

# A WOBBLY UPTURN

... Traversing Uncertain Paths

Meristem 2021  
Half Year Outlook

MERISTEM

## Content Highlights

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### **Uneven recovery across board**

Coming into the year, we premised our positive outlook for the global economy on wide-spread resumption of economic activities due to rapid vaccination. So far, recovery has been uneven across regions as some countries were forced to reintroduce lockdowns, while others gradually eased strict measures. However, in many countries Monetary and Fiscal authorities have maintained a supportive posture, keeping policy parameters accommodative till “skies are clear”. Going forward, we still expect speedy vaccination to spur growth although the emergence of a Delta variant poses downside risk to our outlook

**Domestic Economy.....19**

### **Slow but Steady Economic Growth**

As witnessed in Q4:2020, the pace of economic growth in the first quarter of the year remained sluggish due mainly to low oil output. While the steady recovery points to the impacts of fiscal and monetary stimulation, key macro indicators like exchange rate, inflation and capital flows highlighted lingering domestic weaknesses. In the second half of the year, a key tailwind to growth would be the possible OPEC quota relaxation amid supportive oil prices.

**Domestic Equities Market ..... 32**

### **Increase in Fixed Income Rates Turned Equities Fortune**

The improvement in fixed income yields triggered rotation of funds out of equities. Continued profit-taking across counters dragged the index performance even further into the negative territory. The buying pressure during earnings season turned out to be a dead cat bounce as the market soon reverted to its bearish-course. Yields in the fixed income market, foreign portfolio participation and corporate financial results are the major factors expected to call the market’s direction in the second-half.

**Fixed Income .....64**

### **Yields to Rise Less Steeply Over the Next Half**

The much-anticipated increase in domestic fixed income rates happened earlier than expected but the momentum has since declined. While the Federal Government (issuer of treasury risk-free instruments) has a strong need for investor funds, its increasing debt-service burden weighs heavily on its capacity to offer higher rates. In the corporate space, the relatively low interest rate environment presents an opportunity to raise low-cost debt, however, activities have been skewed towards the short end of the market (commercial papers) due to high interest rate risk.

**2021 Strategy .....69**

**Tilt Towards Value and Income Counters and Stay Short in the Fixed Income Market**

We anticipate an ultimate dominance of the bears in the equities market. Hence for short to mid-term investors, we recommend a tilt towards dividend paying stocks to make up for temporal market jitters. For investors with patient capital, we recommend a portfolio of value stocks. For fixed income instruments, in view of our expectation for a less steep rise in yields, we recommend a healthy mix of Eurobonds (to provide a hedge against Naira inflation and devaluation) and FGN bonds with less than 10-year maturities.

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## Executive Summary

Unlike in H1:2020, when global policymaking was focused mainly on discovering the path out of the COVID-19 health crisis, H1:2021 presented a new challenge of navigating the path to recovery. This followed the development and deployment of vaccines and gradual return to normalcy which began in H2:2020. Although significant progress has been achieved with respect to the pace of vaccinations, a lot still needs to be done to achieve global herd immunity. At the time of writing, the average daily vaccination rate stood at about 38 million, while roughly 14% of the global population has been vaccinated. At this rate, it would take approximately one year from now to achieve global herd immunity. Of concern, however, is that vaccination progress has been uneven, with wealthy nations getting vaccinated a lot faster than their poorer counterparts.

Meanwhile, price levels across the global economy have trended upwards in H1:2021, buoyed by sustained fiscal and monetary supports, fragile commodity supply chains and rising crude oil prices. We note that most monetary authorities seem unprepared to narrow their economic support programmes despite inflationary pressures. Thus, investors have shown an increased appetite for higher-risk investments, with sell-off sentiment observed on risk-free treasury instruments across advanced and emerging markets. Notably, high-risk instruments such as crypto assets witnessed strong investor buying interest. Furthermore, we examined global monetary policy within the context of capital flows between advanced and emerging markets. We concluded that while rates in advanced markets will remain stable over the near term, emerging markets do not present a strong investment case due to heightened risks.

On the domestic front, economic growth has maintained a slow but steady path influenced by several counterbalancing factors. On the one hand, the accommodative monetary policy stance of the Monetary Policy Committee, in addition to various (credit) intervention programmes by the CBN, has been supportive of growth. On the other hand, oil output cap, FX illiquidity, heightened insecurity and inefficient supply chains have continued to constrain GDP growth. Foreign investors have also held back on FDIs and FPIs (despite high rates on OMO securities) due to weak macroeconomic indicators and funds repatriation difficulties.

In forming our outlook for Nigerian markets and asset classes, we considered the not-so-optimistic economic prospects, fiscal and monetary policy direction, sector-specific risks, inflationary pressures, and weak foreign capital inflows.

SECTION ONE:

# GLOBAL ECONOMY & MARKET



Route to economic growth,  
paved with risks and changes

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## The Global Economy

### Vaccination- A Long Way till Herd Immunity

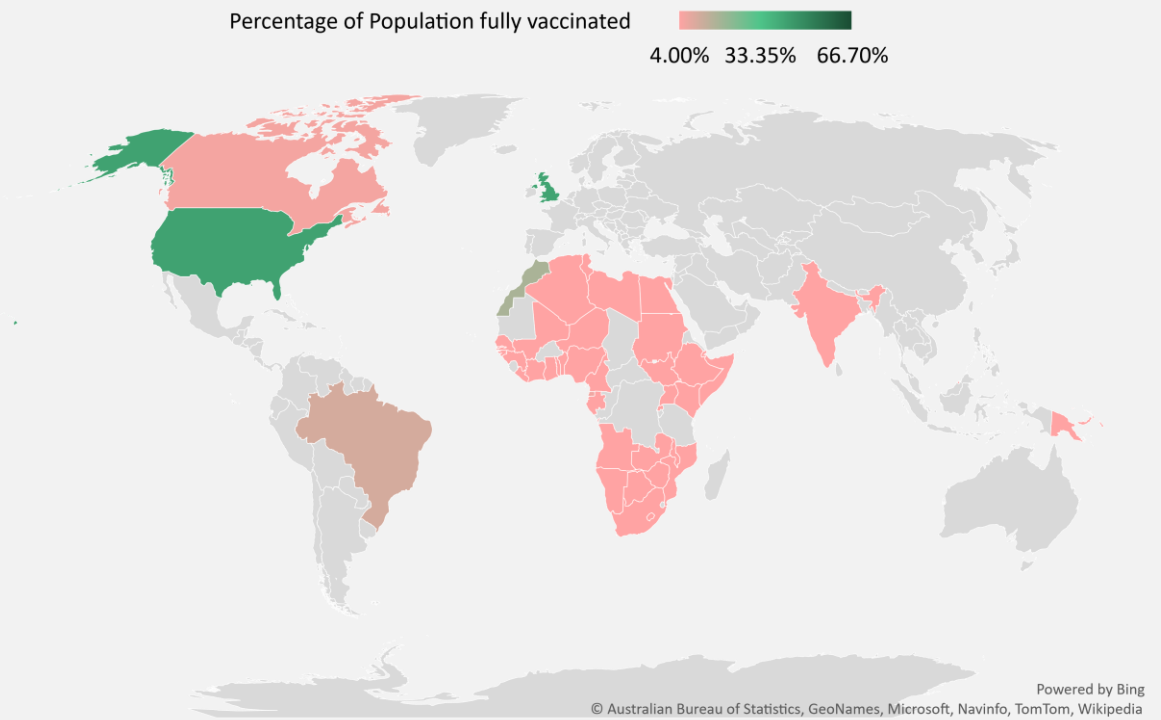
At the start of the year, our position was that the pace of the global economic recovery would depend largely on how fast countries moved past the pandemic and social restrictions. Given the challenges related with vaccine production and distribution, we expected herd immunity no earlier than mid-2023. We also envisaged a pick-up in activities, particularly in the worst-hit industries like tourism and airline, as social distancing measures are gradually rolled back. While this is playing out in some developed countries, there are risks to that outcome in many other emerging markets and developing economies.

Since the first batch of vaccines was granted Emergency Use Authorization (EUA) by both the Food and Drug Administration (FDA) and the World Health Organization (WHO) last December, about 2.15 billion doses have been administered across 176 countries. This number implies that roughly 14% of the global population has been fully vaccinated (*assuming at least two jabs are required to be fully vaccinated*). At the time of writing, average daily vaccination rate stands at about 38 million, meaning it would take at the very least an additional year to achieve global herd immunity (that is, for a substantial proportion of the world's population to be immune to the disease).

While the race towards vaccine development was unprecedented (*with Emergency Use Authorizations being granted in under a year - a process that typically takes longer*), progress with vaccination efforts has been less impressive. There have been setbacks due to the side effects of some vaccines (*notably blood clotting from the use of the AstraZeneca and Johnson & Johnson vaccines*), leading to public hesitation. Production challenges such as the shortage of essentials supplies (*glass vials and critical raw materials*) and vaccine export controls have also impacted the availability of vaccines and the slowing vaccination rates, particularly in low-income countries. Another clog in the vaccination wheel was the emergence of newer, more virulent strains of the Coronavirus from the U.K. (B.1.1.7), India (B.1.617.2), Brazil (P.1), and South Africa (B.1.351). Fortunately, currently available vaccines are just as effective against the new strains, according to the World Health Organization (WHO).

In our annual outlook, we raised concerns about how vaccine inequality could potentially hurt global vaccination efforts. So far, vaccinations have been lopsided, with the wealthiest twenty-seven (27) countries in the world getting vaccinated more than thirty times (30) times faster than the lower-income countries. To offer perspective, forty-two (42) doses of the vaccine have been administered per hundred (100) people globally, but in Africa, it is about two (2) doses per hundred (100) people. To even out vaccine distribution, the G-7 leaders have pledged to distribute 1 billion COVID-19 vaccines to developing nations and areas with vaccine shortages before the end of 2022. This distribution will go through the COVAX AMC- a scheme led by The Vaccine Alliance (GAVI), together with the World Health Organization (WHO) and the Coalition for Epidemic Preparedness Innovations (CEPI).

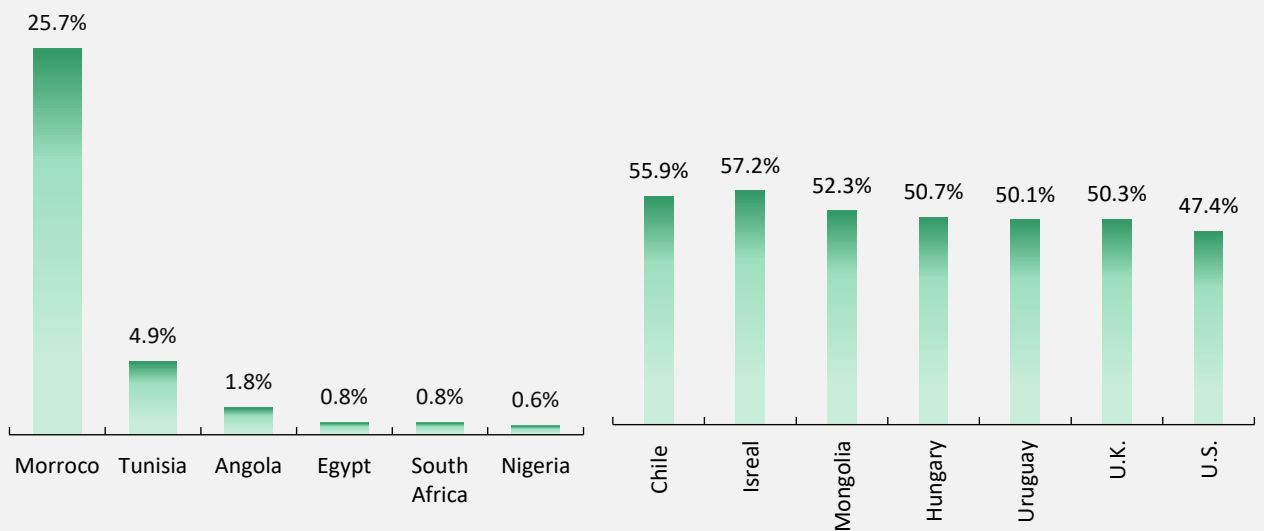
Chart 1: Vaccination Rate by Country



Source: Johns Hopkins Vaccine Tracker, Meristem Research

Chart 2: Population Fully Vaccinated in Africa (%)

Chart 3: Population Fully Vaccinated (Population > 1mn)



Source: John Hopkins Vaccine Tracker, Meristem Research

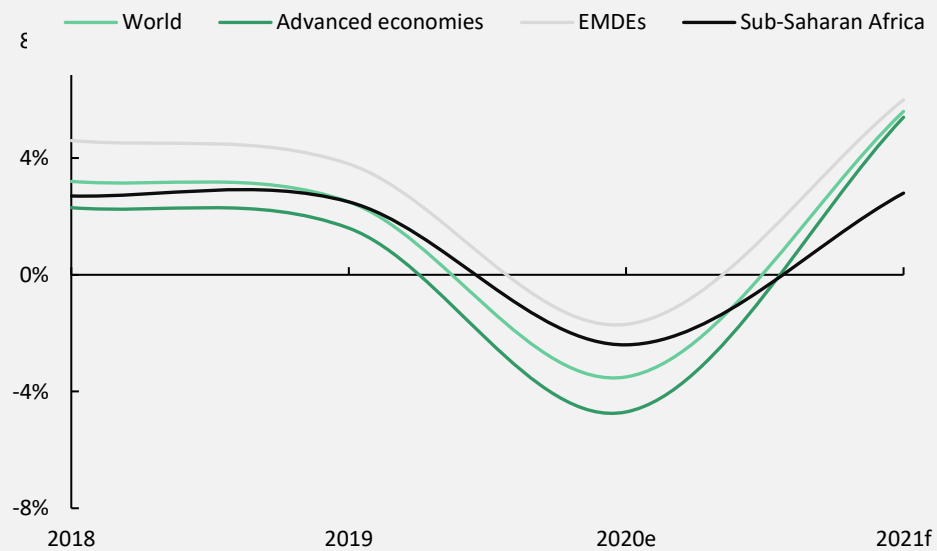


### Global Growth- Uneven Recovery Across Board

The outlook on economic recovery across regions is uneven, with Emerging Market and Developing Economies (EMDEs) expected to record the highest growth rate (+6%YoY and +6.7% according to the World Bank and IMF, respectively) by year-end. However, there is even more divergence in growth expected from countries within the same region as the extent of growth in each country depends on vaccination rates and the existence of supportive fiscal and monetary policies.

Nonetheless, global growth prospects in 2021 are skewed towards countries that have achieved high vaccination rates and have successfully reopened a large portion of their economies. **In particular, the World Bank's Global Economic Outlook outlined that the U.S. and China will contribute more than 25% of global growth in 2021. The IMF's growth projection is also hinged primarily on vaccination progress while noting other critical factors such as access to international liquidity and ease of global trade tensions.** Generally, the growth outlook for EMDEs is expected to be modest, while that of low-income economies is expected to be tepid. The risk of a renewed outbreak of the virus, the emergence of new strains, and constraints from fiscal support are some of the factors contributing to the weak recovery prospects in Sub-Saharan Africa (SSA). **In our view, global growth depends much on equitable vaccination across all countries. Thus, a more universally coordinated effort is imperative to achieving a meaningful rebound in the global economy.**

**Chart 4:** Growth Trajectory Across Different Regions (%)

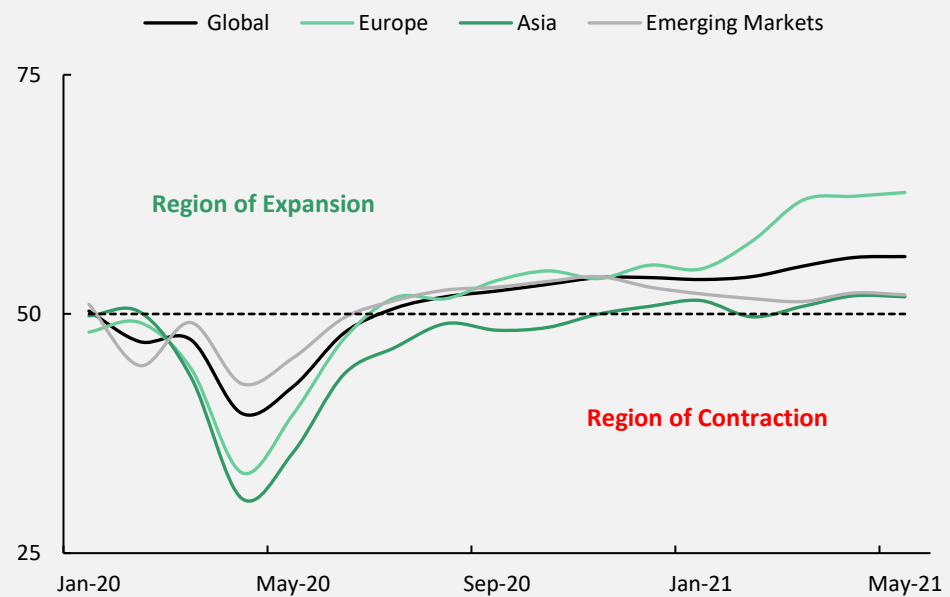


Source: World Bank, Meristem Research

## Monetary & Fiscal Policy- Early Responses Yielding Positive Outcomes

The timely and coordinated responses of monetary and fiscal authorities at the onset of the pandemic set the pace for a rapid recovery from the initial shock. Early fiscal and monetary interventions such as stimulus payments, large asset purchase programmes, and lowering of interest rates are behind the economic recovery being recorded, although to varying degrees. Broadly, global PMI data points to improvements in employment and production conditions across countries.

**Chart 5:** Manufacturing Indices in Select Regions



Source: IHS Markit, Meristem Research

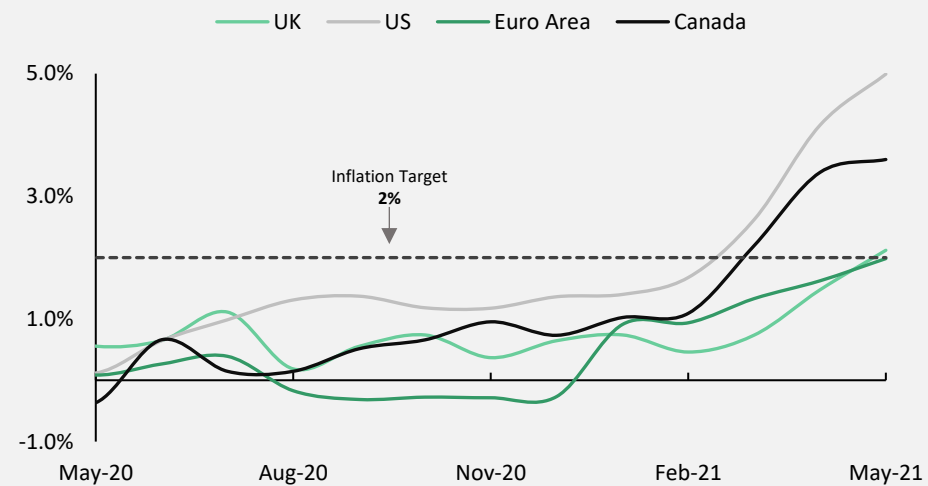
## Inflation- Inflation Rising as Monetary Authorities Remain Accommodative

To further boost their respective economies, most monetary authorities seem unprepared to narrow their economic support programmes. At its April 2021 meeting, the U.S. Federal Open Market Committee opted to maintain the Federal Reserve Bank's monthly Asset Purchase Programme and leave interest rates at near-zero levels until it observes substantial improvement in employment. Similarly, the BoE voted to retain its benchmark rate at 0.1% while also carrying on with its Quantitative Easing Programme. Same as in the Euro Area, where interest rates remain at historic lows.

With various forms of monetary support, the inflation rate in many advanced climes has gathered momentum over the last few months, shooting past the 2.00% target level, particularly in the U.S. and Canada. Monetary authorities have attributed the rising price levels to transitory factors, especially the low base from 2020, and as such appear undeterred. For the U.S., the focus is on the inflation rate averaging 2.00% over a longer time frame. **Although**

inflationary pressure suggests the need to pull the plug on its dovish stance, the Fed has signaled that it would announce long before it embarks on relaxation of its assets purchases. This is to avoid a repeat of the taper-tantrum, that is, a massive selloffs of government securities triggered by panic, pushing yield upwards.

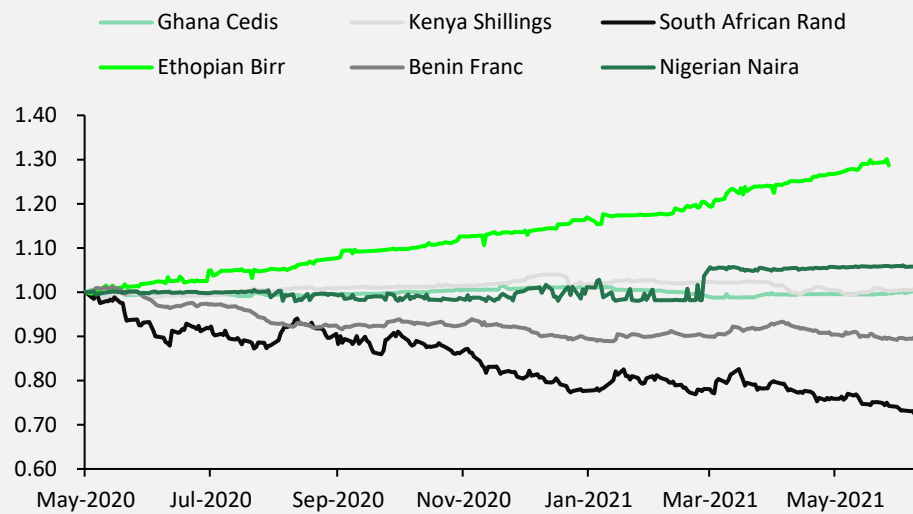
Chart 6: Inflation Rate in Select Advanced Economies



Source: BIS, Meristem Research

Meanwhile, little has changed since 2020 concerning the dynamics of capital flows. We highlighted the negative impact of the pandemic on capital flight from emerging markets in our 2021FY Outlook. According to the World Bank, the pace of capital outflows from these economies has not subsided as investors' preferences shift towards capital safety over short-term gains. The worse-hit economies are those with high debt profiles, leading to a modest widening of sovereign credit spread and currency depreciation in some cases. In our view, the incentive for any meaningful capital inflow into these economies would be a significant rate hike, which is not likely in the near term as most monetary authorities stick to their accommodative policies. **Therefore, we do not foresee any significant reversal of capital into developing countries in the near term until substantial economic growth triggers monetary policy rate hikes in those regions.**

Chart 7: Select SSA Currencies Against the Dollar



Source: Bloomberg, Meristem Research

## Oil- Prices Rally Strongly Despite Frail and Uneven Recovery

Demand shocks occasioned by the pandemic sent oil prices crashing to historic lows in April last year. Though prices have bounced back at a much faster pace than anticipated (*hitting a 3-year high of USD71/bbl in the first week of June*), the road to recovery was not as smooth as prices might suggest. In Q1:2021, demand came in lower than expected, owing to a renewed increase in Coronavirus cases in Europe and the severe winter weather, which disrupted trade flows in the U.S. In Europe, oil consumption fell by 4.16%QoQ, while the U.S. recorded a decline of 1.57% QoQ to 18.41mbpd. This consequently pulled global oil consumption volume to 94.49mbpd, dipping slightly by 0.95% QoQ.

