CARDINALSTONE

2018 OUTLOOK - A RISING TIDE

JANUARY 2018

FY'18 Outlook – A Rising Tide

CARDINALSTONE

Global - Global economy to strengthen in 2018

The IMF projects global GDP growth at 3.7 percent even as expectations for global economy remains upbeat. Domestic consumption, on the back of improving consumer confidence as well as tax cuts effect, is expected to further catalyze growth in the US in 2018. More so, with inflation expected to rise further in line with- or beyond-expectations, more Fed rate hikes are anticipated during the year. The Euro Area looks to shrug off economic repercussions of Brexit towards ensuring steady growth for the region. Likewise, emerging market economies are expected to further consolidate on recovery experienced in 2017 and possibly be a key driver for global growth in 2018.

Nigeria Economy – the party just started!

Nigeria's Gross Domestic Product is projected to consolidate further in 2018 following the rebound from economic recession in 2017. Rising consumer confidence indicates positive outlook for private consumption which is expected to be a key driver for growth. Furthermore, oil price stability together with the observed decline in oil production disruptions, presents opportunities for a more sustainable growth. These, alongside moderation in FX demand, increased foreign direct inflows and a relatively liquid FX transaction window, further translates into positive implications for the domestic currency. More so, growth is expected to feed off an expansionary fiscal theme, with particular pivot towards infrastructure building and a reduction in the high unemployment rate. This rides on expectations of government's capability to meet a significant portion of its funding needs through increased oil revenues, higher tax collections and increased, yet sustainable, external borrowing. Likewise, monetary policy is projected to ease following expectations of continued moderation in inflation.

Financial Markets – Improving optimism positive for equities

Following the rally in the equities market in 2017, we expect momentum to remain positive given optimistic outlook for macro-economic fundamentals. Nevertheless, we are cautious in our excitement as any disappointment in corporate results, or political tension in the pre-election year, can spook the market and cause it to falter. Other than these concerns, we expect the bulls to ride the year. Our outlook for the fixed income market hinges on the pace of inflation decline. In the short to mid-term, however, we expect a sustained decline in yields in the face of the much anticipated monetary policy easing.

Top picks	Price[1](₦)	12M TP (₦)	Upside	Fwd. P/E	D/Y
UBA	12.60	16.50	31.0%	4.4x	7.5%
FCMB	2.99	4.47	49.5%	3.8x	10.4%
FIDELITY	3.59	4.92	37.1%	4.1x	8.5%
FLOURMILL	30.00	44.90	49.7%	4.9x	9.5%
WAPCO	52.24	73.71	41.1%	5.3x	5.6%

[1] Prices as at 16th January, 2018

Analysts:

Omonegho Imoagene
Omonegho.Imoagene@cardinalstone.com
(234) 818 062 2000

Jerry Nnebue
Jerry.Nnebue@cardinalstone.com
(234) 809 713 2016

Clement Adewuyi (Team Lead)
Clement.Adewuyi@cardinalstone.com
(234) 809 022 1951

Team
research@cardinalstone.com
(234) 7100 433

Securities Trading
invest@cardinalstone.com
080 9044 2500
090 9859 9454

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Summary of stock recommendations

Company Ticker	Rating	TP (₦)	Current Price[1] (₦)	Up/ Down Side	Mkt Cap (N'Bn)	2018F P/E	2018F D/ Y
Financial Services							
FBNH	Buy	17.27	12.85	34%	461.25	5.0x	8.1%
FCMB	Buy	4.47	2.99	49%	59.21	3.8x	10.4%
FIDELITYBK	Buy	4.92	3.59	37%	104.02	4.1x	8.5%
GUARANTY	Hold	48.24	51.00	-5%	1,500.99	8.4x	5.9%
UBA	Buy	16.50	12.60	31%	457.12	4.4x	7.5%
ZENITHBANK	Hold	35.00	33.51	4%	1,052.10	6.0x	9.1%
Consumer Goods							
DANGSUGAR	Buy	25.00	21.31	17%	255.72	5.1x	8.3%
FLOURMILL	Buy	44.90	30.00	50%	78.73	4.1x	11.2%
PZ	Buy	28.24	23.32	21%	92.59	14.1x	3.4%
Industrial Goods							
DANGCEM	Buy	307.90	260.00	18%	4,430.53	12.7x	5.9%
WAPCO	Buy	73.71	52.24	41%	291.28	12.7x	5.9%

Global

Outlook: World economy to further expand in 2018

Global economic expansion experienced in 2017 is expected to continue into 2018 with an IMF forecast of 3.7 percent for global GDP. Growth in the Euro Area is expected to slow down to 1.9 percent per IMF projections on the back of unwinding of ECB stimulus. Emerging markets economies are expected to continue to enjoy robust growth in 2018 on the back of improving macro fundamentals, policy reforms and stable commodity prices.

United States of America

Growth remains robust despite political fireworks: US economic outlook remains positive with the IMF projecting 2018 growth at 2.3 percent. Unemployment figures showed steady moderation during the year, on the back of slightly loose fiscal policy. We foresee further expansion on the fiscal front in 2018 following the passage into law of the US tax reform bill, designed to bring about corporate tax cuts. This, coupled with increased infrastructure spending as well as corporate capital investments, makes a case for accelerated growth, increased production output, enhanced capacity utilization, diminishing slack, as well as growth in consumer demand, thereby sustaining economic recovery.

US economic outlook remains upbeat with the IMF projecting U.S economic growth at 2.3 percent

Uncertainties trail trade policy moves: Trade and immigration remain major policy concerns of the Donald Trump administration going into 2018. The administration has consistently signaled its intent to reduce US trade deficit through restructuring of existing trade deals or renegotiating ongoing ones for more favourable terms for instance the North Atlantic Free Trade Agreement (NAFTA) between the US, Canada and Mexico and the Trans-Pacific Partnership (TPP) between the US and eleven other countries along the Pacific region. If fully accomplished, this is expected to support domestic growth through the creation of more job opportunities on the home-front following possible elimination/reduction of low-wage competition emerging from countries such as Mexico. However, there are concerns amongst most economists that a protectionist trade stance would bring about a cost disadvantage that could weaken US trade position against global rivals like China. More so, any major unilateral changes to US trade policies in the coming year will likely attract retaliatory measures from partner nations. This conceivably explains the slow pace in the roll out of the administration's trade plans.

The Euro Area

Broad-based recovery shrugs off divorce worries: Like in the US, economic data from the Eurozone show strong growth and momentum in economic recovery. This follows from significantly rising consumer confidence with positive implications for domestic consumption and corporate investment, supported also by strong external demand. Following better than anticipated jobs data, unemployment rate declined in 2017, and this is expected to moderate further in 2018 with a European Commission projection at 8.1 percent. Employment growth, backed by increasing corporate investment as well as somewhat loose fiscal policy, will culminate in stronger private consumption which is

Eurozone to experience strong economic growth following significant rise in consumer confidence

expected to remain the key catalyst for growth. This is all the more attainable given increasingly favourable economic sentiment in almost all economies of the euro area. Despite expectations of a more expansionary fiscal theme, the IMF projects real GDP growth at 1.9 percent in 2018.

Myriad of challenges to test union's resolve: Trade concerns remain, as a result of US trade policy uncertainties- given that the United States is the Euro Area's largest exports market and the outcome of a post-Brexit trade deal with the UK. A rollback in US trade agreements could possibly hurt economic activities, leading to job losses and a slowdown in potential growth. The pace and direction of ongoing Brexit negotiations also present politico-economic challenges for the Eurozone, with specific implications for trade, markets and migration. Rising populist trends pose a key challenge for any planned economic reforms for the Eurozone going into 2018. The influence of right-wing parties has proven a political scare in key European economies such as France and this is likely to impact policy formations, which in turn can hurt the union's economic integration.

Myriad of challenges facing the EU could impact policy formations in 2018

The United Kingdom

Growth limping on Brexit scares: No other tune resonated the UK's politico-economic situation in 2017 more than its divorce from the European Union. Going into 2018, the outcome of the ongoing Brexit negotiations is expected to remain the dominant theme. Despite the uptick in the intensity of negotiations, the full extent of any systemic impact of Brexit on the overall UK economy remains hazy. The observed sluggishness in growth mirrors an economic terrain marred by low productivity and Brexit uncertainties. Although lacklustre, growth surpassed expectations but with inflation spiking to record levels, the Bank of England had to raise rates for the first time in a decade. This uncertainty is projected to continue into 2018 unless there are major breakthroughs in Brexit negotiations. Investors are likely to remain wary about bringing in new investments or expanding current operations unless there is clarity in the direction of negotiations and the implications for business in the UK. Consumer confidence has remained low since the Brexit referendum in June 2016, and this build-up of fear is expected to further drive down domestic demand, thus exacerbating economic deterioration.

Japan

Economic expansion set to outpace outlook: In Japan, the outlook remains buoyant on the back of external sector expansion as well as corporate investments boost following strong fiscal stimulus. According to OECD data, falling unemployment figures and rising wages have boosted domestic consumption, while inflation continues to rise steadily on the back of higher energy prices and the Bank of Japan's monetary easing programme. However, with inflation still below the BOJ's target rate of 2 percent, accommodative monetary policy is expected to persist in 2018. This should further bolster growth and stimulate domestic demand while keeping inflation in positive territory.

Japanese outlook remains buoyant on the back of external sector expansion and corporate investment boosts

Emerging Markets and Developing Economies

China's high growth in recent years has been deemed unsustainable by most economic strategists given its large debt. Despite efforts to rebalance the economy, growth remained elevated at 6.9 percent as at September 2017. Over time, China's economy has been export and investment driven, with consequent implications for domestic consumption. However, the ongoing structural transformation seeks to make domestic demand the economic pivot, which should eventually lead to a more sustainable growth for the Chinese economy with wealth shifting from large investment entities to households. Following the gradual departure from over-reliance on external demand, which has seen rapid rise in its current account surplus, the contribution of domestic consumption to GDP growth has begun to gradually improve, although this still lags behind expectations. In 2018, growth is expected to slow down with an IMF forecast of 6.5 percent. The implications of a China manufacturing slowdown remains elevated especially among countries dependent on commodity exports as demand is expected to wane thus leading to possible depression in prices.

Going into 2018, key themes for the overall Chinese economic landscape have been identified to include reforms in State-Owned Enterprises (SOEs) to rein in the burden of excessive corporate debt within the entities; dealing with excess industrial capacity given shifting focus from manufacturing and over-dependence on external sector demand to services and local consumption; environmental and climate challenges due to extreme pollution from industrial activities.

In India, growth slowed in early 2017 mostly as a result of currency demonetization as well as the implementation of a goods and services tax. However, a recovery seems on track and is expected to permeate into 2018 with an IMF forecast of 7.4 percent. Inflation, however, is expected to rise and possibly breach the 4 percent target (IMF forecast 2018: 4.9 percent) leaving the possibility of a reversal of loose monetary policy stance.

Russia's economy, despite being hit by US and EU sanctions remains on the path of recovery, thanks to oil price rebound, improving consumer confidence as well as domestic demand boost. Import substitution has had a lift with the agricultural sector greatly benefitting. More so, a weaker rouble has seen Russian exports competitively priced in the international market. Notwithstanding, IMF expects a slowdown in 2018 (1.5 percent) due to an expected moderation in oil prices.

After grappling with its worst recession in recent times, **Brazil** finally showed signs of recovery in 2017 driven by private consumption boost and trade expansion. Decline in unemployment rate, while inflation continued a faster than expected descent, has led to improved purchasing power as well as an increase in consumer confidence. As a result, monetary policy easing is expected in 2018. This should bring about lower interest rates and enhance corporate expansion, thus fostering further growth. However, with a key presidential election coming up in 2018, analysts remain sceptical about the sustainability of economic recovery given challenges posed by rising populism in the country. One bad

policy move can significantly alter the momentum and direction of growth. Nevertheless, the OECD projects growth for 2018 at 1.9 percent.

Cross border conflicts, tensions and political strife continue to constrain economic growth in **Middle East and North African countries**. Economic activities is expected to remain subpar going into 2018 following extension of OPEC oil production cuts till the end of the year. Expansionary fiscal theme should play out in countries like Saudi Arabia currently grappling with recession. This should help boost confidence in the domestic sector. Economic embargo placed on Qatar by Egypt, Bahrain, UAE and Saudi Arabia is expected to continue to further strain its economic outlook especially given lack of breakthrough in mediation by Kuwait and the US. Following the devaluation of its currency, Egypt has been hit by rising inflation and interest rate hikes. This has curtailed corporate expansion and stalled employment growth with consequent ramifications for domestic demand. Still, the IMF predicts growth to reach 4.5 percent supported by economic and political reforms.

Financial Markets: Global financial market to remain robust

Global financial markets in 2017 showed resilience despite looming uncertainties at the beginning of the year. After enjoying one of the best growth streaks since the 2008 financial crisis, financial markets are expected to remain robust in 2018. Emerging markets have also benefited from the global rally and remain positioned for increased investment exposure from advanced economies. Improving macro fundamentals as well as stable commodity prices will provide strong support for increased investor confidence in emerging economies

US equities the toast for global markets in the short term

Equities in the US and Europe were apathetic to President Trump's America-First themed inauguration speech in January 2017 and since then, the ride has been a rollercoaster. With US economic policies largely favourable to corporates, equities seem set for another positive ride in 2018. European stocks have largely benefitted from better than expected corporate earnings performance and this is expected to play out further in 2018. In the US, the recent passage of the tax reform bill is expected to boost corporate earnings and further open up opportunities for growth and expansion. While there are expectations that the impact of tax cuts are already being priced in, especially among high tax-rate companies, there remains an opportunity for modest growth backed by the impact of corporate expansion on earnings. Also, the possibility of share repurchases, as companies with huge amount of cash abroad repatriate them, should serve as a boost to earnings per share, lead to increased dividend payouts and consequently further propel equities. A downside risk to this, is a faster than expected rise in inflation in 2018 following a surge in spending and domestic demand boost. This should consequently cause the Fed to hasten rate hikes and possibly, slow down trimming its balance sheet. While this may cause a temporary drawdown in equities, it remains unlikely that higher treasury yields would trigger an abrupt and persistent equity sell off. The outlook is less buoyant for Europe, as the ECB's tapering of its bond buying program, as well as a more robust US market, is likely to put a strain on liquidity. Notwithstanding, strong trade performance, as well as improved domestic demand should boost corporate growth and earnings performance and make a case for European equities. This is, of course, barring the implementation of any global protectionist trade policies.

US and European equities set for another positive ride in 2018

Emerging Markets to reap where they have sown

Emerging market equities have greatly benefitted from the global rally in 2017. While the region remains volatile owing to huge exposure to economic policies of developed markets and trend in commodity prices, we expect ongoing economic reforms in individual countries to serve as a positive buffer against any potential market shock. Commodity exporters are more likely to benefit from more stable oil and other commodity prices in 2018. This, should likely support growth and make their foreign currency denominated bonds more attractive for investors as the likelihood of default diminishes. There are fears that rollback of quantitative easing program by both the Fed and the ECB may choke out opportunities for emerging market securities, most

Modest returns expected from emerging markets in 2018

economists are sceptical regarding the extent of the impact given the lack of any historical precedence. Any significant impact on emerging market equities should come from rising policy rates in developed markets. Nevertheless, supported by strong growth, lower inflation, weaker currency as well as other improving macroeconomic fundamentals, we expect returns to be more modest in 2018.

Inflation in the driver's seat for bond yields

The recent passage of the tax reform bill is expected to put upward pressure on US bond yields going into 2018 and while inflation is already predicted to continue its uptrend, a faster than expected climb could see a more aggressive Fed rate hike, possibly more than the anticipated three times this year. Yields are likely to remain elevated given sustained inflation expectations towards its 3 percent target by 2019. This also applies to Japan and the Euro Area where inflation is still below the target rate of 2 percent. As global expansion consolidates and wages rise, inflation could accelerate faster than expected. And as the ECB gradually removes stimulus, bond yields should continue to inch higher.

Frail recovery in global commodities

Energy and metal commodities were outperformers during the year while agricultural commodities faltered.

Chinese slowdown to determine metals trajectory: Metal commodities fared positively in 2017 owing to strong global demand as well as manufacturing expansion, especially in China. Being the world's largest consumer of refined metals, China remains a key driver of metal commodities demand. However, there are concerns that its economic rebalancing program can negatively impact on demand for key metals especially if there is a manufacturing slowdown. On the supply side, however, curtailments in mining capacity due to environmental concerns and illegality can place constraints on metals such as zinc and nickel which will consequently propel their prices. More so, as advancement in electric cars heats up further in 2018 with consequent expansion in adoption rate, there are expectations that investors will gradually increase their exposure to commodities like copper, lithium and cobalt which are critical to the development of these cars and their batteries especially in the face of looming supply shortages.

Agricultural prices to remain steady: Most agriculture commodities endured price declines during the year. Food and raw material commodities, were weak following inventory build-up as in cases of sugar and grains. While Coffee and Soybean largely strengthened Beverage and Oil and Meal prices. The World Bank forecasts stable growth across all agriculture commodities in 2018 on anticipation of tightness in supply from major producers. Observed weakness in dollars led to increased demand for Precious metals such as Gold, Platinum and Palladium. However, anticipation of a stronger US Dollar in 2018, given proposed interest rate hikes as well as further equity market rally suggests a possible downturn in prices of these commodities. An upside risk to this is an outbreak of confrontation between the US and the Democratic People's Republic of Korea

World Bank forecasts stable growth across all agriculture commodities in 2018 on anticipation of tightness in supply from major producers

(DPRK) or any key catastrophic event that unnerves global financial markets. Even a hint of clashes can trigger a huge demand for safe haven commodities like gold, thus spiralling their prices.

Oil prices to tread on slick: Oil prices experienced a rebound in 2017, with the Brent rising by 17.7% to $66.87 on the back of improved demand, lower inventories and greater cooperation between OPEC and non-OPEC producers to achieve oil cuts. Despite concerns of a surge in US shale oil production, given advanced drilling technology and seemingly cost-effective strategies, we expect the impact on prices in 2018 to be diluted following the extension of oil production cuts by both OPEC and a number of key non-OPEC producing nations till December 2018. While a significant threat to prices abound in the form of renewable energy alternatives as well as advances in electric car development (some countries such as the UK and Norway have set plans in motion to ban fossil fuel cars in the near future, while companies like Tesla are already making giant strides in the rollout of cheap but reliable battery-powered car models), the impact is not expected to be significant in the near term. As a matter of fact, most assessments suggest that the demand for oil will last for at least another 10 years. OPEC estimates reveal expectations of global oil demand growth of 1.51mbpd in 2018 to 98.45mbpd reflecting improved demand from OECD countries, China and India. Consequently, oil is forecast to continue its stable recovery in 2018, albeit at a much slower pace.

OPEC estimates reveal expectations of global oil demand growth of 1.51mbpd in 2018 to 98.45mbpd

Geopolitical Concerns

North Korea Crisis: This remains the biggest geopolitical risk facing investors in 2018 and while most strategists have downplayed the chances of an all-out war between the US and North Korea, the constantly escalating rhetoric between the two leaders have investors' hearts in their mouth. Nevertheless, in a worst-case scenario, the breakout of war is likely to rattle global markets, with US and Asian equities taking the worse hit. Gold and other safe haven assets such as Swiss Franc are likely to be the winners in an ensuing conflict.

US – China Tensions: Tensions already abound between the US and China over the latter's land reclamation activities and militarization of the South China Sea. Add to that any formulation or implementation of adverse policies that could potentially upset either economy with respect to trade or currency and you are set for the possibility of an all-out economic war with very inimical ramifications for global markets and growth. The question of North Korea, like a landmine, also offers an avenue for confrontation.

Trump Jerusalem Decision: Trump's Jerusalem decision caught many by surprise and the recalcitrance with which he upholds this resolve is all the more baffling despite the lack of broad-based support even from key allies. While uncertainty lingers as to how wildly this flame would rage in 2018, investors are sure to keep an eye on that space.

Other Middle East Crisis: Besides Israeli – Palestinian crisis, the Middle East remains a hotbed for politico-economic tensions that threaten the stability of the region. The United States, Russia, Turkey, Saudi Arabia, and Iran are key players in this regard with Syria, Yemen, Iraq and Lebanon serving as fitting proxies. A miscalculation of sorts could well plunge the region into a full-blown conflict with grave implications for the wider world. The Middle East emerging markets and commodities would mostly be affected by any escalation.

Table 1: Summary of 2018 investment themes

Theme	Rationale	Key risks
US equities	Solid economic growth, corporate earnings boost, expectations of rollback in financial regulations as well as tax cuts to propel US equities in the near term.	Geopolitical events with ramifications for financial markets; poor corporate earnings performance as well as policy uncertainties
US Treasuries	Anticipation of further rate hikes in 2018; attractive safe haven asset for investors wary about heightened geopolitical concerns	Bond yields to come under pressure if inflation fails to recover as expected
Increase EM/FM Exposure	Strong market performance in 2017 in countries like Nigeria and Argentina; valuations relatively cheap owing to weak currencies; improving macroeconomic fundamentals and economic reforms to revamp ailing economies; stable commodity prices for major commodity exporters	Volatility in commodity prices pose downside risk to emerging market stability. Weak implementation of reforms as well as political instability can also weaken investors' confidence. A stronger US dollar could make USD denominated debts more expensive to service.
Reduce Commodities Exposure	Expectations of lower demand from China due to its shift from manufacturing to services should put downward pressure on commodity prices, notably metals such as copper. More so, strengthening of the US dollar on the back of expected rate hikes in 2018 to weigh on commodities.	Increasing geopolitical tensions pose upside risk to safe haven commodity assets like gold, platinum and palladium.

Source: CardinalStone

Nigeria

Economy: Growth consolidation in 2018?

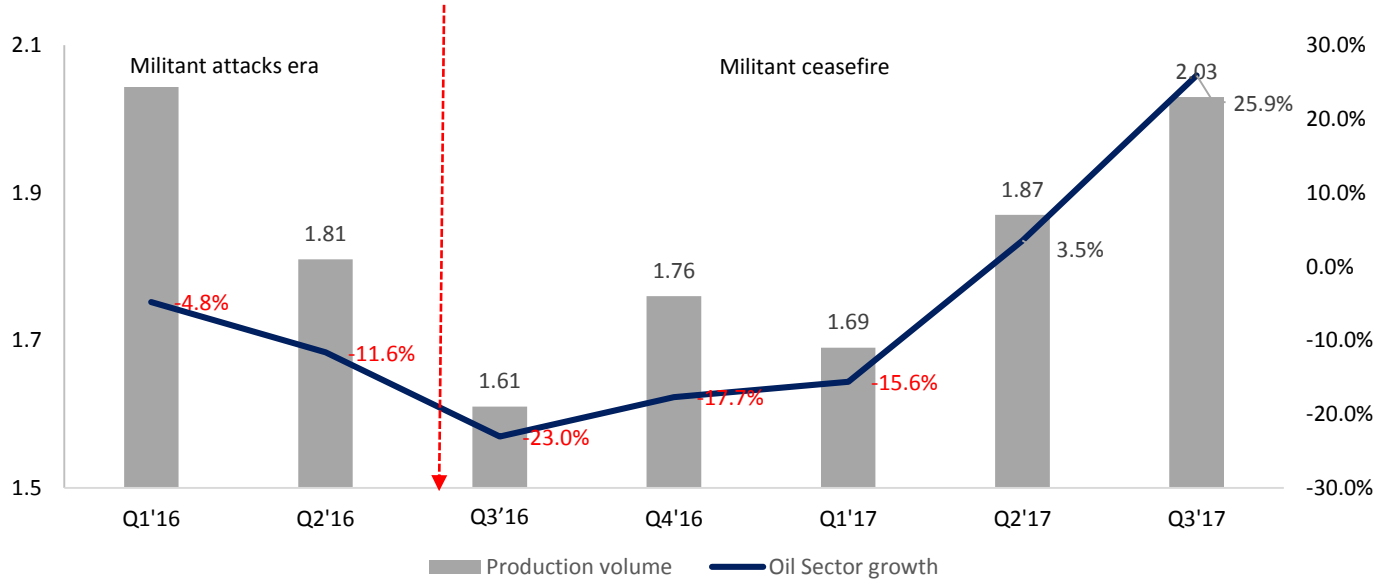
With the sustained stability in FX, moderating interest rate and the improved outlook for private sector credit, we expect the non-oil sector to start contributing positively to total output in 2018. Given that the oil sector is also expected to maintain its positive trajectory, we expect the Nigeria economy to further consolidate on 2017 growth in 2018.

We see sustained growth in the oil sector

The Nigeria economy emerged from recession in Q2'17 primarily driven by higher crude oil prices as well as the recovery in oil production volumes on the back of the tranquillity experienced in the Niger Delta region. After five consecutive quarters of contraction, the oil sector advanced in Q2'17 and Q3'17 by 3.53% and 25.9% respectively as the price of the Brent crude averaged $50.93 (Q2'16: $46.8) and $52.1 (Q3'16: $46.8) in these periods respectively. With Brent crude currently trading at $67.6 and projected to average $57.3 in 2018, we envisage further expansion in the oil sector in 2018. On the production bit, government negotiations and actions seems to be yielding results in the Niger Delta region given the sustained peace and the absence of any significant attack in the past 16 months - this has seen crude oil production climb as high as c.2.2 million barrels daily (including condensates) in the last quarter of 2017. While pocket of risks still exists as the demands of the militants in the region are yet to be fully met, in the interim, we expect the ongoing consultation to continue to yield positive results and thus we think crude oil production volumes will hover around 2.0 million barrels per day in 2018

Nigeria's crude oil production volumes will hover around 2.0 million barrels per day in 2018

Figure 1: Crude oil production volume (million barrels per day) oil sector growth (%)



Source: NBS, CBN

Government policies positive for the agriculture sector

The agricultural sector has enjoyed tremendous support from the government as well as the Central Bank of Nigeria (CBN) in recent times. Despite the recession, the industry recorded positive growth, expanding by 3.39%, 3.01% and 3.06% in Q1'17, Q2'17, and Q3'17 respectively. The improved financing of the agricultural sector, particularly via the Anchor Borrowers' Programme (ABP) has seen close to ₦50 billion ($164 million) disbursed to over 218,000 farmers as at October 2017. Building on the success of the ABP, the CBN recently announced that it will be extending cheap credits (with interest rate as low as 5% compared to over 22% from commercial loans) to farmers for the procurement of agricultural processing equipment. We laud the CBN's move to extend cheap financing beyond the basic farm operations to financing the processing of agricultural produce, as this is a positive step towards transforming Nigeria's agricultural value chain. We believe this initiative has the potential to accelerate the growth in the agricultural sector. However, the implementation has to be as efficient as the ABP to get the desired outcome. While there is yet a lot to be done in the agricultural industry (given the agricultural trade deficit of $3.9 billion), we are encouraged by the improved commitment to the sector and thus, expect further traction in 2018.

Improve financing of the agricultural sector set to boost output in 2018

Better FX supply, lower interest expense good for the manufacturing sector

Growth in the manufacturing industry slowed significantly following the FX crunch and the hike in interest rate. Manufacturing output plunged from an increase of 15.0% in Q3'14 to –7.0% in Q1'16. However, the contraction moderated as the CBN prioritized the sector for FX supply. Consequently, the purchasing manager's index (PMI) rose and stayed above 50 for the past 9 months. With the last spanner in the works – high-interest rate – currently being resolved, we expect credit to the manufacturing sector to significantly improve while interest expense will moderate which will strengthen profitability in 2018. Furthermore, growing consumer wallet will support demand and revenue while lower inflation is expected to enhance margins in the manufacturing sector in 2018. Therefore for 2018, we believe the manufacturing industry will return to positive growth on the back of sustained FX supply, increase access to credit, lower funding cost, improving consumer wallets as well as moderating inflation.

