MERISTEM HALF YEAR OUTLOOK (2023)

Tough Start, Bumpy Road, Propitious End.

MERISTEM RESEARCH | JULY 2023

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Content Highlights

Limited Optimism in an Unending Crisis

The outlook for global growth in 2023 is moderate based on the adverse impact of monetary policy tightening on demand. Consequently, fears of a recession have become heightened as there are expectations of more rate hikes as inflation is expected to remain above the target of economies, especially in advanced economies.

Dampened Outlook

Going forward, we do not expect significant improvement in the status quo of the macroeconomic indicators of countries in the Sub-Saharan region. This is hinged on the impact of declining commodities prices, low production volumes, weak fiscal sustainability, as well as currency weakening. Thus, growth in the region is expected to slowdown in 2023.

Painting a Canvas of Growth

Domestic output is envisaged to remain positive albeit at a slower pace in comparison to 2022. This is to be driven by the pro-market policies of the new administration which is expected to support growth in the non-oil sector. Similarly, our outlook on the oil sector remains positive due to the intensified efforts of the government. Macroeconomic indicators such as inflation and exchange rate are envisioned to worsen due to the immediate effect of policy changes. Therefore, we anticipate a 100bps increase in the monetary policy rate. In addition, we project an increase in debt given the securitization of ways and means and the impact of the devaluation of the naira on foreign debts.

An Upbeat Outlook for the Stock Market

Based on our forecast, we project a 26.85% return for the equities market in 2023 while the All Share index is expected to settle at 60,974.33 pts. This is hinged on the expectation of improved corporate performance, gradual improvement in FPI inflows and likelihood of equity capital raising.

Mixed Sentiments; Positive Returns

We expect system liquidity to dictate yield direction in the fixed income market for the rest of the year. The removal of cap and floor on the interbank placements, alongside the drive for a less aggressive discretionary cash reserve will further push liquidity higher thus driving yields lower.

Betting on Risk

Across the different forms of investments, outlooks differ. Thus, we advise caution.

Executive Summary

Coming into 2023, at least a third of global economies was expected to record a recession owing to tight monetary policies implemented across the globe. This expectation has largely been reflected in different countries as output growth in major economies like the USA and UK has been sluggish, while the Eurozone recorded a contraction. Inflation rates across countries have also remained higher than most monetary authorities target range, spurring a continuation of the rate hike cycle, though broadly at a less aggressive pace. Unexpectedly, the first half of 2023 also heralded the financial services sector crisis which rocked financial institutions like Credit Suisse. The burning question of how long the financial crisis would last and how far reaching the effect will be thus continued to bear on investors.

In Sub-Saharan Africa, inflationary pressures, depreciating currencies, worsening debt burdens and poor fiscal strength remained at the centre stage of discussions. Declining commodities prices has also been a pain point for exporters like Nigeria and Angola. Thus, both the IMF and World bank have forecasted economic growth in the region to decline for the second consecutive year.

On the domestic front, economic growth in H1:2023 was majorly impacted by the poorly implemented Naira redesign policy which led to a currency crisis and cash crunch. Monetary policy also remained contractionary as the campaign against rising inflation continued. Foreign investors continued to hold back for the most part on grounds that the economic environment has remained weak and the country is unattractive as an investment destination.

The inauguration of a new administration whose tough start seems to signal a willingness to address some necessary economic pain points (like the fuel subsidy bill) has however sent some positive signal to domestic and foreign investors. We expect output growth to remain positive in 2023 though lower than 2022. We also opine that the monetary policy authority is likely to consider other tools to control inflation (which is expected to further increase) asides the monetary policy rate.

In forming our outlook for financial markets, we considered activity levels in the primary and secondary fixed income market, the macroeconomic environment, foreign portfolio investments and the new administration’s expected policies. We expect the equities market to remain positive in H2:2023, though with pockets of profit taking activities. System liquidity should remain a major factor in determining the direction of fixed income yields for the rest of the year.

Global Economy

Limited Optimism in an Unending Crisis

The global economy has gone from one cycle of crisis to another over the past few years. While still recovering from the effects of COVID-19 and Russia's invasion of Ukraine, 2023 introduced a new challenge in the form of a financial sector crisis. This new challenge resulted from the different rounds of monetary policy rate hikes aimed at taming decades-high inflation.

Going forward, the growth in the global economy is expected to slowdown further owing to the myriad of issues. For one, the banking sector crisis that hit the USA and Europe raised new concerns about a global contagion. The war in Ukraine is also far from being over and continues to pose a risk to both global growth and inflation.

Fears of a Recession Amidst Rate Hikes Dampen Growth Prospects

In our 2023 Annual Outlook, we highlighted the risk of a recession in at least a third of the global economy. Reiterating the likelihood of a global slowdown in 2023, the twin Bretton Woods Institutions: the IMF and the World Bank, expect a decline in growth at different variations. The IMF in a baseline conservative forecast expects output growth to decline to 2.80% while the World bank projection is even lower at 2.10% (from 3.40% and 3.10% in 2022, respectively).
Advanced economies are expected to experience the steepest decline in growth as they have been the worst hit by the overlapping shocks, particularly the UK and the Euro Area. Purchasing Managers' Index (PMI) for the UK (47.10pts) and Euro Zone (44.8Opts) in May 2023 further buttresses the weakening growth prospect as both declined from 54.60pts May 2022. The UK also recorded a weak growth of 0.13% YoY in Q1:2023 while the Eurozone's economy contracted by 0.10% in the same period.

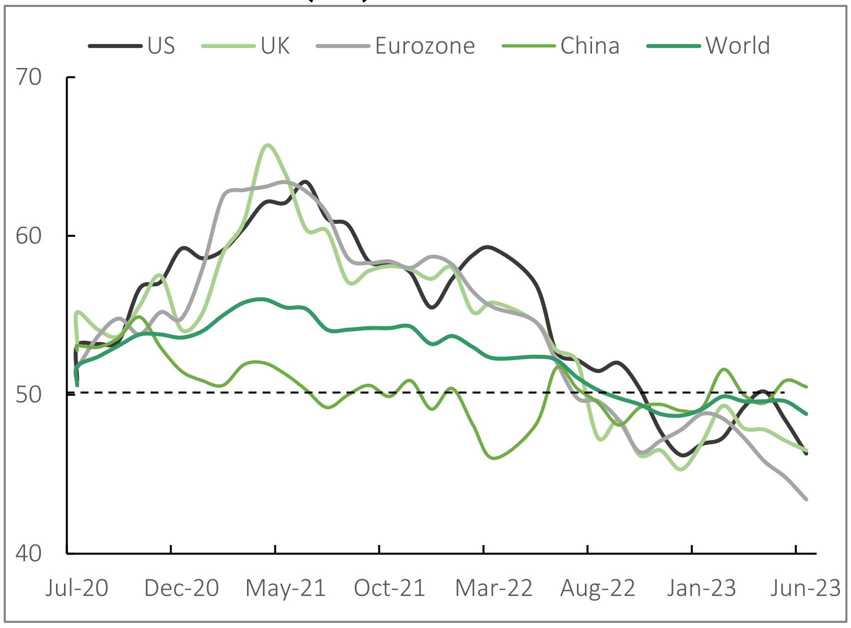
On the bright side, certain improvements have been recorded with respect to factors that dampened the growth. Such improvements include: an ease in supply-chain disruptions, and the decline in energy and food crises. These developments played a role in shielding output growth in the USA as it increased to 1.30%YoY in Q1:2023 (from -1.60% YoY in Q1:2022). Other pull factors include stronger consumer spending amid a tight labour market, higher exports, and the reopening of China's economy.

Similarly, for EMDEs, the IMF projects a deceleration in growth to 3.90% in (2023 from 4.00% in 2022), premised on heightened debt, inflationary pressures, constant depreciation in currencies, and instabilities besetting the global economy, amongst others.

Yet, as mentioned earlier, the banking sector crisis which shook up three banks in the USA and the European giant, Credit Suisse, create new worries for global economic prospects. Precisely, the risk of global contagion and the continued policy rate hikes limit the optimism that the financial sector crisis is truly over.

The potential impact and strain of interest rate hikes on the balance sheet health of certain Systemically Important Banks (SIBs), as mentioned earlier, raises concerns about the vulnerability of other regional banks and the possibility of a financial instability akin to the Global Financial Crisis (GFC) of 2008. Additionally, the ongoing cycles of rate hikes and a slowdown in lending could significantly impede economic growth.

Chart 1: Global PMI (Pts)



Source: Bloomberg, Meristem Research

Even so, risks remain elevated for global inflation from two major sources. One is the expiration of the Black Grain Sea Deal in July and Russia's threat of a likely non-renewal. The other is the recent cut in crude oil production by OPEC+. These two factors could reverse the gains recorded in the battle against food and energy inflation, respectively, in addition to other specific factors in some countries.

Thus, avoiding a fallout between stakeholders of the Black Sea Grain Deal is crucial to preventing resurging food prices while the likelihood of an increase in energy cost is another risk factor to inflation".

Global Inflation

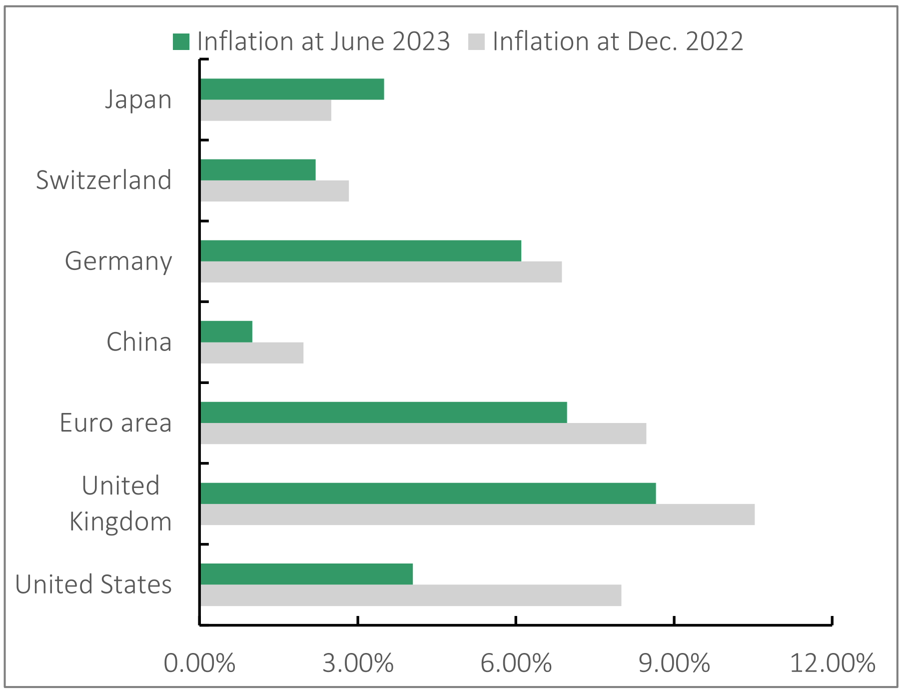
Tentative Recovery And the Battle Against Inflation

So far this year, global headline inflation has continued to moderate owing to declining food and energy prices. Key contributory factors to declining food price levels are the UN-brokered Black Sea Grain Deal, improvements in the global supply chain, and a decline in commodities prices. As an indication, the FAO's global food index dropped to 122.30pts as of June 2023 from 131.80pts in December 2022.

On the other hand, core inflation has been sticky downwards, particularly due to the tightness in the labour market in most advanced economies. Thus, this has limited the extent of the reduction in headline inflation.

According to the IMF's estimate, global inflation will decline to 7.00% in 2023 from 8.70% the previous year. However, the prospect of inflation receding to the 2.00% target of most advanced economies is remote until at least 2025.

Chart 2: Movement in Inflation Rate of Key Economies



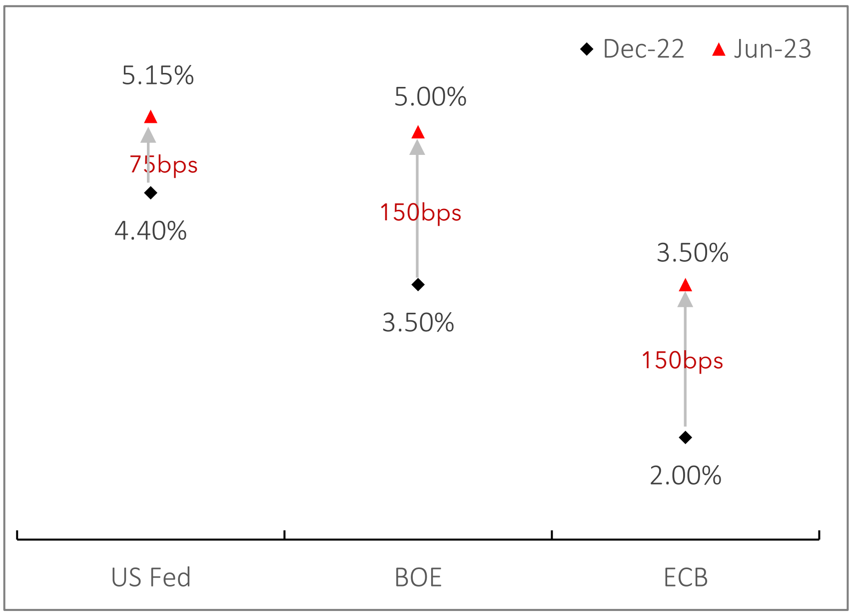
Source: IMF, Meristem Research

Global Monetary Policy

The Ripple Effects of Policy Rate Hikes

Monetary policymakers have been unequivocal in their commitment to achieving lower and stable price levels, leaving no doubts about their hawkish stance. Thus, the US Fed, BOE, and the ECB have all continued to raise their respective monetary policy rates.

Chart 3: Magnitude of Rate Hikes in H1:2023



*NB: Texts in **Red** represent magnitude of rate hike*

Source: BIS, Central Banks' Policy Announcements, Meristem Research

A ripple effect of the subsequent policy rate hikes has been the failure of some regional banks in the USA as well as Europe's Credit Suisse. Banking sector regulators and other related parties were however swift in responding to the situation that threatened to trigger another global financial crisis, although with some pains.

"There is no gainsaying that more policy rate hikes are still expected this year as the battle against inflation is far from being over; however, the magnitude is expected to be lower. Meanwhile, the risks of higher policy rates on the financial system is a dilemma policymakers must contend with. Coupled with that is the negative effect of high interest rate on output which policymakers are also not oblivious of. Nevertheless, bringing inflation down together with a well-anchored inflation expectation remain the most prominent objectives of monetary authorities. That said, we expect a broad-based pause in rate hikes later this year, unless another significant risk emerges".

Worsening Debt Crisis: A Looming Doom?

In the previous year, there was a decrease in the global fiscal deficit. According to the IMF advanced economies experienced a minimal respite in their primary balances by 3.20% and emerging market and developing economies (EMDEs) (excluding China) by 1.10%. These positive developments materialized as the erstwhile shocks (including events such as the food and energy crises, the global pandemic) to the global economy diminished.

However, significant vulnerabilities persist for major countries in both developed and emerging economies. These vulnerabilities are driven by declining fiscal balances and the burden of borrowing costs. According to projections from the IMF, the debt-to-GDP ratio in advanced economies remains above pre-pandemic levels at approximately 113% and is expected to hover around same levels in 2023 due to projections of weaker growth and higher borrowing costs.

Particularly noteworthy are the projected upticks in 2023 debt to GDP ratio, compared to 2022; UK (106.30% vs 102.60%), Germany (67.20% vs 66.50%) and the US (122.20% vs 121.70%). These countries have experienced pronounced increase in their debt levels, primarily driven by increased expenditures on wages, social benefits, and various stimulus initiatives aimed at promoting the adoption of renewable energy sources. Likewise, EMDEs are projected to witness a deterioration in their fiscal balances.

In all, the convergence of rate hikes and escalating debt expenses, alongside the decline in oil and commodity prices impacting exporting nations, is anticipated to result in an expansion of the government deficit. Projections suggest that the deficit could reach approximately -5.80% of GDP in 2023.

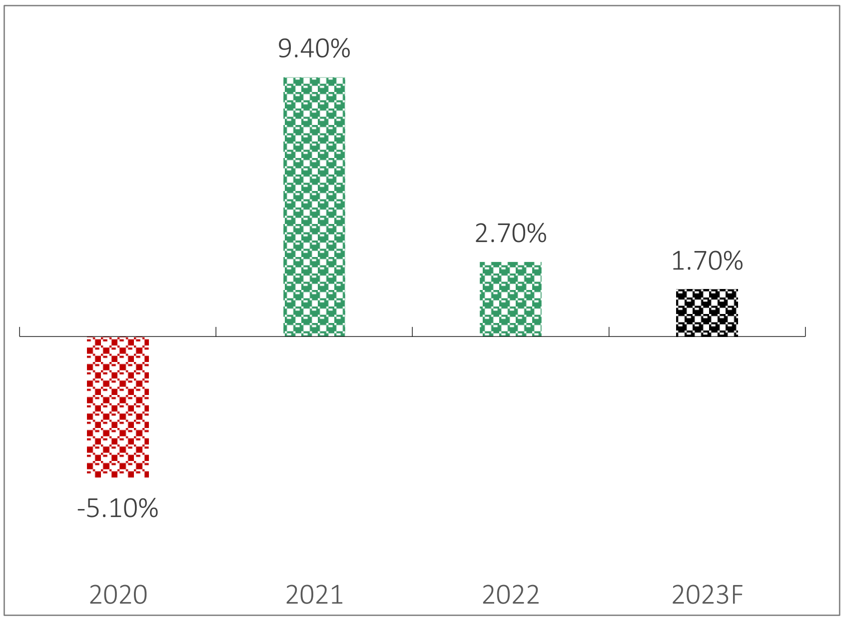
Global Trade

Global Headwinds Slow Trade Recovery

Available data from UNCTAD global trade picked up momentum in Q1:2023 after a slowdown in Q4:2022 as China's re-opening and easing of COVID-19 restrictions at the start of 2023, improved global trade prospects. The organisation reported that global services trade expanded by 1.30% YoY while goods trade declined only marginally by 0.04% YoY. In the same vein, rising demand for information and communication technology (ICT) services and recovery in the tourism and travel sectors bolstered services trade during the period. We also note the depreciation of the USD against other currencies which boosted demand for goods as a huge percentage of global trade is transacted in USD.

On the back of these early recovery sign, the World Trade Organization (WTO) revised its 2023FY forecast for global trade growth to 1.70% from its initial estimate of 1.00% at the beginning of the year.

Chart 4: Global Trade Growth Rate



Source: WTO, Meristem Research

"In the second half of 2023, a moderate improvement in global trade is expected, albeit at a slower pace compared to 2022. This anticipated progress will be primarily driven by the resumption of economic activities in China following the reopening of its borders. However, persistent geopolitical tensions, fears of a recession, uncertainty regarding the Black Sea grain extension, potential trade restrictions, and adverse weather conditions (El Nino) dampen our outlook for global trade outlook.

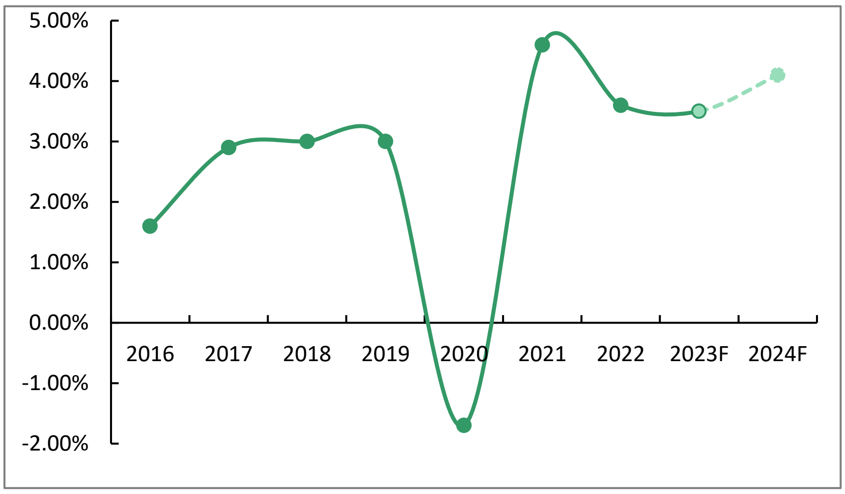
Sub-Saharan Africa

Economic Growth

SSA Growth Revised Downwards

Economic recovery in the Sub-Saharan region has been largely disrupted by the pandemic and the Russian Ukraine crisis. Given that many SSA countries are commodity exporters, the decline in commodities prices have also have significant negative impact on the ability of fiscal authorities to support growth in the region. Declining yet high inflation rates and increasing policy rates in the global economy also made fiscal conditions stringent . On the back of these conditions, the IMF expects the region's economic growth rate to decline for the second year in a row to 3.60% (from 3.90% in 2022 and 4.80% in 2021).

Chart 5: SSA Historical (2016-2022) and Forecasted (2023-2024) Growth Rate

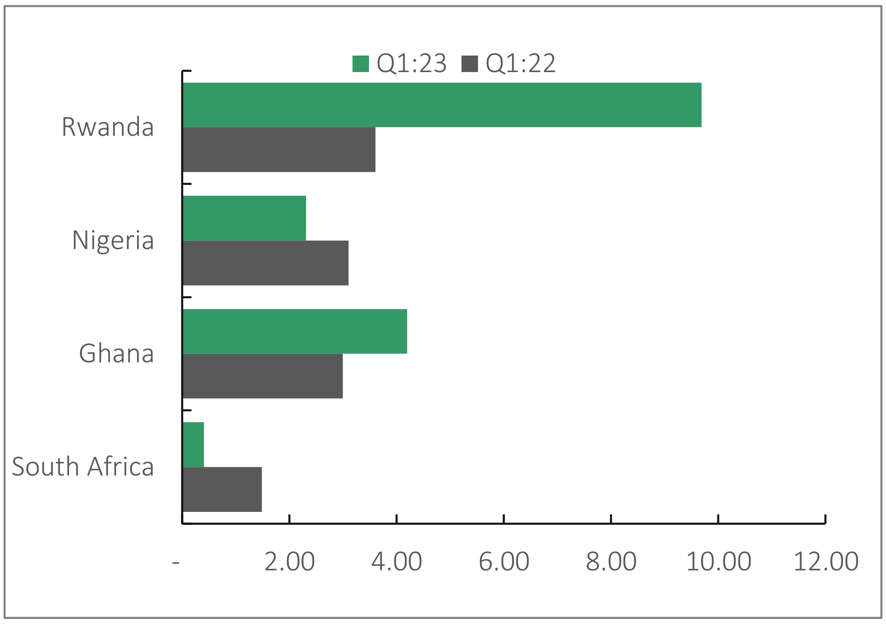


Source: IMF, Meristem Research

Growth has however been diverse across countries with countries like Rwanda (9.69% from 3.61%), Ghana (4.20% from 3.00%), recording higher growth numbers in Q1:2023. Output growth in South Africa and Uganda on the other hand declined to 0.42%, 4.90% (from 1.49%, and 4.95%), respectively in Q1:2023, resulting from the energy crisis and declining commodity prices, respectively. Also, Kenya's growth declined to 5.30%, from 6.2% due to decline in manufacturing and construction sectors, as macroeconomic challenges hampered production activities.

Apart from the aforementioned conditions, countries like South Africa and Angola are expected to continue to grapple with challenges in their energy value chain and declining oil production volumes respectively which will further slow-down the region's overall growth in 2023.

