtainable in other sectors of the economy. Elsewhere, better than expected financial performance in Q2 20 despite lockdown measures, which continued into Q3 20, coupled with investor optimism on Q4 20 performance was largely supportive of the gains posted in the Cement sector. Consequently, Dangote Cement, Lafarge and BUA Cement gained 72% YoY, 38% YoY and 101% YoY to close the year at ₦244.90, ₦21.05 and ₦77.35, respectively. It is instructive to also point out that the announcement by management of Dangote Cement to commence on its share buyback programme played a role in the gains posted in FY 20. Furthermore, attractive dividend yields following the downtrend in the prices of players in the banking space amidst robust system liquidity and absence of attractive investment outlets in the fixed income space was responsible for the improvement in the banking index.

Investor bias against the Oil & Gas, Breweries and Personal Care segment however persisted in FY 20. The southward trend in crude oil prices and uncertainties that clouded the global economic outlook led to investors selling down on upstream players like Seplat (-39% YoY) and Oando (-7% YoY). Notwithstanding, downstream players like Total (+17% YoY) and Mobil (+54% YoY) benefited from federal government’s move to deregulate the downstream sector of the economy. For the Breweries segment, NB (-5% YoY), Guinness (-58% YoY) and IB (-37% YoY) were largely responsible for the downtrend. Similarly, Unilever (-37% YoY) and PZ (-6% YoY) were the biggest losers in the personal care segment and mainly accounted for the contraction seen in this space over the FY 20 period.

Figure 3: Sectoral returns over FY 2020

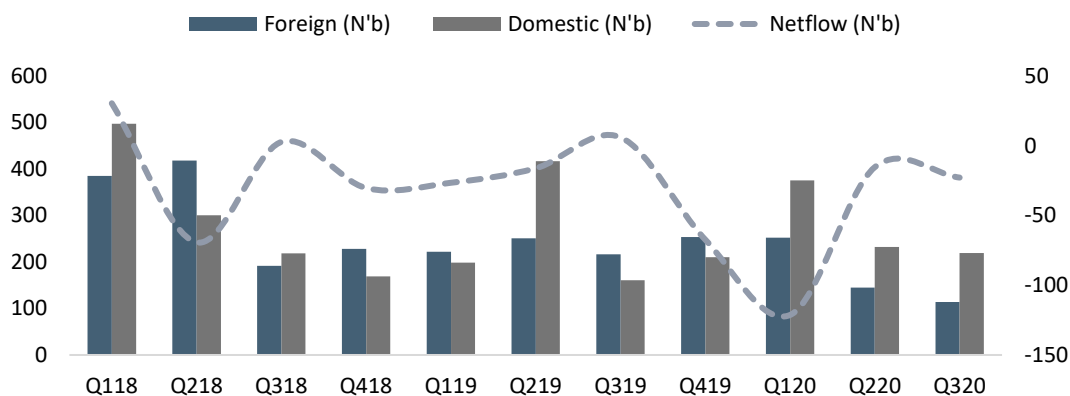


Source: NSE, ARM Research

Locals dominated the bourse in FY 20

Like in FY 19, local investors were the largest participants on the Nigeria stock exchange market in 2020. The latest data released by the Nigeria Stock Exchange revealed that total domestic transactions rose by 34.6% YoY to ₦1.24trillion in November 2020, supported by increased participation from both retail and institutional investors. For institutional investors, total transaction value rose by 46% YoY to ₦682.05 billion – faster than the 23% YoY growth in transaction value from retails to ₦557.57 billion. We note that prolonged downward movement in fixed income yields amidst robust system liquidity was largely responsible for the higher participation witnessed from these investors in 2020. However, participation from foreign investors declined by 25% YoY to ₦659.28 billion and worse still, was characterized by significant net outflow than was witnessed in 2019. Net foreign outflow increased by 144% YoY in November 2020 to ₦207.02 billion, reflecting the negative bias towards the Nigeria equity space amidst the global uncertainty brought about by the COVID-19 pandemic.

Figure 4: Foreign and domestic share of transactions



Source: NSE, ARM Research

Taking a cursory look at what played out on a quarterly basis, we observed that local transactions have been dominating the equity market scene since Q1 20 when it constituted 59.8% (Q4 19: 45.3%) of total market transaction value. In absolute terms, total value of transactions by domestic investors increased by 89.0% YoY and 78.6% QoQ to ₦374.99 billion in Q1 20. Although total market transaction value declined in both Q2 20 and Q3 20 relative to Q1 20, we note that participation from local investors progressively increased and touched 73.5% in the first two months in Q4 20. We had earlier mentioned that unattractive yields in the fixed income space was largely responsible for the increased inflow of funds from domestic investors as system liquidity heightened on the back of apex bank’s accommodative

monetary policy stance. On the flip side, foreign transaction took the back seat in Q1 20 as it contributed 40.2% (Q418: 54.7%) of the total market transaction value. Contrary to what we observed for local investors, participation rate from foreigners continued to decline over the course of the year printing at 34.2% as at the end of Q3 20. In the first two months of Q4 20, foreign participation rate further declined to 26.5%. Furthermore, we note that net foreign outflow from the Nigerian equity market peaked in Q1 20 (₦121 billion), higher than the FY 19 net foreign outflow of ₦104 billion. It however moderated to ₦15 billion and ₦23 billion in Q2 20 and Q3 20 respectively following CBN decision to halt the sales of FX to the market. In the first two months of Q4 20, we observed an increase in net foreign outflow to ₦47 billion, higher than Q2 20 and Q3 20 levels.

Pockets of gains persist amidst heightened volatility...