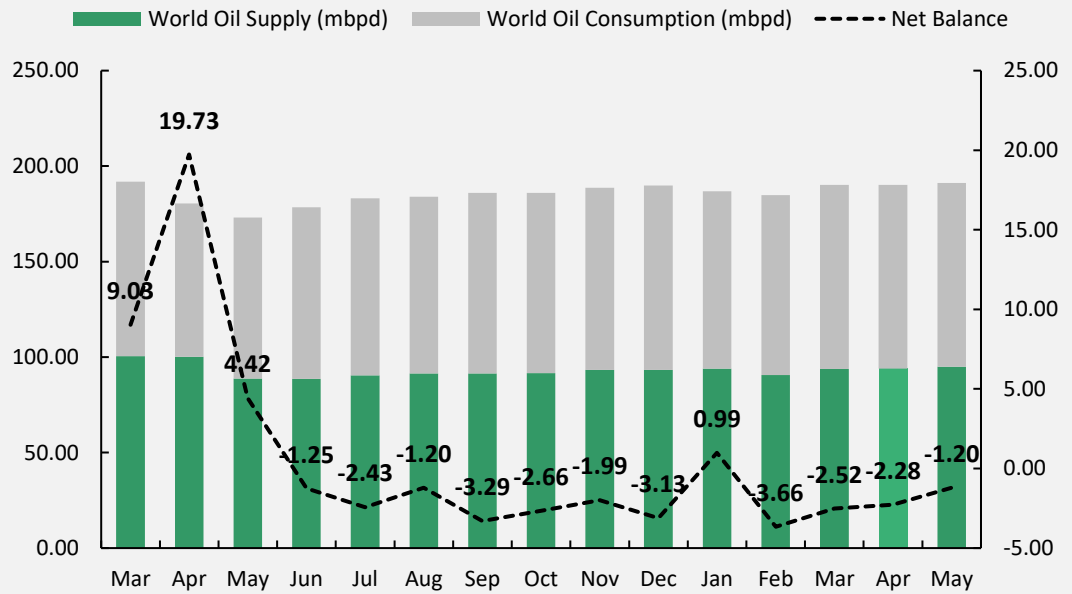
In its attempt to stabilize prices, OPEC+ continued to guard production levels to prevent an oversupply (*or glut*) and slump in prices. Production levels were also dampened by the Texas cold snap in February 2021, pulling US production down by 11.51% MoM. This drove prices to about USD63.54/bbl at the end of the first quarter.

For Q2:2021, a mix of bearish and bullish events have kept prices between USD64 – USD70/bbl. In April, a fresh increase in Coronavirus cases in India and Brazil unsettled the market. However, prices rose as oil imports in the U.K. and U.S. improved month-on-month above 3%.

The oil market remains frail as many countries are still struggling to vaccinate a critical mass of their populations that will allow economic activities to reopen fully. There are other downside risks too; we note the adverse impact of a likely comeback of Iranian supply to the oil market as negotiations with the U.S. are ongoing. Since the U.S. placed sanctions on Iran in July 2018, Iranian export has declined by up to 95.66% to 97,000 bpd. **In our view, a likely comeback would mean an increase in export by 1mbpd. However, we do not expect this to be sudden as the country's production (currently at 2.46mbpd) is still below capacity of 4mbpd. Also, as demand gains momentum and supply still at a**

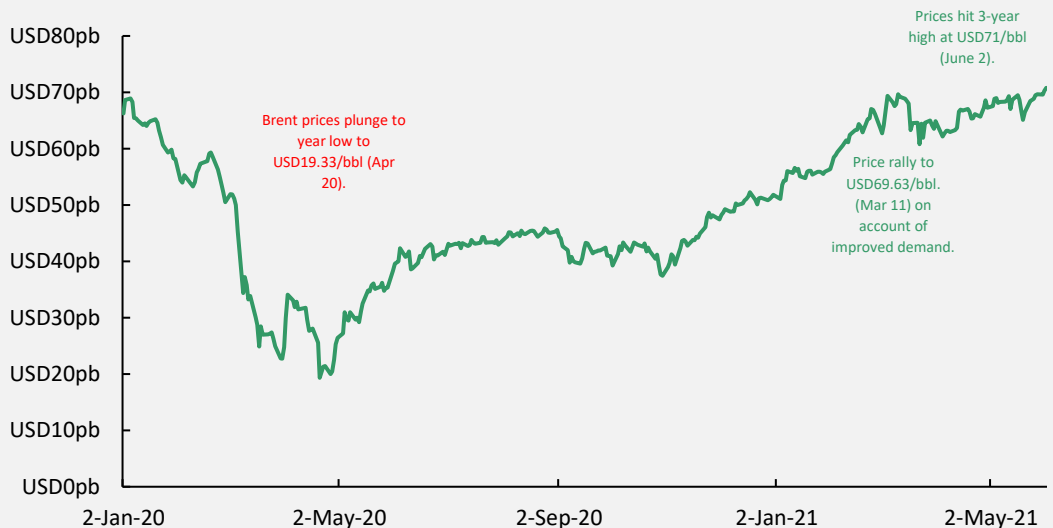
deficit, we expect this to pose a minimal threat to price levels. Another headwind that might disrupt price growth is U.S. production nearing pre-COVID levels, given that WTI prices are now encouraging. **While these should temper prices over the second half, we hold a positive view of the market. Therefore, we have revised our oil price forecast for 2021, with the average Brent crude price to range between USD60.48pb - USD69.66pb (previous forecast. USD49bp – USD53pb).**

Chart 8: World Oil Liquid Production and Consumption (March 2020 – May 2021)



Source: U.S. Energy Information Administration, Meristem Research

Chart 8: Timeline of Events that Impacted Oil Prices (2020 – till date)



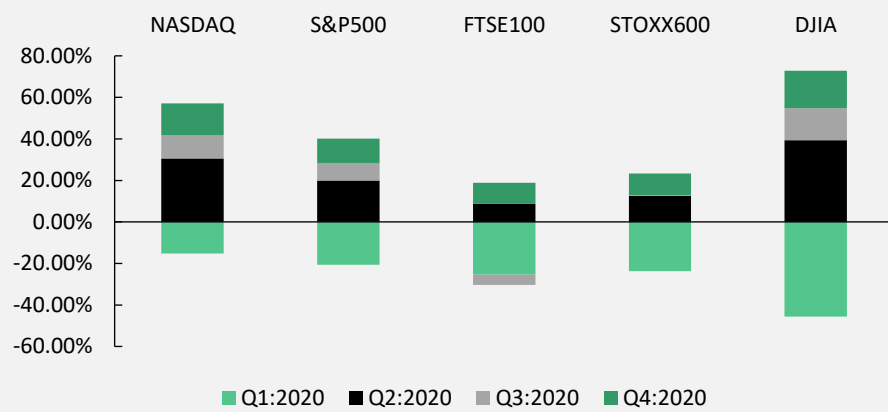
Source: Bloomberg, Meristem Research

## Global Equities

### Equity Markets React Positively to Vaccine Shots

The development of effective COVID-19 vaccines in November last year restored optimism to global equities in hopes of a return to economic normalcy. Across different regions, value stocks and small-to-mid cap stocks rallied the strongest, as investors took positions in anticipation of an exit from the economic downturn. In some markets, the gains posted in the last quarter of 2020 outstripped preceding quarters, with emerging market stocks posting their most substantial quarterly gain in over a decade (*MSCI Emerging Markets rose 19.71% in Q4:2020*).

Chart 9: 2020 MoM return

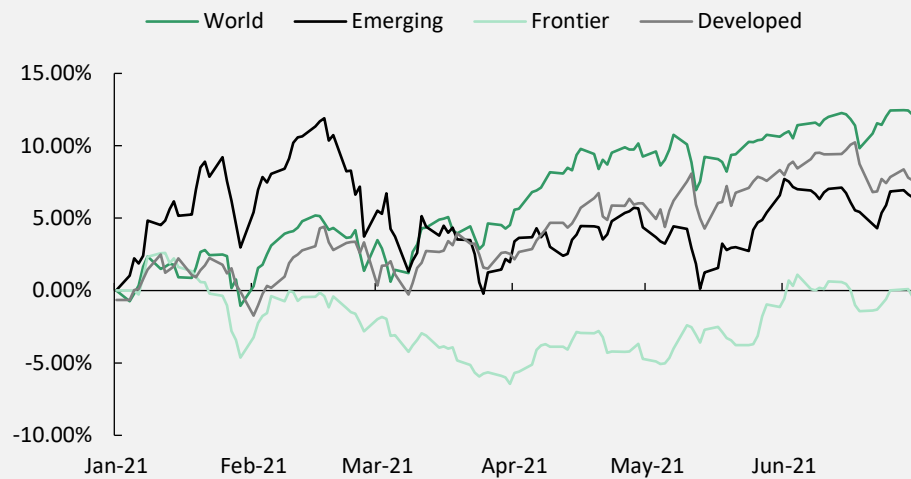


Source: Bloomberg, Meristem Research

Anchored on the news of further fiscal stimulus and the roll-out of COVID-19 vaccines, global stocks launched into 2021 in good cheer. The MSCI World Index recorded a +4.53% return in Q1, fueled by gains from the MSCI Developed Market Index (+2.83%) and MSCI Emerging Market Index (+1.95%). The momentum continued into the second quarter despite the concerns about rising inflation rates. The efforts of developed nations in containing the economic consequences of the pandemic through fiscal stimulus and asset purchase programmes, coupled with the relatively fast pace of vaccination, roused investors' confidence in equities. Likewise, positive sentiment trailing the release of the first-quarter corporate results contributed to the existing drivers of the developed market, as a wide range of results beat consensus estimates.

Emerging market equities also witnessed increased participation and, ultimately, positive returns but lagged developed markets as the virus continues to spread in certain regions.

Chart 10: MSCI World, Frontier, Emerging and Developed Market Indices



Source: Bloomberg, Meristem Research

## United States

The US equities market has displayed marked resilience, following the multiple signs of economic recovery induced by the Government’s fiscal and monetary support. The increasing rate of vaccinations (*about 47.0% of Americans have been fully vaccinated*), USD1.9trn relief package signed by the US Government in early March and proposed additional USD2.25 trillion American Jobs have fueled the bullish run witnessed in the equities market. The Dow Jones Index (DJIA) crossed 33,000pts for the first time in March, while the S&P 500 hit the first milestone above 4,100pts on the 1st of April 2021. The S&P 500 and DJIA hit an all-time high of 4,232.60pts and 34,777.76pts, respectively, on the 7th of May 2021.

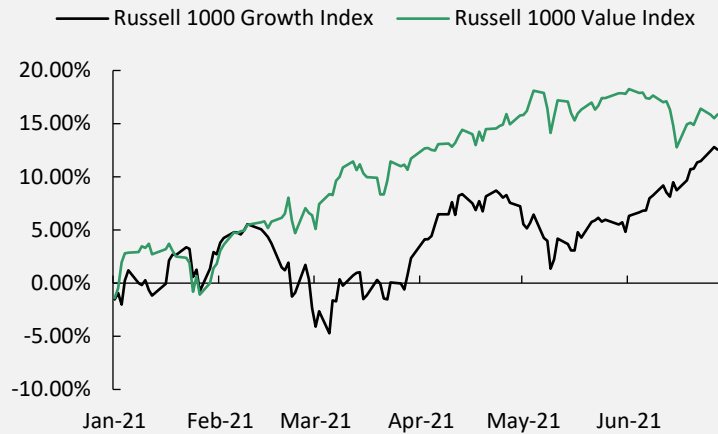
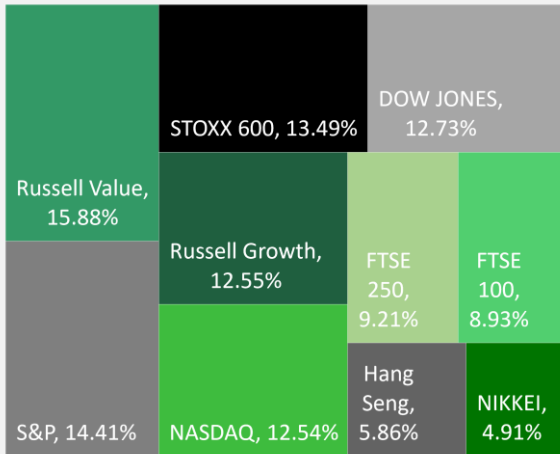
## Value Stocks Outpacing Growth Stock

Contrary to historical trends, value stocks are significantly gaining momentum, outperforming growth and large-cap stocks as investors tilt their focus to previously neglected sectors. Some of the high-flying technology stocks that make up large-cap indices (*like TESLA: -3.68%*) are starting to wane as consumers rotate to value stocks in travel and entertainment sectors, amongst others. As illustrated below, the Russell 1000 Value Index, which is predominantly made up of value stocks, has since February outperformed its growth counterpart.

**As we advance further into the year, we expect factors such as the continuous vaccine roll-out, moderating US unemployment rate (*from 13.07% in June 2020 to 5.8% in May 2021*), supply chain improvement plan (*unveiled in May 2020 to boost domestic manufacturing of critical inputs*), continued fiscal stimulus, and a favorable Fed stance to support the prevailing optimism in the US stock market.**

Chart 11: Half Year Return Across Key Market as at 30<sup>th</sup> of June

Chart 12: Russell Growth & Value Indices Trajectory



Source: Bloomberg, Meristem Research

### Eurozone and United Kingdom Equities

The 27 EU countries recently ratified the EUR750bn recovery and resilience facility to address the economic and social impact of COVID. The fund is set to be disbursed from July, signaling a positive positioning for an economic rebound in the Eurozone. The market has responded to this, with the STOXX600 Index rising by 13.49% in the first half of the year.

Equities trading in the United Kingdom kicked off on a higher note relative to January last year, following the trade deal signed at the end of 2020. The market performance was led by small to mid-cap stocks as the FTSE-250 hit record-high (22,000pts for the first time in 2021) in April. Momentum on stocks in the domestic areas of the economy propped the FTSE-250 bullish performance, as additional steps were taken to ease social restrictions. Premised on this, the stock market has rebounded strongly, returning 9.21% as of June 2020 from 0.24% YtD as of January 2021.

**We expect the presence of current drivers and release of corporate financial results, to sustain the momentum on equities in these markets for the rest of the year.**



## Global Fixed Income Market

### Yields to Remain Stable Over the Near Term

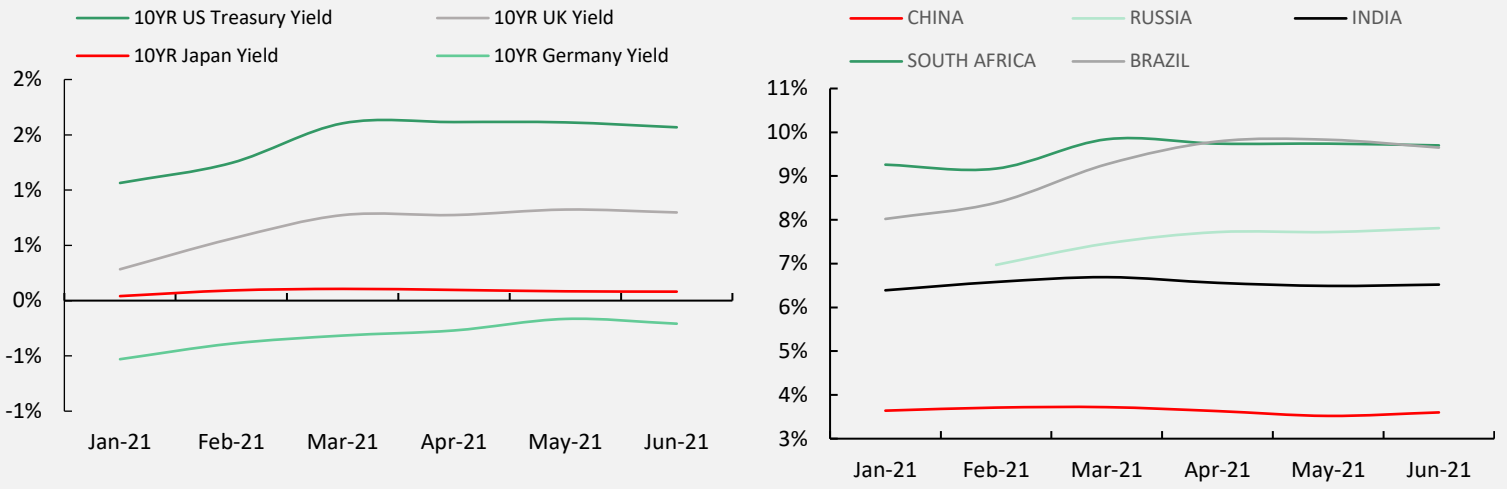
The first half of 2021 witnessed uptrends in yields on Treasury instruments across several economies. The factors responsible for this vary across treasury fixed income markets. However, the increase in yields is consistent with the generally improving outlook for the global economy. The positive outlook for the global economy, especially major economies, has been driven by increased vaccinations and sustained fiscal and monetary support.

Specifically, in the US, the additional fiscal stimulus packages, high inflation expectations, alongside the Fed's revision of GDP growth forecast from 4.20% to 6.50% in 2021, drove the 10-year treasury yield from 0.92% at the start of the year to 1.63% as of June 1, 2021. Similarly, 10-year bond yields across key European markets such as the UK and Germany also trended up, albeit Germany's 10-year yields remain negative. This is also attributed to high inflation expectations driven by increased government spending and accommodative monetary policies. The only exception to the observed global trend in H1:2021 is Japan's 10-year bond yield which remained mostly flat despite huge stimulus injections. This is due to Japan's significantly weak inflation outlook, in defiance of the global trend.

The sentiment was broadly similar across key emerging markets, including Brazil, Russia, and South Africa, primarily due to sensitivity to US rates and inflationary pressures. The notable exceptions were yields in China and India. Indian yields remained flat due to the intervention of India's Central Bank via securities purchases and the cancellation of auctions to cap yields at 6% with the aim of reducing the government debt cost. Chinese yields were, however, less sensitive to US rates during the period.

**Also influencing the direction of yields globally is the shift towards riskier assets such as stocks and commodities, emerging crypto assets. The search for higher-yielding investments to compensate for inflationary risks and the generally improved economic outlook are mainly responsible for the declining appetite for relatively safe treasury instruments. Nevertheless, over the near term, we expect global yields to remain stable at current levels, given the counterbalancing effects of policies that aim to keep inflation in check on one hand and those in place to drive stronger economic growth. Most Central Banks have so far favored the latter. However, curbing inflationary pressures will increasingly become a priority due to the impact of sustained expansionary fiscal and monetary policies.**

Chart 13: Movement in Yields of 10-Year Bonds Across Global (Advanced and Emerging) Markets



Source: Bloomberg, Meristem Research

**SECTION TWO:**  
**DOMESTIC  
ECONOMY**



Route to economic growth,  
paved with risks and changes

**MERISTEM**

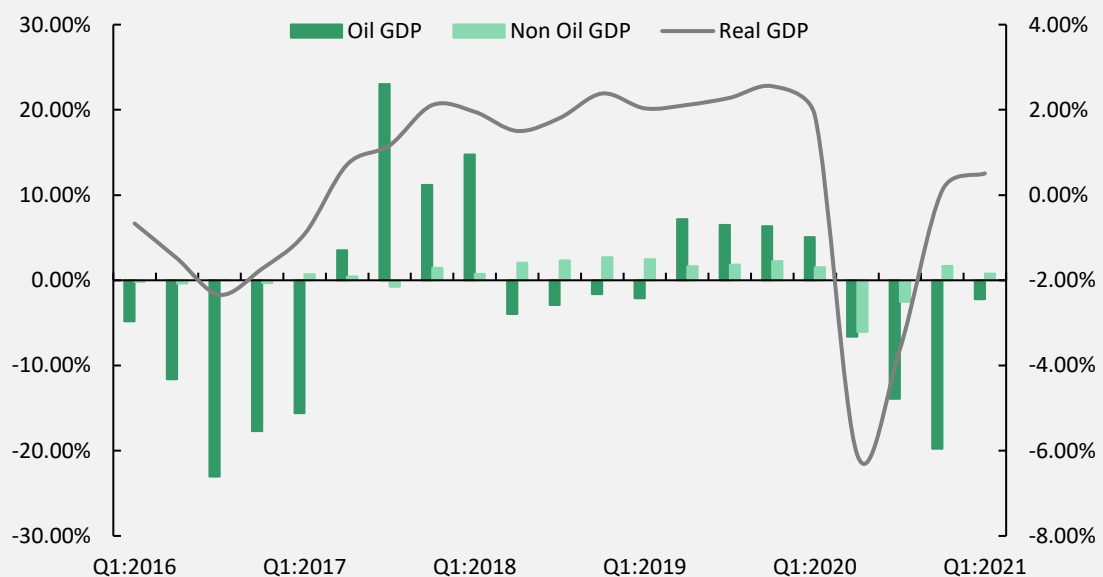
## Domestic Economy

### Economic Growth- Slow but Steady

Like many economies across the world, the Nigerian economy has sustained a trajectory of recovery in 2021, reflective of the broad-based resumption of economic activities. It also demonstrates the impact of the various interventions by the Central Bank of Nigeria and the Federal Government in swiftly stimulating the economy away from the pandemic-induced recession. However, real GDP figures indicate that the pace of recovery remains sluggish.

In Q1:2021, GDP expanded by 0.51% YoY, in the wake of the 0.11% YoY growth recorded in Q4:2020. Economic output has been constrained by persisting effects of the lockdowns on business activities, heightened insecurity, relatively low crude oil production, Naira depreciation, FX illiquidity, among others. However, signs are emerging of modest improvements in economic activities and the broader macroeconomic conditions. Although the PMI was below the point of expansion, it was 49pts in May, the highest level since February, amidst encouraging signs of improvement in manufacturing activities. Oil prices have also been favorable, averaging USD65.23pb in 2021. This has strengthened FX earnings and the capacity of the CBN to stabilize the FX market. More is however required to sustain the economy’s growth trajectory. Overall, we maintain our projection of 2.33% growth in real GDP for 2021.