Chart 6: Economic Growth Rate of Selected SSA Countries(%)



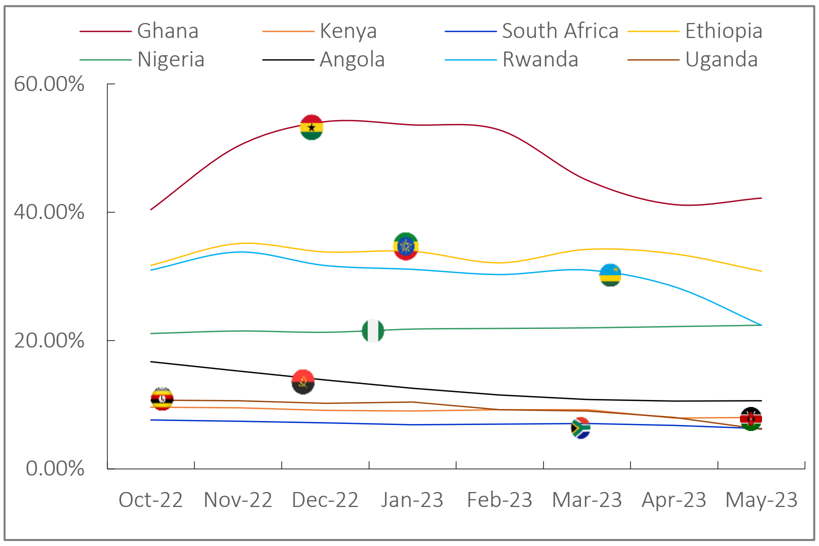
Source: Bloomberg, Meristem Research

Inflation and Monetary Policy

Lingering Inflation Fuels Sustained Rate Hike

While variations across countries exist, headline inflation in the SSA has broadly declined in 2023 on the back of declining commodities prices and continuous rate hike across monetary authorities in the region. Inflation rates in the region however remain above the monetary authorities target band.

Chart 7: Headline Inflation across SSA Countries

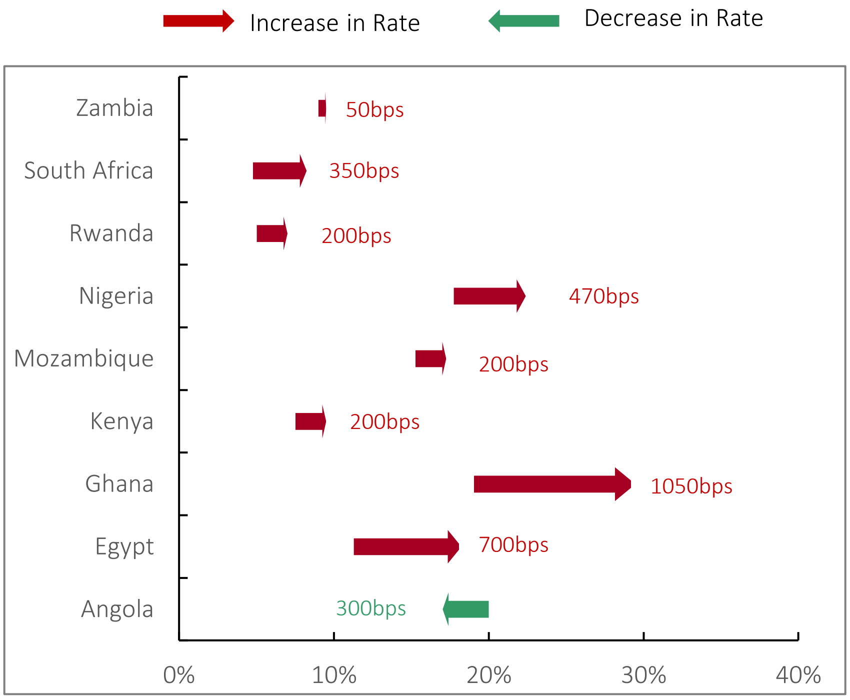


Source: Bloomberg, Meristem Research

For the rest of the year, we maintain that inflation would remain elevated in most countries across the region. However, considering the slower inflation observed in advanced economies, we anticipate a slowdown in commodity prices in the region. Nonetheless, certain threats persist, including the phasing out of food and fuel subsidies in countries like Ethiopia, Cameroon, Senegal, etc., and the imminent increase in oil prices due to the OPEC production cut. Our outlook is subject to these multiple downside risks; we therefore expect monetary authorities across the region to maintain their hawkish stances to rein in inflation though with less intensity.

To further maintain price stability, monetary authorities sustained the rate hiking cycle which began in 2022. The need to continue tightening was also aggravated by higher monetary policy rates across global economies and the need to retain and attract investors in the face of safer havens.

Chart 8: Movement In Monetary Policy Rates May 2022 – May 2023



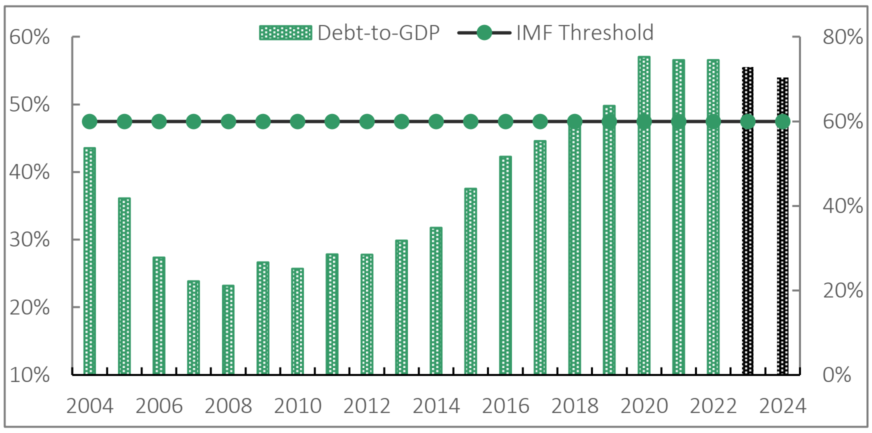
Source: Bloomberg, Meristem Research

Weak Debt Sustainability

The negative effect of the pandemic on fiscal sustainability in the SSA region has dwindled marginally as the IMF reports the region's debt to GDP ratio to have declined to 55.52% in April 2023 from 57.06% in 2020. However, some countries like Ghana (-11.92%), South Africa (-8.81%) and Nigeria (-71.32%) experienced significant exchange rate depreciation which has further worsened external debt burden in the region.

Thus, fiscal sustainability in the region remains a challenge as countries grapple with weak fiscal positions and increasing global interest rates. To this end, the World Bank projects that total external debt service payments in SSA would increase to USDSD22.30bn in 2023 (vs. USD21.42bn in 2022). Moreover, debt rating agencies have also downgraded sovereigns like Nigeria, Egypt, and South Africa.

Chart 9: Debt-to-GDP Trend in SSA (2004 – 2024)



Source: IMF, Meristem Research

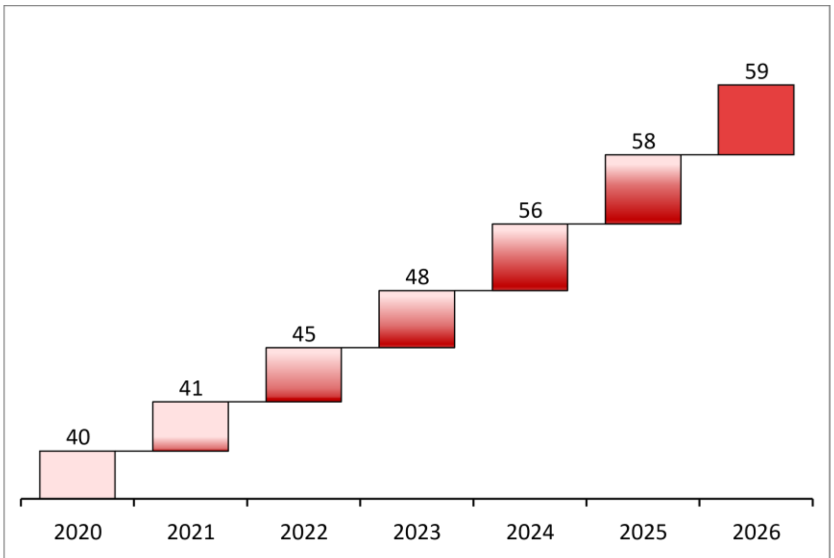
In line with our expectation at the start of the year, more countries in the region obtained concessional loans (like Ghana, Zambia, Ethiopia and Angola) from multilateral organizations like the world bank and the IMF. Zambia also renegotiated the terms of its local debt restructuring in a bid to reduce their lower fiscal vulnerabilities.

Given expectations for weak fiscal positions, the high inflation rate, low credit ratings, high cost of debt and expected debt repayment, we expect more debt restructuring arrangements to spring up with countries within the SSA region.

Ivory Coast also reversed its decisions to raise Eurobonds during the year owing to higher debt cost. We opine that other countries could have also made this decision as the World Bank reports that Eurobond issuances declined to 30.60pts as at March 2023 (from 106.40pts in March 2022).

Despite these fiscal actions, SSA Eurobonds yields climbed. Across countries like Kenya (11.08% vs 10.94%), South Africa (7.51% vs 7.13%) and Angola (11.34% vs 10.71%), we observed an increase in Eurobonds yields at the end of H1:2023, compared to 2022.

Chart 10: External Public Debt Service in SSA (USD' bn)



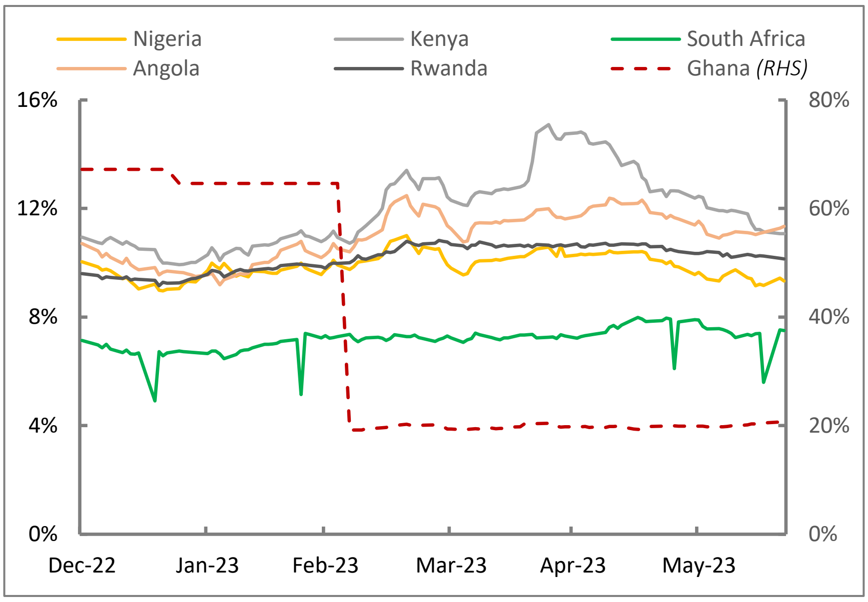
Source: IMF, Meristem Research

Table 1: Maturities and Refinancing Risk in SSA

Country	2023 (USD)	2024 (USD)	2025 (USD)	Refinancing Risk
Angola	N/A	N/A	3.00bn	Low credit rating and debt burden
Ethiopia	N/A	1bn	N/A	Might face difficulties given its ongoing conflict and debt distress
Ghana	N/A	2bn	2.25bn	High debt level and fiscal deficit
Ivory Coast	N/A	750mn	1.25bn	Manageable, given the relative stability
Kenya	N/A	2bn	N/A	High debt level and fiscal deficit
Namibia	N/A	N/A	500mn	High debt level and weak economic growth
Nigeria	500mn	500mn	1.50bn	Manageable, given relative stability
Senegal	N/A	500mn	N/A	Manageable, given relative stability
Zambia	750mn	750mn	1bn	Default status and debt distress

Source: Bloomberg, Meristem Research

Chart 11: Average Eurobond Yields



Source: FMDQ, Meristem Research

For the rest of the year, SSA countries will remain focused on fortifying their fragile economic fundamentals and fixing their debt sustainability concerns (via debt restructuring). In this context, we opine that the trajectory of the Eurobonds market will largely be dictated by happenings in the global economy. Thus, we expect Eurobond yields to hover around current levels, albeit with notable variations across countries, and the potential for yield spreads to widen in the coming months.

Domestic Economy

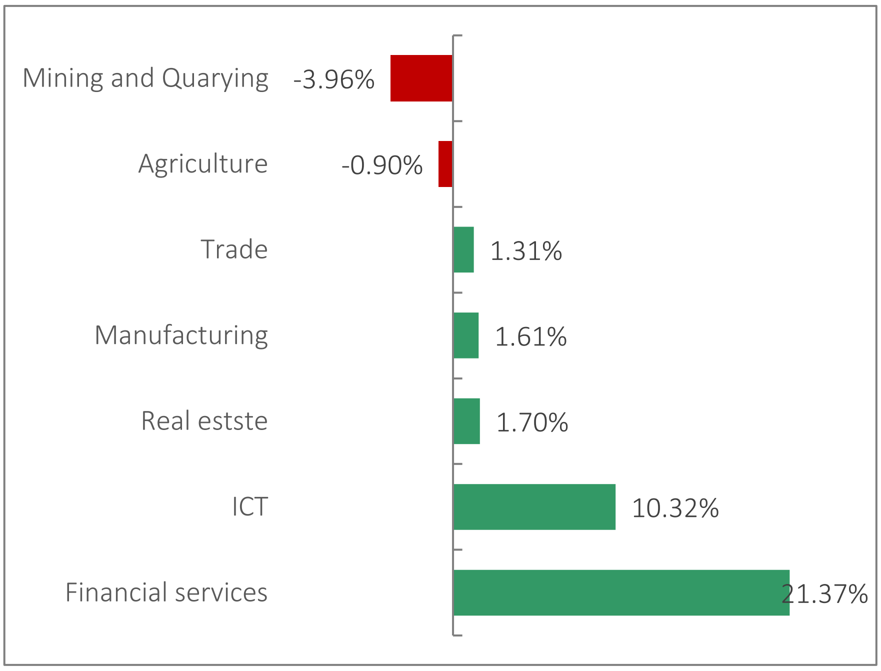
Painting a Canvas of Potential Growth

In line with our expectations at the start of the year; electioneering activities, restricted access to FX (for raw materials importation), lower crude oil production, the cash crunch, and tightening of monetary policy rates impacted output growth in Q1:2023. The NBS reported GDP in Q1:2023 to have grown by 2.31%YoY, lower than the preceding (3.52%) and corresponding quarter (3.11%) rate.

In our Q1:2023 GDP report, we highlighted that the major driver of the growth remained the non-oil sector which grew by 2.77%, its lowest growth in 8 consecutive quarters. The key contributors to GDP growth include Information & Telecommunication sector- ICT (c.72%), financial services (c.42%), trade (c 9%), and Manufacturing (c. 7%).

Though improving compared to Q1:2022 (-26.04%) and Q4:2022 (-13.38%), the oil sector remained in contraction during the period (-4.21%).

Chart 12: Sectoral Real GDP Performance in Q1:2023

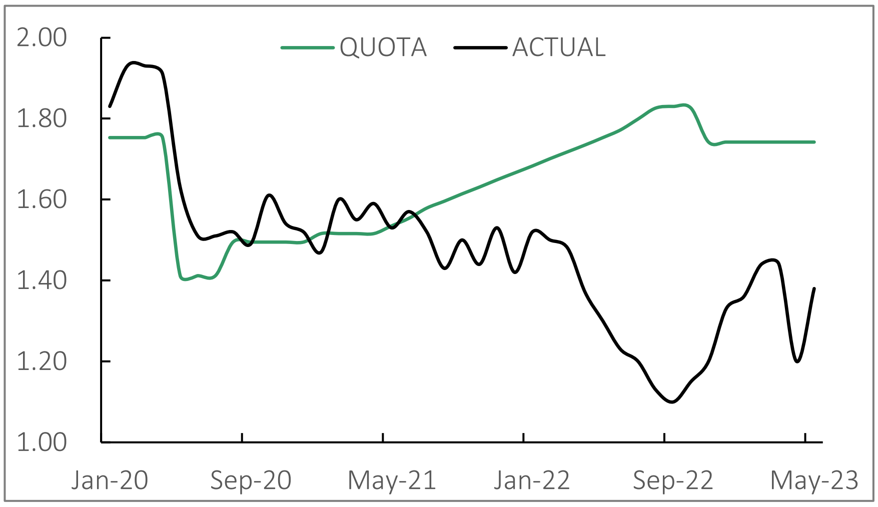


Source: *NBS, Meristem Research*

NB: Key sectors highlighted above make up c.82% of total GDP

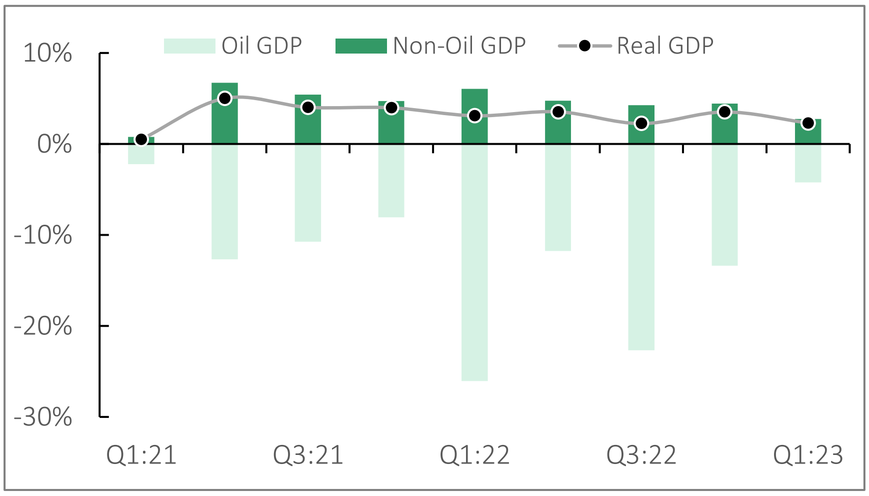
The lower growth is largely reflective of lower oil production volumes in the quarter at 1.28mbpd (vs 1.30mbpd Q1:2022) according to data from the NUPRC. This is also despite an increase in rig count to 14 in Q1:2023 (from 8 in Q1:2022).

Chart 13: Nigeria Oil Production vs OPEC+ Production Quota (mbpd)



Source: *OPEC, Meristem Research*

Chart 14: Historical Real GDP Growth Rate



Source: *NBS, Meristem Research*

The new administration's Policy Advisory Committee (PAC) has put forth some action points which we expect are likely to define the road map for the economy for the next quadrennial. These policies and our assessment of the feasibility of achievement is discussed in the table below.

Table 2: Some Action Points on Economic Growth for the Incoming Administration

Topical issue	Action Points	Expected Result	Feasibility Assessment
Supply Chain	✓ Expand rail infrastructure for agricultural and trade logistics. ✓ Decongest port areas	✓ Increased productivity ✓ Timely delivery of goods and services. ✓ Reduced transportation cost	✓ Improving productivity is expected through the decongestion of port areas and the expansion of rail infrastructure. Nevertheless, these policy actions entail significant expenses.
Low Non-Oil contribution to GDP	✓ Domesticate the value chains of the three largest manufacturing subsectors. ✓ Backward integration program. ✓ Subsidize interest rates via tax incentives for commercial banks ✓ Review and restructure existing incentives, waivers and tariffs to plug leakages ✓ Improve manufacturing cost-competitiveness.	✓ Import substitution ✓ Reduced exchange rate induced inflation ✓ Boost key sectors of the economy such as Agriculture, Manufacturing, Entertainment and Tourism etc.	✓ Technology should be incorporated in the approach to increase productivity. ✓ This will also require significant investment to achieve.
Low FDI	✓ Bilateral investment agreements with FDI target nations. ✓ Ease of Doing Business Program	✓ Attractive destination for foreign investment ✓ Improved ease of doing business	✓ The improvement in economic prospects will be fritical to attracting significant foreign investments

Outlook:

Output Growth Prospects Improve for H2:2023

For the non-oil sector, we anticipate a significant improvement to business activities in the second half of the year compared to the challenging first half, which was impacted by a cash shortage. The new administration's policies aimed at enhancing backward integration and domesticating the manufacturing sector value chain, should also have long run positive effect on the non-oil sector. However, the business environment faces additional challenges due to the removal of fuel subsidies, resulting in a substantial increase in petrol prices. Additionally, the introduction of a 7.50% Value Added Tax (VAT) on diesel imports adds further pressure on manufacturers and firms.

For the oil sector, we maintain our projection of an average production of 1.50mbpd in H2:2023 premised on the following factors: increased surveillance measures targeting pipeline infrastructure to combat crude oil theft & vandalism, and the expected operationalization of the commissioned Dangote refinery. Generally, we expect GDP growth to be higher in the second half of the year compared to the first half. Cumulatively however, the expected growth rate should come in lower than 2022's 3.10%. Thus, we revise our GDP forecast upwards to 2.94% (from 2.70% at the start of the year).

Table 3: Sectoral Outlook for H2:2023

Sector	% of GDP	Drivers	Drags	Outlook
Information and Communication	17%	Adoption of 5G network, Increase in subscribers base,	Exchange rate, high borrowing cost	Bullish
Trade	16%	Increasing free and bilateral trade and zones agreements, Bilateral trade agreements, standardized commodity exports.	Increase in electricity tariff, PMS prices, potential socio-political riots	Modest
Mining and Quarrying	7%	Increased rigs count and improving production volumes, fuel subsidy removal, increased industrial investment.	Pipeline theft and vandalism, Challenges with sourcing FX for importation.	Bullish
Agriculture	22%	Backward integration, Improved Commodities market and standards	Unfavorable weather conditions and expected flooding in H2:2023, Insecurity	Modest
Manufacturing	10%	Re-opening of land borders, encouragement of local manufacturing	Increasing inflationary pressures, additional taxes in Finance Act 2023, FX sourcing for importation, Limited port access	Modest
Real Estate	5%	Provision of long-term mortgages, PENCOM increased investments in mortgage asset class.	High interest rate, reduced purchasing power due to inflation	Bearish
Financial and Insurance	5%	Sustained technological and digital advancement, increased underwriting profitability, increased prospects for FX transactions	Regulatory uncertainties,	Bullish

Fiscal Policy

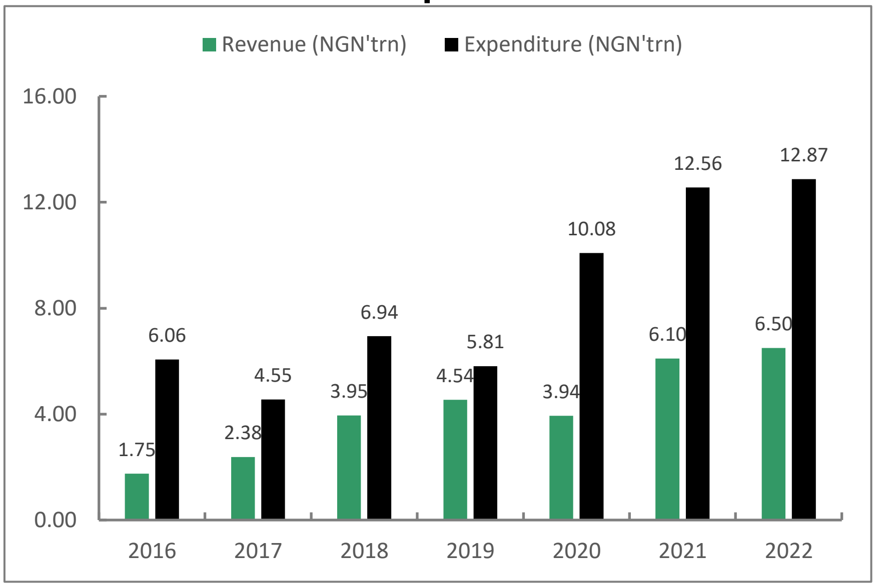
Charting Nigeria's Fiscal Frontier

The fiscal space has been rife with activities in H1:2023 following the approval of the NGN21.83trn 2023 budget. The decline in crude oil price (below the budget benchmark) and the FGN's inability to ramp up crude oil production to the budgeted level (*as anticipated in our October 2022 report on* *critiquing the budget assumptions*) is expected to have impacted government revenue for H1:2023. Oil prices have declined by 39.96%YoY to USD76.22bp at the end of H1:2023 and average crude oil production for the year stood at 1.46mbpd according to NUPRC. The NBS report on Company Income Tax (CIT) for Q1:2023 also reveals that CIT declined by 14.96% during the period, a consequence of lower business activities due to the cash crunch referenced earlier.

