MERISTEM

Monthly Market Review & Preview

October 2022

Macros

FX to Remain Pressured in the Near Term

Review

In October, the Central Bank of Nigeria (CBN) announced the redesigning of the NGN200, NGN500, and NGN1000 notes. The new notes will circulate simultaneously with the existing bank notes between December 15, 2022, and January 31, 2023 (when the existing notes will no longer be accepted as a legal tender). The redesign is aimed at controlling money supply, as the Bank estimates that 85% of the cash in circulation sits outside the banking system.

The likely impact of this policy includes:

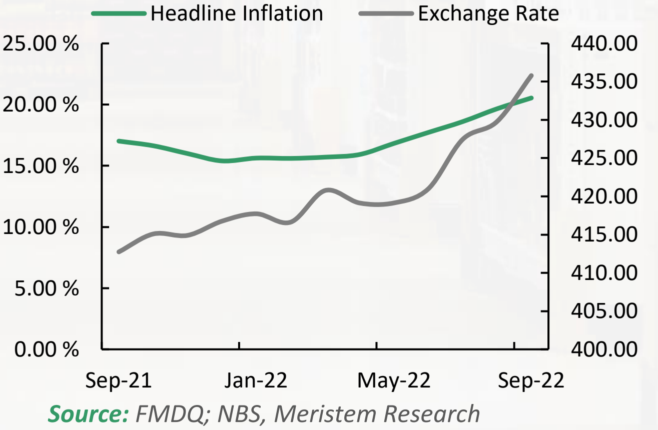
- ***The issuance of new notes will give the CBN more control over the money supply and likely increase the effectiveness of the monetary policy.***
- ***Pressure on the naira and further depreciation in the near term, as individuals with significant naira holdings seek to convert to dollars before the deadline.***
- ***The higher exchange rate would also negatively impact the production cost for import-dependent manufacturers, thereby further slowing down production. We expect a persistent decline in PMI and manufacturing GDP as a result.***
- ***Likelihood of increased financial inclusion, as the unbanked population can open a bank to exchange old notes for new notes.***

During the month, the National Bureau of Statistics (NBS) reported that headline inflation for September 2022 increased to 20.77% YoY (vs. 20.52% YoY in August 2022). This was driven by an uptick in both the food and core indices. However, on a monthly basis, the growth of headline and food inflation slowed down due to the impact of early post-harvest supplies: 1.36% and 1.43% (vs 1.77% and 1.98% in August), respectively. While core inflation remained flat at 1.59%

We expect the uptrend in inflation to persist, considering the presence of events that can potentially drive it northward.

- ***The recent flooding in the country has affected major food-producing areas and led to the mutilations of farmlands and produce. This translates to the loss of post-harvest supplies, low supply of products, as well as disruptions to the supply chain and route to market.***
- ***Fuel scarcity in October would also exert increased pressure on fuel prices and pass-through items such as transport cost.***
- ***As the festive season approaches, demand increases and prices are expected to be elevated, given the limited supply.***
- ***Concerns about Russia pulling out of the UN-brokered grain export deal are envisioned to exert pressure on food prices globally, especially for grains. As an import-dependent country, we predict that imported food inflation will remain elevated.***