Stable FX supply, lower interest expense to enhance profitability in the manufacturing sector in 2018

Figure 2: PMI trend in 2017

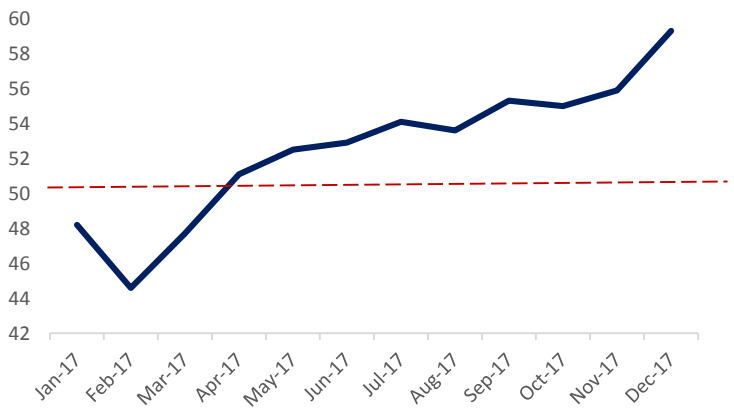
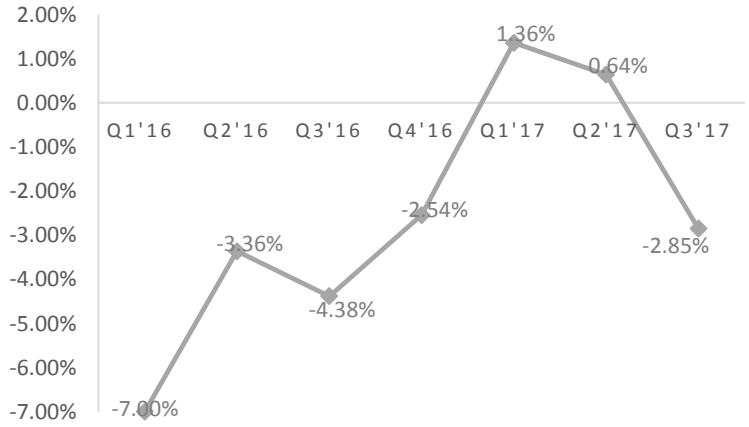


Figure 3: Manufacturing GDP Trend



Source: NBS, CBN

Better business environment to further spur investment in 2018

The business climate has significantly improved in recent times with Nigeria's Ease of Doing Business ranking moving 24 steps to 145 following the approval of the implementation of a 60-day national action plan which commenced in February 2016. Government reforms have concentrated on improving private sector investment with a focus on the ease of starting a business, access to credit, registering property, entry, and exit and so on. The former foreign exchange regime which had been another significant impediment to foreign investments is now out of the way with the new one – IE window-recording massive success in the past eight (8) months. Hence, with a very positive outlook for FX coupled with a more friendly business environment, we expect further improvement in investment which is expected to trickle down to various economic sectors.

Domestic Economy to fire on both engines in 2018?

The Nigeria economy emerged out of recession off the back of the positive performance of the oil sector, while the engine of the non-oil GDP continued to stutter in 2017. Government borrowings crowding out credit to the private sector, high funding cost and weaker consumption were mostly responsible for the slowdown in the non-oil sector in 2017. However, in 2018, with government resulting to more of foreign borrowings coupled with the CBN's monetary easing stance, we expect funding cost to trend downwards with a significant improvement in credit to the private sector. We believe the improved lending to the private sector will drive individual investment growth and consequently impact employment and consumer consumption positively. With the engine driving the oil sector expected to continue firing on the positive outlook of crude oil prices as well as consistent production volume, we anticipate further consolidation in 2018 given that most factors that hindered growth in the non-oil sector have started to improve significantly.

Fiscal Policy: Budget of consolidation?

From our simulations, we expect budget deficit and borrowings to deviate by 45.0% and 52.9% respectively from the assumptions presented in the 2018 budget. While we envisage significant improvement in non-oil revenue, we expect the actual performance to underperform expectations in the 2018 budget markedly.

2018 Budget – Government plans to ramps up spending by 18%

In pursuit of its economic stimulus drive, the federal government plans to ramp up spending by 18.0% to ₦8.6 trillion ($28.2 billion) to consolidate the 2017 economic recovery. The implementation of the 2017 budget grossly underperformed expectations with just 23% of the capital budget implemented as at September 2017. However, with the government presenting the 2018 budget in Q4'17, we expect the Senate to pass the appropriation bill in Q1'18 - this will give enough time to implement the 2018 budget efficiently. In the proposed 2018 budget, capital expenditure, recurrent expenditure and debt servicing account for 28.2%, 36.5%, and 23.4% respectively compared to 29.2%, 35.5% and 22.4% proposed in the 2017 budget. From the income side, government projects growth of 30.0% in total revenue - 37% of oil revenue and 63% of non-oil revenue. Compared to 2017 estimated revenue, the federal government plans to increase non-oil revenue by 117% to ₦4.17 trillion. We think the projected growth in non-oil revenue is ambitious despite ongoing reforms to diversify government's income.

Despite ambitious projections, we see improvements in non-oil revenue.

Owing to the need to diversify government's revenue base, we have seen some traction in government's effort to deepen tax penetration as well as plug revenue leakages from its revenue-generating agencies. The implementation of the Voluntary Asset and Income Declaration Scheme (VAIDS) in 2017 set the ball in motion to widen the tax net while offering benefits like immunity from prosecution, interest and penalty waivers to tax defaulters, who voluntarily declare their assets and pay their tax liabilities. Also, to further boost revenue from taxation, the government plans to increase value added tax on luxury items to 15% from 5%, this is expected to raise income from the value-added tax on luxury items effectively by 200% when implemented. While non-oil revenue is likely to improve on the back of better government policies and reforms, the anticipated 40.3% growth in non-oil revenue remains overly optimistic given that non-oil revenue is currently underperforming 2017 projections by 32.9% as at September 2017.

Conservative projections in oil revenue may cover expected shortfall in non-oil revenue.

With Brent crude oil price currently trading above $65 per barrel and projected to average $58 per barrel in 2018 (compared to $45 per barrel proposed in 2018 budget), we expect the extra income from the conservative budget to provide buffers for the shortfall of the aggressive 2018 non-oil revenue estimate. We also do not envisage any material disruption in Nigeria's crude oil production in 2018 given the sustained peace in the Niger Delta region.

To properly analyze the impact of government's revenue performance in 2018, we have sensitized the expected revenue projections in the 2018 budget based on three scenarios: Bear, Base, and Bull. We also considered the respective impact of these scenarios on capital expenditure, budget deficit, and government borrowings.

Table 2: 2018 BUDGET SCENARIO ANALYSIS

Highlights	2018 Budget	2017 Estimate	Bear	Base	Bull
Budget assumptions					
Price per barrel of crude oil (US$/bbl.)	47.5	45	45	60	75
Daily crude oil production (mbpd)	2.3	2.0	1.5	1.9	2.3
Oil & oil related revenue	2,442	1,922	1,665	2,812	4,256
Non-oil revenue	4,170	1,920	1,813	2,090	2,367
- CIT	797	315	346	441	535
- VAT	208	125	138	175	213
- Customs	325	245	269	342	416
- Others	1,992	239	263	334	406
- Independent revenue	848	997	798	798	798
Total revenue	6,612	3,842	3,478	4,903	6,623
Capital expenditure	2,430	672	972	1,458	1,944
Recurrent expenditure	3,496	2,980	3,496	3,496	3,496
Debt servicing	2,014	1,660	2,230	2,230	2,230
Statutory transfer	456	418	456	456	456
Total expenditure	8,612	5,730	7,154	7,640	8,126
Fiscal deficit (₦'billion)	2,005	1,888	3,676	2,737	1,503
Income for JV sale	306	306	306	306	306
Estimated borrowing	1,699	1,582	3,370	2,431	1,197
Estimated local borrowing (50% of total borrowing)	849	791	1,685	1,216	599

Source: Budget office, CardinalStone

Bull Scenario: Fiscal deficit to widen by 32.6% to ₦2.6 trillion

- Oil-related revenue to surpass budget expectations by 74.3%, positive for FX reserves and overall government income.
- Non-oil revenue to fall short budget projections by 43.2% despite the 23.3% estimated growth in 2018.
- CIT and VAT revenue growth expected to average 70% in 2018 mainly as a result of the aggressive drive to increase tax penetration.
- Capital expenditure implementation to average 80%, boosting economic activities in the construction, agriculture and power sectors.
- Fiscal deficit and borrowings to contract by 25.0% and 29.5% to ₦1.5 trillion and ₦1.2 trillion respectively in comparison to the 2018 budget

Base Scenario: Borrowing to deviate by 76.5% from government projections

- Oil-related revenue to come in higher than budget projections (+15.2%), positive for FX reserves and overall government income.
- Non-oil revenue to underperform budget projections by 49.9%. However, non-oil revenue is estimated to rise by 8.8% in comparison to 2017 estimate
- CIT and VAT revenue growth expected to average 40% in 2018 primarily as a result of modest success in the tax penetration campaign.
- Capital expenditure implementation to average 60%, relatively positive for overall economic activities.
- Fiscal deficit and borrowings to widen by 36.5% and 43.1% to ₦2.7 trillion and ₦2.4 trillion respectively in comparison to the 2018 budget

Bear Scenario: Fiscal deficit and borrowing to more than double on significant revenue miss

- Oil-related revenue to come significantly lower than budget expectations (-31.8%), negative for FX receipts as well as overall government income.
- Non-oil revenue to fall short budget projections and 2017 estimates by 56.5% and 5.6% respectively.
- CIT and VAT revenue to record marginal growth of 10% in 2018 mainly as a result of poor implementation of the ongoing tax reforms.
- Capital expenditure implementation to average 40% with marginal impacts on economic activities.
- Fiscal deficit and borrowings to widen significantly by 83.3% and 9.4% to ₦3.7 trillion and ₦3.4 trillion respectively in comparison to the 2018 budget.

How we see 2018 budget turning out

- We expect our **base case** to hold for oil revenue in 2018. Thus, we believe income from oil revenue will surpass 2018 budget assumptions – this is positive for FX inflows and government revenue.
- For non-oil revenue, while we acknowledge government's resolve to boost tax penetration and improve non-oil revenue, we think 2018 budget assumptions for non-oil revenue are too bullish. Hence, we expect our **base case scenario** to hold. Our base case scenario assumes the ongoing tax reforms will translate to an average increase of 40% in tax revenue receipt.
- Given government's effort to pass the budget on time as well as the need to improve the economy ahead of the 2019 elections, we expect our **bull case** to hold for capital expenditure implementation (80%).
- Overall, considering the above scenarios, we expect fiscal deficit and borrowings to widen by 60.7% and 70.3% to ₦3.2 trillion and ₦2.9 trillion respectively in comparison to the 2018 budget. Assuming the budget financing strategy holds (50% local and 50% foreign borrowings), we expect the federal government to raise Eurobond to the tune of $4.75 billion (₦1.45 trillion) to finance the budget in 2018.

FX: Outlook for the domestic currency very sunny in 2018

The outlook for the local currency remains very bright in 2018 on the back of the sustained recovery in crude oil prices, moderating FX demand, relatively liquid FX market and lower dependency on portfolio FX flows. Beyond 2018, we expect the major source of FX – importation of refined crude oil – to be eliminated further evincing the stability of the Naira in short to medium term.

Declining FX demand to support domestic currency stability

According to the CBN, total monthly FX demand slumped by 65% from a high of $5.5 billion to $1.9 billion in H1'17. Supporting the CBN's claim is the recent trade data released by the National Bureau of Statistics (NBS) which reveals that total value of Imported goods declined by 4.5% YoY to ₦2.35 trillion ($7.7 billion) in Q3'17. We believe the moderating demands for FX is the early signal of the progress made on import substitution which is helping to boost the production capacity of the local industry while at the same time reducing the need to import foreign goods. One significant achievement of the import substitution program is the development of the domestic rice industry. Following the FX ban on rice importation, the capacity of the local industry increased and with the big cut on the amount spent on foreign goods and the improving capacity of the local industry, Nigeria is better positioned to weather any volatility in FX earnings that may arise from fluctuating crude oil prices.

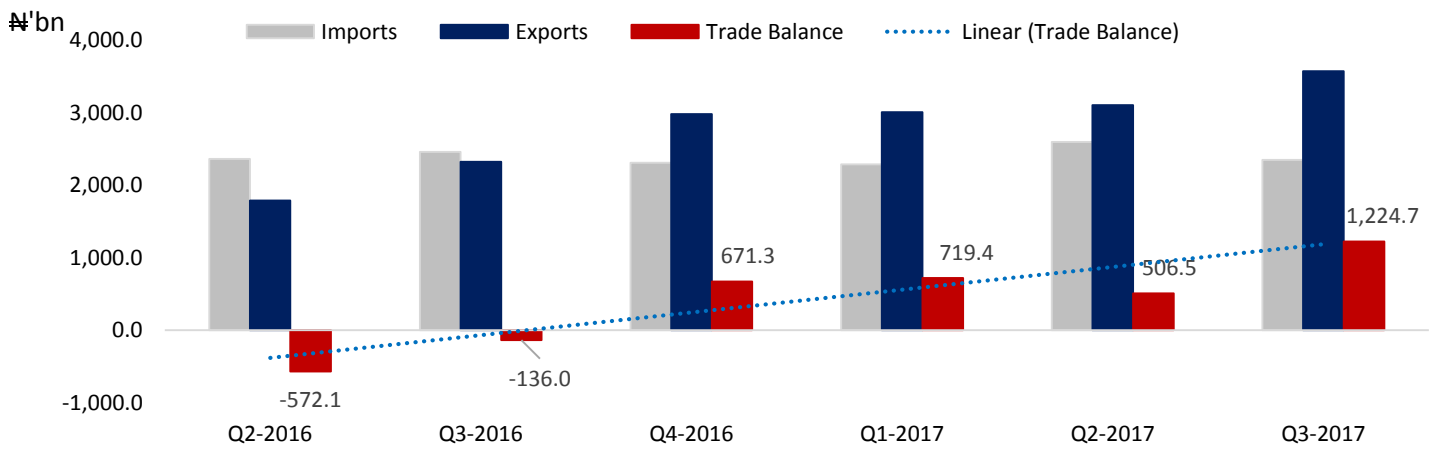
Domestic FX demand moderating on the back of the development of the local industry

Increasing trade surplus positive for FX reserves (up to 34-month high)

Evincing the opposite direction of Nigeria's import (-11.1% YoY) and export (+74.5%), trade balance soared from a deficit of ₦961.4 billion ($3.2 billion) in to a surplus of ₦2.5 trillion ($8.2 billion) as at September 2017. This implies that the country effectively recorded a net FX inflow of $8.2 billion as at 9M'17 and with a potential net FX inflow of $10.9 billion by full year 2017. As a result of the significant improvement in trade balance, Nigeria's FX reserve recorded a massive jump of 50% from $25.8 billion as at 31st December 2016 to $38.8 billion as at 31st December 2017.

Rising export, declining import enhances net FX receipt as FX reserves surged by 50% in 2017

Figure 4: Nigeria Trade balance trend



Source: NBS, CardinalStone

Increasing foreign borrowings to reduce domestic currency volatility

Before now, the federal government funds the budget deficit with 64% of local borrowings and the balance of 34% with foreign borrowings. As a result, the funding of the budget deficit is primarily dependent on the local bond market, leading to increase in the supply of government debts and invariably higher and attractive yield levels. The attractiveness of the domestic yield has endeared foreign portfolio investors (FPIs) who typically have a short-term investment horizon. Hence, the frequent exit and entry of these FPIs create significant volatility for the domestic currency. However, with the government's resolve to fund fiscal deficit with 50% via foreign borrowings (Eurobonds), which are medium to long-term (10 to 30 years), this will significantly reduce the need to depend on FPI funds in the local bond market and therefore, reduce the volatility of the domestic currency. More so, the increase in foreign borrowings will also be a source of additional long-term FX supply which will further strengthen the position of the domestic currency.

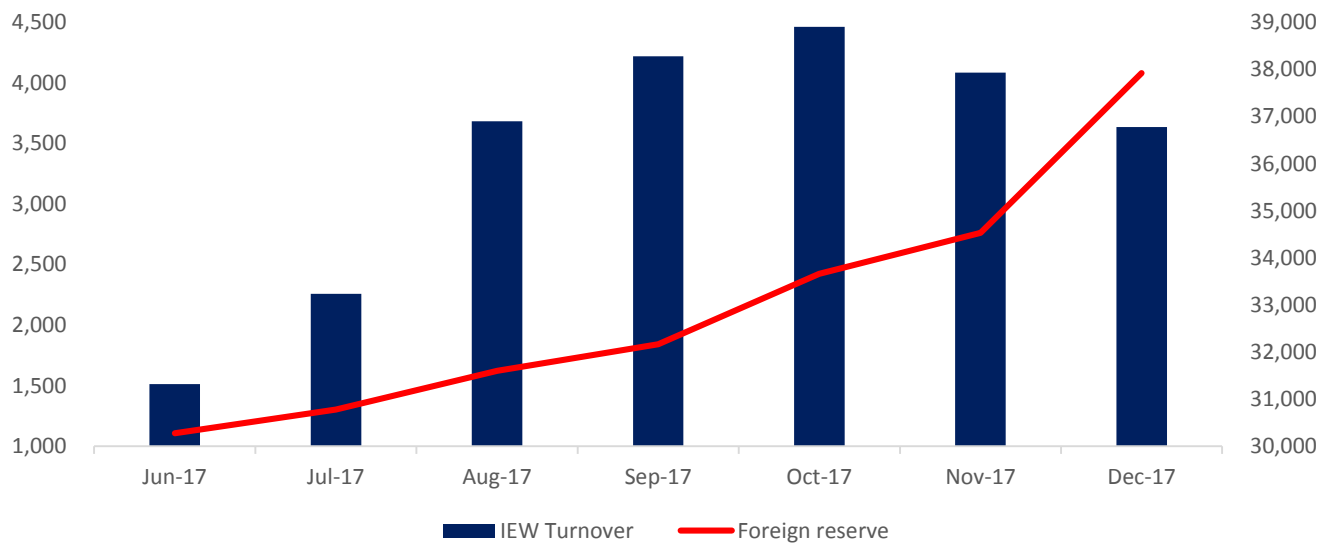
Higher expected foreign borrowings to further enhance FX liquidity in 2018.

Investors & Exporters Window will continue to provide FX liquidity

The launch of the investors & Exporters FX window in April 2017 was the answer to Nigeria's FX crisis as this gave foreign portfolio managers (incoming and exiting) the opportunity to fairly trade the currency and provide the liquidity required to complete FX transactions. As at the end of October 2017, the window had turned over $17.9 billion in FX trade transactions since inception (an average daily turnover of $139.5 million). The establishment of the I&E window which provided liquidity for foreign portfolio managers, invisible transactions, trade-related payment obligations and so on took the FX supply burden off the country's reserve thereby giving the CBN the opportunity to conserve the foreign exchange and build the foreign reserve. We expect the FX inflows through this window to continue to provide FX liquidity both to foreign investors and domestic demands and thus, we expect the accretion in foreign reserve to persist in 2018.

The I&E window has been a steady source of liquidity to FPIs and other users thereby affording the CBN the opportunity to conserve government FX receipt

Figure 5: IEW turnover and foreign reserve trend



Source: FMDQ, CBN, CardinalStone

Looking beyond 2018

We think the outlook of the Naira beyond 2018 is encouraging despite fears that the crude oil supply glut may bring crude oil prices down in 2019. Having moderated its monthly FX demand by 65% in 2017, we expect it to further decline significantly in 2019 as Nigeria's largest FX expenditure – importation of refined petroleum products – is likely to be taken out when Dangote refinery comes on stream. The commencement of the refinery will not only moderate FX demands but will also boost FX export proceeds as Nigeria is expected to switch from a net importer of refined petroleum products to a net exporter, further enhancing the country's FX position beyond 2018.

Inflation: we see headline inflation printing at 12.90% by the end of 2018.

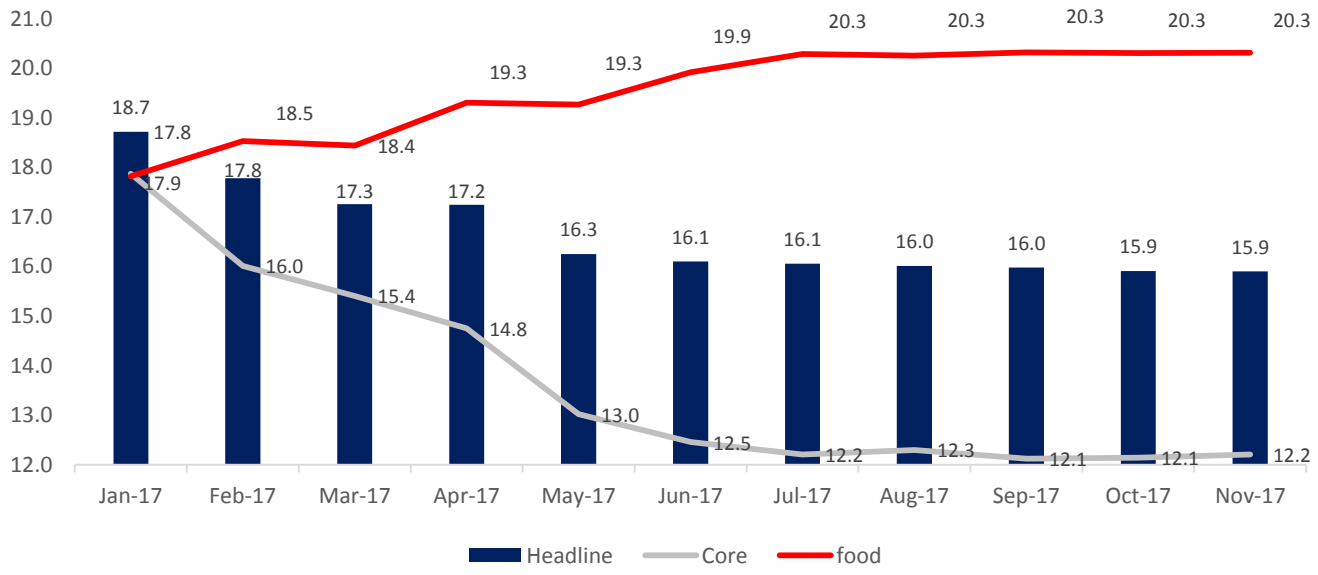
Given our expectations that MoM food inflation will continue to moderate on the back of government and CBN interventions in the agricultural sector, we expect headline inflation to further converge toward core inflation in 2018. Hence, we project headline inflation to print at 12.9% by December 2018.

Food inflation to moderate on base effect and improved local food production

While core inflation spiralled downwards to 12.2% YoY in November 2017 from 18.1% YoY in December 2016; food inflation inched up further to 19.39% YoY. The spike in food inflation was as a result of higher global food prices for staples, higher transport costs (due to price increases in diesel) as well as the flooding experienced in select south-eastern and central regions of the country. The impact of higher food inflation moderated the effect of lower core inflation on Headline inflation in 2017. Notwithstanding, on a MoM basis, we noticed an improving trend in food inflation as MoM food inflation consistently declined from 2.5% in May 2017 to 0.9% in November 2017. We believe this developing trend reflects the progress made on local import substitution, particularly in agriculture where the CBN and the government partnered with Farmers to improve yield and crop production. Therefore, we expect food inflation to moderate significantly on a Year-on-Year basis in 2018 on the back of the declining month-on-month food inflation coupled with the high base effect of 2017. Consequently, we expect the decline in food inflation to dampen the acceleration in headline inflation. As such, we forecast headline inflation of 12.9% by December 2018 from 15.80% in December 2017.

Progress made on import substitution of agricultural products to enhance local production and moderate rising prices of agricultural commodities

Figure 6: Core inflation, Food inflation and headline inflation YoY trend



Source: NBS, CardinalStone

Figure 7: Core and food inflation MOM trend

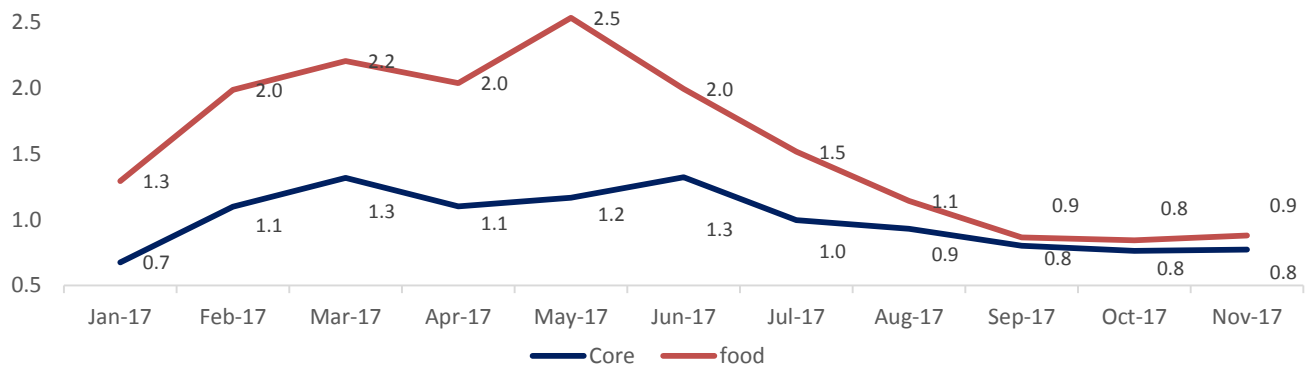
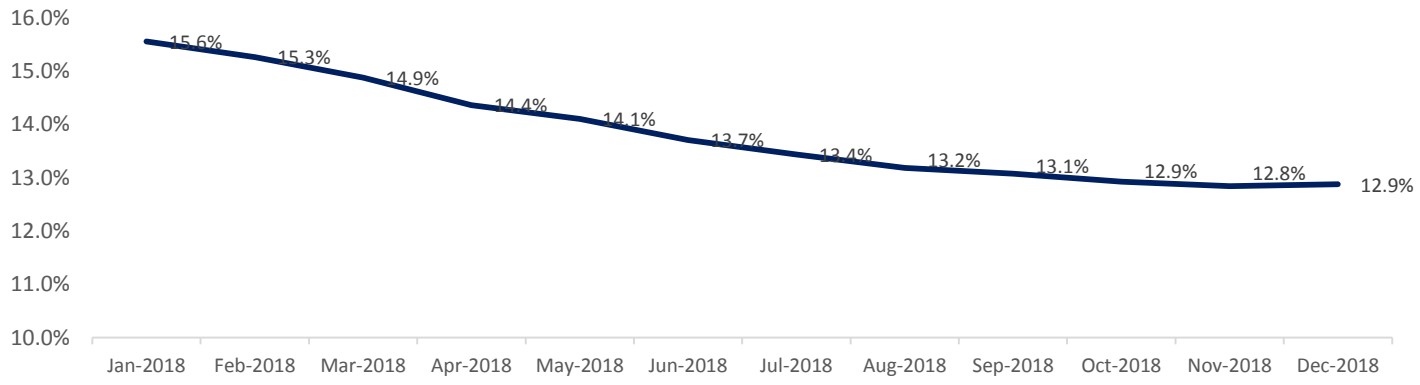


Figure 8: Headline inflation forecast for 2018



Source: NBS, CardinalStone

Risk I: Higher electricity tariff may threaten core inflation in 2018

The high likelihood that energy tariffs may rise in the near future poses threats to the trend of core inflation in 2018. According to the Nigerian Electricity Regulatory Commission (NERC), it is awaiting the final approval of the federal government to implement the new tariff – a 61.5% increase in electricity charges. While the stance of the NERC was recently reiterated by the vice president – Prof Yemi Osinbajo-, we believe the government may delay the execution to avoid labour and civil protest, particularly as the election approaches. However, should the government decide to implement the new tariffs, we expect to see a significant uptick in core inflation in 2018.

