CardinalStone

Nigeria: 2021 Outlook
AWAITING DAWN
January 2021

Executive Summary

Drawing inspiration from the Irish poem "Second Coming", written in the aftermath of the First World War in 1919 amid a rampaging flu pandemic, we argue that the fate of several countries hangs in the balance in the face of the second wave of the deadly COVID-19 virus. The re-opening of economies combined with slack preventive measures and the evolution of mutated strains of the virus opened the doors to the second wave of widespread infections. The globe's economic fate now rests on the success or otherwise of distributing a few vaccines, with broad expectation skewed in favour of a V-shaped recovery.

In Nigeria, the V-shaped recovery is likely to be led by the non-oil sector on the impact of 2020 low base effect, a ramp-up of government spending, increase in credit creation and sustained normalisation of economic activities. The current pace of yield increases is likely to moderate in Q1'21 on the impact of excessive liquidity but pick pace in Q2'21. Our expectation of an eventual pick-up in yields reflects lower OMO maturities, lesser dovish inclinations on macro recovery, and a wider budget deficit. Thus, investors are likely to stay short in the fixed income space. The government could also frontload greater than expected domestic borrowing ahead of a potential pick-up in yields, especially if there are signs that external funding conditions could deteriorate.

In the equities market, we expect investors to take advantage of bargain hunting opportunities in cheap, fundamentally strong names with a track record of shareholder wealth creation or veritable evidence of structural breaks from previous constraints. Investors are likely to follow volatilities in these names and try to take advantage of mispricing when they occur.

Analysts

Kayode Eseyin
kayode.eseyin@cardinalstone.com
(234) 817 834 8569

Ngozi Chukwuneke
ngozi.chukwuneke@cardinalstone.com
(234) 809 056 6324

Olufisayo Ademilua
olufisayo.ademilua@cardinalstone.com
(234) 809 056 6338

Khalil Woli
khalil.woli@cardinalstone.com
(234) 908 702 2238

Michael Nwakalor
michael.nwakalor@cardinalstone.com
(234) 809 022 1946

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

Philip Anegbe (Team Lead)
philip.anegbe@cardinalstone.com
(234) 809 041 5178

Investment Research
research@cardinalstone.com
(234) 7100 433

Securities Trading
equities@cardinalstone.com
(234) 802 9755 644

Contents

Summary of recommendations

Company Ticker	Rating	TP (N)	Ref Price[1] (N)	Upside/ Downside	Market Cap (N'bn)	2020F P/E	2020F D/Y
Financial Services							
ACCESS	HOLD	**10.52**	9.50	**10.7%**	337.68	2.7x	7.3%
ETI	HOLD	**7.45**	6.50	**14.6%**	119.27	6.3x	0.0%
FBNH	BUY	**8.86**	7.50	**18.1%**	269.21	3.3x	2.6%
FCMB	SELL	**2.68**	3.22	**-16.7%**	63.76	3.5x	4.4%
FIDELITYBK	HOLD	**2.94**	2.70	**8.8%**	78.23	2.9x	5.2%
GUARANTY	BUY	**44.03**	33.00	**33.4%**	971.23	4.4x	7.7%
STANBIC	BUY	**58.55**	44.00	**33.1%**	488.66	5.3x	5.6%
UBA	BUY	**10.97**	9.05	**21.2%**	309.50	3.2x	11.1%
ZENITHBANK	BUY	**31.04**	26.40	**17.6%**	828.87	3.6x	11.0%
Consumer Goods							
DANGSUGAR	HOLD	**20.72**	20.35	**1.8%**	244.20	7.4x	7.7%
FLOURMILL	HOLD	**32.49**	30.00	**8.3%**	123.01	7.0x	6.9%
GUINNESS	HOLD	**21.05**	18.85	**11.7%**	41.29	85.4x	0.0%
NB	SELL	**49.50**	58.05	**-14.7%**	464.22	52.4x	1.9%
NESTLE	HOLD	**1575.42**	1505.00	**4.7%**	1,192.95	27.0x	3.3%
UACN	HOLD	**8.36**	7.50	**11.5%**	21.61	9.7x	8.5%
Industrial Goods							
DANGCEM	HOLD	**241.29**	237.00	**1.8%**	4,038.60	14.8x	6.8%
WAPCO	BUY	**28.61**	23.50	**21.7%**	378.53	10.9x	7.4%
Agriculture							
OKOMU	SELL	**91.07**	93.00	**-2.1%**	88.71	17.0x	4.3%
PRESCO	HOLD	**82.18**	72.00	**14.1%**	72.00	12.5x	2.8%
Telecoms							
MTNN	HOLD	**168.08**	168.00	**0.2%**	3,419.56	16.6x	5.0%
Oil & Gas							
ARDOVA	HOLD	**25.37**	21.85	**16.1%**	28.46	10.5x	4.8%
MOBIL	SELL	**188.54**	249.50	**-24.4%**	89.97	14.7x	2.2%
SEPLAT	BUY	**739.90**	540.00	**37.0%**	317.76	-9.9x	5.3%
TOTAL	SELL	**119.40**	143.00	**-16.5%**	48.55	28.1x	2.8%

[1]Close price as at January 14, 2021

Of Vaccines and V-shaped recovery

Ploughing through a crisis for sustainable growth

Perhaps COVID-19 may have elevated the need for vaccines to a level not seen in over 100 years, so much so, that hopes for a 2021 V-shaped recovery have been, almost entirely, built on them. Yet, a large swath of the Nigerian populace has failed to accept the reality of COVID -19, with the "apathy" often bothering on the lack of first-hand experience or education. Most people also rely on "hand-to-mouth" existence, usually requiring physical contacts that make social distancing difficult. The latter means the re-imposition of a full lockdown could be a long shot amidst the resurging infections. However, the government can take a little solace from multiple vaccine developments in parts of the world, even though there is hardly any budgetary space or provision at the moment. Nevertheless, the prospect of timely vaccine accessibility appears slim, given the slow pace of vaccine churn-outs relative to the scale and urgency of global demand.

Current growth concerns are more ubiquitous than in 2016, but, we believe the outturn of the six largest sectors could, again, be critical to Nigeria's size and pace of recovery in 2021. We also argue that a proper harnessing of the abundance of low-skilled labour can be a crucial fulcrum for industrialisation and a hedge against social unrests. On this wise, structural reforms and policy initiatives to improve labour force participation may be a sine qua non for more inclusive growth going forward. Also, we emphasise the need to augment the government's limited resources with private capital by activating pro-market initiatives such as improved currency managements, privatisations (or private & public partnerships), enhanced security conditions, and an increase in regulatory arbitrage opportunities.

COVID-19: The second coming

Are we prepared?

Drawing inspiration from the Irish poem "Second Coming", written in the aftermath of the First World War in 1919 amid a rampaging flu pandemic, we argue that the fate of several countries hangs in the balance in the face of the second wave of the deadly COVID-19 virus. The premature re-opening of economies combined with a general slack in preventive measures and the evolution of a mutated strain of the virus opened the door to the second wave of widespread infections.

Even though Nigeria appears to be recovering from the impact of its first COVID lockdown, an alarming rise in new cases has posed some reality checks and prompted a partial re-introduction of containment measures in Lagos, which houses a significant proportion of the newly infected. The mortality rate remains contained (relative to world numbers), but cautious handling of the virus situation appears justified by its unpredictability and capacity to mutate.

Recorded highest daily number of cases on Jan 15, 2021

+1,867

Nonetheless, domestic mortality rate for COVID-19 cases lags that of the rest of the world

2.16%

1.42%

Another full lockdown is unlikely

Considering the adverse impacts of the lockdown measures enacted in March 2020, and the relatively moderate mortality rate from the first wave of the virus spread, another wholistic lockdown appears unlikely in 2021. Furthermore, anecdotal evidence may suggest that lower-income households and those in the informal sector are disproportionately affected by the lockdowns. This inequitable impact may increase the risk of civil unrest, structural unemployment, poverty, and other unwanted welfare outcomes.

Vaccine rollout is critical for growth

While we recognize the slow but steady recovery in the domestic economy in line with the resumption of economic activities, there are still areas of real pain for businesses in the form of supply chain disruptions and weak consumer spending power. More so, the recent imposition of curfews, social distancing, and limitation of people at social centres are likely to dent some of the progress made over the last few months. These recent restrictive developments underscore the importance of having quick access to a COVID-19 vaccine in Nigeria.

Figure 1: AstraZeneca is the cheapest and most suitable to climatic conditions

Metrics	Moderna	Pfizer/BioNTech	Johnson & Johnson's	Novavax	AstraZeneca
No of dose(s)/ vaccination	2	2	2	2	2
Price/dose ($)	32-37	19.5	10	16	3-4
Total price ($)	64-74	39	20	32	6 - 8
Efficiency	94%	95%	N/A	N/A	70%
Required temp. (°C)	Transported at -20° Lifespan of 30 days when stored at between 2° and 8°	Transported at -75° Lifespan of 5 days when stored at between 2° and 8°	Transported and stored at between 2° and 8° for 3 months	Transported and stored at between 2° and 8° for 6 months	Does not expire. To be stored at between 2° and 8°

Source: Healthline; Financial Times; CardinalStone Research

Nigeria vaccines plans still a long way off

Nigeria hopes to get enough vaccines to take care of 20.0% of its population (c.42 million people), aided by its partnership with the WHO-led global COVAX scheme. According to the National Primary Health Care Development Agency, frontline health workers, those with underlying health conditions, and the elderly will be considered priorities in the first set of vaccinations. Despite the government's optimism, cost, logistic limitations, delayed commencement of vaccinations campaigns, and slow pace of demand churn outs (relative to demand urgency) suggest that actualization could be a long shot. In any case, COVAX has disclosed that the promised "20.0% of the population" vaccine support will be over the longer term, subject to funding. Should Nigeria decide to partly self-fund some purchases to accelerate the process of vaccine deployment, it may have to provide an upfront payment of $1.6/dose (or 15.0% of total cost per dose). This upfront implies that c.N169.8 billion would be required to take care of 42 million Nigerians. However, the government recently disclosed that there is no provision for the purchase of COVID-19 vaccines in the 2021 appropriation bill.

Towards a more dynamic macro reboot

Since the 2017 recovery, growth has persisted at sub-optimal levels leaving the economy less secure from exogenous risks factors and raising questions about the adequacy of measures introduced such as the ERGP. Worryingly, consumption and investment, which are key growth drivers, have remained constrained in recent years. Government spending alone pales into insignificance compared to the level of investment needed to drive the economy. Another expected recovery is on the cards. Our previous report highlighted the need to make the most of the COVID-19 induced economic crisis to reinvigorate structural weaknesses within critical aspects of the economy. 2021 will afford the first opportunity to test the adequacy government's latest efforts. Although we project that the economy could grow by 1.5% this year, we highlight that a simple economic rebound will not suffice based on lessons learnt from the last recovery cycle. This economy needs more.

Non-oil sector to lead recovery

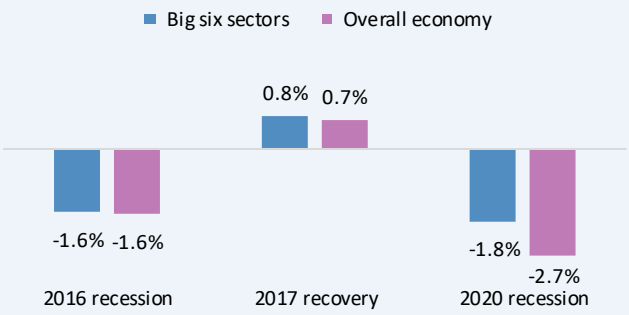
Six sectors (agriculture, trade, telecoms, manufacturing, crude oil and real estate) that account for 76% of Nigeria's GDP were responsible for 68% of the 2.7% economic contraction in the first nine months of 2020. Other than the 6.5% growth in agriculture and telecoms sectors (36.7% of GDP combined), the economic contraction could have been worse. We also note the significant weakness recorded in the transportation sector during the year. Hence, we assess that how quickly the economy recovers from recession will depend on how activities improve in these depressed sectors in 2021.

Although economic activities appear to have improved since the third quarter of 2020, it is yet to be seen whether that could significantly improve consumption and gross capital formation, which are necessary catalysts for growth. While domestic consumption could improve compared to the prior year, devaluation impact and inflationary concerns could exacerbate the cost of living, leading to depressed real consumption.

Our expectation for drivers to an economic recovery contrasts with that observed in 2017. Then the recovery was predominantly driven by the oil sector. Now, economic recovery will need to be propelled by the non-oil sector, particularly the manufacturing and trade sectors, in addition to oil sector rebound.

Likewise, business spending could accelerate slowly than desired on muted bank lending and foreign direct investments. Positively, trade balance could improve on the back of border re-openings and a possible return to global trade normalcy in the latter half of the year should global vaccine rollouts attain the desired effects.

Figure 2: Overall economic performance have typically tracked activities in the Big Six sectors[1]. A potential 2021 recovery could depend on how much those sectors improve during the year



Source: Nigeria Bureau of Statistics; CardinalStone Research

[1]We assess the following sectors as the Big Six: agriculture, trade, telecoms, manufacturing, crude oil and real estate

Growth indicators in a tug-of-war

Growth indicators may be sending mixed signals about a potential timing of an economic recovery and, more importantly, the ensuing growth's sustainability.

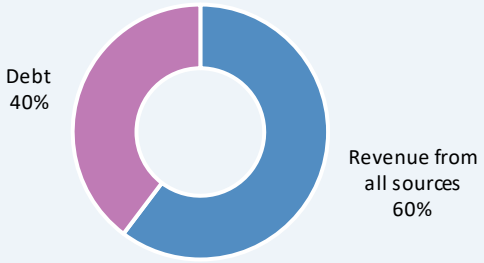
	Indicator	Directional view	Commentary
Some leading growth indicators	Equities market		Equity market rally in late 2020 and sustained positive sentiments in early 2021 are suggestive of expectations of an economic recovery
	Manufacturing PMI		Manufacturing PMI returned to contraction following the expansion in November 2020. Before that, the index indicated a squeeze for six consecutive months
	Bank credit		CBN survey suggests that supply of credit to households and the corporate sector improved in Q4'20 and could increase further in Q1'21
	Inventory level		Both manufacturing and non-manufacturing inventory indices have contracted in nine consecutive months
	Construction & Housing		Construction PMI levels have declined for nine consecutive months, weakening across business activity, new orders and employment indicators
	New business start-ups		Business start-up processes have eased leading to a 3.2 ppts jump in Nigeria's doing business score under the starting a business criteria

Budget funding

The widening gross capital formation gap worsened by the pandemic has made the role of government spending critical. The 2020 budget performance suggests a remarkable improvement in capital implementation rate at 81.6% (as at September pro-rated, albeit on a revised capital budget of N1.96 trillion) versus a four year average of 40.4%. 2021 promises a more ambitious capital budget of N4.1 trillion and a similar capex implementation rate could be of the utmost benefit to the economy.

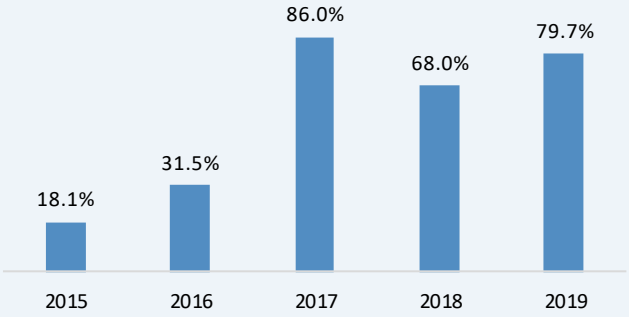
However, a key consideration in achieving a high capex implementation, in our view, is government access to the required level of funding. Our concern considers expected slowdown in the government's revenue, given less than comfortable oil price level, tax exemptions and import duty waivers. Consequently, the government is more likely to tilt towards borrowing, leading to an actual fiscal deficit that materially trumps the budgeted shortfall.

Figure 3: Debt accounts for 40% of N13 trillion budget funding



Source: Budget Office; CardinalStone Research

Figure 4: Total debt-service to federation revenue has been elevated over the years



Source: CBN; CardinalStone Research

Exploiting demographics for sustainable growth

A basic assessment of the demography versus economic growth relationship suggests that favourable demographics drive growth. Nigeria has three key demographic variables that positively underscores its high growth potential: 1) a large labour force that implies significant output opportunities; 2) favourable age distribution—a relatively young working population versus the ageing population of other countries; 3) an enormous population size, signifying strong market potential.

Notwithstanding the positive factors, Nigeria's growth trend remains sub-optimal partly due to the high unemployment (27.1%) and underemployment (28.6%) levels, especially among the youth population. This high rate of unemployment/underemployment effectively dilutes the impact of a larger labour force size and reduces actual labour force participation, both of which are critical elements in the demography vs economic growth dynamics. The low labour force participation disappointingly caps the country's growth potential, unless the government strategically devises its structural reforms and policy initiatives to improve labour force participation.

Nigeria can learn significant lessons from the growth of the Chinese and Indian economies. Both countries, which account for about 40% of the world's population, have become attractive destinations for foreign direct investments due to labour availability and market size. Consequently, these countries' increasing investment appeal implies positives for employment, manufacturing, consumption, export and technological adoption (capital deepening), all of which can drastically propel growth.

Most notably, China and India have been able to grow rapidly because of high growth in labour, capital and total factor productivity resulting from, for example, the ability to 'draw on technology existing in the advanced economies and play catch-up'

The World Under Pressure: How China and India Are Influencing the Global Economy and Environment Carl J Dahlman Page 98

Journal of Energy & Natural Resources Law Vol 31 No 1 2013

Risks to growth outlook

COVID-19

The discovery of a new, more infectious COVID-19 variant and worries about a new wave of cases poses risks to Nigeria's economic prospects. Likewise, several countries return to different degrees of lockdown could either slow or disrupt the global trade recovery altogether. Again, there could be a disruption of the crude oil market.

Domestically, there is still the possibility of enforcement of certain forms or restrictions; as well as a worst-case scenario reinstatement of a lockdown

Socio-political risks

Socio-political concerns and civil disorders are risks to growth prospects. The recent spate of vandalism several growth-inducing infrastructures that trailed the #EndSars protest and Xenophobia reactions demonstrates our worry. Some consequences could include:

- A slowdown in foreign direct investments and domestic investment as apathy heightens
- Higher operational risks and increased insurance premiums which could increase the cost of doing business in Nigeria

Monetary policy

Risks of currency devaluation and increased illiquidity could adversely affect consumer discretionary income and production cost.

More so, a sharp CBN U-turn on dovish monetary policy to attract FPIs and avoid a devaluation could lead to higher borrowing costs and, possibly, disincentivize capital investments

Currency repricing – Are we done yet?

The CBN devalued the official exchange rate to N360/$ in March 2020 (from N305/$ previously) and further downwards to N379/$ in August 2020. The currency adjustments followed a COVID-19 induced crash in crude oil price (to as low as $19/bbl) and subsequent capital flow reversals. Despite the two currency adjustments, persistent FX shortages at recognized FX windows inadvertently rerouted demand to the parallel market, resulting in the sharpest rate divergence witnessed since the introduction of the I&E window in 2017. In 2021, we expect further naira repricing on subsisting current account weaknesses, sustained declines in FX receipts, and rising inflation. However, the extent of repricing may be a bit more contained due to firmer crude oil prices, likely Eurobond issuances, and projected dollar weakening. Overall, we expect the currency trade between the N420-N440/$ band at the I&E window by year-end versus our fair value estimate (FVE) of N505/$. Our FVE reflects Nigeria's external vulnerabilities and expected acceleration in the inflation rate.

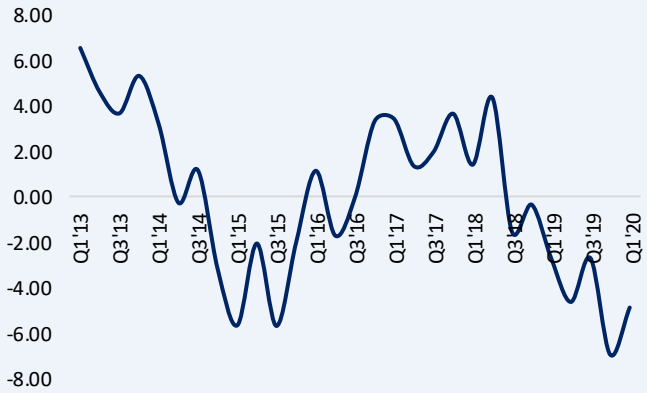
Currency pressure points to subsist in 2021

Current account weakness to worsen – Nigeria experienced Balance of Payments (BoP) setback in 2020 as plummeting crude oil price drove trade deficit to its worst level on record (N4.3trillion) in 9M'20 amid a drop in capital inflow to pre-2017 levels (c.$'8,610 million). We expect a rebound in oil prices to improve trade balance in 2021, but note that a potential increase in services (travels and education accounts for c.35.0% of services FX outflows) could offset the impact of higher oil sales.

Low rates and High inflation – Lower domestic yields and high inflation rates increase the appeal of foreign securities and currencies as investors seek to protect their purchasing power and investment returns. Our average inflation forecast of 16.0% for 2021 suggests that positive real yields would be hard to come by domestically.

External pressure to unify exchange rates – Nigeria secured substantial financing from multilateral institutions last year, including a $3.4 billion facility from the IMF and a $1.5 billion facility from the World Bank for social programs and institution building. In our view, Nigeria is under pressure to improve the flexibility of its currency pricing and unify its exchange rates to get increased funding from these institutions and encourage FDI inflows.

Figure 5: Current account balance 2013-2020 ($'billions)

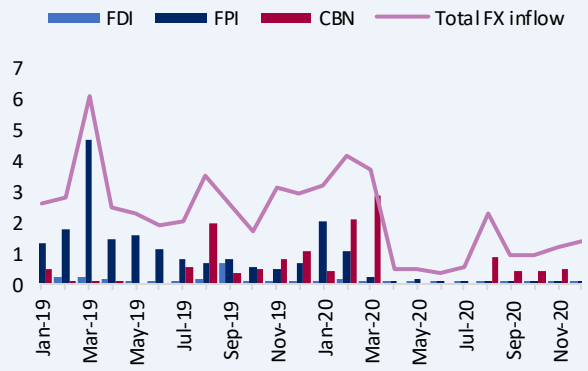


Source: CBN; CardinalStone Research

The Bilateral Currency Swap Agreement (BCSA) between China and Nigeria, which comes due in April 2021 may lower reserves by $2.5 billion if not rolled over. The Swap did not materially reduce demand for US dollar for Chinese related transactions ($250 million worth of Yuan sold in 2019 v $15.2 billion in total Chinese imports). However, its maturity could stoke speculative reaction in the market and hasten the potential FX adjustment.

Foreign capital flows to remain weak - Foreign direct investment remained relatively flat at c.$1.0 billion over the last three years, but, robust foreign portfolio flows (3 -year average: $11.8 billion) provided some stability to the nation's foreign reserve position. However, the attractiveness of domestic assets to FPI investors may have diminished on lower interest rates, FX accessibility issues, and the OMO ban. In our view, sustained unorthodox policies, FX illiquidity, and widening inflation differential makes frontier peers, like Egypt, more attractive destinations for foreign capital.

Figure 6: FX inflows at I&E still far below pre-pandemic levels



Source: FMDQ; CardinalStone Research

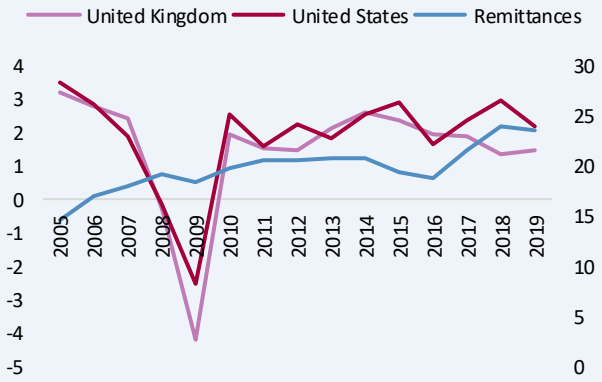
Oil price rebound and likely external financing to cap currency repricing

The rebound in crude oil price and volumes on greater vaccine distribution should support FX reserves and import cover in 2021. Additionally, we expect the FGN to tap the Eurobond market in 2021, given improved financing conditions versus when it decided to shelve plans of doing so last year (March 2020 avg Eurobond rate: 13.3%; December 2020 avg rate: 5.56%). Also, we discount the likelihood of material multilateral funding, given the amount tapped last year as we monitor the progress of the outstanding $1.5 billion budget support request to the World Bank. Firmer oil prices and external borrowing may mitigate FX supply constraints, especially when accompanied by devaluation. Improved supply may cap currency adjustment at the I&E window at N420-N440/$ (vs FVE of N505/$) by 2021.

Remittance policy and devaluation to spur rate convergence

We expect exchange rates at the I&E and parallel markets to slightly converge by year-end. The convergence is likely to be driven by currency repricing at the former and improved supply in the latter, partly due to the amended remittance guidelines. Notably, these guidelines already allowed recipients to access to funds in dollars and eased the naira from the lows of N500/$ at the unofficial market. The measure also fast-tracked the recovery of remittance flows from the through of the second quarter of 2020. A 10-20% YoY increase in remittances (similar to the rebounds in South Asia and Kenya last year) could mean a $200-400mn increase in FX inflows (based on 2019 numbers). Thus, we expect the move to considerably ease FX pressures in the parallel market and boost FX reserves, which had fallen by c.$271.8 million monthly in 2020. All in, we expect the differential between the I&E and parallel market rates to narrow to N20-30/$ (vs current spread of N60-N75/$). The latter is also likely to end the year at around N425/$ levels.