Chart 1: Inflation, Average Exchange Rate



Source: *FMDQ; NBS, Meristem Research*

Macros

FX to Remain Pressured in the Near Term

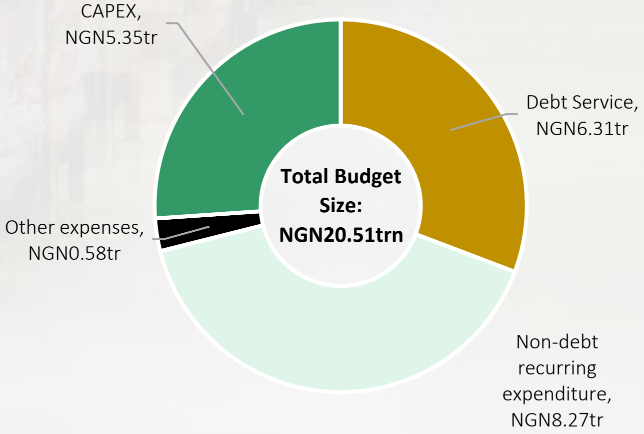
The external reserve balance also maintained a decline in October (-4.18% to USD38.88bn from USD40.51bn as of October 1st, 2022) despite higher crude oil prices (average of USD94.83pb vs USD 87.96pb in September 2022). Persistent structural challenges have resulted in a decline in oil production, leading to a loss of crude oil revenue. Thus, the Naira depreciated further on the I&E by 1.32% in October.

While we note that CBN maintains that the parallel market accounts for only 5% of FX transaction, the disparity between official and parallel market rates remain wide (premium of 76.98% over official rates in October).

We view the inability to generate sufficient revenue from oil sources, significant FX volatility, low FDI and FPI inflows, and the recent currency management efforts as significant headwinds to the strengthening of the domestic currency in the short term.

The Federal Government also presented the 2023 budget themed the Budget of Fiscal Sustainability and Transition.

Chart 2: Breakdown of 2023 Budget



Source: FMoF, BOF, Meristem Research

In our recent macroeconomic report - Critiquing the Assumptions Underlying the 2023 FGN Budget, we review past budget performance of the government, detailed our opinions on the assumptions used to prepare the budget and discuss the likely implications of the proposed 2023 budget.

Macroeconomic environment Outlook- Weak

- ***Uptrend in inflation given factors considered above.***
- ***Given the occurring global macroeconomic events and continued rate hikes to combat inflation by global economies, we expect the Monetary Policy Committee to sustain its hawkish stance to curb inflation and guide against capital flight. We also expect reduced money supply.***
- ***Lower real GDP due to contractionary monetary policy, disruptions in agricultural and manufacturing value chain.***
- ***Reduced capital importation (FDI, FPI and others) as foreign investors continue to prefer safer havens.***
- ***We expect higher crude oil prices to support trade surplus and current account in November. Higher FX rate could also limit import, while import cover declines due to lower external reserves.***

Equities

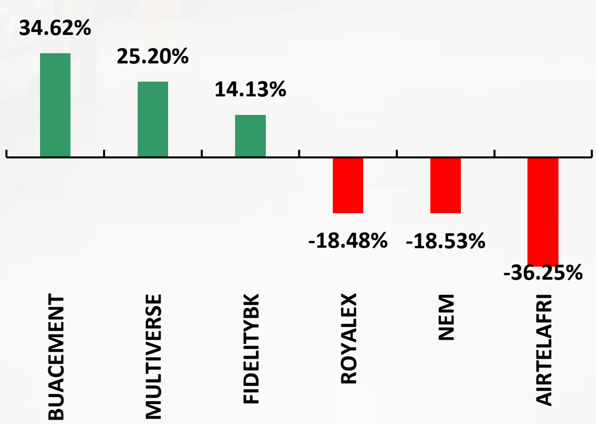
Sell-offs on AIRTELAFRI Drags Local Bourse

Review

Like the previous five months, the equities market recorded a Monthly loss in October, as the All-Share index declined by 10.58% MoM (vs -1.63% MoM in September). This represents the highest monthly decline since the emergence of the pandemic in March 2020 (-18.75%). Consequently, the Year to Date return dropped to 2.63% (vs. 14.77% as of September). We attribute the decline majorly to profit taking on **AIRTELAFRI** (-36.25% MoM) (**AIRTELAFRI** accounted for 28.42% of the total market capitalization as at the start of October). Furthermore, sell-offs on other heavyweight tickers, such as **DANGCEM** (-10.00% MoM) and **NB** (-13.53% MoM) contributed to the decline. Notably, the market capitalisation ex-**AIRTELAFRI** appreciated by 0.80% MoM.