Risk II: Monetary easing may moderate the pace of slowdown in inflation

With the recent body language of the monetary policy committee (MPC) signalling a quantitative easing in the near term, we may see a further slowdown in the pace of decline in inflation as broad money supply increases. In recent times, the CBN has reduced the frequency of its mop-actions causing yields on government securities to decline by an average of 500bps across all maturities. We believe the excess system liquidity rising from the new monetary strategy may prop-up demand thereby adversely affecting general price levels in 2018.

Interest rate: lower interest in 2018 positive for Nigeria's economic health

We expect yields and interest rate to be significantly lower in 2018 as the fiscal and monetary parties look to harmonize their policies to support growth. The outlook for inflation, government borrowings and a more stable currency makes a good case for quantitative easing and lower interest rates in 2018.

Restructured government borrowing supports lower interest rate

The plans to restructure government borrowing by increasing the portion of external borrowings that will be required to finance the budget deficit to 50% in the 2018 budget from 24% in the 2017 budget is expected to reduce the supply of government debts and moderate yields on government securities. More so, the government also plans to refinance $3billion (24.2% of outstanding treasury bills as at September 2017) worth of outstanding treasury bills with longer tenure Eurobonds in 2018. This is expected to reduce the value of Primary market auction that would have been conducted to refinance the maturing bills by ₦915 billion ($3.0 billion) in 2018 – c.20% of treasury bills issued in 2017. We believe the refinancing of existing bills in addition to lower local borrowings will reduce the supply of government debt and consequently moderate treasury bills yields in 2018.

Government debt restructuring to reduce local borrowing and consequently moderate interest rates.

Positive inflation outlook and better FX supply support monetary easing

The monetary policy committee (MPC) has been sighting inflationary pressures and the low FX liquidity as the reason for its aggressive monetary policies. However, with the improved outlook for both FX and inflation, we expect monetary policies to prioritize growth by favouring quantitative easing in 2018. Moreover, this stance can be observed in the reduced frequency of CBN's OMO auction as well as the consistent decline in stop rates at these auctions. For 2018, we believe the interest of the Fiscal and monetary policymakers are aligned to push policies that will reduce borrowing cost and further stimulate growth.

Lower interest rate good for real sector growth

Nigeria's exit from recession was primarily driven by the rebound in oil output, due to the correction in global oil prices and the improve crude oil production. The non-oil sector, on the other hand, remained under water primarily due to the hostile interest rate environment which encouraged banks to boycott lending to the real industry for juicy government securities. With the gradual change in interest rate direction and overall improved economic outlook, we expect credit to the private sector to improve significantly in 2018. This will drive growth across the various economic sector. Furthermore, on the back of the lower interest rates, we expect debt service cost to crash significantly across businesses thus, improving profitability as well as shareholders' return in 2018.

We expect credit to the private sector to improve significantly as government need for local funds decline

Government debt service burden to ease

Government debt service cost has increased significantly in recent times and currently accounts for 23.4% of fiscal expenditure. This is largely as a result of the high-interest rate environment and the need to increase borrowings to fund fiscal deficit. Expensive local borrowings is expected to make 50% of government's total borrowing in 2018 (₦1.3 trillion according to our estimate). From our calculations, a 600bps moderation in local yield, as well as the 26% increase in foreign borrowings, will see government save c.₦149.5 billion in debt service cost in 2018. More so, the government plans to refinance $3 billion of local debt with Eurobonds at a yield of 9.0 % (compared to the average domestic yield of 14%) should see government save an additional ₦100.6 billion in debt service in 2018. Cumulatively, government's new debt strategy should result to a savings of ₦250.1 billion (11.2% of projected total debt service cost in 2018). Thus, we expect the lower interest rate environment and the higher ratio of foreign borrowings to significantly moderate debt service burden henceforth thereby, freeing funds for other government expenditures.

Government to save c.₦250.1 billion in debt service cost on debt restructuring.

Risk: Lower interest rate may discourage foreign portfolio investors

On the back of the introduction of the Investors & Exporters Window (IEW) which alleviated investors FX supply concerns, foreign portfolio investors (FPI) have dominated the window in order to take advantage of juicy yields on government securities. Whilst we expect to see some moderation in FPI interest on the back of the lower yields, we think the government strategy to increase foreign borrowings via Eurobonds will compensate for the decline in FX liquidity to a great extent. Hence, we do not expect this to materially impact our positive outlook for the domestic currency in the short term.

Capital Markets

Equities: is the party of the bulls just getting started?

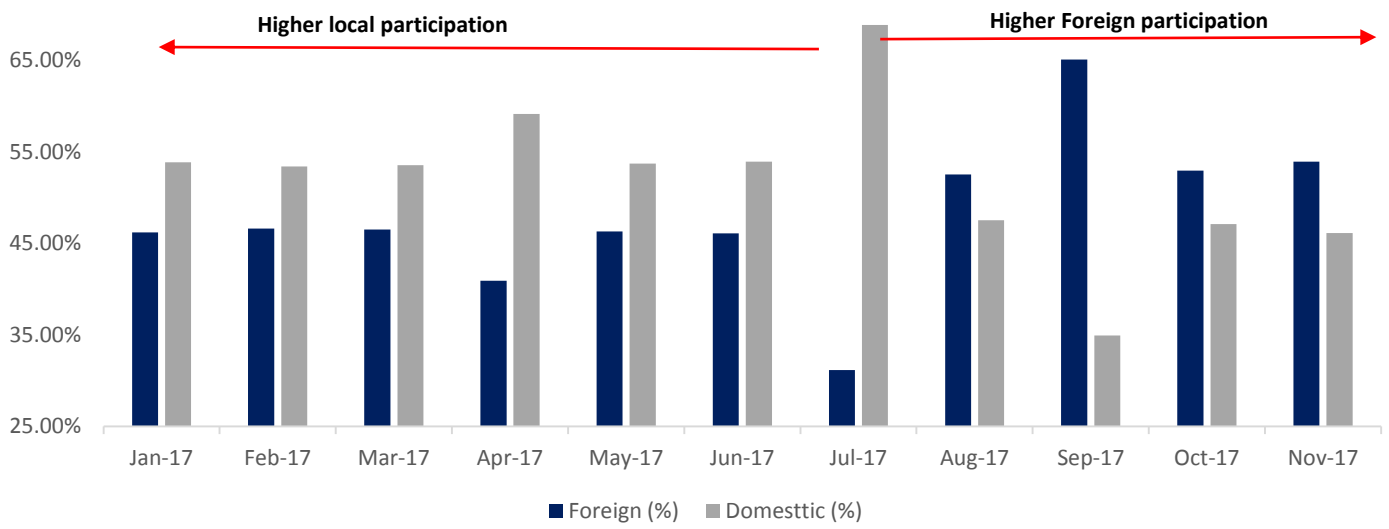
We think our base scenario will play out in the equities market in 2018. In this scenario, we expect the equities market to ride on the positive optimism of the improving economic fundamentals in H1'18 whilst we see a slight slowdown in activities in H2'18 on the back of upcoming elections in early 2019.

For how long can stocks maintain current positive momentum?

H1'18 performance to be positive on renewed local and foreign investor's interest: Given the strong economic outlook on the back of improving crude oil prices, stable FX market and moderating interest rates, we believe the Nigeria bourse is on course for another positive performance in the first half of 2018. Following the success of the investor and exporter's window, foreign interest in the equities market has improved significantly – with the equities market gaining c.48.5% after the implementation of the IEW (April 24, 2017 to December 31, 2017). With the last hurdle – the decision by MSCI to retain Nigeria in the frontier market – now out of the way, we believe the track is now set for another bull run in the first half of 2018. Further supporting the outlook of equities in H1'18, is the new PENCOM regulations which are expected to prompt the Pension Fund Administration (PFAs) to improve their exposure to stocks, thus enhancing the outlook of equities in 2018.

We expect sentiments in the equities market to remain upbeat in H2'18

Figure 9: Foreign inflows trend in 2017



A slowdown likely in H2'18 as investors become weary of approaching elections: The performance of the local bourse in H2'18 will largely be dependent on the tone of the political environment as election preparations kick-off. Whilst we expect a relatively peaceful election with a high likelihood of the incumbent remaining in power, investors are likely to remain cautious. Thus, we see optimism in the equities market moderating in the second half of the year. However, we expect the sustained positive economic outlook as well as the expected less volatile political environment to prevent significant sell-offs during the period.

Election blues may depress sentiments in H2'18

Our base scenario presents a green ASI in 2018: We expect the anticipated recovery in corporate earnings of companies in the consumer goods sector, industrial goods as well as tier-II banks to drive the ASI to a green close in 2018. We also expect the positive outlook for interest rate, FX, government spending, and improving consumer wallet to support profitability margins of companies in the consumer and industrial goods space. For the tier-II banks, we expect the improved economic environment to improve asset quality, reduce provisions and create an enabling environment to grow loans thus, enhancing earnings in 2018. Our base case scenario projects a return of 15-35% factoring the sustained economic outlook and the expected slowdown in H2'18 on political concerns. Our bull scenario anticipates a rally in H2'18 and downplays the impact of political concerns resulting in a growth of 25% - 40%. Finally, our bear scenario factors the possibility of a turn in the crude oil trend and political instability leading to an overall decline of negative 10% - 0%.

We anticipate a positive close of 15%-20% in the equities market in 2018

Table 3: ASI Scenarios for 2018

Scenarios	Rationale	ASI return projections
Bull	The bull scenario expects the impact of election to be mild and thus expect sentiments in H2'18 to be relatively bullish.	35% - 55%
Base	This Scenario expects the impact of elections on the equities market to be fairly significant in H2'18 but expects positive economic fundamentals to drive sentiments in H1'18.	15%-35%
Bear	Our Bear scenario expects the economic optimism to slowdown in H1'18 with the election effects further weakening sentiments in H2'18	-10%-15%

MTN's proposed listing set towards the end of Q2 could revive the Nigerian IPO market

Following a long hiatus in the Nigerian Initial Public Offering (IPO) market, MTN, one of Africa's largest telecommunications companies and the largest in Nigeria with about 36.2% market share (over 51 million subscribers as at November 2017 according to data from the Nigerian Communications Commission), has set the stage to commence action on its long-awaited court-mandated IPO. It was stated by the company's group CEO in November that plans for the IPO were already underway and should be completed within six months. Thus, we expect the official listing to be in May 2018. Given the anticipated value of MTN Nigeria ($5 billion – $8 billion (₦1.8 trillion to ₦2.9 trillion at $1/N360) using EV/EBITDA multiples), we expect investors to increase their exposure in the ICT sector which would in turn result in increased activity and liquidity for the market. With the listing of MTN Nigeria, the ICT sector could be another large cap sector on the local

MTN IPO to further deepen the Nigerian equities market.

bourse, which will in turn help improve market depth. Notwithstanding these upsides, however, the company had included a caveat to its IPO announcement, stating that the proposed listing would be subject to suitable market circumstances and conditions, as well as the appropriate approvals from the relevant regulators and other stakeholders. Given the improved optimism surrounding the equities market, we think the box for a suitable market environment is checked and approvals from relevant stakeholders would not be a challenge.

Will Upcoming 2019 Presidential elections sway the market to bears in H2'18?

With the election cycle officially kicking in through Q3'2018 following the traditional party primaries, we expect activities in the equities market to begin to wane as foreign and local investors take to the sidelines in anticipation of the outcome of the presidential elections. However, we do not expect to the see the extreme bearishness observed in 2014 as a result of the 2015 upcoming elections. The 2014 trend was exacerbated by the rout in crude oil prices and the degree of uncertainty surrounding the upcoming election as a result of the strong opposition. On the other hand, we think the expected trend will be similar to what was observed in 2010, where the market slowed down a bit and eventually picked up to close the year positive. Two major theme remains identical between the 2010 and upcoming 2019 elections: 1) oil prices were recovering from a downturn 2) the chances of the incumbent returning was significantly high. Whilst, we expect increased cautiousness in the equities market in H2'17, we believe that performance during the period will swing between marginal gains and marginal losses as opposed to the steep decline observed in 2014.

We expect sentiments in the equities market to remain upbeat in H2'18

Figure 10: Pre-election year 2010 crude oil ($) and ASI trend

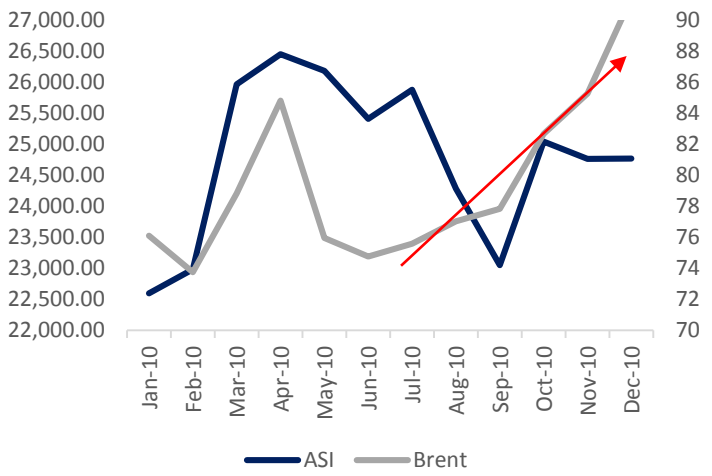
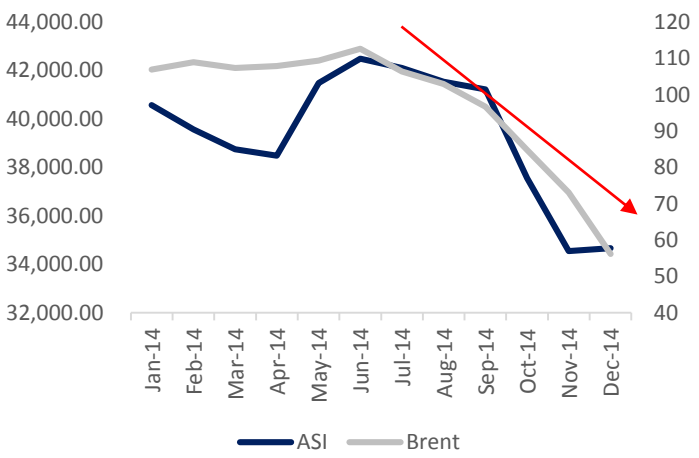


Figure 11: Pre-election year 2014 crude oil and ASI trend



Source: NSE, CardinalStone

Table 4: Market trend showing pre-election years' market performance in Nigeria from 1998 till date			
Year	Open	Close	YTD (%) change
1998	6,440.51	5,680.06	(11.8)
2002	10,903.80	12,059.20	10.6
2006	24,085.80	33,189.30	37.8
2010	20,827.17	24,770.52	18.93
2014	41,329.19	34,657.15	(16.14)
2017	**26,874.62**	**38,243.19**	**42.30**
2018 pre- election year	**38,264.79**	**?**	**?**

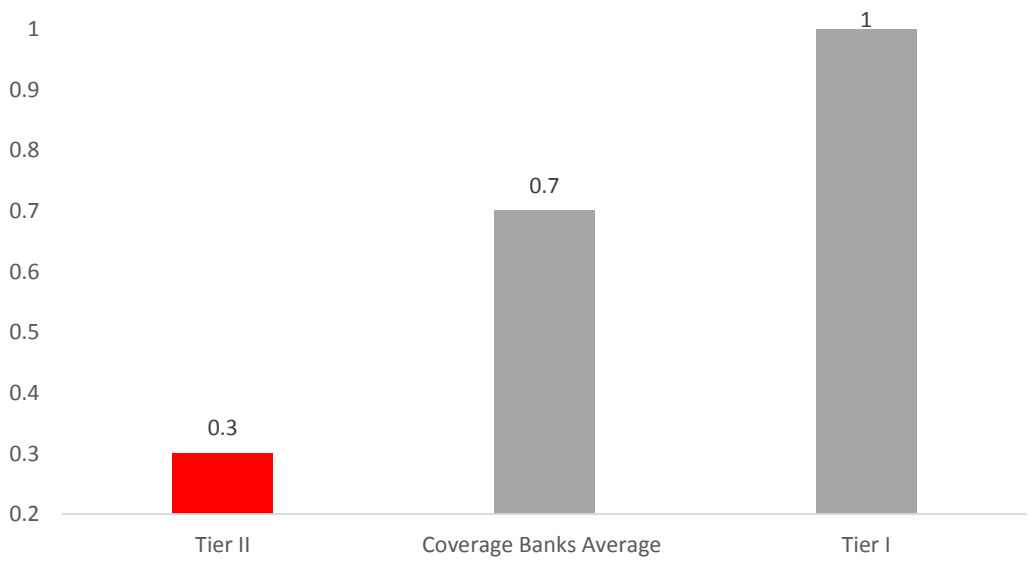
Investment strategies to employ in 2018

Banks: The tier 1 banks to a very large extent have enjoyed their fair share of recovery in 2017- tier-I banks share price appreciated by an average of 101.4% in 2017. Though upside potential still persists for the likes of UBA and FBNH, we believe the opportunities for significant capital gains are in the tier-II names. We believe the positive economic environment provides an opportunity for improved asset quality and growth of credit asset for the tier-II banks. Thus, we expect to see gradual improvement in ROE and profitability in 2018 which will translate to improved share prices.

Increase exposure to undervalued tier-II names

Investment advice: *we think investors should increase their exposure to quality tier-II names (FCMB and FIDELITY) especially in the first half of the year when we expect sentiments to be mostly positive, and also take strategic positions in tier-1 banks (UBA and FBNH) with potential to further improve profitability.*

Figure 12: Banks Relative Valuation



Source: NSE, CardinalStone

Consumer Goods Sector: Stocks in the consumer goods sector recovered mildly despite the strong Bull Run in 2017. The consumer goods sector returned just c.35.2% YTD which is significantly lower than returns of c.77.6% recorded in the financial services sector. We believe the muted appreciation was primarily as a result of lower profitability on the back of high interest expense and the lag impact of the Naira appreciation in 2017. In 2018, we expect the lower interest rate and the stable FX supply to be significantly positive for consumer goods companies. Hence, we expect profitability in consumer names to strengthen in 2018.

Investment Advice: *increase exposure to undervalued consumer goods names like Flourmills and PZ. We also think investors should take advantage of the bullish sentiment expected in the first half of the year. In the second half of the year, re-balance portfolio to defensive stocks like Nestle and NB to weather the mild bearishness anticipated in the period*

Overweight undervalued consumer goods stocks like Flourmills.

Industrial Goods Sector: the outlook for the industrial goods sector is improving, as the government is set to increase borrowing and improve private-public partnerships to finance capital projects which will eventually trickle down to earnings for the industrial goods companies. More so, we think the lower interest rates may spur lending for constructions and infrastructure projects which will eventually improve top-line. However, we expect the impact of the improved spending from both the government and private sector to be lagged largely due to the speed of budget implementation and the gradual transition period for banks to start lending. Hence, we think profitability for the industrial goods companies may not start trending up until the second half of the year which coincides with the anticipated slowdown expected in the equities market.

Investment Advice: *we are not bullish on industrial goods companies in the first half of the year given the aforementioned. However, we think there are cherry-picking opportunities from early second half of the year to strategically position in the undervalued names ahead of the probable rally of the sector in 2019.*

Fixed Income: Bond yields- Destination South!

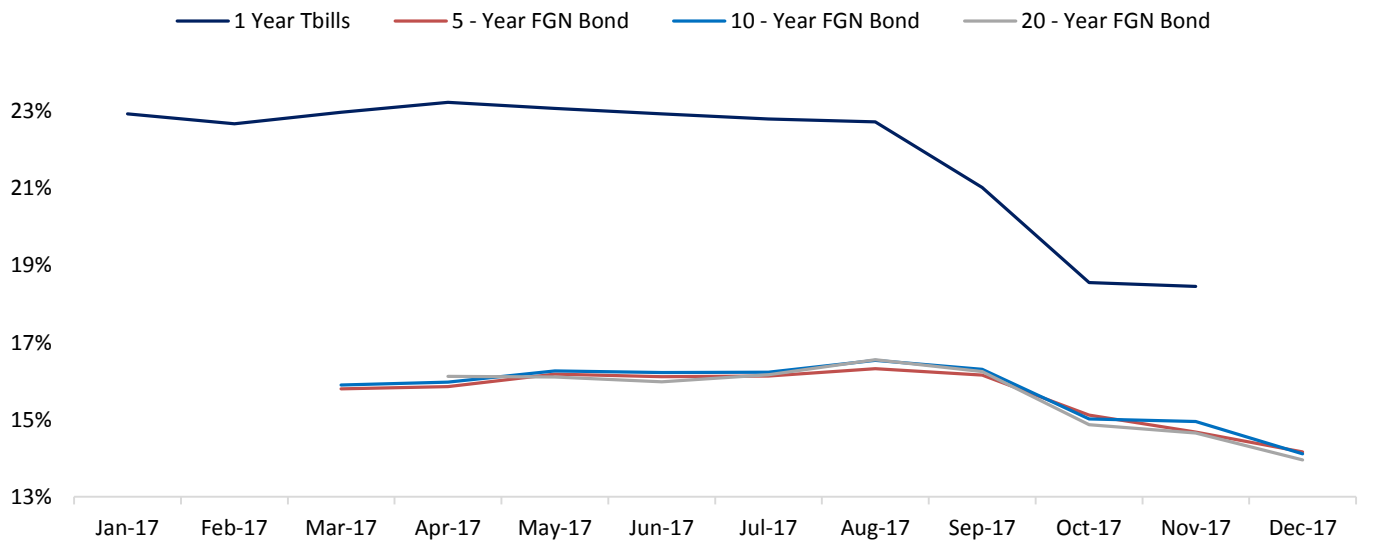
Yields are expected to trend lower following expectations of inflation decline. More so, government's initiative to pivot more towards Eurobonds may appear positive for private sector credit.

Monetary policy Easing to pressure yields down

While there seems to be an overall consensus that the MPC would loosen its policy in 2018, most market participants differ on the pace and weight of the expected monetary policy easing. We think that the slow pace of inflation decline, despite other seemingly improving macro fundamentals suggests looming sluggishness in monetary policy normalization. An argument for a much steeper dip in monetary policy rate could be made given increasing economic slack. Nevertheless, this is likely to be counter-productive to inflation moderation. While we favour easing of the policy rate, we posit this will only be mild especially if inflation continues to decline slower than anticipated. In the near term, however, with inflation expectations still forecast to fall, we expect yields to come under downward pressure as the MPC gradually implements dovish policies. Subsequently, bond yields should take a cue from expectations in inflation movements.

We expect yields to trend downwards as MPC gradually implement its expansionary policies

Figure: Treasury securities yield trend in 2017



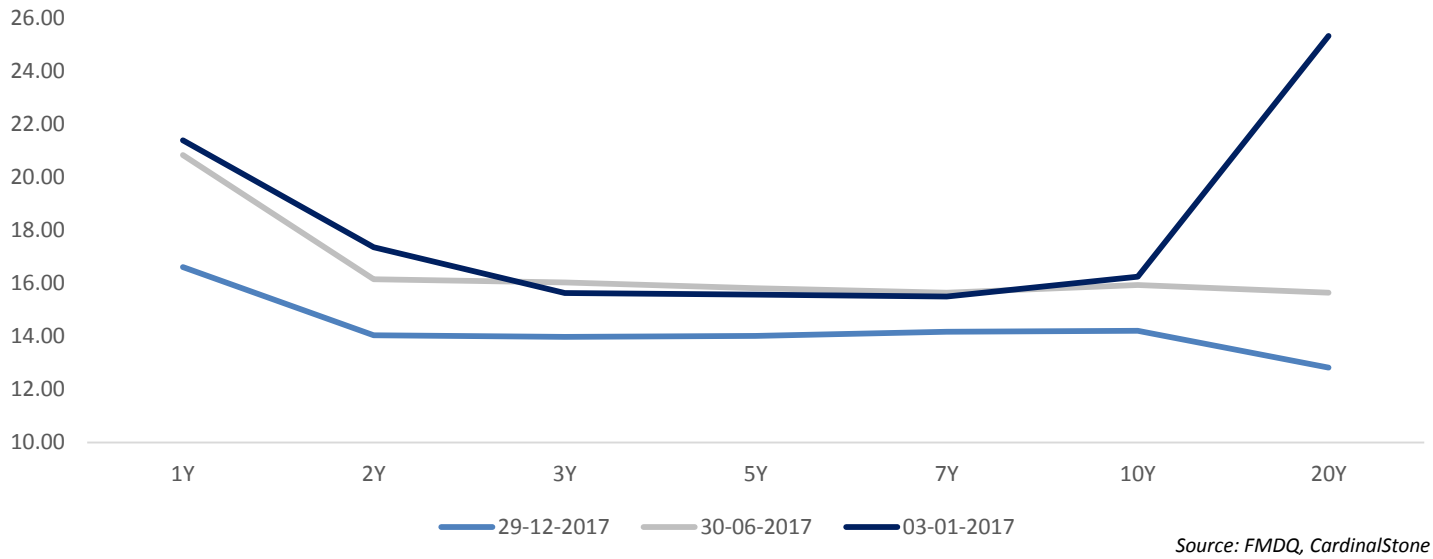
Source: FMDQ, CardinalStone

Sustained equities market growth to have adverse impact on bonds

The equities market recorded strong growth in 2017 and there is increasing expectation that this rally will be sustained in 2018. Corporates have shown signs of overcoming the growth hurdles experienced in the last two years, notably FX constraints, higher input costs, increasing finance costs for manufacturers, as well as high NPLs for banks.

Improving corporate fundamentals, coupled with gradually declining bond yields should make fixed income market a less attractive destination for investors. However, sustained growth in equities market suggests that there will be upward pressure on bond yields at some point especially if the pace of inflation decline continues to slow down.

Figures: Yield curve at the beginning, middle and end of the Year



Source: FMDQ, CardinalStone

Eurobonds the next bus-stop; corporate credit to step on the gas

Corporate borrowing to increase as government hits the break on local borrowing

The Federal Government has reiterated its commitment to rebalance its debt mix to 60:40 with external borrowing making up the larger component. Therefore, while fiscal deficit is expected to widen in 2018 compared to 2017, deficit financing strategies, we think, will tilt more towards external sources. This already is in play following the government's raising of $3 billion in Eurobonds issue in December 2017, part of an approved plan for a $5.5 billion issue. A slow-down in domestic bill issuance will pressure the NIMs of financial institutions which have largely benefitted from high yields in previous periods. As a result, in order to preserve margins, we expect financial institutions to increase loan assets towards private sector with the consequent implications for economic growth and expansion.