Figure 7: Remittances have tracked US growth in recent years. LHS - US/UK GDP growth (%); RHS - Remittances



Source: World Bank, CBN, CardinalStone Research

We envisage that currency repricing at the I&E and better remittances will drive exchange rate spread to between N20-30/$ (vs current spread of N60-N75/$)

Playing a potential recovery

Leveraging volatilities for upside

In line with global expectations, Nigeria is likely to exit the current recession in the first half of 2021. Investors are, therefore, facing another test of their capacity to virtually time market entry and positioning. No thanks to the liquidity-induced rallies, the Nigerian equities market is currently trading above its 3-year mean level. But this new level may be slightly justified by lower yields and a shortage of alternative investment options domestically. In any case, a few tickers are still trading at a discount to historical mean levels and boasting attractive dividend yields. In addition, some of these stocks offer returns close to or in excess of the cost of equity of market or promise same over the short to medium term (perhaps aided by some form of internal restructuring). Investment in such names is likely to leave equity investors well-off, in our view.

In fixed income, we expect investors to play short in anticipation of likely yield reversals, with the anticipated proliferation of commercial papers likely to provide higher -yielding options for this strategy. We also expect high-yield bonds to outperform in the current year as their relatively elevated coupons make up for price declines that may be occasioned by potential yield increases. While we recommend this option where possible, asset liquidity and volume concerns are likely to limit investors capacity to add it to their pool of strategies. However, we see a timely investment in Eurobond (ahead of widespread distribution of vaccines that could drive price upsides) as a more realistic outlet for investors. Besides, Eurobonds could also provide a much-needed currency and inflation hedge in 2021.

Fixed Income: In the wake of the liquidity glut

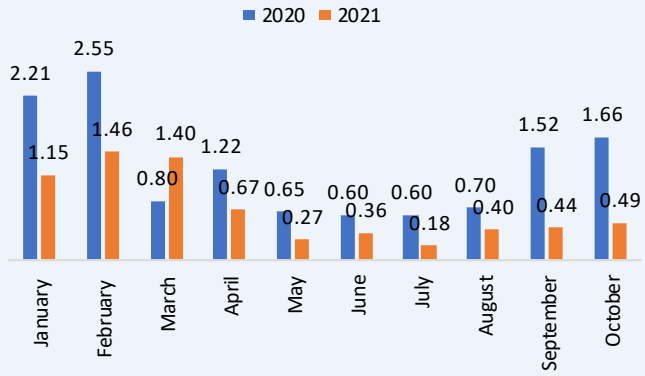
Interest rates plummeted last year as CBN's ban on local non-bank players from participating in OMO securities precipitated a liquidity glut through the year. The monetary policy rate cut of the MPC worsened the downward pressure on yields and market interpreted it as a signal from the CBN to keep rates subdued in the interim. Notwithstanding discretionary CBN policy risk, we see an upside bias to yields in 2021 on normalised liquidity pressures and persistent macroeconomic weaknesses.

We see an upward bias for yields in 2021

The drastic drop in yields in 2020 was mainly driven by liquidity pressures, which offset the impact of deteriorating macroeconomic fundamentals. However, we expect subsisting macro frailties to affect yield trajectory, considering materially lower liquidity pressures. Following CBN's extensive balance sheet deleveraging in 2020, scheduled OMO maturities for 2021 (2021: c.N4.2 trillion; 2020: over N11.1 trillion) may have a considerably lower impact on yields. Furthermore, half the maturities occur in the first two months of the year, with 100% belonging to banks and FPIs who are likely to reinvest in OMOs rather than rotate into other government instruments. We expect the bulk (over 50%) of these maturities to be rolled-over as well. Beyond the milder liquidity impact, we expect rising inflation, widening current account & budget deficits, and currency weaknesses to drive the upward repricing yields in 2021. Precisely, expectations of economic recovery in Q2'21 may forestall further policy rate cuts, considering the expected surge in inflation on higher energy and food prices.

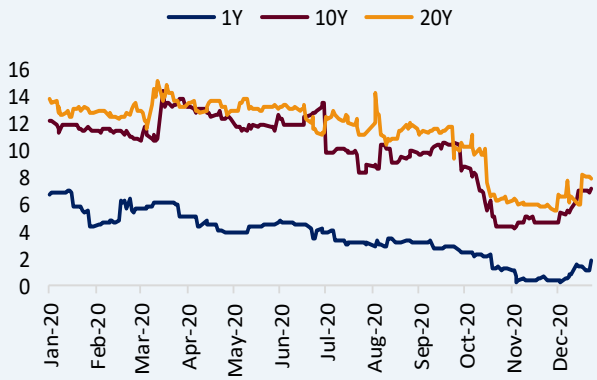
Beyond the milder liquidity impact, we expect rising inflation, widening current account & budget deficits, and currency weaknesses to drive the upward repricing yields in 2021

Figure 8: Expected OMO and NTB maturities are materially lower in 2021



Source: CBN; CardinalStone Research

Figure 9: Bond yields (%) plummeted in 2020 despite macro weaknesses



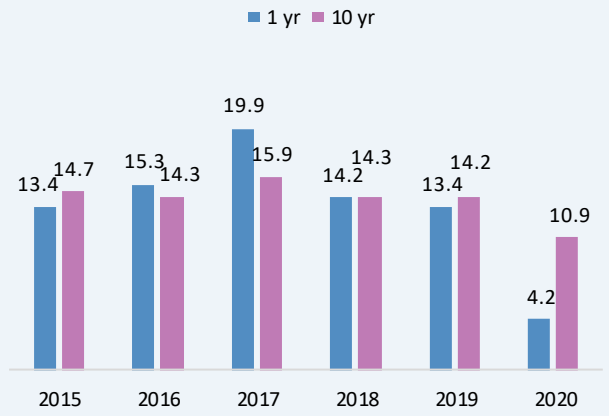
Source: FMDQ; CardinalStone Research

Reversal likely to gather steam in H2'21

FI yields trended higher in December following the introduction of N4 trillion worth of "special bills", a surprise rate hike at the December NTB auction, and investor apathy for instruments with depressed yields. For context, the yield curve advanced by c.2.8 ppts in December and resulted in a c.10.3% decline in the S&P/FMDQ sovereign bond index. However, yield trajectory is likely to moderate in the first quarter on relatively higher liquidity and potential Eurobond issuance expectations. After that, a reversal should kick in Q2'21 on lower liquidity, expected "special bills" roll-over, heightening FX pressures from services as international travel increases, and higher local borrowing. These pressures are likely to intensify in H2'21, with vaccine distribution and growth rebound reducing scope for policy rate cuts.

In all, we expect a 150-300 bps rise in yields to 9.5% and 11.2% for the 10-year and 30-year benchmark notes, respectively. We note that the effective dissociation of FPIs from domestic bond markets may have placed a lasting discount on future sovereign yields vis-à-vis historical levels. Future rate hikes to attract foreign flows are likely to be conducted cost-effectively through OMO instruments (in the absence of a policy reversal), thus diluting the transmission impact on sovereign notes as was historically the case.

Figure 10: Interest rates may trade at a sustainable discount to historical levels (%)

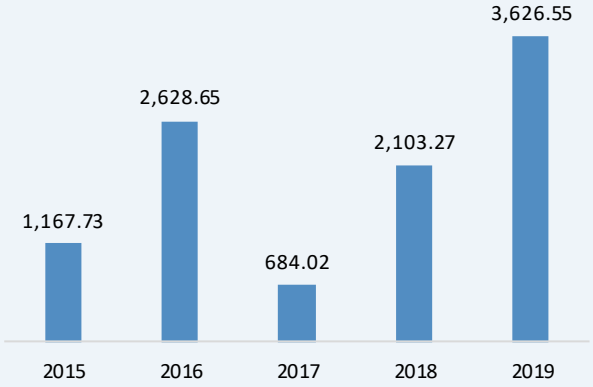


Source: FMDQ; CardinalStone Research

Risks to our expectations

In our view, there are several discretionary factors which could inhibit a material rate reversal. First, the impact of a record deficit may be thwarted by increased backdoor budget financing by the CBN and more extensive than expected foreign borrowing (from Eurobond issuances and multilateral borrowing). Secondly, a more profound than expected impact from the ongoing viral spread is likely to provoke more accommodative measures and mute potential yield reversal. CBN's discretion over the rolling over of the recently introduced bills and its unpredictable, unorthodox measures, also poses a risk to expectations in 2021.

Figure 11: FGN incremental overdraft financing from CBN (N'billions)



Source: CBN; CardinalStone Research

Source: CBN; CardinalStone Research

Stay short amid uncertainties

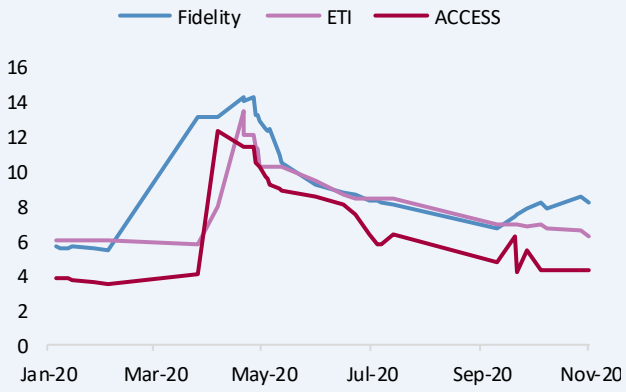
Fixed income Investors should play in short tenor bills, commercial papers, or fixed deposits in the interim, given current macroeconomic weaknesses and the likelihood of higher yields in coming months. We expect the continued proliferation of CP issuances in 2021 to provide higher-yielding options for this short strategy. We recommend gradual rotation into longer-dated instruments from H2'21 on lower liquidity pressures and improved monetary policy clarity. For a bond portfolio, we prefer staying on the shorter end of the curve in the interim to lessen the adverse price impact of rising rates.

We recommend gradual rotation into longer-dated instruments from H2'21 on lower liquidity pressures and improved monetary policy clarity. For a bond portfolio, we prefer staying on the shorter end of the curve in the interim to lessen the adverse price impact of rising rates

High yield corporate bonds could outperform

We favour adding high-yield corporate bonds to boost portfolio returns at the expense of relatively modest dilution of portfolio information ratio (excess return per unit of risk). Since total returns are the price moves of a bond plus coupon payments, these riskier papers typically outperform in rising yield environments because their higher coupons absorb declines in prices provoked by interest rate hikes. Expected economic rebound in H2'21 should also be favourable for credit spreads of high yield notes. Generally, we prefer to play in the short-to-mid tenored durations due to their lower sensitivity to interest rate risks. However, asset liquidity and volume may present constraints to adding high yield instruments to portfolios.

Figure 12: Select corporate Eurobond yield trend 2020 (%)

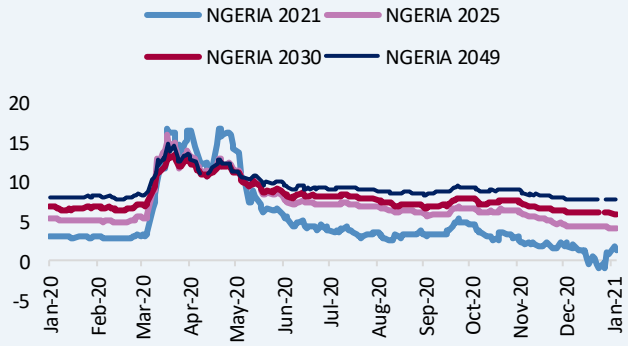


Source: Bloomberg; CardinalStone Research

Eurobonds to be supported by oil price recovery

A rebound in crude oil prices amid widespread distribution of vaccines, improved US global trade relations, and a weaker dollar should bode well for Eurobond performance in 2021. A position in the dollar-denominated instrument could result in decent returns in H2'21, as well as provide a welcome currency and inflation hedge.

Figure 13: Sovereign Eurobond trend 2020 (%)



Source: Bloomberg; CardinalStone Research

Equities: Get more active to outperform

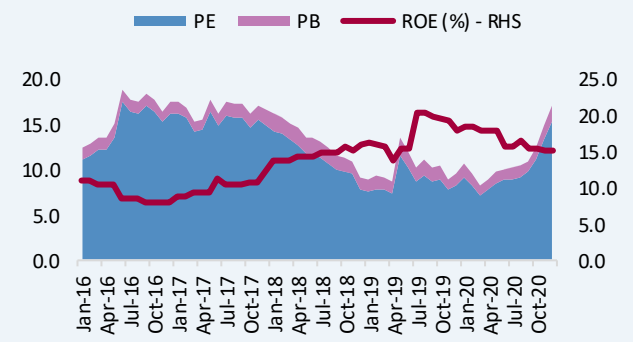
In our Mid-Year 2020 Outlook report, we arrived at 12-month TPs that reflected a risk-free rate of 10.0% (equivalent to the six-month average yield on a 10-year bond) and equity risk premium. The basis for these valuation inputs was relatively consistent with prevalent market uncertainties that characterised the peak of COVID-19 fears, in our view. However, the sustained uptrend in system liquidity has conspired with unorthodox monetary measures to drive yields considerably lower. We believe the yield changes have ramifications for the market cost of equity with implications for asset prices and funding decisions across our coverage firms.

Modest ASI return expected in 2021

The rarity of investment options stoked by depressing yields, corporate actions, favourable news on COVID-19 vaccines (c.90% effectiveness for most), and recovery in crude oil prices combined to drive Nigeria's equity market to its best performance since 2008. The bourse hit a year-low on April 6, 2020, amid intense selling pressure at heights of the pandemic and then went on to gain 94.8%, closing 2020 50.1% up. Between July and December 2020, the CardinalStone Hypothetical Power (CHP) portfolio recorded a weighted price return of 53.7% (vs projected total return of 42.5%). The unique selection criteria adopted for the CHP portfolio did not support inclusion of BUACEMENT and MTNN despite our standalone BUY rating on the latter. That said, cement titans (DANGCEM and WAPCO) accounted for 17.7% of the 53.6% weighted return of the CHP. Allocations to banking tickers contributed a further 23.6% while agric exposures recorded 8.6%, with PRESCO outperforming OKOMU over the period.

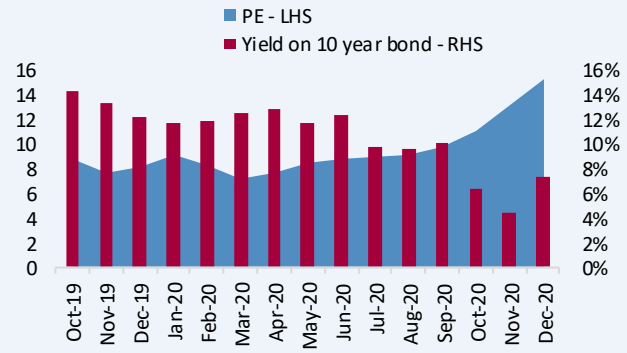
For 2021, we expect a modest All-Share Index (ASI) return of 7.4% on relatively contained liquidity, Q2'21 expected yield reversal and corrections in some overpriced stocks. The current valuation (PE) of the ASI exceeds its 3-year mean, but, our return expectation remains consistent with the existing yield realities. In our view, equity index tracking should outperform both fixed income and cash if CBN's policy orientation extends for at least six months. An active investment strategy should also return more than 7.4%.

Figure 14: ASI was repriced to near 2017 levels in H2'20



Source: Bloomberg; CardinalStone Research

Figure 15: Low yields may have been factored into H2 ASI pricing



Source: NSE; CardinalStone Research

Still a search for wealth accretion

In our view, the second-wave of COVID-19, its potential pass-through to commodity prices, and the legroom for yield reversal are palpable 2021 risks that could stoke renewed anxiety among investors. Therefore, investment in stocks with track records of high-consistent profitability and strong balance sheets (relative to the market) may still be a good bet to improve capital preservation if one must play equities. In our view, to boost shareholder wealth, a stock should boast a forecast ROE that exceeds the cost of equity of the market (c.20.2% in our estimate) and its 3-year average ROE. The former satisfies investors' minimum condition for taking equity market risk, while the latter demonstrates value accretion capacity.

However, we try to isolate companies whose ROEs are driven by core operating performances from those thriving on relatively unsustainable drivers such as leverage. To capture this, we set a minimum 3-year mean operating profit growth of 5.0% as a desirable threshold for our coverage. Within our universe, tickers that satisfy at least two of the above criteria include MTNN, NESTLE, DANGCEM, OKOMU, DANGSUGAR, STANBIC, GUARANTY, and PRESCO. We, however, make concessions for notable structural breaks inspired by macro-induced industry shifts or internal restructurings. For the former, the banking tickers may represent a case in point, with the liquidity-induced plunge in yields creating a new normal for interest incomes and ROEs. Considerations for the latter capture restructurings in the likes of FBNH, FLOURMILLS, and WAPCO, with the last duo on course to report their first double-digit ROE in three years in 2020. That said, stocks tend to oscillate in value, with the canny investors likely to trade between low and high valuations in choice names.

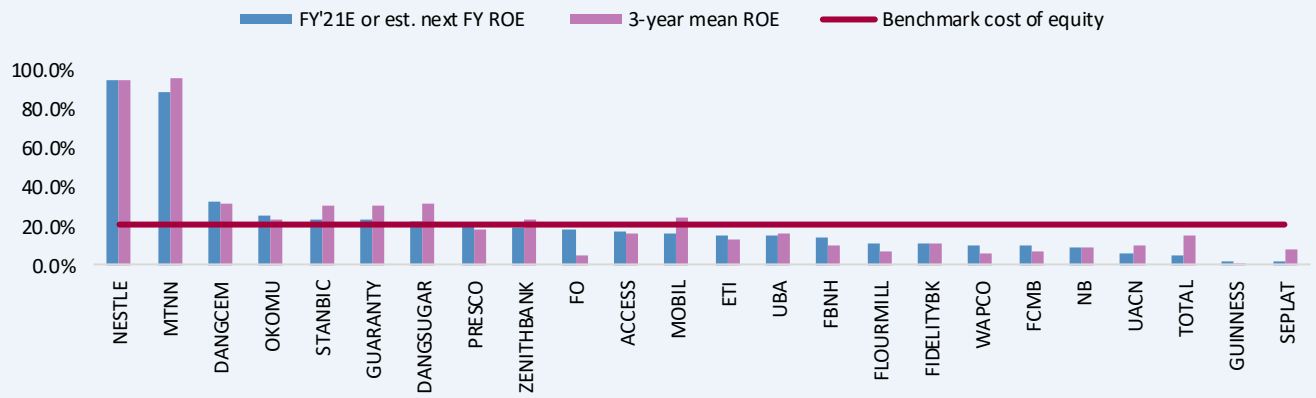
Go tactical if you can

Our position remains that proactive investing in targets of restructurings and corporate actions is likely to improve equity returns of portfolios. For this to work, proper market timing with a keen eye on oil market developments are likely to be sin qua non. Passive investors who seek to replicate the NGSE may experience only modest returns in 2021, in line with the new yield realities that investors appear to be pricing into valuations.

Positioning in high dividend-yielding stocks, which have managed to come out of the 2020 financial year mostly unscathed (or surprisingly, better off), could prove a tactical masterstroke before full-year numbers begin to roll in in April. To our minds, a decision to embark on such a dividend play could make sense amid broad expectations of sustained low yield levels in the fixed income space in the first quarter. Yet, the savvy investor should be wary of potential corrections in some overpriced stocks that could reduce total returns.

We try to isolate companies whose ROEs are driven by core operating performances from those thriving on relatively unsustainable drivers such as leverage

Figure 16: How coverage ROEs compare to their historical levels and the cost of equity of market (ASI)



Source: S&P Capital IQ; Company financials; CardinalStone Research

How to structure a winning portfolio for 2021

We recommend spreading investments across different asset classes to minimize risks and potentially increase returns over the next 12-months. Therefore, our hypothetical portfolio assigns weights to equities and fixed-income.

Equities

Combining our adjusted stock selection criteria and expected upside relative to our target prices, we expand the CHP portfolio to accommodate SEPLAT, FBNH, MTNN, and FLOURMILLS. We also exclude OKOMU from the bucket of stocks given expected downside following recent rallies. In our view, the hypothetical portfolio is likely to post a 12-month total return of c.25.8%, comprising 18.7% in capital appreciation and 7.1% in dividend yield. On the capital appreciation front, we expect GUARANTY, STANBIC, SEPLAT to emerge the top three contributors over the next 12-months, with the quartet: GUARANTY, ZENITHBANK, DANGCEM and UBA likely to account for 66.7% of the weighted dividend yield of the portfolio. DANGCEM has the most significant market weight in the NGSE (18.8%) across the selected stocks, while PRESCO boasts the smallest proportion of the broad market index (0.3%).

Figure 17: CHP portfolio and expected total return of 25.8% in 12-months

	3-year mean ROE (%)	FY'21E or next FY ROE (%)	3-year mean EBIT growth (%)	12-month TP (N)	UPP (%)	Expected dividend yield (%)	Portfolio weight (%)	Weighted return (%)
GUARANTY	30.6	22.9	5.3	44.03	33.4%	7.7%	20.5%	**8.4%**
STANBIC	30.8	23.3	13.8	58.55	33.1%	5.6%	9.7%	**3.8%**
ZENITHBANK	23.5	19.4	7.0	31.04	17.6%	11.0%	12.1%	**3.5%**
SEPLAT	8.0	1.4	30.6	739.90	37.0%	5.3%	6.9%	**2.9%**
UBA	15.8	15.2	8.3	10.97	21.2%	11.1%	5.2%	**1.7%**
WAPCO	6.2	10.0	2.9	28.61	21.7%	7.4%	5.7%	**1.7%**
DANGCEM	32.0	31.5	5.3	241.29	1.8%	6.8%	17.8%	**1.5%**
FBNH	9.8	14.3	12.3	8.86	18.1%	2.6%	2.9%	**0.6%**
ACCESS	16.4	16.7	12.7	10.52	10.7%	7.3%	3.2%	**0.6%**
MTNN	95.1	88.6	12.1	168.28	0.2%	5.0%	9.2%	**0.5%**
NESTLE	94.1	94.0	2.8	1575.42	4.7%	3.3%	4.9%	**0.4%**
FLOURMILLS	6.8	11.2	3.4	32.49	8.3%	6.9%	1.0%	**0.2%**
PRESCO	17.7	21.0	4.1	82.18	14.1%	2.8%	0.6%	**0.1%**
							Expected return (%)	**25.8%**

Source: Bloomberg; Company financials; CardinalStone Research

Fixed Income

We suggest holding onto existing positions in Q1'21 as expected liquidity inflow may pressure yields downwards. However, prospective investors may opt to play on the short end of the naira curve in anticipation of interest rate increases in subsequent quarters. A record budget deficit, subsisting current account weaknesses, and relatively lower liquidity support yield reversal. We recommend a fixed income portfolio consisting of a mix of domestic sovereign instruments and select corporate Eurobonds to buoy portfolio returns and provide a currency hedge.

Sector Opportunities

Sieving for winners

Across our coverage equities sectors, we are broadly positive on banking, upstream oil & gas, and cement; neutral on agriculture and consumers; and bearish on the downstream petroleum industry. In line with their cyclicality, the banking and cement sectors are likely to ride the recovery wave in 2021. Even though interest income concerns may remain in the near term, we see legroom for offsetting impacts from macro-induced loan growth with lower funding cost also providing some support for NIMs. We also like banks with latitude for increases in fee and commission income and propensity to activate planned restructuring initiatives quickly. Elsewhere, we view projected increases in crude oil prices amidst rising hopes of vaccine distribution as upside risks to the upstream oil & gas sector. Notably, besides offsetting potential impacts of production shocks, price increases should reduce the risk of impairment of oil & gas assets in coming quarters.

In the cement sector, projected macro recovery, government's planned CAPEX increase and high associated implementation rates suggest that there may be some latitude for earnings growth in 2021. We note the risks posed by potential naira repricing and believe that prior balance sheet restructuring and regulatory backing (including passage of finance bill) could be critical for earnings. For agriculture and consumer goods, the impact of potential naira depreciation holds mixed fortunes. A weaker naira could provide price cushion and support market share push for the agro-firms, while simultaneously aggravating cost pressures for consumers goods. However, prior years of backward integration efforts, hedges, and internal restructurings could cushion the impact for a few consumer names.

*We converted our naira forecasts using an exchange rate of N410/$ for coverage names in the sector/company part of this report. This is to aid comparison across forecast years.

Nigerian Banks: Needing a bit more dynamism

Regulatory uncertainty, socio-political concerns, unfavourable operating environment, weak macros, and digital disruptions are few of the many scares facing the Nigerian banking sector as 2021 unravels. Despite the earlier than anticipated resumption of major economic activities, which, we believe, offered some respite for earnings, we fear that the road to recovery and sustainable growth may still be arduous. Banks ROEs appear to be reverting to their mean, and unless banks look for ways to achieve earnings flexibility and resilience, we could well see ROEs dip below their historical mean level. A few banks have begun to restructure their operations in light of this new reality. However, the impact may not be immediate. The move is, however, a good start towards seeking a bit more dynamism in performance.