Chart 14: Economy Recovers from Second Recession in 4 Years



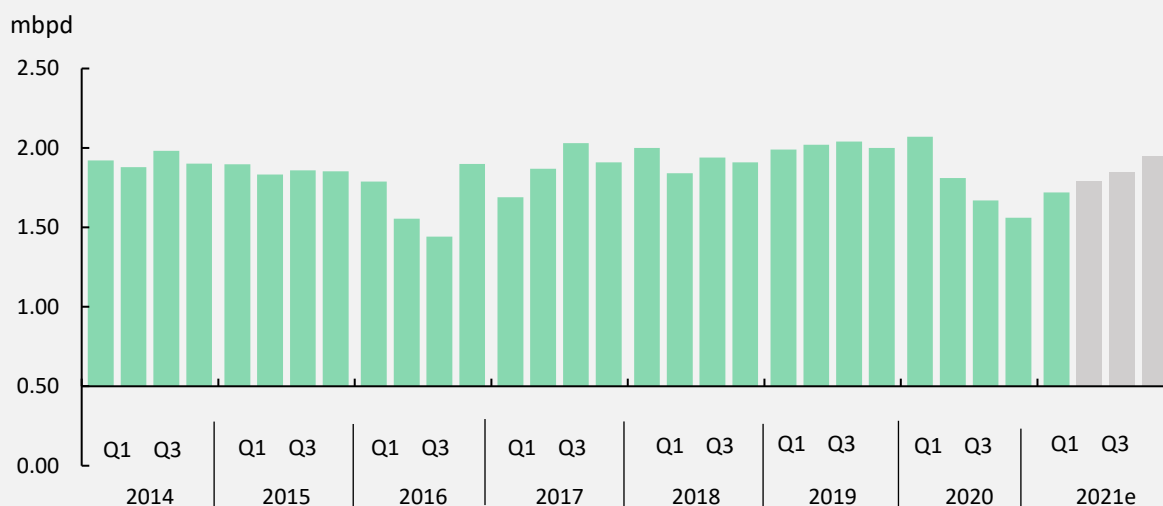
Source: NBS, Meristem Research

### Oil Sector- Growth Capped by OPEC Quota

In Q1:2021, the oil sector contracted by only 2.21% YoY, compared to a decline of 19.76% YoY in Q4:2020. Although the moderated contraction signals relative improvement, the oil sector continues to reel from low crude oil production, in accordance with the quota regime put in place by the OPEC to stabilize crude oil prices. Domestic average daily production volumes for Q1:2021 dropped to 1.72mbpd (vs. 2.07mbpd in Q1:2020), but slightly better than 1.56mbpd in Q4:2020.

On the bright side however, oil prices have improved for the most part of the year, averaging USD61.32pb as at Q1:2021 (vs. USD52.46pb in Q1:2020 and USD45.26pb in Q4:2020). With stronger demand for oil, especially in countries like the US and the Eurozone, where significant progress in vaccination have been recorded, some members are already pushing for a relaxation of the output cuts. Thus, we expect some improvement in Nigeria’s crude oil output in H2:2021. Risks to this outlook include a resurgence of COVID-19 infections, especially in trading partner countries and local supply disruptions due to agitations by militants in the Niger Delta.

Chart 15: Average Daily Crude Oil Production



Source: NBS, Meristem Research

## Non-Oil Sector- Prospect Remains Bright

The Non-oil sector, which accounts for c.92% of domestic output, grew by 0.79% in Q1:2021. This is 89bps and 76bps lower than was reported in Q4:2020 and Q1:2020 respectively. Growth in this sector was majorly driven by the Information and Communication sector (+6.47% YoY) while other drivers include the Agricultural (+2.28% YoY) and Manufacturing (+3.40% YoY) sectors. These three sectors jointly accounted for c.47% of the GDP in Q1:2021. Other sectors that recorded growth include - Real Estate (+1.77% YoY) and Construction (+1.42%YoY).

The Agricultural sector posted a 2.28% expansion in the quarter – better than the 2.20% growth recorded in Q1:2020. Interventions by the FGN such as the APPEALS project (Agro-Processing, Agricultural Productivity Enhancement and Livelihood Improvement Support) and the Zero-Reject Initiative supported the growth recorded during the period. This is in addition to ongoing schemes from the CBN like the provision of NGN107.60bn credit to 548,109 farmers between Q4:2020 and Q1:2021 in support of agricultural value chain development.

Notwithstanding, the sector's growth potential is still plagued by inefficiencies in value chains of different agricultural commodities and in the livestock sectors. The impact is visible in rising food prices, given how inward-looking policies meant to protect the sector has limited food imports in the short term. In addition, the security challenge in food producing regions has constrained output from the sector, worsening the supply of agricultural produce and allied products.

The manufacturing sector also grew by 3.40% YoY in Q1:2021 – the highest since Nigeria exited the 2016 recession. To a large extent, this can be attributed to the improved manufacturing activities that followed the easing of lockdowns, as well as the NGN1trn Intervention Fund for the real sector. Nonetheless, manufacturing output continues to be restrained by the adverse impact of FX shortages and weak supply chains. Although, there have been improvements, PMI data from the CBN shows that the sector has not recorded an expansion since the start of the year. **We expect continued improvement in economic activities to drive growth in the sector in the second half of the year.**

**Table 1:** H2: 2021 Outlook for Key Sectors (c. 70% of GDP)

Sector	% GDP	Drivers	Drags	Outlook
<b>Information and Communication</b>	15%	Increased smartphone penetration, increased 4G network spread out, strong data demand, lifting of SIM registration suspension	Volatile Government policies, Currency devaluation	<b>Bullish</b>
<b>Manufacturing</b>	10%	Disbursement of intervention funds to the real sector, enhanced access to credit, implementation of the AfCFTA.	FX illiquidity and supply chain bottlenecks	<b>Modest</b>
<b>Agriculture</b>	22%	Continuation of intervention programs such as the CBN-RIFAN partnership (RIFAN- Rice Farmers Association of Nigeria), targeted ABP to 120,000 maize farmers, Presidential Fertilizer Initiative.	Insecurity-induced disruptions to production and distribution.	<b>Modest</b>
<b>Trade</b>	16%	Reopened borders, Improvement in global supply chain, Implementation of AfCFTA.	New waves of COVID-19 virus in trade partner countries, Inflationary-pressured purchasing power in the domestic economy	<b>Modest</b>
<b>Mining and Quarrying</b>	9%	Stronger demand for crude petroleum and natural gas hinged on global economy recovery, Expansion of local refinery capacity.	Insecurity, low budgetary allocation to fund required capital	<b>Modest</b>

### **Fiscal Policy- Fiscal Health Pressured by Rising Debt**

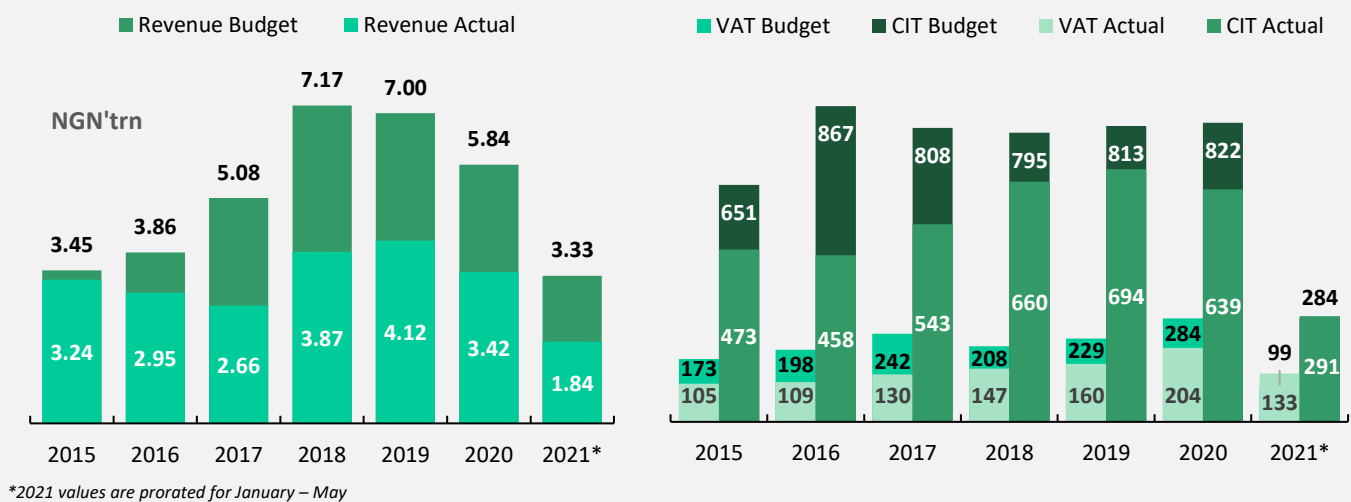
The Nigerian fiscal environment has remained even more vulnerable due to rising debt to manage the impact of COVID-19 and the continued over-dependence on crude oil earnings. Between 2017 and 2021, the budget deficit has grown by a CAGR of 20.66% from NGN2.19trn to NGN5.60trn. While total public debt to GDP ratio (21.35% in 2020FY) remains within the acceptable threshold of 40%, the high debt service to revenue (70.95% in 2020FY) underscores the impact of the rising debt stock for fiscal sustainability.

Meanwhile, oil revenue so far this year has been constrained by OPEC+ quota, despite the rally in oil prices (average of c. USD64pb in H1:2021). Although, the realized oil price is significantly higher than the conservative budget oil price benchmark of USD40pb, the average daily production volume of c.1.70mbpd for H1:2021 falls short of the target (1.86mbpd), due to the OPEC+ imposed quota. Hence, total oil receipt for the first five months in 2021 stood at NGN423.00bn, representing only 50.48% of the prorated target (NGN837.92bn). However, non-oil revenue provided some respite, reflective of

efforts at widening the tax net and improvement of tax collection through digitization. At NGN290.90bn and NGN132.85bn, CIT (Company Income Tax) and VAT (Value Added Tax) exceeded set targets for January to May by 102.41% and 133.73% respectively. This comes despite the various tax exclusions made under the Finance Act, 2020. Overall, the Federal Government realized a total revenue of NGN1.84trn for the first five months in 2021 - falling short of expected amounts by NGN3.33bn or 44.55%.

**Although we anticipate better oil production volumes in H2:2021, the Government is unlikely to realize its revenue target for the year, given the estimated 45% shortfall at half year.**

**Charts 16 & 17: Historical Revenue and Tax Revenue Performance**



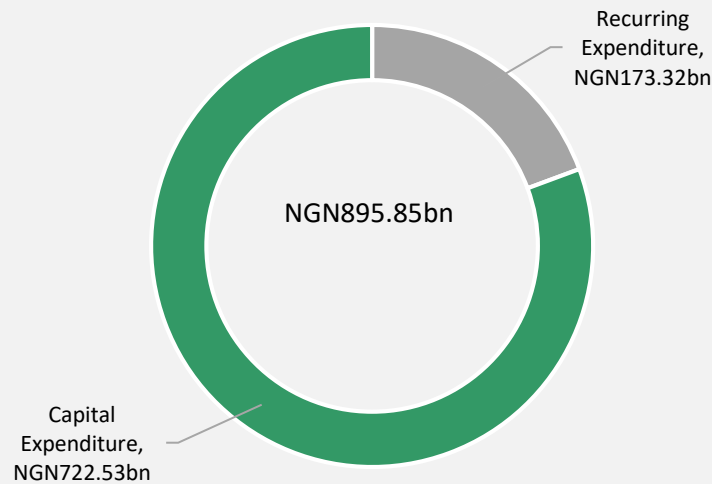
Source: Budget Office, Meristem Research

### Supplementary Appropriation Bill Proposes More Deficit Financing

In June 2021, the Federal Government revealed a proposal to supplement its 2021 spending plan with NGN895.84bn. The proposed expenditure, if approved, will bring the total Government expenditure for 2021 to NGN14.49trn (an increase of 6.59% from the initial NGN13.59trn approved for the 2021 budget).



**Chart 18:** Breakdown of the Proposed Supplementary Appropriation Bill



*Source: Budget Office, Meristem Research*

The proposal includes plans to spend NGN83.56bn in funding the Federal Government’s COVID-19 vaccination Programme. The objective is to vaccinate 70% of eligible citizens between 2021 and 2022. To fund this Appropriation Bill, the FG plans to borrow NGN135.00bn from some special reserve levy account and plug the balance (NGN760.84bn) with other forms of debt financing.

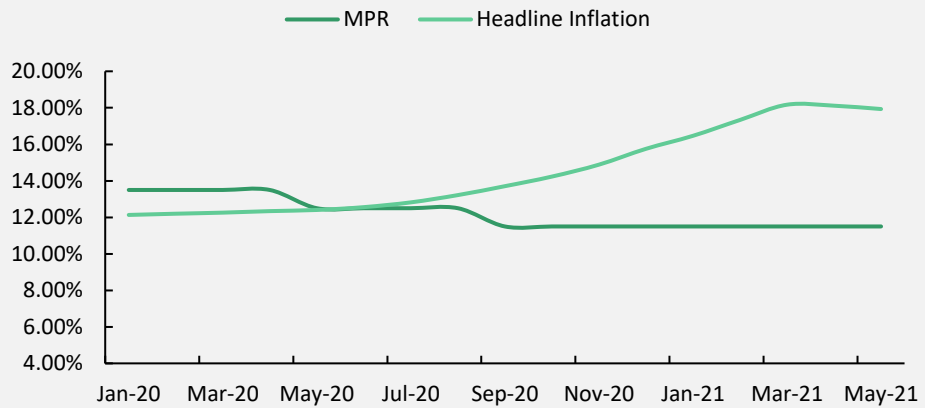
Although, we view the objectives of the Supplementary Bill as a necessity, our concern remains over the continued reliance on the use of debt to finance budget deficits. **In our 2020FY outlook, we highlighted how the deficit for the 2021 budget (at 3.68% of GDP) was higher than the recommendation under the Fiscal Responsibility Act (3.00%). This proposal will bring the total deficit to NGN6.36trn or 4.12% of GDP. Government should therefore work with the private sector and multilateral agencies for more creative funding structures for these projects.**

### Monetary Policy- Focus Remains on Economic Growth Objective

Continuing with the theme in 2020, the monetary policy stance in the year remains expansionary to strengthen the weak economic recovery. The apex bank has been supporting the economy through its various intervention schemes while maintaining existing policies put in place to encourage bank lending to the real sector. The challenge has however been in stabilizing the general price level. The Monetary Policy Committee has been reluctant in pulling the respective policy levers as it awaits a pickup in the pace of growth. The Committee’s stance is supported by the fact that the rising inflation rate is

being driven by supply-side factors, over which the influence of monetary policy is limited. **For the rest of the year, we expect the Committee to maintain this view, in line with our expectations of modest improvements in macroeconomic conditions. The recent slowdown in the rate of inflation will no doubt strengthen the resolve of Committee members.**

**Chart 19:** Monetary Policy Rate (MPR) and Headline Inflation- Jan 2020- May 2021

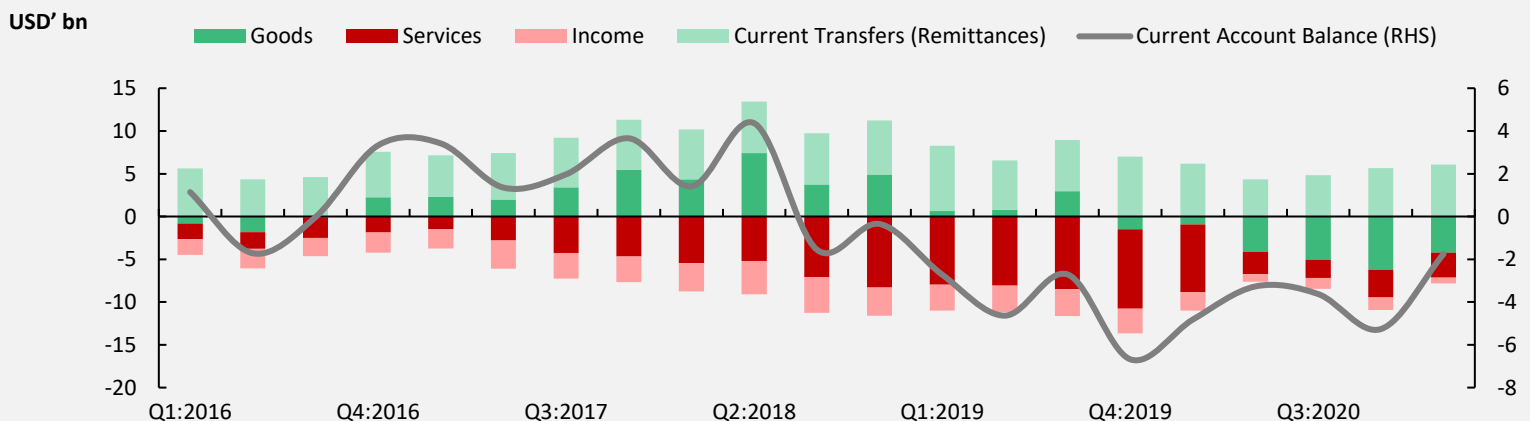


Source: NBS, CBN, Meristem Research

### Current Account and Exchange Rate

Nigeria’s current account deficit moderated to USD1.75bn in Q1:2021 (from USD5.26bn in Q4:2020) due mostly to a reduced import bill (c.19% QoQ reduction to USD11.94bn in Q1:2021). Nevertheless, the country’s current account position remains unfavorable as a result of depressed inflows. So far in the year, the CBN has implemented policies aimed at improving FX inflows such as the “Naira 4 Dollar” scheme along with capital control policies. However, the impact has been limp. We expect relatively higher remittance inflows during the rest of the year as a result of the improved outlook of the US and other major economies. However, the current account position will remain pressured due to strong import appetite and low crude oil earnings.

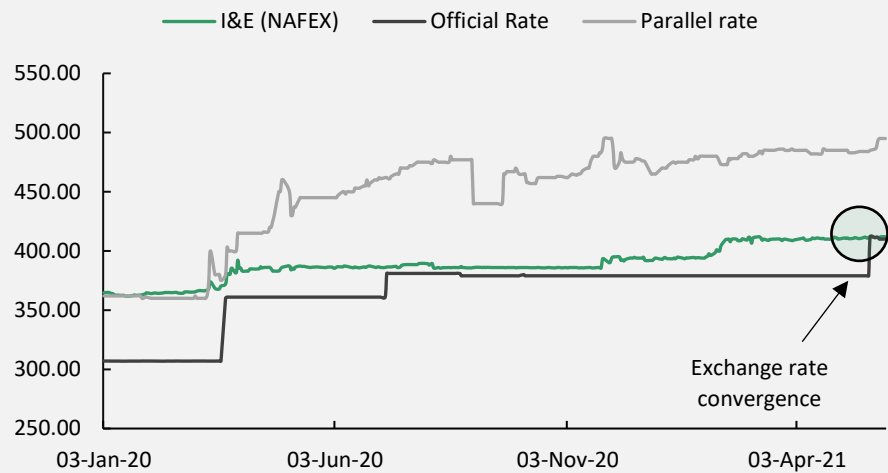
**Chart 20:** Current Account Balance Still in the Negative Zone



Source: CBN, Meristem Research

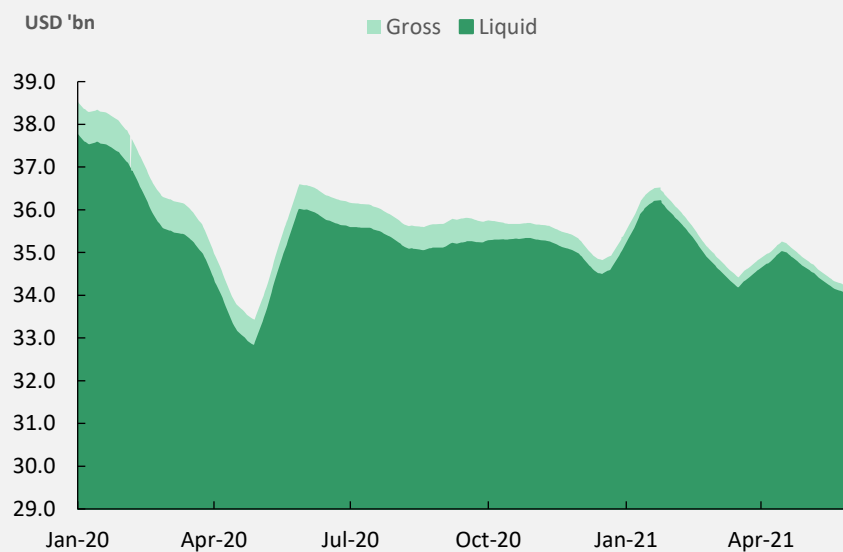
Meanwhile, the exchange rate on the Investor and Exporters Window has remained within our projected Base Case band of NGN400-420/USD after a technical devaluation by CBN to NGN410/USD. We think that the stronger than expected crude oil price increase and general global economic recovery will help keep the rates within this band in H2:2021. However, we note that gross FX reserves have declined by c.6% YtD, indicating sustained pressure on FX liquidity. While we think that the adoption of the NAFEX rate as benchmark FX rate by the CBN should bode well for overall FX market efficiency, we do not expect this to translate to a significant improvement in FX liquidity over the next half of the year due to low turnover on the IEW and the outlook for current account.

**Chart 21:** Movement in Foreign Exchange Rate Across Official & Parallel Market



*Source:* CBN, FMDQ, AbokiFX, Meristem Research

**Chart 22:** Foreign Reserve Balance



*Source:* CBN, Meristem Research

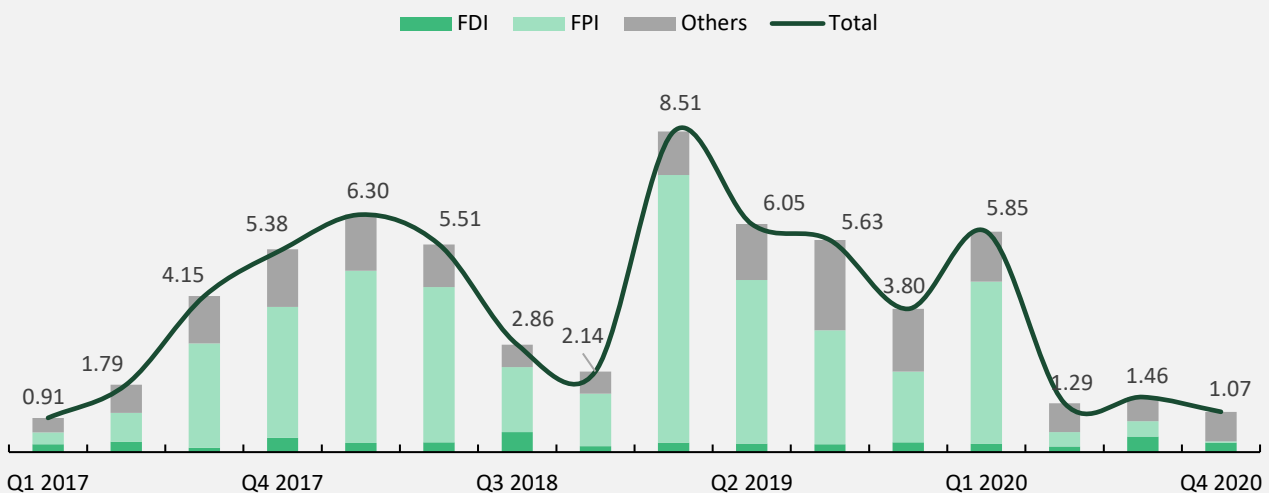
### Capital Flow- Offshore Capital Inflow Remains Elusive

Since the capital flow reversals of 2020, the economy has been struggling to attract the much-needed foreign capital, given weak macroeconomic indicators, foreign exchange liquidity challenges and an increasingly volatile regulatory environment, whilst yields are still not adequately reflective of country risks.

Data from the National Bureau of Statistics (NBS) showed a c.57% YoY plunge in capital importation in 2020FY to USD9.68bn – the lowest in 4 years. This is despite a 10.12% YoY growth in foreign direct investment (FDI), as foreign portfolio investment (FPI) and other investments dropped significantly by 68.61% YoY and 47.47% YoY, respectively. The increased demand for equities (+11.25% YoY) – a key constituent of FDI (99.75%) drove FDI in 2020 with the Banking sector gaining the most interest. However, the depressed interest rate environment dragged money market inflows by 69.14%YoY. Other constituents of FPI – equity (c.15%) and bonds (c.4%) also witnessed a 60.11% YoY and 77.38% YoY decline respectively.