Interest Rate hikes in developed economies

Following the Fed hint of further rate hikes in 2018, we anticipate that this will spur increased capital outflow from emerging market securities as foreign investors take advantage of higher yields on US based risk-free assets. The possibility of this is further worsened by expectations of a lower yield environment in the domestic space as the CBN gradually eases its policy rate. While we think there may be an initial market overreaction to further Fed rate hikes, we expect this to eventually stabilize with time. We do not

foresee a massive net capital outflow as foreign investors' interest in Nigeria's foreign currency denominated bonds remains. The recent oversubscription of the $3 billion Eurobond issue by as much as 280% is a pointer to improving foreign interest in Nigeria's fixed income market. Furthermore, expectations of improvement in oil prices, as well as improved production output following reduction in disruptions should serve as a boost for increased foreign exposure as the possibility of a default significantly diminishes.

Hope for an index readmission?

Following the exclusion of Nigeria from a number of emerging market bond indexes notably the JP Morgan emerging markets bond index in 2015, there is ongoing speculation as to whether and when the country can be eligible for a possible readmission. The paramount issue that facilitated Nigeria's expulsion from the index revolved around foreign investors' struggle to trade naira bonds due to lack of liquidity for FX transactions, lack of transparency in exchange rate determination as well as the lack of a fully functional two-way FX market. This consequently saw a number of portfolio managers decrease their exposure to the Nigerian bond market in favour of other emerging market opportunities represented in the index. However, following improvement in macro-fundamentals possibly point to we have observed considerable improvement notably in key areas that led to Nigeria's exclusion from the JP Morgan emerging market index. A major development is the establishment of the Investors and Exporters window which technically deals with two of the three identified issues previously mentioned. While we are of the opinion that most foreign investors already have positive inclination towards the Nigerian financial market owing to observed improvements in economic fundamentals as well as pace of ongoing reforms in the country, we think that Nigeria's readmission in the bond index will further enhance the appeal of the Nigerian capital market, put paid to foreign investors positive sentiments and consequently bring about increased foreign portfolio investment into the economy.

We have seen noticeable improvements in factors that led to the exclusion of the Nigeria from the bond index

Investment Theme

Instrument	Our Position	Key risk
Government Bonds	Investors should position in longer duration bonds to take advantage of capital gain from moderating yields.	Inflation fails to turn as expected; wider fiscal deficit prompting government to increase planned borrowing.
Treasury Bills	Investors should position in longer maturities to reduce reinvestment risks.	Inflation fails to turn as expected; wider fiscal deficit prompting government to increase planned borrowing.
Corporate Bonds	Offers higher yields compared to government securities.	Default risk exists

Sectors

Banking: Earnings- No Free lunch Even in Freetown

Lower asset yield, improving asset quality and the direction of loan growth are themes we expect to dominate the banking industry in 2018. In all, we think growth in bottom-line will significantly slowdown albeit it will remain positive as we expect lower provisions, interest expense and rising loan growth to largely offset the effect of lower asset yield in 2018.

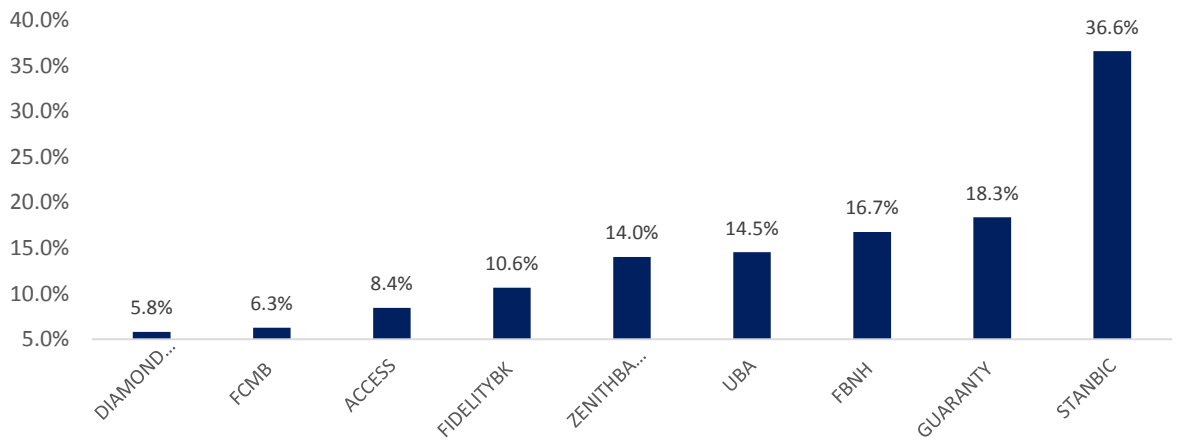
Lower interest rate environment may moderate profitability in 2018

The persistent decline in yields on government securities in recent times hints that the era of high yields may have come to an end. We believe the extent to which the lower yield environment will affect bank profitability in 2018 will be largely dependent on the following factors:

1. The relative composition of treasury bills securities in total interest-bearing asset
2. The willingness and ability to quickly ramp up loans to support interest income
3. The sensitivity of funding cost (interest expense) to interest rate

The recent monetary easing activities of the CBN has seen yield across all treasury bills maturities moderate by an average of 500 bps in recent times. With income from government securities accounting for an average of 34.7% of total interest income amongst our coverage banks, we expect the declining yield environment to impact asset yield and interest income in 2018 negatively. We expect the magnitude of the impact on individual banks to be largely dependent on the duration of their government securities portfolio and their ability to quickly ramp up credit asset generation. Based on this consideration, we estimate an average decline of c.10% in interest income across our coverage banks in 2018.

Figure 13: Treasury bills (% of total asset)



Source: financials, CardinalStone

Given the high relative exposure of **STANBIC**, **GUARANTY** and **FBNH** (36.6%, 18.3% and 16.7% respectively), we expect the impact of lower yields on government securities to be more severe. While for DIAMONDBNK, FCMB and ACCESS, the impact of lower yields should be milder given the relatively lower exposure of **5.8%**, **6.3%,** and **8.4%**. We reiterate that the overall impact on bottom-line will be determined by the sensitivity of interest expense to the lower yields and the ability and willingness to scale up loans in 2018.

Impact of asset yield reversal on interest income

In the simulation analysis below, we assumed that asset yield of coverage banks reverses to a three-year average pre-interest rate hike era (Pre 2016) and we examined the expected impact on interest income as well as the required loan growth to mitigate the effects on earnings. The analysis, however, assumes that the size of bank's portfolio of government securities remains constant.

Figure 14: Asset yield trend (Pre and during high interest rate)

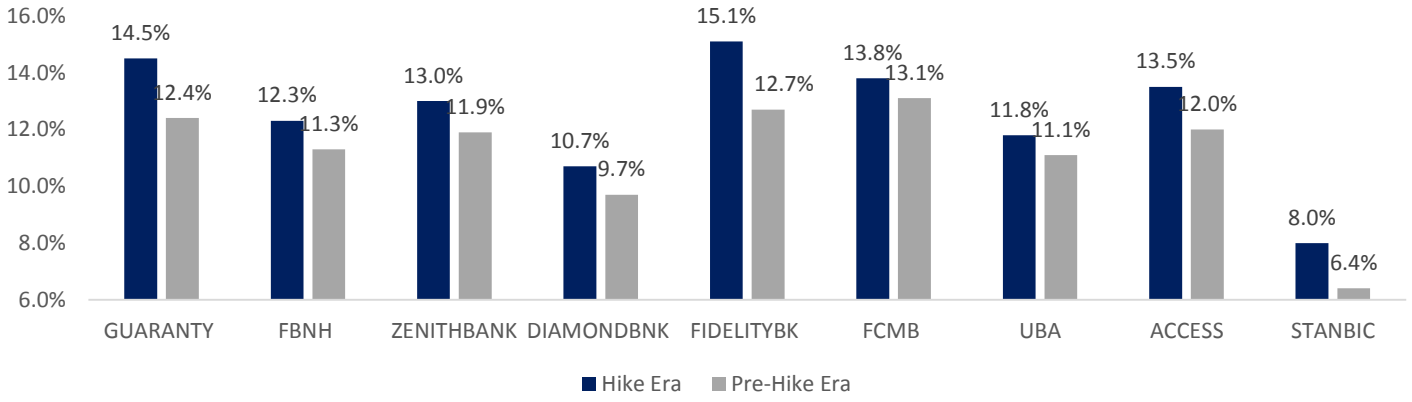


Table 4: Interest income sensitization to asset yield reversal

	change in asset yield (bps)	Interest bearing asset (₦'billions)	Est. decline in interest income (%)	Est. loan growth to offset income gap (%)
STANBIC	160	1,657.90	29.6	54.4
GUARANTY	210	2,664.50	22.5	31.6
FIDELITYBK	240	1,247.10	27.1	31.1
ACCESS	150	3,235.60	19.7	22.8
ZENITHBANK	110	4,861.30	14.8	20.8
DIAMONDBNK	100	1,797.60	13.7	19
FBNH	100	3,505.30	9.8	15.2
UBA	70	3,562.40	10.5	14.1
FCMB	70	1,069.20	7.8	8.7

Source: Financials, CardinalStone

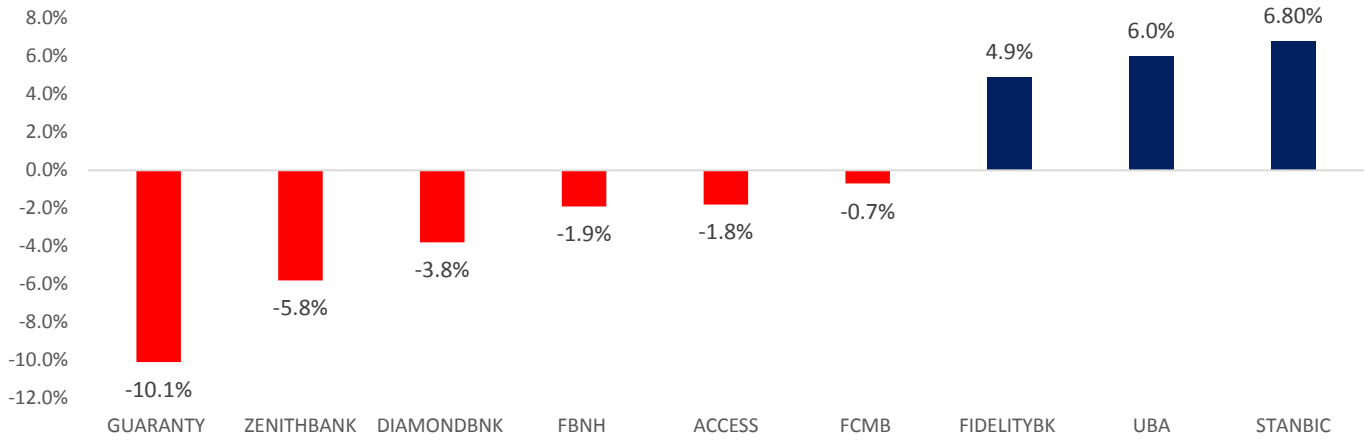
Impact on interest income: From our analysis, we expect **STANBIC, FIDELITYBK,** and **GUARANTY** to be most impacted by the ongoing yield reversal with an estimated decline in interest income of 29.6%, 27.1% and 22.5% respectively. On the flip side, we believe **FCMB**, **UBA,** and **FBNH** will be the least impacted with estimated declines of 7.8%, 9.8%, and 10.5% respectively.

Expected loan growth to mitigate impact: From our analysis, banks in our coverage will need to grow loans by an average of 23.4% to offset the effects of lower yields on interest income. STANBIC, GUARANTY, and FIDELITY will have to increase loans by 54.4%, 31.6% and 31.1% respectively to mitigate the impact of the lower asset yields.

Will falling yields spur loan growth in 2018?

Given the direction of the monetary and fiscal policy as well as the recent downward spiral of the yield on government securities, we expect banks to resume and very meticulously ramp up lending. During the high yield terrain, banks benefited significantly from risk and tax-free income coming from the attractive yields on government securities with interest income from government securities rising on the average by 61.6% amongst coverage banks. On the other hand, the poor economic condition and high default rate created apathy for credit assets causing net loans to moderate on the average by 3.0% across coverage banks. With the stretch of high yields on government securities coming to an end, we believe banks will need to generate quality risk assets to support the current level of revenue generated via government securities. However, we expect the ramp up in loans to be gradual given the fragile state of the economic recovery. As mentioned earlier, the impact of lower yields on profitability will likely be smoothened over the first six months in 2018 given that the duration of the investment securities portfolios is most likely tilted towards mid to longer tenor treasury bills. Thus, we expect the banks to take advantage of the first six months grace period in 2018 to gradually grow credit asset to offset the expected slump in interest income in the second half of 2018 when most of the Treasury bill securities would have matured. Overall, we project a moderate growth of 10% across our coverage banks in 2018.

Figure 15: Coverage banks loan growth as at 9M'17

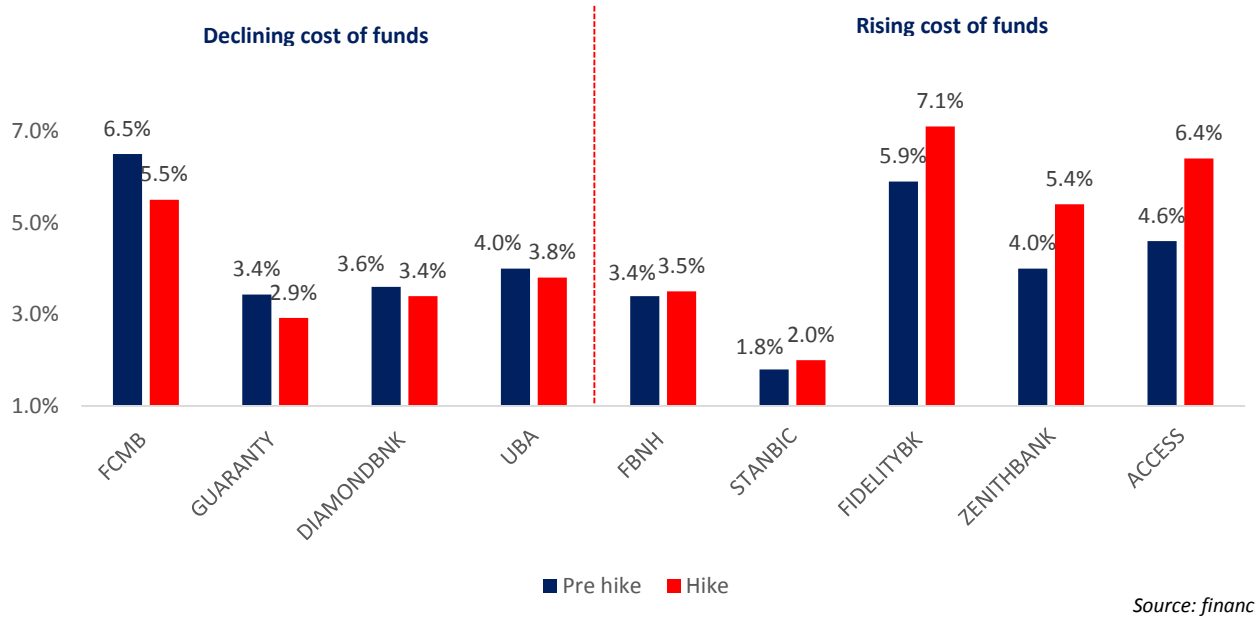


Source: Banks presentation, CardinalStone

Lower cost of funds to support Net Interest Margin (NIM)

The high-interest rate era was not all good for the banks, particularly for banks with high exposure to corporate and term deposit. During the high rate regime, cost of funds across our coverage banks inched up by an average of 30bps (compared to an average increase of 120bps in asset yield). Surprisingly, **GUARANTY**, **UBA,** and **FCMB** reported lower cost of funds when compared to the pre-high interest rate era. **ACCESS** and **ZENITHBANK**, however, were the most impacted as cost of funds rose by 180bps and 140bps during the period. We think the impact of the high-interest rate reversal will be more beneficial to **ZENITHBANK** and **ACCESS** due to their high composition of corporate and term deposits while we expect the effect on the likes of **GUARANTY**, **UBA**, **FBNH,** and **DIAMONDBNK** to be very marginal as a result of their relatively large concentration of low-cost (retail) deposits. Overall, as interest rates continue to spiral downwards, we expect the resulting moderation in cost of funds to cushion the impact of lower interest income on bottom-line. However, given the higher sensitivity of interest income to interest rate, we expect the overall effect on Net Interest Income (NII) to be negative.

Figure 16: Cost of funds trend (pre and during interest rate hike)

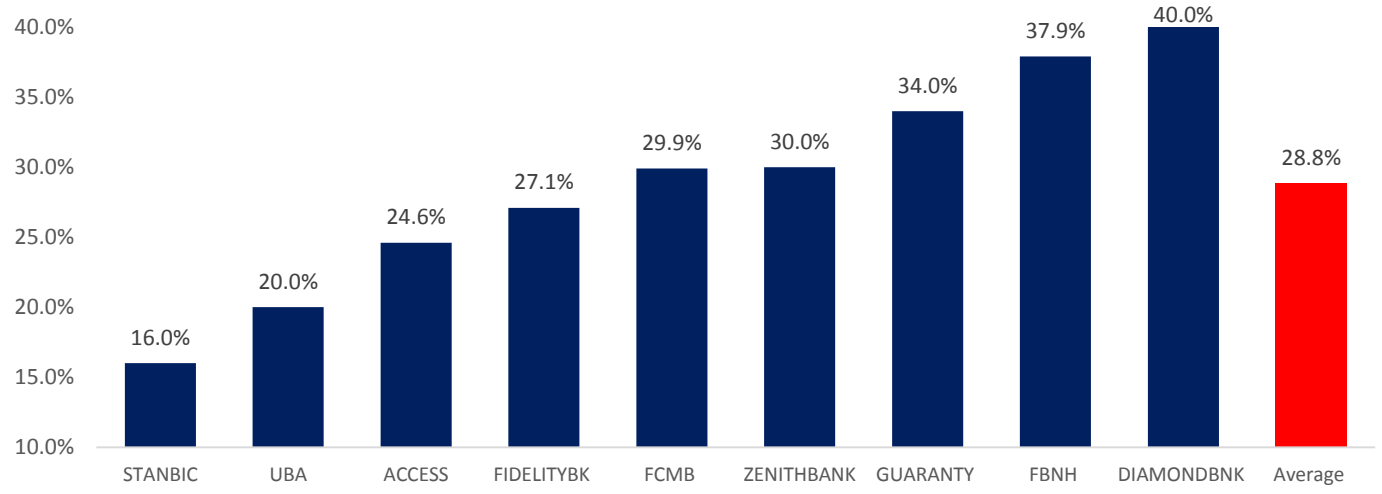


Source: financials, CardinalStone

Respite for asset quality on better oil outlook

Given the massive exposure of the banking sector to the upstream oil & gas sector, we expect the improved outlook for the upstream Oil & Gas sector to impact asset quality in 2018 positively. The average exposure of banks under our coverage represents 28.8% of total loans. Hence, with the sustained peace as well as higher crude oil prices, we expect a significant improvement in the cash flows of upstream oil & gas companies which will subsequently translate to improved loan performance, reduced impairment and increased write-backs in 2018. We expect GUARANTY, FBNH and DIAMONDBNK to benefit the most given their significant relative exposure of34.0%, 37.4% and 40% respectively to Oil & Gas sector. More so, given the high correlation of most economic sector to the supply of petrodollars, we also expect the performance of loan exposed to the manufacturing and general commerce to improve on the back of better FX liquidity. Overall, we anticipate a general decline in impairment provisions as well as marked improvement in loan and provision write-backs in 2018. Thus, we expect cost of risk amongst our coverage banks to ease by 50bps to 0.7% by FY'18.

Figure 17: Coverage banks' exposure to the oil & gas sector



Source: Banks presentation, CardinalStone

IFRS 9 – Coverage banks are adequately capitalized to weather the impact

The CBN has directed banks to comply with the new IFRS 9 regulation that is due to take effect in January 2018. The IFRS 9 regulation is expected to affect how impairment charges on financial assets (including loans) are computed. The new regulation introduces an "expected loss" model which focuses on the risk that a loan will default rather than whether a loss is incurred. This implies that banks will have to start providing for possible future credit losses the moment a credit asset is created even if it is highly probable that all cash flows pertaining to the asset will be realised. The new model considers factors like obligor's credit rating, collateral and various macroeconomic scenarios in determining probable future loss. Owing to the highly subjective nature of the process it is difficult to ascertain the extent of the impact on individual banks. However, we believe the banks with strong risk management processes coupled with high quality obligors are likely to be least affected. Thus, we expect the impact to be more severe on tier II banks as they have higher tendencies of holding lower quality obligors and collateral given the size of their balance sheet. Overall, we do not expect the impact to materially impact profitability given that the adjustment in provisions is expected to be passed through other comprehensive income (OCI) statement. However, there will be consequences for capital. Management of our coverage banks expects the impact on capital adequacy ratio to average a decline of 200bps. Going by management average estimate, most banks are sufficiently above the minimum requirement and therefore we don't expect significant deterioration in capital adequacy across our coverage banks upon the implementation of IFRS 9.

Capital raising: will the banks join the right issue bandwagon?

After a spell of huge impairment losses and loan write-offs that has significantly eroded capital during the recent economic slowdown, we believe the banking industry is ripe for another round of equity capitalization. During the high impairment era which significantly eroded capital (especially for tier- II banks), the high interest environment shielded the banks from the dire need for capital to grow loans. As such, it was easy for the banks to channel their liquidity into risk-free government securities. However, with the largesse of the high interest rate environment finally coming to an end, the need to raise equity capital to support credit growth is now back to the fore. And thankfully, this is coinciding with a time where the optimism in the market is heightened and investors are actually looking to increase investment in the equities market. We believe the trend already started as the likes of Union Bank, UACN, Lafarge, UNILEVER and GUINNESS had successfully completed their right issues in 2017. Going into 2018, we expect the tier-II banks to be the first to test the waters as they were most impacted by the economic downturn. More so, the implementation of IFRS 9 in 2018 which is expected to moderate capital adequacy ratio by an average of 200bps further makes a case for bank management to buff up capital via right issue in 2018.

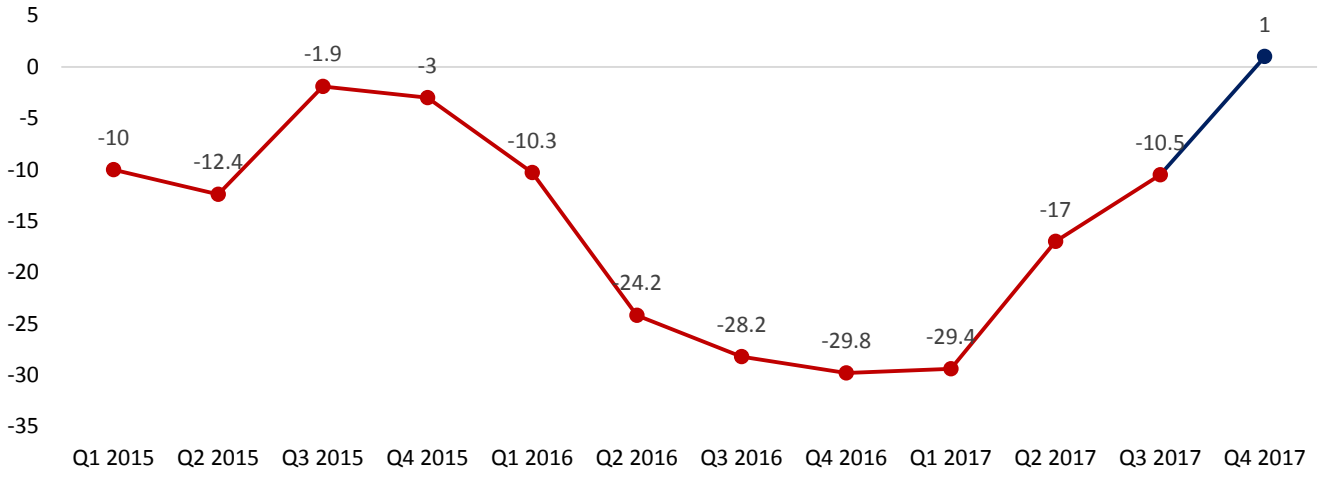
Consumer goods: Revenues to feed off consumption boost

Improving consumer confidence and the recovery in domestic consumption are key themes we expect to dominate the consumables space in 2018. This rides on the back of improvement in macro-economic fundamentals, with direct benefits for households. We also expect improved FX access to settle import bills as well as moderation in input costs to support margins in 2018.

Rising consumer confidence to spark consumption rebound

Macroeconomic fundamentals are gradually strengthening following Nigeria's exit from recession in Q2'17 and there is improving sentiment about what positives it portends for disposable income and domestic consumption. While there are concerns that growth remains fragile given the volatility in the price of the oil onto which Nigerian economy hangs, there is no doubt, at least, of a slight respite currently- with confidence gradually ramping up. Indications from CBN's recent Consumer Expectations Survey reveal consumers' optimism about the macroeconomic outlook for 2018, and this has led to improvements in the consumer confidence index which crossed positive for the first time in twelve quarters.

Figure 18: Consumer Confidence Index



Source: CBN, CardinalStone

Depressed disposable income saw demand shift from other consumer items to mostly food and personal care products in 2017. However, consumer companies look set for broad-based growth across critical segments other than food products in 2018. With the gradual improvement in consumer's wallet, households are more likely to increase their spending on non-food consumer items. This is expected to translate to higher demand and better revenue for the non-food consumer companies in 2018. If expectations of lower inflation in 2018 materialize, we expect this to enhance the real purchasing power of wages and consequently propel demand. Also, the expected improvement in

unemployment rate following expected economic expansion should further contribute to domestic consumption growth.

Backward integration, economies of scale to drive efficiency.

CBN's decision to restrict specific items from accessing its official window in 2015 placed significant pressure on input costs for FMCGs, as they had to source for FX from the parallel market at higher rates to settle import bills which consequently depressed gross margins. In response to this, we highlight that several companies have developed backward integration strategies and effective supply chain management to reduce over-reliance on imports to mitigate against exchange rate volatility that has hitherto hampered growth. Notably, **FLOURMILL** has set up its Sunti Golden Sugar Estate sugar mill ready for commissioning in early 2018. It has also enhanced its grain silos in Kano to begin to receive locally grown wheat while engaging local farmers for supply as well as several other backward integration projects for it agro allied segment to improve local sourcing of materials. **PZ** is leveraging its supply chain network to manage and ultimately reduce distribution inefficiencies to support operating margin. **DANGSUGAR** is expanding its sugar cane plantation across the country, supported by the government's initiative to boost sugar production in the country. However, we note that a number of these efforts may not have any significant impact in the near term given their capital-intensive nature. Nevertheless, it is our view that they portray optimistic outlook for the sector. The Central Bank has also touted the possibility of FX concessions for manufacturing firms who are willing to set up production facilities in the country rather than continually depending on the CBN for FX to import their inputs – and this led to UNILEVER's commissioning of a new Blue Band Factory in 2017.