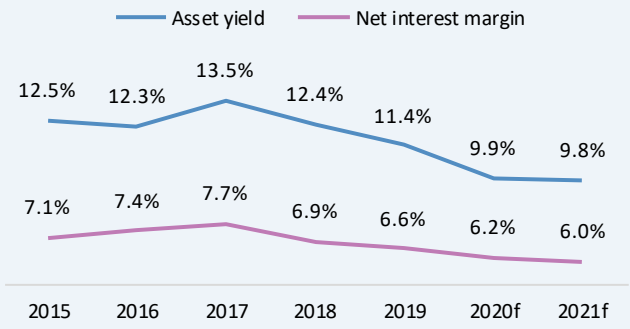
Interest income worries if low rates persist

Interest rates remained low in FY'20 despite initial questions about the sustainability of holding such a stance by the central bank. Doubtlessly, whatever hopes there were of a possible directional change in rates during the year were puffed out following the advent of the coronavirus pandemic. The realities of low rates cascaded to c.1.1% moderation in interest income for our coverage banks, despite a 10.6% growth in loans as at 9M'20.

As the 2021 financial year unravels, the interest rate sustainability question persists. Our base expectation is rates would reverse direction (although we have conservatively assumed an average 20 bps cut in asset yields for our coverage) both as the economy recovers from recession and the monetary authorities attempt to rein in rising inflation. Banks also share the notion that a change in direction lurks somewhere soon, and some are playing short tenors for asset creation in anticipation.

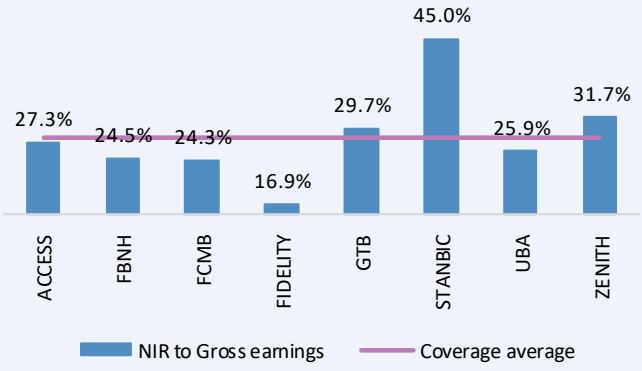
However, say rates remain persistently low through most, or all, of the year, then we envisage that banks will have to rely on increased lending volumes to support interest income. Positively, low rates could bode well for interest costs, but there is only so much that can fall further from current levels. We envisage that material interest cost savings could come in H1'21, and be flattish YoY by H2'21 or inch higher.

Figure 18: Coverage average asset yield and NIM in free fall



Source: Company financials; CardinalStone Research

Figure 19: Banks will need improved NIR contributions to ensure earnings sustainability



Source: Company financials; CardinalStone Research

With low NIR contributions, banks will be tested again for earnings vulnerabilities in FY'21

Banks are unlikely to quickly escape the test to their earnings and capital resilience experienced in FY'20. Banks are also having to deal with diversifying their earnings base for ROE sustainability and responding to disruptions to the traditional banking model.

With the potential for interest income likely to be constrained by monetary policy, banks, indispensably, have to turn attention to boosting their non-interest revenue (NIR) sources. Only STANBIC generates as much as 45.0% (4-year average) of gross earnings from non-interest sources (54.6% as at 9M'20) of our coverage. The average NIR contribution to gross earnings for the rest is 25.7% (27.0% as at 9M'20). FIDELITYBK appears to be the least reliant at 16.9% NIR contribution (13.8% as at 9M'20). Even HOLDCO banks such as FBNH and FCMB lag at 24.4% average NIR contribution, which, in our view, is insufficient for ROE sustainability. More worrying is the steady deceleration in NIR contribution over the past four years for our coverage (-5.5% CAGR), with only ZENITHBANK (+13.8% CAGR) and STANBIC (+2.5% CAGR) recording uptrends.

Our estimates suggest that coverage ROE could improve by 3 ppts on average over our forecast horizon if NIR contribution rises by 10 ppts on average, all else constant.

ROE may be weaker but deserves less attention for the near term

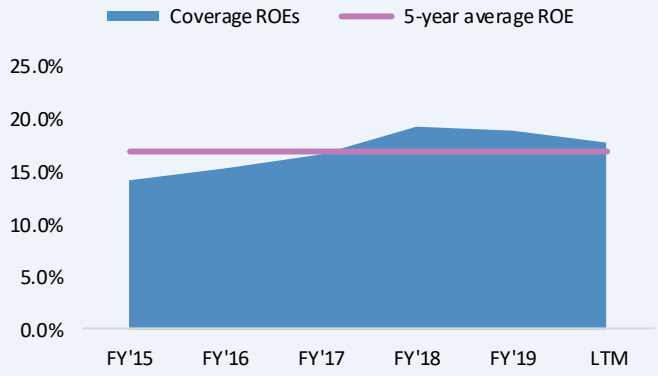
At 17.8%, our coverage banks' average ROEs appear to be gradually reverting to their historical five-year mean of 16.8%, from a high of 19.2% in FY'18. This reversion is consistent with our expectation of ROE normalization amidst low yields and weak operating environment. Over our forecast horizon, ROE will likely only accrete at a much slower pace as banks reorganize their operations for more earnings flexibility and resilience. At such, we place more weight on the stability and sustainability of ROE compared to its potential uptrend.

In contrast, improvement in asset quality, capital adequacy and earnings diversification merit our attention. On the one hand, almost all our coverage, bar FBNH, currently have total capital ratios at least 200 bps above the regulatory requirement. On the other hand, banks' need for CBN and IFRS 9 forbearances due to COVID-19 indicate just how susceptible they can be during weaker economic cycles. Sustained frailty of domestic macros heightens lending apathy such that banks have been willing to relinquish liquidity to the CBN as excess CRR. And this lethargy is likely to persist as average sector LDR was relatively flat at 60.7% in 2020 (60.6% in 2019) compared to an average of 71.5% in the preceding four years vs 2019 level, despite the introduction of credit inducing measures.

10 bps

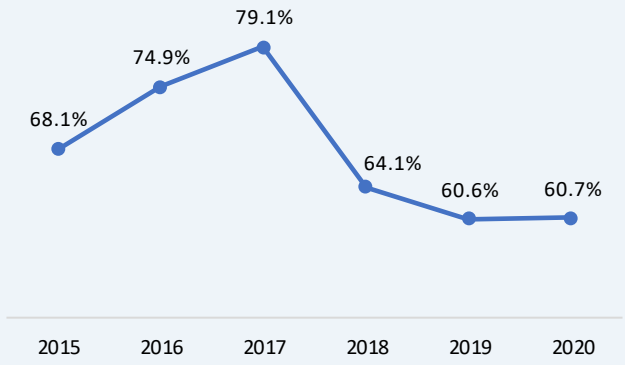
The increase in 2020 average LDR over 2019

Figure 20: Coverage ROEs are reverting towards historical mean



Source: NBS; Company financials; CardinalStone Research

Figure 21: Sector LDR yet to remarkably improve



Source: NBS; Company financials; CardinalStone Research

ACCESS BANK PLC

Reaching for new frontiers

BLOOMBERG: ACCESS NL

Access bank has posited a strong proposition for the next five years hinged on an aggressive Africa expansion and a restructuring into a holding company. Specifically, the bank hopes to have a presence in 22 African countries over the next five years, a more than two-fold increase over its current footprint in 10 African countries (vs UBA's presence in 19 countries currently). This strategy's key considerations are the higher earnings asset base and earnings diversification, leading to a more sustainable bottom line and improved efficiency from operating synergies.

For FY'21, however, our forecasts suggest a modest 1.2% growth in earnings as we do not anticipate drastic earnings impact from the expansion strategies in the coming year. Instead, our earnings expectation reflects the likelihood of weaker non-interest revenue offsetting the effect of a potential improvement in net interest income. Our projected slowdown in non-interest revenue for the bank reflects our conservative stance on the bank's volatile derivative plays as well as muted FX revaluation gains versus FY'20. However, the accelerated rollout of the bank's payment initiatives that could propel non-interest income portends an upside.

We raise our 12-month target price to N10.52 (previous: N8.48) which implies a 10.7% upside to our ref price. Our higher TP reflects expected improvement in earnings sustainability post FY'21 on the bank's recent expansion and restructuring initiatives. Our TP suggests an exit PB of 0.47x. We rerate the counter a HOLD.

HOLD

Target Price: N10.52

Ref Price: N9.50

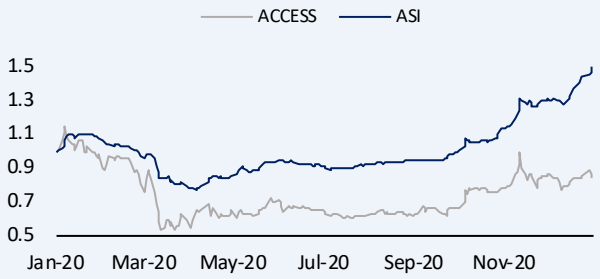
Upside/(Downside):+10.7%

Market Cap: N337.7bn

Financial ratios	FY'19	FY'20	FY'21
NIM	6.6%	4.9%	5.0%
Cost of risk	0.7%	1.4%	0.8%
Cost to income	65.2%	63.0%	65.0%
ROE	17.9%	19.0%	16.7%
ROA	1.6%	1.6%	1.5%
NPL ratio	6.0%	5.7%	5.9%
Loan to deposit	72.9%	60.7%	69.0%

Multiples	FY'19	FY'20	FY'21
P/E	3.48x	2.73x	2.70x
P/B	0.56x	0.48x	0.42x
Div yield	6.8%	7.3%	8.5%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Net interest income	173,578	277,229	261,437	283,425	440	702	662	718
Non-interest income	138,229	112,109	248,939	209,829	350	284	631	532
Net impairments	(14,657)	(20,189)	(46,265)	(28,288)	(37)	(51)	(117)	(72)
Operating costs	(193,962)	(253,770)	(321,537)	(320,615)	(491)	(643)	(815)	(812)
Profit before taxes	103,188	115,379	142,574	144,351	261	292	361	366
Loans to customers	1,993,606	2,911,580	3,116,298	3,326,165	5,051	7,377	7,896	8,428
Deposits from customers	2,564,908	4,255,837	5,442,858	5,126,692	6,499	10,783	13,791	12,990
Total assets	4,954,157	7,146,610	8,004,203	8,404,413	12,553	18,108	20,281	21,295
Total liabilities	4,463,645	6,536,417	7,295,228	7,599,827	11,310	16,562	18,484	19,256
Shareholders funds	490,512	610,193	708,976	804,586	1,243	1,546	1,796	2,039

ECOBANK TRANSNATIONAL INCORPORATED

FY'21 earnings to bounce from one-off impairment blow

BLOOMBERG: ETI NL

HOLD

Target Price: N7.45

Ref Price: N6.50

Upside/(Downside):+14.6%

Market Cap: N119.3 bn

ETI surprised by recording a one-off goodwill impairment charge of $159 million in Q3'20, effectively leading us to slash our FY'20 earnings forecast by 57.1% to $86.3 million. However, management asserts that the goodwill impairment charge would have no impact on the firm's liquidity or capital adequacy ratios, given its non-cash nature.

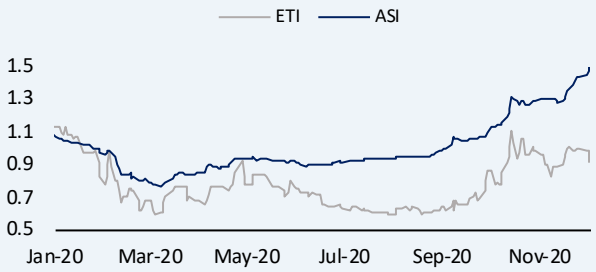
While the bank appears on course to record its lowest earnings performance in at least ten years (other than the loss recorded in 2016), we anticipate a swift rebound in FY'21, based on our projection of a nearly three-fold earnings growth to $246.7 million. Our earnings growth forecast's key drivers are the non-recurrence of the goodwill impairment charge and increase in non-interest revenue, propelled by rising adoption of the bank's digital offerings (49% rise in digital transactions vs 52% decline in in-branch transactions as at 9M'20).

Across its geographical markets, ETI continues to be supported by its performances in the Anglophone West Africa (AWA) and Francophone West Africa (UEMOA) regions, notwithstanding their moderately lower ROEs due to the COVID-19 impact. Nigeria has sustained its path to recovery with an ROE of 5.9% from 0.4% in FY'19. Management has hinted that it will focus more on its digital offerings and less on risk asset creation for the Nigerian business. In contrast, the Central, Eastern and Southern Africa (CESA) region appears somewhat volatile due to the impact of Zimbabwe's hyperinflationary environment.

Adjustments to our estimates suggest a target price (TP) to N7.45 (previous: N5.90), reflecting an exit P/TB of 0.26x, a discount to peer median of 0.50x. Our TP implies an upside of 14.6% to our ref price of N6.50. We rerate the counter a HOLD.

Financial ratios	FY'19	FY'20	FY'21
NIM	4.2%	4.9%	4.5%
Cost of risk	1.4%	2.3%	2.0%
Cost to income	66.2%	63.0%	65.0%
ROE	13.0%	5.7%	15.2%
ROA	1.2%	0.4%	1.0%
NPL ratio	9.7%	11.7%	10.9%
Loan to deposit	60.5%	57.0%	54.2%
Multiples	**FY'19**	**FY'20**	**FY'21**
P/E	2.04x	6.27x	2.21x
P/B	0.26x	0.25x	0.23x

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Net interest income	289,039	271,227	369,012	353,278	930	750	900	862
Non-interest income	278,361	315,652	298,880	310,527	895	873	729	757
Net impairments	(106,750)	(48,317)	(89,808)	(80,229)	(343)	(134)	(219)	(196)
Operating costs	(349,041)	(388,313)	(420,772)	(431,473)	(1,123)	(1,073)	(1,026)	(1,052)
Profit before taxes	110,830	146,544	74,729	134,883	357	405	182	329
Loans to customers	3,310,105	3,383,179	3,699,256	3,739,902	9,089	9,277	9,023	9,122
Deposits from customers	5,803,572	5,924,960	6,999,649	7,396,728	15,936	16,246	17,072	18,041
Total assets	8,195,043	8,621,940	10,129,065		22,503	23,641	24,705	25,940
Total liabilities	7,563,911	7,934,197	9,330,407	9,764,609	20,770	21,755	22,757	23,816
Shareholders funds	631,132	687,743	798,659	870,909	1,733	1,886	1,948	2,124

FBN HOLDINGS PLC

Still on course for performance stability

BLOOMBERG: FBNH NL

We expect FBNH's capital adequacy and liquidity ratios to improve in FY'20-21 on the back of 1) the N25 billion cash injection into the commercial banking arm and a potential capitalization of full-year earnings which could propel CAR towards 16.5% by FY'20 per our estimates (vs 15.3% in FY'19). Higher capital buffers could expand the bank's scope for interest-earning risk asset creation and possible dividend payouts; 2) the release of banks' excess CRR above the regulatory requirement through the issuance of CBN Special Bills which could ease the pressure on the bank's liquidity ratio.

More so, we see scope for continued moderation in the bank's NPL ratio to 8.8% and 8.5% in FY'20 and FY'21 respectively, supported by write-offs and recoveries. However, while we project a 50 bps decline in cost of risk (CoR) to 2.5% in FY'21, we highlight that the bank's performance remains vulnerable to adverse CoR movements, noting that a potential 30 bps negative shift in expected CoR could lead to a 90 bps drop in forecasted ROE.

Adjustment to our estimates suggests a 12-month Target Price (TP) of N8.86 (previous: N7.83), a 16.6% upside to our ref price. Key drivers to our TP are projected earnings growth of 19.3% YoY and the relative comfort from improved regulatory buffers. Our TP also suggests an exit PB of 0.40x, a 5.3% premium to the bank's four year average of 0.38x. We retain our BUY rating.

BUY

Target Price: N8.86

Ref Price: N7.50

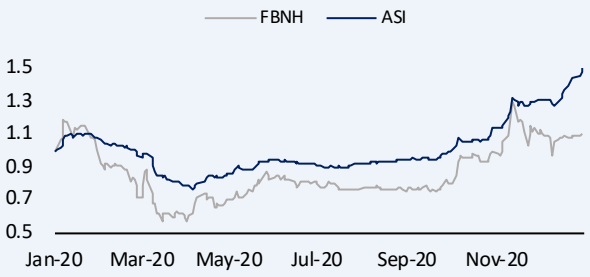
Upside/(Downside):18.1%

Market Cap: N177.7 bn

Financial ratios	FY'19	FY'20	FY'21
NIM	6.4%	5.6%	5.5%
Cost of risk	3.0%	3.0%	2.5%
Cost to income	70.0%	66.0%	65.0%
ROE	12.4%	12.1%	11.1%
ROA	1.3%	1.2%	1.1%
NPL ratio	10.2%	8.8%	9.5%
Loan to deposit	48.0%	47.1%	48.8%

Multiples	FY'19	FY'20	FY'21
P/E	3.84x	3.31x	3.35x
P/B	0.41x	0.37x	0.34x
Div yield	2.7%	2.6%	6.2%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Net interest income	284,168	290,214	260,240	285,351	720	735	659	723
Non-interest income	131,714	159,089	167,733	160,433	334	403	425	406
Net impairments	(86,911)	(51,133)	(63,844)	(59,749)	(220)	(130)	(162)	(151)
Operating costs	(263,706)	(314,662)	(282,463)	(289,760)	(668)	(797)	(716)	(734)
Profit before taxes	65,288	83,595	81,667	96,275	165	212	207	244
Loans to customers	2,055,949	1,931,321	2,128,137	2,389,973	5,209	4,894	5,392	6,056
Deposits from customers	3,486,691	4,019,836	4,513,614	4,899,885	8,834	10,185	11,436	12,415
Total assets	5,568,316	6,203,526	7,413,675	8,016,986	14,109	15,718	18,784	20,313
Total liabilities	5,037,669	5,542,401	6,689,340	7,225,643	12,764	14,043	16,949	18,308
Shareholders funds	530,647	661,125	724,335	791,343	1,345	1,675	1,835	2,005

FCMB GROUP PLC

Dragged from both ends

BLOOMBERG: FCMB NL

FCMB's acquisition of AIICO PFA has been the dominant theme in the firm's strategy. We note delays to the completion of the deal despite management's initial guidance of Q4'20. Nonetheless, our base case impact assessment is a potential 50-70 bps contribution to ROE post-deal completion. Our modest post-deal ROE impact reflects two key considerations: 1) The low contribution of FCMB's Investment Management division (which will absorb the AIICO acquisition) which only accounts for 9.3% of Group PBT (9M'20). It is unlikely that this deal will translate into a notable double-digit PBT contribution that will materially propel ROE, in our view; 2) Potential cap to the pension business's growth prospect following the recent opening of the RSA transfer window by PENCOM.

Other strategic themes we are watching for FCMB:

1) The group's management of credit exposures with over 40% of loan book restructured due to COVID-19 impact and implications for NPL and cost of risk

2) How management navigates the lingering weakness in the Corporate and Investment Banking business which has so far returned negative PBT in consecutive fiscal years

All in, we project relatively flat ROE of 8.8% in FY'20 (FY'19: 9.0%), rising to 9.6% in FY'21. FCMB appears over-priced in our view, given our TP of N2.68, which represents a 16.7% downside to our reference price of N3.22. We rerate the counter a SELL.

SELL

Target Price: N2.68

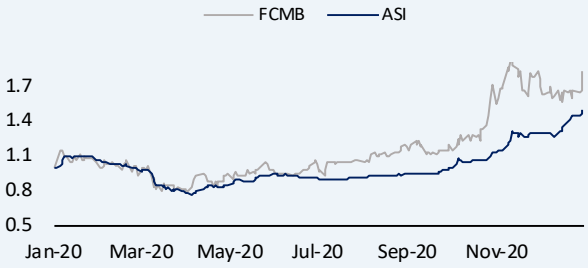
Ref Price: N3.22

Upside/(Downside):(16.7%)

Market Cap: N63.8 bn

Financial ratios	FY'19	FY'20	FY'21
NIM	5.2%	5.1%	5.1%
Cost of risk	1.8%	2.0%	1.9%
Cost to income	69.4%	69.6%	70.0%
ROE	9.0%	8.8%	9.6%
ROA	1.1%	1.0%	1.0%
NPL ratio	3.7%	4.7%	4.2%
Loan to deposit	91.4%	80.3%	83.0%
Multiples	**FY'19**	**FY'20**	**FY'21**
P/E	3.66x	3.45x	2.92x
P/B	0.32x	0.29x	0.27x
Div yield	4.4%	4.4%	5.8%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Net interest income	72,573	75,976	88,939	99,898	184	193	225	253
Non-interest income	39,207	34,802	35,680	39,801	99	88	90	101
Net impairments	(14,113)	(13,747)	(17,245)	(17,530)	(36)	(35)	(44)	(44)
Operating costs	(79,224)	(76,901)	(86,719)	(97,790)	(201)	(195)	(220)	(248)
Profit before taxes	18,443	20,130	20,655	24,380	47	51	52	62
Loans to customers	681,326	754,391	862,269	922,628	1,726	1,911	2,185	2,338
Deposits from customers	821,747	943,086	1,148,557	1,223,289	2,082	2,390	2,910	3,100
Total assets	1,431,298	1,668,505	2,002,206	2,142,360	3,627	4,228	5,073	5,428
Total liabilities	1,247,871	1,467,840	1,785,915	1,908,060	3,162	3,719	4,525	4,835
Shareholders funds	183,427	200,665	216,291	234,301	465	508	548	594

FIDELITY BANK PLC

New leadership signals sustained strategy

BLOOMBERG: FIDELITY NL

We note the recent change in the firm's leadership, with Nneka Onyeali-Ikpe replacing Nnamdi Okonkwo as the MD/CEO effective January 1, 2021. Of interest to us is the sustainment of FIDELITYBK's growth initiatives initiated by the outgoing management. To this point, Nneka Onyeali-Ikpe's vast experience (over 30 years in banking) and contributions in achieving those results enhance our optimism.

We project a 5.4% earnings decline for FIDELITYBK in FY'20 principally impacted by high impairment charges compared to write-backs recorded in FY'19.

In FY'21, however, we see opportunities for earnings to potentially rebound by 8.7% on higher net interest income and lower cost of risk. FIDELITYBK appears poised to sustain gains from lower cost of funds which has declined to 4.0% as at 9M'20 vs 6.3% in FY'19 (5-year average: 6.4%). Accelerating deposit growth and the refinancing of its 16.5% N30 billion local currency bond with a new 7.5% N75 billion local currency bond are two potential drivers for moderating funding cost, which could likely catalyze net interest income. Elsewhere, we expect impairment charges to moderate in FY'21 following the bank's prudence towards early recognition of loan losses in FY'20.

Following adjustments to our estimates, we raise our 12-month Target Price (TP) to N2.94 (previous: N2.38) which implies an exit PB of 0.30x, an 7.0% premium to the bank's four year average of 0.26x. Our TP also suggests a 8.8% downside to our ref price; hence, we rerate the counter a HOLD.

HOLD

Target Price: N2.94

Ref Price: N2.70

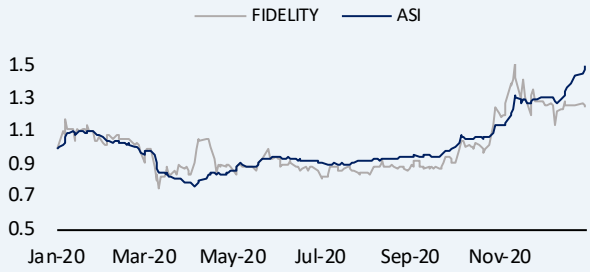
Upside/(Downside):8.8%

Market Cap: N78.2 bn

Financial ratios	FY'19	FY'20	FY'21
NIM	5.8%	5.7%	5.5%
Cost of risk	0.0%	1.0%	0.7%
Cost to income	73.4%	69.0%	70.1%
ROE	13.3%	11.0%	10.9%
ROA	1.5%	1.2%	1.1%
NPL ratio	3.3%	5.1%	4.7%
Loan to deposit	96.2%	87.8%	91.4%

Multiples	FY'19	FY'20	FY'21
P/E	2.75x	2.91x	2.68x
P/B	0.33x	0.30x	0.28x
Div yield	7.4%	5.2%	7.5%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Net interest income	69,587	83,055	99,050	108,421	176	210	251	275
Non-interest income	31,845	28,703	28,708	28,527	81	73	73	72
Net impairments	(4,215)	587	(13,204)	(10,167)	(11)	1	(33)	(26)
Operating costs	(72,128)	(81,992)	(86,236)	(95,685)	(183)	(208)	(219)	(242)
Profit before taxes	25,089	30,353	28,317	31,096	64	77	72	79
Loans to customers	906,623	1,178,935	1,320,407	1,452,448	2,297	2,987	3,346	3,680
Deposits from customers	979,413	1,225,213	1,504,001	1,589,903	2,482	3,104	3,811	4,028
Total assets	1,719,883	2,114,037	2,536,844	2,714,424	4,358	5,356	6,428	6,878
Total liabilities	1,525,467	1,880,007	2,279,948	2,434,143	3,865	4,763	5,777	6,168
Shareholders funds	194,416	234,030	256,896	280,280	493	593	651	710

GUARANTY TRUST BANK PLC

BLOOMBERG: GUARANTY NL

Digging new wells for earnings resilience

BUY

Target Price: N44.03

Ref Price: N33.00

Upside/(Downside):+33.4%

Market Cap: N971.2 bn

The transition to Holdco is the paramount consideration for GUARANTY in FY'21. Management estimates that all activities relating to the change will be completed in the early weeks of January 2021, paving the way for strategic expansion into key business areas to allow for more earnings flexibility and resilience.