Consistent with expectations in our 2021FY outlook, rates across auctions (primary market and OMO auctions) have increased compared to what was obtained for the most part of 2020. While this has spurred domestic interest in the fixed income space, we are of the view that foreign investors would stick to prioritizing the macroeconomic health of the country as a major determinant for capital inflow. The continued foreign apprehension towards Nigerian securities despite a relatively better yield environment (compared to emerging markets peers) corroborates our view. On the bright side however, the Federal Government plans a USD3bn Eurobond issuance. For us, we expect robust participation at the auction to support capital inflow in H2:2021. For FDI, although the rising incidence of insecurity continues to weaken the country’s investment case, we reason that rising interest in the domestic fintech space could attract more long-term capital as was seen last year.

**Chart 23:** Capital Importation at Lowest Levels in 4 Years (USD ‘bn)



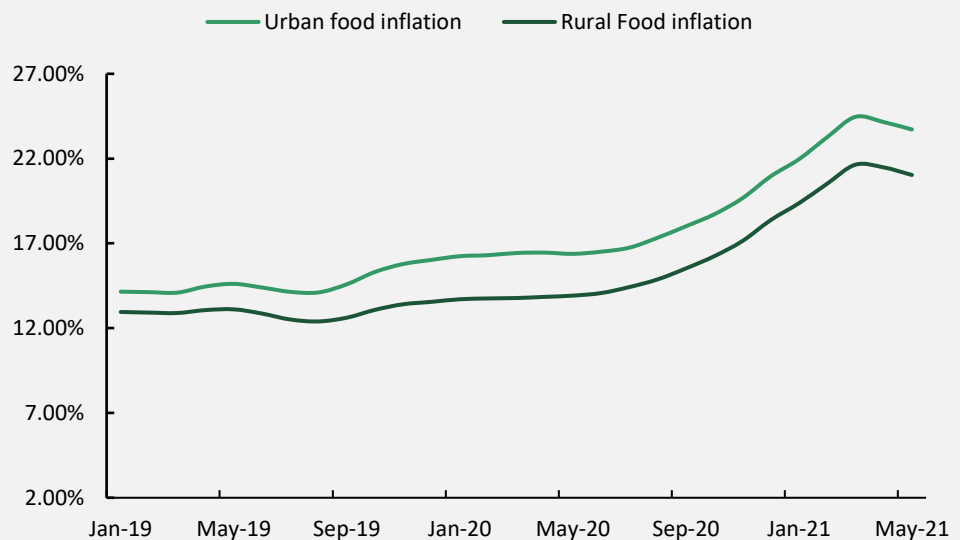
Source: NBS, Meristem Research

### Inflation- Base Effect Should Relieve Soaring Inflation

The inflation rate trended up from 15.75% YoY to 18.17% YoY in the first quarter, before moderating to 18.12% YoY and 17.93% YoY in April and May respectively. The factors driving the general price level remain supply-side induced, and they include insecurity challenges in food producing regions, logistic challenges facing agri-businesses and exchange rate induced price increments. These factors were mainly responsible for the increasing food inflation, which rose from 19.56% in December 2020 to 22.28% in May 2021.

In the same vein, the pass-through from the weakening currency has driven Core inflation to 13.15% YoY in May 2021, compared to 11.37% YoY in December 2020. This will probably continue as persistent FX illiquidity from the official channels continues to drive prices at the parallel market. In sum, headline inflation should moderate in the coming months majorly due to base effects. **Accordingly, we review our base case inflation projection slightly from 15.61% YoY to 15.69% YoY by December 2021. We also expect headline inflation to average 16.70% YoY in H2:2021. The upside risks to the outlook include a likely deregulation of the downstream oil sector and increases in electricity tariffs.**

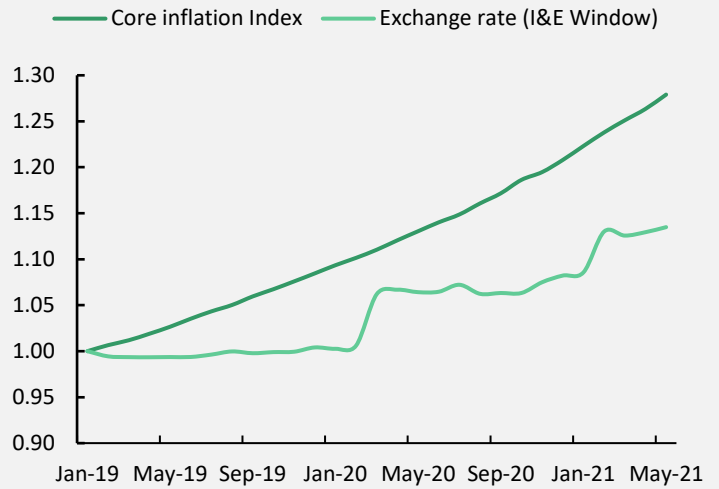
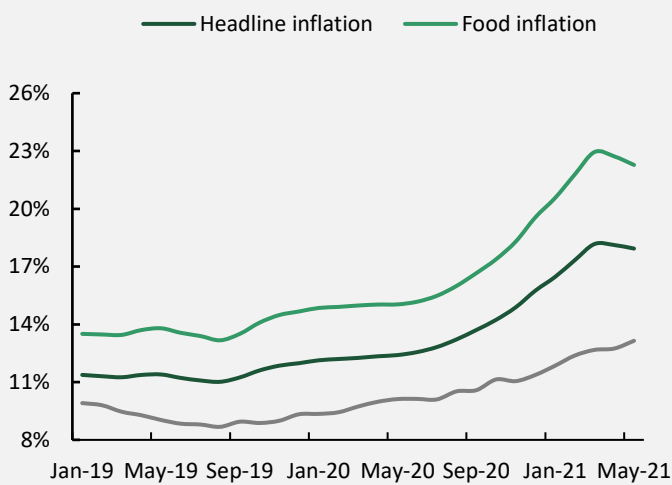
**Chart 24:** Urban and Rural Food Inflation rate (January 2019-May 2021)



Source: NBS, Meristem Research

Chart 25: Headline, Food and Core Inflation

Chart 26: Correlation of core Inflation Index and Exchange rate



Source: NBS, FMDQ, Meristem Research

## Politics and Security- Renewed Efforts at Tackling Security Challenges

Although heightened tensions due to the #EndSARS Protests have moderated, in its stead, agitations from secessionist groups from different regions of the country have grown, with recorded incidences of violence with security agents. In addition to the long-drawn fight against insurgency in the north-eastern region of the country, rising cases of kidnappings, banditry and herdsmen conflicts with rural farmers have continued to challenge the security framework of the country. These have made the economy less attractive for foreign capital.

In light of these challenges, the Federal Government is planning to spend NGN770.61bn in strengthening the security agencies to acquire additional equipment to combat the security challenges in the country. There are however renewed calls for a political restructuring as a sustainable solution in resolving these lingering security crises.

In the political space, there have been a spate of defections across political parties as politicians with electoral ambitions begin posturing ahead of next year. This is also as the Independent National Electoral Commission (INEC) commence the process of national voter registration. This could potentially raise the political barometer a few notches in H2:2021.

SECTION THREE:

# DOMESTIC FINANCIAL MARKET



Route to economic growth,  
paved with risks and changes

MERISTEM

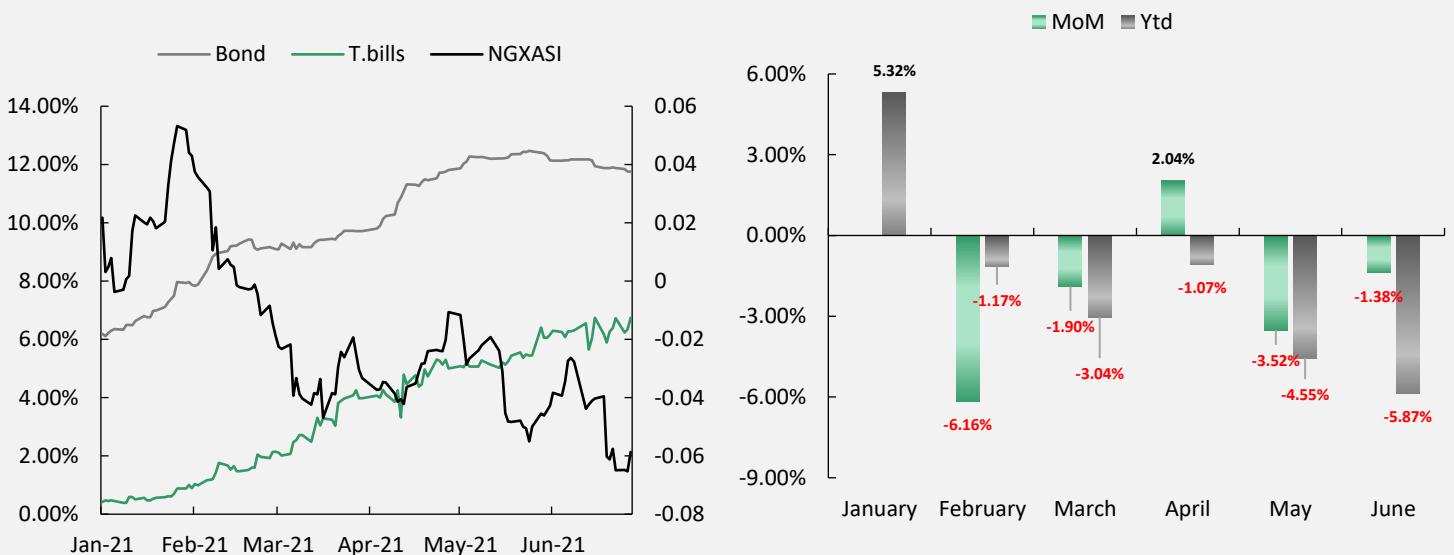
## Domestic Equities

### A Bearish Affair

Our outlook for the market included expectations that the momentum in the market will remain positive in the first half of the year owing to our expectation of depressed fixed-income yields and relatively impressive corporate performance. However, the downside risk to our forecast was an earlier than expected rally in fixed income yields. As predicted, the bullish sentiments from the prior year lingered, spurring the market to return 5.32% in January. The gradual recovery of economic activities and the prevalently low yields in the fixed income market contributed to the positive sentiment on equities. For context, the stop rates across instruments during the last Treasury Bills auction held in January were 0.55%, 1.30% and 2.00% across the 91-day, 182-day and 364-day instruments respectively.

Chart 27: NGXASI and Fixed Income Yield

Chart 28: 2021 MoM and Ytd NGXASI Performance



Source: FMDQ, Bloomberg, Meristem Research

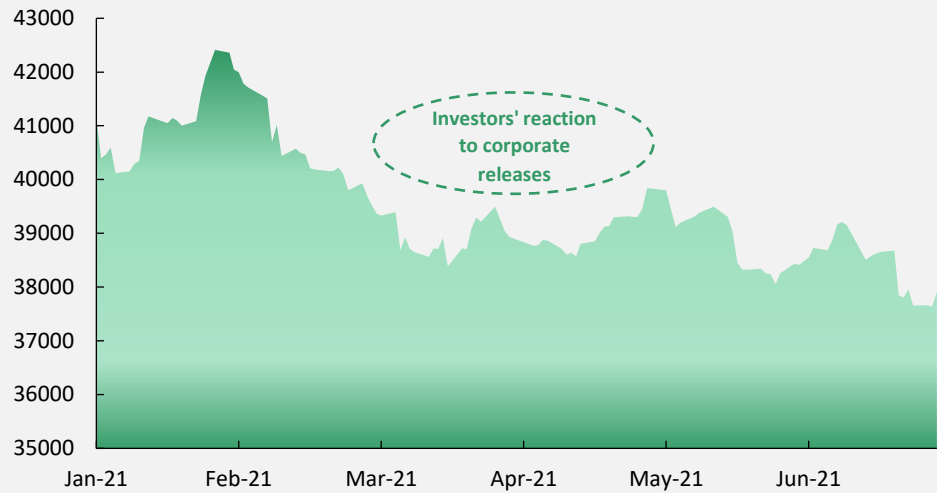
However, the sharp uptick in yields halted the momentum of the market (*stop rates rose to 2%, 3.5%, and 5.5% across the 91-day, 182-day and 364-day instruments*). The hunt for better yields spurred a rotation into the fixed income market, marking the beginning of a pullback on the local bourse. In February, the All-Share Index dipped 6.16% and recorded further sell-offs in March to lose 1.90% month on month.

Corporate filings set the theme for March. Several companies in the insurance, pharmaceutical, consumer, and industrial goods sectors were the biggest winners, with impressive year-on-year performances. However, the market's positive reaction to the financial results and dividend announcements turned



out to be a dead cat bounce as the market soon reverted to its bearish course, driving the Year-to-Date Return underwater by the end of May (-4.55%).

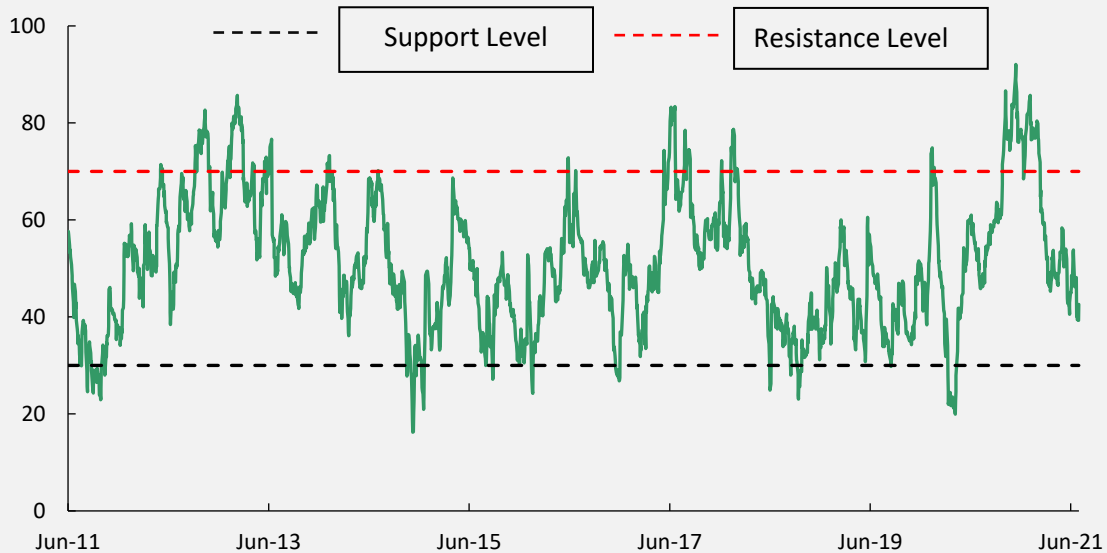
**Chart 29:** Trend in NGXASI



*Source: Bloomberg, Meristem Research*

From a technical standpoint, the market’s Relative Strength Index neared the Oversold region on several occasions during the pullback. At its nadir in May, the Year-to-Date losses stood at 5.50%, with the broad market Index pegged at 38,056.21pts.

**Chart 30:** 30-Day Relative Strength Index

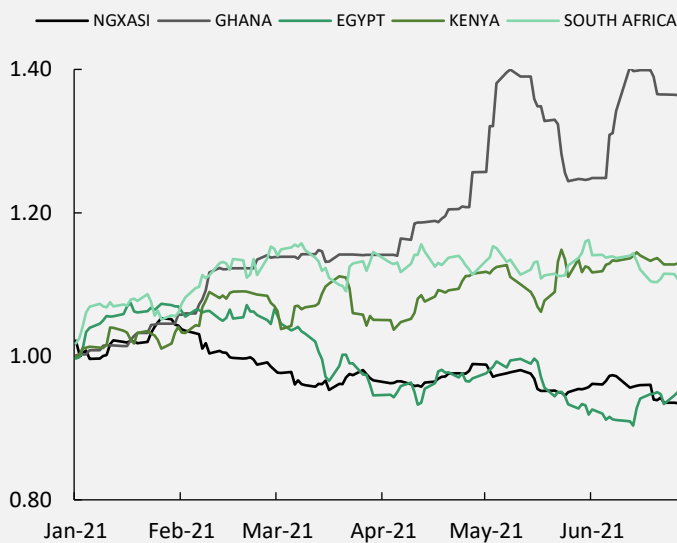


*Source: Bloomberg, Meristem Research*

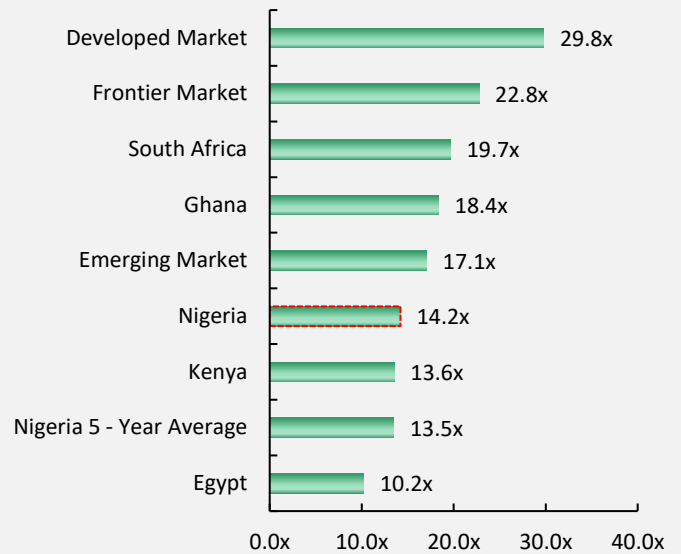
Compared to its peers in the African region, the Nigerian Exchange’s year to date return has been one of the most underwhelming, with a first-half market return of -5.89% (vs. Kenya: 14.96%, South Africa: 12.07%, Ghana: 36.77% and Egypt: -5.43%). However, in terms of relative valuation, the local bourse

currently trades at a discount of 14.22x (P/E) relative to its peer average of 15.45x times.

**Chart 31: Equity Performance across Markets**



**Chart 32: PE Ratio Across Market**



**Source:** Bloomberg, Meristem Research

While this might depict an opportunity for bargain hunters and value investors to position for mid-to-long term capital appreciation, the macroeconomic backdrop remains a sticking point, souring appetite for the Nigerian market. The market’s fortune is closely tied with the macro-economic environment, particularly the illiquidity in the foreign exchange market. Measures by the Central Bank to control dollar outflows have further rattled foreign participation in the equities market. The most recent capital importation data released by the National Bureau of Statistics reveal a 71.87% year-on-year decline in Total Capital Imported to USD1,069mn in Q4:2020. Foreign Portfolio Investment accounted for a paltry 3.59% (USD35.15mn) of total capital imported. In the same vein, foreign participation on the bourse continues to dig new lows, down to NGN20.29bn as of May 2021, from NGN70.31bn in January 2020. This is a testament to the dwindling confidence of foreign investors in domestic equities, despite incentives by the Government such as the availability of Naira settled non-deliverable OTC FX Futures for up to 60 months (*which is mainly being embraced on the short end*).

Chart 33: Participation in the Equities Market

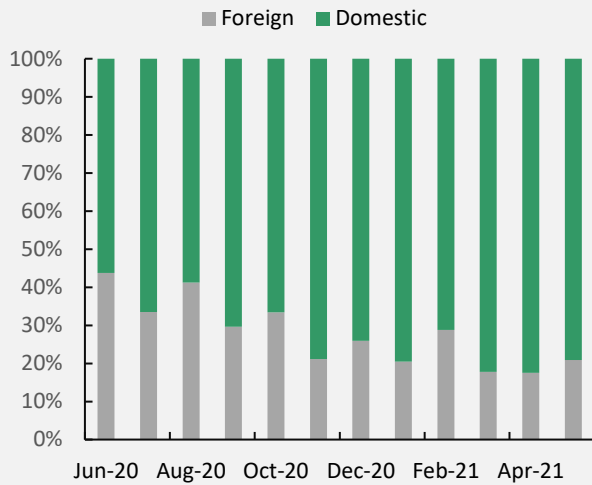
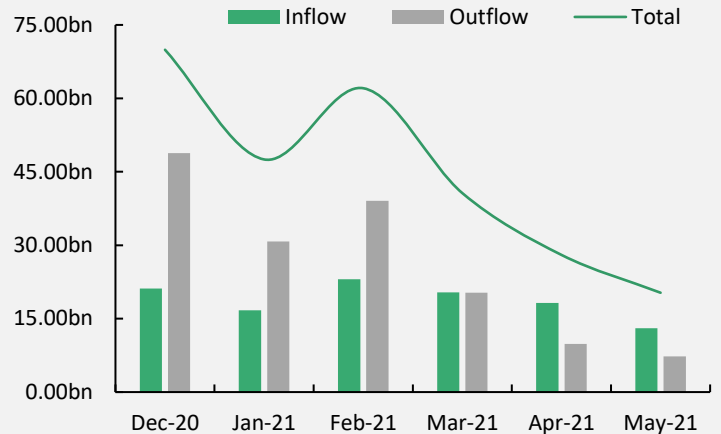


Chart 34: Foreign Transactions in the Equities Market

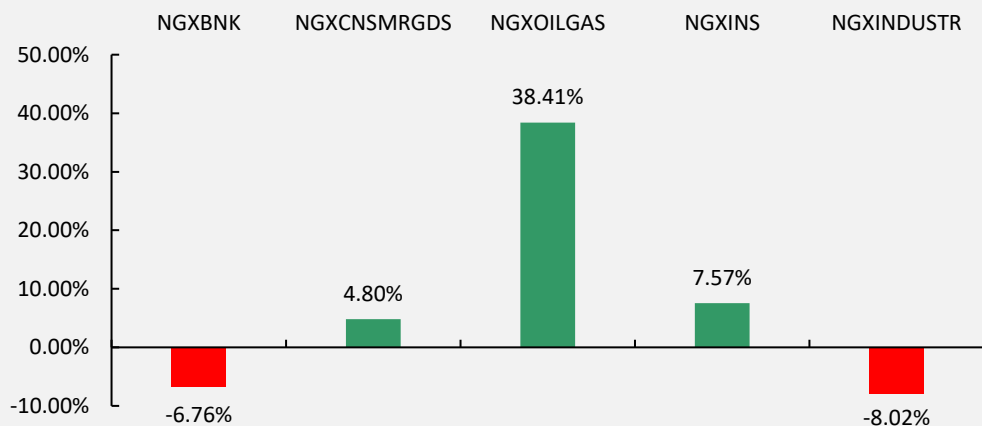


Source: NGX Group, Meristem Research

### Oil and Gas Sector Gets Back on Track

On a sectoral basis, the biggest winners this year have been the Oil and Gas and Insurance sectors. Positive sentiment on the bellwether counter- **SEPLAT** (up by 71.51%) in the first half propped the **NGXOILGAS** to return 38.41% during the period. We attribute this to the improvement in oil prices, the outstanding top-line performances, and ultimately, bargain hunting on the counter, considering the cheap valuation it was trading at. On the contrary, underwhelming full-year financial results in the banking sector dampened investors' appetite towards counters within the space. Dividend mark-downs coupled with profit-taking activities after short intervals of market gains have contributed to the negative returns on the Industrial and consumer goods indices.