Revenue growth to become more volume- than price-driven

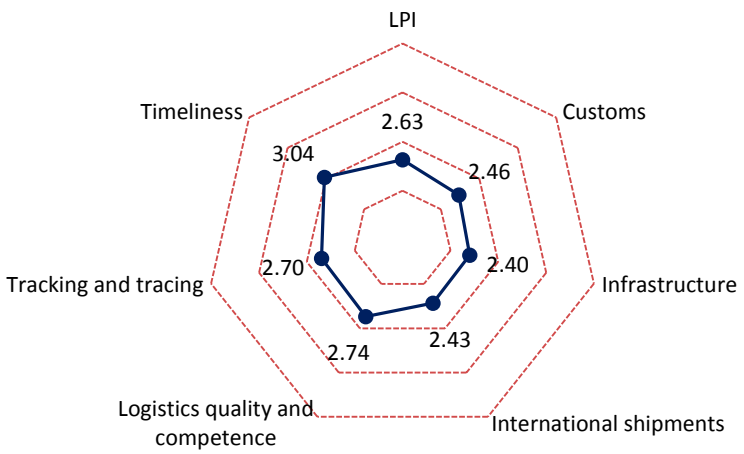
Rising input costs and FX constraints, saw gross margins come under pressure for most FMCGs in 2017. This led to several price increases in products as companies responded to keep up with margin expectations. As a result, consumer demand declined given the strong price elasticity of most consumer items other than the household necessities. In essence, revenue growth in 2017 primarily reflected price increases rather than volume expansion. Nevertheless, we expect that with further moderation in inflation in 2018 and improved consumer confidence, domestic consumption should improve leading to increased demand. Also, as input costs moderate due to lower commodity prices as well as ease of FX access, we expect consumer companies to adopt market penetration strategies through lower pricing, product resizing as well as product offering diversification to drive product acceptance, spur demand growth and boost revenues.

Inefficiencies in distribution network- a chink in the armour

Despite seeming improvements in transportation system over the years, distribution problems for consumer products continue to linger, from collection of inputs to final delivery to end-users. Inefficiencies in sales and distribution channels continue to worsen lead time with consequent implications for inventory management. The critical problem is the long time it takes for input importers to take delivery of their cargos from the ports as well as the state and reliability of existing distribution infrastructure such as roads and

warehouse facilities. The gridlock experienced at the Apapa port in 2017 is a typical concern for most FMCGs with the attendant surge in haulage and storage costs following an increased delay in cargo evacuation. For instance, with storage charge of ₦15,000 per day for overtime containers, according to media reports, cargo haulers are susceptible to face higher fees with consequent pass-through to the FMCGs. While the impact may be milder for vertically integrated firms such as FLOURMILL, we also think that the reliability and performance of any supply chain strategies to a large extent depends on a well-functioning interaction of logistics platforms, some of which may well be beyond the control of individual firms. Thus, we opine that this presents a critical challenge with adverse implications for FMCG profit margins- unless businesses decide to ultimately pass on the costs to consumers which in itself can inhibit volume expansion. According to the latest World Bank's Logistics Performance Index (December 2016- released biennially) which assesses the ease of movement of goods across the supply chain, Nigeria ranks 90 out of 160 countries measured (with a score of 2.63 out of 5 points), 20 places below its previous position on the index- an indication of worsening supply and distribution logistics.

Figure 19: Nigeria LPI* key indicators

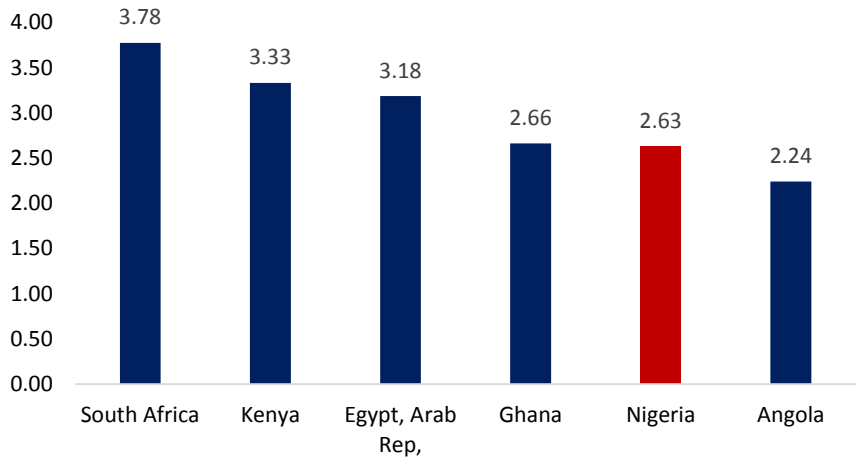


*The World Bank LPI measures the efficiency of logistics supply chain within a country based on feedback from operators on the ground.

Source: World Bank

Notwithstanding, increasing developments are being made to ease the flow of goods into and within the country notably with the ongoing construction of the Lekki Port in Lagos to support both the Lagos Port and the Tin Can Island Port Complexes. Also, as a temporary fix to the Apapa gridlock, the federal government has concluded measures for importers to take delivery of their shipments cleared from Lagos Ports at Ogun state via rail. This, we expect, would ease the logistics burden- even if slightly- on the FMCGs.

Figure 20: Logistics Performance Index of select African countries



Source: World Bank

Improving FX and stable commodity prices to drive down costs

Despite ongoing efforts to encourage local sourcing of critical inputs, several FMCG companies still depend on imports for raw material supply understandably due to quality concerns and, in some cases like PZ, it is due to strategic third-party partnerships. As a result, we expect sustained FX demand for corporates in 2018. The implications of this on costs depend on the two-pronged improvements in FX receipts and FX accessibility. Already, we anticipate further currency appreciation on the back of increasing oil revenues to ease off gross margin pressures through lower input costs. We also note the success of the Investors and Exporters FX window in enhancing liquidity for the facilitation of FX transactions as key in relieving the high exchange rate pressure on the cost of inputs.

Inventory build-up due to rising commodity prices

Other than the easing of FX restrictions for imports, stability in commodity prices is also a cornerstone for preserving- and possibly- enhancing profit margins for FMCGs. In the past year, prices of most agriculture commodities trended lower, thanks to buoyant harvest across major geographies which led to a supply-demand mismatch. However, in 2018, data from both the World Bank and the US Department of Agriculture suggests that agricultural prices will rise marginally due to an anticipated decline in global supply. Notwithstanding, we highlight the outlook for crucial material inputs for consumer companies in Nigeria:

Sorghum: Prices firmed up by 10 percent in 2017 according to report from the Food and Agricultural Organisation, and while the commodity is produced in Nigeria, a further rise in global benchmark prices may impact local prices, leading to increased input costs for consumer firms. Following FAO's forecast for global sorghum production at 59 million tonnes, 5.4 percent lower than the previous season, we expect prices to continue to hover

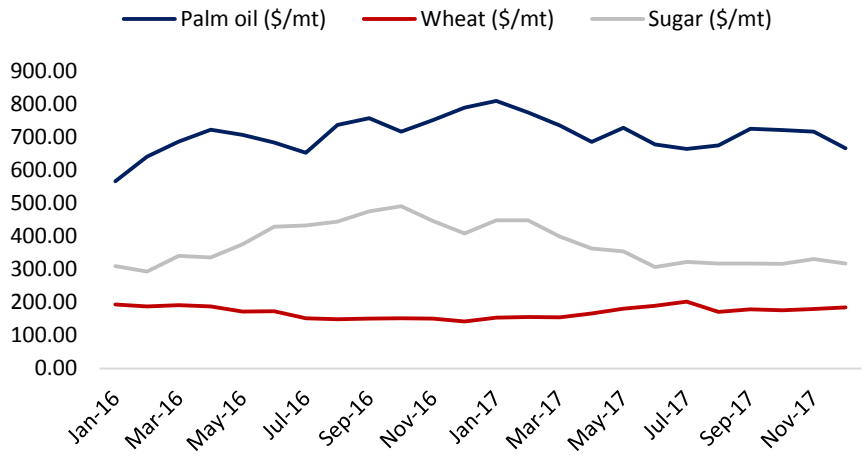
around current or slightly higher levels in 2018 as any excess demand- especially for industrial uses- can be met by other alternative coarse grains.

Wheat: According to the US Department of Agriculture data, the global wheat production forecast for 2017/18 season climbed by 3.5 million tonnes to 755.2 million tonnes driven mainly by robust yield from Canada. Consumption is also expected to rise, but only as high enough to absorb two-thirds of output increase thus leaving inventories to edge slightly higher. As a result, we expect lower prices with positive implication for FMCGs.

Sugar: The Food and Agricultural Organisation projects that sugar prices will remain below 2016 levels owing to expected higher output from the EU, Russia, and Brazil as well as a slowdown in Chinese imports due to higher tariffs. In Nigeria, the National Sugar Master Plan has performed below expectations following a mid-term review by the National Sugar Development Council- with implementation reported at 43 percent. Hence, with local production capacity still beneath self-sufficiency targets, we expect consumer firms such as FLOURMILL and DANGSUGAR to continue to depend on imports for a significant proportion of their material needs.

Oil Palm: Palm oil prices declined 17.8 percent between January and December 2017 according to World Bank data. Prices are expected to continue to moderate following projected expansion in global output led by Indonesia (2 million tonnes projected increase) and Malaysia (2.1 million tonnes projected growth) in 2018. The downward trend in prices is expected to filter into local markets with local producers such as Presco and Okomu taking in price cuts as a result. This presents opportunities for gross margin expansion in FMCG companies like PZ and UNILEVER.

Figure 21: Commodity price trend



Source: World Bank

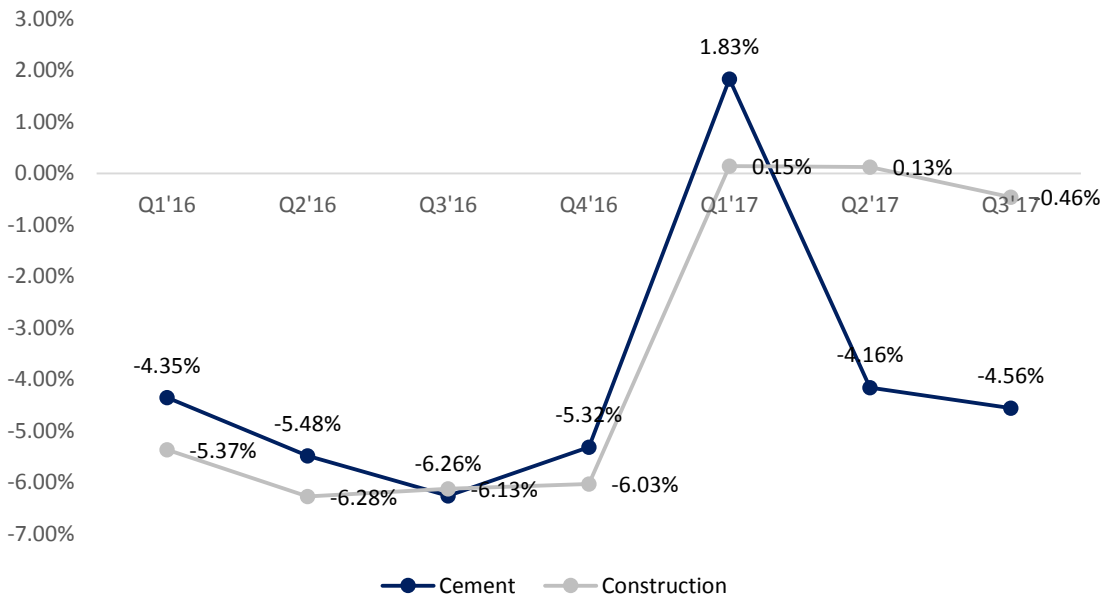
Industrial Goods: Improved Fiscal spending to spur sector

We expect improved CAPEX spending in 2018, following last year's low implementation rate, to drive revenue growth in the industrial space. We also expect efforts to enhance private sector participation towards bridging infrastructural gap to be a key theme during the year.

Poor CAPEX implementation; Industrial go-slow despite GDP recovery

Despite real GDP rebound in the second quarter of 2017 signifying Nigeria's recovery from recession, we observed declining growth in both the construction and cement sectors of the economy. As a matter of fact, there were declines in both sectors during the two successive quarters of GDP growth. Both the cement and construction sectors fell from a seven-quarters high of 1.83% and 0.15% in Q1'17 to -4.56% and -0.46% in Q3'17 respectively**.**

Figure 22: Construction and Cement GDP Trend



Source: NBS, CardinalStone

In assessing the catalysts for the industrial slowdown, we point out the very low implementation of the 2017 CAPEX appropriation. Of the *c.*N1.5 trillion budgeted for capital expenditure in 2017, only *c.*N377 billion (of which N94.3 billion was allocated to the Federal Ministry of Works, Power and Housing) was released for appropriation to the relevant MDAs as at September 2017 which represents 25.1 percent of planned CAPEX.

Pre-Election year to spur infrastructure spending.

Despite the slow rollout of infrastructure expenditure in 2017, we are optimistic on the spending outlook for 2018. In December 2017, the federal government raised $3 billion (₦915 billion) via Eurobond with $2.5 billion (₦762.5 billion) channelled towards financing capital expenditure in the 2017 budget. With 60% of the capital budget expected to be rolled into the 2018 budget, the government can continue to finance capital projects

approved in the 2017 budget in 2018 pending the senate approval of the 2018 budget. Thus, we expect a significant amount of the $2.5 billion (₦762.5 billion) raised in December 2017 to filter into the industrial goods sector in the first half of 2018. Also for the full year 2018 budget the government proposed to spend a cumulative of ₦820 billion ($2.7 billion) on industrial goods related capital projects. Going by our budget expectations that about 80% of capital projects will be executed in 2018, we expect c.N650 billion to filter in to the industrial goods sector in 2018. Furthermore, with the year 2018 being a pre-election year, we expect speedy implementations of capital projects as politicians race to fulfill their election promises ahead of the 2019 elections. On the back of this, we expect the incumbent government to facilitate the quick passage of the 2018 appropriation bill to give enough time to effectively implement 2018 capital projects. Notable key CAPEX spending in 2018 include:

Table 5: Selected Proposed 2018 CAPEX

Item	Amount (N'000)
CONSTRUCTION/PROVISION OF RESIDENTIAL BUILDINGS	36,368,293,747
CONSTRUCTION/PROVISION OF ELECTRICITY	48,138,552,803
CONSTRUCTION/PROVISION OF HOUSING	3,598,363,868
CONSTRUCTION/PROVISION OF PUBLIC SCHOOLS	1,650,688,000
CONSTRUCTION/PROVISION OF LIBRARIES	1,113,058,285
CONSTRUCTION/PROVISION OF ROADS	138,811,390,106
CONSTRUCTION/PROVISION OF INFRASTRUCTURE	976,558,080
CONSTRUCTION/PROVISION OF OFFICE BUILDINGS	7,140,024,969
REHABILITATION/REPAIRS OF RESIDENTIAL BUILDING	60,000,000
REHABILITATION/REPAIRS – HOUSING	10,000,000
REHABILITATION/REPAIRS - WATER FACILITIES	78,000,000
REHABILITATION/REPAIRS - HOSPITAL / HEALTH CENTRES	15,000,000
REHABILITATION/REPAIRS - PUBLIC SCHOOLS	90,000,000
REHABILITATION/REPAIRS - FIRE FIGHTING STATIONS	50,776,766
REHABILITATION/REPAIRS – ROADS	159,595,739,178
REHABILITATION/REPAIRS - WATER-WAY	8,000,000
REHABILITATION/REPAIRS OF OFFICE BUILDINGS	5,972,034,611

Source: Budget Office, CardinalStone

Private sector involvement key to bridging infrastructural gap.

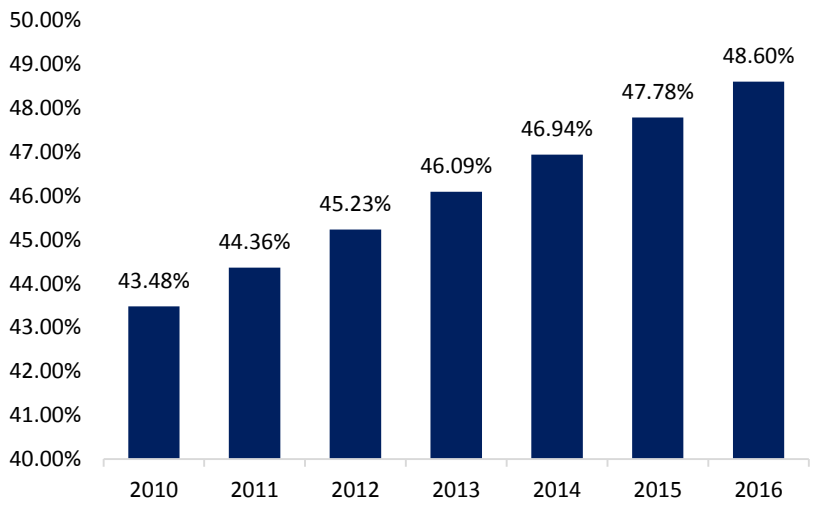
According to the National Integrated Infrastructure Master Plan, Nigeria needs about $3 trillion in infrastructure over the next 30 years and because the federal government alone cannot achieve this, it will leverage on private sector capacity in a variety of strategic partnerships such as Private Public Partnership (PPP). Housing remains a key challenge with an estimated deficit of 17 million units largely due to rapid rate of population growth and urbanization. It is expected, according to the Master plan, that private sector spending in excess of 60 percent would be required to close the housing gap with an

expected total investment layout of $350 billion over a 30 year period. Over the years, a key hurdle to improved private sector involvement in infrastructural development has been issues of accountability, integrity and transparency of PPP transactions in Nigeria. However, in recognition of this drag-back, the Infrastructure Concession Regulatory Commission (ICRC) in July 2017 set in motion the process for amending its 2005 Act in a bid to improve private sector confidence. The Commission has also highlighted strategic efforts to enhance PPP process transparency, while eliminating the tailbacks that impede successful implementation of PPP projects. These include the launching of the PPP Contracts Information Disclosure Web Portal in September 2017 as well as the discontinuation of the collection of Outline Business Case and Full Business Case Compliance Certification Fees starting from October 2017. These initiatives have led to Nigeria being ranked high in the World Bank Group 2017 PPP ranking, according to a statement by the Group. Consequently, it is our view that these initiatives, while facilitating the ease of doing business in Nigeria, will significantly improve investment in infrastructure and this will invariably enhance the output of the construction and cement sector in the medium to long term.

Real estate firms to benefit from planned infrastructural spending

We anticipate increased real estate investments towards the development of both residential and commercial properties in 2018 as a result better access to credit facilities. This is premised on our expectation of lower interest rates during the year. More so, on the back of planned fiscal capital spending in 2018, which we expect to lead to gradual improvements in amenities, more and more remote areas within cities with higher population density such as Lagos and Kano would open up. Although some of these projects may be long term, we think that real estate firms will be proactive to secure choice locations at much cheaper prices on anticipation of faster rate of urbanization, thus enhancing their prospects of a higher return on Investment (ROI).

Figure 23: Nigeria Rate of Urbanization



Source: Statista, CardinalStone

Companies

Zenith Bank Plc

Moderating yields to pressure top-line in 2018

For ZENITHBANK, despite moderating yields, we expect profitability to improve marginally in 2018. We expect this upside to be unlocked by our expectations that the bank will grow credit asset to provide buffers for the declining yields on government securities as well as our anticipation of reduced cost of funds on the back of the lower interest rates.

Lower impairments, interest expense to support bottom-line in 2018

For ZENITHBANK, we expect the lower interest environment in 2018 and the anticipated moderation in trading income to pressure top-line in 2018. On non-interest revenue, we have been very conservative on our trading income projections as we do not expect the bank to repeat the 2017 derivative income performance given improved FX supply and outlook for 2018. Thus, we see gross revenue moderating by 6.5% to ₦645.0 billion in FY'18. However, despite the expected moderation in interest income, we believe the lower interest rate environment will positively impact interest expense (-16.7% YoY) thereby cushioning the impact of lower interest income on overall profitability. Furthermore, we expect impairment charges to decline by 57.6% to ₦24.5 billion given the improved economic outlook and the sustained recovery in crude oil prices. We expect this to further bolster bottom-line in 2018. Overall, we expect EPS to rise by 3.4% to ₦5.19 in FY'18, this will translate to an ROE and ROA of 20% and 2.9% respectively. On balance sheet, we project a growth of 10.0% in total asset driven primarily by our estimate of 11.0% growth in credit assets. We believe the lower interest rate environment coupled with the relatively better economic environment will resuscitate the appetite for loans. We expect NPLs to ease to 3.5% on larger loan assets as well as improving asset quality.

We downgrade to HOLD: We have slightly raised our target price to ₦35.23 (previous: ₦30.62). Our current target price implies a 5.1% upside to the current price of ₦33.51. Hence, we downgrade the counter to a **HOLD**. The upward revision of our TP is influenced by our expectation of normalised impairments (or possible write-backs) and lower interest expense which as in the past affected net interest margins. At current price, ZENITHBANK P/B of 1.3x trades at a premium to local peers of 1.0x.

Risk to earnings – Uncertainty still surrounds Etisalat assets

Given the existing uncertainty around when the sale of 9mobile will be completed, the risk that ZENITHBANK may need to increase provisions for the asset still persist – management has currently taken 30% provision on the asset. The implementation of IFRS 9 may also further affect how the bank may have to treat the exposure although, this is likely to impact capital than bottom-line. Overall, we think the improving economic fundamentals and outlook for Nigeria may encourage investors to take up the assets and this may speed up recovery in 2018.

HOLD **TP: ₦35.23**

Company Information	
Address	84 Ajose Adeogun Str, V/I
Website	www.zenithbank.com
MD	Peter Amangbo
FYE	December
NSE Sector	Financial Services

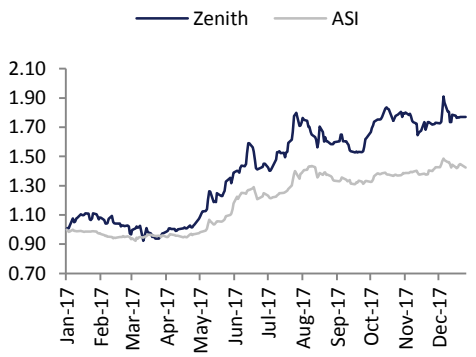
Ownership Structure	
Jim Ovia	9.4%
Stanbic Nominees	16.3%
Others	74.3%

Stock Data	
Bloomberg Ticker:	ZENITHBANK.NG
Market Price (₦)	33.51
Shares Outs (Mn)	31,396
Market cap (₦'Mn)	1,052,079

Price Performance	ZENITHBANK	NSE
12-month	78.1%	43.7%
6-month	22.7%	14.9%
3-month	9.6%	7.9%

Valuation	2016A	2017F	2018F
P/E (x)	7.6	6.2	6.0
P/BV (x)	1.4	1.3	1.2
Div. Yield	6.6%	8.5%	9.1%

One-year Price Performance (rebased)



Source: *NSE*

Financial Statements and Key Ratios

Income Statement	2015A	2016A	2017E	2018F	2015A	2016A	2017E	2018F
		₦'Mn				$'Mn		
Gross Earnings	432,535	507,997	689,558	645,015	2,171	2,057	2,261	2,048
Interest Income	348,179	384,557	482,208	470,814	1,748	1,557	1,581	1,495
Interest expense	(123,590)	(144,378)	(210,611)	(175,420)	(620)	(585)	(691)	(557)
Loan loss provisions	(15,673)	(32,350)	(57,712)	(24,462)	(79)	(162)	(290)	(123)
Net interest income	224,589	240,179	271,598	295,394	1,127	972	890	938
Non-interest income	84,580	123,440	207,350	174,201	425	500	680	553
Operating income	293,496	331,269	421,235	445,133	1,473	1,341	1,381	1,413
Operating expenses	(167,880)	(174,521)	(229,900)	(247,344)	(843)	(707)	(754)	(785)
Pre-tax earnings	125,616	156,748	191,335	197,789	631	635	627	628
Taxation	(19,953)	(27,096)	(33,484)	(34,613)	(100)	(110)	(110)	(110)
Profit after tax	105,663	129,652	157,851	163,176	530	525	518	518
Statement of financial position	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Assets		₦'Mn				$'Mn		
Cash and Short term funds	1,026,612	669,058	739,887	842,942	5,174	2,194	2,426	2,676
Interbank placements	272,194	459,457	528,490	569,713	1,372	1,506	1,733	1,809
Treasury bills and Govt. bonds	591,069	1,168,040	1,638,321	1,744,019	2,979	3,830	5,372	5,537
Loans and Advances	1,989,313	2,289,365	2,208,820	2,452,656	10,025	7,506	7,242	7,786
Other Assets	40,632	48,621	53,119	76,171	205	159	174	242
Property and Equipment	87,022	105,284	116,268	127,895	439	345	381	406
Total Assets	4,006,842	4,739,825	5,284,905	5,813,395	20,193	15,540	17,328	18,455
Liabilities								
Customer deposits	2,557,884	2,983,621	3,297,358	3,697,087	12,891	9,782	10,811	11,737
Due to other banks	286,881	350,657	330,307	308,110	1,446	1,150	1,083	978
Other Liabilities	205,446	275,514	292,792	364,014	1,035	903	960	1,156
Taxation	3,598	8,998	15,855	23,452	18	30	52	74
Borrowings	358,680	416,570	569,070	569,070	1,808	1,366	1,866	1,807
Total Liabilities	3,412,489	4,035,360	4,505,381	4,961,733	17,197	13,231	14,772	15,752
Capital and Reserves								
Share capital	15,698	15,698	15,698	15,698	79	51	51	50
Share Premium	255,047	255,047	255,047	255,047	1,285	836	836	810
Other reserves	323,015	432,737	506,842	580,191	1,628	1,419	1,662	1,842
Minority Interest	593	983	1,936	727	3	3	6	2
Total Equity	594,353	704,465	779,523	851,662	2,995	2,310	2,556	2,704
Total liabilities and equity	4,006,842	4,739,825	5,284,905	5,813,395	20,193	15,540	17,328	18,455
Key Ratios	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Profitability								
Net Interest Margin	8.4%	8.1%	7.9%	7.0%	8.4%	8.1%	7.9%	7.0%
Cost to Income Ratio	59.4%	56.9%	60.1%	57.9%	59.4%	56.9%	60.1%	57.9%
Cost of Risk	0.8%	1.4%	2.6%	1.0%	0.8%	1.4%	2.6%	1.0%
Loan to Deposit Ratio	77.8%	76.7%	67.0%	66.3%	77.8%	76.7%	67.0%	66.3%
Non-Performing Loan ratio	2.2%	3.2%	4.0%	3.8%	2.2%	3.2%	4.0%	3.8%
Return on Average Equity	18.4%	20.0%	21.3%	20.0%	18.4%	20.0%	21.3%	20.0%
Return on Average Assets	2.7%	3.0%	3.1%	2.9%	2.7%	3.0%	3.1%	2.9%
Valuation Multiples								
P/E (x)	9.3	7.6	6.2	6.0	9.3	7.6	6.2	6.0
P/B (x)	1.7	1.4	1.3	1.2	1.7	1.4	1.3	1.2
Dividend Yield	5.8%	6.6%	8.5%	9.1%	5.8%	6.6%	8.5%	9.1%

Source: *CardinalStone Research*

FBN Holdings Plc

Profitability to trend up in 2018

Contrary to expected industry trend, we expect to see significant improvement in profitability (PAT: +22.4% YoY) in 2018, primarily driven by lower provisions (-16.2%) on the back of improving asset quality. However, we expect provisions to remain relatively high in absolute terms (₦109.6 billion) as the bank hopefully concludes its clean-up in 2018.