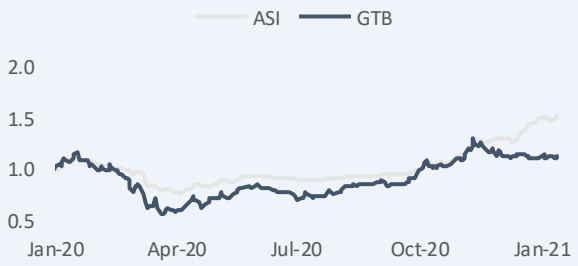
We expect a significant improvement in non-interest revenue (NIR) due to the restructuring. NIR's contribution to gross earnings is likely to increase to 45% through our forecast period, vs a five-year average of 30%. This NIR improvement could support a 200 bps increase in forecasted ROE, in our view. More importantly, while GUARANTY has had the least volatile earnings amongst our coverage, it equally boasts strong near-term ROE sustainability potential.

However, we anticipate the immediate impact of the transition to be less momentous in FY'21. We forecast a modest 4.1% YoY growth in earnings for the period. GUARANTY's earnings is likely to benefit from improved loan growth, supported by economic recovery, and a potential soft rebound in interest rates. Elsewhere, the cost to income ratio could rise, weighed by one-off restructuring expenses. Downside risks are a COVID-19 second wave and sticky low rates.

We adjust our 12-month Target Price (TP) to N44.03 (previous: N36.98) which implies a 33.4% upside to our ref price. Our TP also suggests an exit PB of 1.43x, an 7.7% discount to the bank's five-year average. We retain our BUY rating.

Financial ratios	FY'19	FY'20	FY'21
NIM	10.5%	9.3%	9.0%
Cost of risk	0.3%	0.8%	0.7%
Cost to income	35.6%	39.0%	41.0%
ROE	30.9%	25.3%	22.9%
ROA	5.6%	4.5%	4.0%
NPL ratio	6.5%	7.2%	6.9%
Loan to deposit	48.9%	51.9%	51.9%
Multiples	**FY'19**	**FY'20**	**FY'21**
P/E	4.22x	4.40x	4.22x
P/B	1.41x	1.22x	1.07x
Div yield	9.1%	7.7%	9.1%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Net interest income	222,434	231,363	242,120	264,190	563	586	613	669
Non-interest income	125,188	136,228	142,591	147,957	317	345	361	375
Net impairments	(4,906)	(4,912)	(14,298)	(13,762)	(12)	(12)	(36)	(35)
Operating costs	(127,128)	(130,971)	(150,037)	(168,981)	(322)	(332)	(380)	(428)
Profit before taxes	215,587	231,708	220,376	229,405	546	587	558	581
Loans to customers	1,359,076	1,567,757	1,787,243	1,965,967	3,441	3,970	4,525	4,978
Deposits from customers	2,273,903	2,532,540	3,207,899	3,441,730	5,758	6,412	8,122	8,715
Total assets	3,287,343	3,758,918	4,698,648	5,074,539	8,324	9,518	11,897	12,849
Total liabilities	2,711,776	3,071,580	3,899,554	4,167,567	6,866	7,777	9,874	10,552
Shareholders funds	575,567	687,338	799,094	906,973	1,457	1,740	2,023	2,296

STANBIC IBTC HOLDINGS PLC

BLOOMBERG: STANBIC NL

Earnings resilience justifies higher valuation

BUY

Target Price: N58.55

Ref Price: N44.00

Upside/(Downside):+33.1%

Market Cap: N488.66 bn

Our considerations for STANBIC revolve around two key themes: earnings resilience and strong regulatory buffers.

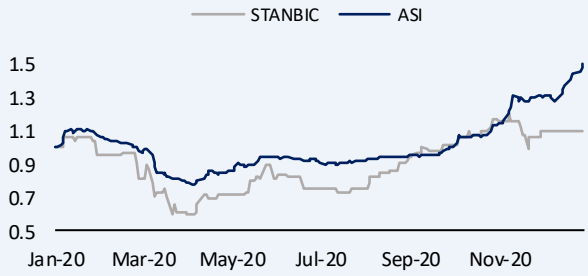
Firstly, STANBIC's diversified business model appears likely to insulate it from drastic fluctuations in earnings due to weaknesses in the operating environment. For context, the bank's earnings volatility reduced from 46% over the last six years to 30% over the most recent four years (a 34% reduction vs a 1.5% increase on average for the rest of our coverage). Besides, we note the substantial non-interest income contribution to gross earnings (a five-year average of 45% vs our coverage average of 28.2%). In the near term, we view the potential PFA transfer window and onboarding of a life-insurance business as broadly supportive of non-interest income.

Secondly, we note that STANBIC's capital adequacy ratio of 21.3% is more than two-fold the regulatory requirement of 10.0%. Liquidity ratio at 117.3% (H1'20) is nearly four times the regulatory requirement, ex the impact of the recent CRR release. NPL ratio, though currently 20 bps over the prudential limit, has historically been sub 5%.

All in, we project a 6.3% growth in FY'21 earnings and adjust our 12-month Target Price (TP) to N58.55 (previous: N49.20) which implies a 33.1% upside to our ref price. Out TP also suggests an exit PB of 1.46x (ROE: 23.0%), a 17.4% discount to the bank's four year average of 1.84x (ROE: 27.6%). We retain our BUY rating.

Financial ratios	FY'19	FY'20	FY'21
NIM	4.8%	3.4%	3.1%
Cost of risk	0.3%	1.5%	1.0%
Cost to income	50.4%	46.0%	49.8%
ROE	27.3%	26.0%	23.3%
ROA	4.2%	3.4%	2.7%
NPL ratio	3.9%	5.0%	3.9%
Loan to deposit	87.2%	71.1%	66.4%
Multiples	**FY'19**	**FY'20**	**FY'21**
P/E	6.02x	5.34x	5.03x
P/B	1.52x	1.30x	1.10x
Div yield	6.8%	5.6%	6.0%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Net interest income	78,209	77,831	77,524	93,631	198	197	196	237
Non-interest income	102,604	108,755	127,437	135,497	260	276	323	343
Net impairments	2,940	(1,632)	(9,527)	(6,987)	7	(4)	(24)	(18)
Operating costs	(95,601)	(94,029)	(94,282)	(114,025)	(242)	(238)	(239)	(289)
Profit before taxes	88,152	90,925	101,151	108,116	223	230	256	274
Loans to customers	458,946	556,383	635,159	698,675	1,163	1,410	1,609	1,770
Deposits from customers	807,692	637,840	893,193	1,052,692	2,046	1,616	2,263	2,667
Total assets	1,663,661	1,876,456	3,189,975	3,508,973	4,215	4,754	8,083	8,891
Total liabilities	1,423,994	1,574,227	2,827,873	3,082,542	3,608	3,989	7,165	7,810
Shareholders funds	239,667	302,229	362,102	426,431	607	766	917	1,080

UNITED BANK FOR AFRICA PLC

BLOOMBERG: UBA NL

New initiatives could strengthen growth potential

BUY

Target Price: N10.97

Ref Price: N9.05

Upside/(Downside):+21.1%

Market Cap: N309.5 bn

UBA has tracked ahead of our FY'20 estimates, leading to an upward adjustment in earnings to N99.2 billion (+6.9% increase). We now expect net interest income to grow 13.7% YoY versus our initial growth forecast of 7.9% YoY. More so, we estimate that cost of risk could come in 5 bps lower than our initial estimate of 0.8%, a possible testament to a less severe COVID-19 impact on the bank's asset quality measures than previously feared.

In FY'21, we expect earnings to rise by 4.4% supported by net interest income (+10.0% YoY). The higher net interest income should reflect an estimated 10.0% growth in risk assets amidst flattish cost of funds. In contrast, non-interest revenue could potentially slowdown on weaker FX revaluation gains.

In our view, new near to mid-term initiatives could be critical to earnings growth for the bank. The bank recorded the least earnings volatility (9.6% vs coverage average of 49.3%) amongst our coverage over the last five years, possibly supported by its pan-African diversification. However, it also had the least five-year earnings CAGR of 13.2% compared to tier 1 banks' average of 16.6%.

Following adjustments to our estimates, we raise our 12-month Target Price (TP) to N10.97 (previous: N8.15), which implies a 21.1% upside to our ref price. Out TP also suggests an exit PB of 0.51x, which is at par with the bank's four year average of 0.52x. We retain our BUY rating.

Financial ratios	FY'19	FY'20	FY'21
NIM	6.1%	5.9%	5.7%
Cost of risk	0.9%	0.8%	0.8%
Cost to income	62.7%	65.5%	65.0%
ROE	16.6%	16.1%	15.2%
ROA	1.7%	1.6%	1.4%
NPL ratio	5.3%	5.0%	5.4%
Loan to deposit	56.0%	50.0%	52.4%
Multiples	**FY'19**	**FY'20**	**FY'21**
P/E	3.51x	3.15x	3.01x
P/B	0.52x	0.47x	0.42x
Div yield	11.0%	11.1%	11.6%

1-year price performance (rebased)

Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Net interest income	205,646	221,875	252,173	277,414	521	562	639	703
Non-interest income	102,572	124,418	140,632	133,916	260	315	356	339
Net impairments	(4,529)	(18,252)	(18,842)	(22,108)	(11)	(46)	(48)	(56)
Operating costs	(197,342)	(217,167)	(257,287)	(267,364)	(500)	(550)	(652)	(677)
Profit before taxes	106,766	111,287	116,675	121,857	271	282	296	309
Loans to customers	1,807,393	2,147,283	2,512,321	2,763,553	4,580	5,441	6,366	7,002
Deposits from customers	3,349,120	3,832,884	5,021,231	5,272,292	8,486	9,712	12,723	13,359
Total assets	4,869,738	5,604,052	7,173,187	7,531,846	12,339	14,199	18,175	19,084
Total liabilities	4,367,130	5,006,074	6,511,321	6,803,231	11,065	12,684	16,498	17,238
Shareholders funds	502,608	597,978	661,865	728,615	1,273	1,515	1,677	1,846

ZENITH BANK PLC

BLOOMBERG: ZENITHBA NL

Retail moves could ease NIR concerns

BUY

Target Price: N31.04

Ref Price: N26.40

Upside/(Downside):+17.6%

Market Cap: N828.87 bn

We raise our FY'20 earnings estimate by 6.3% to N211.6 billion, driven by lower than initially expected impairment charges (-23.5%) and better non-interest revenue outcomes (+4.9%).

In FY'21E, we see scope for moderate earnings uptick (+3.8% YoY), principally backed by growth in interest income (+10.7% YoY). The improvement in interest earnings is likely to be driven by increased lending volumes (+8.0% YoY) as the economy opens up, even if rates do not recover robustly. To this point, our model assumes a further 20 bps drop in ZENITHBANK's asset yield for FY'21E. Elsewhere, we project flattish non-interest revenue as higher fees and commission offsets a potential weakness in trading gains and lower revaluation gains. We had previously highlighted that ZENITHBANK's foray into the retail space portends near to mid-term opportunities for fee income, given that the lender has one of the lowest net fee income contribution to NIR amongst our coverage. We expect gains from the launch of its agency banking in H1'19 to subsist in the near to mid-term.

Following adjustments to our estimates, we raise our 12-month Target Price (TP) to N31.04 (previous: N26.72), which implies a 17.6% upside to our ref price. Our TP also suggests an exit PB of 0.82x (ROE: 20.6%), a 3.6% discount to the bank's four year average of 0.83x (ROE: 22.6%). We retain our BUY rating on the counter.

Financial ratios	FY'19	FY'20	FY'21
NIM	7.1%	6.8%	6.6%
Cost of risk	1.2%	1.3%	1.2%
Cost to income	46.4%	49.0%	50.0%
ROE	23.8%	21.0%	19.4%
ROA	3.4%	2.9%	2.7%
NPL ratio	6.8%	8.1%	7.5%
Loan to deposit	57.8%	52.6%	54.9%
Multiples	**FY'19**	**FY'20**	**FY'21**
P/E	3.69x	3.64x	3.50x
P/B	0.82x	0.72x	0.65x
Div yield	12.2%	11.0%	12.8%

1-year price performance (rebased)

Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Net interest income	295,594	267,031	304,813	332,572	749	677	772	843
Non-interest income	179,963	232,120	228,291	228,889	456	588	578	580
Net impairments	(18,372)	(24,032)	(36,812)	(36,699)	(47)	(61)	(93)	(93)
Operating costs	(225,500)	(231,825)	(261,221)	(280,731)	(571)	(587)	(662)	(711)
Profit before taxes	231,685	243,294	235,071	244,032	587	616	596	618
Loans to customers	2,016,520	2,462,359	2,831,713	3,058,250	5,109	6,239	7,175	7,749
Deposits from customers	3,690,295	4,262,289	5,383,962	5,574,239	9,350	10,800	13,642	14,124
Total assets	5,955,710	6,346,879	8,060,536	8,463,563	15,090	16,081	20,423	21,445
Total liabilities	5,139,959	5,404,993	6,991,712	7,273,943	13,023	13,695	17,715	18,430
Shareholders funds	815,751	941,886	1,068,824	1,189,620	2,067	2,387	2,708	3,014

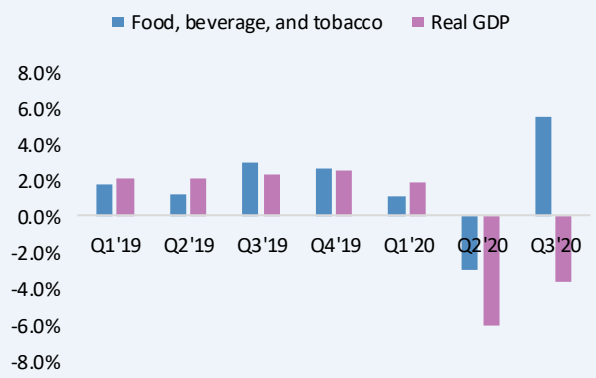
Consumer Goods: Rivers in the desert?

The output of consumer goods sector (proxied by food, beverage, and tobacco GDP) increased by 5.6% YoY in Q3'20, after shedding 3ppts in the prior quarter due to COVID-19 restrictions. The rebound in performance reflected the impact of pent-up demand for consumables following a gradual return to normalcy. The sector currently contributes at least 4.0% of GDP (c.17.0% of the stock market) and has strong MNC presence, intense competition between the formal and informal segments, and high operational cost. Companies producing non-essential items have had to provide incentives such as price discounts to spur discretionary spend over the last 12 months. Yet, the recent re-opening of borders suggests that consumer goods companies may endure far lower prices in 2021 as imported competition gradually creeps in.

The COVID-19 talking point

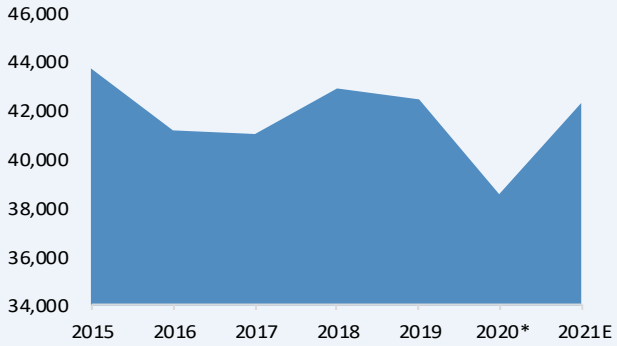
Early COVID-19 restrictions resulted in the discontinuation of production activities of some non-essentials across most parts of the country. These restrictions even complicated route to market for a few companies classed as providers of essentials. The pandemic may have also impacted the purchasing power of consumers, with annualized numbers from the National Bureau of Statistics (NBS) pointing to a 9.2% YoY plunge in total consumption expenditure in 2020. However, sector performance notably improved in the third quarter on the impact of pent-up demand following a gradual re-opening of the economy and government/CBN interventions. While we note the second wave of COVID-19, we believe that the government is unlikely to impose the same level of restrictions on economic activities observed in H1'20 in the coming year.

Figure 22: FMCG outperformed broad economic growth in



Source: NBS; CardinalStone Research

Figure 23: Consumption (N'bn) could recover from trough of 2020



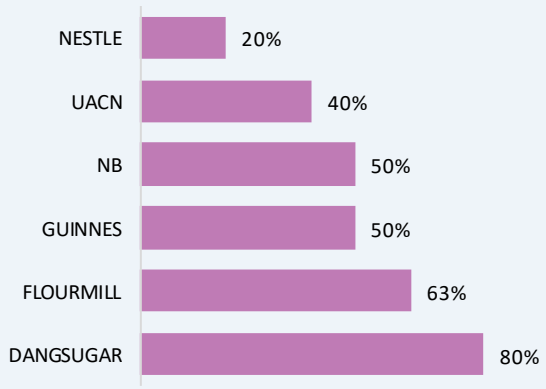
Source: NBS; CardinalStone Research

In addition to consumption recovery from its trough, other factors that are likely to affect the performance of consumer goods companies in 2021 include:

- The re-opening of land borders
- FGN/CBN interventions
- Naira outlook and inflation
- Prior years of backward integration investments and FX hedge
- Proactive balance sheet restructuring

- **Border re-opening** — The viral spread of 2020 forced an expansion of cross country trade restrictions across West Africa. This restriction resulted in market share increases for companies involved in B-to-C activities while cascading to higher cost for manufacturers reliant on imported raw materials. The recent re-opening of the borders could therefore cascade to a slight reversal in fortunes within the sector in 2021.
- **FG/CBN intervention** — As part of its COVID-19 response initiatives, both the Central Bank of Nigeria (CBN) and the Bank of Industry (BOI) reduced the interest rate on all facilities extended to select manufacturers in March and April 2020, respectively. These initiatives could place a cap on interest expense increases for a few firms like FLOURMILLS in 2021.
- **Naira devaluation** — The CBN repriced the naira to c.379/$ and 394/$ at the official and I&E windows in 2020 (vs N307/$ and N362/$ in Dec. 2019). This repricing was due to pressures from the World Bank and weaker oil inflows. As at September 2020, our coverage companies reported varying levels of FX losses, with FLOURMILLS more adversely impacted. In our view, FX losses are likely to remain ubiquitous in 2021 on further naira repricing.
- **Prior years of backward integration and FX hedge** — Companies who had previously invested in backward integration and hedged some dollar exposures received some protection from the naira repricing of 2020. These investments and FG/CBN interventions could result in earnings growth for companies like DANGSUGAR and FLOURMILLS despite their traditionally high FX exposures.

Figure 24: FX exposures across our consumer coverage



Source: Companies; CardinalStone Research

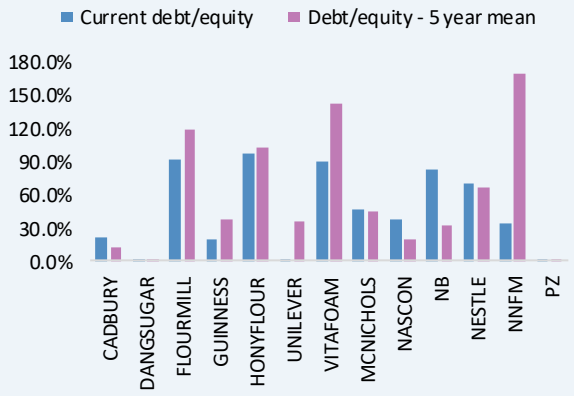
Figure 25: Impact of NGN depreciation on earnings (N' Million)

	5%	7%	10%	Base case (% of last FY PAT)
NB	(228)	(319)	(456)	2.0%
NESTLE	(1,036)	(1,450)	(2,072)	3.2%
DANGSUAR	(1,576)	(2,206)	(3,152)	9.9%
FLOURMILLS	(1,945)	(2,723)	(3,891)	23.9%
GUINNESS	(501)	(702)	(1,002)	NM
PZ	(899)	(1,258)	(1,797)	NM

Source: Company Sensitivity Analysis; CardinalStone Research

- **Proactive balance sheet restructuring** — Unorthodox monetary policies have driven interest rates to multi-year lows and opened up opportunities to refinance expensive borrowings and restructure leverage ratios to either industry or historically efficient levels. CADBURY, MCNICHOLS, NASCON, NB, and NESTLE have leverage ratios that are higher than five-year mean levels, with interest payment of over 7.0% of gross debt for DANGSUGAR, VITA FOAM, NB, and NNFM (vs 4.5% average 5-year bond yield in December 2020). However, only a handful of companies have locked in the current low rates for the longer term, with short term borrowings constituting 100% of borrowings at INTERBREW and GUINNESS and over 50.0% in VITA FOAM and NB. We believe that further balance sheet restructurings and FX hedges may be needed to unlock material earnings growth across the sector in the near term, as was the case in 2020. Failure to take advantage of the abnormality in the fixed income market may be looked back upon as missed opportunity in the medium term, given our position on yield reversal.

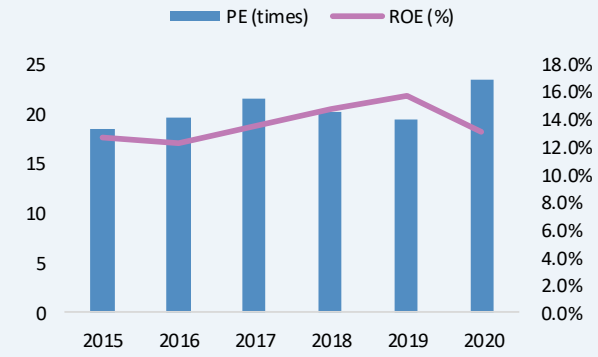
Figure 26: More balance sheet restructuring is likely in 2021



Source: Companies; CardinalStone Research

Sector valuation: The consumer goods sector trades 7.8ppts higher than its five-year average PE of 20.7x. This premium to historical level is, however, unjustified by the index's relatively lower ROE of 11.3% (vs historical mean of 13.8%). On a forward basis, the sector's PE is expected to slightly moderate as sector-wide performance tracks macro recovery. However, coverage companies have faired differently in terms of their ability to proactively take advantage of macro and regulatory changes as well as engineer needed internal restructurings. This, in our view, underscores the need for investors to cherry pick within the space if they must consider it.

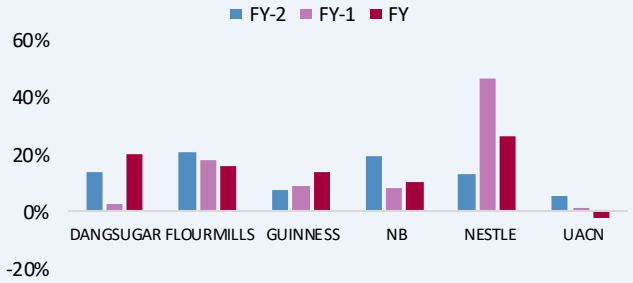
Figure 27: Sector is overpriced relative to historical mean



Source: Bloomberg; CardinalStone Research

On earnings quality: On average, FLOURMILLS (17.7%) and NESTLE (28.3%) boast the highest cash return on assets across our coverage. GUINNESS has, however, shown the most consistent growth on this front over the last 3 years.

Figure 28: Cash return on asset over the last 3 years

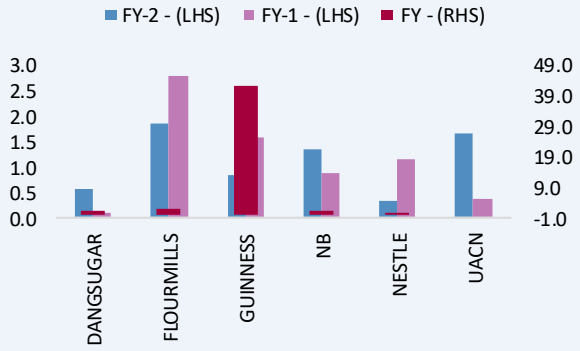


Source: Company Annual Reports; CardinalStone Research

FLOURMILLS consistently reported CFOs that are ahead of normalised EBIT in the last 3 years. GUINNESS also achieved the feat in its previous two financial years, even though its most recent ratio was flattered by materially low reported earnings. As at last full-year, across our coverage, only DANGSUGAR and FLOURMILLS boasted CFOs that are enough to cover dividend, interest expense on debt, and CAPEX.

Elsewhere, cash-flow based accrual ratios suggests that FLOURMILLS and UACN have consistently enjoyed high cash component of earnings in the last 3 years. An equally-weighted ratings system that considers the above ratios suggests that FLOURMILLS and NB are the top two in terms of earnings quality in our coverage.

Figure 29: CFO to Normalised EBIT ratio over the last 3 years (%)



Source: Bloomberg; CardinalStone Research

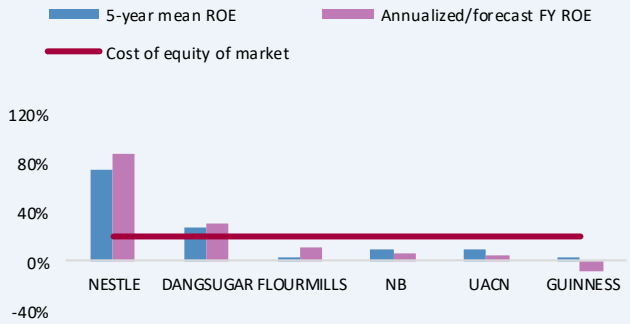
Figure 30: Ranking of earnings quality ratios (last 3 years)

	Cash return on asset	CFO:EBIT	Cash flow based accrual ratio	Total rank
FLOURMILLS	2	2	2	1
NB	3	3	3	2
GUINNESS	5	1	4	3
NESTLE	1	4	5	3
UACN	6	6	1	4
DANGSUGAR	4	5	6	5

Source: Bloomberg; CardinalStone Research

On ROE: Only NESTLE and DANGSUGAR boast ROEs that are over the cost of equity of the market. These firms established themselves as top performers on this front over the last 5-years. We also note the progress of FLOURMILLS, which is on course to achieve its first double-digit ROE in 3 years in the current financial year.