Other efforts to increase the FGN's revenue are largely underway including the enactment of the 2023 Finance Act which introduced additional taxes to the federations' revenue coffers. Key changes include an increase in the education tax rate to 3% (from 2.50%), the implementation of a 10% capital gains tax on cryptocurrency transactions, a 0.50% levy on imported goods, and the requirement for companies to remit withheld taxes.

With the anticipation that government revenue data so far for 2023 will remain at subpar levels and the current budget deficit still at NGN10.78trn, the reduction of unproductive spending would be critical to the achievement of the 2023 budget. Already the removal of fuel subsidy (which according to the NNPC, stood at NGN1.51trn in H1:2022) and education subsidy payments are right steps in this direction.

Chart 15: FG Revenue and Expenditure Trend



Source: DMO, Meristem Research

Policy Reforms to Increase Debt Burden

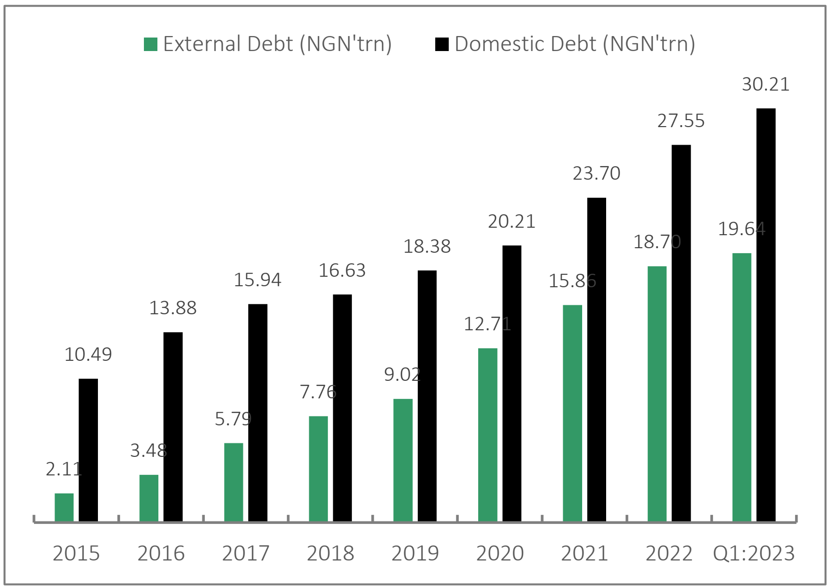
At the start of the year, we expressed concern about the government's rising debt burden and explored the idea of a rating downgrade by international credit rating agencies. During the year, Moody's and S&P downgraded the Federal government to Caa1 from B-(negative outlook) rating from B3 and B1 respectively.

Total debt stock for 2022 stood at NGN46.25tn (divided into external debt - NGN18.70tn & domestic debt NGN27.55tn), indicating a 14.46%YoY increase, excluding the NGN23.72tn ways and means loan from the Central Bank. Following the move to collapse all official FX windows and allow market forces determine the exchange rate, the value of Nigeria's external debt in Naira is set to shoot up to NGN33.54trn (+70.75%). This coupled with the securitization of the CBN's Ways and Means debt is expected to lead the country's debt to GDP ratio upwards to 38.85% by the end of 2023 (from 23.20% in 2022), though still within the FG's (40%) and IMF's (55%) range.
We consider some of the fiscal policies and plans of the new administration and discuss our opinion on the feasibility of achievement in the table below.

Table 4: Some Fiscal Policy Action Points for the New Administration

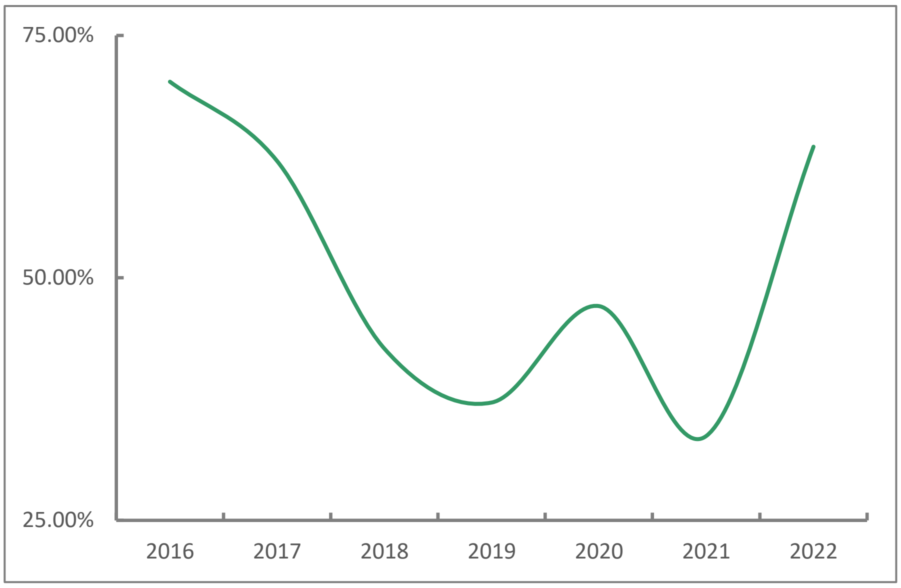
Topical issue	Action points	Expected Result	Feasibility assessment
Oil Theft and Pipeline Vandalism	✓ Increase special security forces to cover the Niger Delta. ✓ Employ technology for increased visibility of crude to crease production as well as effectively trace stollen crude. ✓ Negotiate with OPEC+ to revise oil production quota. ✓ Increase domestic refining capacity.	✓ Ramp up production capacity to 4m barrels within 4 years. ✓ Increase crude oil revenue generation ✓ Grow domestic refining capacity to 2mbpd over the next 8years. ✓ Double gas production from 22m MTPA to 40m MTPA over the next 8years.	✓ Maintaining a good relationship with the natives of the Niger Delta region & training and employing them as security agents for the oil wells would assist in resolving security issues. ✓ Refining capacity would increase if local refineries are revived and invested in.
Tax Reforms	✓ Restructure and automate tax collection. ✓ Broaden tax net. ✓ Implement tax harmonization reforms and eliminate multiple taxation. ✓ Frameworks that encourage voluntary compliance including incentives.	✓ Increase revenue generation from tax. ✓ Achieve a Revenue to GDP ratio of 22%. ✓ Eliminate tax evasion.	✓ Tax reforms are achievable if automation plans are followed through and properly monitored. ✓ Tax harmonization would require a technology system that is easy to use and can be deployed across states and agencies.
Explore the Solid Minerals Sector	✓ Identify location of minerals ✓ Liaise with state governors and security agencies to address security issues around mining. ✓ Develop a mining framework which repositions the sector for investors. ✓ Formalise illegal mining activities	✓ Attract foreign investors into the sector. ✓ Generate revenue from solid minerals mining. ✓ Harness value in unexplored mineral deposits in the country.	✓ Could attract foreign participation in the mapping and mining process. ✓ Could also allow for FDI and FPI in the country.
Rationalise Select Government Assets	✓ Privatise and/or sell down FG's state in some assets (NNPCL's refineries). ✓ List the shares of select government assets including (NEPL, NNPCL Trading, NGIC and NGML). ✓ Regionalise power transmission.	✓ Proceeds to settle existing debt stock of the country. ✓ Invite private and foreign participation to bring in new ideas. ✓ Liquidity generation in the short/medium term for the FG.	✓ Possible buyback option gives the FG and opportunity to regain control over assets. ✓ Reduction in debt stock of the country when proceeds are used to offset debt. ✓ Allows for innovation and technology. ✓ Provides an avenue for FDI and FPI.
Debt Financing	✓ Debt financing for infrastructure development.	✓ Raise more debt locally. ✓ Eliminate dependence on ways and means. ✓ Keep borrowing rates low, to reduce servicing costs. ✓ Achieve a Debt to GDP ratio cap of 40%.	✓ Additional debt would add up to existing debt portfolio of NGN74trn (including ways and means). More debt means a higher debt to GDP ratio. ✓ External debt in Naira terms has significantly increased (c.NGN90trn) due to the devaluation of the naira putting more pressure on the debt to GDP ratio.
Expenditure	✓ Complete removal of Fuel Subsidy ✓ Manage operating costs and leakages.	✓ Encourage shared services amongst MDA to minimise cost. ✓ Implement e-solutions to improve transparency and eliminate cost leakages. ✓ Increase minimum wage as cushion for subsidy removal. ✓ Reduced budget deficit.	✓ Top-notch technology would be needed to provide e-solutions platforms that provides effective monitoring of payments. ✓ High PMS prices due to subsidy removal and the unification of FX segments. ✓ More revenue saving from the export of crude.

Chart 16: Trend in Domestic and External debt



Source: DMO, Budget Office, CBN, Meristem Research

Chart 17: Debt Service to Revenue



Source: Budget Office, Meristem Research

Given that the fuel subsidy payment constituted a major portion of the FGN's expenditure channelled to unproductive use of the country's revenue, its removal should help to reduce the expected budget deficit for upcoming fiscal periods. On the revenue side, concerted activities to improve crude oil receipts coupled with rechannelling of expenses to more productive (capital) uses should improve revenue generating prospects in the long run. However, OPEC+'s production cuts which caps Nigeria's crude oil production volumes at 1.38mbpd from 2024 is expected to impact oil receipts for 2024 given that it has made up 30.76% of total revenue over the past 5 years.

On expenditure and debt, the President's policy advisory council report proposed an increase in debt financing to fund infrastructural development in the country, which also portends long run positives.

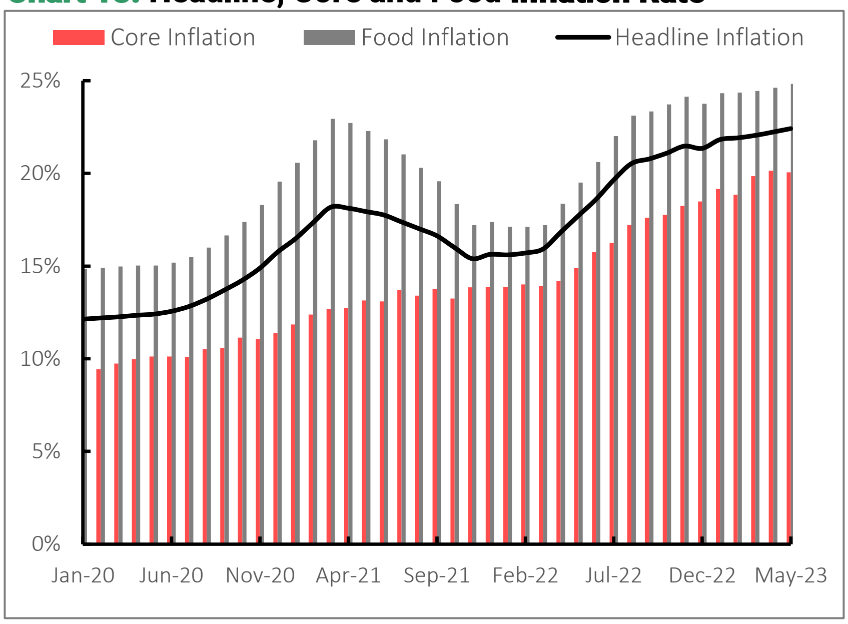
Lastly, we opine that consistent implementations of anticipated policies could also result in a rating upgrade for Nigeria's debt.

Inflation & Monetary Policy

Inflation To Sustain Upward Course

Nigeria's inflation rate has maintained a consistent upward trajectory, reaching 22.41% YoY in May 2023 (vs 22.22% and 17.71% in April 2023 and May 2022 respectively), marking its highest levels since September 2005. A combination of legacy and recent issues contributed to the uptick in both food and core inflation. These issues include insecurity in food producing areas, inadequate storage facilities, stockpiling ahead of the Presidential election, FX depreciation during the period, fuel subsidy removal, and jitters surrounding the extension of the Black Sea grain agreement at the global level.

Chart 18: Headline, Core and Food Inflation Rate



Source: NBS, Meristem Research

Table 5: Summary of Key Monetary Policy Actions by the New Administration

Topical issue	Action Points	Expected Result	Feasibility Assessment
Unification of Exchange rate	✓ Collapse of all FX segments into the I&E window. ✓ Introduce an operative exchange rate management system, viz the crawling peg. ✓ Implement policies to eliminate the barriers to attracting increased Nigeria's diaspora remittances. ✓ Attain an estimate of USD50.00-USD60.00 billion in reserves, with a monthly inflow of at least USD6.00bn-USD8.00bn/month from export earnings and other forms of capital inflow.	✓ To incentivise diaspora remittances , enhance dollar supply, and bolster a more positive economic outlook. ✓ Achieve Naira to USD exchange rate band of 550 to 600. ✓ Increase capital flow into the economy through FDIs and FPIs. ✓ Improve FX availability. ✓ Substantially grow accretion to external reserves.	✓ Foreign investors participation in the economy needs to improve to foster optimal supply of FX. ✓ Not viable in the short term due to insufficient FX supply. ✓ Infrastructural challenges need to be addressed to increase the attractiveness of the country as investment destinations for foreign investors. ✓ Inflation needs to be better managed to ensure a positive real rate of return to achieve this.
Accomplish Interest rate of 9.00%	✓ Align market rates to the Monetary Policy Rate (MPR). ✓ Standardize the Cash Reserve Ratio (CRR) across all banks. Banks are currently being debited in excess of the 30.00% threshold.	✓ Improve the effectiveness of monetary policy measures. ✓ Enhance monetary policy transmission.	✓ An interest rate of 9.00% would be counter-effective for the economy in the near term. ✓ The successful implementation of these measures requires effective coordination between the central bank and commercial banks.

For the rest of 2023, we posit that risks to inflation are tilted to the upside. Asides the existing aforementioned issues (to which there has been hardly any respite), our position on the inflation rate is corroborated by the expectation of higher cost of living due to the removal of fuel subsidy payment. We also expect the proposal to hike electricity tariffs by 40.00% to be a major catalyst for higher inflation numbers in H2:2023.

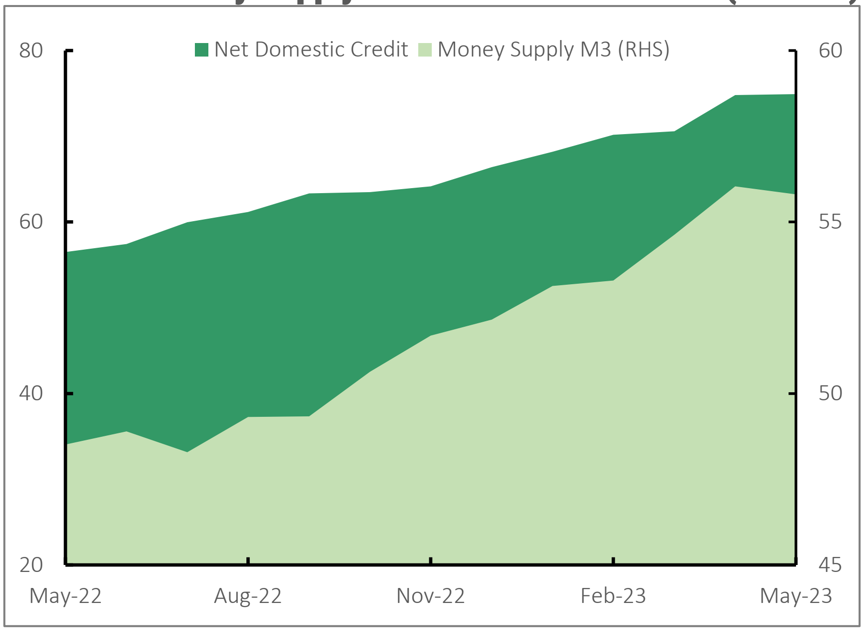
We raise our December 2023 inflation target band to 25.78%- 30.83% (from 21.58% – 26.15% at the start of the year).

Rate Hike Expected to Persist

Largely in line with broad expectations at the start of the year, the monetary policy Committee continued its paces of rate hikes raising the monetary policy rate by 200bps to 18.50% from 16.50%. Ironically, money supply aggregates continued to expand during the first five months of the year. Driven by higher credit to Government (+15.21%YtD) and private sector (+6.43%YtD), broad money supply (M3), and net domestic credit grew by 5.02%YtD and 9.86%YtD, respectively.

The MPC over the course of its meetings during the year acknowledged the threat of inflation and concluded that the price levels would have been higher save for the persistent rate hikes.

Chart 19: Money Supply and Net Domestic Credit (NGN'trn)

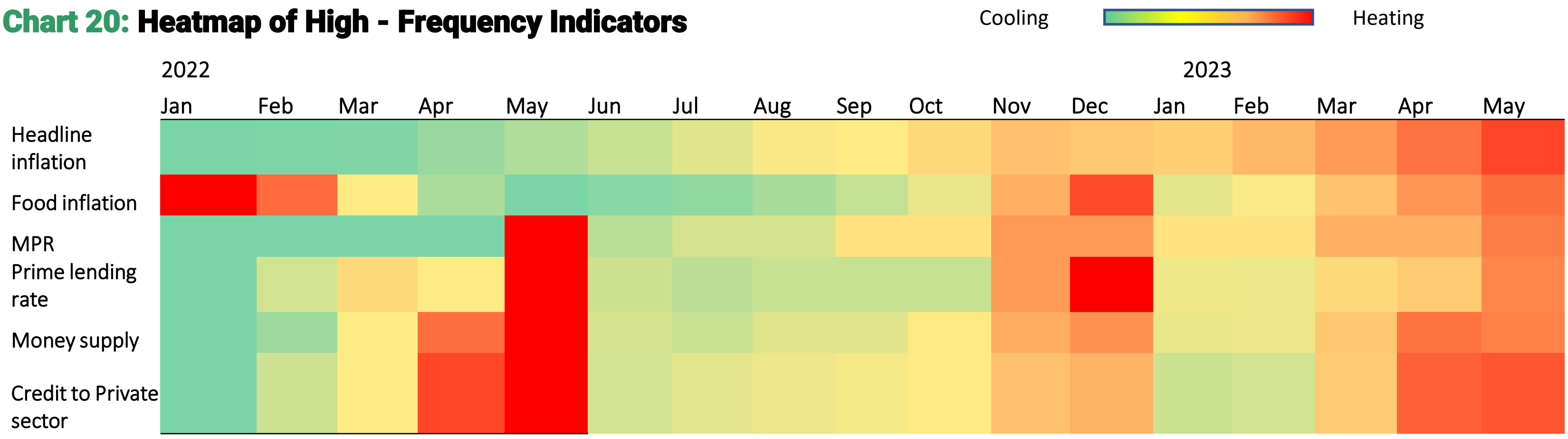


Source: CBN, Meristem Research

With inflation rate projected to continue increasing, we see the possibility of a further 100bps hike in two out of the three remaining meetings for the year. We also opine that the monetary policy authority is likely to consider other tools to control inflation asides the Monetary policy rate (like the Open Market Operation and Liquidity ratio).

While we note that the new administration is keen on keeping interest rates low, we opine that a dovish tilt would be inappropriate in the near term, given the expectation for further rate hikes by global monetary authorities and expected rise in domestic inflation. We also observe that money market investment has attracted the most FPI (c.76.90%) over the past 5 years. Thus, increasing the MPR would also better serve the administration's goal of attracting immediate foreign capital.

Chart 20: Heatmap of High - Frequency Indicators



Notes: Colour coding is based on the deviations of standardized values of each indicator relative to 1-year mean. Red represents growth above the mean (the economy is heating). Green represents the opposite.

Source: CBN, NBS, Meristem Research

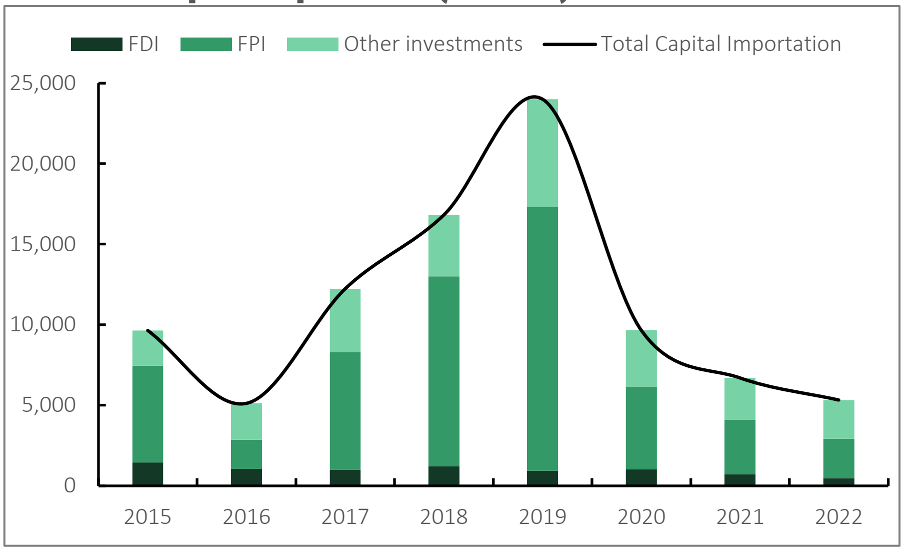
Will Foreign Capital Return to Nigeria?

Since the start of the pandemic, Nigeria's capital importation data has largely depicted low inflows. This has been due to the considerably weak macroeconomic prospects of the country, availability of safer havens in global climes, and concerns around the ease of repatriating invested funds. From its 2019FY high of USD23.99bn, total capital importation declined to USD5.33bn as of 2022FY , its lowest since 2017.

We note that the consistent decline has been majorly driven by lower FPI which typically account for c. 56% of total capital imports into the country.

Nigeria's external reserve balance has also sustained a free fall, hitting a 20-month low of USD34.12bn. The reserve balance has been largely unsupported by low influx of foreign capital as well as the twin devils of lower crude oil production (*average of 1.20mbpd in H1:2023 vs average of 1.28mbpd in H1:2022*), and lower oil prices (*average of USD81.93/bbl vs average of USD111.05/bbl in H1:2022)*.

Chart 21: Capital Importation (USD'mn)



Source: NBS, Meristem Research

In hopes to address this low influx of foreign capital, the new administration has put forth some plans to increase Nigeria's attraction as an investment destination. As major kick-off to this drive, the existing official FX windows were all collapsed into the Investors and Exporters FX Window, with the re-introduction of the Willing buy, Willing Seller module. This led to a significant currency devaluation (c.83.05%) as the currency's price began to reflect more economic realities. We opine that this devaluation would be a positive signal to increase the country's attractiveness to foreign capital.