Improved economic outlook & better risk management positive for asset quality: Owing to the rout in crude oil prices as well as poor risk management process, FBNH asset quality deteriorated significantly with NPLs rising as high as 26.0% as at FY'16. However, following the overhaul of the risk management team and its risk management processes, asset quality has started to recover evidenced by improving NPLs (NPLs of 20.1% at 9M'17) as well as loan recoveries and write-backs (₦20.0 billion in Q3'17). Given the relatively high exposure of the bank's credit asset (21.4% of total loans) as well as NPLs to the upstream oil and gas sector, we expect to see further recovery in 2018 on the back of the sustained recovery in crude oil prices. Thus, we see NPLs improving by 500bps to 15% by FY'18. On loans, we expect FBNH to take advantage of the better economic outlook and its improved risk management system to grow loans and further diversify its credit asset portfolio from the oil & gas sector. We project a growth of 5.0% and 7.0% in credit asset and total asset in 2018.

Earnings outlook: lower impairments to support bottom-line in 2018: On the back of moderating yields, we project a decline of 4.2% in interest income to ₦451.6 billion. However, we expect lower interest expense (-9.4% YoY) to taper the impact of lower interest income on net interest income (-2.0% YoY) in FY'18. Given the high prospect for write-backs of loan provision and the improved economic fundamentals, we expect loan loss provisions to moderate by 16.2% YoY to ₦109.6 billion whilst we expect operating expenses to rise marginally by 3.1% YoY to ₦240.3 billion in FY'18. Cumulatively, we think 2018 will be a better year for FBNH as we see PAT inching up further by 22.4% YoY to ₦84.0 billion in FY'18. As a result, we expect ROE and ROA to improve to 12.8% and 1.7% respectively

Valuation- Target price raised to ₦17.27: We have raised our target price for **FBNH to ₦17.27** implying a 34.4% upside to the current price of ₦12.85 - hence we retain our BUY rating on the counter. Our valuation is premised on the assumptions that profitability and earnings will continue to trend upwards, as we expect impairments to decline significantly going forward. Following the aggressive clean-up of NPLs as well as the improved economic outlook especially for the upstream oil sector, we expect the resultant moderation in provisions to unlock the expected valuation upside. FBNH is currently trading at a P/B of 0.7x which is still at a significant discount to peer average of 1.0x.

BUY **TP: ₦17.27**

Company Information	
Address	35 Marina Lagos
Website	www.fbnholdings.com
MD	Durum Kālu("UK") Eke
FYE	December
NSE Sector	Financial Services

Ownership Structure	
Retail	53.5%
Institutional	43.3%
Government Related	3.2%

Stock Data	
Bloomberg Ticker:	FBNH.NG
Market Price (₦)	12.85
Shares Outs (Mn)	35,895
Market cap (₦'Mn)	418,536

Price Performance	FBNH	NSE
12-month	158.8%	43.7%
6-month	41.9%	14.9%
3-month	56.0%	7.9%

Valuation	2016A	2017E	2018F
P/E (x)	24.6	6.1	5.0
P/BV (x)	0.7	0.7	0.6
Div. Yield	0.6%	5.8%	8.1%

One-year Price Performance (rebased)

Source: NSE

Financial Statements and Key Ratios

Income Statement	2015A	2016A	2017E	2018F	2015A	2016A	2017E	201F
		₦'Mn				$'Mn		
Gross Earnings	502,691	581,831	584,467	573,585	2,523	2,424	1,916	1,821
Interest Income	395,162	405,281	471,344	451,641	1,984	1,689	1,545	1,434
Interest expense	(129,997)	(100,839)	(137,753)	(124,771)	(653)	(420)	(452)	(396)
Loan loss provisions	(118,794)	(226,037)	(130,838)	(109,630)	(596)	(942)	(429)	(348)
Net interest income	265,165	304,442	333,591	326,870	1,331	1,269	1,094	1,038
Non-interest income	97,945	165,490	113,123	121,943	492	690	371	387
Operating income	244,316	243,895	315,876	339,184	1,226	1,016	1,036	1,077
Operating expenses	(222,735)	(220,947)	(233,106)	(240,293)	(1,118)	(921)	(764)	(763)
Pre-tax earnings	21,581	22,948	82,770	98,891	108	96	271	314
Taxation	(6,042)	(5,807)	(14,071)	(14,834)	(30)	(24)	(46)	(47)
Profit after tax	15,539	17,141	68,699	84,057	78	71	225	267
Statement of financial position	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Assets		₦'Mn				$'Mn		
Cash and Short term funds	715,871	690,165	780,625	913,576	3,608	2,465	2,559	2,900
Interbank placements	385,769	444,871	551,317	652,554	1,944	1,589	1,808	2,072
Treasury bills and Govt. bonds	1,045,851	1,294,719	1,331,942	1,299,888	5,271	4,624	4,367	4,127
Loans and Advances	1,817,271	2,083,894	1,992,386	2,062,065	9,158	7,442	6,532	6,546
Other Assets	113,029	134,841	134,819	203,603	570	482	442	646
Property and Equipment	88,398	88,315	87,820	88,747	445	315	288	282
Total Assets	4,166,189	4,736,805	4,878,909	5,220,433	20,996	16,917	15,996	16,573
Liabilities								
Customer deposits	2,970,922	3,104,221	3,542,088	3,757,940	14,972	11,087	11,613	11,930
Due to other banks	144,652	416,078	175,641	208,817	729	1,486	576	663
Other Liabilities	206,687	307,429	189,639	220,119	1,042	1,098	622	699
Taxation	9,012	9,710	25,370	28,712	45	35	83	91
Borrowings	256,116	316,792	316,792	316,792	1,291	1,131	1,039	1,006
Total Liabilities	3,587,389	4,154,230	4,249,530	4,532,380	18,079	14,837	13,933	14,389
Capital and Reserves								
Share capital	17,948	17,948	17,948	17,948	90	64	59	57
Share Premium	252,892	233,392	233,392	233,392	1,274	834	765	741
Minority Interest	3,675	-548	1,601	9,841	19	-2	5	31
Other reserves	304,285	331,784	376,438	426,873	1,533	1,185	1,234	1,355
Total Equity	578,800	582,576	629,379	688,053	2,917	2,081	2,064	2,184
Total liabilities and equity	4,166,189	4,736,806	4,878,909	5,220,433	20,996	16,917	15,996	16,573
Key Ratios	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Profitability								
Net Interest Margin	7.9%	8.6%	8.7%	8.3%	7.9%	8.6%	8.7%	8.3%
Cost to Income Ratio	61.3%	47.0%	52.2%	53.5%	61.3%	47.0%	52.2%	53.5%
Cost of Risk	6.1%	9.4%	5.6%	4.4%	6.1%	9.4%	5.6%	4.4%
Loan to Deposit Ratio	65.9%	77.1%	66.3%	65.6%	65.9%	77.1%	66.3%	65.6%
Non-Performing Loan ratio	18.1%	18.1%	19.0%	17.0%	18.1%	18.1%	19.0%	17.0%
Return on Average Equity	2.8%	2.9%	11.3%	12.8%	2.8%	2.9%	11.3%	12.8%
Return on Average Assets	0.4%	0.4%	1.4%	1.7%	0.4%	0.4%	1.4%	1.7%
Valuation Multiples								
P/E (x)	26.9	24.6	6.1	5.0	26.9	24.6	6.1	5.0
P/B (x)	0.7	0.7	0.7	0.6	0.7	0.7	0.7	0.6
Dividend Yield	1.3%	0.6%	5.8%	8.1%	1.3%	0.6%	5.8%	8.1%

Source: *CardinalStone Research*

Guaranty Trust Bank Plc

Bottom-line growth to slow down in 2018

Guaranty in the past 2 years has posted significant growth in bottom-line, driven by both high interest rates and FX revaluation gain. In 2018, we expect PAT to grow marginally by 3.2% YoY, as we expect lower interest income to weigh down earnings.

Top-line to moderate on weaker interest revenue: Given the downward direction of government securities yield in 2018 and Guaranty's relatively high exposure to treasury bills (30% of total interest-bearing asset), we anticipate a decline of 6.6% YoY in interest income to ₦302.3 billion in FY'18. Given the sustained FX liquidity and the positive economic outlook, we expect non-interest income to rise by 20.0% YoY to ₦108.8 billion in FY'18. Cumulatively, we however, expect gross earnings to moderate marginally by 0.8% YoY to ₦411.0 billion in FY'18. In line with industry trends, we expect interest expense and impairment provisions to contract by 9.8% and 51.6% to ₦71.4 billion and ₦6.1 billion respectively. Overall, we expect profit after tax to come in flat, rising marginally by 3.2% YoY to ₦170.9 billion. However, we expect profitability metric to remain sufficiently above peers as we anticipate an ROE and ROA of 27.1% and 5.1% respectively in FY'18. .

Loan to grow albeit marginally:

Given management's stance on risk asset creation, we do not expect Guaranty to aggressively push loans in 2018. As management has prioritized capital preservation and has shown a very low appetite for loans (loans moderated by 10.1% as at 9M'17), we expect loan portfolio to rise marginally by 5% in 2018. Hence, we see total asset growing marginally by 7% to ₦3.5 trillion in 2018. On asset quality, we expect to see more reclassification of NPLs to performing loans, especially loans exposed to the upstream oil and gas sector, this informs our expectations that NPLs will moderate to 3.2% in 2018.

We downgrade counter to a SELL

Following the revisions to our earnings projections, our revised TP for GUARANTY stands at ₦48.24 (Previous: ₦42.50), which implies a -3.7% return potential from the current price of ₦50.10. GUARANTY remains one of the most profitable and efficient banks in Nigeria with a cost to income ratio and return on equity of 40.0% and 32.1% as at H1'17. Though the bank trades at P/B of 2.5X, which is significantly higher than peers average of 1.0X and the Middle East and Africa peers of 1.3X, we think the premium is justified by its profitability and its strong balance sheet efficiency. However, at the current price level of ₦49.0, we think GUARANTY is currently trading above its fundamentally fair value and hence, we revise our rating to a HOLD.

HOLD **TP: ₦48.24**

Company Information	
Address	635 Akin Adesola Str, V/I Lagos
Website	www.gtbank.com
MD	Segun Agbaje
FYE	December
NSE Sector	Financial Services

Ownership	
Stanbic Nominees	20.0%
GDR (underlying shares)	11.9%
Others	68.1%

Stock Data	
Bloomberg Ticker:	GUARANTY.NG
Market Price (₦)	50.10
Shares Outs (Mn)	29,431
Market cap (₦'Bn)	1,474

Price Performance	GUARANTY	NSE
12-month	69.8%	43.7%
6-month	14.1%	14.9%
3-month	1.9%	7.9%

Valuation	2016A	2017E	2018F
P/E (x)	11.0	8.7	8.4
P/BV (x)	2.9	2.5	2.2
Div. Yield	4.1%	5.7%	5.9%

One-year Price Performance (rebased)

Source: NSE

Financial Statements and Key Ratios

Income Statement	2015A	2016A	2017E	2018F	2015A	2016A	2017E	2018F
			₦'Mn			$'Mn		
Gross Earnings	301,850	414,616	414,224	411,039	1,515	1,679	1,358	1,348
Interest Income	229,237	262,494	323,612	302,234	1,151	1,063	1,061	991
Interest expense	(69,290)	(67,094)	(79,160)	(71,370)	(348)	(272)	(260)	(234)
Net interest income	159,947	195,400	244,452	230,865	803	791	801	757
Non-interest income	69,534	152,121	90,611	108,804	349	616	297	357
Loan loss provisions	(12,408)	(65,290)	(12,700)	(6,145)	(62)	(264)	(42)	(20)
Operating income	217,073	282,231	322,364	333,524	1,090	1,143	1,057	1,094
Total operating expenses	(96,378)	(117,095)	(122,072)	(126,746)	(484)	(474)	(400)	(416)
Pre-tax earnings	120,695	165,136	200,291	206,778	606	669	657	678
Taxation	(21,258)	(32,856)	(34,050)	(35,152)	(107)	(133)	(112)	(115)
Profit after tax	99,437	132,281	166,242	171,625	499	536	545	563
Statement of financial position	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Assets			₦'Mn			$'Mn		
Cash and Short term funds	531,092	784,610	752,609	805,292	2,676	2,572	2,468	2,640
Interbank placements	1,052	654	982	17,506	5	2	3	57
Investment Securities	124,392	128,372	229,055	227,582	627	421	751	746
Treasury bills and Govt. bonds	365,777	461,153	523,554	507,684	1,843	1,512	1,717	1,665
Loans and Advances	1,371,926	1,589,430	1,624,722	1,704,665	6,914	5,211	5,327	5,589
Other Assets	42,367	58,686	43,125	126,498	214	192	141	415
Property and Equipment	87,989	93,488	98,166	112,041	443	307	322	367
Total Assets	2,524,594	3,116,393	3,272,213	3,501,268	12,723	10,218	10,729	11,480
Liabilities								
Customer deposits	1,610,350	1,986,246	2,094,216	2,240,812	8,115	6,512	6,866	7,347
Due to other banks	26,257	125,068	65,444	105,038	132	410	215	344
Other Liabilities	269,729	335,316	367,866	325,426	1,359	1,099	1,206	1,067
Taxation	24,579	38,623	29,450	31,511	124	127	97	103
Borrowings	180,117	126,238	126,238	126,238	908	414	414	414
Total Liabilities	2,111,032	2,611,491	2,683,215	2,829,025	10,639	8,562	8,797	9,275
Capital and Reserves								
Share capital	14,716	14,716	14,716	14,716	74	48	48	48
Share Premium	123,471	123,471	123,471	123,471	622	405	405	405
Other reserves	268,987	357,873	440,994	526,807	1,356	1,173	1,446	1,727
Minority Interest	6,389	8,843	9,817	7,250	32	29	32	24
Total Equity	413,562	504,903	588,998	672,243	2,084	1,655	1,931	2,204
Total liabilities and equity	2,524,594	3,116,393	3,272,213	3,501,268	12,723	10,218	10,729	11,480
Key Ratios	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Profitability								
Net Interest Margin	9.0%	9.7%	10.7%	9.5%	9.0%	9.7%	10.7%	9.5%
Cost to Income Ratio	44.4%	41.5%	37.9%	38.0%	44.4%	41.5%	37.9%	38.0%
Cost of Risk	0.9%	4.1%	0.8%	0.4%	0.9%	4.1%	0.8%	0.4%
Loan to Deposit Ratio	85.2%	80.0%	77.6%	76.1%	85.2%	80.0%	77.6%	76.1%
Non-Performing Loan ratio	3.2%	3.2%	3.6%	3.5%	3.2%	3.2%	3.6%	3.5%
Return on Average Equity	25.1%	28.7%	30.3%	27.1%	25.1%	28.7%	30.3%	27.1%
Return on Average Assets	4.1%	4.7%	5.2%	5.1%	4.1%	4.7%	5.2%	5.1%
Valuation Multiples								
P/E (x)	14.6	11.0	8.7	8.4	14.6	11.0	8.7	8.4
P/B (x)	3.5	2.9	2.5	2.2	3.5	2.9	2.5	2.2
Dividend Yield	3.6%	4.1%	5.7%	5.9%	3.6%	4.1%	5.7%	5.9%

Source: *CardinalStone Research*

United Bank for Africa Plc

African diversification to protect asset yield

We expect UBA to better cope with the new era of lower yields compared to peers, primarily due to its stronger earnings diversification. More so, given the bank's moderate appetite for loans when other banks were largely averse, we expect income for its loan portfolio to support interest revenue in 2018.

Strong earnings diversification to support earnings: Contrary to industry trends, UBA did not wind down its credit asset desk as it grew its loan book by c.6.0% as at 9M'17. We believe given the higher risk appetite during period of economic uncertainty, UBA is expected to be better positioned to easily ramp up on loans to mitigate the impact of dwindling yields in Nigeria. On the back of this, we see loans growing by 13.9% in 2018. Further supporting asset yields, we expect the rising contribution of other African countries to top-line to dampen the impact of lower yields in the Nigerian market. Given the aforementioned, we expect interest income to rise marginally by 2.2% to ₦323.4 billion in FY'18 as oppose to our expectations of an average moderation of 10% across our other coverage banks. We see further improvement in non-interest revenue (+4.9%) on the back of improved trade-related transactions owing to better economic fundamentals and FX supply. For provisions, similar to our expectations across our coverage banks, we anticipate a 21.2% decline in impairment charges to ₦13.4 billion in FY'18. As such, we see cost of risk improving by 31bps to 0.70% in FY'18. All in, we expect growth in profitability to be sustained as we anticipate a 20.0% rise in PAT to ₦100.5 billion in FY'18. Consequently, we see ROE and ROA inch up by 130bps and 20bps to 19.2% and 2.5% respectively.

Benefits continue to accrue from African diversification: With African contributions to revenue standing at c.35% of total earnings, UBA continues to benefit significantly from the growth potential available in other African countries. Asides from the short term benefit of shielding asset yield from the current interest rate shock in Nigeria, we believe the long-term growth potential of UBA's business in this developing countries will unlock significant valuation upside in the mid to long term. Hence, we think capital gains opportunities abound for investors that are looking to take advantage of short-term capital gains that will be driven by stronger earnings in 2018 as well as long-term investors looking for capital appreciations beyond 2018 on the back of strong growth trajectory of the African business.

We maintain our BUY rating: We increased our target price to ₦16.50 (Previous: ₦12.96) which implies a 31.0% upside from the current price of ₦12.60. We believe UBA's strong earnings diversification across Africa better positions UBA amongst its peers for the declining yield environment. We expect interest income contribution from other African countries to shield asset yield from the lower interest rate environment in Nigeria and thus preserve profitability in 2018.

BUY **TP: ₦16.50**

Company Information	
Address	57 Marina, Lagos
Website	www.ubagroup.com
MD	Kennedy Uzoka
FYE	December
NSE Sector	Financial Services

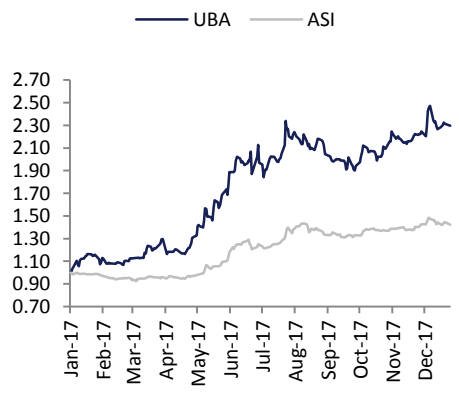
Ownership Structure	
Stanbic Nominees	11.0%
Others	89.0%

Stock Data	
Bloomberg Ticker:	UBA.NG
Market Price (₦)	12.00
Shares Outs (Mn)	36,280
Market cap (₦'Mn)	435,360

Price Performance	UBA	NSE
12-month	131.5%	43.7%
3-month	8.8%	14.9%
YTD	19.2%	7.9%

Valuation	2016A	2017E	2018F
P/E (x)	6.1	5.3	4.4
P/BV (x)	1.0	0.8	0.8
Div. Yield	4.6%	6.2%	7.5%

One-year Price Performance (rebased)



***Source**: NSE*

Financial Statements and Key Ratios

Income Statement	2015A	2016A	2017E	2018F	2015A	2016A	2017E	2018F
		₦'Mn				$'Mn		
Gross Earnings	314,830	383,647	436,538	449,543	1,580	1,553	1,431	1,474
Interest Income	233,969	263,970	316,332	323,413	1,174	1,069	1,037	1,060
Interest expense	(96,030)	(98,770)	(114,231)	(106,308)	(482)	(400)	(375)	(349)
Net interest income	137,939	165,200	202,101	217,105	692	669	663	712
Non-interest income	72,304	119,677	120,206	126,131	363	485	394	414
Loan loss provisions	(5,053)	(27,683)	(17,031)	(13,428)	(25)	(112)	(56)	(44)
Operating income	205,190	257,194	305,276	329,807	1,030	1,041	1,001	1,081
Operating expenses	(136,736)	(166,552)	(195,193)	(205,268)	(686)	(674)	(640)	(673)
Pre-tax earnings	68,454	90,642	110,083	124,539	344	367	361	408
Taxation	(8,800)	(18,378)	(26,420)	(23,662)	(44)	(74)	(87)	(78)
Profit after tax	59,654	72,264	83,663	100,877	299	293	274	331
Statement of financial position	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Assets		₦'Mn				$'Mn		
Cash and Short term funds	655,371	760,930	848,082	890,487	3,303	2,698	2,781	2,920
Interbank placements	14,600	22,765	26,984	42,404	74	81	88	139
Treasury bills and Govt. bonds	869,928	1,033,332	1,156,476	1,250,922	4,384	3,664	3,792	4,101
Loans and Advances	1,036,637	1,505,319	1,616,676	1,840,712	5,224	5,338	5,301	6,035
Other Assets	87,261	88,195	94,908	97,156	440	313	311	319
Property and Equipment	88,825	93,932	111,793	118,732	448	333	367	389
Total Assets	2,752,622	3,504,473	3,854,920	4,240,412	13,872	12,427	12,639	13,903
Liabilities								
Customer deposits	2,081,704	2,485,610	2,659,895	2,989,491	10,491	8,814	8,721	9,802
Due to other banks	61,066	109,080	85,194	84,808	308	387	279	278
Other Liabilities	140,832	196,588	182,043	178,097	710	697	597	584
Taxation & Deferred tax	6,503	5,196	6,512	7,374	33	18	21	24
Borrowings	129,896	259,927	412,427	412,427	655	922	1,352	1,352
Total Liabilities	2,420,001	3,056,401	3,346,071	3,672,197	12,196	10,838	10,971	12,040
Capital and Reserves								
Share capital	18,140	18,140	18,140	18,140	91	64	59	59
Share Premium	117,374	117,374	117,374	117,374	592	416	385	385
Other reserves	190,313	299,337	354,798	421,792	959	1,061	1,163	1,383
Minority interest	6,794	13,218	18,538	10,910	34	47	61	36
Total Equity	332,621	448,069	508,849	568,215	1,676	1,589	1,668	1,863
Total liabilities and equity	2,752,622	3,504,470	3,854,920	4,240,412	13,872	12,427	12,639	13,903
Key Ratios	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Profitability								
Net Interest Margin	7.2%	6.1%	6.9%	6.9%	7.2%	6.1%	6.9%	6.9%
Cost to Income Ratio	65.0%	58.5%	60.6%	59.8%	65.0%	58.5%	60.6%	59.8%
Cost of Risk	0.5%	1.8%	1.0%	0.7%	0.5%	1.8%	1.0%	0.7%
Loan to Deposit Ratio	49.8%	60.6%	60.8%	61.6%	49.8%	60.6%	60.8%	61.6%
Non-Performing Loan ratio	1.7%	1.7%	3.5%	3.0%	1.7%	1.7%	3.5%	3.0%
Return on Average Equity	20.1%	18.8%	17.9%	19.1%	20.1%	18.8%	17.9%	19.1%
Return on Average Assets	2.2%	2.3%	2.3%	2.5%	2.2%	2.3%	2.3%	2.5%
Valuation Multiples								
P/E (x)	7.1	6.1	5.3	4.4	7.1	6.1	5.3	4.4
P/B (x)	1.3	1.0	0.8	0.8	1.3	1.0	0.8	0.8
Dividend Yield	5.0%	4.6%	6.2%	7.5%	5.0%	4.6%	6.2%	7.5%

Fidelity Bank Plc

Decent valuation upside persists

In recent times, FIDELITYBK has stepped up its game by commencing the routine half year audit which was traditionally done by tier-I banks. Asides from the better comfort on reported numbers this offers, we believe this also shows a significant improvement in corporate governance practices and risk management systems.

Profitability to further improve in 2018 despite weaker top-line

From our FY'18 earnings projections, we anticipate an increase of 90bps and 20bps in ROE and ROA to 10.9% and 1.6% respectively. We expect the improvement in profitability ratios to be predominantly driven by the expected improvement in asset quality (translating to lower impairments) and lower interest expense in 2018. For asset quality, we expect impairment provisions to decline by c.51% to ₦5.4 billion in FY'18, translating to a cost of risk (COR) of 0.6% in FY'18 compared to 1.4% estimate for FY'17. The risk however to our impairment forecast is a significant delay to the ongoing remediation of the 9-mobile loan which may lead to increased provisions on the asset given the bank's relatively high exposure of ₦17.5 billion. Whilst we expect top-line to come in 4.7% weaker in FY'18 due to lower asset yields, we expect the transmission to bottom-line to be largely dampened by lower interest expense (-9.2%YoY).

We see sustained growth in loans

FIDELITYBK is one of the banks that bucked the trend in terms of creating credit asset in 2017. Contrary to the zero tolerance for loans exhibited by most banks in 2017, FIDELITYBK actually grew loans by 5.0% as at 9M'17 compared to the average loan growth of -3.0% as at 9M'17 amongst coverage banks. We expect the bank to build on this trend in 2018 thus, we project a growth of 10.0% in credit assets in 2018. Given the improved economic outlook and the expected growth in loan, we expect NPLs to moderate to 4.0% of total loans in FY'18 from an estimate of 5.5% in FY'17.

We maintain a BUY rating

Using our excess return model, our TP for FIDELITYBK stands at ₦4.92, which translates to a 37.0% upside from the price of ₦3.59; thus we recommend a BUY on FIDELITYBK. We believe at the current price, FIDELITYBK is marginally undervalued. However, its outstanding dividend track record makes a compelling investment case. Given the constant proportion of dividend pay-out (c.33% of earnings) adopted by FIDELITYBK, we expect a dividend per share of c.₦0.26, translating to a dividend yield of 7.3% at current price.