Figure 31: Comparing ROE to cost of equity of market



Source: Bloomberg; CardinalStone Research

DANGOTE SUGAR PLC

Border re-opening to drive margin declines

BLOOMBERG: DANGSUGA NL

DANGSUGAR is currently trading at FY'21E PE of 9.1x, which is at a 2.2% discount to its three-year mean level. Our estimated FY'21E ROAE of c.22.4% is also slightly higher than the pre-border closure level but reflect material moderation from the stellar 9M'20 run rate. For context, the combined impact of volume growth, FX-induced price adjustment, and a third-quarter tax credit of c.N3.0 billion catapulted annualized ROAE to c.30.9% in 9M'20. Mostly reflecting this nine-month performance, we expect the company to report FY'20 revenue and EPS of N213.5 billion and N2.75, respectively (vs N160.9 billion and N1.75 apiece in the previous forecasts).

Notwithstanding, 2020 performance also trotted on some unusually stringent restrictions on cross country movements of goods and services (due to COVID-19 containment), which combined with previous border enforcements to drive volume growth and the ability to pass on cost burden. The recent re-opening of the land borders, the expected impact of higher inflation, and weaker currency support our prognosis for some ROAE correction in 2021. We project FY'21 EPS lower at N2.24, with pretax margin likely to shed 52bpts from FY'20 levels on rising inflation, currency depreciation, and a raw sugar market in contango. We note that the reversal of raw sugar import tariff to 5.0% (from 10.0%) places a floor on expected margin correction in the current year.

Despite the expectation of margin declines, current yield realities support a 12-month TP of N20.72, representing a 1.8% upside to our ref price of N20.35. Notably, our new TP also suggests a cautious exit PE of 9.3x, which is at a 0.4% discount to its 3-year average PE. Our new TP implies a HOLD rating (vs SELL previously). To our minds, investors could also opt for dividend play ahead of FY'20 results and dividend while simultaneously avoiding potential market backlash from margin pressures in the current year.

HOLD

Target Price: N20.72

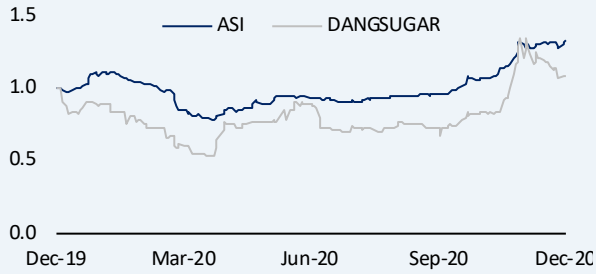
Ref Price: N20.35

Upside/(Downside):1.8%

Market Cap: N244.20 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	22.5%	20.7%	19.4%
Net margin	13.9%	15.5%	13.4%
RoA	12.1%	15.7%	12.9%
RoE	21.6%	28.8%	25.5%
Asset turnover	87.4%	101.2%	96.9%
Current ratio	129.3%	139.2%	138.0%
Quick ratio	79.2%	79.3%	77.7%
Debt to equity	1.2%	0.9%	0.9%

Multiples	FY'19	FY'20	FY'21
P/E	10.92x	7.40x	7.99x
EV/EBITDA	4.06x	3.32x	3.34x
EV/Sales	0.76x	0.58x	0.53x
Div yield	5.4%	7.7%	7.5%



Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Revenue	150,373	161,086	213,499	183,075	381	408	541	464
EBITDA	40,135	36,288	44,264	39,748	102	92	112	101
Profit before taxes	34,601	29,820	38,396	31,396	88	76	97	81
Income taxes	(12,625)	(7,459)	(5,375)	(4,795)		(19)	(14)	(12)
Profit after taxes	21,976	22,361	33,021	27,196	56	57	84	69
Total assets	175,117	193,706	228,246	225,197	444	491	578	571
Total liabilities	76,141	85,569	107,112	103,640	193	217	271	263
Shareholders funds	98,975	108,136	121,123	121,557	251	274	307	308

FLOUR MILLS OF NIGERIA PLC

Stellar year alarm is still likely to buzz

BLOOMBERG: FLOURMILL NL

Flour Mills of Nigeria Plc (FMN) reported an annualized ROAE of 12.8% over the first six months of 2020/21 financial year that dwarfed its prior year and 5-year mean levels of 7.4% and 9.6%, respectively. Even though the ROAE is lower than our estimated market cost of equity, we still consider FMN's recent numbers as a structural break from the relatively tepid performances before FY'18/19. In the ongoing financial year, the strong growth in ROAE reflects panic buying/stockpiling (one-off support for top-line in Q1'19/20), border closures, gravitation to value brands, proactive balance sheet restructuring, and debt-related concessions/interventions from the CBN and BOI.

The recent re-opening of the borders and the one-off support from panic buying in the first quarter suggest that second-half performance (45.0% of our full-year forecast) could be relatively softer for FMN. That said, FMN should comfortably grow earnings by 57.6% YoY to c.N17.9 billion over the full-year period, aided by the impact of sugar duty reversal, gravitation to value SKUs, and a relatively decent first nine months (given that borders were re-opened in December 2020).

After allocating for planned CAPEX (c.N16.0 billion) and working capital needs, FMN is likely to report a free cash flow of N39.8 billion in the current financial year (compared to c.N45.2 billion in the prior year) in our view. Our free cash flow projection implies that the company should conveniently pay our projected dividend of N1.60 (cumulative of N6.6 billion) and effect required interest repayments (c.N20.1 billion forecasted) on existing loans in the near-term.

Adjustments for valuation inputs resulted in a 12-month TP to N32.49 (vs N29.55 previously). Our TP is at an 8.3% premium to our ref price of N30.00 and implies an exit PE of 7.4x (2-year mean: 7.6x). We have a HOLD recommendation on the stock.

HOLD

Target Price: N32.49

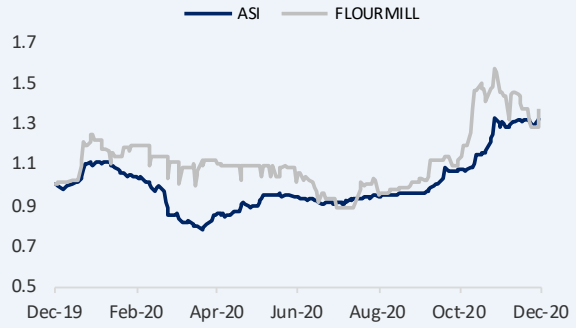
Ref Price: N30.00

Upside/(Downside):+8.3%

Market Cap: N123.01 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	8.8%	9.6%	12.5%
Net margin	0.8%	2.0%	3.0%
RoA	1.0%	2.7%	4.0%
RoE	2.7%	7.4%	11.2%
Asset turnover	127.8%	135.1%	133.8%
Current ratio	97.6%	127.5%	145.9%
Quick ratio	23.6%	37.4%	58.5%
Debt to equity	84.1%	70.3%	79.8%

Multiples	FY'19	FY'20	FY'21
P/E	30.75x	6.99x	8.14x
EV/EBITDA	4.50x	4.85x	8.53x
EV/Sales	0.40x	0.36x	0.35x
Div yield	4.0%	6.9%	1.1%



Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Revenue	542,670	527,405	573,774		1,375	1,336	1,454	1,534
EBITDA	60,787	46,492	55,222	75,432	154	118	140	191
Profit before taxes	16,542	10,174	17,497	25,607	42	26	44	65
Income taxes	(2,926)	(6,174)	(6,120)	(7,682)	(7)	(16)	(16)	(19)
Profit after taxes	13,616	4,000	11,377	17,925	34	10	29	45
Total assets	408,348	416,822	432,454	472,177	1,035	1,056	1,096	1,196
Total liabilities	257,731	265,849	276,646	307,599	653	674	701	779
Shareholders funds	150,617	150,972	155,808	164,578	382	383	395	417

GUINNESS NIGERIA PLC

Earnings set to rebound in FY'20/21

BLOOMBERG: GUINNESS NL

GUINNESS endured an arduous first six months of the year in 2020, characterized by weaker sales, increased costs, and impairment losses. These led to N12.6 billion loss in FY'19/20. However, Q1'20/21 began on a solid footing, as product sales grew by 11.6% YoY upon resumption of business and social activities in several parts of the country. GUINNESS also benefited from the sustained penetration of recently launched Guinness Smooth among younger consumers. However, overall sales growth lagged those of competitors (NB:+25.6% YoY, INTERBREW: 22.8% YoY) possibly due to a double whammy of new strict credit policy and weak value brand presence.

Going into 2021, we expect the sales uptrend recorded in the second half of 2020 to be curtailed by depressed consumer wallets and the social distancing measures implemented in December 2020. Consequently, we forecast moderation in sales growth to 9.1% YoY in the current financial year. Increased cost pressures, emanating from increases in raw material costs and naira devaluation are likely to offset the impact of reduced operating expenses on margins in FY'20/21. Nonetheless, we believe improved supply chains and lower reported floods could rein in the recent increase in domestic maize and sorghum prices. We forecast FY'20/21 PAT at N485.8 million (vs N841.6 million loss in Q1'20/21).

We have a new TP of N 21.05 (vs N15.54 previously), which reflects the new strict credit policy with trade partners that led to N19.1 billion YoY moderation in trade receivables and net debt, between July and September. Our TP implies a 11.7% upside to our reference price and a HOLD rating on the stock. GUINNESS is trading at an EV/EBITDA of 5.6x compared to peer and 5-year averages of 10.3x and 25.4x apiece, but we believe the stock is justifiably cheap relative to peers.

HOLD

Target Price: N21.05

Ref Price: N18.85

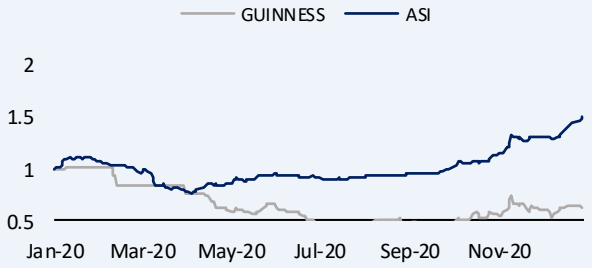
Upside/(Downside):+11.7%

Market Cap: N41.29 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	11.0%	10.0%	9.8%
Net margin	-12.1%	0.4%	0.9%
RoA	-8.3%	0.3%	0.7%
RoE	-15.5%	0.6%	1.4%
Asset turnover	68.5%	76.9%	77.2%
Current ratio	89.1%	136.5%	135.5%
Quick ratio	44.7%	85.3%	83.6%
Debt to equity	31.6%	21.4%	20.0%

Multiples	FY'19	FY'20	FY'21
P/E	-3.30x	85.44x	38.21x
EV/EBITDA	5.59x	4.72x	4.67x
EV/Sales	0.61x	0.56x	0.54x
Div yield	0.0%	0.0%	2.0%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
Revenue	131,498	104,376	114,182	117,790	335	266	291	300
EBITDA	19,060	11,431	13,554	13,682	48	29	34	35
Profit before taxes	7,104	(17,074)	631	1,410	18	(43)	2	4
Income taxes	(1,620)	4,495	(145)	(324)	(4)	11	(0)	(1)
Profit after taxes	5,484	(12,579)	486	1,086	14	(32)	1	3
Total assets	160,793	144,146	147,192	147,096	409	367	375	374
Total liabilities	71,732	71,107	73,668	73,355	183	181	187	187
Shareholders funds	89,060	73,038	73,524	73,741	227	186	187	188

NESTLE NIGERIA PLC

Nestlé to rebound from COVID-19 induced slowdown in 2021

BLOOMBERG: NESTLE NL

Nestlé is likely to grow EPS to N62.15 in FY'21 (vs N55.70 in 2020 estimates), with dividend pay-out projected at 90.0%. Our projected dividend pay-out is 10ppts higher than that of 2020 and should track expected improvements in earnings and cash flow after the initial shocks from COVID-19. We expect ROAE to improve to 94.0% (FY'20: 92.4%) and raise our TP by 8.3% to N1,575.42 (HOLD).

ROAE improvement is likely to reflect a higher profit margin and asset turnover due to a projected increase in household spend on consumer necessities that is likely to trigger a 6.2% growth in revenue for the company. We also consider the sustained investment in brand development and route to market as positive, with bottom-line likely to be supported by the balance sheet deleveraging efforts of 2020.

Levered free cashflows appear robust, and could be supported through FY'21 by possible deferment of planned CAPEX as well as lower finance costs. Further to this, Nestlé is cheap when compared to the trading multiples of its listed operations in other countries. Besides, a robust pay-out ratio is likely to stand the ticker in good stead amongst investors in the near term.

We raise our 12-month TP to N1,575.42 (previous: N1,455.22) and retain our HOLD rating on the counter. Our price review reflects adjustments for moderation in yield environment and terminal growth rate, with the latter likely to reflect improvements in ROE. The risks to our estimates include reinstatement of lockdown measures which could adversely disrupt the company's supply chain and distribution networks.

HOLD

Target Price: N1,575.42

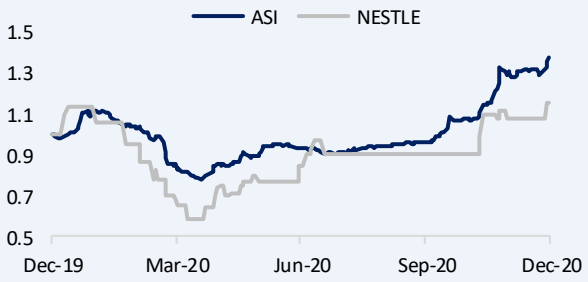
Ref Price: N1,505.00

Upside/(Downside):+4.7%

Market Cap: N1,192.9 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	28.0%	24.4%	25.3%
Net margin	16.1%	15.1%	15.8%
RoA	25.7%	23.4%	26.4%
RoE	95.4%	92.4%	94.0%
Asset turnover	159.7%	155.4%	166.4%
Current ratio	85.3%	89.7%	91.5%
Quick ratio	59.4%	64.3%	64.1%
Debt to equity	18.1%	2.2%	2.2%

Multiples	FY'19	FY'20	FY'21
P/E	26.11x	27.02x	24.22x
EV/EBITDA	16.25x	18.65x	16.86x
EV/Sales	57.63x	55.70x	62.15x
Div yield	3.4%	3.3%	3.7%



Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Revenue	266,275	284,035	292,556	310,823	381	408	541	587
EBITDA	71,995	79,513	71,459	78,526	102	92	112	121
Profit before taxes	59,751	71,124	63,074	70,377	88	76	97	99
Income taxes	(16,743)	(25,441)	(18,922)	(21,113)		(19)	(14)	(15)
Profit after taxes	43,008	45,683	44,152	49,264	56	57	84	84
Total assets	162,334	193,374	183,195	190,443	444	491	578	636
Total liabilities	112,114	147,817	133,222	135,544	193	217	249	268
Shareholders funds	50,220	45,558	49,973	54,899	251	274	329	368

NIGERIAN BREWERIES PLC

Higher operating expense to cap earnings growth

BLOOMBERG: NB NL

We project revenue growth of 2.6% in FY'21, driven by a rebound in economic activities, improved market capture, and capacity expansion. NB has a strong presence in the value segment and a vast distribution network, which should offset the impact of weaker consumer wallets on its performance. While the second wave of COVID-19 outbreak presents a downside risk to our expectation, we note that NB grew market share (by over 3.5 ppts) in 9M'20 despite overall market contraction. Elsewhere, its new PET bottling line at the Ijebu-Ode plant should increase volumes and boost West African exports. However, gross margins are likely to contract further to 38.3% (FY'20E: 38.5%), as FX and inflationary pressures compound the impact of excise duties on raw material costs. NB may leverage its market leadership and brand strength to raise prices, but stiff competition is likely to prevent full cost transfer to consumers.

Likewise, inflationary pressures from higher energy costs are likely to impact operational costs, pressuring EBITDA margin lower by 80 bps to 20.1%. A subdued yield environment and improved cash management will likely moderate additional borrowing costs. Overall, we see a 14.9% growth in EPS in FY'21 to N2.0 on the resumption of economic activity in H2'20 and a strong presence in the value segment amid weaker consumer discretionary income. Risks to forecasts include a longer than expected second wave of COVID-19 as well as operational risks.

We revise our TP higher to N49.50 (previous TP: N33.01) to account for lower debt costs and better-than-expected resilience in performance. Nevertheless, our TP suggests a SELL at our reference price of N58.05 with a downside of 14.7%. Our TP implies a P/E exit multiple of 24.6x versus its 4-year average of 25.4x.

SELL

Target Price: N49.50

Ref Price: N58.05

Upside/(Downside):(14.7%)

Market Cap: N464.22 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	22.6%	21.0%	20.9%
Net margin	6.0%	5.0%	4.4%
RoA	5.0%	4.2%	3.6%
RoE	11.3%	9.6%	8.3%
Asset turnover	84.2%	83.8%	80.9%
Current ratio	52.0%	74.1%	64.4%
Quick ratio	24.4%	51.2%	39.3%
Debt to equity	33.2%	57.1%	28.8%

Multiples	FY'19	FY'20	FY'21
P/E	46.18x	52.44x	45.64x
EV/EBITDA	11.68x	11.64x	11.40x
EV/Sales	2.45x	2.43x	2.35x
Div yield	2.2%	1.9%	2.2%

1-year price performance (rebased)

Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Revenue	324,389	323,007	322,748	331,163	822	818	818	839
EBITDA	73,214	67,936	67,309	66,620	186	172	171	169
Profit before taxes	29,422	23,352	20,261	23,279	75	59	51	59
Income taxes	(9,984)	(7,246)	(6,078)	(6,984)	(25)	(18)	(15)	(18)
Profit after taxes	19,438	16,106	14,183	16,295	49	41	36	41
Total assets	382,228	388,263	382,777	415,131	968	984	970	1,052
Total liabilities	203,930	221,435	215,028	283,877	517	561	545	719
Shareholders funds	178,298	166,828	167,750	172,886	452	423	425	438

UAC OF NIGERIA PLC

Restructuring may yield some benefits

BLOOMBERG: UACN NL

HOLD

Target Price: N8.36

Ref Price: N7.50

Upside/(Downside):+11.5%

Market Cap: N21.61 bn

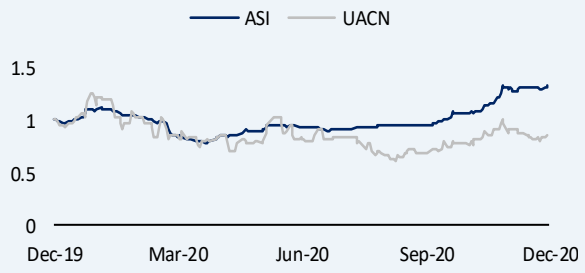
In 2020, UAC of Nigeria Plc (UACN) sold 51.0% of its equity interest in UAC Property Development Company (UPDC) to Custodian Investment Plc (CUSTODIAN) for c.N7.8 billion (82.5 Kobo/share or a 14.1% discount to market). The offer resulted in c.N263 million loss (given the UPDC carrying value in the books of UACN) but reduced exposure to UPDC vulnerabilities to 42.0% (investment in associate). Weaknesses from investment in UPDC are also unlikely to worsen given that the real estate firm is now a less leveraged company (debt-to-equity: -9.2pps from 2019 to 0.4% by mid-year 2020). Disposal of low yielding assets (e.g. Festival Mall in Festac) could also be critical to returns from UPDC in coming years.

Despite our projected P&L weakness on second-quarter weakness, the N7.8 billion proceeds from the transfer of 51.0% stake in UPDC is likely to boost cash flow position in FY'20. According to management, even though the proceed from the transaction was not distributed via a special dividend, its initial cautious stance on full-year dividend payment may now ease. Elsewhere, we have raised CAPEX intensity to c.6.0% in our projections (vs 3.7% in our previous forecast) to match the 9M'20 level. For 2021, we expect margin pressures to subsist on border re-opening, intense market competition, and naira depreciation even though supply chains are likely to improve slightly.

UACN reported an annualized ROAE of c.4.2% in 9M'20 (vs a 5-year average of 6.2%) that partly explains why its stock is trading at a discount to historical levels. However, our 12-month TP of N8.36 (N8.26 previously) captures an expected recovery in ROAE to an average of c.7.3% over our forecast horizon on improved asset turnover and profitability margins. This recovery should reflect ongoing restructuring initiatives to reduce long-dragging vulnerabilities from the likes of UPDC. We retain a HOLD recommendation on the counter.

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	10.2%	6.5%	5.7%
Net margin	6.7%	2.8%	3.0%
RoA	4.5%	2.3%	2.9%
RoE	7.9%	4.4%	5.9%
Asset turnover	66.4%	82.8%	94.9%
Current ratio	152.2%	174.3%	178.7%
Quick ratio	130.2%	155.0%	154.4%
Debt to equity	10.5%	34.8%	59.2%

Multiples	FY'19	FY'20	FY'21
P/E	5.68x	9.66x	8.83x
EV/EBITDA	4.88x	7.68x	8.45x
EV/Sales	0.50x	0.50x	0.49x
Div yield	8.7%	8.5%	3.1%



Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Revenue	70,474	79,202	79,799	81,458	179	201	202	206
EBITDA	5,949	8,107	5,154	4,682	15	21	13	12
Profit before taxes	6,076	7,456	3,290	3,598	15	19	8	9
Income taxes	(1,838)	(2,111)	(1,053)	(1,151)	(5)	(5)	(3)	(3)
Profit after taxes	4,237	5,345	2,237	2,446	11	14	6	6
Total assets	130,972	107,595	85,215	86,459	332	273	216	219
Total liabilities	56,899	47,054	44,111	44,489	144	119	112	113
Shareholders funds	74,073	60,541	41,104	41,970	188	153	104	106

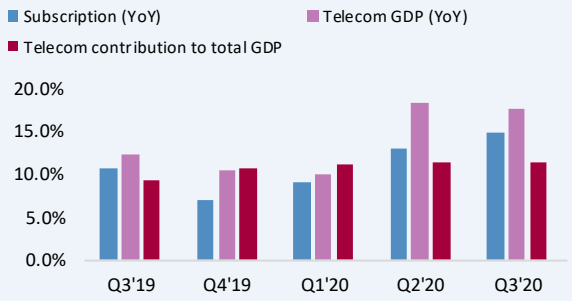
Telecoms: 2021 slowdown is likely

The Mobile Network Operators (MNOs) in Nigeria were relatively unaffected by the effects of COVID-19. Precisely, sector growth accelerated from 9.7% in the first quarter to 18.8% at the peak of the crisis (quarter two) before averaging 17.4% in the third quarter. However, the government's recent move to add valid National Identification Numbers (NIN) to every registered SIM before February is a downside risk to 2021 growth. Besides, the Nigeria Communications Commission (NCC) temporarily barred Telcos from selling new SIM cards ahead of the audits into rule compliance a week before the NIN directive. The forgoing can be made worse by the potential impact of a high base from the year 2020, in our view.

COVID awakens a data hunger

COVID-19 induced restrictions forced Nigerians to look for other ways to remain connected. This inclination resulted in a surge in demand for data-related services. Consumers have had to increase reliance on these services to work from home, maintain social ties, and access entertainment and training amongst others. Consequently, as at September 2020, internet subscribers grew by 23.0% YoY to 151.5 million while the sum of all active telephony subscribers grew by 14.6% YoY to 205.3 million. However, the potential disconnections, in the event of non-linking of registered SIMs to NINs, and low base effect are downside risks to telecom sector growth in 2021.

Figure 32: Sector growth surges on higher subscription levels

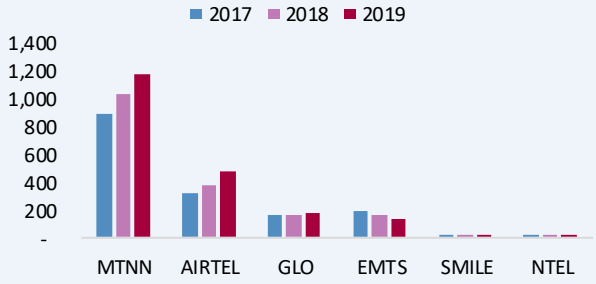


Source: NCC; CardinalStone Research

Changing times means lesser emphasis on voice

Voice revenue growth continues to peter out on rising preference for flexible and relatively cheap OTT services. This trend has cascaded to meagre voice revenue CAGR across the industry (e.g. 5-year voice revenue CAGR of 3.5% for MTNN vs c.20.6% CAGR for data). In addition to changing preference, three other factors that could impact the trajectory of medium-term voice revenue are viz: (1) the growth of subscriber base, (2) the growth of minutes of voice usage and (3) the development of the average voice revenue per subscriber. Projected population growth of c.5.2 million people per annum and increased network penetration is likely to boost subscriber base (barring impacts of shocks). However, the continuing shift to OTT services and increasing competition among MNO's could taper growth in minutes of voice usage and average voice revenue per subscriber, respectively. Overall, growth in voice revenue is likely to stay positive but slightly moderate in the near-to-medium term.