On a sectoral basis, four of the five sectoral indices recorded negative returns in October, with **NGXINDUSTR** being the sole gainer (+6.50% MoM). Notwithstanding, there was an improvement in market breadth to 0.44x (vs 0.35x in the prior month) due to increased investors activities on some tickers.

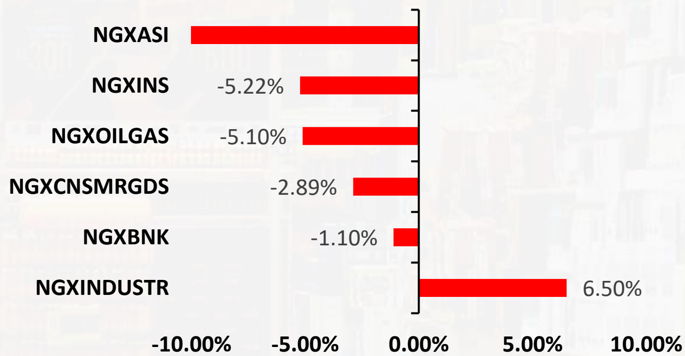
Chart 3: **Top gainers and losers in October**



Source: *NGX, Meristem Research*

October ended with a flurry of 9M:2022 earnings releases, with many companies recording impressive performance. However, there was minimal reaction to these impressive results by investors. Notably, majority of the companies in the agriculture, banking and healthcare sectors recorded impressive top and bottom-line growth.

Chart 4: **MtD sectoral performance**



Source: *NGX, Meristem Research*

Interim Dividend Announcement:

TICKER	DPS	IMPLIED YIELD
NESTLE	25.00	2.06%
SEPLAT	11.04	1.00%
AIRTELAFRI	9.66	0.76%
GUINNESS (FY)	7.14	8.61%
TOTAL	4.00	2.03%
PZ (FY)	1.01	10.98%
MANSARD	0.06	3.68%
NB	0.40	0.99%

Summary of Corporate Actions:

Geregu Power Plc. (**GEREGU**) announced the listing of the company's entire issued share capital (2.50bn units of shares) for NGN100.00 per share on the main board. The ticker closed the month at NGN115.00, (a 15.00% gain from its listing price.

Equities

Summary of Corporate Actions Cont'd

Access Holdings Plc **(ACCESSCORP)** announced the acquisition of majority shareholding of Finibanco Angola S.A. and Sigma Pensions Ltd. Finibanco is an Angolan based full service commercial bank with about USD300.00mn in total assets and has been operating since 2008. Sigma Pension Ltd is a pension fund administrator (PFA) with a total asset size of NGN7.84bn as at 2021FY. This acquisition is expected to diversify **ACCESSCORP's** revenue.

Preview

As the prevailing economic headwinds persist and investors continue to price in the heightened market risk, we expect the bearish sentiment dominating the local bourse to persist. Also, the aggressive hawkish stance adopted by the MPC is expected to spur further increase in fixed income rate, thereby increasing the attractiveness of fixed income instruments. This, combined with the anticipated tighter liquidity following the recent announcement by the CBN to redesign some of the Naira notes, is expected to impact market activities further.

Overall, we can not entirely rule out the potential of investors taking a position on the fundamentally sound stocks, particularly those in the financial services, telecommunication, industrial goods and oil and gas sectors. Moreso, investors with a long-term perspective, may take advantage of the appealing entry points on tickers that have significantly declined over the past few months.

