Equity Research Note

30 June 2020

FSDH MERCHANT BANK LTD

FSDH TOP PICKS: Investor Guide

Nigerian PFAs Conundrum; Robust Liquidity, Limited Asset Classes

Pension Fund Administration (PFAs) and Nigerian Institutional Investors have had to combat sustained pressure on generating above inflation returns, on their clients' RSAs, in the face of growing liquidity and reducing investment opportunities. According to data from CBN, over the next 6 months, N7.6tn (US$20.1bn) worth of T-Bills and OMO instruments would be maturing. The analysis of data from the National Pension Commission (PENCOM) estimates PFAs share of this sum at c.15.0%, which implies an absolute value of N1.1tn, of which c. N867.1bn of the sum are OMO instruments. When the organic growth of pension contributions and possible half-year dividend payments from major banks are factored in, PFAs would be awash with robust liquidity in Q3 and Q4.

However, recent regulations have limited the investment vehicles available for Nigerian PFAs. As at April 2020, data available from PENCOM, Nigerian PFAs hold 66.25% of their assets in FGN securities with FGN bonds getting 54.55% and Treasury Bills (including OMO) getting 10.67%. This huge exposure has left pension managers in a tight space, given the CBN has banned non-banking local corporates from accessing the OMO market of which holds over 8% (c. N1.0tn) of their total assets. This implies these funds must be rotated to different asset classes.

Most PFAs are already significantly exposed to FGN securities, particularly bonds. Thus, similar less risky instruments for consideration, are corporate debt and money market instruments. Nigerian PFAs currently have a 1.44% and 6.53% exposure to commercial papers and corporate bonds respectively, which leaves some room to increase exposure. However, while several corporates have taken advantage of the low interest rate environment, the amounts raised by these corporates have been inadequate to absorb the robust liquidity with PFAs.

As a result, we believe with less risky fixed income instruments in short supply and interest rates continuing to dip on robust liquidity, PFAs would need to take on more risk to generate superior inflation-adjusted return on their client's RSAs. According to PENCOM, PFAs exposure to the domestic equities market stood at 4.62% (or N488.5bn in absolute terms) at the end of April 2020. This is only 3.8% of total NSE equity market capitalization. With valuations still at multi-year lows, we believe value remains to be mined from the equity market. Thus, increasing exposure to domestic equities remains a viable endeavor.

Furthermore, the contribution of PFAs to growth of the venture capital and private equity ecosystem remains quite abysmal. PFAs exposure to PE funds stood at 0.31% of total pension assets. The space has been left for foreign investors to dominate and reap the successes. Considering the increasing success stories being recorded and the technology age of the Nigerian economy, supporting PE firms with a focus on using technology to redefine and disrupt processes, would be very viable. Examples of recent success stories include; Interswitch, Iroko TV, Flutterwave, Paga, Hotels.ng, Paystack, Farmcrowdy, Thrive Agric etc. While these ventures are riskier and do require long term patience, we believe PFAs whose asset base typically consist of long-term funds are well poised to tap into the impressive inflation-adjusted returns in the PE and Venture capital space.

Equity market to sustain pullback in July; FSDH Top Picks

After a record-breaking month in March, which saw the equity market rally significantly as the All Share Index (ASI) gained 9.8%, June has been relatively soft in market movements but with a bearish bias. Month to date, the ASI is down 1.7%. The weak sentiment in equities was broad-based as all sub-indices trended lower during the month. We note that the lull in the market was very much in line with our call in our May note. However, despite the weakness, we observed an interesting technical trend as the ASI managed to remain above its 100-day moving average support level in June, with significant room to break its 200-day moving average resistance.

Going into July, we remain very cautious on the equities market in the short term, due to a number of factors. From a fundamental perspective, July is an earnings reporting month which would span the April to June period where the coronavirus pandemic hit the economy and many businesses hard. Thus, we expect many companies to report significantly weak numbers save for Telecoms, Logistics, Pharmaceuticals and Food focused companies. From a technical analysis perspective, the ASI remains very close to the overbought region with Relative Strength Index (RSI) at 53.8%. This indicates the market in July has more downside potential than upside potential. In addition, investors have not been enthusiastic about taking positions in the market, with average activity level in June remaining below 2020 monthly average. Furthermore, investor sentiment was soured by the recent MSCI review, that placed Nigeria on a watchlist due to FX illiquidity. Thus, we expect minimal activities from index fund managers, while we expect any resumption of FX sale to FPIs could trigger a strong sell-off.

Considering these factors, we make a call that the ASI would pull towards its 50-day moving average in July, particularly if earnings results from major bellwethers prove underwhelming. Thus, we advise short term focused investment managers to trade with a bearish bias. However, for long term focused investment managers, we note that any weakness in July would be short term, thus, we urge them to take advantage of any knee-jerk sell-off to buy quality names on lower prices. Our perspective is further strengthened by the low valuation of the Nigerian market, relative to emerging market peers as well as historical average.

FSDH Top Stock Picks

Stock/Index	Current Price*	52-Week High	52-Week Low	All Time High	All-Time Low	Current P/E	5-Year Average P/E	Current P/B	5-Year Average P/B	Dividend Yield
NGSEINDX Index	24,828.96	29,978.81	20,651.59	n/a	n/a	8.2x	n/a	1.3x	n/a	7.78%
GUARANTY NL Equity	22.70	34.40	16.70	57.00	0.85	3.2x	5.4x	1.0x	1.6x	12.34%
ZENITHBA NL Equity	16.20	23.00	10.70	34.20	5.30	2.4x	3.8x	0.5x	0.8x	17.28%
UBA NL Equity	6.40	9.25	4.40	21.55	1.25	2.5x	3.0x	0.4x	0.5x	15.63%
FNBH NL Equity	5.20	7.85	3.60	30.40	2.27	2.7x	6.5x	0.3x	0.4x	7.31%
STANBIC NL Equity	30.25	42.85	23.50	53.25	4.27	4.3x	7.7x	1.0x	1.7x	10.00%
UACN NL Equity	7.45	11.15	4.30	69.87	1.96	2.3x	10.3x	0.4x	0.6x	1.34%
NESTLÉ NL Equity	1,200.00	1,469.90	750.00	1,645.00	30.13	21.6x	39.8x	16.8x	23.0x	5.83%
FLOURMIL NL Equity	19.60	24.00	12.10	96.05	5.68	15.2x	9.1x	0.6x	0.7x	6.12%
DANGSUGA NL Equity	11.90	16.60	8.50	46.67	3.13	6.5x	6.6x	1.2x	1.7x	9.24%
OKOMUOIL NL Equity	64.00	69.50	40.15	94.70	1.43	10.0x	8.9x	2.0x	2.3x	3.10%
MTNN NL Equity	117.50	145.00	90.00	159.30	90.00	11.7x	n/a	12.2x	n/a	4.23%

Source: Bloomberg, FSDH Researh

***Current Price as of June 26th**

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