Chart 35: First-Half Sectoral Return



Source: Bloomberg, Meristem Research

## Nigerian Exchange Group Births (NGX)

The Nigerian Stock Exchange gained its long-awaited approval from the Security Exchange Commission and Corporate Affairs Commission. It announced its new corporate brand identity -Nigerian Exchange Group (*NGX Group*) and subsidiaries on the 13th of April 2021. The subsidiaries are the Nigerian Exchange (NGX) Limited- the operating exchange; NGX Regulation (NGX RegCo) Limited- the independent regulatory arm of the Exchange; and NGX Real Estate (NGX RelCo) Limited- a real estate company. The exchange has since been listed on the NASD and its shares can be traded by licensed participating institutions and authorized traders registered on the NASD platform. **We envisage an improvement in the Group's corporate governance and transparency on account of increased shareholders' participation. We also see this development as an opportunity for the Group to gain further exposure with the ability to access funds for financing strategic business objectives and improve flexibility in terms of business diversification.**

## NASD-USI: Nigerian Exchange Group Admission Props Performance

The NASD Unlisted Security Index (USI) closed down for three consecutive weeks in January. The bearish run persisted in the subsequent month to return -2.60%, dragging the year-to-date return further into the negative territory. The admission of the Nigerian Exchange group (listed at NGN25.00) into the NASD OTC market turned the fortunes of the index, as the Exchange group currently accounts for c.6.40% of the total NASD OTC market capitalization. This resulted in a significant improvement in the index, as the NASD USI index rose to 785.12pts in the third week of April from 755.84pts in the first week of April. On a cumulative, of the 23 trading weeks recorded so far in 2021, the market closed up on 11 trading weeks, to return 1.80% during the first-half period.

## Equities Outlook

### Is the Market Cheap Enough to Attract Foreign Funds?

Although the uncertainties induced by the pandemic have begun to subside gradually, the absence of growth sustaining drivers (*such as an enabling business environment and improved foreign inflows*) dampens our outlook for equities in the second half of the year.

To stimulate economic recovery from the COVID-19 pandemic, developed economies have maintained a dovish monetary stance for the rest of the year. As such, the relatively cheap valuations of emerging and frontier equities markets make them attractive destinations for foreign inflows. However, foreign portfolio investors have continued to snub the local bourse despite its cheap valuation (P/E Ratio of 14.2x) relative to its Emerging Market (P/E Ratio of 17.1x) and Frontier Market Peers (P/E Ratio of 22.8x). We can infer from the Nigerian Exchange FPI data that foreign investors are looking beyond the market's attractive valuations to consider FX liquidity and the volatile policy environment. The MSCI has indicated the possibility of reclassifying the MSCI Nigeria Index to a Standalone Market Status due to the difficulties faced by foreign investors to repatriate funds from investments. **We, therefore, expect continued foreign apathy in local equities for the rest of the year.**

### What Role will the Fixed Income Market Play?

The FG's new Debt Management Strategy points to a renewed focus on the domestic debt market. **While we expect yields to rise less steeply in the second half, the need to fund the budget deficit has the potential to drive yields even higher. This could redirect the flow of funds into the equity market.**

### Will Corporate Actions Offer Support to Equities?

In past years, the introduction of new stocks to the bourse and corporate actions such as acquisitions, right issues, and share buybacks have ignited positive sentiment in the market. The second tranche of DANGCEM's share buyback is likely to take place before the year runs out. **If this happens, we see room for a rally on the counter, which would, in turn, improve market performance during the period, considering DANGCEM's weight on the index.**

### Will Earnings Season Excite Investors?

We note the resilience of firms across industries despite the weak macroeconomic environment and underwhelming economic indicators-inflation, unemployment, and currency devaluation, amongst others. In the second half, we see more room for improved financial performance on the back of base effect, relatively improved yield environment, increased oil prices and improved demand, particularly in sectors that recorded sub-par performances due to the pandemic. **Against this backdrop, we expect dividend aristocrats to maintain interim dividend per share at current levels at the very least.**

However, we do not see positive investors' sentiment extending beyond the earnings season.

## Market Expectation

We are maintaining our position of a decline in market's performance for the year. For a start, we considered the negative impact a reclassification of the MSCI Nigeria Index (*due to the difficulties faced by foreign market participants to repatriate funds*) would have on foreign investors' sentiment. While we acknowledge the recent liquidity improvement in the I&E FX window (*monthly average of USD143.34mn in June from USD57.31mn in January*), on the back of the Central Bank's efforts to clear the backlogs, our opinion is that improved oil revenues currently support the CBN's ability to provide liquidity. However, considering the cap on oil production volumes, we do not see room for a sustained increase in oil inflows. As such, a continued supply of liquidity will strain foreign reserves even further (*down to USD33.37bn in June 2021 from USD35.37bn in January 2021*).

Also, we see fixed-income yields hovering at current levels or improving at a slower pace- pointing to a rotation from equities as seen in February.

Our fundamental analysis suggests a positive return on the back of an expectation of improved corporate performances based on continued economic recovery, the relative improvement in yield environment (*for financial sector players*), improved oil prices, base effect, among other drivers. However, the release of sub-par financial results by highly-rated and heavy-weight stocks could trigger sell-offs on these counters, driving the market further downwards.

On a balance of these factors, while we expect the market to reward fundamentals, judging by the attractive upside potentials across many counters, we note the dismal impact the following will have on the market's overall performance: Sustained decline in Foreign Portfolio Investments, Reclassification of the MSCI Nigeria Index, Uptick in PMA rates, Increased Corporate debt issuances and Profit-taking activities following a momentary reaction to earnings seasons. We are of the opinion that the impact of these factors put together will ultimately call the direction of the market for the rest of the year, resulting in a negative return of **-0.35%**.

## Fundamental Approach

Using the fundamental approach, our expected market return for 2021 is based on the target prices of 49 stocks, which accounts for c.98.71% of the market capitalization as of June 2021.

	Weight	Expected Return	Weighted Return
Banking	13.1%	24.6%	3.2%
Insurance	0.8%	-0.1%	0.0%
Materials and Industrials	25.8%	3.7%	1.0%
Consumer staples & Consumer Discretionary	9.2%	0.8%	0.1%
Agricultural Products*	0.7%	14.2%	0.1%
Energy	2.1%	-0.1%	0.0%
Pharmaceuticals	0.1%	17.1%	0.0%
Information Technology	47.1%	7.3%	3.4%
<b>TOTAL</b>	<b>98.71%</b>		
<b>Expected Return</b>			<b>+7.80%</b>

## Neural Network Approach

This approach is superior to classical statistical models in that it can be used to model complex and non-linear relationships as is obtainable in the real world. Therefore, it is commonly used to forecast index values and the daily and weekly direction of changes in the index. Hence, we used annual time series NGXASI data from 1998 to 2020. The trained neural network was used to predict the index level for 2021 at 37,999.45pts, implying a negative return of 5.64% from the 2020 year-end level of 40,270.72pts.

## Econometrics Approach

The forecast was obtained using the ARMA econometric model. The ARMA model is one of the most widely used time series models in forecasting stock market series primarily due to its integrated property, which reduces the effect of seasonality inherent in stock market variables. This approach appeals more as it applies weight to its previous terms based on how recently they occur. This enables the model to capture recent sentiment in the equities market and smooth out outliers. Based on this methodology, we expect the All-Share Index to settle at 38,978.03pts, implying a return of **-3.21%** by 2021FY.

## Weighted Market Return

	Return	Weight
Fundamental approach	7.80%	33%
Neural Network	-3.21%	33%
Econometrics approach	-5.64%	33%
<b>Expected Market Return</b>	<b>-0.35%</b>	

## Corporate Earnings Outlook

<b>Agriculture</b>	<b>Positive</b>
	With the gradual pick-up in economic activities, we expect the sector to ride on the back of the rally in global price and robust local demand for CPO. Meanwhile, policy interventions by the CBN and FG - especially for maize production and livestock breeding will also positively impact the sector in the coming half of the year.
<b>Banking</b>	<b>Modest</b>
	Higher yields, improved CASA mix, growth in loans and electronic transaction volumes should bode positively for earnings. However, slow growth in lending rates and fixed income yields in H2:2021 are expected to constrain earnings growth.
<b>Consumer Staples</b>	<b>Positive</b>
	<p>Although we acknowledge the pressures on consumer incomes and heightened raw material costs as the major downside risks to Consumer Goods sector performance in 2021, we expect the gradual economic recovery and the non-discretionary nature of most goods in this category to support our positive outlook in the second half. We continue to see prospects for revenue growth for wheat-based products as demand remains robust. Our projection is hinged on the importance of wheat-based food products (<i>as a raw material for some staples in Nigeria</i>). We also do not rule out likely price increase to offset pressure from production costs.</p> <p><b>BREWERIES:</b> We are optimistic about the prospects for the brewers in H2:2021, particularly considering the low base of last year. We expect the full reopening of on-trade market channels to drive demand in Q3:2021. Our optimism is fueled by our expectations of better alcohol demand during the year and festivity driven demand in Q4:2021 which should push sales volume upward. Also, the full reopening of the on-trade channels and likely price increases across specific products should sustain the momentum recorded so far.</p>
<b>Energy</b>	<b>Upstream (Positive) Downstream (Modest)</b>
	<p><b>UPSTREAM</b> - For the rest of the year, we expect profitability to be fueled by improved oil prices as well as slight decline in production OPEX, as the ease in OPEC+ cut increase production volume, thus improving economies of scale.</p> <p><b>DOWNSTREAM</b> - We expect higher sales volume to drive revenue growth. Based on daily PMS truck-out report, truck out volume continues to gain traction, implying higher import volume and consumption rate.</p>
<b>Pharmaceutical</b>	<b>Positive</b>
	We expect increased demand for pharmaceutical products in the year to boost revenue for companies in the sector. We also note the slight uptick in prices of some products in Q1:2021- a theme which we expect to continue into H2:2021 as the impact of macro-economic conditions like rising inflation exerts pressure on production costs. Bottomline expansion is however hinged on the respective company' ability to effectively manage these costs.



Industrial Goods	<b>Positive</b>
	<p><b>CEMENT MANUFACTURERS</b>- Although, cement manufacturers are yet to fully take advantage of the export opportunities arising from the re-opened land borders and the implementation of AfCFTA, our view is that <b>DANGCEM</b> is best placed for exports, given its strategic positioning across Africa and its newly commissioned Apapa and Onne Export Terminals. Based on this, we anticipate an improved export performance from DANGCEM in H2:2021. Also, we expect earnings to receive a lift from the approval of a pioneer tax status on its new Obajana Line 5 plant as well as the utilization of its NGN22.32bn tax credit certificates (<i>accrued under the road infrastructure tax credit scheme</i>).</p> <p>A key highlight for <b>BUACEMENT</b> is the completion of its Kalambaina plant reconfiguration (<i>to run on gas - formerly LPFO</i>). This is expected to aid the company’s fuel optimization and should support profitability. Also, existing tax incentives on its Obu line 1 and Kalabaina Line 2 should support earnings.</p> <p><b>WAPCO</b> continues to maintain a low leverage – 1.44x (DANGCEM – 2.18x, BUACEMENT – 1.91x); after it divested from its loss making South African subsidiary in 2019 and settled its dollar debt obligations. As a result, the company’s lower finance obligations supported its profitability in 2020FY. However, with plans to unlock an estimated 2MTPA capacity from its existing plants over the next two years, we do not rule out the possibility of a debt issuance to finance a turnaround maintenance in the near term. While its health, cost, and cash initiative have yielded some results, we look to the possible approval of a 2-year tax credit extension on its Mfamosing line 2 to further support earnings.</p> <p><b>PAINT MANUFACTURERS</b> - Given the high competition, which constrains the ability of paint manufacturers to pass on cost to their consumers, earnings performance largely depends on the ease of sourcing raw materials and foreign exchange stability. As foreign exchange devaluation risks continue to loom large, we expect paint maker’s earnings to remain pressured for the rest of the year, save for <b>CAP</b>, whose merger with <b>PORTLAND</b> should yield some cost savings and ultimately improve its earnings in absolute terms. However, we expect an initial EPS dilution arising from the merger.</p>
Insurance	<b>Modest</b>
	For H2:2021, we expect positive underwriting performance, however, industry profitability growth is expected to be muted due to relatively high operating costs and modest investment income growth.
Telecommunication	<b>Positive</b>
	While we envisage a sluggish growth in subscriber base due to new regulatory requirements, we anticipate steady growth in data revenue ( <i>to be driven by the increased 4G capacity expansion and smartphone penetration</i> ) and fintech revenue ( <i>driven by the increase in services and agent networks</i> ). We also expect these to be complemented by increased cost efficiency and a rebound in traditional revenue sources, such as voice and SMS.

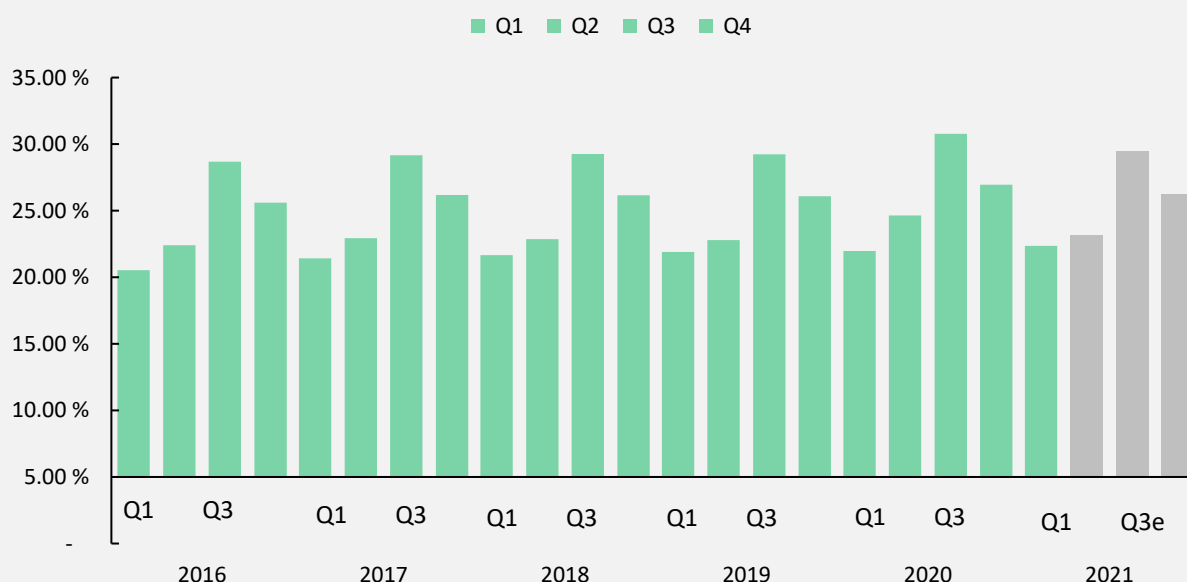
## Sector Outlook

### Agricultural Sector: Still Grasping at Straws

The agricultural sector reaffirmed its position as the largest sector in Nigeria, contributing c.22% to GDP in Q1:2021 (vs. five-year average contribution of c.26%). Growth has, however, been largely constrained in the sector, with an average growth of 2.25% in the past ten quarters. In Q1:2021, the sector grew by 2.28%YoY (vs. 3.42%YoY in Q4:2020). Apart from perennial constraints to growth (such as land tenure problems, low access to credit, poor pricing policies and poor market access), budgetary allocation for the sector continues to fall below the required level. The low agricultural budget for 2021 represents only 2.06% of the total budget size and falls short of the 10% recommended by the Maputo Declaration of 2003. The sector is also bedeviled by inadequate infrastructural facilities as more than 90% of Nigeria’s agricultural produce comes from smallholder farmers (representing c. 80% of total Nigerian farmers).

Rising insecurity challenges in the country have, however, emerged to cripple production in the sector further. Violent clashes between nomadic herdsmen and crop farmers in the South, along with reports of banditry, incessant kidnappings, terrorism, continue to affect farmers’ activities in significant food-producing States.

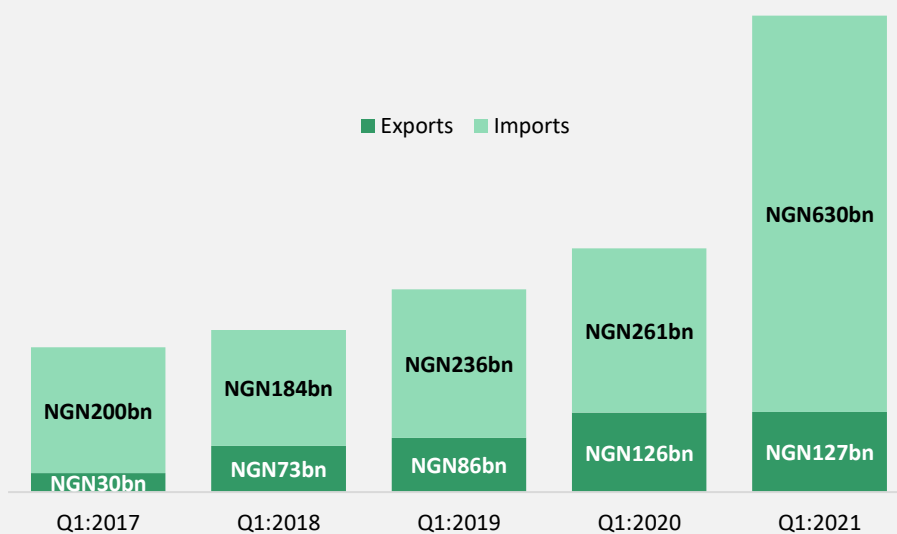
Chart 36: Agricultural GDP as a Share of Total GDP



Source: NBS, Meristem Research

The unabating insecurity challenge, especially in the food-producing regions of the country, coupled with the increase in food demand, has resulted in an overreliance on agricultural imports. By Q1:2021, importation of vegetable and animal products rose significantly by c.108% YoY and c.105% YoY to NGN359.09bn and NGN221.60bn respectively. The nation’s agricultural trade has remained in a deficit position as far back as 2012. In Q1:2021, the deficit widened by NGN503.01bn, compared to NGN126.35bn in the corresponding quarter of 2020- as imports of agricultural goods rose to their highest since Q1:2011. The sudden jump in imports was first witnessed at the onset of the pandemic. Data from the National Bureau of Statistics (NBS) showed a c.66% YoY increase in agricultural imports in Q2:2020 to USD415.62bn. With the rising incidence of insecurity which grossly limited farming activities, agricultural imports continued to rise – reaching an all-time high of NGN630.18bn in Q1:2021. This development is further testament to the structural imbalance in the economy that needs to be addressed. In the short term, we expect the agricultural import bill to remain high for the rest of the year.

**Chart 37:** An Import-Dependent Economy (NGN’ bn)



Source: NBS, Meristem Research

### Government Continues to Prop Sector

The Government has continued to provide support through various policy interventions aimed at driving growth in the sector. Specifically, the Federal Ministry of Agriculture and Rural Development (FMARD) flagged off the National Livestock Breed Improvement Program, in line with the NGN1.08bn budgetary allocation to the National Grazing Development. This was designed to address the development and transformation of the livestock value chain while mitigating the incessant herder and crop farmers’ conflict that has hindered productive activities in major agricultural regions.

Also, the Central Bank of Nigeria (CBN) is trying to moderate the price of maize, the source of inputs for many important industries, having distributed c. 300,000MT of maize under the Anchor Borrower’s Program (ABP). **While we expect a continuation of these interventions and their short-term impact in driving growth, additional investment in value chains of target crops will be required in unlocking the value within the sector.**

### Oil Palm

In line with our expectations for the first half of the year, palm oil prices have continued to trend upwards owing to increasing demand as economies have started to reopen due to modest progress with vaccination. Also, the higher export levy imposed by Indonesia and the prolonged foreign-labor crunch in Malaysia have strained Crude Palm Oil (CPO) supply, hence the price rally. **However, we expect this bullish price momentum to temper in the second half of the year due to the cyclicity of CPO production. Notwithstanding, oil palm millers are expected to benefit from a better pricing environment as well as increased demand compared to H2:2020.**

Valuation and Ratings															
	Fundamentals				Trailing					Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
LIVESTOCK	0.55	5.26%	28.42%	10.39%	2.73	0.21	0.75	8.87	2.52	10.5	0.17	1.79	1.89	-6%	HOLD
OKOMUOIL	0.22	41.99%	28.84%	19.22%	1.50	11.56	40.07	9.52	2.75	10.99	11.56	127.04	110	15%	BUY
PRESCO	0.10	48.49%	20.93%	9.58%	2.18	7.31	34.89	10.20	2.13	12.01	7.25	87.07	74.5	17%	BUY

*AT (Asset Turnover); NM (Net Margin); ROE (Return on Equity); ROA (Return on Asset); Lev. (Financial Leverage); EPS (Earnings Per Share); BVPS ( Book Value Per Share); PE (Price to Earnings); PBV (Price to Book Value); Target PE (Target Price to Earnings Ratio); Price\*( Price as at 30<sup>th</sup> June 2021); Exp. Div. Yield (Expected Dividend Yield); UPP (Upside Potential); Tot. Return (Total*

## Banking Sector: Outlook for Interest Income Remains Modest

In Q1:2021, interest income for banks in our coverage universe fell by an estimated 9.71% YoY, despite a 4.51% YtD growth in loan book. This was due to relatively lower lending rates (*average prime and maximum lending rates fell to 11.20% and 28.53% in Q1:2021, from 14.91% and 30.63% in Q1:2020, respectively*). Furthermore, while T-Bills and bond yields have generally trended upwards in 2021, the Q1:2021 average (*1.70% and 8.35%, respectively*) lags Q1:2020 rates (*3.84% and 10.39%, respectively*). **Despite this weak start, we expect a positive, albeit modest growth in interest income by 2021FY based on expected loan repricing in H2:2021 and higher average fixed income yields in 2021. However, we note that the MPC's accommodative stance poses a downside risk to interest income, as lending rates may remain sticky upwards. In addition, interest rates on fixed income instruments could rise more slowly than anticipated or even decline over the near term.**

## Rising e-Banking Transaction Volume to Sustain Non-Interest Income

Results released so far in Q1:2021 show that e-banking income grew by 28.89% YoY for banks in our coverage universe, driven by a sustained rise in transaction volumes on electronic platforms. This lends credence to our earlier position expressed in our 2021 Annual Outlook, that fee-based income will increasingly rely on banks' ability to leverage technology to drive transaction volumes. **Thus, we maintain our optimism about transaction volumes and fee-based income for the rest of the year. We also expect higher demand for credit facilities to bode well for credit-related fees.**

For trading income on investment securities, which came in strong (+48.34% YoY) in 2020FY due to the relative decline in yields, we had indicated that we expected a moderation given the outlook for yields. In Q1:2021, trading income for banks in our coverage universe declined significantly by 66.57% YoY. **For the rest of the year, we still expect yields to rise, albeit more slowly. Thus, we maintain that trading gains on investment securities will be muted for the rest of 2021. Similarly, we do not expect strong FX revaluation gains given the relative stability of the NAFEX rate so far in the year.**

## Moderate Loan Loss Provisions to Drive Profitability

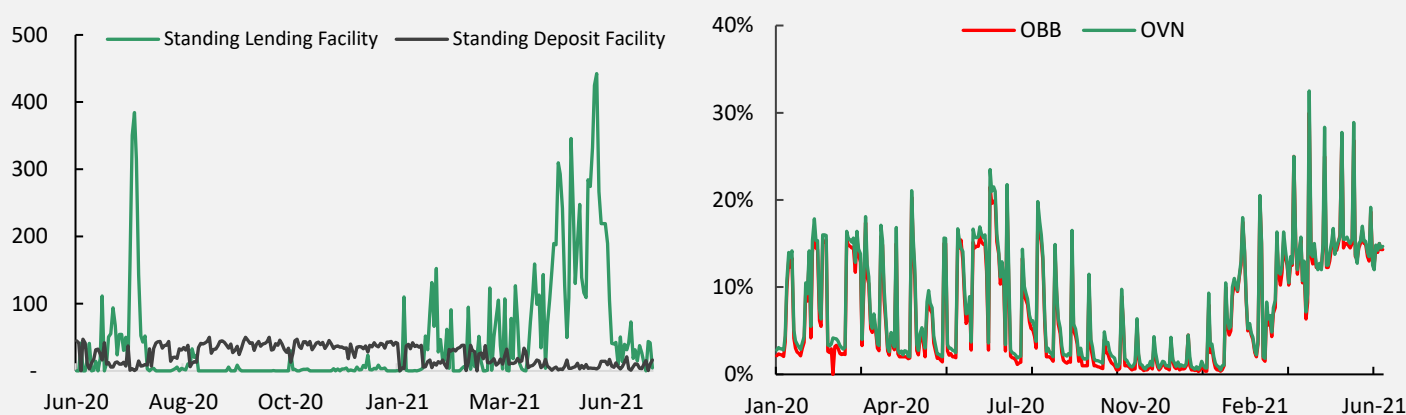
Banks have continued to drive down funding costs via improved CASA mix. As at Q1:2021, industry CASA mix was estimated at over 71% of total deposits. This is expected to continue to support margins and profitability in H2:2021. In terms of overall cost efficiency, the industry is yet to achieve an improvement, although average Cost-to-Income ratio (CIR) increased only marginally by 29bps YoY to 66.84% in Q1:2021, from 66.55% in Q1:2020. Meanwhile, the most significant threat to profitability in the industry in 2020FY has been high

impairment provisioning due to the weak business environment. In view of the improving business climate, we projected a moderation in impairment charges for 2021FY. So far in 2021, impairment charges have increased by 12.61% YoY (vs. 50.48% YoY in 2020FY). **We expect this trend to continue over the near term and thus lead to stronger industry profitability in 2021. Risks to our projection of strong profit growth in 2021 may emanate from the high inflationary environment which could materially impact operating expenses.**

### Liquidity Crunch in the Banking Sector?

We had earlier expressed concerns over increased liquidity risks faced by the sector and particularly on how it is adversely impacting the relatively smaller sized banks. Certain events which occurred over the first half of the year further highlight this challenge. Notable is the observed surge in drawings from the CBN Standing Lending Facility (SLF) and a spike in the interbank lending rates. Data from the CBN shows that banks' drawings from the SLF window has been increasing since mid-March 2021. This indicates that Special Bills issued by CBN to help in managing liquidity have not been sufficient.