However, other conditions need to be fulfilled. In our note on the recent FX policy changes, we highlighted a number of these conditions, one of which includes increasing yields on money market instrument (c.39% of total capital inflows over the past 5 years), reduce capital controls and lift the ban on items restricted for imports.

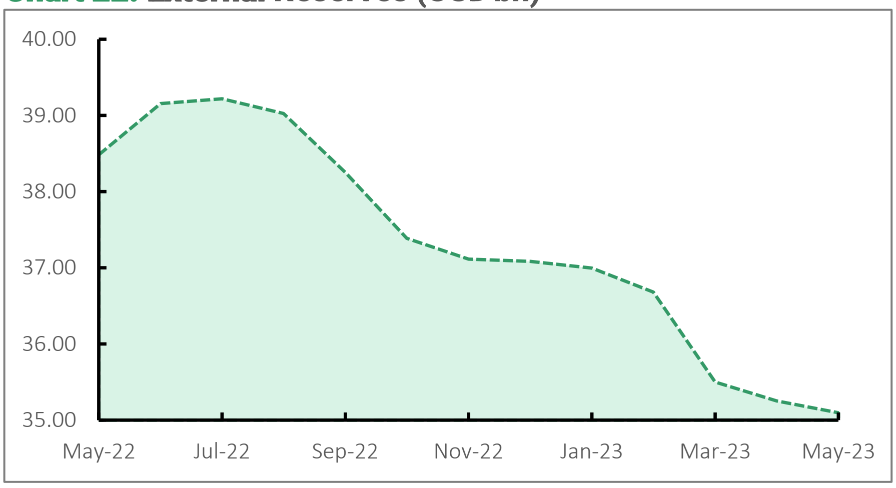
Current Account Prospects Improve

With the expected increase in global crude oil prices and concerted efforts to ramp up production volumes, the outlook for oil export earnings in H1:2023 have improved. This outlook is also supported by the significant Naira devaluation on the official which should improve the country's trade balance (*79.37% of export earnings are from crude oil exports*). Following up the FX reforms with other aforementioned policies should also serve to attract foreign inflows into the country, thereby boosting FX supply, trade balance and current account position. Increased refined crude importers (previously only the NNPCL) and removal of the petroleum subsidy is also expected to free up some pressure from the country's external finances.

Downsides to this expectation would however be an unprecedented shock to crude oil markets which would lead demand and prices lower. Expectations of continued pro-market policy decisions of the present administration would also be crucial to strengthening the county's external sector position.

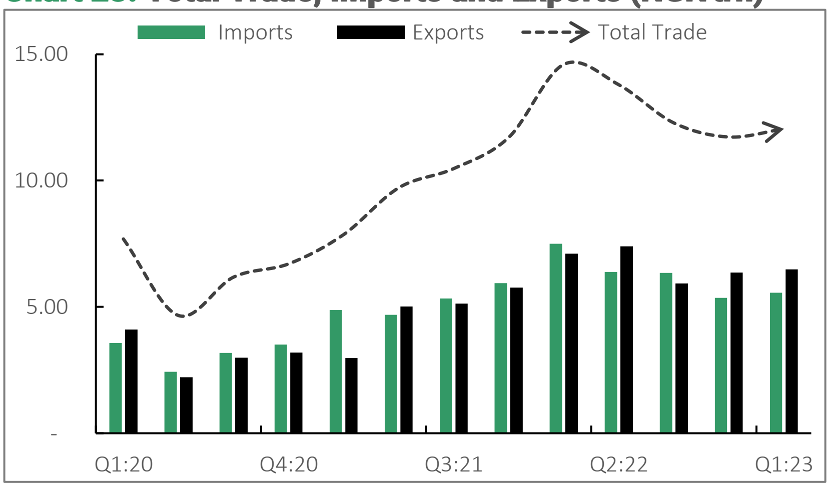
We have reviewed our end-of-year forecast of the NGN/USD exchange rate to reflect these expectations. Particularly, our expectation is for the NGN/USD to trade within a band of NGN779.08/USD to NGN786.08/USD.

Chart 22: External Reserves (USD'bn)



Source: CBN, Meristem Research

Chart 23: Total Trade, Imports and Exports (NGN'trn)



Source: NBS, Meristem Research

Politics and Security

Accelerating Hope: The New Administration's Momentum

As persons with diverse expectations continue to voice their opinions on the potential capabilities of the elected administration to tackle the myriad of headwinds in the country, the new president, Bola Ahmed Tinubu, delivered an inaugural speech to reaffirm his pro-growth policy direction at both macro and micro levels. The speech instilled hope and optimism among the stakeholders of the country, effectively dousing the raging post-election agitations. Since assuming office, the new administration is renowned for its swift action. Notably, the administration has sent fuel subsidy packing, demonopolized electricity generation, collapsed all FX segments into the I&E window and engaged in various discussions to achieve other goals outlined in its manifesto as seen in our macro-economic commentary.

Anticipation Around The Cabinet Selection

To fulfil his constitutional responsibilities effectively, the President expressed his intention to swiftly form a capable cabinet to assist him in managing the nation's affairs. Contrary to his immediate predecessor, within a few weeks after his inauguration, the president wasted no time to initiate appointments to key roles in his cabinet. This move signals a keen sense of urgency and a determination to ensure seamless implementation of enacted policies. Although certain roles still await suitable candidates, there remains a spirited debate surrounding the selection of individuals who possess the requisite qualifications and expertise to fill these vital positions.

A Charge to Curtail Insecurities

The reduced media coverage of insecurities incidents has created a cloak regarding whether there has been a dwindle in the crime rate. However, a closer examination reveals that the subject is still a burgeoning concern. According to the Nigeria Security Tracker from the Council of Foreign Relations, as of May 2023, there have been 2,690 deaths motivated by political, economic, or social grievances in the country.

As a matter of fact, Borno (855 cases), Niger (324 cases), and Benue (276 cases) are the states with the highest concentration. Recognizing the urgency of the situation, Mr President has emphasized that security shall be a top priority of his administration because neither business prosperity nor economic growth can prevail amidst insecurity. Subsequently, he has appointed new security chiefs in a bid to battle insecurity and insurgency in Nigeria.

Despite the bottlenecks inherent in the administration of Africa's most populous country, we remain optimistic that the new administration is forward-thinking and should make the Nigerian federal system work by promoting political accountability, inclusive governance, and national reconciliation across all levels.

As we look ahead to the second half of the year, there is a possibility of an upsurge in civilian violence and banditry due to the rising cost of living, occasioned by the removal of fuel subsidies and an increase in electricity tariffs. However, we anticipate the new administration to confront insecurity head-on by initiating reforms in the security doctrine and its structure.

Financial Markets:

Equities & Fixed Income

Global Equities

Global Markets Close Positive

In H1:2023, the global equities market took a different turn from last year as the bulls maintained dominance of the market. All major equity indices recorded gains, despite fears of economic slowdown and lingering inflationary pressure. The S&P global Broad Market Index returned 15.91% in H1:2023 (vs -21.12% in H1:2022 and -19.46% in 2022FY). Similarly, the MSCI World, Emerging and Frontier indices gained 13.99%, 9.66% and 3.46% respectively. Attractive stock valuations, better than expected corporate performance (especially for tech stocks), deceleration in inflation rate as well as the anticipation of monetary pivoting were the major factors responsible for the positive market sentiment.

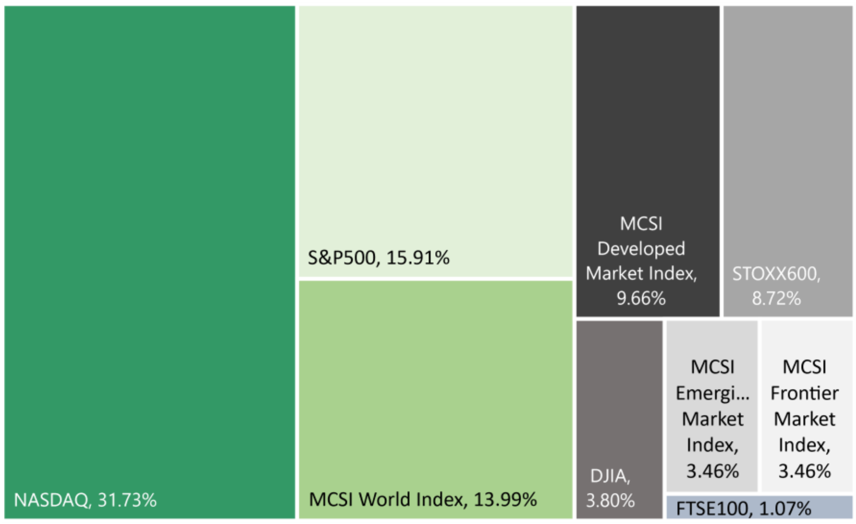
The multiple bank collapses and ensuing turmoil in the financial services sector resulted in a temporary stock market decline, especially in developed climes. However, investors' confidence in the market was restored with the intervention of relevant government agencies.

Notably, the impressive financial performance and relatively cheap valuation of tech stocks made them investors favourite. This propped the performance of the tech heavy Nasdaq Index making it the top performing index with a 31.73% return in H1:2023.

The Eurozone and UK markets also recorded gains, albeit lower than the US equities market. Particularly, the industrials and consumer discretionary sectors outperformed despite fears of a recession in the UK.

Similarly, China's stock market was bullish, as the country reopened its economy at the beginning of the year and eased regulatory pressure on the technological sector. This optimism also impacted the Emerging markets despite the tensions between USA and China that resurfaced during the first quarter of the year.

Chart 24: Global Equities Market Returns in H1:2023



Source: Bloomberg, Meristem Research

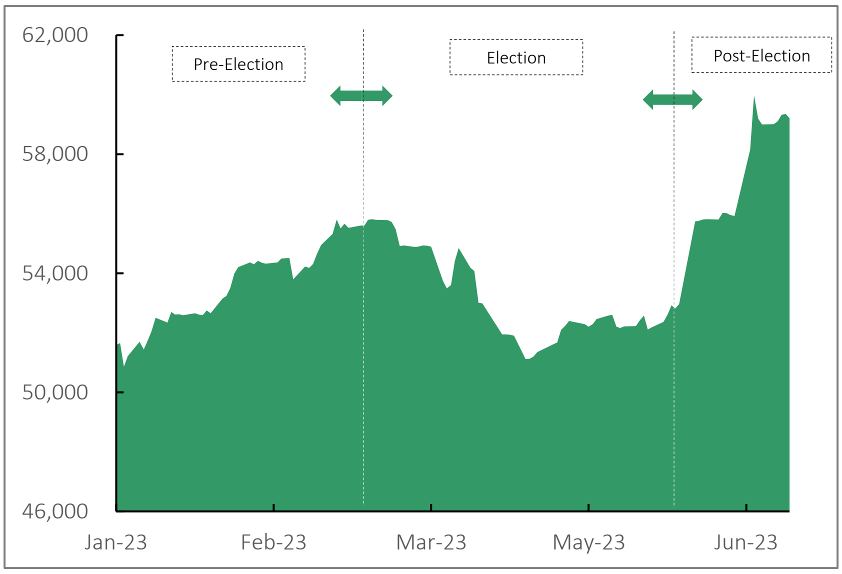
We expect investors interest in the equities market to be sustained and the positive sentiment to persist for the rest of the year. Our considerations include the less hawkish monetary policy stance leading to improved valuations and a likely moderation in fixed income yields. Furthermore, the anticipation of positive corporate results in coming quarters should continue to buoy equities market performance. Particularly, we expect investors interest in the financial services and tech sectors to remain strong. However, the looming concerns of a recession in some major economies poses a downside to this outlook.

Domestic Equities

Climbing Momentum, Slow Retreat

Expectedly, the equities market commenced 2023 on a positive note, as the broad market index recorded gains during the first two months of the year. By the end of February, the market All-Share Index had gained 8.89%, with all sectoral indices recording positive returns save for the insurance and telecommunications indices. The subsequent two months marked a mild correction in the market – March (-1.70% MoM), April (-4.47% MoM), as investors took profit on stocks that had recorded appreciable gains in the prior months.

Chart 25: NGX-ASI Trend in H1:2023 (pts)



Source: Bloomberg, Meristem Research

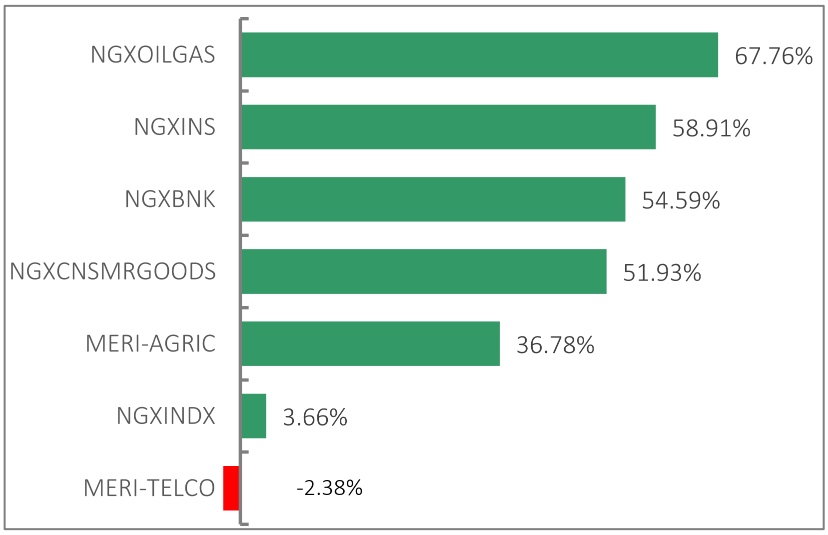
Local Bourse Takes a Quantum Leap

In our 2023 full-year outlook, we cited the ease of transition of power, investors' confidence in the newly elected president and immediate policy decisions as our expectations for major market catalysts post-election. True to that, market buzz resurfaced at the start of May (ahead of the inauguration of the new President). The inauguration and key policy changes announcement by the President aroused optimism in the market, leading to a strong market rally in the following days. Notably, on the day after the inauguration, the market recorded the largest single day gain (+5.23%) since November 2020. Subsequent policy announcements sustained the positive mood in the market for the rest of the half, and the All-Share Index reached its 15 years peak of 60,968pts on 30th of June. Thus, the market ended H1:2022 with a return of 18.96%. As such, the Nigerian equities market outperformed its peers – Ghana (+14.90%), Kenya (-16.06%), South Africa (+4.24%) and MSCI frontier market (+3.46%).

A Stellar Ensemble Marred by a Lone Slump

The telecommunications sector index bucked the trend of all other sectoral indices, being the sole decliner (-2.38%) in H1:2023. The decline was caused by sell-off on AIRTELAFRI (-19.27%). On the flipside, the Oil and Gas sector was the top performer, propped by buying interest on downstream Oil and Gas tickers - CONOIL (+213.21%), MRS (+460.28%), ETERNA (+213.21%), TOTAL (+81.35%) - following the announcement of subsidy removal.

Chart 26: Sectoral Performance in H1:2023

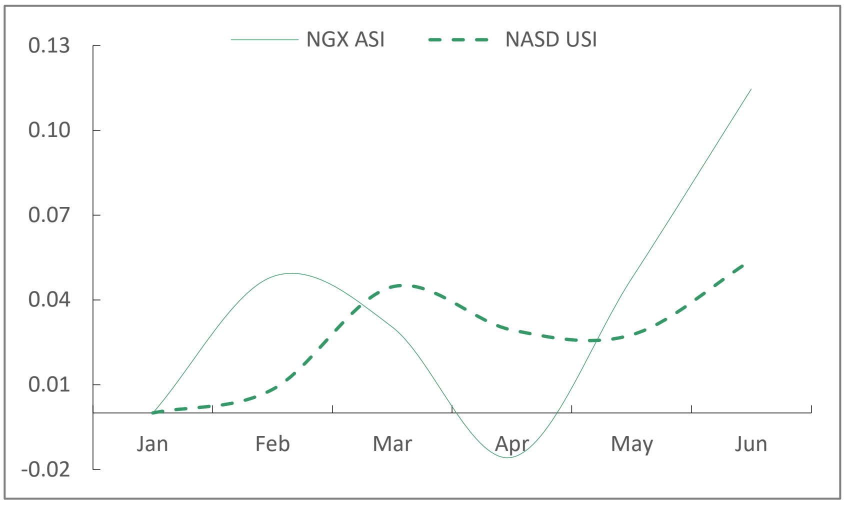


Source: Bloomberg, Meristem Research

Foreign Investors Re-Entrance Imminent?

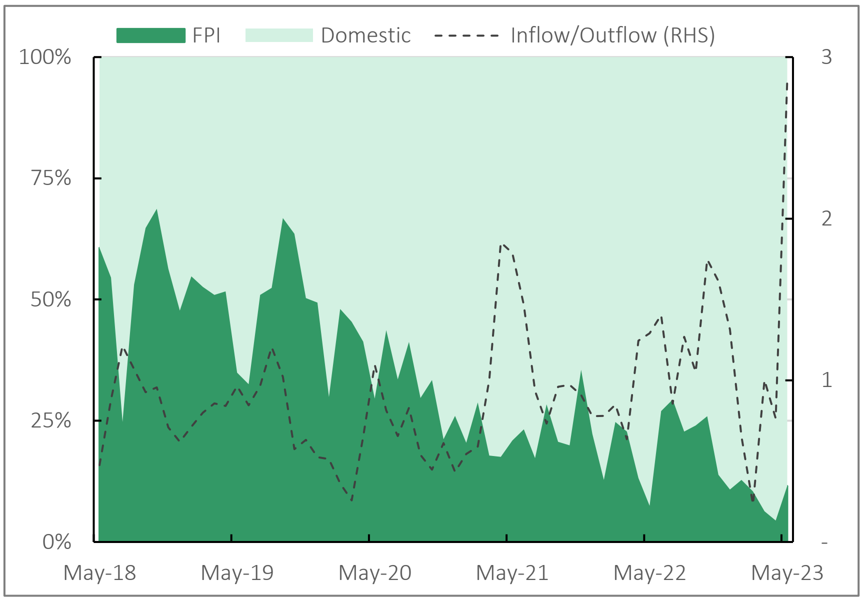
As discussed in our MPC report, foreign participation on the local bourse reached new lows in H1:2023. The value of foreign participation in the market plunged to NGN8.47bn in April 2023 (the lowest on record). Furthermore, FPI participation accounted for only 4.43% of total market activities (also the lowest on record). However, an improvement was recorded in May, as the value of FPI participation and contribution to total activity level in the market increased to NGN37.16bn and 11.51% (the highest since June 2022 and February 2023 respectively). Oddly, FPI inflow was significantly higher than outflow during the month (the ratio of inflow/outflow jumped to 2.85x, the highest since December 2017).

Chart 28: NASD-USI vs NGX- ASI in H1 2023



Source: NASD, Bloomberg, Meristem Research

Chart 27: Participation in Nigerian Equities Market



Source: Bloomberg, Meristem Research

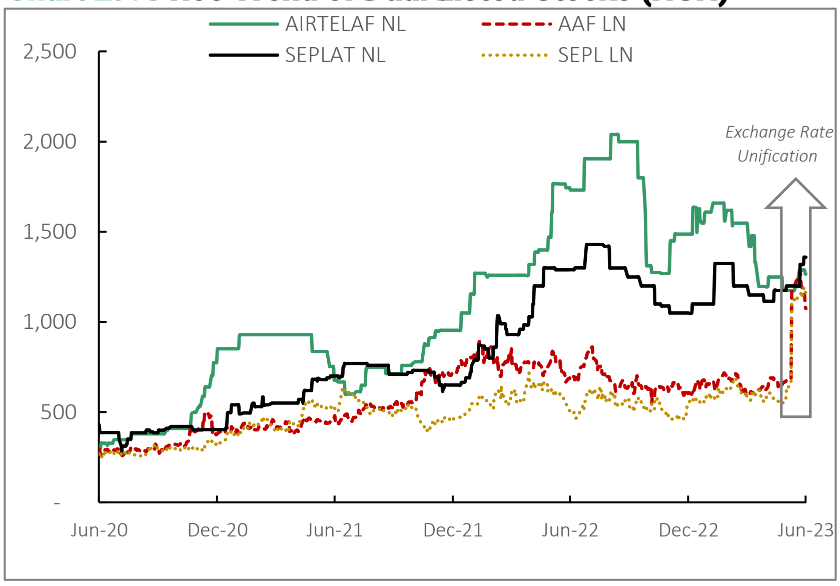
Balancing the Price Disparities

Dual listed stocks (AIRTELAFRI and SEPLAT) have long traded on the NGX at a significant premium relative to the price on the LSE, reflecting exchange rate risk and creating an arbitrage window. The recent devaluation of exchange rate, which caused the NGN/GBP rate to increase to a high of NGN978.75 (by the end of H1:2022) led to a convergence in price of the stocks on both exchanges, thus eliminating the arbitrage opportunity.

Resonating Similitude: NASD Mirrors the NGX

Similar to the NGX-ASI, the NASD-USI began the year on a positive note, returning 4.46% in Q1:2023. However, a bearish mood prevailed in April, as the USI declined by 1.63% in May 2023. As witnessed in the NGX, the market reacted positively to the new administration as the USI spiked in June. Overall, the market returned 5.97% in H1:2023.

Chart 29: Price Trend of Dual Listed Stocks (NGN)



Source: NGX, Meristem Research

NL- Nigeria Exchange **LN**- London Stock Exchange

LN prices were converted to Naira using NGN/GBP exchange rates from CBN

Outlook

The factors that we expect to impact market performance for the rest of the year include:

Macro-Economic Fundamental:

Given the optimism around the ongoing macroeconomic reforms (exchange rate price discovery, fuel subsidy removal, CBN reform) and anticipated improvement in the country's macroeconomic condition, we expect investors to continue to take position strategically, especially in sectors that are poised to benefit from the changes (financial services, oil and gas, agriculture).

On Corporate Actions and Equity Funding:

We expect the pro-growth stance of the new Government to increase investors' confidence and private investment across sectors. Thus, we expect more companies to explore equity capital raise to appropriately position for market opportunities. Furthermore, we recognise likely corporate actions such as recapitalization of some banks. Another factor underpinning this is the deliberate efforts by the NGX to increase participation on the exchange through incentivising the use of the bigtech and fintech boards.

On Foreign Investment: Coincidence or Re-emergence:

The unification of the exchange rate is a potential solution to one of the most pressing FPI concerns in the Nigerian economy – repatriation of funds. With this and other macroeconomic reforms, we anticipate a gradual return of FPI into the equities market in the coming months.

On Corporate Performance:

We expect the trifecta effect of macroeconomic indicators (soaring inflation, high-interest rate regime and currency devaluation) to constrain earnings of certain companies. Specifically, we consider companies that incur huge capital expenditure in dollars, import raw materials, are exposed to foreign and floating rate debt and previously sourced FX at the Investors and Exporters window vulnerable. However, for other companies that generate revenue in foreign currency, we view it as a positive. Thus, we expect corporate performance to be mixed.

On Valuation:

The recent rally in stock prices has led many tickers to their multi-year highs. Also, in our view, most tickers in the Oil and Gas and Financial services sectors have found new support levels and trading range. Thus, while the Nigerian equities market trades at a premium relative to peers, we do not expect significant sell-offs based on elevated valuations.

On a balance of factors, our prognosis is that the market will remain largely positive we also expect investors to continue reacting to key policy changes implemented by the new administration.

Domestic Equities Outlook:

Fundamental Approach

Using the fundamental approach, our expected market return for 2023FY was calculated using the 2023FY target prices of our coverage stocks.