Fixed Income

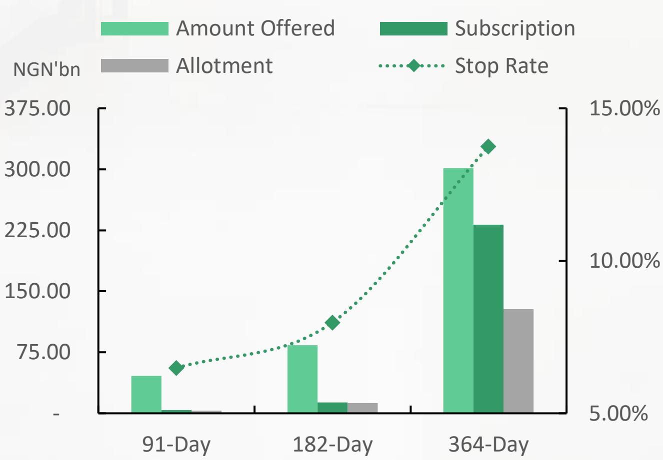
Declining Investors' Appetite Despite Higher Rates

Review

In October, the trend was similar to the previous month. Tight system liquidity, the consolidated effect of rate hikes, and investors' demand for higher incentives to compensate for surging inflation – the major factor influencing the high rates – were predominantly existent during the month.

In October's Treasury Bills Primary Market Auctions (PMAs), the Central Bank of Nigeria (CBN) offered NGN431.16bn. However, contrary to September's PMA, investors' appetite and participation were significantly lower as total subscription-to-offer dipped to 0.58x (vs 1.68x in September). Nevertheless, the bid-to-cover ratio improved to 1.73x (vs 1.57x in September), which was on the back of lower-than-expected allotment despite the total subscription hitting a year-low. For context, the total allotment was 33.40% of the total amount offered (vs an average of 136.22% from Jan to Sept). This can be traced to the Federal Government's strategy to manage borrowing costs, considering the high-interest rate environment. As a result, the stop rates on the trio instruments increased by 1bp, 55bps, and 250bps to 6.50%, 8.05%, and 14.50%, respectively.

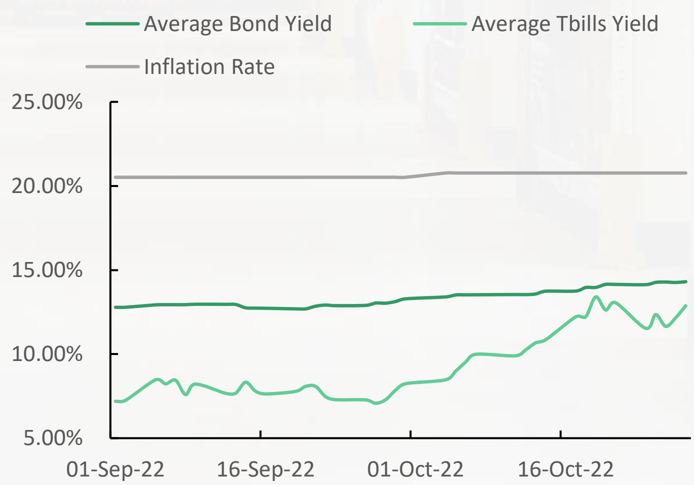
Chart 5: T-bills' PMA Activities in October 2022



Source: *CBN, Meristem Research*

At the bond auction held in October, the Debt Management Office (DMO) offered NGN225bn across the three instruments (Apr-2029, Apr-2032, and Apr-2037). Similar to the T-bills PMA, the total bid-to-cover ratio improved marginally to 1.10x in October from 1.08x in September. This was primarily due to the Federal Government's move to manage borrowing costs (total allotment declined by 52.93% MoM), which outweighed the decline in investors' participation (total subscription declined by 51.64% MoM). Overall, the marginal rates on the Apr-2032 and Apr-2037 instruments increased by 115bps and 150bps to 15.00% and 16.00%, respectively. At the same time, the rate on the Apr-2029 instrument settled at 14.50%.

Chart 6: Average T-bills and Bond Yield in October 2022



Source: *FMDQ, Bloomberg, Meristem Research*

The sentiment in the primary market filtered into the secondary market as investors' demand for higher yields lingered. This, and the tight system liquidity, triggered continued selloffs in the secondary market. Therefore, the average bond and T-bills yield increased to 13.87% and 11.26% in October (vs 12.90% and 8.80% in September), respectively.