**Chart 38:** Indicators of Financial System Liquidity (NGN' bn)    **Chart 39:** Money Market Indicators (%)



Source: CBN, Meristem Research

While liquidity ratio (LR) stood at an average of 50.76% as at 2020FY for our coverage universe, LRs for the following players were only a little above the regulatory minimum of 30%: **WEMABANK (30.04%), FCMB (34.20%), FBNH (34.80%), and STERNLNBK (34.90%)**. The relatively low liquidity could negatively impact the ability of these banks to expand their risk asset, hence limiting their interest revenue and bottom-line (particularly for smaller sized banks as earlier mentioned).

**Table 2:** Our Outlook for Key Banking Sector Metrics in H2:2021

Metric	Upside Factors	Downside Risks	Outlook
<b>Earnings</b>	Expanding risk asset portfolio, higher yields, growth in e-banking transaction volume, lower impairment provision and lower cost of funds.	Inflationary pressure, Monetary Policy Committee's accommodative stance	Positive/Modest
<b>Asset Quality</b>	Improved business climate, Strong credit risk management	Slower rate of economic recovery	Positive/Strong
<b>Capital Adequacy</b>	Funding opportunity in the capital market, strong earnings growth.	Slower rate of economic recovery, weak earnings growth	Positive/Strong
<b>Liquidity</b>	Access to capital market funds	Sustained CRR debits.	Positive/Weak

### Valuation and Ratings

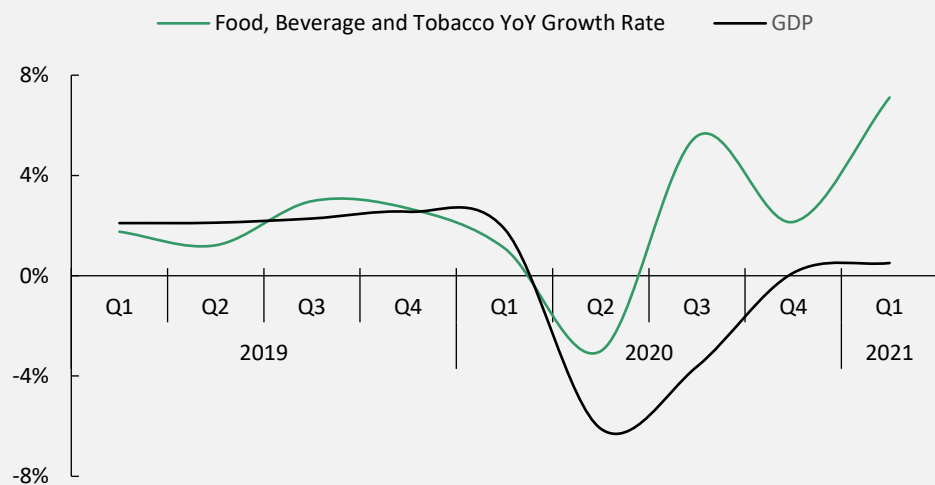
	Fundamentals				Trailing					Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
<b>ACCESS</b>	0.25	23.66%	14.93%	13.08%	1.14	3.33	22.31	2.54	0.38	2.76	3.4	9.38	8.45	11%	<b>BUY</b>
<b>ETI</b>	0.02	14.23%	4.96%	0.38%	13.09	1.61	32.40	3.11	0.15	2.37	4.4	10.43	5	109%	<b>BUY</b>
<b>FBNH</b>	0.02	114.37%	28.79%	2.81%	10.25	6.14	21.31	1.20	0.34	3.22	2.59	8.34	7.35	13%	<b>BUY</b>
<b>FCMB</b>	0.02	8.27%	8.06%	0.86%	9.37	0.93	11.57	3.59	0.29	2.71	1.06	2.87	3.35	-14%	<b>SELL</b>
<b>FIDELITYBK</b>	0.02	17.40%	11.49%	1.05%	10.94	1.05	9.13	2.20	0.25	2.83	1.01	2.86	2.31	24%	<b>BUY</b>
<b>GTCO</b>	0.02	42.92%	23.52%	3.94%	5.96	6.69	28.45	0.00	0.00	4.9	6.99	34.25	29.9	15%	<b>BUY</b>
<b>STANBIC</b>	0.02	24.62%	19.26%	2.87%	6.70	6.65	34.52	6.05	1.17	6.8	7.37	50.12	40.25	25%	<b>BUY</b>
<b>STERLNBANK</b>	0.02	7.74%	8.78%	0.83%	10.58	0.40	4.58	3.88	0.34	4.12	0.46	1.90	1.56	21%	<b>BUY</b>
<b>UBA</b>	0.02	24.48%	15.98%	1.54%	10.35	3.56	22.29	2.05	0.33	3	3.6	10.80	7.3	48%	<b>BUY</b>
<b>UBN</b>	0.02	16.88%	7.11%	0.87%	8.13	0.65	9.11	8.65	0.62	9	0.88	7.92	5.6	41%	<b>BUY</b>
<b>WEMABANK</b>	0.02	6.68%	31.41%	1.84%	17.11	0.49	1.57	1.28	0.40	3.07	0.23	0.71	0.63	12%	<b>BUY</b>
<b>ZENITHBANK</b>	0.02	33.73%	21.35%	2.68%	7.95	7.42	34.78	3.20	0.68	3.85	7.68	29.57	23.75	24%	<b>BUY</b>

AT (Asset Turnover); NM (Net Margin); ROE (Return on Equity); ROA (Return on Asset); Lev. (Financial Leverage); EPS (Earnings Per Share); BVPS (Book Value Per Share); PE (Price to Earnings); PBV (Price to Book Value); Target PE (Target Price to Earnings Ratio); Price\* (Price as at 30<sup>th</sup> June 2021); Exp. Div. Yield (Expected Dividend Yield); UPP (Upside Potential); Tot. Return (Total

## Consumer Staples Sector: Food Beverage and Tobacco Sector Rebounds from Setback

Supply chain disruptions triggered by the Coronavirus pandemic, coupled with the weakened purchasing power, were the highlights of the pandemic year for players in the FMCG space. In Q1:2021, the Food, Beverage, and Tobacco sector rebounded sharply from the setback witnessed in 2020, up by 7.11% in Q1:2021 (vs. 1.10% in Q1:2020). The growth outpaced the GDP growth rate of 0.51% in Q1:2021, benefiting from continued demand for essential consumer items.

Chart 40: Food, Beverage and Tobacco, and GDP

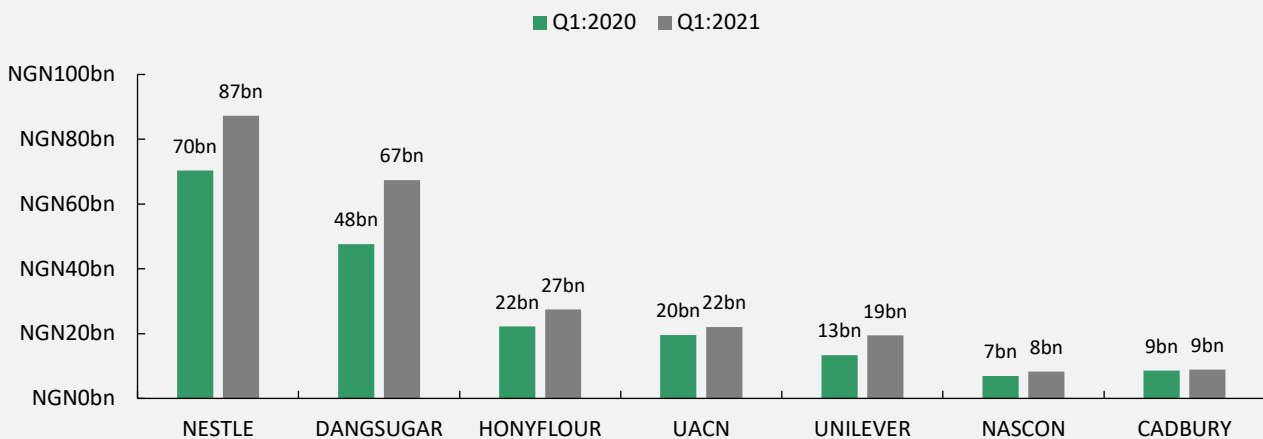


Source: CBN,NBS, Meristem Research

In a bid to maintain margins amidst rising raw material costs, increased excise duties, and inflationary pressures, most firms operating within the Consumer Goods sector adjusted prices upwards. This, in turn, reflected positively on their financial performance, as consumers continued to spend on essential food items. Another factor that played a critical role in how companies performed was the FG’s border closure directive, which effectively shut out smuggled competition. While the directive was reversed in December, the firms within the sector still reported record volume growth. Hence, players in the sector have been able to sustain the growth into the new year. **DANGSUGAR** (+41.16%), **NESTLE** (+24.07%), **NASCON** (+21.64%), **HONYFLOUR** (+23.61%) all recorded double-digit increase in sales in Q1:2021. Companies with more discretionary offerings (like the brewers) also recorded significantly better sales in the first quarter of the year, relative to the corresponding period last year.



Chart 41: Revenue of Selected Industry Players (NGN' bn)



Source: NBS, Meristem Research

### Macroeconomic Headwinds & Government Policies Intensify Cost Pressures

The Central Bank of Nigeria’s (CBN) recent policy to restrict wheat and sugar importers from accessing FX in the official window is a significant development that will adversely impact raw material sourcing for players in the flour milling industry. Nigeria currently produces c. 55,000 tonnes of wheat, which is insufficient to cater to domestic demand c.4.5 million tonnes. For sugar, local consumption (of 1.53 million metric tons) also outstrips domestic sugar cane production levels (c. 70,000 metric tons). The challenge with domestic wheat production ranges from adverse weather conditions, unavailability of high-yielding wheat seeds, inadequate land area and irrigation infrastructure, and lack of financing for wheat farmers. The nature of these challenges highlights the need for synergy between both policymakers and industry players for wheat sufficiency to be actualized in the country. This explains the Flour Millers Association of Nigeria’s (FMAN) request that the CBN include wheat production in its Anchor Borrowers Program, as this will improve the industry’s financing needs.

For a sector already grappling with a high-cost profile (5-year industry average cost to sales is c.87.51%), adding wheat and sugar to the FX restriction list would push most companies to source FX in the parallel market, pushing pressure on production costs and straining already thin profit margins. On the flip side, we expect that most companies would double-down on backward integration. Dangote Sugar currently boasts of sugarcane plantations covering more than 150,000 hectares of land, with an installed capacity to produce 1.5million tonnes of refined sugar annually. Sunti Golden Sugar Estate has a production facility area of about 15,000 hectares, with a capacity to produce 4,500 metric

tonnes of sugarcane daily. Dangote Sugar Refinery, BUA Sugar and Golden Sugar of Flour Mills have already announced and (or) commissioned new plants to support local sugar production. However, these strategies are not expected to provide immediate solutions to the local production deficit.

**In the near term, while we consider the possibility of increased prices of existing products, we opine that the adjustment of product quantities to suit low-price consumers (*that is, pocket-friendly packaging*) will be at the front burner for companies in the quest to expand market share. We also anticipate increased cost pressures in the second half (*as players source for foreign exchange in the Parallel FX market*) to inhibit the improvement in margins. Overall, while we see headway for revenue expansion, the ability of these firms to keep costs at bay will ultimately determine earnings performance in the second half.**

### Brewery Sub-Industry

The brewery sector has recorded a remarkable performance so far this year, with sales recovering to pre-pandemic levels. The return of on-trade sales following a rollback of social restrictions have upheld sales so far this year. We also note price increases across board as another support channel. Most of the brewers increased prices across product categories as shown below:

**Table 3:** Price Comparison in January and June 2021

Category	Brands	Price/cl	
		Jan 2021	June 2021
Value	Life (NB)	4.16	4.33
	Goldberg (NB)	4.00	4.16
	Eagle Stout (INTBREW)	4.16	4.16
Mainstream	Trophy (INTBREW)	4.16	5.08
	Hero (INTBREW)	4.16	4.42
	33 Export (NB)	4.16	4.5
	Gulder (NB)	4.16	5.33
Premium	Budweiser (INTBREW)	5.83	5.83
	Heineken (NB)	5.5	5.5
	Guinness Gold (GUINNESS)	5.5	5.75
	Guinness Foreign Extra Stout (GUINNESS)	5.5	7.16
	Legend Stout (NB)	5.5	5.67

**Source:** Open Market Survey, Meristem Research

Like its consumer goods counterparts, inflation contributed to the increase in the cost of production within the sector. We also note that the CBN's inclusion of sugar and wheat on the FX restriction list will add to the cost burden faced by the brewers. After last year's slowdown, marketing and promotional activities have picked up as the quest to capture market share continues. Marketing expenses of the top three brewers amounted to NGN30.04bn in Q1:2021 (vs. NGN27.97bn in Q1:2020).

For the rest of the year, we expect a positive performance for the sector hinged on the full reopening of on-trade market channels, the likely increase in prices where possible and our expectation of better demand which should boost sales volume during the year. While we acknowledge the pre-existing headwinds affecting the industry, we expect the performance in topline to cushion expected pressures on cost, thereby sustaining the momentum gained since the turn of the year.

Valuation and Ratings															
	Fundamentals				Trailing					Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
DANGSUGAR	0.23	12.32%	23.84%	10.86%	2.19	2.61	10.95	7.18	1.71	6.52	3.08	20.08	18.75	7%	HOLD
FLOURMILL	1.42	3.33%	14.73%	4.72%	3.12	6.27	42.58	4.76	0.70	5.00	7.76	38.80	29.85	30%	BUY
GUINNESS	0.73	1.60%	-16.16%	-7.69%	2.10	-5.53	34.18	-5.25	0.85	14.84	2.13	31.61	29	9%	HOLD
HONYFLOUR	0.74	1.03%	2.78%	1.09%	2.54	0.20	7.31	8.23	0.23	9.00	0.15	1.35	1.67	-19%	SELL
INTBREW	0.10	-6.62%	-6.24%	-2.49%	2.50	-0.35	5.55	-15.31	0.95	0.00	0	5.51	5.3	4%	HOLD
NASCON	0.18	8.67%	20.73%	5.88%	3.52	0.21	1.03	66.97	13.88	13.00	1.17	15.21	14.35	6%	HOLD
NB	0.24	7.25%	4.33%	1.64%	2.64	0.91	21.11	65.70	2.84	44.36	1.38	61.22	60	2%	HOLD
NESTLE	0.36	14.21%	97.12%	16.78%	5.79	50.99	52.50	30.20	29.33	27.92	53.09	1482.27	1540	-4%	HOLD

*AT (Asset Turnover); NM (Net Margin); ROE (Return on Equity); ROA (Return on Asset); Lev. (Financial Leverage); EPS (Earnings Per Share); BVPS (Book Value Per Share); PE (Price to Earnings); PBV (Price to Book Value); Target PE (Target Price to Earnings Ratio); Price\* (Price as at 30<sup>th</sup> June 2021); Exp. Div. Yield (Expected Dividend Yield); UPP (Upside Potential); Tot. Return (Total*

## Energy Sector: Crude Oil Production Still at Risk

Nigeria's crude oil production declined by 16.91%YoY to 1.7mbpd in Q1:2021, as it continues to comply with the OPEC+ production quota. However, quarterly volume grew significantly by 10.26% QoQ, owing to the completion of the compensation cut penalty in January. OPEC+ had in June 2020 introduced a compensation penalty for member countries who flouted their output caps to curb the supply glut in the market at that time.

For Q2:2021, crude production (*ex-condensate*) fell in April and May by 19.53% YoY and 6.41%YoY respectively to 1.37mbpd and 1.34 mbpd. This also persisted on a month-on-month basis, plunging by 3.99%MoM in April and 2.04%MoM in May, despite an increase in OPEC+ quota to 1.54mbpd in May. This can be traced to the Nembe Creek Trunk Line (150,000bpd pipeline) leakage, one of the key pipelines used by producers to transport crude to export terminals. This consequently led to production shut-in during the period. Also, Nigeria's aging infrastructure and growing insecurity (sabotage) continue to impact production, thus causing incessant disruption to rig activities. A recent FAAC report showed production losses amounting to 6.46 million barrels in December 2020, implying a 219.80% increase in losses month-on-month.

For the rest of the year, our outlook for production is positive, relative to 2020 volumes (1.78mbpd). This is premised on the anticipated relaxation of OPEC+ production cuts alongside the passage of the Petroleum Industry Bill, which should provide better incentives for producers. Thus, we project oil production to average 1.83mbpd in 2021.

## Gas Business Holds Great Potential

Gas business in Nigeria was similarly impacted severely by the pandemic, with export revenue dipping by 30.14%YoY to USD4.59bn in 2020 (*as global natural gas demand fell by an estimated 4% according to the International Energy Agency (IEA)*). However, gas demand is picking up with Nigeria's gas export revenue growing faster than expected in Q1:2021, up by 25.11% QoQ, albeit lower than in the corresponding period last year by 16.44%. To boost gas supply, the Federal Government has recently flagged off the construction of the Nigerian Liquefied Natural Gas (NLNG) Train 7 Project, which is expected to expand the current production capacity by 35% to 30 Million Tonnes Per Annum (mtpa). While the Government is focused on improving gas exports, a huge local supply gap remains to be filled. Key challenges to local supply remain the absence of clear fiscal terms to govern activities in the space, especially as it relates to gas pricing. For the few oil majors that play in the space, there is a strong bias towards the international export market due to higher prices there. Domestic pricing of the commodity (USD2.7/mcf on average) is still at a much wider discount compared to international prices (of c. USD3.4/mcf). Though the

PIB is expected to address this price discrepancy, the higher price could potentially hurt domestic consumption, especially Liquefied Petroleum Gas (cooking gas).

**Chart 42:** Nigeria Gas Export Revenue – Year Average (USD mn)



Source: CBN (Balance of Payment), Meristem Research

Valuation and Ratings															
	Fundamentals				Trailing					Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
CONOIL	0.62	1.28%	8%	3%	2.66	2.31	28.74	8.65	0.70	8.5	2.9355	24.95	20	25%	BUY
ETERNA	0.46	1.77%	11%	5%	2.28	1.19	10.43	6.30	0.72	7.56	0.79	5.97	7.5	-20%	SELL
ARDOVA	0.64	2.05%	12%	3%	3.46	1.71	14.52	9.08	1.07	10.65	1.52	16.19	15.5	4%	HOLD
MRS	0.47	0.03%	-7%	-3%	2.20	-3.95	55.28	-3.19	0.23	4	4.4677	17.87	12.6	42%	BUY
SEPLAT	0.04	16.31%	2%	1%	2.05	22.71	1090.36	30.38	0.63	0	0	681.55	690	-1%	HOLD
TOTAL	0.38	4.45%	17%	3%	5.59	15.31	91.74	9.47	1.58	19.65	7.48	146.98	145	1%	HOLD
CONOIL	0.62	1.28%	8%	3%	2.66	2.31	28.74	8.65	0.70	8.5	2.9355	24.95	20	25%	BUY
ETERNA	0.46	1.77%	11%	5%	2.28	1.19	10.43	6.30	0.72	7.56	0.79	5.97	7.5	-20%	SELL

AT (Asset Turnover); NM (Net Margin); ROE (Return on Equity); ROA (Return on Asset); Lev. (Financial Leverage); EPS (Earnings Per Share); BVPS (Book Value Per Share); PE (Price to Earnings); PBV (Price to Book Value); Target PE (Target Price to Earnings Ratio); Price\*(Price as at 30<sup>th</sup> June 2021); Exp. Div. Yield (Expected Dividend Yield); UPP (Upside Potential); Tot. Return (Total

## Health Care Sector: Improved Health Consciousness Sustain Volume Growth

COVAX- an organization co-led by the World Health Organization (**WHO**), Coalition for Epidemic Preparedness Innovations (**CEPI**), the Global Alliance for Vaccine and Immunizations (**GAVI**) and the United Nations Children's Fund (**UNICEF**) have contributed massively to the vaccination of the world's population, particularly in developing nations. In March, Nigeria received 3.94million doses of the AstraZeneca/Oxford vaccine- its first batch from the COVAX facility. In a bid to increase the pace of vaccination in the country, a sum of NGN38.56bn was approved in June to purchase 30 million doses of the Johnson and Johnson vaccine.