Table 6: **Expected Sectoral Returns**

Sector	Weight	Expected Return	Weighted Return
Banking	18.16%	59.45%	10.80%
Insurance	0.55%	63.01%	0.34%
Materials and Industrials	26.92%	12.50%	3.36%
Consumer Goods	15.04%	46.80%	7.04%
Agricultural Products	1.39%	69.09%	0.96%
Energy	3.50%	63.01%	2.20%
Healthcare	0.20%	105.11%	0.21%
Information Technology	33.27%	11.55%	3.84%
Other Financial Services	0.35%	17.85%	0.06%
TOTAL	100%		
Expected Return			28.82%

Econometrics Approach

In recent years, statistical models, such as the ARIMA model, have been widely used for stock market indices forecasting. Here, we use an ARIMA model to obtain a forecast of the NGXASI using daily data on the All-share index. The popularity of the ARIMA model is due to its inherent properties which reduces the effect of seasonality in stocks market variables and its capacity to model the random noise in the data.

Based on this model, we expect the All-share index to settle at 60,974.33pts, implying a return of +18.97% by 2023FY from close of 30th December 2022.

Table 7: **Weighted Market Return**

Approach	Weight	Returns	Weighted Return
Fundamental approach	80%	28.82%	23.06%
Econometrics approach	20%	18.97%	3.79%
Expected market return			**26.85%**

MERISTEM

Equities Strategy

Market Expectation

Our strategic portfolio in H1:2023 returned 37.95%, outperforming the benchmark (NGX-30 index) by 1,848bps.

In line with our outlook for the rest of the year, we have constructed a strategic portfolio aimed at maximizing returns. The portfolio has been constructed to include quality growth stocks likely to outperform the market.

The stocks in the portfolio, must have met at least 6 criteria.

- Omega ratio higher than 1.
- Expectation of top-line and bottom-line growth in 2023.
- ROE >10% or ROE in excess of COE.
- At least three years of revenue and earnings growth in the past five years.
- Double digit or above industry-average margins
- Upside Potential >10%
- Relatively high beta.

Table 8

H2:2023 Strategic Portfolio

	Fundamentals					Trailing				Valuation								
	AT	NM	ROE	ROA	Lev	EPS	BVPS	PE	PBV	Target PE	Exp. EPS	TP	CP	Int. Div. Yield	UPP	Omega Ratio	Portfolio Weights	Tot. Return
CUSTODIAN	0.49	10%	15%	5%	2.92	1.9	12.69	4.02	0.59	4.00	2.07	8.28	7.50	1%	10.40%	1.40	4.80%	11.73%
DANGCEM	0.60	24%	33%	14%	2.29	22.6	69.17	12.80	4.19	6.54	50.75	331.91	290.00	-	14.45%	1.18	6.66%	14.45%
DANGSUGAR	0.74	14%	32%	10%	3.04	4.8	15.15	5.59	1.78	5.98	5.04	30.11	27.00	-	11.51%	1.78	5.31%	11.51%
FIDELITYBK	0.09	14%	16%	1%	12.62	1.8	11.33	4.45	0.72	3.93	2.23	8.78	8.12	1%	8.12%	1.67	3.75%	9.35%
FIDSON	0.95	11%	24%	10%	2.41	1.9	7.97	8.09	1.95	8.26	2.72	22.47	15.50	-	44.95%	1.96	20.72%	44.95%
GUINNESS	0.97	5%	14%	5%	2.70	5.0	36.73	15.88	2.18	12.74	7.67	97.68	80.00		22.10%	1.51	10.19%	22.10%
MAYBAKER	0.80	10%	19%	8%	2.23	0.9	4.94	5.68	1.05	10.41	0.61	6.33	5.20		21.66%	1.34	9.99%	21.66%
MTNN	0.70	17%	83%	12%	6.92	17.9	21.41	15.35	12.80	15.40	19.94	307.08	274.00	2%	12.07%	1.54	5.57%	14.26%
NESTLE	1.12	10%	102%	11%	8.91	59.5	58.58	20.15	20.48	21.25	66.51	1413.44	1200.00	2%	17.79%	1.23	8.20%	19.87%
OKOMUOIL	0.87	35%	61%	30%	2.02	28.4	46.35	8.62	5.29	13.19	24.03	316.86	245.00	-	29.33%	2.94	13.52%	29.33%
UBA	0.08	19%	19%	2%	11.67	5.3	28.45	2.50	0.47	2.35	6.22	14.61	13.35	1%	9.40%	1.76	4.34%	10.90%
WAPCO	0.64	14%	12%	9%	1.35	3.2	26.76	9.46	1.12	5.07	6.80	34.48	29.95	-	15.11%	1.30	6.97%	15.11%
Exp Return																	**100%**	**18.64%**

AT=*Asset Turnover]*
NM=*Net Margin*
ROE=*Return on Equity*
ROA=*Return on Asset*
Lev=*Leverage*
EPS= *Earnings Per Share*

BVPS= *Book Value Per Share*
P/E=*Price to Earnings Ratio*
PBV=*Price to Book Value*
Target PE=*2023 Target PE*
Exp. EPS= *2023 Dec Expected EPS*
Int. Div Yield= *Interim dividend yield*

TP=*Target Price*
CP= *Price as at December 30, 2022*
Exp Div. Yield=*Expected Dividend Yield*
UPP=*Upside Potential*
Omega Ratio= *A risk adjusted performance ratio that measures returns per unit of risk.*

Data in the Fundamental columns are based on trailing performance.

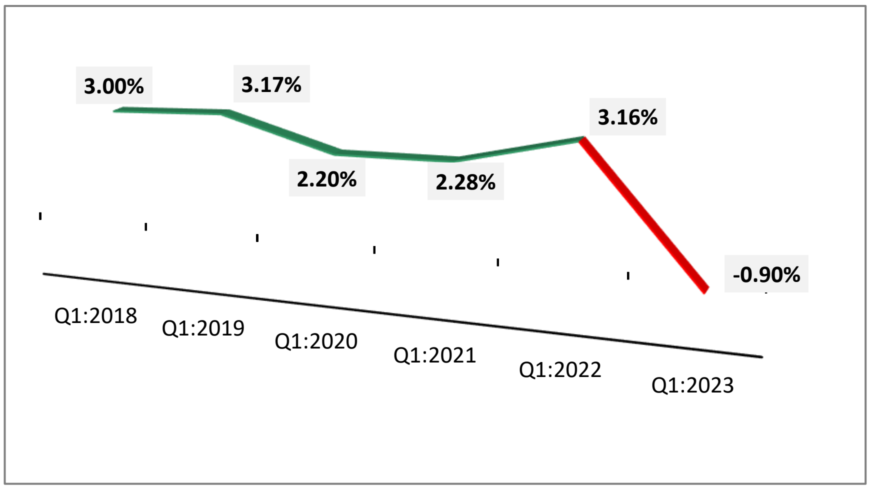
Sectors
Review and Outlook

Agriculture

Homegrown Falter; Hope Flickers

The agricultural sector, despite its resilience, experienced a significant setback in Q1:2023, as its GDP declined for the first time since 1988 by 0.90% YoY (compared to a 3.16% YoY growth in Q1:2022). Similarly, the sector's contribution to the GDP dropped to 21.66% in Q1:2023 (from 22.36% in Q1:2022). This contraction can be attributed to domestic factors, primarily the Naira scarcity that occurred in February 2023. Other major drags to the sector's performance include FX shortage impacting imports, lingering effects of last year's flooding, tomato disease outbreak, and insecurity in food-producing states.

Chart 30: Trend in Agricultural Sector GDP Growth



Source: NBS, Meristem Research

In H1:2023, global palm oil prices initially rallied, rising from USD942.00/tonne in January 2023 to USD1,005.00/tonne in April 2023; however, it subsequently declined to USD934.00/tonne in May 2023. The price spike in April can be attributed to supply constraints in Indonesia, a major producer of crude palm oil (CPO), which raised the CPO export duty from USD52.00/tonne to USD74.00/tonne. This resulted in palm oil scarcity in the domestic market, driving up domestic prices.

Local oil palm millers like **PRESCO** and **OKOMUOIL** benefited from this rally, recording impressive revenue performance in 2022FY and Q1:2023 respectively. Similarly, feed millers have been faced with higher operating costs due to increased global prices of major inputs such as corn and maize. This was reflected in **LIVESTOCK**'s Q1:2023 financial scorecard as its cost-to-sales ratio worsened to 92.73% YoY (from 88.96% in Q1:2022). The black sea grain deal and the "Grains from Ukraine" programs have been put in place to improve the supply chain efficiency of feed mill inputs.

Domestically, the new administration offers a form of respite through its policy reforms, which include the relaunching of the Kano and Calabar Free Trade Zones, the development and implementation of backward integration programs, and the revitalization of the National Commodities Exchange such as the Lagos state Commodities Exchange Board. These reforms are expected to enhance production, improve the quality of locally produced agricultural commodities, foster increased exports, and stimulate investment in the agricultural sector.

*On the back of sustained policy interventions, we expect improved performance in the sector in terms of growth and contribution to GDP. However, persistent inflationary pressure and potential flooding as predicted by the National Emergency Management Agency (NEMA) pose downsides. Oil palm millers (**OKOMUOIL and PRESCO**) are expected to record improved profitability from increased demand during the harvest season (typical of the second half-year). Uncertainty regarding the black sea grain deal poses threats to growth for feed millers.*

Valuation and Fundamental Metrics

	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Exp Div Yield	Target PE	Exp. EPS	2023 TP	CP	UPP	RT
OKOMUOIL	0.87	34%	61%	30%	2.02	28.43	46.35	8.31x	5.10x	9.47	11.74	24.03	316.86	235.00	34.83%	BUY
PRESCO	0.57	25%	50%	14%	3.40	21.47	42.65	8.29x	4.17x	2.50%	9.04	22.34	201.91	200.00	+0.96%	HOLD

Banking

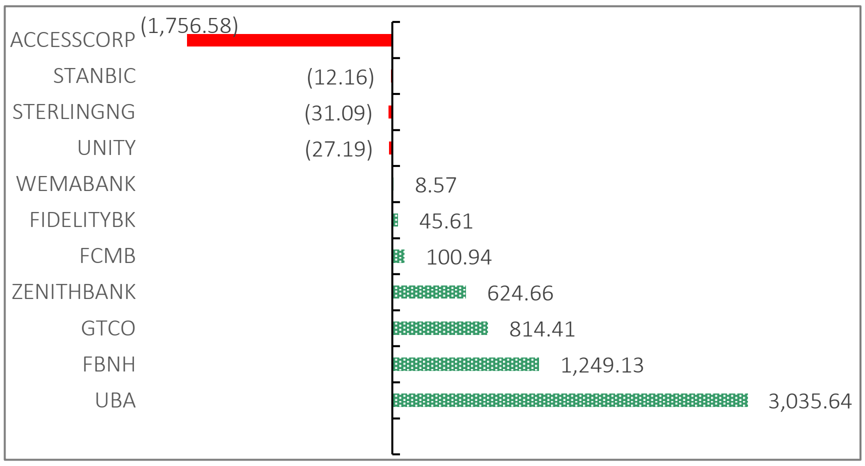
A New Chapter Unfolds

H1:2023 was especially eventful for the Nigerian banking sector, with the different occurrences setting the stage for the rest of the year. The sector faced a challenging cash crunch in March, which tested the strength and adaptability of banks' fee and commission structures. Furthermore, the suspension of the CBN governor garnered widespread attention, leading to increased market activity in banking stocks. Notably, the introduction of the exchange rate unification policy brought about significant changes, creating a ripple effect that could affect the performance of various banks.

Navigating the New Currency Currents

The shift towards a market-determined exchange rate has both positive and negative consequences for the Nigerian banks. On one hand, banks that are Net Long (FCY Assets > FCY Liabilities) have a chance to enhance profitability through increased foreign exchange trading activities and potential gains from FX revaluation. On the other hand, banks that are Net Short (FCY Assets < FCY Liabilities) will be exposed to FX revaluation losses, which could negatively impact their balance sheets and potentially affect their risk-weighted assets. Loans extended to industries and sectors facing difficulties in repaying at the new exchange rate may contribute to higher NPLs (above the 5% threshold), which could impact banks' asset quality and their Capital Adequacy Ratio (CAR).

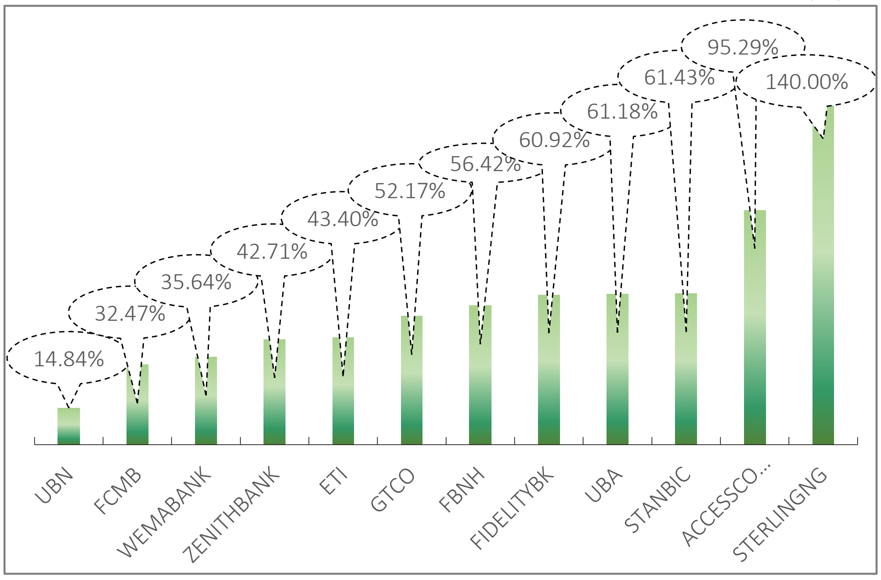
Chart 31: Banks' Net FX Position as at 2022FY (NGN' bn)



Source: Companies' Financials, Meristem Research

Amidst a backdrop of positive market sentiment, investor interest and anticipation in Nigerian banking tickers have soared, buoyed by expectations of good financial performance. Notably, the sector's index (NGNBNK) delivered an impressive return of 54.59% in H1:2023, reflecting substantial value appreciation and investor confidence. Additionally, the suspension of the CBN governor reverberated throughout the economy, particularly impacting the banking sector. In the aftermath of the suspension, the market responded swiftly with heightened buying activities observed on banking tickers, indicating a surge in investors' interest and optimism.

Chart 32: Price Returns of Banking Tickers in H1:2023 (%)



Source: NGX, Meristem Research

"The banking sector finds itself at a pivotal crossroads, where adaptability and strategic decision-making are of utmost importance. This transitional phase offers banks a unique opportunity to evaluate their current strategies and make necessary adjustments to align with potential regulatory shifts. By seizing this moment, banks can capitalize on increased investor interest and the prevailing market momentum, leading to enhanced performance and effective navigation through the uncertainties that lie ahead".

Table 9: Our Outlook for Key Policies

Key Policies	Positive Impact	Adverse Impact	Outlook
Higher MPR	• Increase in asset yield	• Higher funding cost • Higher impairment charges	Positive
Naira Devaluation	• FX revaluation gains • Higher FX trading income	• Potential threat to capital adequacy • Higher operating expenses • Higher non-performing loans	Moderate
New CBN Governor	• Increased investors' optimism and likely increase in foreign investment	• Likely regulatory uncertainty	Positive
Overall			**Positive**

Valuation and Fundamental Metrics

	Fundamentals					Trailing				Valuation						
	NIM	CoF	CIR	CAR	NPL	EPS	BVP	P/E	P/BV	Exp Div Yield	Target PE	Exp. EPS	2023 TP	CP	UPP	RT
ACCESSCORP	4%	4%	58%	18%	3%	4.67	39.28	3.55x	0.42x	7.63%	3.13x	5.44	17.01	18.35	-7.32%	**HOLD**
ETI	5%	2%	56%	14%	5%	8.65	49.72	1.76x	0.31x	3.80%	1.90x	8.07	17.88	15.80	+13.16%	BUY
FBNH	6%	2%	62%	17%	4%	4.29	49.89	3.98x	0.34x	2.89%	4.17x	4.36	16.70	19.00	-12.11%	**SELL**
FCMB	7%	4%	65%	16%	7%	1.78	15.32	2.86x	0.33x	4.96%	3.07x	1.81	5.55	6.05	-8.26%	**HOLD**
FIDELITYBK	6%	5%	67%	18%	3%	1.82	11.33	3.84x	0.62x	6.16%	3.93x	2.23	8.77	8.12	+8.03%	BUY
GTCO	7%	1%	48%	24%	5%	5.95	30.99	3.69x	0.76x	8.07%	5.01x	6.96	34.84	35.95	-3.08%	**HOLD**
STANBIC	4%	2%	54%	21%	2%	7.30	2.33	7.40x	0.23x	3.45%	7.60x	7.46	56.70	57.95	-2.16%	**HOLD**
STERLINGNG	8%	4%	73%	15%	4%	0.67	5.35	5.01x	0.63x	5.14.%	4.65x	0.81	3.76	3.89	-3.26%	**HOLD**
UBA	6%	2%	59%	28%	3%	5.33	28.45	2.30x	0.43x	7.49%	2.35x	6.22	15.16	13.35	+13.56%	BUY
UBN	4%	4%	73%	14%	4%	1.59	10.63	4.63x	0.69x	-	7.06x	0.75	5.30	8.25	-35.79%	**SELL**
WEMABANK	7%	4%	80%	13%	6%	1.07	1.12	4.96x	0.05x	6.24%	4.93x	1.12	5.52	5.39	+2.50%	**HOLD**
ZENITHBANK	7%	2%	54%	20%	4%	7.38	45.91	4.64x	0.75x	8.68%	3.92x	8.03	31.49	34.55	-8.84%	**HOLD**

Kindly note the following legends for the fundamentals tables.

***NIM**= Net Interest Margin; **CoF** = Cost of Funds; **CIR** = Cost to Income Ratio; **CAR** = Capital Adequacy Ratio; **NPL** = Non-Performing Loan Ratio*

**TP calculated with EV/EBITDA multiple.*
TP=Target Price
CP= Price as at July 6, 2023
UPP=Upside Potential
RT= Rating
***Exp. EPS**= 2023 Dec Expected EPS*
***EV/EBITDA**= Enterprise Value to EBITDA Ratio*
Data in the Fundamental columns are based on trailing performance.

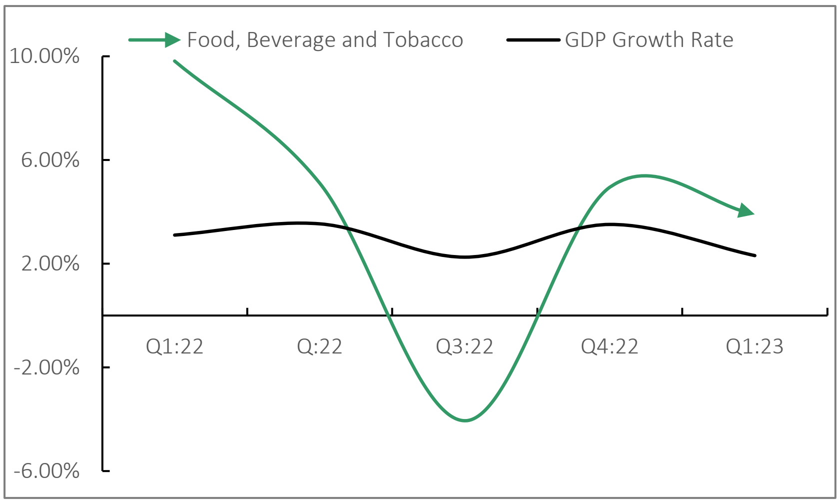
BVP= Book Value Per Share
P/E=Price to Earnings Ratio
AT=Asset Turnover
OM=Operating Margin
NM= Net Margin
Lev=Leverage
EBITDA=Earnings Before Interest, Tax, Depreciation and Amortization

Consumer Goods

A Dimmer Outlook in the Face of a Rocky Operating Environment

The Nigerian consumer goods sector offers significant opportunities with its large consumer base, diverse products and emerging middle class. However, several headwinds have continued to bedevil the sector. These include cash scarcity, unabating inflationary pressure, infrastructural deficiencies, exchange rate volatility, and a spike in borrowing costs. The effect of these factors include reduced production volume and lower consumer demand for some products. Consequently, the food and beverage sector growth declined significantly to 3.90% YoY (vs. 9.81% YoY in Q1:2022 and 4.94% YoY in Q4:2022). The brewers were the most affected as three of the listed companies recorded decline in revenue. However, the consumer staples were able to withstand these negative factors.

Chart 33: Food & Beverage Sector Performance



Source: NBS, Meristem Research

Corporate Strategies and Price Reviews Drive Top-line Growth

Stemming from upward price reviews, increased sales volume, robust distribution networks, and resilient demand from consumers in the sector, some industry players were able to achieve revenue growth bringing industry revenue to stand at NGN734.72bn in Q1:2023 (+c.12%YoY). Particularly, **UNILEVER** delivered a topline expansion (+19.69% YoY), bolstered by the performance of their food segment (+41.19% YoY).

This is noteworthy as **UNILEVER** recently divested from its home and personal care (HPC) segment, citing mounting cost pressures.

We expect the company to continue to leverage on its strong brand presence and broad distribution networks to grow revenue.

Mounting Cost Pressures Pose a Major Risk to Performance

The previously mentioned challenges exerted upward pressure on industry costs with average production cost rising by 11.33% YoY in Q1:2023. Coupled with that is the continuous hike in interest rates which significantly impacted the borrowing cost (+109.39% YoY) of these players. Consequently, bottom-line performance was dragged (-13.34% YoY) to NGN69.71bn.

We have a moderate outlook for the consumer goods sector in 2023. While the price elasticity of consumer discretionary products should sustain its demand, , dwindling consumer wallets and high inflationary pressures present significant downside risks.

Flour Millers: Tackling Substantial Cost Pressures

The Nigerian flour milling industry has also had its fair share of the macroeconomic headwinds. Given that Nigeria relies heavily on wheat imports (c.90% of total wheat consumption), the continuous Naira depreciation has amplified the cost of wheat imports for local manufacturers, eroding the positive impact of declining global wheat prices (-19.10% YtD).

In line with efforts to improve wheat self-sufficiency, the Flour Millers Association of Nigeria (FMAN) and the Wheat Farmers Association of Nigeria (WFAN) signed an MOU- ensuring that wheat millers pay wheat farmers a predetermined price, to ensure a stable market and competitive pricing for wheat.

While the government has made modest short-term progress towards wheat self-sufficiency, particularly through initiatives like the Anchor Borrowers Program and loans provided by the Bank of Industry to small and medium-sized farmers, significant challenges persist in the wheat value chain persist, These challenges include insecurity in the wheat-producing region, climate constraints, infrastructure deficits, and the high cost of inputs such as seeds and fertilizers.

We expect the Naira devaluation to have a negative impact on flour millers production cost, thus product prices are likely to increase in order to protect margins. Nevertheless, the essential nature of their products, should keep demand elevated.

Breweries: Recovery Prospects Muted by Cost Pressures

In addition to general industry issues, other specific factors that will affect the brewery sector in H2:2023 include the increase in excise duty on beer, stouts and imported wine (NGN75 per litre) effective in September 2023. Also, Nigerian Breweries Plc disclosed an ongoing review of a proposal to acquire Heineken Beverages Holdings Limited's majority interests (80.00%) stake in Distell Wines & Spirits Nigeria Limited. We believe that the successful execution of this proposal will expand the company's brand portfolio and contribute to revenue growth.