BUY **TP:₦4.92**

Company Information	
Address	2 Kofo Abayomi Street, VI, Lagos
Website	www.fidelitybankplc.com
MD	Nnamdi Okonkwo
FYE	December
NSE Sector	Financial Services

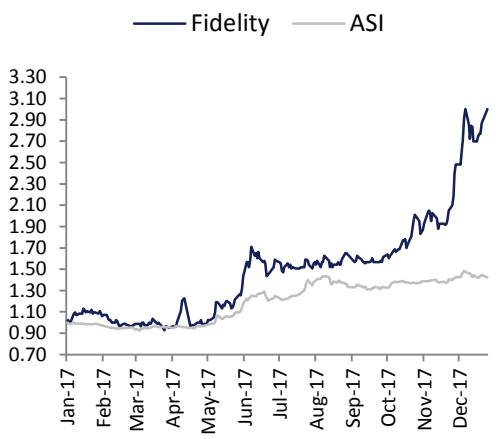
Ownership Structure	
Nigerian citizens & corporations	100.0%

Stock Data	
Bloomberg Ticker:	FIDELITY.NL
Market Price (₦)	3.59
Shares Outs (Mn)	28,975
Market cap (₦'Mn)	104,020

Price Performance	FIDELITYBK	NSE
12-month	196.4%	43.7%
6-month	86.4%	14.9%
3-month	83.6%	7.9%

Valuation	2016A	2017E	2018F
P/E (x)	9.5	4.8	4.1
P/BV (x)	0.5	0.5	0.4
Div. Yield	3.2%	7.2%	8.5%

One Year Price Performance (rebased)



***Source**: NSE*

Financial Statements and Key Ratios

Income Statement	2015A	2016A	2017E	2018F	2015A	2016A	2017E	2018F
	₦'Mn				$'Mn			
Gross Earnings	146,891	152,021	173,902	165,655	737	633	570	543
Interest Income	121,158	123,153	147,375	135,783	608	513	483	445
Interest expense	(60,294)	(61,225)	(76,843)	(69,749)	(303)	(255)	(252)	(229)
Net interest income	60,864	61,928	70,531	66,034	306	258	231	217
Non-interest income	23,322	28,868	26,527	29,872	117	120	87	98
Loan loss provisions	(5,764)	(8,671)	(11,053)	(5,365)	(29)	(36)	(36)	(18)
Operating income	78,422	82,125	86,005	90,541	394	342	282	297
Operating expenses	(64,398)	(71,064)	(64,242)	(65,031)	(323)	(296)	(211)	(213)
Pre-tax earnings	14,024	11,061	21,764	25,510	70	46	71	84
Taxation	(120)	(1,327)	(2,612)	(3,061)	(1)	(6)	(9)	(10)
Profit after tax	13,904	9,734	19,152	22,449	70	41	63	74
Statement of financial position	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Assets	₦'Mn				$'Mn			
Cash and Short term funds	185,332	207,061	229,511	226,811	934	740	752	744
Interbank placements	79,942	49,200	40,502	39,692	403	176	133	130
Long term investments	301,413	244,818	229,511	202,713	1,519	874	752	665
Loans and Advances	578,203	718,401	750,320	826,226	2,914	2,566	2,460	2,709
Other Assets	46,847	38,305	55,670	75,348	236	137	183	247
Property and Equipment	39,985	40,356	44,552	46,780	202	144	146	153
Total Assets	1,231,722	1,298,141	1,350,067	1,417,570	6,207	4,636	4,426	4,648
Liabilities								
Customer deposits	769,636	792,971	810,040	864,718	3,879	2,832	2,656	2,835
Due to other banks	0	0	0	0	-	-	-	-
Other Liabilities	134,263	159,406	175,807	168,424	677	569	576	552
Taxation	2,332	1,327	6,750	12,758	12	5	22	42
Borrowings	141,975	159,035	159,035	159,035	715	568	521	521
Total Liabilities	1,048,206	1,112,739	1,151,632	1,204,934	5,282	3,974	3,776	3,951
Capital and Reserves								
Share capital	14,481	14,481	14,481	14,481	73	52	47	47
Share Premium	101,272	101,272	101,272	101,272	510	362	332	332
Other reserves	67,763	69,649	82,681	96,882	341	249	271	317
Shareholders' funds	183,516	185,402	198,434	212,635	925	662	651	697
Total liabilities and equity	1,231,722	1,298,141	1,350,067	1,417,570	6,207	4,636	4,426	4,648
Key Ratios	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Profitability								
Net Interest Margin	6.1%	5.4%	4.0%	4.0%	6.1%	5.4%	4.0%	4.0%
Cost to Income Ratio	76.5%	78.3%	66.2%	67.8%	76.5%	78.3%	66.2%	67.8%
Cost of Risk	1.0%	1.2%	1.4%	0.6%	1.0%	1.2%	1.4%	0.6%
Loan to Deposit Ratio	75.1%	90.6%	92.6%	95.5%	75.1%	90.6%	92.6%	95.5%
Non-Performing Loan ratio	4.4%	5.0%	5.0%	5.0%	4.4%	5.0%	5.0%	5.0%
Return on Average Equity	7.8%	5.3%	10.0%	10.9%	7.8%	5.3%	10.0%	10.9%
Return on Average Assets	1.1%	0.8%	1.4%	1.6%	1.1%	0.8%	1.4%	1.6%
Valuation Multiples								
P/E (x)	6.7	9.5	4.8	4.1	6.7	9.5	4.8	4.1
P/B (x)	0.5	0.5	0.5	0.4	0.5	0.5	0.5	0.4
Dividend Yield	4.4%	3.2%	7.2%	8.5%	4.4%	3.2%	7.2%	8.5%

FCMB Group Plc

Investment in legacy pension to boost earnings

Whilst prior year one-off FX revaluation gains masked the earnings growth in 2017, we expect the improvement in core business to be revealed in 2018 now that the 2016 high base is out of the way. We also expect the acquisition of the legacy pension to further unlock upside value in 2018.

Legacy Pension acquisition positive for earnings

FCMB recently acquired an additional 60% stake (₦6.96 billion) in Legacy pension bringing the bank's total stake to 88.2% (₦7.35 billion) which implies the bank now has control and hence, will consolidate the performance of the entity (Legacy Pension) as one of FCMB group subsidiaries. The legacy pension's asset under management (AUM) was c.₦228.7 billion as at October 2017 with a three-year average growth rate of c.15.0%. We believe the acquisition will both act as a means to boost earnings as well as also diversify the bank's revenue sources. From our projections, we expect the pension business to contribute about ₦1.3 billion to PBT in FY'17 – 10.5% of FCMB's total PBT. Prior to the acquisition, the legacy pension business reported an ROE and ROA of 26.2% and 23.3% respectively thus, we expect its contribution to enhance profitability going forward. As a result, we project an increase of 180bps and 40bps in ROE and ROA respectively for FCMB in 2018.

We expect profitability to improve in FY'18

On the back of weaker interest income due to the expected moderation in asset Yield, we anticipate a marginal decline of 2.4% to N157.9 billion in top-line in FY'18. However, we expect the additional revenue from the recently acquired pension business to enhance non-interest income in 2018. As such, we project an increase of 20% YoY in non-interest revenue to N36.4 billion in FY'18. Given the relatively high exposure of the bank's portfolio to the upstream sector, we think impairment provisions will moderate by 37.0% due to better crude oil prices and economic outlook. Cumulatively, we PBT and PAT, come in 33% stronger to N16.6 billion and N13.1 billion respectively in FY'18.

We retain our BUY rating

Considering the contribution to earnings from the acquisition of legacy pension coupled with the relatively stable outlook for the upstream oil and gas sector where a large portion of FCMB's credit asset are concentrated and its positive implication for asset quality, we have revised our target price for the counter upwards to ₦4.47 (Previous: ₦1.74). At current price of ₦2.99, our target price presents a 49.5% capital appreciation opportunity thus, we maintain our BUY rating on the counter. FCMB trades at a P/B ratio of 0.3x which is at a discount to peer average of 1.0x.

BUY **TP: ₦4.47**

Company Information	
Address	Primrose Towers, 17A Tinubu Street
Website	www.fcmb.com
MD	Ladi Balogun
FYE	December
NSE Sector	Other Financial Institutions

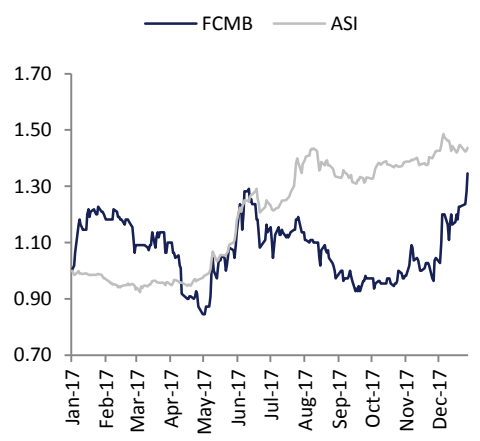
Ownership	
Capital IRG Trustees Ltd	7.5%
Others	92.5%

Stock Data	
Bloomberg Ticker:	FCMB.NL
Market Price (₦)	2.99
Shares Outs (Mn)	19,803
Market cap (₦'Mn)	59,210

Price Performance	FCMB	NSE
12-month	34.5%	43.7%
6-month	15.6%	14.9%
3-month	38.3%	7.9%

Valuation	2016A	2017E	2018F
P/E (x)	3.5	5.1	3.8
P/BV (x)	0.3	0.3	0.3
Div. Yield	11.4%	7.8%	10.4%

One Year Price Performance (rebased)



Source: *NSE*

Financial Statements and Key Ratios

Income Statement	2015A	2016A	2017F	2018F	2015A	2016A	2017F	2018F
		₦'Mn				$'Mn		
Gross Earnings	152,508	176,352	161,708	157,875	766	714	578	564
Interest Income	123,584	125,109	131,257	121,442	620	507	469	434
Interest expense	(59,647)	(55,576)	(63,317)	(54,948)	(299)	(225)	(226)	(196)
Net interest income	63,937	69,534	67,940	66,494	321	282	243	237
Non-interest income	25,760	51,243	30,452	36,433	129	207	109	130
Loan loss provisions	(15,033)	(35,522)	(14,689)	(9,297)	(75)	(144)	(52)	(33)
Operating income	74,663	85,254	83,702	93,630	375	345	299	334
Operating expenses	(66,979)	(69,276)	(71,505)	(77,310)	(336)	(280)	(255)	(276)
Exceptional item	85	273	293	313	0	1	1	1
Pre-tax earnings	7,769	16,251	12,490	16,633	39	66	45	59
Taxation	(3,008)	(1,913)	(2,623)	(3,493)	(15)	(8)	(9)	(12)
Profit after tax	4,761	14,339	9,867	13,140	24	58	35	47
Statement of financial position	**2015A**	**2016A**	**2017F**	**2018F**	**2015A**	**2016A**	**2017F**	**2018F**
Assets		₦'Mn				$'Mn		
Cash and Short term funds	180,922	108,105	159,263	170,412	912	383	565	604
Interbank placements	125,552	139,461	121,723	130,243	633	495	432	462
Treasury bills and Govt. bonds	191,294	198,568	170,639	182,584	964	704	605	647
Loans and Advances	592,957	659,937	654,216	683,673	2,988	2,340	2,320	2,424
Other Assets	38,838	34,424	6,726	23,535	196	122	24	83
Property and Equipment	29,971	32,283	25,027	26,779	151	114	89	95
Total Assets	1,159,534	1,172,778	1,137,595	1,217,226	5,844	4,159	4,034	4,316
Liabilities								
Customer deposits	700,217	657,610	614,301	691,257	3,529	2,332	2,178	2,451
Due to other banks	5,461	24,798	4,550	4,869	28	88	16	17
Other Liabilities	91,043	79,796	100,672	149,866	459	283	357	531
Taxation	3,566	2,925	5,688	6,147	18	10	20	22
Borrowings	196,856	228,776	228,776	228,776	992	811	811	811
Total Liabilities	997,143	993,905	953,987	1,080,914	5,025	3,524	3,383	3,833
Capital and Reserves								
Share capital	9,901	9,901	9,901	9,901	50	35	35	35
Share Premium	115,392	115,392	115,392	115,392	582	409	409	409
Other reserves	37,098	53,579	59,500	67,384	187	190	211	239
Total Shareholders' funds	162,391	178,873	184,793	192,677	818	634	655	683
Total liabilities and equity	1,159,534	1,172,778	1,138,780	1,273,592	5,844	4,159	4,038	4,516
Key Ratios	**2015A**	**2016A**	**2017F**	**2018F**	**2015A**	**2016A**	**2017F**	**2018F**
Profitability								
Net Interest Margin	4.7%	3.3%	5.0%	5.0%	4.7%	3.3%	5.0%	5.0%
Cost to Income Ratio	74.7%	53.7%	69.2%	72.1%	74.7%	53.7%	69.2%	72.1%
Cost of Risk	2.5%	5.2%	2.1%	1.3%	2.5%	5.2%	2.1%	1.3%
Loan to Deposit Ratio	84.7%	100.4%	106.5%	98.9%	84.7%	100.4%	106.5%	98.9%
Non-Performing Loan ratio	4.2%	3.7%	5.0%	5.0%	4.2%	3.7%	5.0%	5.0%
Return on Average Equity	2.9%	8.4%	5.4%	7.0%	2.9%	8.4%	5.4%	7.0%
Return on Average Assets	0.4%	1.2%	0.9%	1.1%	0.4%	1.2%	0.9%	1.1%
Valuation Multiples								
P/E (x)	10.6	3.5	5.1	3.8	10.6	3.5	5.1	3.8
P/B (x)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Dividend Yield	3.8%	11.4%	7.8%	10.4%	3.8%	11.4%	7.8%	10.4%

Source: *CardinalStone Research*

Dangote Sugar Refinery Plc

Earnings outlook still positive

Easing cost pressures support gross margins: Following moderation in sugar prices in 2017 (down 23.9% between January and December according to World Bank data), input cost pressures eased on DANGSUGAR's 9M'17 gross margin, which consequently climbed 890bps YoY to 25.4%. The impact was even more significant on a quarterly basis as Q3'17 gross margin rose 2160bps YoY to 32.9%. Gains also filtered into operating profit margin which also rose 950bps YoY and 2110bps YoY in 9M'17 and Q3'17 respectively. This was despite ongoing constraints from the Apapa gridlock where the company is located. We also highlight the impact of the firm's ongoing backward integration project aimed at producing 1.5 million tonnes of refined sugar locally (also in line with the National Sugar Master Plan) while reducing over-reliance on imported sugar as well as curtailing excessive FX exposure. Although implementation has been beleaguered with challenges, we are optimistic that benefits will gradually accrue to overall bottom-line with over ₦110 billion spent towards actualization of the project, especially with respect to the full expansion of the Savannah Sugar Company Ltd (a subsidiary of DANGSUGAR) as well as other ongoing projects in Nasarawa and Taraba states.

Recovery in sales volume to uplift earnings: Our revenue projections for FY'2018 comes in at ₦230 billion (FY'2017E: ₦220 billion). This is premised on an expected growth slowdown as the company continues to reduce prices (in order to drive volume growth and increase market share) following the gradual decline in the price of imported raw sugar. We also believe that some measure of progress in the firm's backward integration project, notably with the Savannah Sugar Company, will positively impact material costs, albeit slightly. Meanwhile, given that DANGSUGAR is still expected to import a significant chunk of its material needs, we expect FX pressure on material cost to ease following improvements in FX accessibility (given success recorded at the NAFEX window) as well as currency appreciation. Thus, we project FY'2018 gross margin at 27.2% and EPS at ₦2.97.

We upgrade our rating to BUY: We raise our price target to ₦25.00 (previous: ₦14.35). Our TP implies a potential upside of 17.3% to current market price. As such, we upgrade our recommendation on the stock to a BUY. DANGSUGAR is also trading at a forward PE of 6.5x compared to Bloomberg emerging market peer average of 31.45x

Risks to our valuation: Given the slow pace of implementation of the DANGSUGAR's "Sugar for Nigeria" project, we note that the firm remains exposed to volatility in global raw sugar prices, especially in the event of a slowdown in supply from Brazil. We also highlight continued exposure to exchange rate fluctuations as key risks to our valuation.

BUY **TP: ₦25.00**

Company Information	
Address	GDNL Building, Terminal E, NPA Apapa
Website	www.dangote.com
MD (act)	Engr. Abdullahi Sule
FYE	December
NSE Sector	Consumer Goods

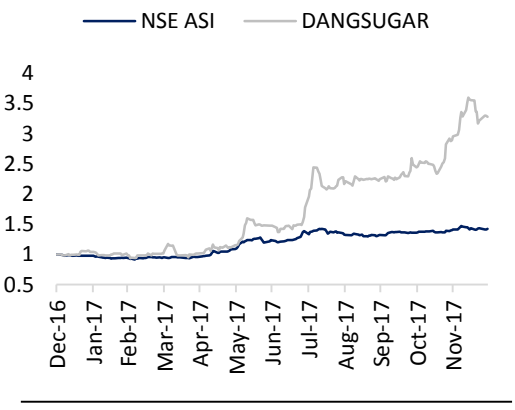
Ownership Structure	
Dangote Industries Limited	67.69%
Alhaji Aliko Dangote	5.44%
Others	26.87%

Stock Data	
Bloomberg Ticker:	DANGSUGA:NL
Market Price (₦)	21.31
Shares Outs (Mn)	12,000
Market cap (₦'Bn)	255.7

Price Performance	DANGSUGAR	NSE
12-month	227.3%	42.3%
6-month	112.2%	15.5%
3-month	46.0%	7.9%

Valuation	2016A	2017E	2018F
P/E (x)	6.8	7.2	6.5
P/BV (x)	2.6	2.2	1.9
Div. Yield (%)	9.6	9.6	10.4

One Year Price Performance (rebased)



Source: *NSE*

Financial Statements and Key Ratios

Income Statement	2015A	2016A	2017E	2018F	2015A	2016A	2017E	2018F
	₦'Mn				$'Mn			
Revenue	101,058	169,725	220,049	230,447	321	539	699	732
Cost of Sales	(76,588)	(142,076)	(157,488)	(167,812)	(243)	(451)	(500)	(533)
Gross Profit	24,470	27,649	62,560	62,635	78	88	199	199
Distri. And Admin Expenses	(6,209)	(6,929)	(8,098)	(9,909)	(20)	(22)	(26)	(31)
EBITDA	18,261	20,719	54,462	52,726	58	66	173	167
Depreciation and Amortisation	(3,742)	(4,660)	(4,565)	(6,211)	(12)	(15)	(14)	(20)
EBIT/Operating profit	14,519	16,059	49,897	46,514	46	51	158	148
Other Income	2,682	3,253	3,415	3,586	9	10	11	11
Interest Expense/Income	(653)	302	2,106	2,282	(2)	1	7	7
Pre-tax earnings	16,548	19,614	55,419	52,383	53	62	176	166
Taxation	(5,013)	(5,218)	(17,956)	(16,762)	(16)	(17)	(57)	(53)
Profit after tax	11,535	14,396	37,463	35,620	37	46	119	113
Statement of financial position	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Assets	₦'Mn				$'Mn			
Fixed Assets	59,063	64,919	65,855	71,166	188	206	209	226
Inventories	15,548	47,409	43,147	41,378	49	151	137	131
Trade Debtors	14,704	17,734	24,115	22,098	47	56	77	70
Bank and Cash Balances	8,993	35,020	49,767	67,110	29	111	158	213
Other current assets	3,925	13,299	13,299	13,299	12	42	42	42
Total Assets	102,232	178,382	196,184	215,051	325	566	623	683
Liabilities								
Trade Creditors	28,092	88,278	75,508	75,860	89	280	240	241
Other Creditors	2,113	2,808	863	920	7	9	3	3
Taxation	5,542	6,600	8,103	8,206	18	21	26	26
Borrowings	2,500	2,036	2,252	2,260	8	6	7	7
Retirement Benefit Obligation	1,079	1,031	1,566	2,188	3	3	5	7
Deferred taxation	5,150	11,475	11,475	11,475	16	36	36	36
Total Liabilities	44,476	112,230	99,768	100,909	141	356	317	320
Capital and Reserves								
Share capital	6,000	6,000	6,000	6,000	19	19	19	19
Share Premium	6,321	6,321	6,321	6,321	20	20	20	20
Retained Earnings	45,706	54,092	84,356	102,083	145	172	268	324
Minority Interest	(271)	(261)	(261)	(261)	(1)	(1)	(1)	(1)
Shareholders' funds	57,756	66,152	96,415	114,143	183	210	306	362
Total liabilities and equity	102,232	178,382	196,184	215,051	325	566	623	683
Key Ratios	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Profitability								
Return on Average Equity	21.0%	23.1%	45.9%	30.6%	21.0%	23.1%	45.9%	30.6%
Return on Average Assets	8.1%	19.1%	16.6%	16.9%	8.1%	19.1%	16.6%	16.9%
EBITDA Margin	12.2%	24.8%	22.9%	24.6%	12.2%	24.8%	22.9%	24.6%
EBIT Margin	11.4%	24.2%	21.7%	22.8%	11.4%	24.2%	21.7%	22.8%
Pretax Profit Margin	11.6%	25.2%	22.7%	24.0%	11.6%	25.2%	22.7%	24.0%
Net Profit Margin	8.5%	17.0%	15.5%	16.3%	8.5%	17.0%	15.5%	16.3%
Valuation Multiples								
P/E (x)	17.7	6.8	7.2	6.5	17.7	6.8	7.2	6.5
P/B (x)	3.8	2.6	2.2	1.9	3.8	2.6	2.2	1.9
Dividend Yield (%)	3.9%	9.6%	9.6%	10.4%	3.9%	9.6%	9.6%	10.4%
EV/EBITDA (x)	11.9	4.5	4.7	4.2	11.9	4.5	4.7	4.2

Flour Mills of Nigeria Plc

Positive earnings outlook in FY'17/18

Backward integration, balance sheet deleveraging- the pivot for margin expansion: Flour Mills of Nigeria Plc (FLOURMILL) reported improved revenue growth in H1'17/18 (N298.4 billion; cf H1'16'17- ₦255.3 billion) despite seeming difficult business environment, notably with supply logistics. This is especially typified by the Apapa port congestion along with its inimical tailwinds. Notwithstanding expansion in revenue, gross margin came under immense pressure (down 240bps to 11.9%) largely due to increase in material costs (up 21.1% YoY) during the period. FLOURMILL continues to import some of its raw materials such as wheat and rice; and despite observed weaknesses in agricultural commodity prices, higher import bills (due to delays and bottlenecks at the Apapa port) imposes higher material cost implications on gross margin. However, the firm is currently involved in backward integration of its agro-allied products and we expect that this, when fully implemented, will ease its reliance on imports as well as exposure to foreign exchange volatility. FLOURMILL also carries a huge amount of debt (c. ₦188.2 billion as at Q2'17/18) with its consequent effect on PAT. However, the firm has set plans in motion to deleverage its balance sheet through a c.₦40 billion rights issue shelf program, which we expect to begin to impact results from FY'18/19. The firm also plans to issue c.₦70 billion in medium-term notes, taking advantage of the lower interest rate environment. We view this as positive strategies that will serve as a fulcrum for future growth with positive implications for ROE.

Core business to continue to drive profitability: In FY'17/18, we are optimistic about the firm's outlook and thus project an EPS growth of 130% to ₦7.08. This is premised on expected expansion in sales volume even as improvements in macro-fundamentals enhance the real purchasing power of households. Thus, our forecast for FY'17/18 revenue comes up at ₦572.1 billion- a 9.1% YoY growth (cf. FY'16/17- ₦524.5 billion). Other than the Apapa gridlock, we note improving efficiency and economies of scale through the firm's vertically integrated platforms as key to driving down operating costs and thus forecast EBIT margin to grow by 128bps to 9.2%. While finance costs remain high, we expect slight moderation in FY'17/18 thus providing elevation for profit after tax which is projected at ₦19.3 billion.

Counter remains undervalued: Given positive outlook for the firm for FY'17/18, we revise our target price to ₦44.90 which is a 49.7% upside to current price of ₦30.00. Thus, we retain our BUY rating on the counter. Also, FLOURMILL is trading at a forward PE of 4.9x compared to emerging market peer average of 16.15x.

BUY **TP: ₦44.90**

Company Information	
Address	Apapa Mills, 2 Old Dock Road, Lagos
Website	www.fmnplc.com
MD	Mr. Paul Gbededo
FYE	March
NSE Sector	Consumer Goods

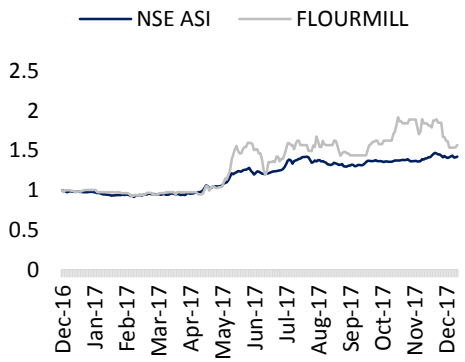
Ownership Structure	
Excelsior Shipping Co. Ltd.	52.18%
Others	47.82%

Stock Data	
Bloomberg Ticker:	FLOURMIL:NL
Market Price (₦)	30.00
Shares Outs (Mn)	2,624
Market cap (₦'Bn)	68

Price Performance	FLOURMILL	NSE
12-month	56.8%	42.3%
6-month	7.4%	15.5%
3-month	9.2%	7.9%

Valuation	2017A	2018E	2019F
P/E (x)	10.2	4.4	4.9
P/BV (x)	0.8	0.7	0.7
Div. Yield (%)	3.2	7.1	8.3

YTD price performance (rebased)



Financial Statements and Key Ratios

Income Statement	2016A	2017A	2018E	2019F	2016A	2017A	2018E	2019F
		₦'Mn				$'Mn		
Revenue	342,586	524,464	572,122	582,290	1,088	1,665	1,816	1,849
Cost of Sales	(292,810)	(441,935)	(477,722)	(485,630)	(930)	(1,403)	(1,517)	(1,542)
Gross Profit	49,777	82,529	94,400	96,660	158	262	300	307
Distri. And Admin Expenses	(18,312)	(23,761)	(28,606)	(30,279)	(58)	(75)	(91)	(96)
EBITDA	31,465	58,768	65,794	66,381	100	187	209	211
Depreciation and Amortisation	(14,692)	(15,840)	(17,906)	(19,216)	(47)	(50)	(57)	(61)
EBIT/Operating profit	16,773	42,928	47,888	47,165	53	136	152	150
Interest Expense/Income	(21,294)	(30,967)	(24,101)	(12,423)	(68)	(98)	(77)	(39)
Other Income	16,011	(1,488)	4,649	4,649	51	(5)	15	15
Pre-tax earnings	11,489	10,473	28,436	39,391	36	33	90	125
Taxation	2,931	(1,636)	(9,099)	(12,605)	9	(5)	(29)	(40)
Profit after tax	14,420	8,836	19,336	26,786	46	28	61	85
Statement of financial position	**2016A**	**2017A**	**2018E**	**2019F**	**2016A**	**2017A**	**2018E**	**2019F**
Assets		₦'Mn				$'Mn		
Fixed Assets	220,613	225,791	233,630	240,617	700	717	742	764
Investments	50	1,929	1,929	1,929	0	6	6	6
Inventories	58,699	117,296	108,633	110,431	186	372	345	351
Trade Debtors	18,966	21,403	25,079	25,525	60	68	80	81
Bank and Cash Balances	33,213	45,019	70,300	10,788	105	143	223	34
Other current assets	13,808	71,165	56,175	6,100	44	226	178	19
Total Assets	345,348	482,603	495,747	395,390	1,096	1,532	1,574	1,255
Liabilities								
Trade Creditors	50,417	94,567	65,441	66,525	160	300	208	211
Other Creditors	11,030	12,453	12,453	12,453	35	40	40	40
Taxation	1,336	2,136	3,970	5,801	4	7	13	18
Short term loan	117,243	190,726	214,150	94,508	372	605	680	300
Other current liabilities	3,013	7,614	7,614	7,614	10	24	24	24
Long term loans	48,010	50,879	50,879	11,023	152	162	162	35
Retirement Benefit Obligation	4,078	3,676	3,977	4,275	13	12	13	14
Deferred taxation	5,768	7,819	7,819	7,819	18	25	25	25
Other long term liabilities	8,688	10,187	10,187	10,187	28	32	32	32
Total Liabilities	249,583	380,059	376,490	220,206	792	1,207	1,195	699
Capital and Reserves								
Share capital	1,312	1,312	1,312	2,050	4	4	4	7
Reserves	36,723	36,701	36,701	75,819	117	117	117	241
Retained Earnings	54,901	60,451	77,163	93,234	174	192	245	296
Minority Interest	2,830	4,080	4,080	4,080	9	13	13	13
Shareholders' funds	95,766	102,544	119,257	175,184	304	326	379	556
Total liabilities and equity	345,348	482,603	495,747	395,390	1,096	1,532	1,574	1,255
Key Ratios	**2016A**	**2017A**	**2018E**	**2019F**	**2016A**	**2017A**	**2018E**	**2019F**
Profitability								
Return on Average Equity	15.2%	8.2%	17.4%	44.9%	15.2%	8.2%	17.4%	44.9%
Return on Average Assets	4.2%	1.8%	3.9%	6.8%	4.2%	1.8%	3.9%	6.8%
EBITDA Margin	9.2%	11.2%	11.5%	11.4%	9.2%	11.2%	11.5%	11.4%
EBIT Margin	2.6%	7.9%	9.2%	8.9%	2.6%	7.9%	9.2%	8.9%
Pretax Profit Margin	3.4%	2.0%	5.0%	6.8%	3.4%	2.0%	5.0%	6.8%
Net Profit Margin	4.2%	1.7%	3.4%	4.6%	4.2%	1.7%	3.4%	4.6%
Valuation Multiples								
P/E (x)	6.0	10.2	4.4	4.9	6.0	10.2	4.4	4.9
P/B (x)	0.9	0.8	0.7	0.7	0.9	0.8	0.7	0.7
Dividend Yield (%)	3.2%	3.2%	7.1%	8.3%	3.2%	3.2%	7.1%	8.3%
EV/EBITDA (x)	20.0	10.7	9.5	9.5	20.0	10.7	9.5	9.5

PZ Cussons Nigeria Plc

Earnings expected to recover from FX pressures

FX losses pressure bottom-line: PZ Cussons Nigeria (PZ) has seen profits weakened in the past periods owing to huge FX losses on its foreign denominated payables, largely as result of naira devaluation experienced in 2016. We believe that following the strengthening of the naira, the company continues to settle its FX obligations at higher rates, hence the exchange losses (Exchange losses as a percentage of EBIT: H1'16/17- 113.6%; H1'17/18- 66.3%). Other than this, we are confident that the company remains firmly positioned operationally for value accretion. This is premised on improvements in supply chain capabilities and distribution/depot networks which the firm leverages on to further drive down costs and enhance operational efficiency. While we note that revenue growth has largely been price-driven in order to mute the effects of high production costs (Q2'17/18 revenue growth: 17.6% QoQ and 34.3% YoY), we also reckon that PZ continues to streamline and optimize its product portfolio in order to drive sales volume, with particular focus on its Branded consumer goods segment, for instance, the re-launch of the Cussons Baby product. (Branded consumer goods segment contribution to revenue: FY'15/16- 66.1%; FY'16/17- 70.6%).