Members of the Coalition Against COVID-19 (CACOVID) continue to play a significant role in the country's vaccination efforts. Telecommunications giant - MTN donated about 1.4 million doses of the Vaccine to Nigeria, of which 300,000 doses have been received. At the same time, the CACOVID's leadership in coalition with Afreximbank agreed to contribute USD100 million to procure more vaccines for Nigeria.

Nigeria has only succeeded in vaccinating 0.99% of its population, most of whom are healthcare workers, members of the police force and strategic leaders. The country remains very far from achieving herd immunity due to several factors. The major reason being the inadequacy of the donated vaccine doses to cover the entire population as Nigeria currently lacks the expertise and infrastructure required to carry out the manufacturing of COVID-19 vaccines on its own. To this end, the Federal Government approved the allocation of NGN10bn at the start of the year for the local production of the COVID-19 vaccine. The funds have been set aside for strategic collaborations with recognized institutions to explore options for licensed production. **However, we note that this might not yield immediate results considering the huge vaccine infrastructural deficit, lack of expertise in COVID-19 vaccine production (particularly the mRNA technology) and the vaccine patent protection currently in place.**

Currently, no private pharmaceutical firm is involved in the COVID-19 vaccine manufacturing and distribution process. Yet, the pandemic has had a positive impact on their performances. The majority of the listed companies in the healthcare sector recorded an expansion in revenue, primarily driven by increased product demand. As predicted, the revenue performance of the pharmaceutical companies under our coverage has been broadly impressive in the first quarter. **FIDSON** (+68.48%), **MAYBAKER**, (+47.46%) **NEIMETH** (+9.99%) all reported expanded top-lines due to increased sales volume and a slight uptick in prices. Earnings of **FIDSON** and **MAYBAKER** also improved in tandem during the period, evinced by bottom-line growth and expansion in profitability ratios. **NEIMETH** and **GLAXOSMITH**, however, witnessed earnings decline on the back of significant cost pressures.

In our full-year outlook, we had highlighted the NGN100bn credit support facility granted by the Central Bank to support the efforts of healthcare

practitioners and pharmaceutical firms. Operators in the healthcare sector, such as those involved in drug manufacturing, sales of medical equipment, and medical and pharmaceutical research, were granted these loans at a concessionary rate of 5%, which was initially structured to lapse in February 2021. However, the concessionary rate period has been extended till February 28, 2022, after which a 9% rate would be applicable. We note the potential impact of the extension, as it gives more room for the firms to enjoy lower financing obligations.

The strategic partnership between GlaxoSmithKline Consumer Nigeria and Fidson Healthcare Plc is scheduled to commence in the second half of this year. Fidson's appointment comes as part of GSK's plan to restructure its supply chain operating model. It is also in alignment with the Nigerian Industrial Revolution Plan (NIRP) to ensure Nigeria becomes the preferred pharmaceutical hub in West Africa. Under the partnership, GSK will transfer the responsibility to manufacture five of its respiratory and wellness products to Fidson. **As a result, we expect the benefits of economies of scale to accrue to Fidson, even as it rakes in contract manufacturing income. On the other end, we also anticipate a visit to the capital market to raise additional funds in order to meet capacity expansion needs.**

### Persisting Cost Pressures Burden Manufacturers

On the supply side, we note the cost impact of the Naira's technical devaluation in the Investors and Exporters FX window in February (to NGN410/USD from NGN400/USD). Industry players are still largely dependent on imports for their Active Pharmaceutical Ingredients (APIs); hence the devaluation adds an extra layer of pressure on input cost for manufacturers. The effect has since been reflected on price levels, according to data published by the NBS. Pharmaceutical products and hospital services have been among the key drivers of core inflation in recent times.

**For the second half of the year, we see a continuation of the current theme in the industry. The expansion in top-line is expected to be driven by the non-discretionary nature of drugs and the improved health consciousness among the populace. Along with volume growth, most companies implemented price increases in the first quarter; we see this lingering through the year and across firms in the industry to make up for higher input costs.**

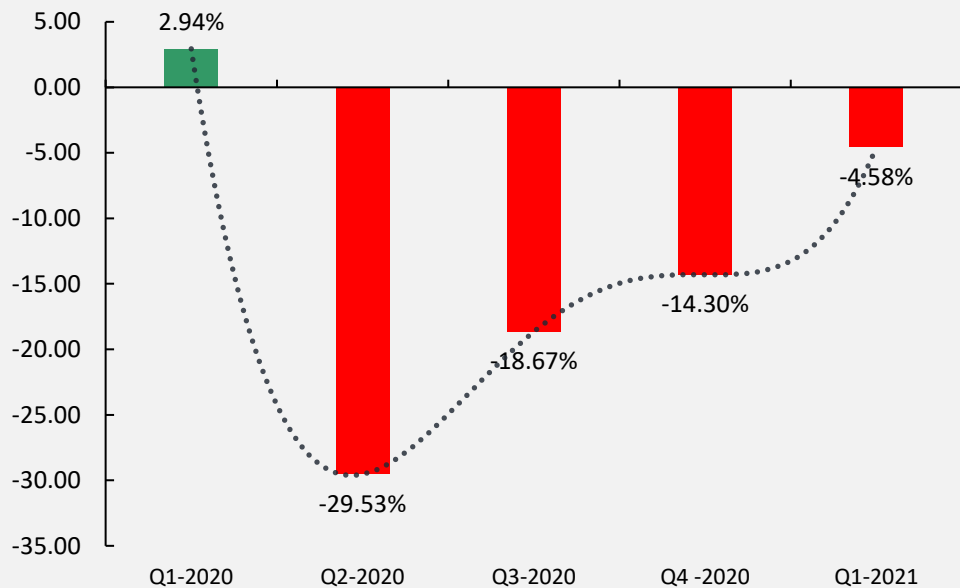
Valuation and Ratings															
	Fundamentals				Trailing					Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
<b>FIDSON</b>	0.20	9.17%	14.68%	5.20%	2.82	0.78	5.33	7.67	1.13	7	1.02	7.14	6	19%	<b>BUY</b>
<b>GLAXOSMITH</b>	0.18	-6.88%	3.05%	1.38%	2.21	0.23	7.43	26.73	0.81	8	0.89	7.12	6.05	18%	<b>BUY</b>
<b>MAYBAKER</b>	0.18	9.26%	16.74%	7.81%	2.14	0.68	4.04	5.97	1.00	7.7	0.63	4.85	4.04	20%	<b>BUY</b>
<b>NEIMETH</b>	0.20	2.21%	15.74%	2.91%	5.40	0.10	0.62	17.54	2.76	8	0.28	2.24	1.7	32%	<b>BUY</b>

*AT (Asset Turnover); NM (Net Margin); ROE (Return on Equity); ROA (Return on Asset); Lev. (Financial Leverage); EPS (Earnings Per Share); BVPS (Book Value Per Share); PE (Price to Earnings); PBV (Price to Book Value); Target PE (Target Price to Earnings Ratio); Price\* (Price as at 30<sup>th</sup> June 2021); Exp. Div. Yield (Expected Dividend Yield); UPP (Upside Potential); Tot. Return (Total*

## Insurance Sector: Insurance Output Maintains Recovery Path

The sector recorded a decline of 4.58% in Q1:2021, its fourth consecutive contraction since the COVID-19 pandemic struck in Q2:2020. This is however the lowest, a sign of the sector’s recovery. Innovation in the sector is tilted towards product distribution as insurance penetration remains low.

**Chart 43:** Insurance GDP Percentage Growth between Q1:2020 – Q1:2021



Source: NBS, Meristem Research

## Fall in Investment Income Beclouds Earnings

The improvement in insurance output was adequately reflected in Q1:2021 financial performance of listed insurance firms. On an aggregate basis, underwriting profit grew by 166.97% YoY, as growth in premium income outpaced the growth in claims expenses. However, this performance was not broad based as some players are yet to recover fully from the impact of the pandemic, while others have achieved remarkable growth. Meanwhile, investment income declined by 7.33%YoY in Q1:2021, mainly due to reduction in interest income. This alongside increase in operating expenses (OPEX) dragged bottom line performance during the period as earnings dropped by 26.70% YoY. **While we expect underwriting performance to remain strong in H2:2021, the outlook for profit growth is clouded by rising OPEX. Nevertheless, a modest increase in investment income given the improvement in the fixed income yield environment should support bottom line growth, particularly for life insurers.**



## Recapitalization: The Progress So Far

Despite the suspension of the phased recapitalization of the sector by the House of Assembly, players have continued to work towards increasing their capital base. However, out of all the listed insurance companies, only six (6) have been able to increase their capital base (share capital, share premium, retained earnings) to fully meet the requirement.

**Table 4:** Compliance Levels of Insurers

Company Name	Capital Base (NGN'bn)	Required Capital(NGN'bn)	Compliance Level (%)
AXA Mansard Insurance Plc	18.00	18.00	100% ↑
Coronation Insurance Plc	19.66	18.00	109% ↑
Cornerstone Insurance Plc	9.27	18.00	51% ↗
AIICO Insurance Plc.	25.86	18.00	144% ↑
Mutual Benefit Insurance Plc	10.37	18.00	58% ↗
Niger Insurance Plc	4.66	18.00	26% ↓
LASACO Assurance Plc	5.48	18.00	30% ↓
Custodian Investment Plc.	35.68	18.00	198% ↑
Royal Exchange Insurance Plc	5.26	18.00	29% ↓
Universal Insurance Plc	8.83	10.00	88% ↗
Veristas Capital Assurance Plc	7.60	10.00	76% ↗
Prestige Insurance Plc	6.66	10.00	67% ↗
Sovereign Trust Insurance Plc	5.76	10.00	58% ↗
Consolidated Hallmark Insurance	6.33	10.00	63% ↗
Nem Insurance Plc.	12.79	10.00	128% ↑
Linkage Assurance Plc	8.02	10.00	80% ↗
Staco Insurance Plc	5.10	10.00	51% ↗
International Energy Insurance	1.61	10.00	16% ↓
Regency Alliance Insurance Plc	4.87	10.00	49% ↓
Guinea Insurance Plc	3.41	10.00	34% ↓
SUNU Assurance Plc	5.40	10.00	54% ↗
African Alliance Insurance Plc	10.29	8.00	129% ↑
<b>Total</b>	<b>220.90</b>	<b>290.00</b>	<b>76%</b>

Source: NGX, Meristem Research

**A substantial capital gap exists in the industry which is unlikely to be filled organically. Thus, we expect more consolidations and capital raising activities in the industry.**

Valuation and Ratings															
	Fundamentals				Trailing					Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
AIICO	0.08	8.93%	13.81%	2.28%	6.07	0.24	1.72	4.37	0.60	5.14	0.26	1.34	1.04	29%	BUY
CUSTODIAN	0.10	6.89%	20.84%	6.42%	3.24	2.08	10.00	2.90	0.60	3.8	2.22	8.44	6.05	39%	BUY
LASACO	0.45	7.82%	8.63%	3.51%	2.46	0.42	4.91	3.54	0.31	3.21	0.47	1.51	1.5	1%	HOLD
MANSARD	0.12	20.53%	12.79%	4.75%	2.69	0.14	1.13	6.22	0.80	1.23	0.88	1.08	0.9	20%	BUY
NEM	0.28	11.65%	26.35%	15.17%	1.74	0.51	1.94	3.76	0.99	4.19	0.56	2.35	1.92	22%	BUY
WAPIC	0.44	4.36%	3.15%	1.93%	1.63	0.03	1.01	17.89	0.56	1.9	0.31	0.59	0.57	3%	HOLD

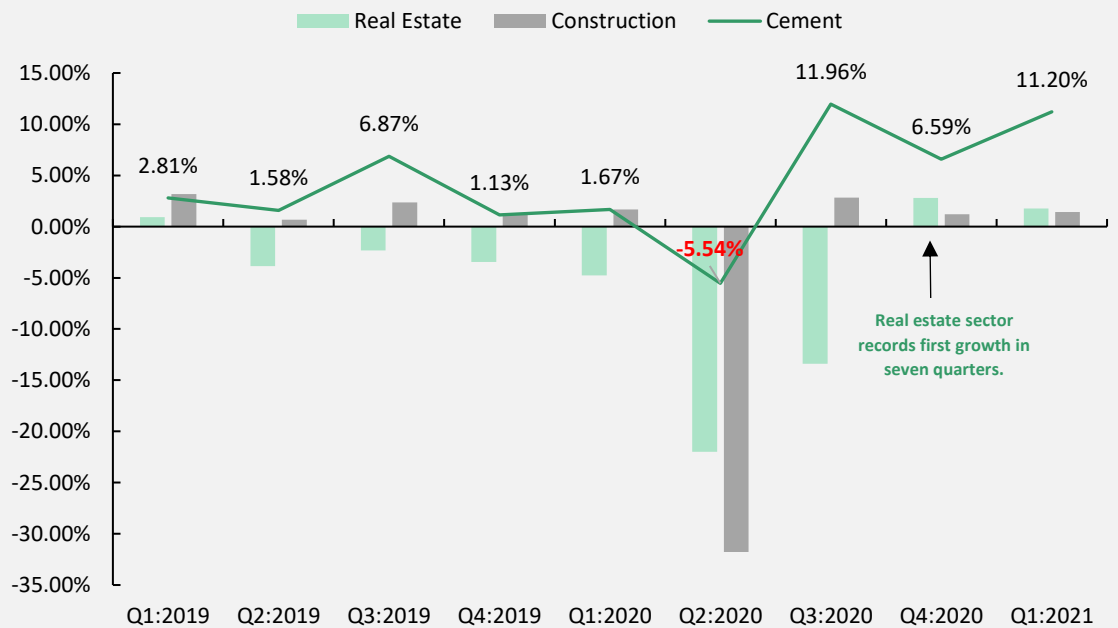
AT (Asset Turnover); NM (Net Margin); ROE (Return on Equity); ROA (Return on Asset); Lev. (Financial Leverage); EPS (Earnings Per Share); BVPS (Book Value Per Share); PE (Price to Earnings); PBV (Price to Book Value); Target PE (Target Price to Earnings Ratio); Price\*(Price as at 30<sup>th</sup> June 2021); Exp. Div. Yield (Expected Dividend Yield); UPP (Upside Potential); Tot. Return (Total

### Industrial Goods Sector: The Odds are in Favour of Cement Manufacturers

Driven by the increasing need to diversify the economy from oil, infrastructural development has been a priority for the current Government. This is evinced by the NGN4.13trn earmarked for capital expenditure and the early passage of the 2021 Budget, which is expected to fast track implementation. Consequently, the construction sector grew in tandem with the larger economy, expanding by 1.42% YoY in Q1:2021 (vs 1.21% YoY in Q4:2020).

Expectedly, the cement sector started the year with a growth of 11.20% YoY in cement GDP for Q1:2021 (vs. 1.67% YoY in Q1:2020). This is apparent in the impressive performance of cement manufacturers, as all the major players recorded year-on-year growth in sales volume, revenue, and bottom-lines in Q1:2021. The stellar performance reflects our expectations of an increased public sector demand in Q1:2021. Furthermore, after six consecutive quarters of decline in output, the real estate sector recorded its first growth (+2.81%YoY) in Q4:2020. This trend also persisted in Q1:2021 where the sector expanded by 1.77%YoY. In our view, increased activity in the real estate sector contributed to the improved cement demand in Q1:2021.

**Chart 44:** Real GDP Growth for Cement, Real Estate, and Construction



Source: NBS, Meristem Research

After reaching a revenue milestone in 2020FY (NGN1.03trn), DANGCEM recorded a 33.50% YoY growth in topline in Q1:2021; extending its domestic market share to 64.37% (vs 61.10% in 2019FY). While WAPCO and BUACEMENT also grew revenue in Q1:2021 by 12.21% YoY and 13.39% YoY, respectively, there was a marked decline in their market shares to 19.19% and 16.43% respectively (vs. 21.33% and 17.57% in 2019FY). Although, the Nigerian cement industry still suffers capacity underutilization, a major theme for the second half of the year is the additional capacity expected to come onstream (in our view, this is more of a strategy to capture the tax benefits in the sector than growth). DANGCEM's 3MTPA Okpella plant, as well as BUACEMENT's 3MTPA Kalambaina third line are expected to commence operations in H2:2021. This will further intensify the jostle for market share, and thus, we expect an increased investment in marketing and distribution as cement manufacturers push for more sales volumes in the second half of the year.

**We remain upbeat about the performance of cement manufacturers as all indicators point to a stellar 2021FY. A key tailwind is the continued implementation of the Federal Government's sizable capital expenditure plan and the continued adoption of cement for road construction (which is already gaining traction). This is expected to keep public sector demand for construction materials steady. We also expect the demand from the private sector to remain robust for the rest of the year. Although, we acknowledge the high rain volumes associated with the third quarter of the year and its impact on construction activities and cement distribution, we envisage that cement and clinker exports will buoy sales in Q3:2021.**

### Naira Devaluation Portends an Uptrend in Energy Costs

Despite fuel mix optimization efforts, the spate of naira devaluations worsened the impact of energy costs on the profitability of cement manufacturers. In 2020FY, average energy cost for the major players rose sharply by 19.80%YoY. The technical devaluation of the I&E exchange rate in February 2021 further drove up energy costs, with **DANGCEM** and **BUACEMENT** recording increases of 21.44%YoY and 11.91%YoY respectively in Q1:2021. The potential for further currency devaluations as the CBN moves towards exchange rate convergence portends a downside risk for earnings performance in the sector. Also, we consider the potential impact of a successfully passed Petroleum Industry Bill (**PIB**). The deregulation of the energy sector (*one of the key themes of the PIB*) is expected to trigger a repricing of gas and the terms of distribution. Although, we do not expect the repricing to be immediate (*it may take several months*), our outlook for energy prices remains tilted to the upside. Against this backdrop, we anticipate an increase in ex-factory prices of cement as cement manufacturers may be forced to pass on the costs to consumers to preserve profitability margins. When combined with premiums placed by middlemen, higher retail price of cement should be expected.

For paint manufacturers, the lingering impact of COVID-19 on the industry supply chain, combined with foreign exchange challenges highlighted the difficult start to the year. The two players under our coverage (**CAP** and

**BERGER**) suffered significant declines of 55.47%YoY and 32.35%YoY respectively in profit after tax for Q1:2021. However, we recognize the efforts of CAP to turn around its fortunes. The company's management highlighted its new supply agreement with Akzo Nobel South Africa (*formerly Akzo Nobel United Kingdom*) and the substitution of imported raw materials with locally sourced ones as mitigating moves made so far. Regardless, we believe a lot still depends on the overall improvement in supply chains and exchange rate stability.

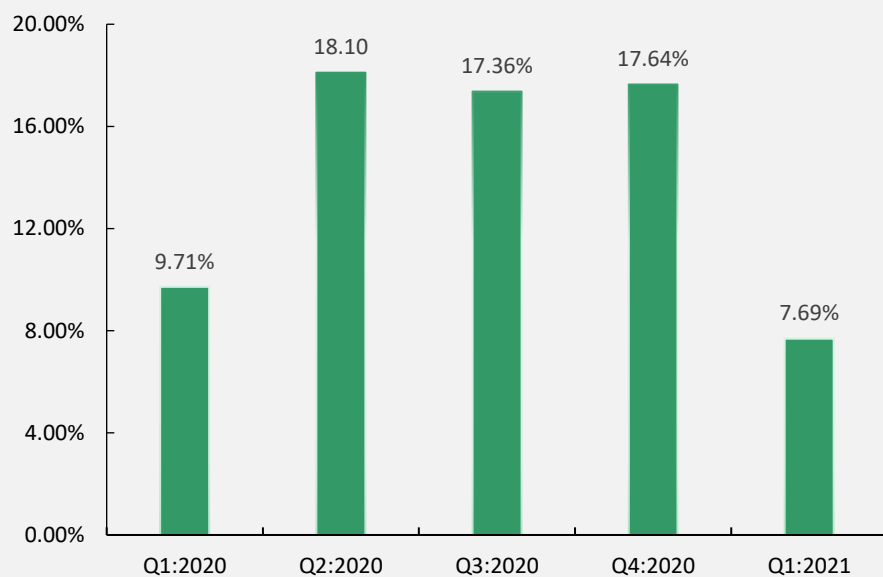
Valuation and Ratings															
	Fundamentals				Trailing					Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
<b>BERGER</b>	0.24	3.78%	3.90%	2.50%	1.56	0.43	11.01	19.55	0.76	10.47	0.84	8.79	8.4	5%	<b>HOLD</b>
<b>BUACEMENT</b>	0.09	36.55%	18.81%	10.49%	1.79	2.21	11.76	32.32	6.08	0	0	71.57	71.5	0%	<b>HOLD</b>
<b>CAP</b>	0.22	9.72%	9.96%	9.96%	1.00	1.39	13.90	13.71	1.37	9.89	2.1	20.77	19	9%	<b>HOLD</b>
<b>DANGCEM</b>	0.16	26.97%	31.43%	14.39%	2.18	17.91	56.99	12.34	3.88	0	0	232.64	221	5%	<b>HOLD</b>
<b>WAPCO</b>	0.13	12.78%	8.65%	5.99%	1.44	1.98	22.89	10.73	0.93	0	0	23.91	21.25	13%	<b>BUY</b>

*AT (Asset Turnover); NM (Net Margin); ROE (Return on Equity); ROA (Return on Asset); Lev. (Financial Leverage); EPS (Earnings Per Share); BVPS ( Book Value Per Share); PE (Price to Earnings); PBV (Price to Book Value); Target PE (Target Price to Earnings Ratio); Price\*( Price as at 30<sup>th</sup> June 2021); Exp. Div. Yield (Expected Dividend Yield); UPP (Upside Potential); Tot. Return (Total*

## Telecommunication Sector: Growth Prospect Dimmed by Regulatory Impediment

Despite the continued growth trajectory of the telecommunications sector, recent limitations such as the incessant regulatory issues have partly stifled the sector’s potentials. GDP figures for Q1:2021 reflected the inability of players in the sector to add new subscribers during the first quarter of the year. Thus, the growth of the sector in the first quarter of the year came in slower than previous quarters.

**Chart 45:** Telecoms Sector Output Growth



Source: NBS, Meristem Research

## Regulatory Headwinds Present New Challenges

2020 did not end on a very good note for the mobile network operators. Towards the tail end of the year, the Nigerian Communications Commission (NCC) embarked on a nationwide SIM registration database audit, to ensure that Network Operators complied with the new requirements for SIM card registration issued by the Federal Ministry of Communications and Digital Economy. Hence, the sale and registration of new SIM cards was suspended as the commission began the enrolment of all existing SIM cards with National Identity Numbers (NIN). This suspension presented a new headwind to sector performance which lingered through the first quarter of the year.