In H2:2023, we anticipate improved sales volume for brewers supported by the resolution of the currency crisis. However, the higher excise taxes will add another layer of cost pressure Thus, we expect producers to pass on higher rising costs to consumers.

The discretionary nature of brewery products should however limit ability to pass this cost. Overall, we expect only marginal improvement in earnings.

Sugar Industry:
Reliance On Imports Persists

Global sugar prices have steadily increased since the start of 2023 (USD0.56/kg in May 2023 vs USD0.42/kg in January 2023). This rally can be attributed to the El Nino weather events which led to a supply squeeze from major sugar-producing countries including Brazil (due to rain-delayed harvest), Thailand (due to drought and competition with high-priced cassava), China, and India amongst others. This increase in prices flows through to the domestic market as the industry is still largely dependent on imports of raw sugar. In Q1:2023, sugar imports ranked second on the list of imported food items at NGN75.79bn (as against the zero-import Phase 2 target of the NSMP).

*In the near term, we expect sugar production to remain flat as the target of the Phase 2 of the NSMP is yet to be realized. The supply gap created by a drop in production from top-producing countries creates a market for Nigerian producers, especially as Nigerian exports become cheaper alternative. In addition, the elevated global sugar prices means higher market price of sugar in the domestic market, which should translate to higher revenue for industry players like **BUAFOODS** and **DANGSUGAR**. In the long term, our view is that refined sugar production will increase owing to the new administration's plan to provide incentives and foster strategic partnerships with trading counterparts.*

Valuation and Fundamental Metrics

	Fundamentals					Trailing				Valuation							
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Exp Div Yield	Target PE	Exp. EPS	2023 TP	CP	UPP	RT
NESTLE	1.12	10%	102%	11%	8.91	59.54	58.58	20.99x	21.34x	3.88%	21.25x	66.51	1,413.44	1,200.00	17.79%	BUY
UNILEVER	0.68	6%	8%	4%	1.93	0.93	12.23	17.53x	1.33x	2.92%	18.45x	0.97	17.90	17.15	4.35%	HOLD
CADBURY	0.85	4%	15%	4%	4.13	1.33	8.92	13.10x	1.95x	1.74%	20.62x	0.52	10.75	17.85	-39.77%	SELL
UACN**	1.13	-5%	-13%	-6%	2.12	-1.96	15.11	-5.51x	0.71x	0.25%	1.09x	16,24	17.70	11.85	49.38%	BUY
FLOURMILL	1.50	1%	11%	2%	4.90	5.12	48.39	6.66x	0.70x	6.41%	8.21x	4.50	36.95	33.55	10.12%	BUY
NASCON	1.10	10%	33%	11%	2.86	2.54	7.81	7.37x	2.40x	2.05%	9.15x	2.20	20.13	21.00	-4.14%	HOLD
DANGSUGAR	0.74	14%	32%	11%	3.04	4.83	15.15	5.18x	1.65x	5.56%	5.98x	5.04	30.14	27.00	11.63%	BUY
BUAFOODS	0.73	23%	40%	17%	2.39	6.05	15.08	22.42x	9.00x	3.31%	16.95x	5.66	95.91	135.75	-29.33%	SELL
GUINNESS	0.97	5%	14%	5%	2.70	5.04	36.73	15.88x	2.18x	4.84%	12.74x	7.67	97.68	80.00	22.10%	BUY
NB*	0.82	-2%	-7%	-2%	3.85	-1.08	16.49	-41.50x	2.73x	3.41%	6.41x	9.24	59.25	44.00	34.66%	BUY

**Exp. EPS: EBITDA per Share   Target PE: EV/EBITDA*

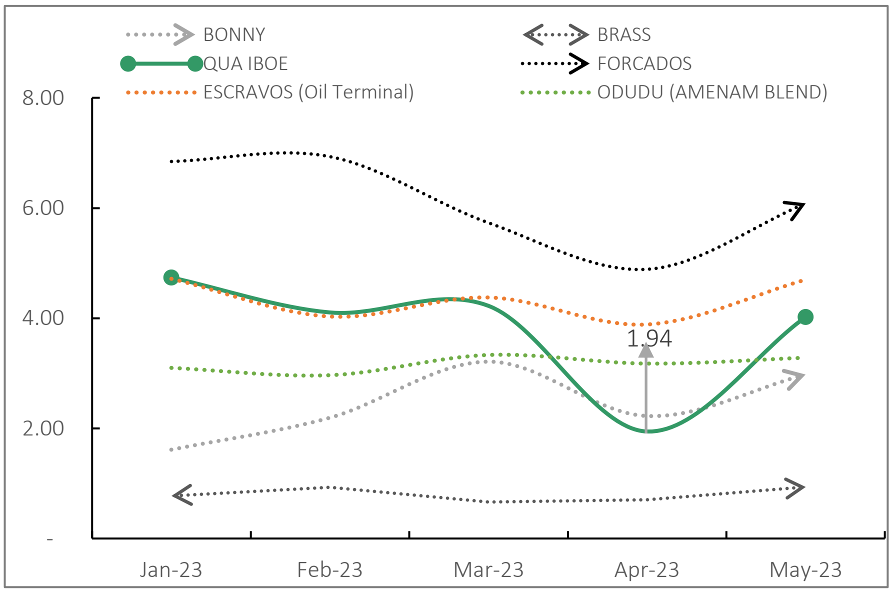
***EPS: Book value per Share   Target PE: Price to Book value*

Energy

Optimistic Outlook Despite Dwindling Oil Price

Due to efforts to combat oil theft by the government, production output recovered from a low of 1mbpd in August 2022 to 1.24mbpd as of December 2022. The first quarter of 2023 saw a continuation of this growth as oil production rose 11.30%QoQ. SEPLAT's financial results for Q1:2023 also showed this increased oil production as growth was fuelled by the company's higher volume (+8.59% YoY), which offset the drop in oil prices (15.60%). As a result, the top line and bottom line increased to NGN151.99 billion and NGN26.42 billion, respectively, by 51.06% and 218.75%.

Chart 34: Nigeria's Oil Production by Terminal (mbpd)



Source: NUPRC, Meristem Research

Despite a significant decline in oil production by 21.26% MoM in April 2023 due to the disruptions at the Qua Iboe terminal as a result of the Petroleum and Natural Gas Senior Staff Association of Nigeria (PENGASSAN) strike, we remain positive on oil production performance for 2023FY. Hence, we maintain our projection for oil production at an average of 1.50mbpd for 2023FY.

*However, it is still shy away from the production quota of 1.74mbpd. Overall, we expect the improved oil production performance to drive **SEPLAT's** 2023FY financial performance. In addition, we expect the Naira devaluation to boost to the company's revenue in Naira and would increase dividend earnings as dividends are declared in USD.*

Downstream Sector Deregulation: An Opportunity for Higher Margins?

The long-awaited Dangote refinery, with a refining capacity of 650,000 barrels per day, was commissioned in May 2023. The refinery is expected to start supplying the market in Q3:2023, producing about 60 million liters per day of Premium Motor Spirit (PMS), with approximately 40% to be exported. This full operation of the refinery is expected to improve fuel supply and reduce the consistent scarcity faced in the country.

Another development is the removal of fuel subsidies which allows PMS prices to reflect market conditions, consequently, PMS prices rose by c. 180%. This development is beneficial to companies operating in the downstream sector of the oil and gas industry as it poses an avenue to improve revenue and possibly earnings in the near to long term. Furthermore, we envisage that current prices would wedge against unnecessary demand for PMS, allowing the Dangote refinery to cater to a larger portion of the country's demand with minimal importation.

In the near term, considering that the old stock of PMS purchased at erstwhile subsidized rate was sold at c. 180% higher than the purchase price, we expect this to filter into and boost the net profit of oil marketers in Q2:2023. For 2023FY, we project that the uptick in prices would drive revenue growth for players in the sector. Production cost should however increase propelled by the Naira devaluation. In addition, the high borrowing cost environment creates a downside risk to earnings growth.

With all the listed companies under our coverage being major oil marketers, we expect that they all should qualify for importation licenses to import PMS.

Overall, we expect the deregulation to enhance price competition, with the most efficient players posting higher margins.

Table 9: Expectations at a Glance

+ Ve's	- Ve's
Upstream	
Higher oil production output Higher naira revenue Higher naira dividend	Lower oil prices
Downstream	
Higher net margin Improved Revenue	Higher finance cost Increased direct and operating cost

Valuation and Fundamental Metrics

	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Exp Div Yield	Target PE	Exp. EPS	2023 TP	CP	UPP	RT
SEPLAT	0.27	14%	7%	4%	1.98	106.32	1,424.74	12.79x	0.95x	5.06%	14.09x	102.09	1,438.36	1,399.80	2.76%	HOLD
TOTAL	1.40	1%	8%	1%	6.05	10.98	139.37	30.61x	2.41x	7.04%	6.57x	51.31	337.12	370.00	-8.89%	HOLD
CONOIL	1.82	6%	31%	11%	2.74	12.50	40.38	6.42x	1.99x	3.91%	5.96x	13.56	80.79	102.30	-21.03%	SELL
MRS	1.97	1%	7%	2%	4.32	0.78	10.91	20.27x	1.45x	0.55%	6.49x	12.39	80.38	91.30	-11.96%	SELL
ETERNA	1.79	-3%	-82%	-6%	14.50	-5.85	7.13	-2.89x	2.37x	1.01%	1.56x	12.54	19.56	25.85	-24.33%	SELL
ARDOVA*	2.36	2%	14%	6%	2.41	8.34	58.75	9.47x	1.34x	0.00%	10.17x	1.24	12.61	16.85	-25.16%	SELL

Healthcare

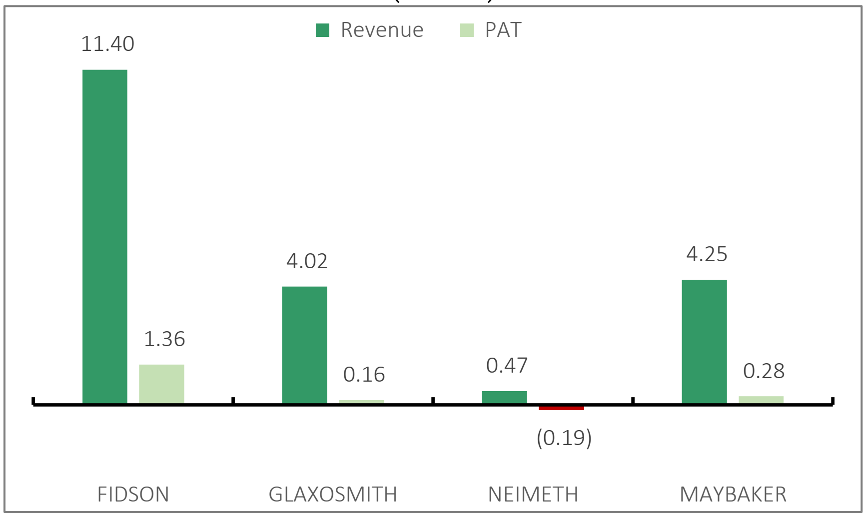
Improving Landscape for Pharmaceuticals

The Nigerian healthcare sector recorded some developments in H1:2023. Firstly, NAFDAC granted approval for the marketing of R21 Malaria Vaccine by Fidson Healthcare Plc. **(FIDSON)**; Swiss Pharma Nigeria Ltd **(SWIPHA)**, became the first in West Africa to receive WHO Prequalification for their *Zinc sulfate 20mg* dispersible tablet. Also, National Institute for Pharmaceutical Research and Development (NIPRD) and Bloom Public Health launched a World Bank-funded project to support Nigerian pharmaceutical companies producing malaria drugs in obtaining the Good Manufacturing Practices certification and to obtain WHO prequalification. In our opinion, these initiative should improve capacity expansion opportunities for players in the sector.

Lastly, real GDP for the chemical and pharmaceutical sub-sector expanded by 0.26% in Q1:2023 vs. 0.22% in Q4:2022).

Chart 35: Listed Industry Players Performance Q1:2023

(NGN' bn)



Source: Company Financials, Meristem Research

A Tale of Mixed Fortunes

Despite its essential nature, topline performance in the healthcare sector was somewhat impacted in Q1:2023 owing to macroeconomic headwinds and the afore-mentioned cash crunch effect.

Pharmaceutical companies under our coverage recorded largely mixed results: **FIDSON** (+11.33% YoY) and **MAYBAKER** (+27.22% YoY) recorded an increase in revenue, while **NEIMETH** (-40.90%) and **GLAXOSMITH** (-45.39%) recorded a decline.

The outlook for 2023FY remains broadly positive. We expect ongoing and prospective capacity expansion initiatives to boost sales volumes. Also, 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. Lastly, majority of the listed players typically record more revenue performance in the second half, a theme we expect to persist this year.

However, we project a significant surge in production and operating expenses (especially raw materials and transportation and energy costs) hinged on the fuel subsidy removal and inflationary pressure.

Valuation and Fundamental Metrics

	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Exp Div Yield	Target PE	Exp. EPS	2023 TP	CP	UPP	RT
FIDSON	0.95	11%	24%	10%	2.41	1.92	7.97	5.92x	1.42x	3.23%	8.26x	2.72	22.47	15.50	+44.97%	BUY
GLAXOSMITH	0.72	3%	8%	2%	3.17	0.61	8.10	12.17x	0.92x	7.19%	12.95x	0.67	8.68	8.35	+3.95%	HOLD
MAYBAKER	0.80	10%	19%	8%	2.23	0.91	4.93	6.02x	1.12x	5.77%	10.41x	0.61	6.33	5.20	+21.73%	BUY
NEIMETH**	0.31	-12%	-6%	-4%	1.54	-0.09	1.52	-17.12x	1.02x	2.20%	2.09x	1.03	2.15	1.82	+18.13%	BUY

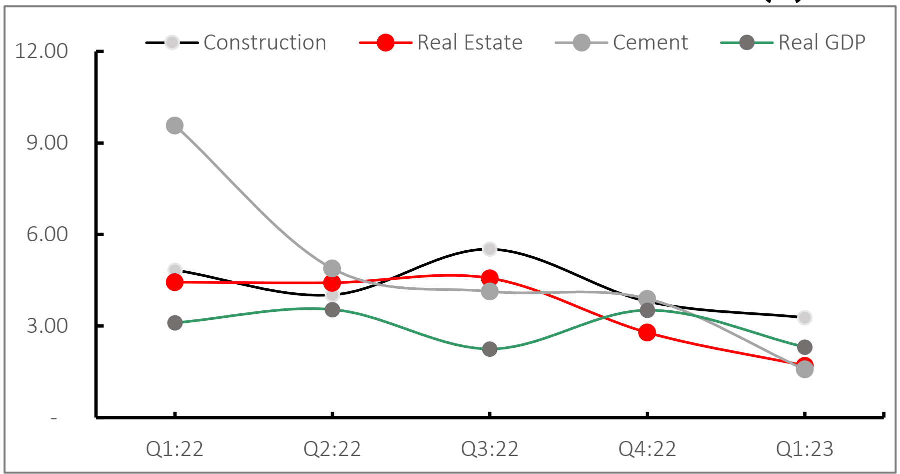
***EPS: Book value per Share Target PE: Price to Book value*

Industrial Goods

Building Bridges from Dire to Dauntless

The industrial goods sector recorded lower growth in Q1:2023 evinced by the decline in real GDP growth rate of the construction and real estate sectors by 3.27% and 1.70% (vs. 4.83% and 4.44% in Q1:2022) respectively. The ill-implemented Naira redesign policy affected the sector. Additionally, high cost of production and building materials for construction activities, reduced consumer spending and electioneering activities impacted the contribution of the industry to the overall GDP. Consequently, the cement sector took a hit with a declining GDP growth rate of 1.58% (vs. 9.57% in Q1:2022).

Chart 36: GDP Growth and Industrial Sector Growth (%)



Source: NBS, Meristem Research

Slow Down in Demand and High Costs Drag Earnings

A deeper dive into the financial performance of cement players reflected the general reduction in activities in the industry during the period as demand (sales volume) declined by 16.56% YoY to 6.65MT in Q1:2023. We reiterate the effect of the cash shortage on the ease of supply and delivery of cement products. Thus, the sector struggled to grow its revenue by +0.69% to NGN604.90bn (vs. NGN600.78bn in Q1:2022) supported by upward price revision (NGN3900 – NGN4500 per bag ex-factory). Particularly, the reduction in DANGCEM's revenue (1.56%) being the largest contributor (67.24%) to total industry revenue dragged the overall industry topline performance. The firm witnessed significant drop (12.92%) in sales from its Nigerian operations. Conversely, BUACEMENT and WAPCO reported revenue growth of +9.65% YoY and +1.34% YoY, respectively.

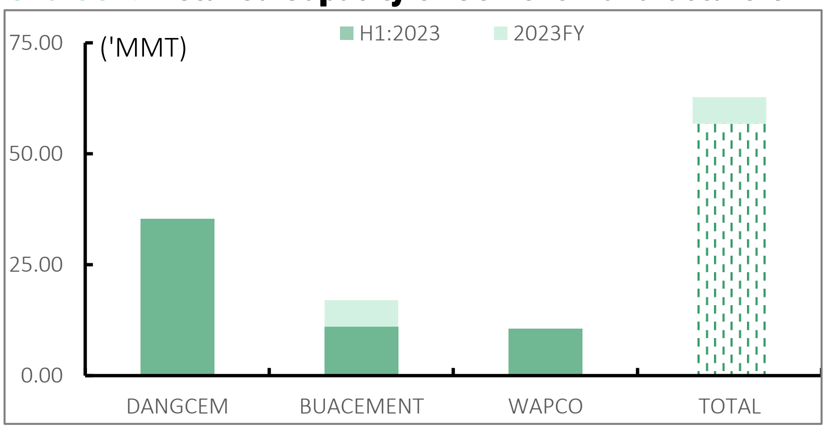
Dismally, in Q1:2023, the industry earnings declined by 3.39% to NGN151.24bn (vs. NGN156.55bn in Q1:2022). In addition to lower demand, other factors highlighted below prompted the drop in bottom-line:

Higher cost of production (+5.44% YoY) due to higher inflationary pressures. However, we note the slowdown in energy costs, which constitute a substantial portion of direct costs, in line with our expectation in our 2023FY outlook. This was supported by declining energy prices and cement players' dedicated efforts towards adopting alternative fuel sources. Thus, energy cost to cost of goods sold (COGS) ratio reduced to 40.67% (vs. 43.25% in Q1:2022).

Secondly, elevated operating cost (+19.23%) pressured earnings. Selling, distribution and administrative expenses by industry players contributed to the significant increase in OPEX during the period. Specifically, BUACEMENT and DANGCEM's operating cost spiked +100.53% and +12.59% respectively, reducing their EBITDA margin to 36.09% and 38.59% (vs. 43.69% and 44.24% in Q1:2022) respectively.

Meanwhile, with the industry capacity still at 53.80MMTPA and capacity utilisation of c.12% as of Q1:2023, cement players have continued to intensify capacity expansion efforts. Precisely, BUACEMENT's 3MMTPA plants in Kalambaina, Sokoto state and Obu, Edo states are projected to come on stream by the end of 2023, while DANGCEM's 6MMTPA newly purchased plant in Itori Ogun state is expected to commence production in late-2025.

Chart 37: Installed Capacity of Cement Manufacturers



Source: Companies' Filings, Meristem Research

Despite the slowdown in industrial activities in Q1:2023, we maintain a positive outlook for the sector by 2023FY as a lot factors that necessitated the slow down wanes.

Positive Drivers:

- *Projected increase in sales volume as manufacturers capitalize on expansion of installed capacity and extend their distribution networks within and outside Nigeria to meet growing demands.*
- *Further reduction in energy costs given the general expectation of a drop in energy prices.*
- *Increase in infrastructural expenditure evinced by the 10% increase in CAPEX to NGN6.45trn in the 2023 budget.*
- *Potential collaboration between local cement manufacturers and the Nigerian Building and Road Research Institute (NBRRI), as highlighted in the PAC, to commercialise domestic building materials.*

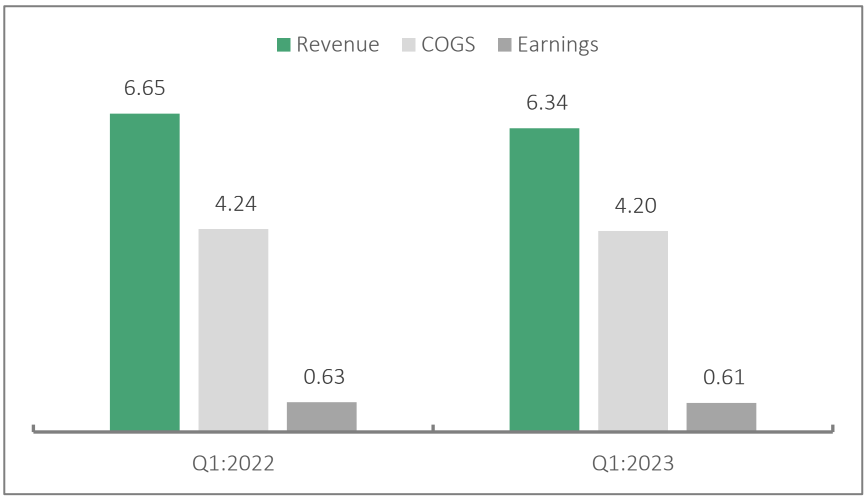
Key Risks:

- *Increased inflationary pressures is a major drag on production costs.*
- *Naira devaluation initiated by the new administration to float the exchange rate, could pressure finance costs and borrowings, particularly for companies like DANGCEM and BUACEMENT with foreign currency-denominated debt.*

Paint Sub-Sector

Paint manufacturer's performance also exhibited a similar trend to that of the cement industry players. As a result of the contraction in real estate sector, the combined revenue of listed paint players (CAP, BERGER, and MEYER) in Q1:2023 decreased to NGN6.34bn, a 4.66% decline from NGN6.65bn reported in Q1:2022. The primary factor influencing this decline was the significant reduction in consumer spending a consequence of prevailing cash crunch witnessed during the period. Although, industry players recorded marginal decrease (0.91% YoY) in production cost, Finance cost surged (+235.97% YoY) due to high interest on asset finance facilities. Thus, industry's earnings decline by 2.51% YoY to NGN611.42mn during the period.

Chart 38: Cumulative Performance of Listed Paint Players in Q1:2023 vs. Q1:2022 (NGN'bn)



Source: Company Financials, Meristem Research

Whilst we maintain a positive outlook for the paint manufacturers in 2023FY, especially with the expected expansion in the real estate sector. Significant rise in the direct costs as inflationary pressures persist and the imported dependent nature of paint manufacturers remain key risks.