Figure 33: Historical total revenue (N'billion) across sector



Source: NCC; CardinalStone Research

Figure 34: unfolding 2020 numbers show the data growth edge

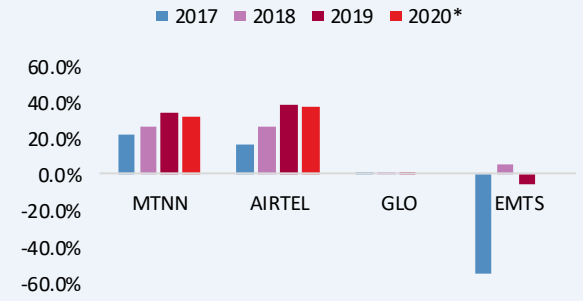
	Data	Voice	Total Revenue
MTNN	46.8%	2.7%	13.9%
AIRTEL NIGERIA	36.3%	9.5%	18.4%

Source: NCC; CardinalStone Research

Electricity tariff and naira weakening to drive margin contraction

Since 2017, only MTNN, AIRTEL and GLO reported consistent operating profit in the Nigerian MNO universe. Notably, GLO did not record an operating margin of over 1.0% between 2017 and 2019, while AIRTEL outperformed MTNN's operating margin despite its smaller market share. Margins were lower in 2020, with MTNN and AIRTEL shrinking 1.8ppts and 1.2ppts apiece, attributable to naira depreciation on lease contracts, investments on networks, & higher VAT. These pressures are likely to extend into 2021 on expected naira repricing and higher electricity tariff. For AIRTEL, a 1.0% naira depreciation could have a negative $14 million impact on revenues, $8 million on EBITDA, and $7 million on finance costs. Similarly, MTNN expects a 10.0% naira depreciation to result in a 2ppts margin contraction.

Figure 35: Historical operating margin across sector

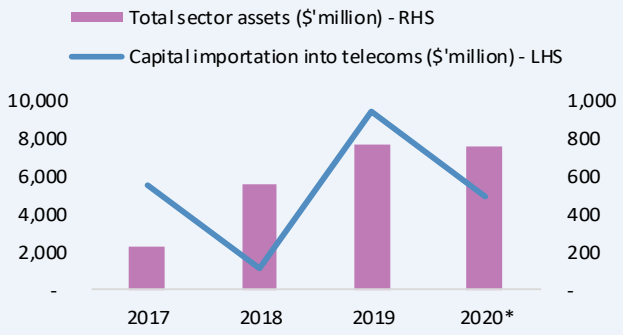


Source: NCC; CardinalStone Research

Foreign capital inflows may remain weak in 2021

MTNN and AIRTEL accounted for c.70.0% of sector assets in 2020. In the last three years, sector assets grew by over three-fold to c.$7.5 billion (using an official FX rate of N379/$ in conversion). We attribute this growth to CAPEX spending of companies and a c.$1.9 billion inflows of foreign capital. The latter was materially weak in 2020 and could remain so in 2021 on the impact of the slow pace of reforms and high regulatory risk.

Figure 36: Sector asset growth was mostly muted in 2020

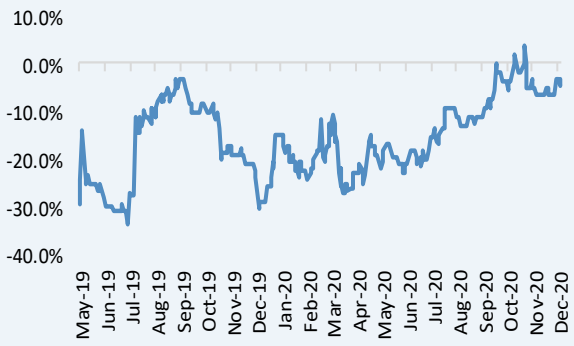


Source: NCC; NBS; CardinalStone Research

Sector valuation

The two listed telecom giants (MTNN and AIRTEL) are currently trading at FY'21E EV/EBITDA of 6.1x and 6.6x, respectively, compared to 6.8x and 7.3x apiece for Sub Saharan Africa and Emerging Market peers. However, only MTNN boasts an ROE (127.9%) higher than the mean return of the selected Emerging Market peers (ROE: 25.4%). Over the last three years, the company recorded an average ROE of 95.0% compared to a five-year mean of 14.2% for these select peers. On this basis, AIRTEL (ROE: 7.6%) looks justifiably underpriced by the market. MTNN, on the other hand, appears unjustifiably cheap even though its mispricing has been materially closed up in recent months.

Figure 37: MTNN is trading at an unjustified discount to peers



Source: Bloomberg; CardinalStone Research

MTNN NIGERIA PLC

Early signals suggest a tough year lies ahead

We expect MTNN to keep revenue flat at c.N1.4 trillion in FY'21 (FY'20E: +15.0% YoY). Despite the ongoing restriction on SIM registrations and the deadline to link registered SIMs with NIN, we believe the subsequent issuance of NIN registration licence to MTNN and other operators could avert a complete repeat of the 2015 debacle. The company has also enabled interfaces to allow customers to upload existing NIN numbers while it sorts the issue of non registered clients. That said, we cautiously expect growth in data income to moderate to 5.0% YoY in FY'21 (vs +46.8% YoY in 9M'20). This data growth and traction in other segments (such as interconnect & roaming sales, and VAS) should offset weaknesses in the voice segment in FY'21.

After-tax profit is likely to decline by 23.7% YoY to N157.6 billion in FY'21 on weaker traction in top-line and rising operating cost. Operating cost pressures could stem from naira devaluation and increased electricity tariff. Specifically, the former could increase network operating cost since tower deals are costed in dollars every quarter. The new electricity tariff came into play in October 2020 and is likely to increase the energy cost of MNOs. Even though MTNN has outsourced management of towers and on-site telecoms equipment to third party operators, we believe the recent spike in electricity cost could lead to a renegotiation of current agreements. In 9M'20, new sites, renegotiation of lease contracts on naira depreciation, and higher VAT contributed to a 25% surge in OPEX. We nonetheless expect a milder rise in operation cost (+6.9%) in 2021 as currency adjustments are likely to be softer relative to those in 2020. We also see scope for improvements in cash balance on better working capital management. This cash generation capacity should enable the company to retain its dividend payout ratio at 85.3% in 2021, in our view.

Adjustments to our model translate to a 12-month TP of N168.28, flat relative to our reference price and implying a HOLD rating (BUY previously) on the counter.

BLOOMBERG: MTNN NL

HOLD

Target Price: N168.28

Ref Price: N168.00

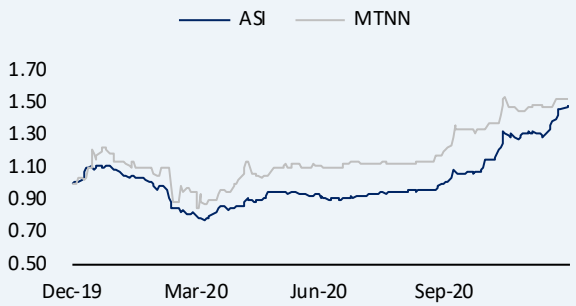
Upside/(Downside):+0.2%

Market Cap: N3,419 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	53.9%	49.5%	47.4%
Net margin	17.3%	15.3%	11.6%
RoA	16.4%	12.4%	8.6%
RoE	111.0%	131.5%	88.6%
Asset turnover	94.8%	80.5%	74.1%
Current ratio	66.0%	78.9%	86.3%
Quick ratio	52.0%	66.5%	73.2%
Debt to equity	285.1%	300.3%	289.0%

Multiples	FY'19	FY'20	FY'21
P/E	16.92x	16.57x	21.70x
EV/EBITDA	5.90x	5.58x	5.79x
EV/Sales	3.18x	2.76x	2.74x
Div yield	3.9%	5.0%	5.1%

1-year price performance (rebased)



Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Revenue	1,039,118	1,169,735	1,345,496	1,464,783	2,633	2,964	3,409	3,711
EBITDA	433,976	629,919	666,021	694,307	1,100	1,596	1,688	1,759
Profit before taxes	221,343	290,104	303,554	280,983	561	735	769	712
Income taxes	(75,657)	(87,993)	(97,137)	(89,915)	(192)	(223)	(246)	(228)
Profit after taxes	145,686	202,111	206,417	191,069	369	512	523	484
Total assets	941,740	1,525,571	1,815,955	1,894,457	2,386	3,865	4,601	4,800
Total liabilities	722,387	1,380,885	1,646,584	1,674,647	1,830	3,499	4,172	4,243
Shareholders funds	219,352	144,686	169,370	219,810	556	367	429	557

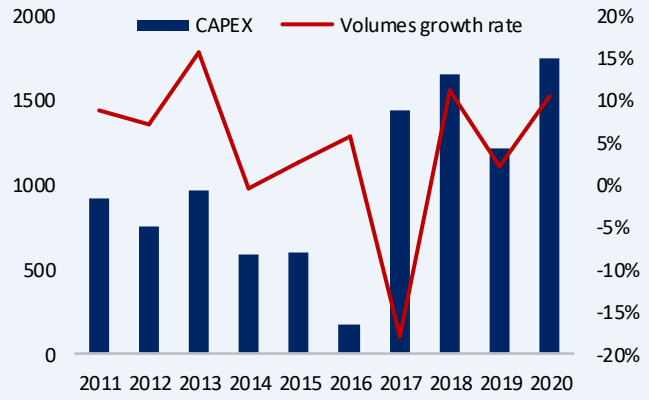
Cement: Sector to benefit from improved CAPEX

The Nigerian cement market recovered sharply in the third quarter of 2020 (+12.0% GDP growth) following a COVID-19 induced 5.5% contraction in the previous quarter. The quick turnaround reflected improvements in the output of the three biggest producers (+20% YoY). In our view, the third-quarter recovery reflected higher private spending on favourable weather condition. Private contractors, uncharacteristically, ramped up demand in the third quarter given an unprecedented dip in rainfall volumes over the period. Likewise, the FG's sustained commitment towards planned CAPEX despite revenue challenges also lent crucial support to domestic demand. For context, the government achieved an impressive 89.2% of its planned CAPEX in 2020, highest in more than a decade.

Cement sector to weather economic headwinds in 2021

In 2021, we see demand support from increased CAPEX spend (proposed 2021 CAPEX: N4.1 trillion vs 2020: N2.7 trillion) and better execution of capital projects, particularly as crude oil price gradually shores up to pre-COVID levels. The re-opening of Nigerian land borders in December 2020 also strengthens our bullish outlook on the sector in 2021. Although DANGCEM and BUACEMENT intermittently received special approvals to export in 2020, the recent border re-opening is likely to have a more positive impact on export volumes. The trio of economic recovery, higher CAPEX and freer cross country trading could nudge industry volumes 4.0% higher YoY in 2021.

Figure 38: Output growth has been mostly in line with FG CAPEX (N'bn)

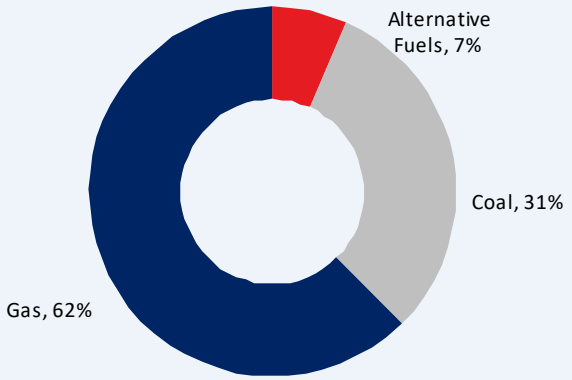


Source: Companies, Budget Office, CardinalStone Research

FX liquidity challenges to further pressure costs in 2021

The scarcity of dollars at the Investors & Exporters (I&E) window have forced cement producers to turn to the expensive parallel market (N60-100/$ differential) to facilitate the purchase of some maintenance equipment to guarantee the longevity of their plants. This position is consistent with reports of an existing backlog of unmet c.$700 million legitimate FX demand of manufacturers. We believe these backlogs are likely to stoke further liquidity issues as they expand. The implied FX concern could naturally force gypsum and gas prices higher, given that they are both priced in dollars. Given that at least 55.0% of the sector's cost is (directly or indirectly) exposed to FX fluctuations, we see legroom for EBITDA margin contraction in 2021.

Figure 39: Energy mix across sector



Source: Company Filings; CardinalStone Research

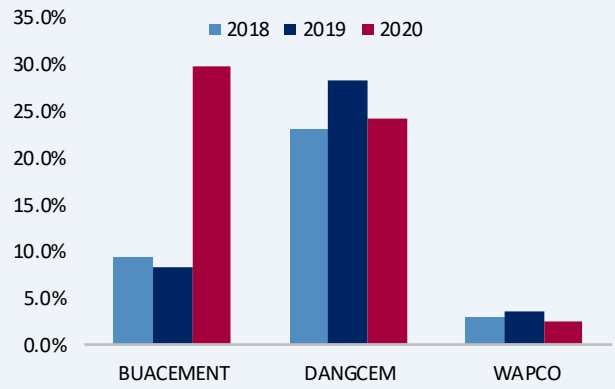
Cost pressures strengthen a case for an upward price adjustment

The passthrough from FX pressures, electricity tariff, and PMS hike strengthens the case for an increase in cement market prices in 2021. Towards the end of September 2020, some distributors took advantage of supply shortages to raise prices, but market rebalancing occurred when producers plugged the gaps. In contrast, our prognosis, this time out, is for a producer-induced price increase in 2021, with smaller players likely to allow the market leader to make the first move.

Finance 2020 bill passage brought some positives for cement players

The recently passed Finance Bill 2020 portends some positives for cement manufacturers. Firstly, the bill allows for tax relief for companies including (Dangote Industries and BUA) that made donations to contain coronavirus under the Private Sector Coalition Against COVID-19 (CACOVID) Relief Fund. The bill also introduces a significant reduction in the rate of import duties on tractors and transport vehicles & co to 10% and 5% respectively (from 35% previously). These provisions could positively impact future tax computation and, help reduce midterm haulage costs in the sector.

Figure 40: Haulage costs as a % of COGS



Source: Company Filings; CardinalStone Research

Battle for capacity dominance may subsist in the midterm

In Q2'20, DANGCEM commissioned a 3MTA Obalana Line 5 project that increased its market share (by capacity) to 63.5% and provided it greater latitude to take advantage of domestic demand and export changes. Similarly, BUACEMENT revealed plans to build three 3MTA production lines in Adamawa, Edo and Sokoto states by 2024. The successful completion of these plants will bring BUACEMENT to 17.0MTA, with WAPCO at 10.5MTA assuming status quo for the latter. In addition to a subsisting infrastructure deficit and CAPEX capacity of both the public and private sectors, we believe substantially low domestic borrowing rates provides another compelling reason for cement titans to fast-track prior capacity projects. These drivers, as well as a need to forestall further deterioration in market share, may also bring WAPCO into the capacity expansion party in the mid-term, with the prospect of a revitalisation of the previously communicated Ashaka expansion plan.

Figure 41: Current and expected capacity of sector players (MTA)

	Current	FY'21E	FY'24E*
BUACEMENT	8	11	17
WAPCO	10.5	10.5	10.5
DANGCEM	32.25	32.25	32.25

Source: Company Financials; CardinalStone Research

All in, we retain our positive outlook on the cement sector in FY'21. Although we expect cost pressures to have a slight effect on margins, we envisage a year-on-year growth in net income across our coverage companies. We forecast FY'21 ROE at an average 20.0% for our coverage names (vs 13.9% in 2019). We, however, highlight limited upside potential in our coverage names following the recent rally in prices. For context, the PE multiples of DANCGEM, WAPCO and BUACEMENT moved from 10.96x, 8.46x and 15.88x, respectively, in September 2020 to 15.42x, 15.64x and 26.3x, apiece, currently. DANGCEM and WAPCO are now trading close to their 5-year PE average of 13.57x and 14.73x.

Figure 42: BUACEMENT was expensively priced relative to sector

	EV/KT (Last Full Year)	PE (Trailing)	EV/EBITDA (Trailing)
BUACEMENT	572.5	47.5	31.5
WAPCO	66.8	11.6	6.05
DANGCEM	189.6	20.8	11.38

Source: Company Financials; CardinalStone Research

DANGOTE CEMENT PLC

Marginal earnings growth in FY'21

BLOOMBERG: DANGCEM NL

In line with its peers, DANGCEM demonstrated a high degree of resilience in 2020 despite overarching macro weaknesses and COVID-19 induced disruptions. At the end of 9M'20, earnings after tax printed 35.2% higher than the corresponding period last year, supported by higher volumes from domestic and Pan African markets; controlled increases in production, administrative and distribution costs; and a plunge in finance expenses.

Capacity expansion, upgrade of Apapa export terminal, and the re-opening of land borders are likely to support domestic and export sales in 20201. We also expect Pan African volumes to grow by 4.0% YoY in 2021 on the gradual resumption of economic activities in countries like Senegal, Ethiopia and Tanzania. Overall, we expect group volumes to grow by 4.6% YoY to 26.6 MT in 2021. However, we project a modest 0.8% YoY growth in earnings after tax to N280.1 billion on projected energy-induced operating cost increases. Our earnings estimate factors in lower finance income from FX gains on expectations of relative stability in currency markets in the Pan African region.

We arrive at a new target price of N241.29 (compared to N177.26 previously) following adjustments to our earnings estimates and the completion of Tranche 1 of the buyback program. The firm successfully repurchased 0.25% of its total issued shares in December 2020. Our TP implies a 1.8% upside to our reference market price of N237.00. DANGCEM is trading at 2021E EV/EBITDA ratio of 9.03x compared to its 4-year average EV/EBITDA of 9.26x. We have a **HOLD** rating on the counter.

HOLD

Target Price: N241.29

Ref Price: N237.00

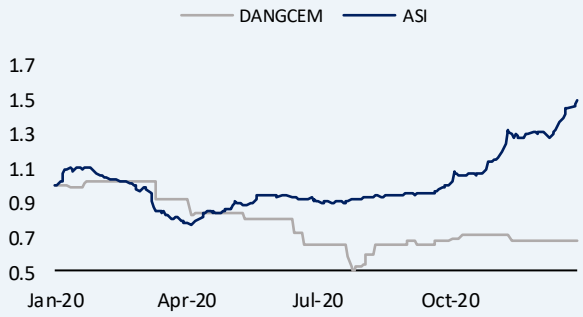
Upside/(Downside): 1.8%

Market Cap: N4,038.60 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	44.3%	46.1%	45.5%
Net margin	22.5%	27.0%	25.9%
RoA	11.7%	15.1%	14.5%
RoE	21.3%	30.5%	31.5%
Asset turnover	51.9%	55.9%	55.9%
Current ratio	64.5%	68.5%	65.2%
Quick ratio	25.1%	28.4%	26.3%
Debt to equity	41.0%	48.0%	56.2%

Multiples	FY'19	FY'20	FY'21
P/E	20.10x	14.81x	14.62x
EV/EBITDA	11.30x	9.62x	9.31x
EV/Sales	5.01x	4.43x	4.24x
Div yield	6.8%	6.8%	6.8%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	(N'million)				($'million)			
Revenue	901,213	891,671	1,008,532	1,054,523	2,283	2,259	2,555	2,672
EBITDA	435,261	395,356	464,634	479,833	1,103	1,002	1,177	1,216
Profit before taxes	300,806	250,479	353,178	354,311	762	635	895	898
Income taxes	89,519	(49,958)	(81,231)	(81,492)	227	(127)	(206)	(206)
Profit after taxes	390,325	200,521	271,947	272,820	989	508	689	691
Total assets	1,694,463	1,741,351	1,868,165	1,906,234	4,293	4,412	4,733	4,830
Total liabilities	707,850	843,414	981,260	1,059,674	1,794	2,137	2,486	2,685
Shareholders funds	986,613	897,937	886,905	846,560	2,500	2,275	2,247	2,145

LAFARGE AFRICA PLC

Set for another prosperous year

BLOOMBERG: WAPCO NL

WAPCO continued its rebirth (post-LSAH sale) in 2020, growing volumes, efficiently managing cost, and reducing finance expense. These positive outcomes were also made possible by aggressive market campaigns, lower quarry costs, and inexpensive travel & consultancy costs, respectively. Together, these initiatives contributed to a 37.0% YoY jump in after-tax profits during the first nine months of 2020. Despite the notable improvement in core operations, naira devaluation inadvertently pressured foreign-sourced materials and domestic gas prices in the first half of 2020. For context, in Q3'20, variable costs, typically inclusive of raw materials and fuel costs, rose by 61.2% YoY. Nonetheless, aided by a knock-on effect from strong top-line, we expect WAPCO to close the year on a positive note, with estimated after-tax profits of N34.9 billion (+124.5% YoY).

In 2021, we expect WAPCO to consolidate its improved route to market strategy through distributor discounts and increased engagement with consumers. This strategy should increase cement sales by 4.0% YoY in our view. However, we expect devaluation-induced pressures to drive EBITDA margins slightly lower to 32.5% (2020E: of 33.0%). Some upside risks to our estimates are the potential Ashaka de-bottlenecking and captive power plant projects, which were stalled by coronavirus restrictions.

WAPCO shares have rallied by 145.8% from its year low in February 2020 to our reference price of N23.50 on resurgent financial performance in the last eight quarters. Nonetheless, we retain our BUY rating on the stock and arrive at a new target price of N28.61, which translates to an upside of 21.75%. WAPCO is trading at 2021E EV/EBITDA and PE ratios of 4.25x and 9.93x, respectively, compared to peer averages of 8.3x and 14.73x apiece. Also, our FY'20 and FY'21E ROEs of 9.8% and 10.0% apiece are considerably higher than the 5-year average ROE of 3.7%

BUY

Target Price: N28.61

Ref Price: N23.50

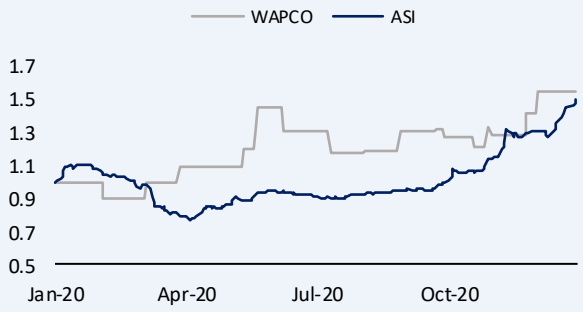
Upside/(Downside):21.75%

Market Cap: N378.53 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	29.5%	33.0%	32.5%
Net margin	7.3%	15.1%	16.1%
RoA	3.0%	6.9%	7.4%
RoE	6.5%	9.8%	10.0%
Asset turnover	41.0%	45.8%	45.8%
Current ratio	88.9%	117.6%	135.7%
Quick ratio	41.8%	63.8%	82.7%
Debt to equity	18.6%	14.7%	11.2%

Multiples	FY'19	FY'20	FY'21
P/E	24.39x	10.87x	9.93x
EV/EBITDA	5.21x	4.31x	4.25x
EV/Sales	1.54x	1.42x	1.38x
Div yield	4.3%	7.4%	8.1%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	(N'billion)				($'million)			
Revenue	217,813	212,999	230,039	236,940	552	540	583	600
EBITDA	57,079	62,876	76,027	77,099	145	159	193	195
Profit before taxes	(1,510)	17,892	43,009	47,076	(4)	45	109	119
Income taxes	9,607	(2,374)	(8,172)	(8,944)	24	(6)	(21)	(23)
Profit after taxes	8,097	15,518	34,837	38,131	21	39	88	97
Total assets	540,737	497,152	507,162	526,418	1,370	1,260	1,285	1,334
Total liabilities	406,196	152,238	138,434	130,932	1,029	386	351	332
Shareholders funds	134,541	344,914	368,728	395,486	341	874	934	1,002

Oil Palm Sector – Ripe for growth consolidation in 2021

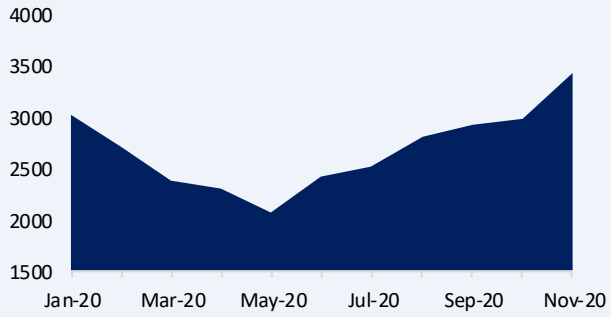
Firmer prices and production volumes have led to the outperformance of oil palm producers in 2020 amidst the COVID-19 pandemic. Crude Palm Oil (CPO) price increases were mostly supported by the land border closures that halted competition from smuggled imports, which typically pressured prices lower. By our estimate, producers charged premiums as high as 40.0% over the global price in H1'20 as local prices remained favourable and in stark contrast to COVID-induced price depreciation globally. The combination of firmer prices and production (due to capacity expansion and more harvests) resulted in sales growth of 19.8% for OKOMU and 24.5% for PRESCO as at 9M'20. We expect both companies to finish the year strongly, with turnover growth of 6.6% and 13.8% in FY'20 respectively.