Fixed Income

In the Eurobond market, we observed significant selloffs on Nigerian instruments during the month. As a result, the average Eurobond yield increased to 11.32% (from 9.90% in September).

Some of the drivers were:

- Moody's Investors Service - a recognised global credit rating agency - downgraded Nigeria's local and foreign-currency long-term issuer ratings to B3 from B2. Moody's highlighted the country's insufficient revenue sources and increased macroeconomic volatility as reasons for the downgrade.
- Further depreciation of the Naira on the I&E FX Window to an average of NGN441.02/USD in October (from an average of NGN437.03/USD in September).
- The Federal Government announced its intention to convert its NGN20trn CBN debt to bonds repayable over forty years (to restructure its repayment schedule). This triggered an immediate reaction from investors.

Preview

This month, the Government has indicated its intention to raise a total of NGN629.46bn (NGN404.46bn T-bills, NGN225.00bn bonds). However, this is marginally lower than the previous month (NGN656.16bn), as the maturing T-bills are lower than the previous month.

In November, we expect a marginal increase in stop rates at the T-bills and Bond PMA. This is premised on investors' demand for higher rates, considering the elevated yield environment and the country's uncertain macroeconomic environment. However, the Government's strategy to manage its borrowing costs remains a risk to this outlook.

In the T-bills and Bond secondary markets, we project that yields will maintain the northward direction, howbeit marginally. This is hinged on lower subscriptions (owing to the recent decline in investors' appetite) and investors' quest for higher yields to compensate for the current market realities. Also, we expect tight system liquidity due to the higher Cash Reserve Ratio. Based on this projection, the instruments' prices are expected to be lower. Thus, we opine that this presents an opportunity for investors to take buying positions, especially at the short end of the curve. Moreover, in the near to medium term, this will enable investors to take profit when yields reverse their momentum.

In the Eurobond market, we anticipate further selloff of Nigerian instruments. This is premised on the persistent macroeconomic headwinds, increased market risks and further depreciation of the Naira (arising from increased speculative activities on the Naira).

CONTACT INFORMATION

Brokerage and Retail Services
topeoludimu@meristemng.com (+234 905 569 0627)
contact@meristemng.com

Investment Banking/Corporate Finance
rasakisalawu@meristemng.com (+234 806 022 9889)
seunlijofi@meristemng.com (+234 808 536 5766)

Wealth Management
funmilolaadekola-daramola@meristemng.com (+234 803 355 0008)
crmwealth@meristemng.com (+234 01 738 9948)

Registrars
oluseyiowoturo@meristemregistrars.com (+234 802 321 0561)
martinaosague@meristemregistrars.com (+234 802 303 1783)
www.meristemregistrars.com (+23401-280 9250)

Group Business Development
saheedbashir@mersitemng.com (+234 802 454 6575)
ifeomaogalue@meristemng.com (+234 802 394 2967)
info@meristemng.com

Trust Services
damilolahassan@meristemng.com (+234 803 613 9123)
trustees@meristemng.com

Investment Research
damilareojo@meristemng.com (+234 816 890 2771)
praiseihansekhien@meristemng.com (+234 817 007 1512)
research@meristemng.com

Client Services
adefemitaiwo@meristemng.com (+234 803 694 3034)
car@meristemng.com (+23401-280 9250)

Meristem Finance Limited
olasokomubo@meristemfinance.com (+234 803 324 7996)
matthewawotundun@meristemfinance.com (+234 802 390 6249)

Corporate websites:
www.meristemng.com **www.meristemwealth.com** **www.meristemregistrars.com**

Meristem Research can also be accessed on the following platforms:

Meristem Research Portal: research.meristemng.com
Bloomberg: MERI <GO>
Capital IQ: www.capitaliq.com
ISI Emerging Markets: www.securities.com/ch.html?pc=NG
Reuters: www.thomsonreuters.com
FactSet: www.factset.com