In response to this, the Telcos took steps to increase subscriber awareness about the enrolment exercise and collaborated with the Government by setting up enrolment centres across the country to expedite the process. Also, they

improved integration with NIMC database to complete verification of the collected NINs (and have achieved a total enrolment of 54million as at May 2021). Nonetheless, there was a churn in customer base for the first time since April 2016. Total subscribers declined from 204.52 million in December 2020 to 187.03 million in May 2021 (-9.35%) according to data from the NCC. For the listed telecommunications companies, **MTNN** and **AIRTELAFRI**, their respective subscribers fell by 5 million and 2.6 million in Q1:2021. **With the lifting of the suspension of new SIM registrations, we envisage the increase in subscriber base to further strengthen growth recorded so far in the year.**

### Demonstrating Resilience Despite Adversity

Telco operators demonstrated resilience during the first quarter of the year despite the regulatory headwinds. **MTNN** recorded a 17.22% YoY growth in its service revenue, with bottom line surging by 42.53% YoY. Similarly, **AIRTELAFRI's** Q4:2021 (Jan – Mar) performance was impressive, with a 15.46% YoY growth in revenue and 100% growth in profit after tax. The stellar performance from both players is attributable to an upsurge in voice and data demand from their customer bases. **MTNN** recorded an increase in MB per user (+48.50%) and voice traffic (+8.7%). While, for **AIRTELAFRI**, data usage per customer increased by 68.42% YoY to 3.2GB per customer, due to increased usage per SIM and smartphone penetration across its operating markets.

### Data and Fintech Pilot Growth

Data services continues to lead growth for telecommunication operators, as the impressive topline growth enjoyed by the listed companies were on the back of continued upsurge in data revenue (**MTNN** +42.83% YoY and **AIRTELAFRI** +24.41% YoY). The growth in data revenue was trailed closely by the promising fintech segment. In the first quarter of the year, **MTNN** and **AIRTELAFRI's** fintech revenue expanded by (+28.54% YoY and 24.51% YoY) respectively, further depicting the prospect of the segment and the player's efforts at improving capacity. We expect consumer induced factors such as increased smartphone penetration, data usage per customer and ultimately data traffic to enhance value.

Players in the sector have remained committed to their CAPEX, keeping 4G network expansion at the heart of their priorities. In the first quarter of the year, **MTNN** increased its CAPEX by 19.31% YoY to NGN89.89bn and CAPEX intensity improved to 23.33% (vs 22.93% in the previous period), with 4G network now covering 61.8% of total population (vs 60.1% in FY2020). Similarly, in the first quarter of the year, **AIRTEAFRI** recorded its highest CAPEX for its 2021FY (USD211mn) and had 76.5% of its site and 36.4% of customers on 4G. This increased data ARPU to USD2.7 (+9.80% YtD), driven by 4G ARPU (5.1USD). The low level of financial inclusion in the country has presented an avenue for MNOs

to deepen their fintech operations and support the Government's financial inclusion drive. In Q1:2021, **MTNN's** fintech customer base stood at approximately 4.6 million, with the firm processing over 24 million transactions (up by c. 400% YoY). The company also strengthened its MoMo agent network to 449,146 (+54,000 YtD) and broadened its service offerings to customers (it began offering assisted withdrawals irrespective of bank where account is domiciled). Likewise, **AIRTELAFRI's** mobile money segment processed a transaction value of USD46bn in 2021FY (+53.6% YoY). The firm increased its mobile money customer base to 21.7 million, while Mobile Money ARPU increased to USD1.7, driven by Increase in transaction value per customer.

Valuation and Ratings															
	Fundamentals				Trailing						Valuation				
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	Price	UPP	Ratings
<b>AIRTELAFRI</b>	0.39	10.62%	12.38%	4.15%	2.98	45.41	366.91	14.70	1.82	0	0.00	748.89	667.7	12%	<b>BUY</b>
<b>MTNN</b>	0.64	16.20%	90.12%	10.40%	8.67	11.16	12.39	14.69	13.24	15.77	12.14	191.45	164	17%	<b>BUY</b>

*AT (Asset Turnover); NM (Net Margin); ROE (Return on Equity); ROA (Return on Asset); Lev. (Financial Leverage); EPS (Earnings Per Share); BVPS ( Book Value Per Share); PE (Price to Earnings); PBV (Price to Book Value); Target PE (Target Price to Earnings Ratio); Price\*( Price as at 30<sup>th</sup> June 2021); Exp. Div. Yield (Expected Dividend Yield); UPP (Upside Potential); Tot. Return (Total*

## Domestic Fixed Income Market

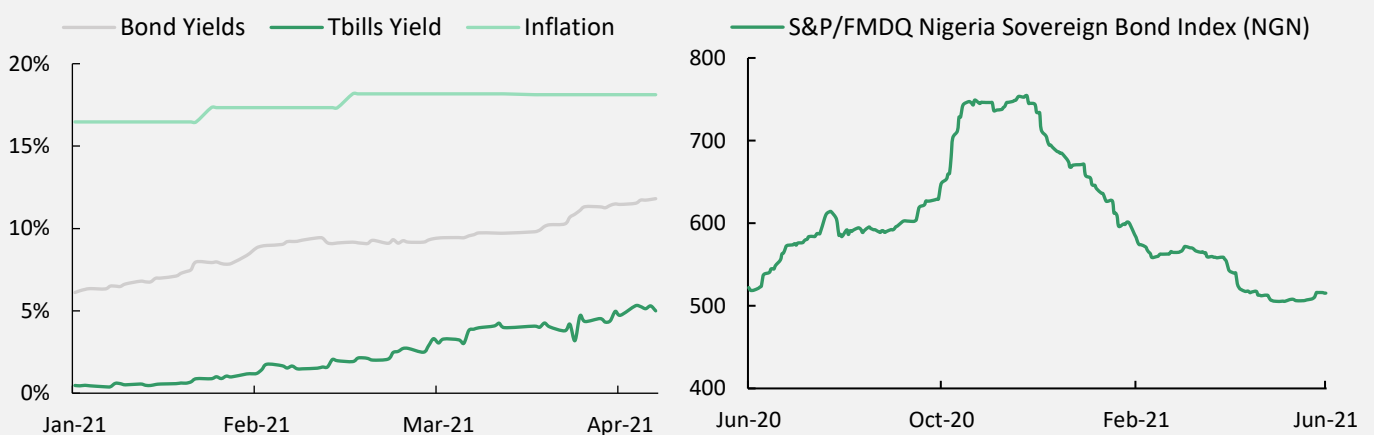
### Yields to Rise Less Steeply Over the Next Half of the Year

The reversal in the direction of yields on treasury instruments came earlier and stronger than anticipated. While the average treasury bills yield has risen to 6.28% as of June 2021 (vs. 0.44% as of the last trading day of 2020), the average bond yield has increased to 12.18% as of June 2021 (vs. 6.04% as at the last trading day of 2020). Recall that at the beginning of the year, guided by our expectation of a sustained accommodative monetary stance by the apex monetary authority, our prognosis was for rates to remain low until at least the end of H1:2021 when a reassessment of the macroeconomic environment would be carried out.

While the CBN has maintained an accommodative stance as expected, yields on treasury instruments have risen sharply due to other factors, including higher rates at primary market auctions (driven by stronger demand for domestic funds by the borrower and higher bid rates by investors), significantly higher OMO rates and the introduction of Special Bills issued by CBN to banks in lieu of excess CRR debits. This development further highlights the weakness in the link between the monetary policy rate and Treasury yields as treasury yields rose despite the accommodative monetary policy.

We expect monetary policy to remain accommodative over the near term in support of economic growth. However, we look to the FGN’s renewed focus on the domestic debt market (per the new Debt Management Strategy) and persistent inflationary pressures as factors that will determine primary market rates over the near term. In our opinion, however, these factors are weak and are further tapered by the need to keep funding costs within tolerable limits by the FGN (which happens to wield significant control over the market due to the availability of few other borrowers). Therefore, we expect yields to rise more slowly over the next half of the year in line with PMA rates. However, a significantly higher rate of corporate issuances in H2:2021 may cause a steeper rise in treasury yields.

Charts 46 & 47: Average Bond Yield, Treasury Bills Yield and Inflation / Sovereign Bond Index



Source: NBS, FMDQ, Meristem Research



## Corporate Debt Market Skewed Towards Short Term Instruments

The corporate debt market has been fairly active so far in the year with a total of four new bond issuances and 11 commercial paper issuances listed on FMDQ, in addition to several private placements.

**Table 5:** Summary of Corporate Bond Issuances in 2021

ISSUER	ISSUE DATE	CREDIT RATING	ISSUE AMOUNT('bn)	COUPON (%)
FIDELITY BANK PLC	27-Jan-21	Agusto&Co/A	41.21	8.5
MTN NIGERIA COMMUNICATIONS PLC	6-May-21	Agusto&Co/Aa	110	13
FSDH Funding SPV PLC	16-Feb-21	Agusto&Co/A	7.05	8.5
FSDH Funding SPV PLC	16-Feb-21	Agusto&Co/A	4.95	8.00

**Source:** FMDQ, Meristem Research

Although the average prime lending rate moderated to 11.22% during 5M:2021 (vs. 15.00% in 5M:2020), corporate institutions found it relatively cheaper to issue commercial papers as the average coupon rate was 6.58% in H1:2021 (vs. 7.16% in H1:2020). However, there were fewer issuances in 2021 (35) than in 2020 (27). Nevertheless, we are of the view that the preference for short-term instruments by corporate borrowers and lenders is due to the relatively high-interest rate risk in the Nigerian fixed income market.

In our view, the corporate debt market remains attractive both for borrowers (as the interest rate environment is still low relative to pre-pandemic levels) and lenders (as corporate instruments offer higher yields per Naira of investment). Thus, we expect both sides to take advantage of these benefits over the next half.

## Alternative Investments

### Cryptocurrencies: Here to Stay?

Cryptocurrencies (particularly Bitcoins) have continued to gain increased acceptance within mainstream payments and investments communities as global corporations adopt them as a means of settlement. Major global corporations which have so far adopted Bitcoin as a means of payment include Microsoft, Shopify, and PayPal. In addition, El-Salvador has championed the list of countries to recognize Bitcoin as a legal tender. This growing acceptance for Bitcoin has caused the value of the pioneer cryptocurrency to increase by 24.95% (as at end of H1:2021).

However, in spite of the positive sentiment, cryptocurrencies remain a highly volatile asset class and have proven to be susceptible to manipulations. Meanwhile, some of the factors which have contributed to negative sentiment on bitcoin include concerns over inefficient energy use, ban on cryptocurrencies by China and a general lack of support by governments and monetary policy authorities. A number of central banks (including the Central Bank of Nigeria) led by the Peoples Bank of China have moved to develop digital currencies which may provide strong competition against cryptocurrencies. We continue to advise caution on cryptocurrencies and related investments until the regulators such as CBN and SEC provide clear guidelines in that regard.

**Chart 48:** Trend in Bitcoin Prices in USD (Jan 2017 to June 2021)



**Source:** CoinDesk, Meristem Research

## Non-Fungible Tokens: Worth the Hype?

Like cryptocurrencies, Non-Fungible Tokens (NFTs) are an emerging digital asset class that have gained widespread popularity since the start of the year. Built on blockchain technology, this asset class mainly represents non-fungible (unique) tangible or intangible items which are non-replaceable and can be digitally uploaded on the internet. Although, NFTs are backed by an underlying asset, the valuation of these assets is largely based on sentiment and other forms of emotional attachments.

**Although, NFTs have the potential to generate good returns on investment, it is plagued by the challenge of determining a “fair value” which does not make it qualify as a reliable asset class. Also, given the regulatory uncertainty, we advise investors looking towards this asset class as a store of value to exercise extreme caution.**

## Real Estate Investments: Largely Untapped Potential

Nigeria’s infrastructure gap continues to present an opportunity for investors looking to diversify their investment portfolio (to include real estate assets) while hedging against inflation. The opportunities for structured real estate investments are however limited and often beyond the reach of retail investors. We considered three available listed Real Estate Investment Trusts (REITs) on the NGX and found that returns on two of them have so far outperformed that of the All-Share Index. Furthermore, the financial performance of listed real estate investment companies improved in 2020FY as aggregate bottom line expanded by 1,945.67% YoY.

**Table 6:** Key Earnings Variables for Listed REITS (2019FY - 2020FY)

Ticker	Average Dividend Per Share (NGN)	Average Dividend Yield	Average Earnings Per Share (NGN)	Average Dividend Payout Ratio
SFS	7.70	10.17%	8.03	96.23%
UHOMREIT	1.59	18.03%	1.94	81.44%
UPDC	-	-	0.28	-

**Source:** Companies’ Financials, NGX, Meristem Research

Growth in the sector is constrained by the general economic performance and significant challenges such as complex regulatory environment. The real estate sector only recently came out of its six-quarter long downturn in Q4:2020 (+2.81% YoY) since Q2:2019, following a general rebound in the economy. In Q1:2021, it grew by 1.77% YoY. Growth is however too slow in view of the demand for real estate in Nigeria.

On the back of the relative stability of listed REITS and the strong growth prospects of the issuers, and high dividend yield, we recommend them to investors with a medium-to-long term investment horizon. However, in view of the relatively low transaction volumes over the past 12 months, we advise that the risk of illiquidity is high.

Chart 49: Real Estate Growth Rate (2016 – Q1:2021)

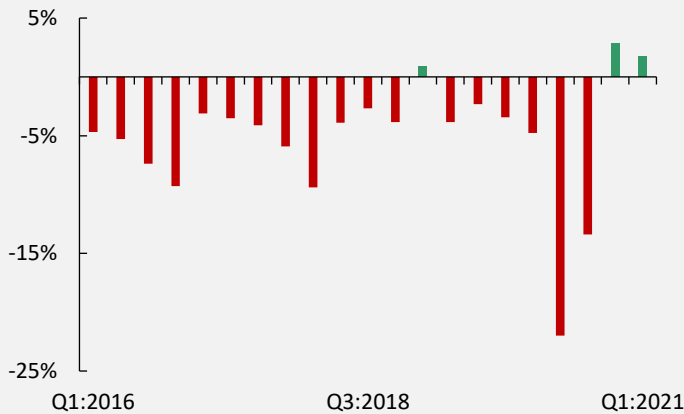
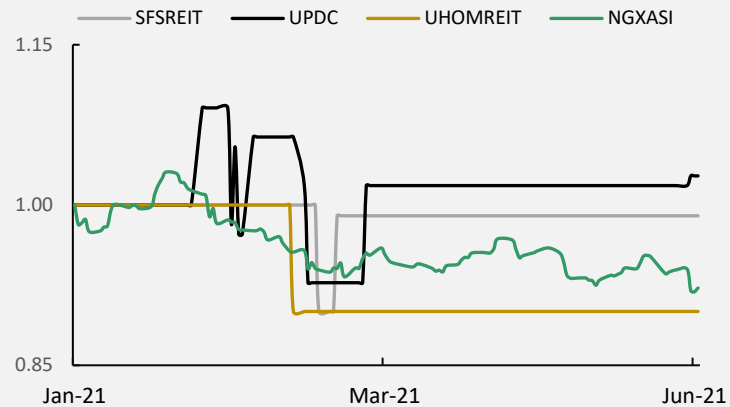


Chart 50: Trend of REITS Prices vs NGXASI (Jan - Jun 2021)



Source: NBS, Meristem Research

Source: Bloomberg, Meristem Research

### Commodities Trading Gaining Traction in Nigeria

Although, the adoption of commodities as investment assets remains weak in Nigeria, commodities trading is gradually picking up steam, especially on agricultural products such as maize, sorghum, paddy rice, soybeans, and ginger. Like real estate investments, commodities provide a means of diversifying portfolio returns and hedging against inflationary risks. However, they are subject price volatility, and counterparty risk (*which is mitigated by commodities exchanges such as AFEX, NCX and LCFE*).

Meanwhile, the CBN and Nigerian Sovereign Investment Authority’s (NSIA) plan to jointly invest NGN50bn towards restructuring the Nigerian Commodities Exchange (NCX) points to an increased interest in commodities trading by the relevant authorities. In addition, there are ongoing efforts by the FMDQ and the Securities and Exchange Commission (SEC) to develop derivative trading in Nigeria following the release of regulatory guidance by SEC in 2019. We envisage that these events will contribute significantly to active commodities trading in Nigeria over the near-to-medium term. More so that the existing commodity exchanges are developing capacities to improve their product offerings.

**Thus, our view is that commodities will increasingly become viable investment assets in Nigeria, and investors can explore the space in the quest for alpha returns.**

# SECTION FOUR: STRATEGY



Route to economic growth,  
paved with risks and changes

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## Equity Strategy

Our 2021 Strategic Portfolio returned **+0.06%** in the first half of the year, outperforming the broad market index **(-5.87%)**. The portfolio constituents were screened based on our expectation of an initial rally interrupted by bearish sentiment, driven specifically by a rotation from stocks to the fixed income market and low foreign participation.

Given our outlook for the second-half, we recommend that clients with long term investment horizon hold a large portion of value stocks in their portfolio as we expect the market to reward good fundamentals in the long run amidst the bears' activities. For short and mid-term investors, we recommend a tilt towards dividend-paying counters to compensate for temporal market jitters.

In light of these, we have updated our strategic portfolio to consider undervalued metrics and upside potentials. **NEM** and **NESTLE** exited the portfolio as they did not adequately meet our criteria for the second half. In line with our criteria, we introduced new fundamentally sound and dividend paying counters into the portfolio. They include: **ACCESS**, **STANBIC**, **CONOIL**, **DANGSUGAR** and **FIDELITY**. The stocks in this portfolio have met at least six of the eight criteria.

### Strategic Portfolio Screens

- At least three years of revenue growth in the past five years.
- At least three years of earnings growth in the past five years.
- Double-digit Return on Equity (>10%).
- Expected 2021FY dividend-yield at least 5%.
- Expectation of top-line growth in 2021FY.
- Expectation of earnings growth in 2021FY.
- Upside Potential >10%
- P/E or P/BV less than industry average.

	H2-2021 Strategic Portfolio															
	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVPS	PE	PBV	Target PE	Exp. EPS	TP	Price*	Exp. Div. Yield	UPP	Exp. Tot. Return
<b>ACCESS</b>	0.25	24%	15%	13%	0.13	1.14	3.33	22.31	2.54	2.76	3.40	9.38	8.45	6%	11%	+4.25%
<b>CONOIL</b>	0.62	1%	8%	3%	0.03	2.66	2.31	28.74	8.65	8.50	2.94	24.95	20.00	6%	25%	+9.51%
<b>CUSTODIAN</b>	0.10	7%	21%	6%	0.06	3.24	2.08	10.00	2.90	3.80	2.22	8.44	6.05	5%	39%	+ 15.15%
<b>DANGSUGAR</b>	0.23	12%	24%	11%	0.11	2.19	2.61	10.95	7.18	6.52	3.08	20.08	18.75	6%	7%	+2.73%
<b>FBNH</b>	0.02	114%	29%	3%	0.03	10.25	6.14	21.31	1.20	3.22	2.59	8.34	7.35	5%	13%	+5.17%
<b>FIDELITYBK</b>	0.02	17%	11%	1%	0.01	10.94	1.05	9.13	2.20	2.83	1.01	2.86	2.31	5%	24%	+9.12%
<b>GTCO</b>	0.02	43%	24%	4%	0.04	5.96	6.69	28.45	0.00	4.90	6.99	34.25	29.90	8%	15%	+5.59%
<b>MTNN</b>	0.18	19%	12%	10%	0.10	1.11	11.16	96.47	14.69	15.77	12.14	191.45	164.00	5%	17%	+6.43%
<b>STANBIC</b>	0.02	25%	19%	3%	0.03	6.70	6.65	34.52	6.05	6.80	7.37	50.12	40.25	7%	25%	+9.42%
<b>UBA</b>	0.02	24%	16%	2%	0.02	10.35	3.56	22.29	2.05	3.00	3.60	10.80	7.30	6%	48%	+ 18.42%
<b>WAPCO</b>	0.13	13%	9%	6%	0.06	1.44	1.98	22.89	10.73	0.00	0.00	23.91	21.25	4%	13%	+4.81%
<b>ZENITHBANK</b>	0.02	34%	21%	3%	0.03	7.95	7.42	34.78	3.20	3.85	7.68	29.57	23.75	9%	24%	+9.41%
<b>Expected Portfolio Return</b>																<b>+32.58%</b>

AT (Asset Turnover); NM (Net Margin); ROE (Return on Equity); ROA (Return on Asset); Lev. (Financial Leverage); EPS (Earnings Per Share); BVPS (Book Value Per Share); PE (Price to Earnings); PBV (Price to Book Value); Target PE (Target Price to Earnings Ratio); Price\* (Price as at 30<sup>th</sup> June 2021); Exp. Div. Yield (Expected Dividend Yield); UPP (Upside Potential); Tot. Return (Total

## Fixed Income Strategy

In arriving at a suitable strategy for fixed income investments, we considered the global fixed income market with respect to the outlook for yield environment and general global risk level. We note global economic risks are abating due to increased COVID-19 vaccinations and concerted monetary and fiscal efforts towards recovery. Although rising inflationary pressures call for higher interest rates, global economic policies are more likely to favor economic growth through low borrowing costs. Therefore, the outlook for global yields over the near term is stable. This implies that interest rate risk is minimal for Eurobond investments over the near to medium term. In addition, Eurobonds provide a hedge against FX volatility.

For Naira instruments, we consider interest rate risk significant over the near to medium term due to the relative disharmony between the benchmark monetary policy rate and rates on treasury instruments and the dominance of the Federal Government in the fixed income market. However, corporate debt instruments provide a reasonable hedge against interest rate risk given their relatively higher coupon rates and higher real rate of returns. Thus, we recommend the following fixed income portfolio:

**Table 7:** Fixed Income Portfolio Recommendation

Instrument Type	Proportion	Duration	Remark
<b>Eurobonds</b>	Up to 25%	Modest	Provides a hedge against Naira inflation and devaluation, highly liquid
<b>Commercial Papers</b>	Up to 25%	Modest	Relatively High Real Rate of Return, Low Liquidity
<b>Corporate Bonds</b>	Up to 20%	Moderately High	Relatively High Real Rate of Return, Low liquidity
<b>Treasury Bills</b>	Up to 15%	Moderately High	Low Real Rate of Return, Highly liquid
<b>FGN Bonds</b>	Up to 15%	High	Low Real Rate of Return, Highly liquid

After considering rates of return, relative liquidity and duration of the universe of instruments available to investors, we recommend the following securities:

Table 8: Fixed Income Securities Recommendation

Instrument	Maturity	Coupon (%)	Ratings
<b>EUROBONDS</b>			
Ecobank Transnational Inc.	18-Apr-24	9.50	B-/B3u/B-
Republic of Ghana	04-Jul-25	-	B/B3/B-
First Bank of Nigeria Ltd	27-Oct-25	8.63	B-/B-
EBN Finance Co BV	16-Feb-26	7.13	B-/B-
Republic of Ghana	26-Mar-27	7.88	B/B3u/B-
Republic of Ghana	02-Nov-27	6.38	B/B3/B-
Arab Republic of Egypt	21-Feb-28	6.59	B+/B2u/B
<b>FGN BONDS</b>			
FGN 12.50 22-Jan-2026	22-Jan-26	12.50	
FGN 16.2884 17-Mar-2027	17-Mar-27	16.29	
FGN 14.55 26-Apr-2029	26-Apr-29	14.55	
FGN 12.49 22-May-2029	22-May-29	12.49	



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