Local CPO prices may remain flat despite volatility in global prices

The recovery in CPO prices that begun in Q4'19 halted as movement restrictions weighed on consumer demand and production operations. CPO prices fell from c.$810.1 per ton at the start of the year, to $576.6 per ton by H1'20. However, prices rebounded to multiyear highs by Q4'20 due to lower supply in Malaysia and Indonesia caused by COVID-19 induced labour shortages, a decline in productivity yields due to dry weather, and lower fertilization application by producers. The tightness in supply accompanied higher demand in China and India – the two largest oil palm consumers. Prices may continue to trend higher in the near term due to the recent reduction of palm oil import duty in India (to soften domestic food prices) and current low stock levels in China. Despite the near-term price support, Global CPO price may trade closer to its 10-year average by year-end (2021F: $610 per ton; 2020E: $710) as the proliferation of cheaper competing crops may dampen palm oil imports (India is one of the most price-sensitive markets).

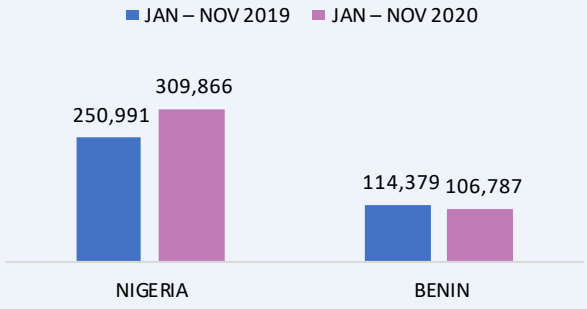
We expect the imminent re-opening of domestic land borders to re-establish the link between global and local prices that weakened due to border closures. The expected rally in global prices in the first quarter of the year should increase domestic pricing power with some price correction likely to occur in the second half of the year counteracted by higher supply impacts from re-opened borders and global price moderation in the second half of the year. Overall, we expect the impact of higher global prices during peak periods (H1'21) to be somewhat counteracted by higher supply impact from re-opened borders and global price moderation in the second half of the year. In our view, cross country border enforcements are likely to be materially better than the pre-closure era. The improved enforcement, peak periods palm production, and the buffer from 30% import duty on imports are likely to leave domestic CPO prices at a premium over global prices in 2021.

Figure 43: CPO price (Malaysian Ringitt) rallied on tight supply



Source: MPOC; CardinalStone Research

Figure 44: Malaysian CPO imports (MT) declined in Benin amid land border closures



Source: CBN; CardinalStone Research

Output consolidation to drive performance in 2021

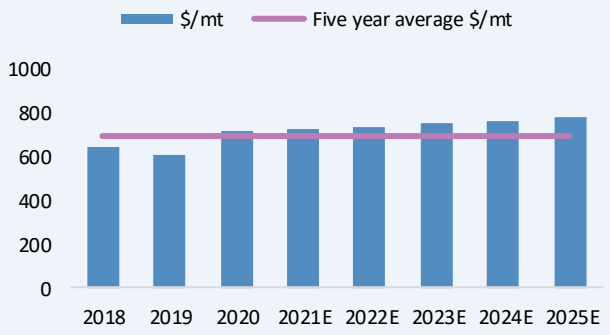
The domestic production to consumption gap for palm oil is roughly 320,000 tons, according to PWC (2018). While production growth amongst smallholder farmers (c. 75% of total) remains slow, the two largest industrial players (OKOMU and PRESCO) ramped up production in 2020. Our estimates suggest that the two producers jointly increased CPO production by c.28.9% to 107,300 tons in 2020. Timely execution on expansion plans (PRESCO) and matured area harvesting from prior old planted areas (OKOMU) spurred improved production outcomes in FY'20E.

In 2021, we foresee a continued ramp-up in production volumes by both players, supported by capacity expansion and resilient domestic demand. In our view, additional oil milling capacity should boost FFB harvests from the recently acquired Sakponba plantation for Presco just as the erection of the 30MT/hr oil processing plant at OKOMU's extension 2 (expected in H1'20) leaves legroom for cost-effective harvesting of crops. Altogether, we foresee an 8.0% increase in industrial CPO production to 114,892 tons. Beyond 2021, sector output could increase on the impact of oil plantation and processing facilities of PZ Wilmar (26,500 hectares) and Dufil Pharma (17,954 hectares).

Persistent FX accessibility issues may delay expansion plans

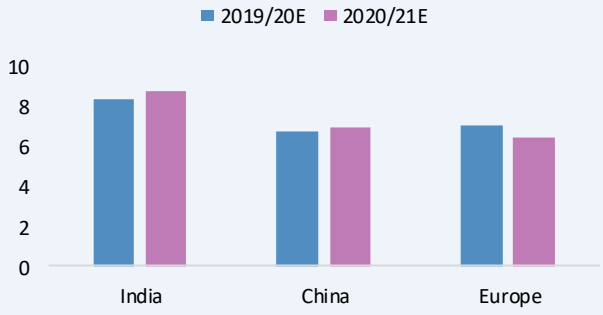
Performance may be influenced by FX developments over 2021, considering importation needs, related to the execution of expansion plans. FX inaccessibility issues may increase project costs or delay project execution for both payers and adversely impact 2021 performance. Our expectation of continued clearing of FX backlogs supported by naira repricing suggests a moderation of FX impediments by H2'20. Elsewhere, we expect operating, administrative and labour costs to be pressured by rising inflation, but note potential earnings support from debt refinancing, considering the current low yield environment.

Figure 45: Global CPO price forecast



Source: World Bank; CardinalStone Research

Figure 46: Expected palm oil consumption (million tonnes) in key countries



Source: Council of Palm Oil Producing Countries; CardinalStone Research

OKOMU OIL PALM COMPANY PLC

Better harvests to support growth momentum

BLOOMBERG: OKOMU NL

SELL

Target Price: N91.07

Ref Price: N93.00

Upside/(Downside):(2.1%)

Market Cap: N88.71 bn

Delayed harvest from planted areas of previous years should cascade to an 18.5% growth in output in 2020, in our view. In 2021, while the impact of delayed harvesting is unlikely to be as notable, we expect support from improved yields from existing plantings and the addition of 1,500 hectares of matured land. Prices are likely to provide additional support and help offset potential weaknesses from the reopening of land borders. Sales of Rubber, which are 100% exported, may also rebound to pre-COVID levels after supply chain disruptions and overseas factory closures weighed on FY'20 sales. Thus, revenue is likely to increase by 11.5% YoY while EBITDA margin could expand by 0.5 ppts to 48.8% in 2021 despite inflation-induced cost increases.

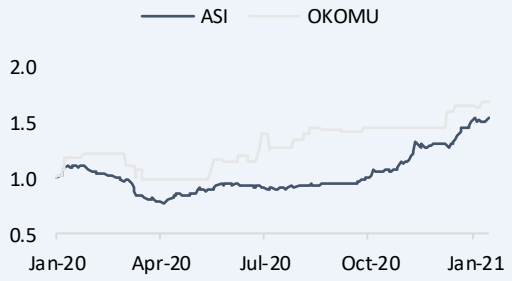
Inflationary pressures on admin costs (c.50% of OPEX) and currency pressures on capital spend (via expenditure related to oil mill at Extension 2), may increase cost pressures in the interim. FX accessibility could further raise currency-related costs for OKOMU. However, these pressures could be offset by energy savings from a five-megawatt turbine, coming onboard in January 2021. According to management, powered by production waste, the installation would reduce cost by 25.0%. We expect the company to continue to grow shareholder returns with projected ROE of 21.4% in FY'20 and 23.3% in FY'21.

We raise our 12-month target price to N91.00, which suggests a SELL recommendation given our reference price. OKOMUOIL currently trades at a forward PE of 15.3x versus mean of 16.3x for MENA peers.

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	38.4%	42.6%	39.0%
Net margin	25.8%	31.3%	26.8%
RoA	12.8%	17.1%	16.3%
RoE	20.5%	24.8%	22.8%
Asset turnover	49.8%	54.6%	0.2%
Current ratio	142.6%	147.0%	195.7%
Quick ratio	100.0%	98.3%	138.7%
Debt to equity	43.7%	31.1%	20.2%

Multiples	FY'19	FY'20	FY'21
P/E	17.57x	17.00x	15.31x
EV/EBITDA	11.20x	10.39x	9.24x
EV/Sales	5.37x	5.04x	4.51x
Div yield	4.3%	4.3%	4.3%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Revenue	20,258	18,867	20,117	22,473	51	48	51	57
EBITDA	10,260	7,354	7,720	8,637	26	19	20	22
Profit before taxes	10,337	7,523	7,457	8,277	26	19	19	21
Income taxes	(1,835)	(2,474)	(2,237)	(2,483)	(5)	(6)	(6)	(6)
Profit after taxes	8,502	5,050	5,220	5,794	22	13	13	15
Total assets	38,418	43,596	43,945	46,359	97	110	111	117
Total liabilities	9,904	14,416	17,724	15,977	25	37	45	40
Shareholders funds	28,514	29,180	26,221	30,382	72	74	66	77

PRESCO PLC

Sustained volume expansion to support top line growth

We expect PRESCO to achieve EPS growth of 50.5% YoY in FY'20 (to N5.78), driven by volume expansion and firmer CPO prices. While PRESCO is likely to sustain volume growth expansion in FY'21, imported competition from re-opened land borders and a relatively high price base in 2020 may constrain revenue growth to 4.7% YoY. We see gross margin expansion to 65.0% (FY'20E: 64.1%) on economies of scale effects. Recently added 30MT/day CPO processing capacity, together with additional 500 ton/day refining plant at its Obaretin estate, should boost scale effects and future output growth as harvest yields from new plantings improve in coming years.

Our expectation of higher SGA expenses (+15.1% YoY), resulting from higher inflation and labour costs, may be offset by lower finance costs over the financial period. PRESCO's finance costs dropped by 7.6% YoY in 9M'20 as it trimmed its loan book of N5.6 billion in short-term borrowings and benefitted from reduced rates on CBN intervention facilities. We see sustained cost savings on this front in 2021, considering the relatively low-interest-rate environment. However, finance cost savings may slightly reduce with the addition of new debt to fund expansion plans at the Sakponba Estate. Continued rotation from shorter to longer-term debt and possible attainment of CBN intervention facilities may limit the upside risk to the performance from higher debt costs in FY'21. All in, we forecast relatively modest PAT growth of 5.3% in FY'21. We are, however, wary of the notorious susceptibility of earnings to revaluation gains or losses.

We retain a positive outlook and a HOLD recommendation on PRESCO with a 12-month target price of 82.18. The company is trading at a forward PE of 11.6x compared to 16.3x for MENA peers.

BLOOMBERG: PRESCO NL

HOLD

Target Price: N82.18

Ref Price: N72.00

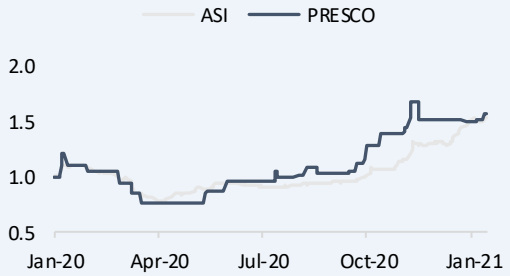
Upside/(Downside):14.1%

Market Cap: N72.00 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	39.3%	58.2%	56.4%
Net margin	19.5%	25.7%	26.5%
RoA	6.6%	5.7%	8.6%
RoE	16.5%	13.7%	19.5%
Asset turnover	318.6%	313.6%	273.9%
Current ratio	79.4%	73.1%	104.6%
Quick ratio	67.1%	42.6%	76.4%
Debt to equity	88.7%	63.6%	73.6%

Multiples	FY'19	FY'20	FY'21
P/E	18.76x	12.46x	11.56x
EV/EBITDA	12.04x	7.14x	7.04x
EV/Sales	4.37x	4.73x	4.16x
Div yield	3.8%	2.8%	2.8%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	N'millions				$'millions			
Revenue	21,345	19,724	22,446	23,493	54	50	57	60
EBITDA	11,513	7,749	13,069	13,246	29	20	33	34
Profit before taxes	6,321	6,060	8,255	8,897	16	15	21	23
Income taxes	(2,037)	(2,221)	(2,477)	(2,669)	(5)	(6)	(6)	(7)
Profit after taxes	4,284	3,839	5,779	6,228	11	10	15	16
Total assets	58,679	70,733	63,099	71,723	149	179	160	182
Total liabilities	34,504	42,845	34,907	40,577	87	109	88	103
Shareholders funds	24,174	27,888	28,192	31,146	61	71	71	79

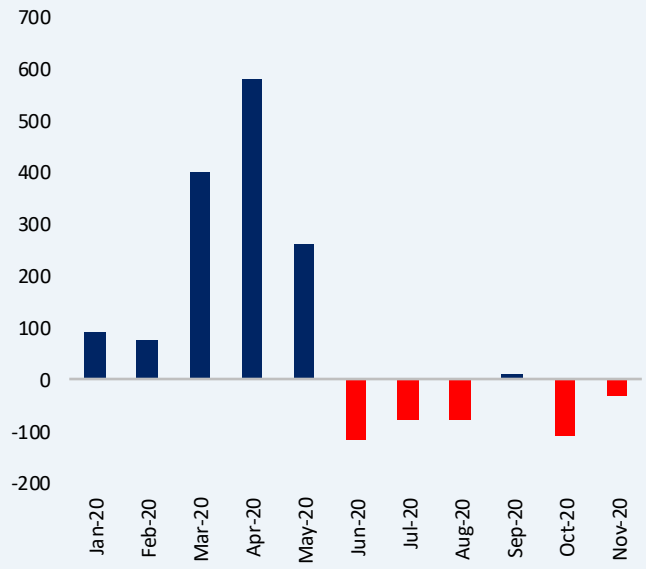
Upstream Oil & Gas: The worst may be over

We envisage the global oil market to continue its recovery in 2021 as countries wade off effects of COVID-19's second wave on demand through effective countermeasures and vaccine deployment. We adjudge that oil prices will likely mirror the extent of vaccine penetration in critical economies as well as pace of OPEC+ easing of current supply cuts. In the domestic market, the imminent passage of the long awaited Petroleum Industry Bill (PIB) may also help bridge the gap to oil and gas investment gap in 2021.

Easing of supply cuts is critical to rebalancing markets

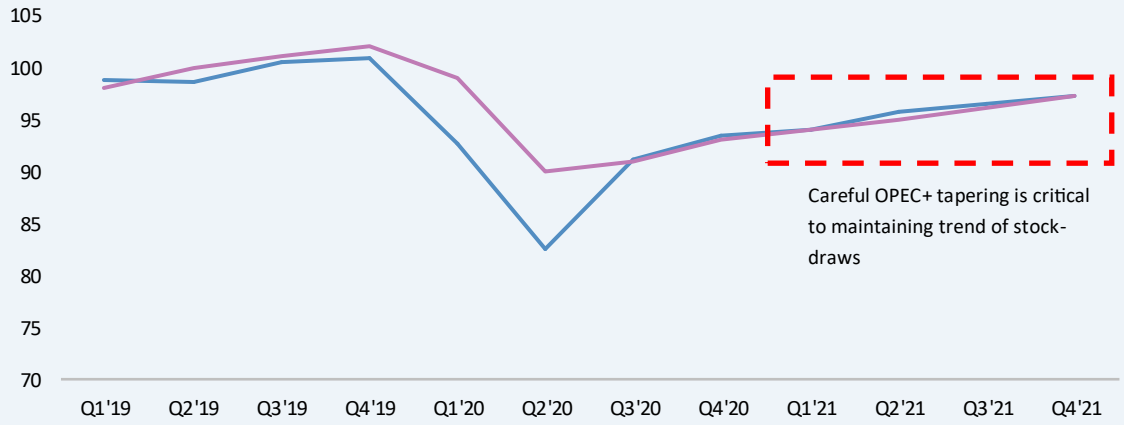
OPEC+ decision to ease production cuts by 0.5 mb/d (to 7.2 mb/d) in January 2021, instead of the earlier agreed 2.0 mb/d, appears critically timed considering rising Libyan production. These cuts could help steady the markets pending widespread distribution of recently released vaccines. For context, North African crude production, excluded from the OPEC+ cuts, surged to c.1.25 mbpd in November 2020 from nearly zero in September, following tentative peace agreements between rival military forces, whose activities had halted production earlier in the year. Additionally, the victory of Joe Biden in the US election raised hopes of a potential easing of US sanctions on Iran subject to its return to strict compliance to the nuclear deal. Over the medium term, a lifting of these sanctions could result in an additional c.2.5 mb/d of oil output globally. Iran currently exports less than 0.3mb/d compared to 2.8mb/d in pre-sanctions in 2018.

Figure 47: Monthly change in Global stocks— (mb)



Source: Energy Intelligence; CardinalStone Research

Figure 48: Global Oil Supply-Demand Balance (mbpd)



Source: OPEC, Energy Intelligence, CardinalStone Research

Vaccine breakthroughs could spur oil demand recovery in 2021

Oil demand recovery is likely to reflect the speed and size of global economic resurgence in 2021, a year after COVID-19 altered a synchronized growth trajectory across markets. According to OPEC, oil demand should increase by c.6mb/d YoY to 96.3mb/d in 2021 (vs an estimated 90.0mb/d in 2020 estimate).

The demand outlook reflects the anticipated rollout of the COVID-19 vaccines and improvements in the movement of goods and services, which may simultaneously boost industrial fuel demand. Leading vaccine developers, Pfizer and its German partner BioNTech expect to have 50 million doses available in 2020 and a further 1.3 billion units in 2021. We also see legroom for improved aviation fuel consumption in the second half of 2021, in line with the International Air Transport Association's (IATA) broad outlook on the aviation industry.

Overall, a concoction of demand-side signals (vaccine developments and global economic recovery) and the cautious stance of OPEC+ are likely to drive oil prices higher in 2021. However, the current high oil inventory levels and surplus crude oil production capacity are downside risks to expectations. All considered, the Energy Information Administration (EIA) forecasts Brent crude oil prices to average $47/b in 2021.

Domestic oil production to benefit from global economic recovery

The sharp fall in crude oil prices and OPEC+ quotas culminated in a slump in domestic crude oil production to 1.46mb/d in Q3'20 (vs 1.8mb/d in Q1'20). We also recorded a decline in rig counts from 19 in the first quarter of the year to 8 in Q3'20. In 2021, we expect crude oil production to average 1.55mb/d (+6.2% YoY), hinged on expectations that OPEC+ will gradually ease additional volumes into the market as demand improves. Elsewhere, we forecast the 2021 average price of Nigeria's crude at $ 49/bbl (vs $50/bbl for Brent), reflecting the current discount in pricing Bonny Light to the international benchmark.

96.3mb/d

OPEC expects oil demand to increase by c.6 mb/d YoY to 96.28 mb/d in 2021

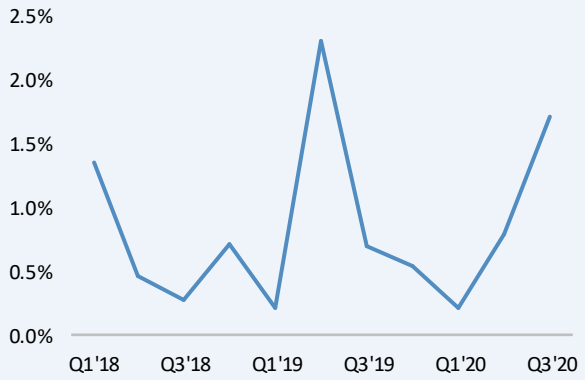
$47/bbl

Energy Information Administration (EIA) forecasts Brent crude oil prices to average $47/b in 2021

PIB passage may spur oil & gas investments

We expect the passage of Petroleum Industry Bill (PIB) to boost investment flows across the oil and gas value chain in Nigeria. The bill prioritizes gas development, infrastructure, and pricing, and eliminates the bureaucracy of previous legislations. According to the Minister of State for Petroleum Resources, Timipreye Sylva, the PIB may be passed into law by the first half of 2021.

Figure 49: Foreign investment in Oil & Gas (% of total CI)



Source: NBS, CardinalStone Research

Figure 50: Latest quarterly capital importation by sector

	$ million	% of total capital importation
Production	400.1	27.4%
Banking	384.4	26.3%
Shares	283.2	19.4%
Financing	134.3	9.2%
Telecomms	101.2	6.9%
Trading	54.2	3.7%
Agriculture	51.7	3.5%
Oil And Gas	25.0	1.7%

Source: NBS, CardinalStone Research

Downstream Oil & Gas: Unearthing value in unclear waters

In the downstream space, we expect the new "deregulated" market to continue to evolve as market players adjust to the new regulatory realities. Despite valid uncertainties about the full extent of the sector deregulation, we believe earnings will remain volume-driven. On the flip side, we may see some drawback in margins of lubricants as oil price gradually retracts to pre-covid levels. For us, we believe the eventual FX availability for PMS self-importation may unlock some value for the oil marketers in 2021.

Deregulation may be here to stay

The Petroleum Products Pricing Regulatory Agency (PPPRA) announced the abolition of the erstwhile monthly pricing guide for the distribution and sale of Premium Motor Spirit (PMS) on September 8, 2020. According to the agency, this abolition would allow the forces of demand and supply and dynamics in the crude oil markets to dictate the price of petrol going forward. Oil marketers are now also free to source products and fix their prices. However, increases in PMS price have been met with public outcry from several labour unions, since the deregulation commenced. To address the price concern, the FG resolved to increase local refining capacity, revamp depot & pipeline facilities, and diversify some consumption away from PMS.

In 2021, we believe market players may likely opt for tacit co-operation instead of price competition, following the full implementation of deregulation. This decision may lead to synchronized price adjustments among players where pump price changes reflect the disparity in crude oil and, to a lesser extent, inflation-induced rise in operating expenses. Such a move could, inevitably, halt the recent margin erosion of oil marketers in the coming years. The PMS price reviews of August, September, and October have been in line with PPPRA's erstwhile template, where PMS pump price was pegged around the historical ex-depot price plus c.N13/litre. However, absolute increases have outpaced that of global oil prices, signalling changes in other cost

The variable nature of the cost elements of PMS such as freight, lightering, and global crude oil could provide a window for oil marketers to accrete better value once given access to FX for sufficient self-importation of petroleum products into the country. Although FX accessibility may be partly contingent on exogenous factors, the National President of Independent Petroleum Marketers Association of Nigeria (IPMAN), in November 2020, disclosed that the Ministry of Finance is confident of availing marketers with sufficient FX supply for petroleum products soon.

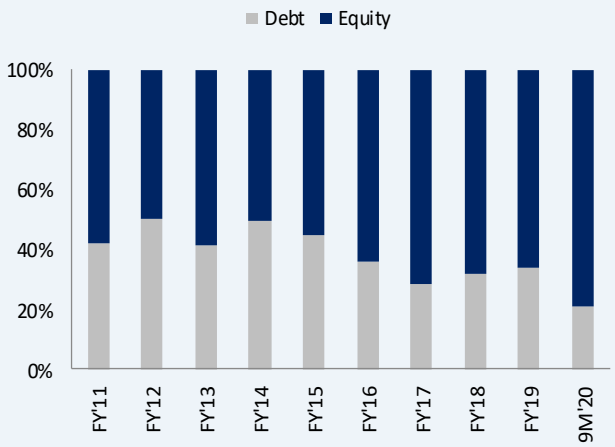
Figure 51: Pump price sensitivity to PPMC Nov'20 key template inputs

Freight costs \ Lightering Expenses	3.5	4.0	4.5	5.0	6.0
12.5	158.7	159.2	159.7	160.2	161.2
10.5	156.7	157.2	157.7	158.2	159.2
8.5	154.7	155.2	155.7	156.2	157.2
6.5	152.7	153.2	153.7	154.2	155.2
4.5	150.7	151.2	151.7	152.2	153.2

Source: NNPC, CardinalStone Research

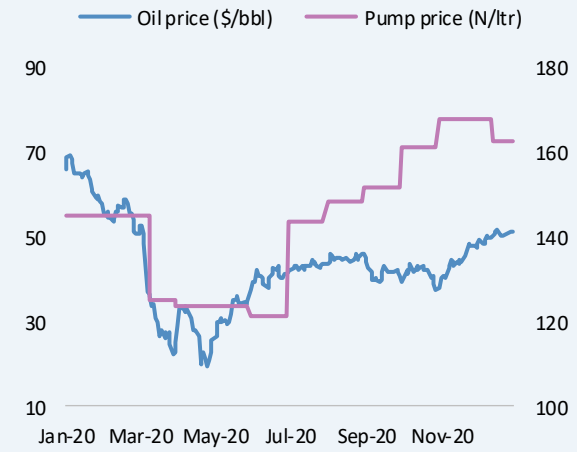
Holding other variables constant, full deregulation and FX availability could drive sector margins closer to those in comparable peer deregulated markets, accrete value to shareholders, and encourage potential investors. We also expect a change in the PMS supply chain environment upon the extermination of current FX liquidity challenges. This development would enable marketers to better interact with foreign supply partners on the one hand and increase working capital needs on the other. We recall that when oil markets were directly involved in importation (pre-2016), debts had greater weights on sector capital structure (an average of 45.4% between 2011 and 2015: compared to 20.9% at the end of 9M'20). In our view, the need for more working capital could drive capital structure to pre-2016 levels, suggesting an increased likelihood of debt raises for downstream companies once self-importation kicks in.