Earnings growth to support margins: On the back of expectations of a consumption rebound in the economy we expect top-line growth of 20% YoY to N95.5 billion for FY'17/18. We also think PZ will benefit from lower input prices- agricultural commodities, for instance Crude Palm Oil, have experienced gradual decline over time- as well as improved FX accessibility which should bring about lower production costs. Meanwhile, we maintain cautiousness in assessing the impact of this, given observed high cost of goods sold margin in previous periods. Thus, we project FY'17/18 gross margin at 34.1% (three year average- 32.3%). More so, whilst we expect PZ to continue to report FX losses for the near term, we think that this will gradually decline as the naira strengthens with positive implications for profitability especially in FY'18/19 going forward. Thus, our overall bottom-line projection for FY'17/18 comes in at N4.5 billion with PAT margin of 5.1% (three year average- 4.7%), which is expected to improve further to 7.7% in FY'18/19.

We retain our BUY rating on the counter: Using a blend of DCF and P/E relative valuation methods, we raise our price target slightly to ₦28.24 (previous: ₦26.44). This implies a potential upside of 21.09% on current market price. Thus, we retain our BUY rating on the stock. PZ Cussons is trading on a 2018E forward PE of 18.6x compared to Bloomberg peer average of 20.87x.

Risk to valuation: PZ employs a regional-cum-global procurement platform and thus remains exposed to volatility in exchange rate as well as material price fluctuation. These pose a downside risk to our estimates.

BUY **TP: ₦28.24**

Company Information	
Address	45/47 Town Planning Way, Lagos
Website	www.pzcussonsng.com
MD	Mr. Christos Giannopoulos
FYE	May
NSE Sector	Consumer Goods

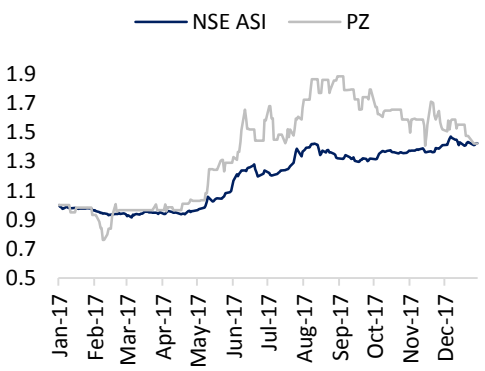
Ownership Structure	
PZ Cussons (Holdings) Limited UK	68.75%
Others	31.25%

Stock Data	
Bloomberg Ticker:	PZ:NL
Market Price (₦)	23.32
Shares Outs (Mn)	3,970
Market cap (₦'Bn)	92.6

Price Performance	PZ	NSE
12-month	42.1%	42.3%
6-month	-10.1%	15.5%
3-month	-20.8%	7.9%

Valuation	2016A	2017E	2018F
P/E (x)	34.6	31.2	14.1
P/BV (x)	1.9	1.9	1.8
Div. Yield (%)	3.3	3.2	3.4

YTD price performance (rebased)



Source: *NSE*

Source: *CardinalStone Research*

Financial Statements and Key Ratios

Income Statement	2016A	2017A	2018E	2019F	2016A	2017A	2018E	2019F
Revenue	69,528	79,630	95,520	98,003	220.72	252.79	303.24	311.12
Cost of Sales	(50,055)	(49,358)	(62,989)	(63,016)	(158.90)	(156.69)	(199.96)	(200.05)
Gross Profit	19,473	30,272	32,531	34,987	61.82	96.10	103.27	111.07
Distri. And Admin Expenses	(14,068)	(14,733)	(17,311)	(20,581)	(44.66)	(46.77)	(54.96)	(65.34)
EBITDA	5,405	15,539	15,220	14,406	17.16	49.33	48.32	45.73
Depreciation and Amortisation	(2,155)	(2,324)	(2,586)	(2,892)	(6.84)	(7.38)	(8.21)	(9.18)
EBIT/Operating profit	3,250	13,215	12,634	11,514	10.32	41.95	40.11	36.55
Other Income	286	(8,599)	(4,822)	(2,301)	0.91	(27.30)	(15.31)	(7.31)
Interest Expense/Income	(387)	195	(1,145)	1,164	(1.23)	0.62	(3.64)	3.70
Pre-tax earnings	3,148	4,811	6,667	10,377	9.99	15.27	21.16	32.94
Taxation	(1,019)	(1,125)	(2,133)	(3,321)	(3.23)	(3.57)	(6.77)	(10.54)
Profit after tax	2,130	3,687	4,534	7,056	6.76	11.70	14.39	22.40
Statement of Financial Position	**2016A**	**2017A**	**2018E**	**2019F**	**2016A**	**2017A**	**2018E**	**2019F**
Assets								
Fixed Assets	26,505	28,199	30,389	32,396	84.14	89.52	96.47	102.85
Inventories	19,278	23,665	22,607	22,617	61.20	75.13	71.77	71.80
Trade Debtors	15,587	23,125	20,936	21,480	49.48	73.41	66.46	68.19
Bank and Cash Balances	12,868	7,519	6,393	-617	40.85	23.87	20.30	(1.96)
Other current assets	192	5,391	5,390	5,389	0.61	17.11	17.11	17.11
Total Assets	74,430	87,899	85,714	81,264	236	279	272	258
Liabilities								
Trade Creditors	25,716	39,216	34,514	25,897	81.64	124.50	109.57	82.21
Other Creditors	0	0	0	0	0	0	0	0
Taxation	1,290	1,259	1,509	2,148	4.09	4.00	4.79	6.82
Due to related companies	0	0	0	0	0	0	0	0
Provisions	327	327	327	327	1.04	1.04	1.04	1.04
Deferred taxation	3,694	3,694	3,694	3,694	11.73	11.73	11.73	11.73
Total Liabilities	31,027	44,496	40,044	32,066	98	141	127	102
Capital and Reserves								
Share capital	1,985	1,985	1,985	1,985	6.30	6.30	6.30	6.30
Share Premium	6,878	6,878	6,878	6,878	21.84	21.84	21.84	21.84
Reserve	0	0	0	0	0	0	0	0
Minority Interest	2,502	2,502	2,502	2,502	7.94	7.94	7.94	7.94
Retained Earnings	32,037	32,037	34,304	37,832	101.71	101.71	108.90	120.10
Shareholders' funds	43,403	43,403	45,670	49,198	138	138	145	156
Total liabilities and equity	74,430	87,899	85,714	81,264	236	279	272	258
Key Ratios	**2016A**	**2017A**	**2018E**	**2019F**	**2016A**	**2017A**	**2018E**	**2019F**
Profitability								
Return on Average Equity	4.9%	8.5%	10.2%	14.9%	4.9%	8.5%	10.2%	14.9%
Return on Average Assets	3.2%	4.6%	5.7%	9.1%	3.2%	4.6%	5.7%	9.1%
EBITDA Margin	7.8%	19.5%	15.9%	14.7%	7.8%	19.5%	15.9%	14.7%
EBIT Margin	5.1%	16.8%	13.4%	12.0%	5.1%	16.8%	13.4%	12.0%
Pretax Profit Margin	4.5%	6.0%	7.0%	10.6%	4.5%	6.0%	7.0%	10.6%
Net Profit Margin	3.4%	5.1%	5.1%	7.6%	3.4%	5.1%	5.1%	7.6%
Valuation Multiples								
P/E (x)	34.6	22.5	16.9	11.2	34.6	22.5	16.9	11.2
P/B (x)	2.1	2.1	2.0	1.9	2.1	2.1	2.0	1.9
Dividend Yield (%)	3.0%	4.0%	2.5%	3.9%	3.0%	4.0%	2.5%	3.9%
EV/EBITDA (x)	14.6	5.4	5.6	6.4	14.6	5.4	5.6	6.4

***Source**: CardinalStone Research*

Dangote Cement Plc

Higher earnings on expected improvement in gross margin

Efficient energy strategy provides support for margins: DANGCEM reported improved Q3'17 revenues with a 27.4% YoY growth to ₦190.9 billion. On a nine-month basis, growth also appeared significant at 36.5% YoY to ₦603.5 billion- just 1.9% shy of total FY'16 revenues (*c.*₦615.1 billion). The firm's strong revenue figures were largely as a result of price adjustments made in September 2016. However, we highlight the consequent 10.1% decline in sales volume during the period (16.5 million tonnes as at September 2017 compared to 18.4 million tonnes in the corresponding period). This, other than price effect, was impacted by the rainy season. Notwithstanding, revenue growth from the Pan-African operations was equally as impressive, with Q3'17 and 9M'17 growth of 11.2% YoY and 40.5% YoY to ₦67.4 billion and ₦191.9 billion respectively. DANGCEM currently employs a cost-efficient fuel strategy through which it reduces over-reliance on gas as well as the expensive LFPO most especially for its Nigerian plants. This it achieves through sourcing of local coal from its parent company at a cheaper price. These initiatives led to improvements in both gross and EBITDA margins which rose by 940bps and 840bps to 56.9% and 48.8% respectively as at 9M'17. Though, we point out that improvements in overall margins largely accrue from the firm's Nigerian operations as the Pan-African segment continues to encounter high-cost pressures as well as lower volume sales. (Pan-African 9M'17 EBITDA margin only grew by 30bps to 16.8% compared to Nigerian growth of 1170bps to 65.0%).

Revenues to benefit from increased fiscal spending: We expect sales volumes to improve in FY'18 to 26.2 million tonnes (FY'16: 23.6 million tonnes; FY'17E: 20.1 million tonnes) owing to anticipation of increased fiscal capital spending by the federal government as well as recovery in private sector construction and increased exports. This is partly premised on the government's rollover of over 60 percent of its 2017 CAPEX appropriation to the 2018 fiscal year. More so, we do not anticipate an eager move by the company to adjust prices downwards despite the easing of cost pressures, as management remains committed to maintaining its strong margins in order to support CAPEX needs. Thus, our revenue projection for FY'18 comes in at ₦962.6 billion (FY'17E: ₦820 billion). While we expect EBITDA margin from the firm's Nigerian operations to remain elevated in FY'18- as the company leverages on production economies of scale especially in its Nigeria plants as well as strategic initiatives to drive down cost and improved logistics - we think that this will be slightly muffled by cost pressures on its Pan-African operations. Thus we project FY'18 EBITDA margin at 41.6% while EPS is expected at ₦15.32.

We retain our Buy recommendation on the counter: Going by our projections, we review our target price upward to ₦307.9. This presents an 18.4% upside to its current price and update our recommendation to a BUY rating on the counter.

BUY **TP: ₦307.90**

Company Information	
Address	Union Marble House, Ikoyi , Lagos
Website	www.dangotecement.com
MD (Acting)	Mr. Joseph Makoju
FYE	December
NSE Sector	Industrial Goods

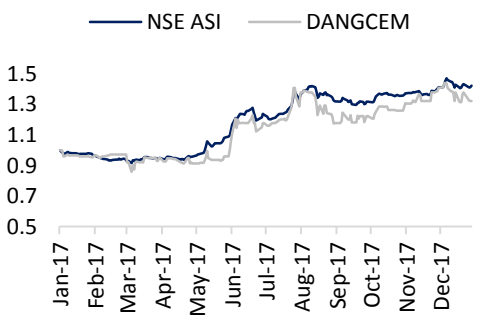
Ownership Structure	
Dangote Industries Limited	90.93%
Others	9.07%

Stock Data	
Bloomberg Ticker:	DANGCEM:NL
Market Price (₦)	260.00
Shares Outs (Mn)	17,040
Market cap (₦'Bn)	4,430

Price Performance	DANGCEM	NSE
12-month	32.2%	42.3%
6-month	12.2%	15.5%
3-month	8.0%	7.9%

Valuation	2016A	2017E	2018F
P/E (x)	23.0	18.2	15.6
P/BV (x)	4.4	3.9	3.5
Div. Yield (%)	4.1	5.5	5.9

YTD Price Performance (rebased)



Source: *NSE*

Financial Statements and Key Ratios

Income Statement	2015A	2016A	2017E	2018F	2015A	2016A	2017E	2018F
		₦'Mn				$'Mn		
Revenue	491,725	615,103	820,137	962,641	1,561	1,953	2,604	3,056
Cost of Sales	(163,565)	(272,571)	(348,891)	(401,225)	(519)	(865)	(1,108)	(1,274)
Gross Profit	328,160	342,532	471,246	561,416	1,042	1,087	1,496	1,782
Distri. And Admin Expenses	(69,663)	(95,831)	(136,965)	(160,763)	(221)	(304)	(435)	(510)
EBITDA	258,497	246,701	334,282	400,653	821	783	1,061	1,272
Depreciation and Amortisation	(54,626)	(74,750)	(64,762)	(71,982)	(173)	(237)	(206)	(229)
Other Income	3,951	10,542	4,101	4,813	13	33	13	15
EBIT/Operating profit	207,822	182,493	273,621	333,485	660	579	869	1,059
Interest Expense/Income	(19,528)	(1,564)	(22,429)	(27,589)	(62)	(5)	(71)	(88)
Pre-tax earnings	188,294	180,929	251,191	305,895	598	574	797	971
Taxation	(6,971)	5,695	(15,071)	(30,590)	(22)	18	(48)	(97)
Profit after tax	181,323	186,624	236,120	275,306	576	592	750	874
Statement of Financial Position	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Assets		₦'Mn				$'Mn		
Fixed Assets	934,287	1,209,966	1,268,225	1,340,639	2,966	3,841	4,026	4,256
Investments	10,676	14,778	14,778	14,778	34	47	47	47
Inventories	53,118	82,903	94,616	104,460	169	263	300	332
Trade Debtors	11,544	26,288	21,512	27,427	37	83	68	87
Bank and Cash Balances	40,792	115,693	15,000	15,000	129	367	48	48
Other current assets	60,526	78,280	110,833	114,810	192	249	352	364
Total Assets	1,110,943	1,527,908	1,524,963	1,617,113	3,527	4,851	4,841	5,134
Liabilities								
Trade Creditors	127,597	268,966	245,233	286,944	405	854	779	911
Taxation	1,289	4,674	5,318	6,239	4	15	17	20
Short term loan	47,275	220,300	87,937	48,467	150	699	279	154
Other current liabilities	24,537	18,307	18,307	18,307	78	58	58	58
Long term loans	208,329	152,475	205,187	193,870	661	484	651	615
Retirement Benefit Obligation	3,992	0	0	0	13	0	0	0
Deferred taxation	24,504	43,695	43,695	43,695	78	139	139	139
Other long-term liabilities	28,700	22,146	22,146	22,146	91	70	70	70
Total Liabilities	466,223	730,563	627,824	619,669	2,893	4,432	3,164	2,974
Capital and Reserves								
Share capital	8,520	8,520	8,520	8,520	27	27	27	27
Share Premium	42,430	42,430	42,430	42,430	135	135	135	135
Retained Earnings	620,501	677,479	775,679	874,125	1,970	2,151	2,462	2,775
Other component of equity	(20,496)	81,841	81,841	81,841	(65)	260	260	260
Minority Interest	(6,235)	(12,925)	(11,331)	(9,472)	(20)	(41)	(36)	(30)
Shareholders' funds	644,720	797,345	897,140	997,444	2,047	2,531	2,848	3,166
Total liabilities and equity	1,110,943	1,527,908	1,524,963	1,617,113	3,527	4,851	4,841	5,134
Key Ratios	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Profitability								
Return on Average Equity	29.3%	25.9%	27.9%	29.1%	29.3%	25.9%	27.9%	29.1%
Return on Average Assets	17.3%	14.1%	15.5%	17.5%	17.3%	14.1%	15.5%	17.5%
EBITDA Margin	52.6%	40.1%	40.8%	41.6%	52.6%	40.1%	40.8%	41.6%
EBIT Margin	42.3%	29.7%	33.4%	34.6%	42.3%	29.7%	33.4%	34.6%
Pretax Profit Margin	38.3%	29.4%	30.6%	31.8%	38.3%	29.4%	30.6%	31.8%
Net Profit Margin	36.9%	30.3%	28.8%	28.6%	36.9%	30.3%	28.8%	28.6%
Valuation Multiples								
P/E (x)	23.7	23.0	18.2	15.6	23.7	23.0	18.2	15.6
P/B (x)	5.5	4.4	3.9	3.5	5.5	4.4	3.9	3.5
Dividend Yield (%)	3.2%	3.2%	4.1%	4.7%	3.2%	3.2%	4.1%	4.7%
EV/EBITDA (x)	14.30	14.98	11.06	9.23	14.30	14.98	11.06	9.23

Lafarge Africa Plc

Optimistic Outlook for FY'18 Earnings

Milder FX pressures support margins: WAPCO reported an impressive 28.2% YoY rise in its 9M'17 revenue to ₦68.8 billion though on a QoQ basis, this was lower by 6.4% largely due to the effects of the rainy season. We also note improvements in gross margins (climbed 1400bps YoY to 19.6%) owing to lower cost of sales to sales ratio- which in itself benefited from the company's turnaround plan towards increasing use of biomass and locally sourced coal to dampen the effects of high energy costs. Revenues remained strong on a nine months basis, however, we highlight lower contribution of the firm's South African operations which declined to 43.8% due to lower selling prices (South Africa has had issues with cement oversupply which led the government to increase import tariffs). We also note the beneficial impact of lower FX losses on its foreign currency debt (9M'17- ₦9.9 billion; 9M'16- ₦31.5 billion) on bottom-line as the company recorded a profit of ₦938 million compared to a loss of ₦37.4 billion in the preceding quarter.

Balance sheet deleveraging to bolster bottom-line: Our revenue forecast for FY'18 comes at ₦361.6 billion (FY'17E- ₦294.9 billion) on the back of expectations of improved spending on capital projects in Nigeria. We also expect gradually improved contribution from the South African operations following the South African government's commitment to increase infrastructure spending within the next three years. In addition, we believe that production costs will continue to moderate in support of gross margins as the company further diversifies away from over-dependence on gas to other cheaper alternatives, notably coal. Thus, we project an FY'18 gross margin of 35.6% (FY'17E: 32.5%). Furthermore, in order to deleverage its balance sheet and also to strengthen its expansion program in Nigeria, WAPCO recently conducted a Rights Issue to raise about ₦131.7 billion. This, if fully subscribed portends positive implication for bottom-line in terms of lower finance costs (WAPCO has committed to reduce its foreign currency debt by about 50%) and much milder FX losses. At such, we forecast an FY'18 profit after tax margin at 18.3% (FY'17E: 3.1%).

Our recommendation remains a BUY: Following our projections, we revise our fair value estimate slightly to ₦73.71 (previous ₦71.14). This presents a 41.1% upside to current market price of ₦52.24. Hence we retain our BUY rating on the counter.

BUY **TP: ₦73.71**

Company Information	
Address	27B Gerrard Road, Ikoyi , Lagos
Website	www.lafarge.com.ng
MD	Mr. Michael Puchercos
FYE	December
NSE Sector	Industrial Goods

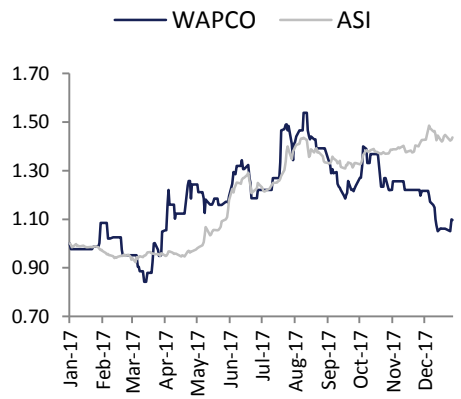
Ownership Structure	
LafargeHolcim	72.74%
Stanbic Nominees	7.27%
Others	19.99%

Stock Data	
Bloomberg Ticker:	WAPCO:NL
Market Price (₦)	52.24
Shares Outs (Mn)	5,576
Market cap (₦'Bn)	262

Price Performance	WAPCO	NSE
12-month	(32.0%)	11.9%
6-month	16.3%	29.8%
3-month	22.1%	23.2%

Valuation	2016A	2017E	2018F
P/E (x)	12.1	9.4	5.3
P/BV (x)	1.0	1.0	0.8
Div. Yield	2.6%	3.2%	5.6%

YTD Price Performance (rebased)



Financial Statements and Key Ratios

Income Statement	2015A	2016A	2017E	2018F	2015A	2016A	2017E	2018F
		₦'Mn				$'Mn		
Net Sales	**267,234**	**219,714**	**294,943**	**361,602**	**1,357**	**720**	**967**	**1,186**
Cost of sales	(168,666)	(163,086)	(218,955)	(232,941)	(938)	(535)	(652)	(764)
Gross Profit	98,568	56,628	95,988	128,661	(937)	186	315	422
Dist & Admin expenses	(30,777)	(46,772)	(18,273)	(21,698)	(157)	(153)	(44)	(71)
EBITDA	67,791	29,024	82,715	106,965	344	95	271	351
Depreciation	(16,037)	(15,967)	(19,303)	(20,180)	(81)	(52)	(63)	(66)
EBIT	51,644	4,988	63,413	86,784	262	16	208	285
Net Interest Expense	(9,029)	(11,840)	(20,879)	(5,559)	(55)	(39)	(36)	(18)
Other Financial Income/(Expense)	(13,341)	(24,748)	0	0	(81)	(81)	0	0
PBT	29,274	(6,852)	17,534	81,226	149	(22)	172	266
Taxes	(2,276)	39,717	(8,290)	(15,276)	(12)	130	(27)	(50)
PAT	**26,998**	**32,866**	**9,244**	**65,950**	**137**	**108**	**145**	**216**
Balance Sheet	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Cash & ST Investments	16,493	19,265	35,087	73,494	84	63	115	157
Accounts Receivable	23,474	25,801	28,485	37,736	119	85	93	124
Inventories	33,027	44,531	25,864	41,706	168	146	85	137
Other Accounts Receivable & Current Assets	882	8,746	3,615	6,177	4	29	12	20
Net Property, Plant & Equipment	364,397	390,489	400,484	404,875	1,850	1,280	1,313	1,327
Other fixed assets	14,738	13,659	43,598	45,198	75	45	143	148
Total Assets	**453,011**	**502,491**	**537,134**	**609,186**	**2,300**	**1,648**	**1,761**	**1,913**
Borrowings	148,288	127,530	84,287	60,460	753	418	276	198
Accounts Payable	76,847	100,808	96,738	120,070	390	331	317	394
Taxation	1,269	825	825	825	6	3	3	3
Dividends	3,828	13,459	13,459	13,459	19	44	44	44
Other Current Liabilities	2,099	1,412	2,190	2,787	11	5	7	9
Pensions &End of service benefits	1,496	3,780	3,780	3,780	8	12	12	12
Other LT Liabilities	9,649	5,724	58,660	50,660	49	19	192	166
Deferred Taxes	33,385	-	-	-	169	-	-	-
Total Liabilities	**276,861**	**253,538**	**259,940**	**252,041**	**1,405**	**831**	**852**	**826**
Shareholders' Equity	117,348	264,919	304,141	357,145	596	869	997	1,171
Minority Interest	58,803	-	-	-	298.49	-	-	-
Shareholders Fund	**176,152**	**264,919**	**304,141**	**357,145**	**894**	**869**	**997**	**1,171**
Key Ratios	**2015A**	**2016A**	**2017E**	**2018F**	**2015A**	**2016A**	**2017E**	**2018F**
Profitability								
Return on Equity	15.3%	12.4%	14.5%	18.5%	15.3%	12.4%	14.5%	18.5%
Return on Assets	6.0%	6.5%	8.2%	11.3%	6.0%	6.5%	8.2%	11.3%
Gross Margin	52.1%	34.1%	32.5%	35.6%	51.9%	34.1%	145.4%	93.0%
EBIT Margin	19.3%	2.3%	21.5%	24.0%	19.3%	2.3%	21.5%	24.0%
Pre-tax Profit Margin	11.0%	-3.1%	17.8%	22.5%	11.0%	-3.1%	17.8%	22.5%
Net Profit Margin	10.1%	15.0%	3.1%	18.2%	10.1%	15.0%	15.0%	18.2%
Valuation Multiples								
P/E (x)	16.3	12.1	9.4	5.3	16.3	12.1	9.4	5.3
P/B (x)	1.9	1.0	1.0	0.8	1.9	1.0	1.0	0.8
Dividend Yield (%)	3.1%	2.6%	3.2%	5.6%	3.1%	2.6%	3.2%	5.6%

Source: *CardinalStone Research*

Disclosure

Analyst Certification

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CardinalStone employs a 3-step rating system for equities under coverage: Buy, Hold, and Sell.

Buy ≥ +15.00% expected share price performance

Hold +0.00% to +14.99% expected share price performance

Sell < 0.00% expected share price performance

A **BUY** rating is given to equities with strong fundamentals, which have the potential to rise by at least +15.00% between the current price and the analyst's target price

An **HOLD** rating is given to equities with good fundamentals, which have upside potential within a range of +0.00% and +14.99%,

A **SELL** rating is given to equities that are highly overvalued or with weak fundamentals, where potential returns of less than 0.00% is expected, between the current price and analyst's target price.

A NEGATIVE WATCH is given to equities whose fundamentals may deteriorate significantly over the next six (6) months, in our view.

CardinalStone Research distribution of ratings/Investment banking relationships as of December 31, 2017

Rating	Buy	Sell	Hold
% of total recommendations	81.8%	9%	9%
% with investment banking relationships	0%	0%	0%

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