Fundamentals and Valuation Metrics

	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Exp Div Yield	Target PE	2023 TP	CP	UPP	RT
DANGCEM*	0.60	24%	33.0%	14.0%	2.29x	22.65	69.17	12.58x	4.12x	7.32%	6.54x	331.91	290.00	14.45%	BUY
WAPCO*	0.64	16%	12.1%	9.0%	1.35x	3.17	26.76	9.09x	1.08x	4.66%	5.07x	34.69	29.95	15.83%	BUY
BUACEMENT*	0.41	12%	23.9%	12.4%	2.13X	4.95	12.14	18.65	7.13	2.32%	16.45x	80.23	91.00	-11.84%	SELL
CAP	1.43	12%	35.2%	20.4%	2.03X	2.65	8.10	7.24	2.37	10.43%	8.13x	21.16	19.25	9.92%	BUY
BERGER	1.15	3%	6.3%	3.8%	1.66x	1.04	11.95	9.62x	0.84x	6.89%	11.00x	11.00	11.00	0.00%	HOLD

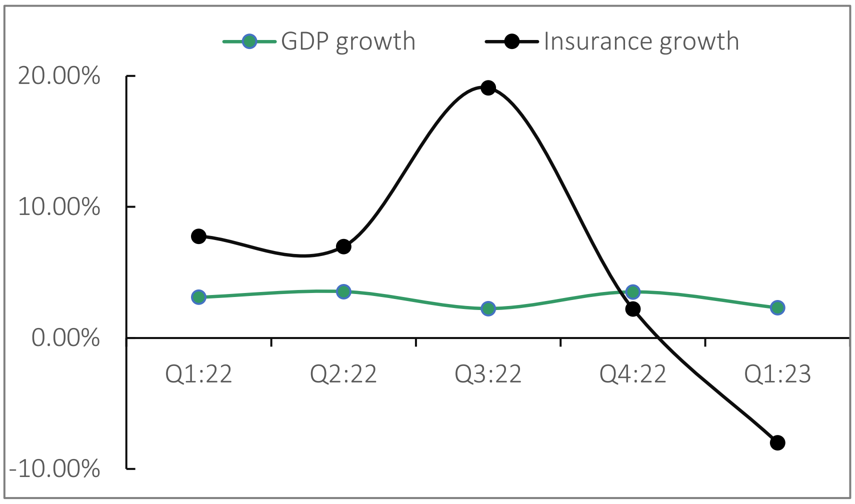
*Exp. EPS: EBITDA per Share Target PE: EV/EBITDA

Insurance

Reshaping Expectations, Defying Conventional Patterns

The insurance sector mirrored the overall slow-down in economic activities in Q1:2023 as the sectors' real GDP declined by -8.01% (vs. 7.77% in Q1:2022) reversing seven (7) consecutive quarters of growth. The resultant effect of the cash crunch witnessed during the period impacted consumer wallet and slowed the demand for insurance products during the period

Chart 39: GDP Growth and Insurance Sector Growth



Source: NBS, Meristem Research

However, despite the decline in the sector's output, insurance players were able to sustain the growth of their core premium income (up 39.14% YoY to NGN311.54bn). The growth was propelled by expansion in the life (+29.35% YoY) and non-life (35.49% YoY) business segment with the non-life business contributing (68.38% YoY) to overall premium income. Specifically, along product lines, the group life insurance (+66.63% YoY), motor insurance (+65.96%YoY), fire insurance (+65.80% YoY), general accident (+65.06% YoY), oil & gas (30.36% YoY), were major catalyst for the growth witnessed during the period. Subsequently, the sector recorded improvement in underwriting profitability (+49.34% YoY gleaning from financial records of listed players in Q1:2023) especially as a result of significant reduction in claims payment (35.40% YoY) which further buttress reduced activities within the sector during the period. Thus, claims ratio reduced to 30.62% (33.67%% in Q1:2022) , while underwriting margin improved to 27.32% (vs. 20.67% in Q1:2022).

We also noted reduction in provisioning for life and annuity funds (62.05%) especially as the fixed income yield environment favoured lower actuarial valuations for this fund.

On the flip side, the industry bottom-line took a hit with a decline (13.31% YoY to NGN13.02bn gleaning from the financial records of listed players) in after-tax-profitability despite the strong investment income (+70.02% YoY) recorded during the period. Increase in operating cost (14.84% YoY) due to the high inflationary environment and significant fair value losses (NGN14.72bn) owing to reduction in prices of financial assets dragged the earnings of insurance players in Q1:2023.

For the rest of the year, we maintain a modest outlook for the insurance sector.

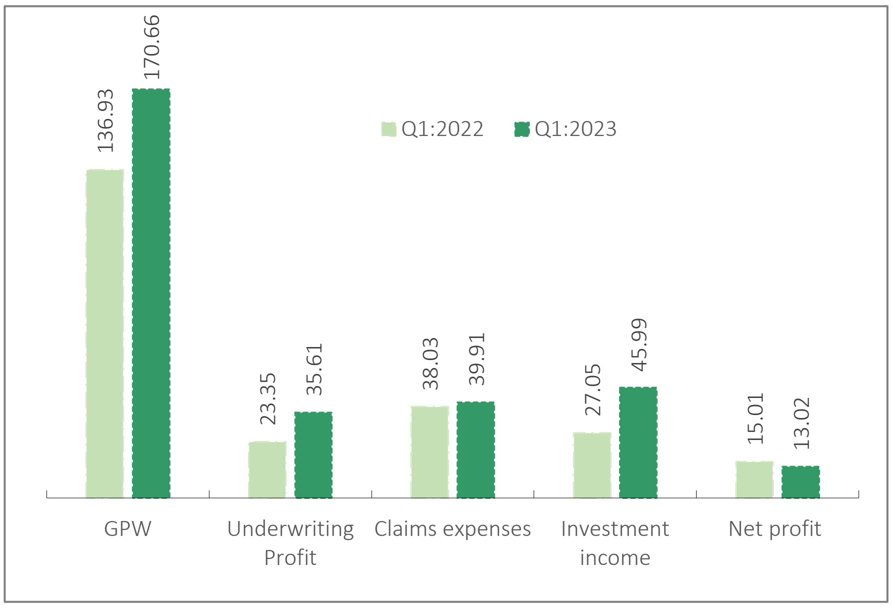
Drivers:

- *Expansion in core premium income as general economic activities improve and insurance players sustained efforts to scale up their businesses with adoption of technological tools. Also, the growth in life segment, especially the health insurance business, as well as non-life business is expected to support premium income.*
- *Increase in interest income is expected to bolster investment income of players within the sector.*

Risk to Outlook:

- *Possibility of increase in provisioning for life and annuity fund given the expected volatility of yields in the fixed income space.*
- *High claims and operating expenses given the persistent inflationary pressures is expected to drag earnings performance of the sector.*
- *Also, fair value losses is expected to constitute a major drag to performance.*

Chart 40: Key Metrics of Listed Insurers (Q1:2022 vs Q1:2023 (NGN' bn))



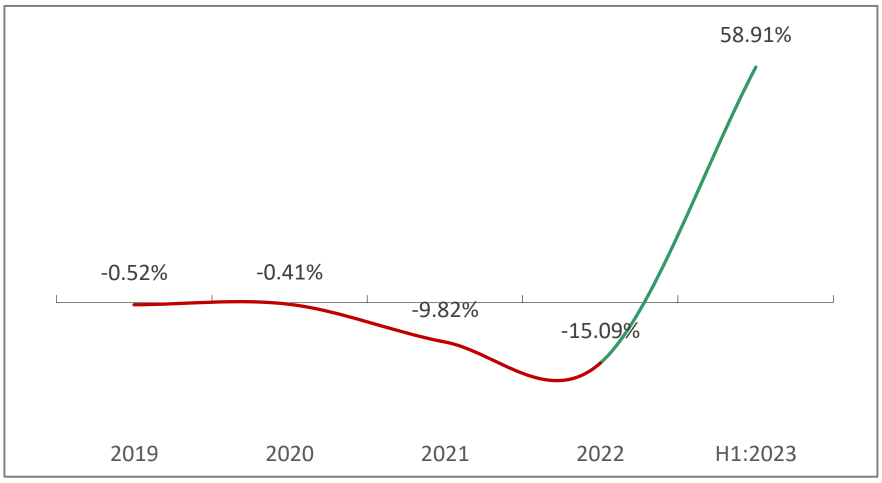
Source: Company filings, Meristem Research

From Shadows to Spotlights

The insurance index (NGXINS) recorded a remarkable performance (second best performing index on the NGX) in the first half of the year (+58.91% YtD return) reversing four (4) years of negative returns on the NGX. Impressive corporate performances (dividend payment and increased dividend yield) spurred positive sentiment on the index. Also, while uncertainties around the recapitalization of the industry waned, the pro-market policy stance of the new administration further prompted confidence and incentivized investors to take position on tickers in the sector. Comparative analysis of the index with its peers in other countries signal that the index is still underbought with more room for bargain hunting.

For context, while the price to earnings (PE) of the index improved to 6.50x (vs. 5,60x in H1:2022), it lagged its peers; South Africa (11.39x), Brazil (9.30x), China (11.40x), India (39.10x), Morocco (13.80x), Malaysia (9.60x). For the rest of the year, we expect the positive sentiment around the index to remain, premised on improved corporate performance of players in the sector.

Chart 41: Insurance Index Return in H1:2023



Source: Bloomberg, Meristem Research

Table 10: Returns on Insurance Tickers in H1:2023

TICKER	Price Appreciation	Dividend Yield	Total Return
AIICO	167.75%	4.05%	171.80%
CORNERST	83.33%	5.41%	88.74%
CUSTODIAN	26.05%	8.21%	34.26%
LASACO	192.13%	6.52%	198.65%
MANSARD	69.50%	7.32%	76.82%
NEM	42.22%	4.76%	47.01%
WAPIC	97.62%	-	97.62%

Valuation and Fundamental Metrics

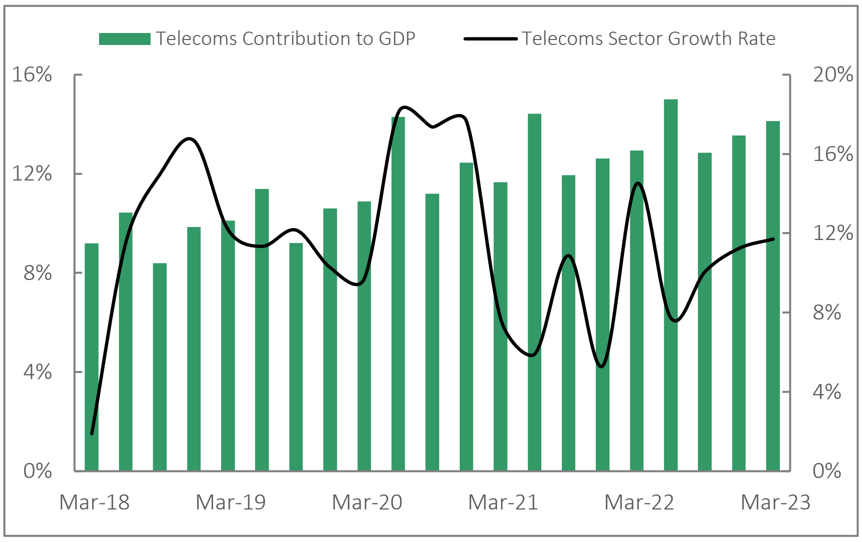
	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Exp Div Yield	Target PE	Exp. EPS	2023 TP	CP	UPP	RT
AIICO	0.3	4%	9%	1%	6.3	0.11	1.22	6.79x	0.61x	4.23%	5.65	0.14	0.79	0.70	+12.86%	BUY
CORNERSTONE	0.4	14%	14%	6%	2.4	0.18	1.24	6.16x	0.89x	4.96%	4.82	0.17	0.80	1.02	-21.57%	SELL
CUSTODIAN	0.5	10%	15%	5%	2.9	1.87	12.69	3.59x	0.53x	9.67%	4.00	2.07	8.29	7.50	+10.02%	BUY
LASACO	0.5	10%	11%	5%	2.1	0.81	7.26	2.84x	0.32x	5.66%	2.50	0.87	2.16	2.06	+3.55%	HOLD
MANSARD	0.6	5%	11%	3%	3.7	0.20	1.86	20.76x	2.21x	6.22%	11.20	0.30	3.34	3.84	-13.02%	SELL
NEM	0.6	21%	23%	12%	1.8	1.34	5.98	4.68x	1.05x	5.28%	4.70	1.24	5.81	6.05	-3.97%	HOLD
WAPIC	0.4	37%	37%	16%	2.2	0.29	0.78	2.29x	0.84x	-	8.61	0.06	0.54	0.66	-18.73%	SELL

Telecommunications

Telecoms Sector Growth Dials Up

Despite the cash crunch which negatively impacted activities of cash subscribers in Q1:2023, the telecoms sector maintained its growth momentum (+11.71% YoY) during the quarter. Also, the sector's contribution to GDP increased to 14.13% (vs. 12.94% in Q1:2022 and 13.55% in Q4:2022). The expansion in output is attributable to the increase in subscriber base, which peaked at 227.18 million in February (the highest on record) and concerted effort of operators to increase adoption of services

Chart 42: Telecommunications Sector Growth and Contribution to GDP



Source: NBS, NCC, Meristem Research

Supercharging Connectivity

With the acquisition of 5G spectrum at the start of the first half, AIRTELAFRI joined MTNN to become the second Mobile Network Operator to commence 5G services in the country. MTNN which pioneered the 5G network roll-out with the pilot launch in Q3:2022, has strategically rolled out its services in different regions in the country, reaching a 5G population coverage of c. 4% in Q1:2023.

We expect the increasing demand for the network and rollout to support adoption. Furthermore, the higher revenue per user from 5G network and lower marginal roll-out cost should increase revenue and profitability of the data segment.

Debt Quandary: Telcos Tug Banks

The dispute between Mobile Network Operators and Deposit Money Banks was revisited in H1:2023, as the telcos under the Association of Licensed Telecommunication Operators threatened to disconnect banks from the USSD services, due to unpaid debt which has risen to NGN120.00bn.

We envisage that the banks and MNOs will reach a resolution including a repayment plan of the debt which should span over a period of time. This is considering the importance of the USSD infrastructure to the operations of the DMBs.

Financial Performance

Telcom Operators defied macroeconomic headwinds to report an impressive topline performance in Q1:2023. Both listed companies MTNN and AIRTELAFRI recorded revenue growth of 20.63% YoY and 9.74% YoY respectively. However, heightened cost pressures (particularly impacted by rising energy costs and currency depreciation) constrained average EBITDA margin to 51.51% from 51.87% in Q1:2022). Furthermore, the surge in finance costs (due to higher foreign exchange losses, increased borrowings and prevailing rate environment) contracted earnings. MTNN reported a 4.63% YoY growth in net profit (lowest YoY Growth since Q2:2020), while AIRTELAFRI's earnings declined by 5.42% YoY. Consequently, average net margin declined by 544bps to 34.76%.

Our prognosis is for the economic reforms being implemented by the present administration to constitute tailwinds to telcos financial performance in the near term. Firstly, the increased exchange rate on the official window will lead to significantly higher Capital Expense (which is borne in USD and was sourced at official rates), lease related expenses settled in dollars and finance cost on foreign denominated debts. Also, the removal of fuel subsidy and ensuing inflation should also pressure operating expenses.

Valuation and Fundamental Metrics

	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Exp Div Yield	Target PE	Exp. EPS	2023 TP	CP	UPP	RT
MTNN	0.7	17%	83%	12%	7x	17.86	21.41	14.87x	12.40x	5.82%	15.40x	19.94	307.13	274.00	+12.09%	BUY
AIRTELAFRI	0.5	14%	20%	7%	3x	199.57	1,013.26	6.35x	1.25x	1.36%	3.96x	315.41	1,249.02	1,319.00	+12.29%	BUY

Global Fixed Income

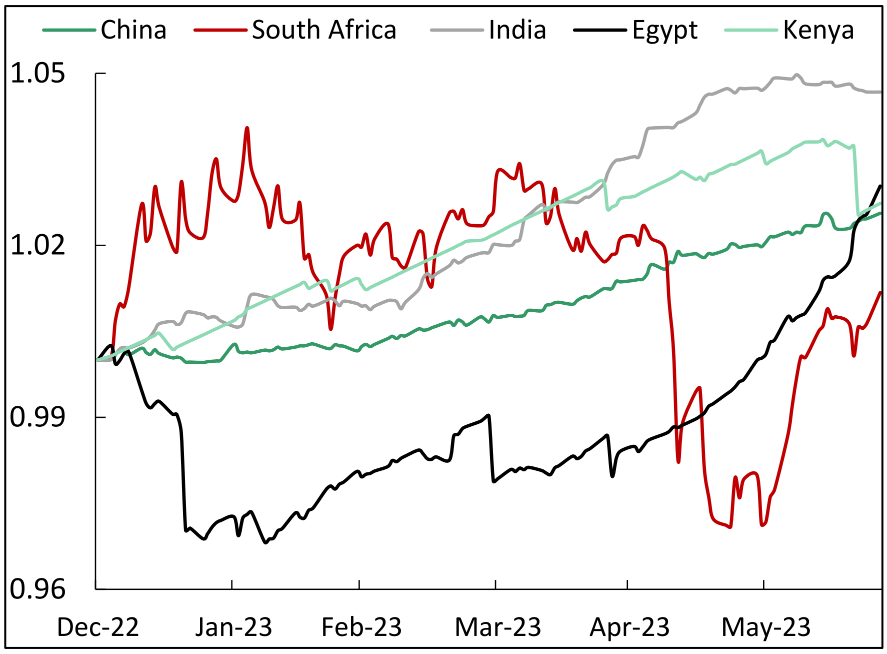
Sustained Positive Returns in H2:2023

The global fixed income market reversed its negative returns from 2022 recording positive gains in H1:2023 (as highlighted in table 6 below). Although the market witnessed high yield volatility during the review period (especially as a result of the banking financial crisis which caused market jitters), factors such as moderation in inflation, and expectation of a less aggressive monetary policy drove the market during the first half of the year.

While the story remains the same for advanced markets especially with the conversation of increasing debt ceiling in the USA and firm commitment of the UK to sustain their contractionary policy stance, average bond yield in the USA and UK rose by 51bps and 136bps to 4.68% and 4.86% respectively as of H1:2023.

For emerging markets, there is a trickle-down effect of factors from the global financial markets including hike in policy rates. Internal issues such as foreign exchange illiquidity and debt sustainability issues have also continued to plague the region. Nevertheless, there was a record of positive returns although divergent across countries.

Chart 43: S&P Emerging Debt Markets Bond Price Indices



Source: S&P, Meristem Research

For H2:2023, we expect the global fixed income market to sustain its positive return and gradual decline in yields for the rest of the year. Continuation of the aggressive monetary policy as central banks grapple with sticky inflation, and the risk of slow growth is expected to shape the market. Thus, the yield curve is expected to remain inverted until there is a signal of a monetary policy pivot. Also, we maintain that the emerging fixed income market will continue to be influenced by inflation and growth (major monetary policy determinants) dynamics in developed markets.

Table 11: Market Performance Across Global Fixed Income Markets in H1:2023

Global Government Bonds	Corporate Bonds				Emerging Market Bonds
	US	UK	Europe	High Yield (HY)	
Bloomberg Global Aggregate Treasuries (USD Hedged)	Bloomberg Global Aggregate USD Corporate (USD Hedged)	Bloomberg Global Aggregated GBP Corporate (USD Hedged)	Bloomberg Global Aggregate EUR Corporate (USD Hedged)	Bloomberg Global High Yield (USD Hedged)	JP Morgan Emerging Markets Bond Index EMBI Global Diversified (USD Hedged)
3.52%	2.88%	2.69%	1.55%	4.44%	4.05%

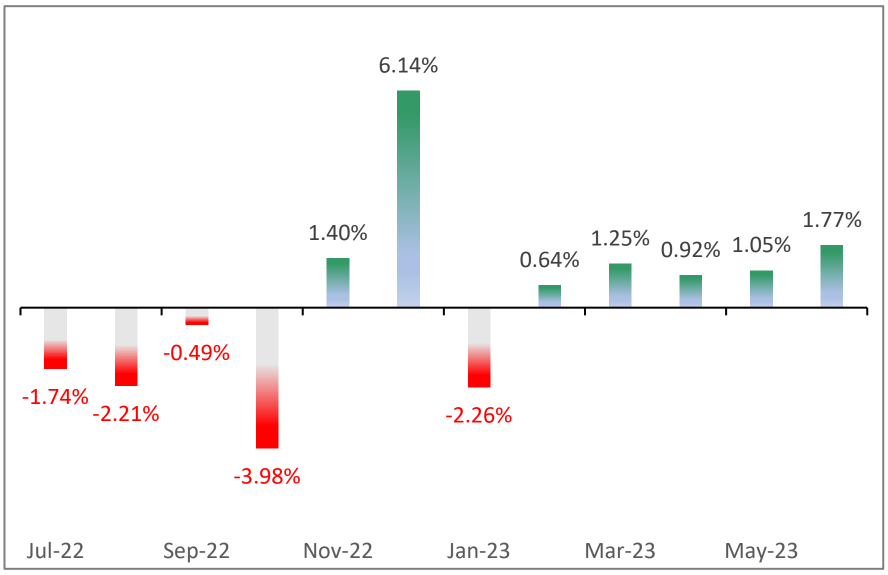
Source: Bloomberg, Meristem Research

Domestic Fixed Income

Mixed Sentiment, Positive Returns

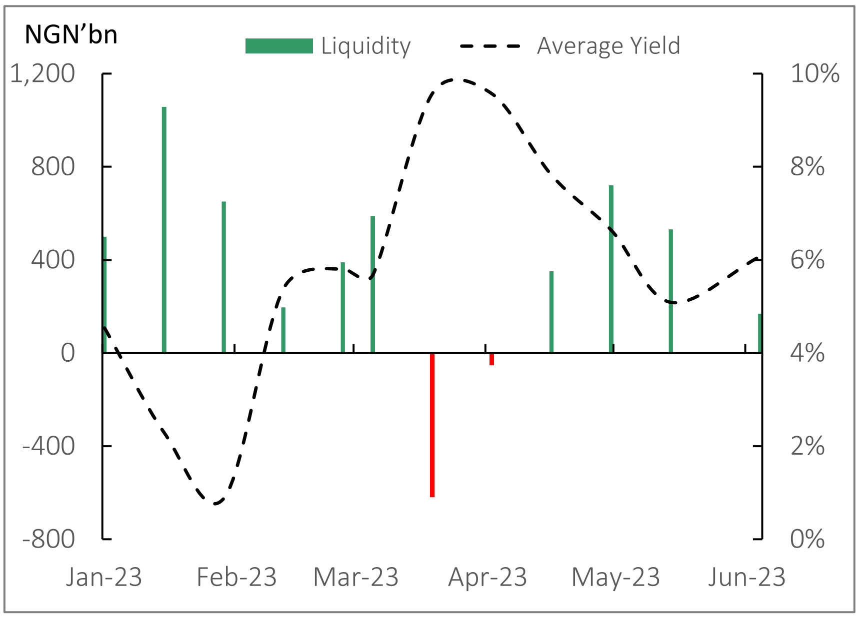
The Nigerian fixed-income market has experienced some volatility this year. Particularly, the Moody's credit rating downgrade to Caa1 at the beginning of 2023 had limited adverse effects on demand for Nigerian treasury instruments, especially longer-tenor ones. As a matter of fact, the surplus interbank liquidity from FAAC disbursements and substantial coupon payments initially drove bullish trends in the local debt markets. However, the momentum was short-lived due to the CBN's heavy CRR debits on banks, leading to a prolonged period of negative liquidity for 21 consecutive trading days and historic low liquidity levels of NGN588.74bn. Consequently, average T-bill and bond yields reached a year-high in April at 9.57% and 15.00%, respectively. However, the new administration's reforms and policies revived investors' confidence in Treasury instruments. As a result, the S&P/FMDQ Nigeria Sovereign Bond Index, which tracks Naira-denominated Sovereign debt, returned +3.79% in Q2:2023 compared to -0.41% in Q1:2023. Overall, the Nigerian fixed-income market remained predominantly bearish in Q1:2023 but recovered in the second quarter, benefiting from policy reforms.