Figure 52: Capital mix between 2015 and 2019



Source: Companies; CardinalStone Research

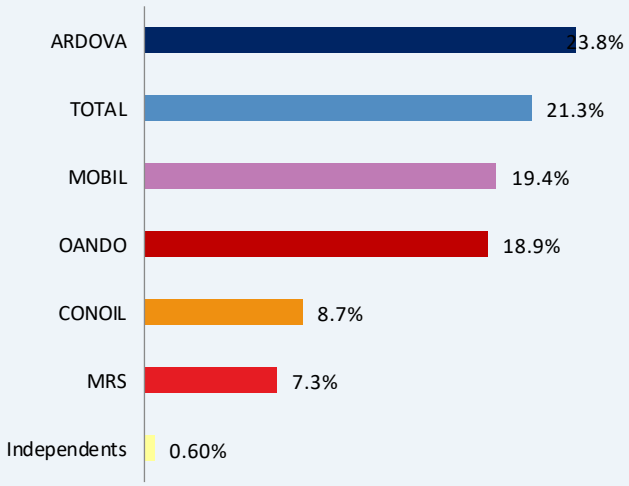
Figure 53: Pump price movement vs crude oil price



Source: IPMAN; CardinalStone Research

On the other hand, a market with renewed price flexibility may usher in new levels of competitiveness as fringe independent players may undercut prices in a bid to gain market share. We place a discount on this scenario due to the strong participation of unions and associations that may prefer coordination. We recall that the Independent Petroleum Marketers Association Of Nigeria (IPMAN) and Major Oil Marketers Association of Nigeria (MOMAN) coordinated the recent price adjustments in the absence of a monthly pricing guide by the PPPRA. Individual marketer's incentive to cut prices is also bleak, considering the already thin margins across the value chain.

Figure 54: MOMAN sextet continued to dominate PMS market at the end of 9M'20



Source: IPMAN; CardinalStone Research

.

Autogas unlikely to dent PMS demand in 2021

To arrest the impact of crude oil fluctuations and deregulation while creating new markets and job opportunities, Nigeria is looking to increase autogas usage in cars and machines. Autogas is a Liquefied Petroleum Gas (LPG) used as fuel in vehicles with internal combustion engines. It is typically a mixture of propane and (or) butane and can also be useful for fixed applications, like generators.

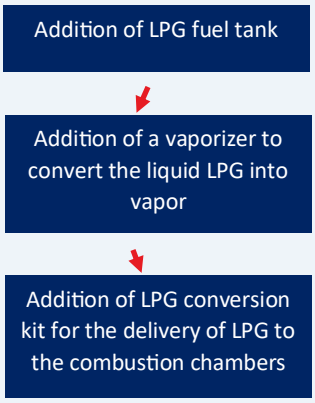
Proper execution, distribution of conversion kits, a proliferation of service stations, level of customer adoption, and the likely discount to PMS are factors that could see the move cascade to cannibalisation of the PMS market. That said, we discount the potential impact on PMS demand in the near term due to high execution risk of FGN initiatives. Current limitations centre around inadequate autogas filling stations and high costs of converting a petrol engine into an autogas powered engine. We assess the likelihood of significant acceptance of autogas among car users below.

Figure 55: Pros & Cons of Autogas

	Pros	Cons
1	Typically, 40% cheaper than Petrol	Expensive to install
2	Lower CO_2 emissions	Low distribution of LPG stations
3	Lower service costs	
4	Quieter than diesel engines	
5	Safely evaporates in the case of a leak, so low risk	

Source: CardinalStone Research

Figure 56: The LPG conversion process for automobile

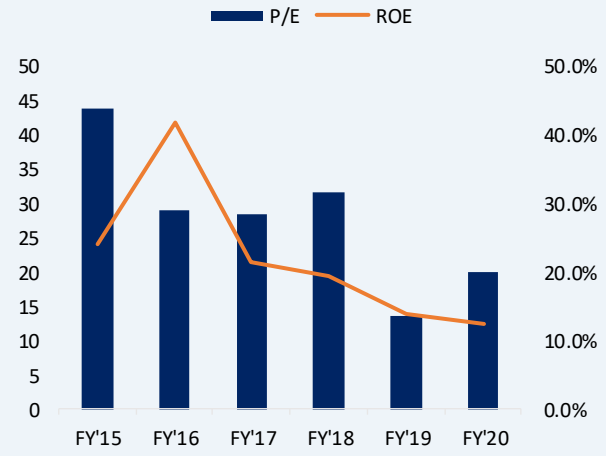


Source: Bloomberg; CardinalStone Research

Sector valuation

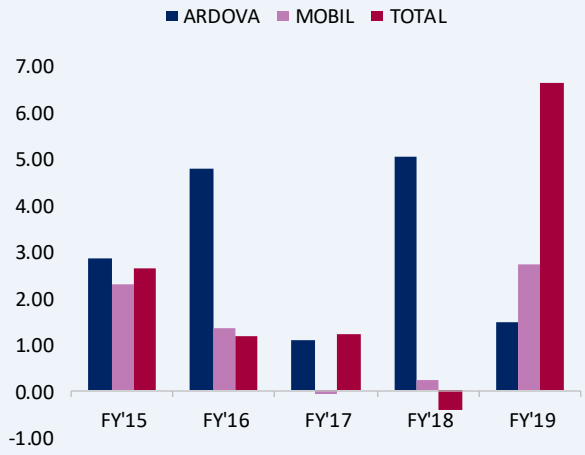
Across our coverage, current market pricing appears mostly justified considering our 2020 ROE expectations. The sector is currently trading at a P/E of 19.9x compared to its 5-year average of 29.3x, even though our 2020 ROE estimate is 11.7ppts lower than historical mean level. However, ARDOVA appears to stand out within our coverage. The stock is currently trading at c.50% discount to its five-year P.E of 67.74 despite returning a higher ROE. From a Quality of Earnings (CFO/Net Income) standpoint, ARDOVA also takes the lead among its domestic peers, averaging 3.1 times compared to MOBIL's 1.3 times and TOTAL's 2.2 times over the last five years.

Figure 57: Sector appears justifiably cheap



Source: Company Annual Reports; CardinalStone Research

Figure 58: CFO:NI across coverage names; ARDOVA leads



Source: Bloomberg; CardinalStone Research

11 PLC

Real estate to keep earnings afloat in FY'21

BLOOMBERG: MOBIL NL

SELL

Target Price: N188.54

Ref Price: N249.50

Upside/(Downside): (24.4%)

Market Cap: N89.97 bn

Across our downstream coverage, MOBIL is the least susceptible to earnings volatility due to support from its real estate business. However, earnings took a massive hit in 9M'20 on weaknesses from the core downstream business. For context, rental income contributed about 92.5% of operating profit at the end of 9M'20, compared to its five-year average of 61.2%

In FY'21, we expect a turnaround in fortunes in its core operations, as businesses and travels resume on a commercial scale. We forecast FY'21 revenue at N171.6 billion (+12.7% YoY), premised on an expected recovery in both Fuels and Lubricants segments. Recent improvements in lubricant demand are also likely to be supportive in the near term. We project FY'20 and FY'21 operating margins at 6.1% and 6.3%, respectively, (vs 6.8% and 5.5% in 9M'20). Our estimates also consider income stability from its real estate business, which has defied frailties in the broad economy. Overall, we expect Overall, we envisage MOBIL to rebound off our projected 31.1% contraction in FY'20 PAT in FY'21, forecasting a 20.1% growth in the succeeding year.

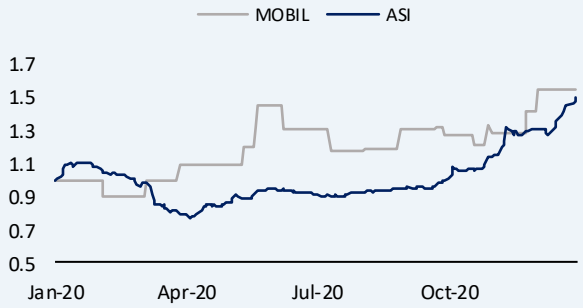
Following adjustments to our previous estimates, we arrive at a new target price of N188.54 (compared to N177.26 previously). Our target price suggests a 24.4% downside to our reference market price and a SELL rating on the stock.

On 19 October 2020, shareholders approved the delisting of the stock from the stock exchange at the Annual General Meeting (AGM).

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	8.7%	8.4%	8.3%
Net margin	4.6%	4.0%	4.3%
RoA	11.0%	6.9%	8.2%
RoE	24.2%	14.8%	16.2%
Asset turnover	236.8%	170.8%	190.1%
Current ratio	112.6%	131.5%	150.9%
Quick ratio	25.8%	33.9%	53.5%
Debt to equity	10.5%	4.9%	1.3%

Multiples	FY'19	FY'20	FY'21
P/E	10.13x	14.70x	12.17x
EV/EBITDA	3.62x	4.72x	4.22x
EV/Sales	0.31x	0.40x	0.35x
Div yield	3.3%	2.2%	2.7%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	(N'billion)				($'million)			
Revenue	164,610	191,676	152,298	171,586	419	488	388	437
EBITDA	16,489	16,671	12,784	14,303	42	42	33	36
Profit before taxes	13,695	13,108	9,031	10,906	35	33	23	28
Income taxes	(4,367)	(4,224)	(2,910)	(3,515)	(11)	(11)	(7)	(9)
Profit after taxes	9,329	8,884	6,121	7,392	24	23	16	19
Total assets	70,661	91,199	87,173	93,391	180	232	222	238
Total liabilities	36,888	51,518	44,345	45,173	94	131	113	115
Shareholders funds	33,773	39,682	42,827	48,218	86	101	109	123

ARDOVA PLC

Retail expansion to drive earnings in FY'21

BLOOMBERG: ARDOVA NL

In a year that has been plagued by a dip in revenues among oil marketers due to COVID-19 induced restrictions, ARDOVA stood out. The company recorded a whopping 2000% jump in normalized profit to N1.9 billion in 9M'20, occasioned by revenue growth and improved operational efficiency.

In FY'21, we expect the firm to consolidate its recent growth trajectory as the domestic economy eases back to pre-covid levels. The imminent acquisition of Enyo Retail & Supply Limited is set to increase the firm's retail outlets by over 20%, making it the biggest downstream company by retail size. Elsewhere, we expect lubricant revenues to grow by 5.0% to N17.7 billion, partly supported by the recent partnership with Shell. Notably, in November 2020, ARDOVA announced its sole distributorship agreement with Shell Trading International Limited for Shell Lubricants branded products in Nigeria. Overall, we forecast a 15.0% growth in revenues to N205.4 billion.

We, however, expect a marginal pullback in operating efficiency in FY'21 from 9M'20 heights. We believe the rebound in oil prices is likely to increase costs attributable to Lubricants sales. Notably, operating expense was down by 13.3% YoY in 9M'20, which reflected a drive to optimize its core assets, benefit from synergies with its parent company, and drive down administrative costs. Overall, we forecast operating margins at 3.3% and 3.2% for FY'20 and FY'21 respectively.

Following our model adjustments, our 12-month target price increased to **N25.37 (**vs N14.42 previously), representing a 16.1% upside to our reference market price. We now have a BUY rating on the stock. The intention to gradually transition the institution to an integrated energy company by harnessing opportunities in commercially cost-effective clean energy solutions strengthens our positive outlook.

BUY

Target Price: N25.37

Ref Price: N21.85

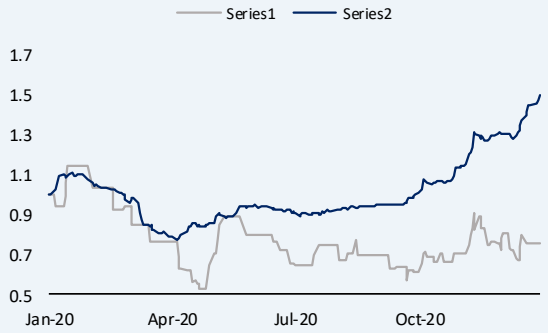
Upside/(Downside): 16.1%

Market Cap: N28.46 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	4.0%	3.3%	4.2%
Net margin	2.2%	1.5%	1.7%
RoA	7.3%	5.6%	6.2%
RoE	26.2%	16.1%	19.7%
Asset turnover	327.7%	369.2%	377.2%
Current ratio	120.5%	124.4%	112.8%
Quick ratio	72.4%	90.0%	82.5%
Debt to equity	16.0%	6.0%	72.4%

Multiples	FY'19	FY'20	FY'21
P/E	7.27x	10.49x	7.84x
EV/EBITDA	2.26x	2.73x	1.72x
EV/Sales	0.09x	0.09x	0.07x
Div yield	5.3%	4.8%	6.4%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	(N'billion)				($'million)			
Revenue	134,706	176,551	178,558	211,744	349	457	463	549
EBITDA	4,371	7,076	5,849	8,199	11	18	15	21
Profit before taxes	1,029	4,654	3,524	3,695	3	12	9	10
Income taxes	(397)	(739)	(810)	(850)	(1)	(2)	(2)	(2)
Profit after taxes	631	3,915	2,713	2,845	2	10	7	7
Total assets	60,730	47,019	49,698	64,883	157	122	129	168
Total liabilities	46,981	30,856	32,178	45,941	122	80	83	119
Shareholders funds	13,749	16,163	17,520	18,942	36	42	45	49

SEPLAT PETROLEUM DEVLOPMENT COMPANY PLC

Higher volumes, prices to drive FY'21 earnings

BLOOMBERG: SEPLAT NL

SEPLAT has endured a challenging financial year in 2020, occasioned by a slump in global oil prices. Increased operating cost, occasioned by Eland acquisition, and higher impairment losses on its oil assets ($158.3 million as at 9M'20) compounded the impact of topline weakness. We do not expect a drastic turnaround in FY'20 earnings despite the crude oil price rebound since the start of Q4'20. We forecast an $82.3 million loss in 2020 (vs $96.3 million loss in 9M'20).

However, we expect key metrics to improve in FY'21 on sturdy oil prices and lower impairment charges. We also factor in the effect of a gradual phasing out of OPEC+ cuts on production in FY'21. According to management, firm gross exports were constrained by the OPEC+ production cuts in Q3'20. Overall, we expect the group's Working Interest (W.I.) production to rise by 6.4% YoY to 54.1 kboepd, barring prolonged maintenance and third-party infrastructure downtime in the mould of the condensate handling challenges that halted Oben Gas Plant operations in H1'20. We project operating margin at 27.4% in FY'21 on expectations of lower operating expenses. Although SEPLAT currently boasts one of the lowest OPEX unit costs ($7.6/bbl) in the sector, we see scope for further cost savings on this front as NNPC reiterates its intent to reduce Nigeria's upstream cost by c.30%. Our projection for a higher proportion of gas revenue in FY'21 is also likely to be margin supportive. For context, gas attracts lower lifting costs and zero transportation costs compared to crude oil.

We adjust our target price to N739.39 (36.9% upside to our reference price). We also retain a BUY rating on the stock. We highlight the firm's commitment to reward shareholders, evinced by the decision to sustain its 5 cents interim dividend after 9M'20 despite dwindling operating performance. Its healthy cash position supports an additional 5 cents payment at the end of FY'20, which translates to a dividend yield of 9.7%.

BUY

Target Price: N739.39

Ref Price: N540.00

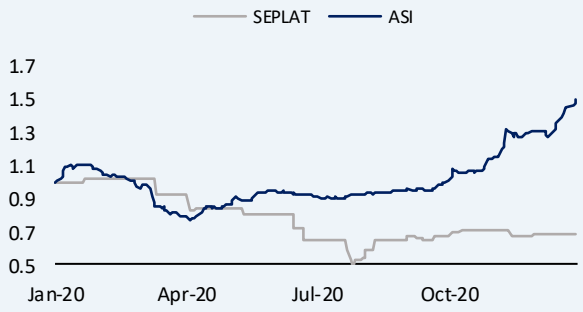
Upside/(Downside):36.92%

Market Cap: N317.76 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	58.2%	14.0%	40.4%
Net margin	37.8%	-14.7%	10.8%
RoA	9.1%	-2.6%	2.6%
RoE	15.5%	-4.7%	4.9%
Asset turnover	24.2%	17.5%	23.9%
Current ratio	149.6%	137.7%	114.8%
Quick ratio	136.1%	125.1%	102.0%
Debt to equity	43.8%	44.5%	40.9%

Multiples	FY'19	FY'20	FY'21
P/E	3.08x	-9.89x	9.92x
EV/EBITDA	2.16x	11.25x	2.87x
EV/Sales	1.26x	1.57x	1.16x
Div yield	5.3%	5.3%	5.3%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	(N'billion)				($'million)			
Revenue	228,391	214,157	215,846	292,491	746	698	559	758
EBITDA	133,220	123,701	30,142	118,132	435	406	78	306
Profit before taxes	80,615	89,914	(39,686)	52,743	266	293	(103)	137
Income taxes	(35,748)	(8,939)	7,937	(21,097)	(117)	(29)	21	(55)
Profit after taxes	44,867	80,975	(31,749)	31,646	149	264	(82)	82
Total assets	775,656	1,004,233	1,197,430	1,250,884	2,497	3,271	3,102	3,241
Total liabilities	284,184	450,425	555,520	599,778	896	1,467	1,439	1,554
Shareholders funds	491,472	553,808	641,911	651,106	1,601	1,804	1,663	1,687

TOTAL NIGERIA PLC

Sales to rebound in FY'21

BLOOMBERG: TOTAL NL

Alongside its downstream peers, TOTAL has endured a frantic year in 2020, headlined by a 31.6% contraction in revenues to N 151.7 billion at the end of 9M'20. Nonetheless, the firm was better off on the earnings after tax front (vs 9M'19) due to a drastic reduction in net finance expense (-93.7% YoY). In addition to the impact of lower interest expense on overdraft and loan facilities (-64.0% YoY), the N2.0 billion interest payment from outstanding Petroleum Subsidy Fund (PSF) receivables provided support for earnings.

For FY'21, we project a rebound in product sales (revenue: +12.1% YoY to N245.8 billion) in line with expectations of a ramp -up in domestic and international travels. We also forecast gross margin at 14.4% and 14.2% in FY'20 & FY'21, respectively, (vs the 5-year average of 12.4%), as passthrough of lower crude oil prices positively impacts deregulated products. However, our FY'21 margin forecast captures a slight moderation in Lubricant margins on a predicted increase in oil prices with vaccine distribution and higher travels.

We see legroom for further interest savings on loans and overdrafts amid the current low yield environment, but our 2021 forecast does not factor in another round of PSF payments. Consequently, we expect earnings after tax to dip by 24.3% and 17.0% to N 1.7 billion and N1.4 billion in FY'20E and FY'21F, apiece.

The lubricant market leader has recorded the most knock-on effect from crude oil price crash on its margins, evinced by the 7.4 ppts jump in gross margin in Q3'20. Our model modifications result in a new TP of N119.4 (vs N95.00 previously). The new TP represents a 16.5% downside to our reference market price and a SELL rating on the stock. A possible foray into self-importation of PMS in 2021 is an upside risk to current estimates.

SELL

Target Price: N119.40

Ref Price: N143.00

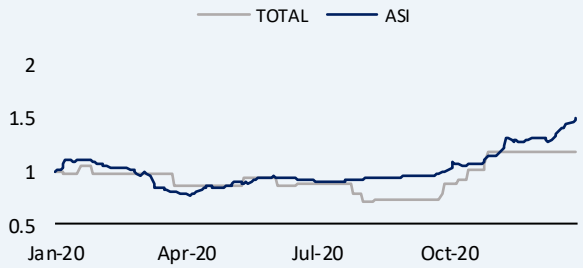
Upside/(Downside): (16.5%)

Market Cap: N48.55 bn

Financial ratios	FY'19	FY'20	FY'21
EBITDA margin	5.6%	4.0%	4.0%
Net margin	0.8%	0.8%	0.6%
RoA	1.7%	1.4%	1.2%
RoE	7.7%	6.2%	5.2%
Asset turnover	219.4%	174.9%	208.7%
Current ratio	87.8%	87.3%	89.3%
Quick ratio	53.7%	58.6%	58.3%
Debt to equity	140.8%	135.5%	124.5%

Multiples	FY'19	FY'20	FY'21
P/E	21.30x	28.13x	33.91x
EV/EBITDA	3.66x	6.78x	6.02x
EV/Sales	0.20x	0.27x	0.24x
Div yield	4.7%	2.8%	2.4%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2018A	2019A	2020E	2021F	2018A	2019A	2020E	2021F
	(N'billion)				($'million)			
Revenue	307,988	292,177	219,321	245,832	784	743	558	626
EBITDA	13,886	16,257	8,784	9,899	35	41	22	25
Profit before taxes	12,098	3,071	2,325	1,929	31	8	6	5
Income taxes	(4,138)	(792)	(599)	(497)	(11)	(2)	(2)	(1)
Profit after taxes	7,961	2,279	1,726	1,432	20	6	4	4
Total assets	132,521	133,788	117,074	118,523	337	340	298	302
Total liabilities	101,790	105,468	89,307	90,704	259	268	227	231
Shareholders funds	30,731	28,320	27,768	27,819	78	72	71	71

Disclosure

Analyst Certification

The research analyst(s) denoted by an "*" on the cover of this report certifies (or, where multiple research analysts are primarily responsible for this report, the research analysts denoted by an "*" on the cover or within the document individually certifies, with respect to each security or issuer that the research analyst(s) cover in this research) that: (1) all of the views expressed in this report accurately articulate the research analyst(s) independent views/opinions, based on public information regarding the companies, securities, industries or markets discussed in this report. (2) The research analyst(s) compensation or remuneration is in no way connected (either directly or indirectly) to the specific recommendations, estimates or opinions expressed in this report.

Analysts' Compensation: The research analyst(s) responsible for the preparation of this report receive compensation based upon various factors, including the quality and accuracy of research, client feedback, competitive factors, and overall firm revenues, which include revenues from, among other business units, Investment Banking and Asset Management.

Investment Ratings

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 January 15, 2021

Rating	Buy	Sell	Hold	Negative Watch
% of total recommendations	29%	50%	21%	0%
% with investment banking	0%	0%	0%	0%

Valuation and Risks: Please see the most recent company-specific research report for an analysis of valuation methodology and risks on any security recommended herein. You can contact the analyst named on the front of this note for further details.

Frequency of Next Update: An update of our view on the company (ies) would be provided when next there are substantial developments/ financial news on the company.

Conflict of Interest: It is the policy of CardinalStone Partners Limited and its subsidiaries and affiliates (individually and collectively referred to as "CardinalStone") that research analysts may not be involved in activities that suggest that they are representing the interests of Cardinal Stone in a way likely to appear to be inconsistent with providing independent investment research. In addition, research analysts' reporting lines are structured to avoid any conflict of interests. For example, research analysts are not subject to the supervision or control of anyone in CardinalStone's Investment Banking or Sales and Trading departments.

However, such sales and trading departments may trade, as principal, based on the research analyst's published research. Therefore, the proprietary interests of those Sales and Trading departments may conflict with your interests.

Company Disclosure:

CardinalStone may have financial or beneficial interest in securities or related investments discussed in this report, which could, unintentionally, affect the objectivity of this report. Material interests, which CardinalStone has with companies or in securities discussed in this report, are disclosed hereunder:

Company	Disclosure
11 Plc	
Access Bank Plc	
Ardova Plc	
Dangote Cement Plc	
Dangote Sugar Refinery Plc	
Ecobank Transnational Incorporated	
FBN Holdings Plc	
FCMB Group Plc	M
Fidelity Bank Plc	
Flour Mills of Nigeria Plc	D & G
Guaranty Trust Bank Plc	
Guinness Nigeria Plc	
Lafarge Africa Plc	M
MTN Nigeria Plc	
Nestle Nigeria Plc	
Nigerian Breweries Plc	
Presco Plc	
Seplat Petroleum Development Company Plc	
Stanbic IBTC Holdings Plc	
The Okomu Oil Palm Company Plc	M
Total Nigeria Plc	M
UAC of Nigeria Plc	
United Bank for Africa Plc	
Zenith Bank Plc	

a. The analyst holds personal positions (directly or indirectly) in a class of the common equity securities of the company

b. The analyst responsible for this report as indicated on the front page is a board member, officer or director of the Company

c. CardinalStone is a market maker in the publicly traded equities of the Company

d. CardinalStone has been lead arranger or co-lead arranger over the past 12 months of any publicly disclosed offer of securities of the Company

e. CardinalStone beneficially own 1% or more of the equity securities of the Company

f. CardinalStone holds a major interest in the debt of the Company

g. CardinalStone has received compensation for investment banking activities from the Company within the last 12 months

h. CardinalStone intends to seek, or anticipates to receive compensation for investment banking services from the Company in the next 3 months

i. The content of this research report has been communicated with the Company, following which this research report has been materially amended before its distribution

j. The Company is a client of CardinalStone

k. The Company owns more than 5% of the issued share capital of CardinalStone

l. CardinalStone has other financial or other material interest in the Company

m. Shareholder and/or bond register(s) managed by CardinalStone Registrars Limited

Important Regional Disclosures

The analyst(s) involved in the preparation of this report may not have visited the material operations of the subject Company (ies) within the past 12 months. To the extent this is a report authored in whole or in part by a Non-U.S. analyst and is made available in the U.S., the following are important disclosures regarding any Non-U.S. analyst contributors: The Non-U.S. research analysts (denoted by an * in the report) are not registered/qualified as research analysts with FINRA; and therefore, may not be subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account. Each analyst (denoted by an *) is a Non-U.S. Analyst and is currently employed by Cardinal Stone.

Legal Entities

Legal entity disclosures: CardinalStone Partners is authorized and regulated by the Securities and Exchange Commission (SEC) to conduct investment business in Nigeria.

Contact:
5 Okotie Eboh Street,
Ikoyi, Lagos, Nigeria

4 Misratah Street ,
Wuse II, Abuja, Nigeria

+234-1 631 2225, +234-1 710 0433

research@cardinalstone.com

www.cardinalstone.com