The Nigerian bourse closed FY 20 on a strong note, despite the macroeconomic challenges that confronted the nation. In 2021, we believe the interplay of a mix of factors such as system liquidity, direction of yields in the fixed income space, corporate earnings and its impact on dividend yields as well as investors perception of valuation of stocks trading in the market will determine the performance of the equity market. From a fundamental standpoint, the Nigeria equity space appears to be relatively expensive compared to peers in Africa. As at FY 20, the NSEASI P/E ratio printed at 15.3x, higher than Egypt (11.6x) and Kenya (11.3x), however, lower than South Africa's FY 20 P/E ratio of 27.1x. Although general market P/E ratio may not be reflective of most traded stock on the exchange market, given that it may be largely determined by few blue-chip names, we note that it forms a basis as to what to expect going forward. We recall that the Telecoms (+108%) and Cement (+106%) were majorly responsible for the strong gains posted on the NSE in FY 20 while the Banking (+12%) and Food (+6%) recorded milder gains. Other segments like the Oil & Gas, Personal Care and Breweries underperformed in FY 20.

In light of this, we do not rule out the possibility of investors booking profits on some of the telecoms and cement names in H1 21. We are of the opinion that valuations on these names are already stretched and we do not see scope for further expansion in valuation multiples. For instance, according to Bloomberg, BUA Cement (44.7x) and MTN (17.1x) FY 20 P/E ratio trades at a premium compared to the MENA median P/E of 16.9x and 16.4x, respectively. This could act as an incentive for investors to book profit on these names bearing in mind the pockets of uncertainties still prevalent in the market. Notwithstanding we envisage we may see milder contraction in BUA Cement prices given that it is tightly held. Similarly, following the strong rally in Dangote Cement and Airtel, we see limited scope for further expansion in the prices of these names as valuations are already stretched. Also, we expect to see increased flow of funds to other segments of the market

that either underperformed or posted slight gains in 2020. For the Oil & Gas space, the crash in oil prices hit hard on Nigeria upstream players like Seplat and Oando in 2020. We expect to see renewed interest in this sector as recovery in global crude oil prices may bode well for earnings. Similarly, recovery in macroeconomic activities may be supportive of consumer spending which may be positive for players in the Food and Brewery segment. For Banking stocks, dividend yields may remain attractive and could be a compelling reason for investors to retain and possibly increase their stakes in the space. Overall, we expect to see a re-allocation of funds across different segments of the market. We suspect investors may decide to switch from sectors that may have met threshold gains to sectors that are perceived to be undervalued or recovering. As such, we anticipate a flattish performance in H1 21 given our expectations on some of these blue-chip names.

We allude to the unattractive rates in the fixed income space and robust liquidity in the system as positive for equity market performance in 2021. Just as discussed in the first paragraph, we expect these factors to support investment in segments of the market that are perceived to be undervalued or recovering. These includes segments such as the Oil& Gas, Food as well as for some players in the Personal Care segment.

Expectations of improvement in corporate earnings, we believe, will play a key role as to how much funds will be allocated to each of these segments of the market. It is important to also mention our expectation of heightened volatility in the equity space over this period as investors would look to book profit as soon as they attain targeted thresholds.

In H2 21, we see scope for a better performance in the equity space than we expect to see in H1 21. Our view is premised on the higher system liquidity in H2 21 mainly from bond maturities and coupon payment estimated at ₦1.53 trillion. Given our expectations that yields may be further subdued than we saw in H1 21, we are of the view that some of these funds may seek other investment outlets which may be positive for equity market performance in the second half of 2021. Putting all these together, we expect flattish to slightly positive performance at the end of the year.

Our strategy for the equity space in 2021 is for investors to bargain hunt for fundamentally sound stocks with potential for price appreciation as well as position in names with relatively appreciable dividend yields. As already mentioned in the report, our view would be for investors to actively play in the equities market in 2021 setting threshold gains and booking profit where necessary. The winning tactic in 2021 could be tied to the popular slogan of buying low and selling high. This clearly supports our view of active participation in the equity space and setting exit target at the start of the investment.

Below is our stock recommendation for our coverage universe.

Table 1: Stock recommendation

Sectors/ Stocks	Rating	FVE (₦)	Price (₦)	Upside	YTD Return	P/E FY 19(x)	P/E FY 20E (x)	P/B FY 19(x)	P/B FY 20E (x)	FY 20E dividend yield
ZENITH	BUY	30.2	26.15	15.50%	5.40%	4.2	3.6	0.7	0.7	11.10%
UBA	BUY	10.39	9.1	14.20%	5.20%	3	2.1	0.5	0.4	10.30%
GTB	HOLD	35.16	33.65	4.50%	4.00%	6.6	6	1.8	1.9	8.40%
ACCESS	BUY	12.92	9.6	34.60%	13.60%	3.5	2.9	0.6	0.5	6.30%
FBNH	BUY	9.4	7.3	28.80%	2.10%	5.8	4.4	0.4	0.5	3.20%
GUINNESS	BUY	21.4	18.5	15.70%	-2.60%	35.9	31.1	2.8	2.6	10.80%
FIDELITY	BUY	3.18	2.72	16.90%	7.90%	3.2	2	0.2	0.1	5.50%
DANGCEM	HOLD	235.35	234.6	0.30%	-4.20%	21	17.3	5	4	4.90%
NESTLE	SELL	1288.63	1505	-14.40%	0.00%	36.6	25.1	27.5	27.5	4.40%
NB	SELL	53.2	60	-11.30%	7.10%	33.9	31	4	3.6	4.30%
OKOMU	SELL	81.17	93	-12.70%	2.20%	9.7	10.4	2	1.7	2.80%
PRESCO	SELL	72.98	74	-1.40%	4.30%	2.9	12	0.7	0.7	1.30%
SEPLAT	BUY	964.45	540	78.60%	34.20%	3.3	3.5	0.6	0.5	10.00%

Source: ARM Research

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