Chart 44: Monthly Returns of S&P FMDQ Nigeria Sovereign Bond Index



Source: S&P Global, Meristem Research

Chart 45: Liquidity and Average T-Bills Rates



Source: CBN, Meristem Research

The underlying forces in the primary market were largely alike to those of the secondary market, experiencing some volatility driven primarily by liquidity. Notably, the average liquidity level during this period was NGN322.83bn. Thus, at the start of the year, average stop rate plummeted to 0.88% - least since 2020 before rising to 6.08% as of June 14. Across the instruments, stop rate on the 91-Day, 182-Day, and 364-Day instruments settled at 4.89%, 5.12%, and 8.24% in H1:2023 (vs 2.75%, 7.15%, and 6.13% at the end of 2022), respectively.

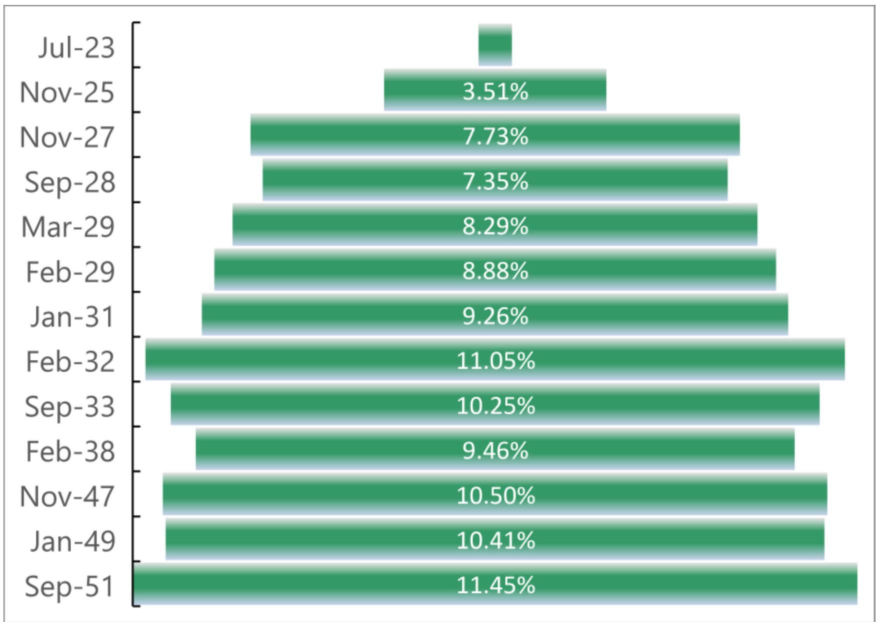
In a bid to manage the Federal Government's debt maturity profile and fiscal sustainability, the DMO issued three new FGN bonds (Jun 2033, Jun 2038, and Jun 2053). This is the highest new FGN bond issuance made in the first half of year for over a decade. This further solidifies the new administration's clear intention to issue long-term, high-yield debt securities, particularly Special Purpose Bonds, dedicated to specific projects and initiatives in sectors like agriculture and industry. As for the marginal rate during the period, the range settled between 13.90% and 16.00%.

Eurobonds

The international market was very active during the period, as several factors contributed to the occasional swings witnessed. These factors include the multiple rate hikes by the U.S. Fed, the global banking crisis, global economic growth outlook, and the economic reforms executed by the new Nigerian president. In Q1:2023, the concerns around global financial stability and the general elections in Nigeria adversely impacted investors' sentiment towards USD-denominated instruments. Thus, sell-offs on the Eurobond instruments pushed average yields upward to 11.73% in Q1:2023 (vs 11.52% at the end of 2022). Similar to the upbeat mood in the domestic market, the Nigerian Eurobonds enjoyed a new wave of market optimism.

Notably, the longer-dated Eurobonds (Feb-32, Nov-47, Jan-49, and Sep-51) appreciated the most in the second quarter of 2023. Overall, average Eurobond yield declined to 9.63% as of June 29.

Chart 46: H1:2023 Performance of Nigerian Eurobonds



Source: DMO, Meristem Research

Commercial Paper and Corporate Bonds

In H1:2023, there was a reduction in the number of corporate issuances of long-tenor debt instruments, which we attribute to the prevailing high-interest environment. According to data from the FMDQ, there were only two new corporate bond issuances during the period, as against eight in H1:2022.

Conversely, the commercial paper (CP) market experienced a surge in activities as companies sought to address their working capital and financing needs amidst the cash crunch at the beginning of the year. The number of new CP issuances listed on the FMDQ Exchange increased significantly by 89.09% to reach 104 issuances in H1:2023, with a total value of NGN786.80bn raised, compared to 55 issuances with a total value of NGN498.52bn in H1:2022.

Following our analysis, we maintain a positive outlook for the fixed income market. Specifically, we assert that year-end yields of the treasury instruments will be lower than the current levels.. This expectation is supported by key drivers, including the Government's unequivocal commitment to finance its growth initiative through credit facilities.

On the demand side, the removal of cap and floor on interbank placements, along with the drive for a less aggressive discretionary cash reserve ratio debits will further push system liquidity higher. Thus, it is anticipated that the improved liquidity should continue to drive yields downward, especially in the T-bills market Additionally, our expectation of a less aggressive monetary tightening in the second half of the year should be a contributing factor.

Specifically, we expect the continued implementation of economic reforms and policies by the new administration to attract both domestic and foreign investors to the local debt market. Thus, we remain bullish on short-dated treasury notes and Eurobond instruments (Feb-32, Nov-47, and Sep-51).

Fixed Income Strategy

To determine the relevant and appropriate strategy to implore, we considered several factors in the global and local debt markets.

In the global market, we highlight that the expectation of disinflation and possibility of monetary pivoting will increase the attractiveness of Treasury instruments. In addition, the increasing risk of recession will likely favor investment grade instruments than high yield instruments. Additionally, we advise investors to remain cautious of emerging market debt instruments, considering the increased volatility across these economies.

For the domestic debt market, we considered the Government's preference to finance its fiscal deficit through borrowings from the local debt market, the drive for lower interest rate, and likelihood for more robust interbank liquidity.

*Based on our reflections, we maintain that **Duration management** is the essential strategy to explore in 2023. Expressly, our **recommendation is that investors should take a long position in short-dated Treasury instruments and Eurobond instruments.** This strategy allows investors to benefit from the expected fall in yields on the instruments. For corporates, we advise cautious and selective investment in line with our outlook for the respective sectors of the economy.*

To balance interest rate, liquidity and default risks in a fixed income portfolio context, we recommend the following:

Table 12: Fixed Income Portfolio Recommendation

Instrument Type	Proportion	Duration	Remark
Eurobonds	Overweight	Modest	Hedge against Naira depreciation, Low Liquidity
Commercial Papers	Overweight	Moderately High	Competitive Real Rate of Return, Low Liquidity
Corporate Bonds	Underweight	Moderately High	Modest Real Rate of Return, Low Liquidity
Treasury Bills	Overweight	Moderately High	Low Real Rate of Return, highly liquid
FGN Bonds	Neutral	Moderately High	Low Real Rate of Return, highly liquid

Table 13: Recommended Nigerian Local Bonds

FGN BONDS	Closing Yield	Coupon	Duration	2023FY Forecasted Yield
16.2884 17-MAR-2027	12.06%	16.29%	2.98	11.56%
13.98 23-FEB-2028	12.00%	13.98%	3.58	11.76%
15.00 28-NOV-2028	12.09%	15.00%	3.84	11.69%
14.55 26-APR-2029	12.14%	14.55%	4.27	11.65%
12.49 22-MAY-2029	12.21%	12.49%	4.45	11.76%
8.50 20-NOV-2029	12.45%	8.50%	4.76	12.03%
10.00 23-JUL-2030	12.82%	10.00%	4.74	12.42%

Table 14: Recommendation on African Countries' Eurobonds

Countries	Macro Fundamentals	1-yr Default Probability	1-yr Default Risk	Credit Ratings	Comment
Angola	**Moderate** (Weak growth; improving revenue outlook; high inflation rate)	8.49%	Moderate	B3 (Moody's) B- (Fitch)	R
Egypt	**Moderate** (Moderate growth; unstable revenue outlook; high inflation rate)	6.08%	Moderate	B3 (Moody's) B (Fitch)	NR
Ghana	**Weak** (Moderate growth; unstable revenue outlook; high inflation rate)	10.06%	High	Ca (Moody's) C (Fitch)	NR
Kenya	**Moderate** (Moderate growth and revenue outlook; moderate inflation rate)	5.57%	Moderate	B3 (Moody's) B (Fitch)	R
Nigeria	**Moderate** (Moderate growth; unstable revenue outlook; high inflation rate)	0.38%	Low	Caa1 (Moody's) B (S&P)	R
Rwanda	**Strong** (Strong growth and revenue outlook; high inflation rate)	3.85%	Moderate	B2 (Moody's) B+ (Fitch)	R
South Africa	**Moderate** (Weak growth; improving revenue outlook; moderate inflation rate)	3.20%	Moderate	Ba2 (Moody's) WD (S&P)	R
Zambia	**Moderate** (Moderate growth and revenue outlook; moderate inflation rate)	10.77%	High	Ca (Moody's) CCC (Fitch)	NR

R = Recommended; NR = Not Recommended

N.B: The 1-yr Default Probability Risk was calculated using Bloomberg DRSK Model

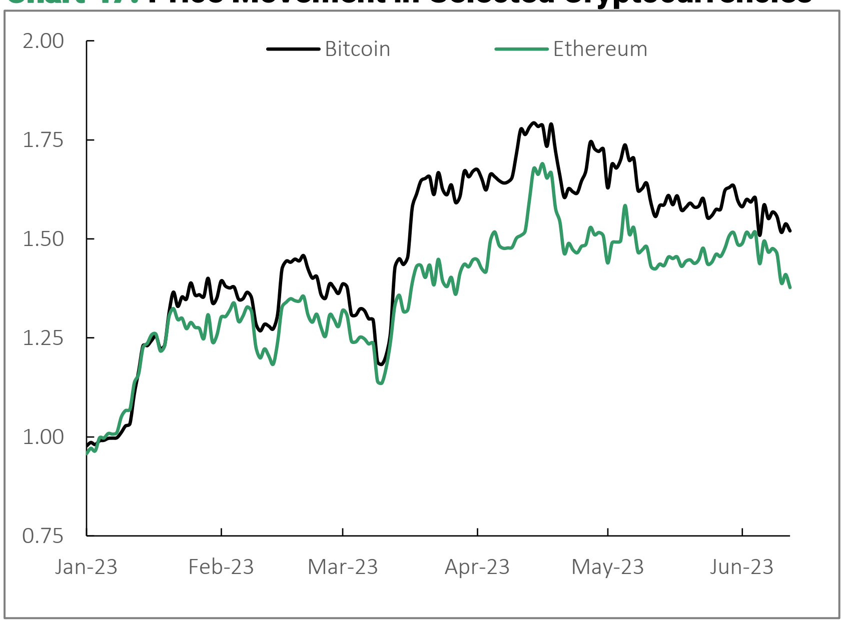
Alternative Investments

Cryptocurrency

A Year of Opportune Risks?

2023 has been very bullish in the crypto universe, with prices trending upwards contrary to the bearish sentiments from last year (as bitcoin lost -65.06% in 2022) when volatility and market uncertainties drove investors to safe havens. The optimism in the market was driven by an expectation of a less aggressive monetary policy. As a result, the prices of Bitcoin and Ethereum increased by 83.05% and 60.28% to USD30,390.91 and USD1,927.01 respectively, as of June 30. Interestingly, the upward movement in prices has been supported by low volatility, indicating that investors are beginning to see possible stability in the direction of crypto prices. For context, according to Bloomberg, the Bitcoin volatility index hit a historic low in May 2023 (50.64pts).

Chart 47: Price Movement in Selected Cryptocurrencies



Source: Bloomberg, Meristem Research

A highlight in the crypto ecosystem has been whether cryptocurrencies can be considered an investment security. During the review period, the Securities and Exchange Commission (SEC) sued major crypto exchanges in the U.S. – Binance U.S. and CoinBase, with allegations of not registering with the commission as they offer security-related services to their clients. While investors' pessimism caused an initial fall in crypto prices, especially stablecoins, the mood reversed not long after.

Furthermore, the domestic crypto ecosystem has received a boost with the approval of a national blockchain technology policy. The policy seeks to set a roadmap for the adoption and utilization of blockchain in Nigeria. The major focus area includes talent development, innovation, and adoption. As a result, we expect a gradual integration of blockchain into the financial services sector and other areas of national life.

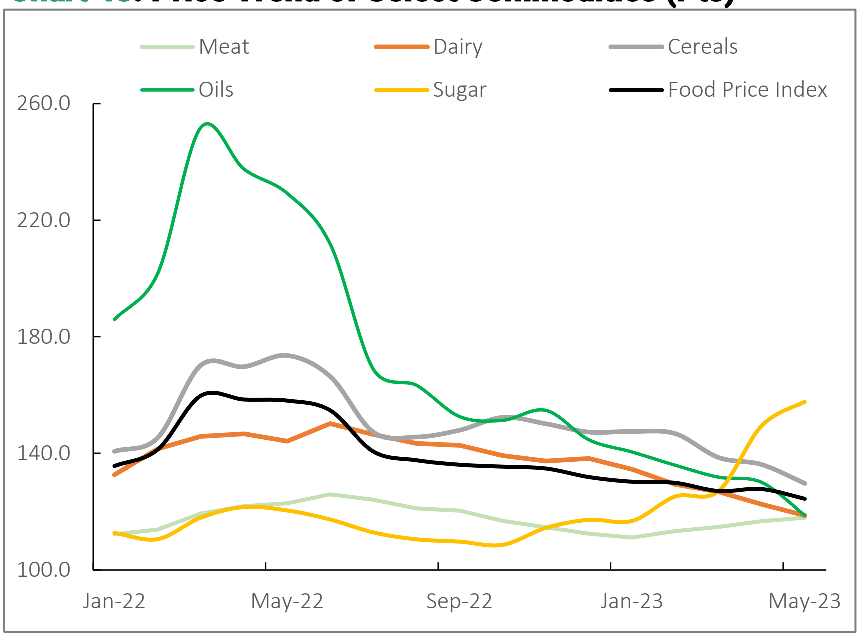
"For the rest of the year, we expect the macroeconomic environment and the outcome of SEC's lawsuit to determine the direction of the market. Consequently, market makers will be on the lookout to avoid a similarity with the FTX collapse last year. Furthermore, we note the growing concerns around a global recession and opine that it constitutes a downside risk to the continued bullish sentiments. On the other hand, a peaceful resolution, and cessation in monetary policy rate hikes may see the crypto ecosystem continue its bullish for much longer."

Commodities

Global Food Prices Trend Exposed to Significant Risk

According to FAO, global food prices declined by 20.94% YoY as of June 2023, driven by ease in the global supply chain. Across the commodities that make up the basket (Meat, Dairy, Cereals, Oils, and Sugar), sugar bucked the trend as the price index rose by 29.73% YoY as of June 2023. The increase in the price of sugar can be attributed to adverse weather conditions in major sugar-producing countries (Brazil and Thailand) which have impacted supply.

Chart 48: Price Trend of Select Commodities (Pts)



Source: FAO, Meristem Research

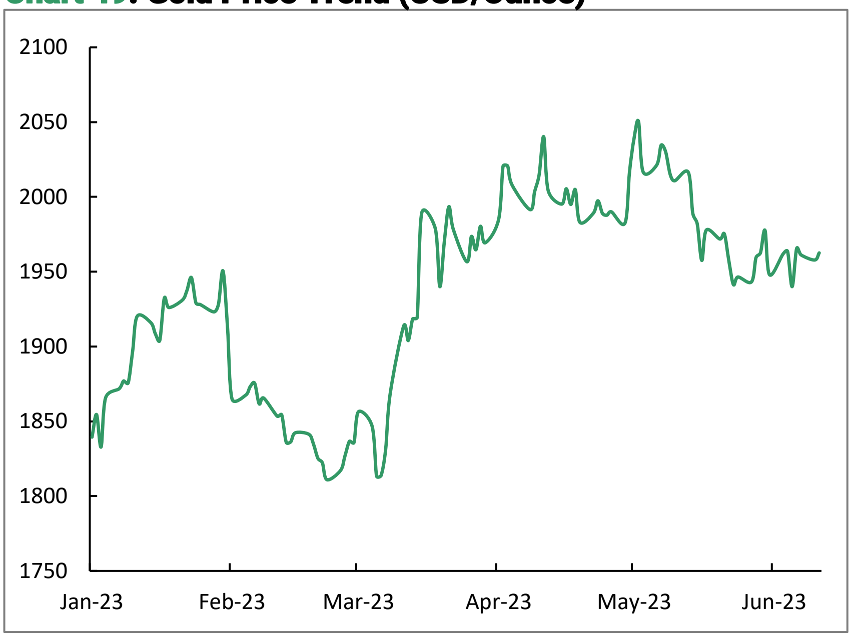
For 2023FY, we anticipate lower food prices driven by the increase in the supply of cash crops. Nonetheless, key risks to this outlook include the uncertainty surrounding the black sea grain deal, geopolitical conflicts, and persisting weather conditions (El Niño-Southern Oscillation (ENSO) in some regions that may affect commodities output in specific countries.

Precious Metals

Gold Market Emerges as Safe Haven Amidst Economic Turmoil

After Silicon Valley Bank (SVB) collapsed in Q1:2023, accompanied by a hawkish monetary stance, inflationary pressures, and global economic uncertainties, investors turned to the precious metal space as an alternative investment option. Consequently, the gold market experienced significant buying activities, prompting a 5.23% price increase as of June 30, 2023.

Chart 49: Gold Price Trend (USD/Ounce)



Source: Bloomberg, Meristem Research

We envisage a marginal improvement in gold prices in H2:2023. Our outlook is hinged on the expectation of global inflation remaining stubbornly above the target of the monetary authorities which should spur buying activities on gold as investors seek to hedge against inflation. Nevertheless, the rate hike response by monetary authorities to combat inflation would enhance the attractiveness of other investments that are considered safer havens such as bonds.

Real Estate

Housing Prices To Remain Elevated

Investors' confidence in the real estate market has been at a low level across major economies worldwide, including the US, UK, Eurozone, and China. Lower confidence in the advanced economies (US, UK, and Eurozone) was sparked by the negative effects of higher interest rates on mortgage prices, which led to higher borrowing costs and decreased valuations in the sector. Additionally, the acceptance of a hybrid work or a full work-from-home environment also had a detrimental impact on commercial premises. Following China's real estate crisis, the market has been battling to pick up steam. This can be linked to the aging population and slow income growth, which have affected demand despite the government's expansionary monetary policy and budgetary steps to support the industry. Consequently, in H1:2023, most of the global Real Estate Investment Trust (REIT) indices showed losses.

Table 15: Price and total returns on some global REITs

REITs	Price Return	REIT Total Return
S&P Global REIT	0.37%	2.70%
S&P China A 1800 Real Estate Index	-14.46%	-13.43%
Dow Jones U.S. REIT Index	3.62%	5.77%
U.K. BMI	-10.05%	-7.92%
Dow Jones Europe RESI	-12.11%	-7.48%

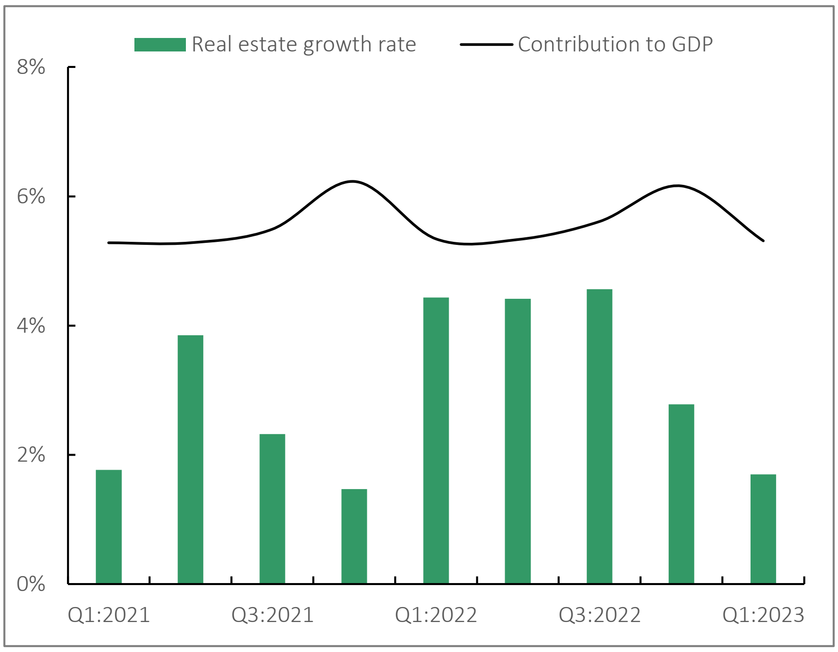
Source: S&P Global, Meristem Research

Based on the expectation of further monetary policy tightening, we envisage that mortgage prices will remain elevated in advanced economies resulting in further weakening of demand and lower prices. On the other hand, we envision a slow recovery in China's real estate sector.

Dampened Real Estate Sector Performance

The domestic real estate sector experienced slower growth of 1.70% YoY in Q1:2023 (vs. 4.44% YoY in Q1:2022). This represents the lowest performance since Q4:2021 and can be attributed to lower disposable income due to rising inflation in the economy.

Chart 50: Real Estate Contribution to GDP and Growth Rate Trend



Source: NBS, Meristem Research

Also, rising interest rates adversely impacted borrowing costs, created a challenging environment for the industry, and contributed to slower growth. These factors have resulted in reduced demand for real estate properties and an increase in housing costs and property development.

We project a slowdown in the growth rate of the real estate sector for 2023FY. This is premised on the adverse impact of rising inflation on the disposable income of consumers which is expected to impact demand. Also, higher borrowing costs pose a major risk to financing in the sector. However, the increasing population of the country presents an opportunity for growth in this sector.

Glossary

Abbreviation	Full Meaning
ASI	All Share Index
BOE	Bank of England
CBN	Central Bank of Nigeria
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DMO	Debt Management Office
ECB	European Central Bank
FAO	United Nation’s Food and Agriculture Organisation
FCY	Foreign Currency
FDI	Foreign Direct Investment
FGN	Federal Government of Nigeria
FPI	Foreign Portfolio Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
LSE	London Stock Exchange
MBPD	Million Barrels Per Day
MDA	Ministries, Departments, and Agencies
MMTPA	Million Metric Tonnes Per Annum
MPC	Monetary Policy Committee of the Central Bank of Nigeria
MPR	Monetary Policy Rate
MSCI	Morgan Stanley Composite Index
NAICOM	National Insurance Commission
NBS	National Bureau of Statistics
NEPL	NNPC Exploration and Production Limited
NGIC	NNPC Gas Infrastructure Company
NGML	NNPC Gas Marketing Limited
NGX	Nigerian Exchange Limited
NNPCL	Nigerian National Petroleum Company Limited
NSMP	Nigerian Sugar Master Plan
NUPRC	Nigerian Upstream Petroleum Regulatory Commission
OPEC+	Organisation of Petroleum Exporting Countries and its Allies
PMI	Purchasing Managers’ Index
QoQ	Quarter-on-Quarter
QtD	Quarter to Date
UNCTAD	United Nations Conference on Trade and Development
UN	United Nations
US Fed	United State Federal Reserves
WB	World Bank
WHO	World Health Organisation
WTO	World Trade Organisation
YoY	Year-on-Year
YtD	Year to Date

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