Equity Research Note

05 August 2020

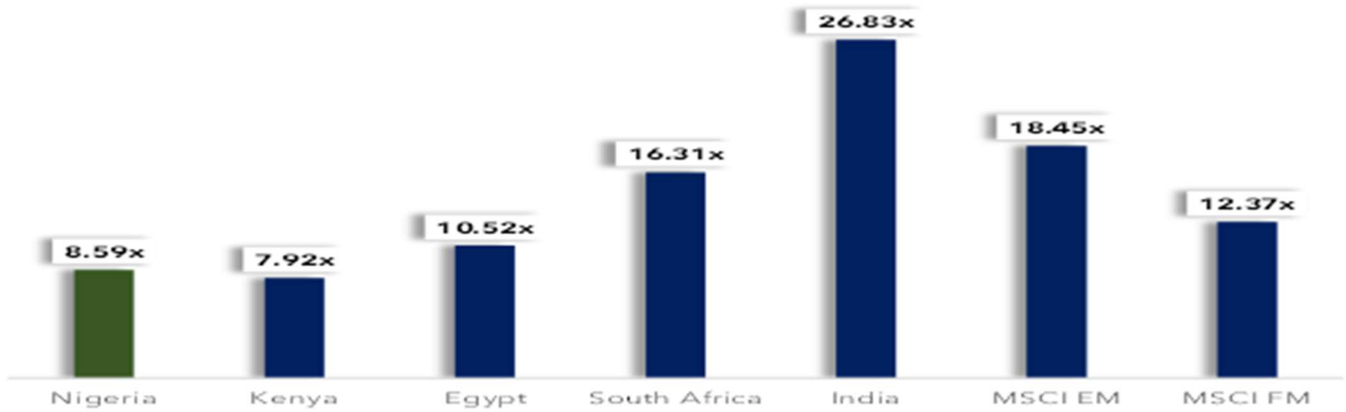
FSDH Top Picks: Nigerian equities set for a bullish end in 2020

The potential of Nigeria Equities Market… Optimism continues

The investor community anticipated a bullish year for the Nigerian Stock Exchange heading into 2020. Optimism was centred largely around relative stability and some of the CBN's unconventional monetary policies which were initially perceived as potentially positive for the equities market. Indeed, the optimism fueled a risk-on appetite for investors as buying interest pushed the All Share Index (ASI) northwards by 7.5% by the end of January. However, as the global COVID-19 pandemic spread and Nigeria recorded its index case at the end of February 2020, coupled with macroeconomic challenges and policy uncertainty, investors particularly Foreign Portfolio Investors (FPIs) began to sell-off Nigerian risk assets. As a result, the Nigerian equities market lost 26.2% between end of January and end of March bringing YTD loss to 20.6% at the end of March.

Nevertheless, the equities market has seen significant bounce back since the gradual reopening of the economy as well as resultant excess liquidity due to CBN's unorthodox monetary policies. This is reflected by the fact that the bourse has gained 15.9% from the end of March till end of July. However, Nigerian equities remain some way off where they started the year, with YTD loss at 8.0% at the end of July. In addition, Nigerian equities remain one of the cheapest globally. At the end of June, the benchmark ASI (PE ratio – 8.59x) traded at a 53.4% and 30.6% discount to the MSCI Emerging Market (PE ratio – 18.45x) and MSCI Frontier Market (PE ratio – 12.37x) index. This valuation comes despite resilient earnings from major Nigerian corporates which has confounded analyst consensus. As a result, we think Nigerian equities has considerable buoyancy till the end of the year.

ASI PE Ratio vs Comparable countries & indices



Source: Bloomberg, FSDH Research

Below, we highlight some of the factors we expect to propel Nigerian equities higher in the coming months:

CBN's heterodox policies…Is this a major gamechanger?

Last year, the CBN announced that local non-banking corporates can no longer access the apex bank's Open Market Operation (OMO) window. This implies PFAs, HNIs and other big corporates will no longer have access to the relatively higher short-term yields on offer via the OMO window. As a result, this affected group of investors need to find alternative asset classes to put their maturing investments. In our June investor guide note ("Nigerian PFAs Conundrum; Robust Liquidity, Limited Asset Classes"), we stated that PFAs are expecting c.N1.1tn worth of money market maturities in Q3 and Q4 of which we estimate N867.1bn of this sum are OMO maturities. In addition, HNIs and other corporates are expected to receive maturities worth c.N38.0bn in Q3 and Q4 respectively. This is expected to result in excess liquidity in the financial markets creating a condition of robust liquidity in the face of limited asset classes. As a result, we expect a good chunk of this liquidity to flow into the equities market in Q3 and Q4 which in our opinion would propel a healthy market rally.

Fixed income yields are unattractive…could revive risk-on appetite

In what is largely an indirect result of CBN's unorthodox policies, fixed income yields have continued to trend lower with fixed income assets seeing prices climb higher. To give a perspective, closing prices for FGN bonds on FMDQ (as of 4th August) show that the c.10-yr TTM bond yields 8.02% (a year back, a similar TTM FGN Bond would yield c.13.7%). In addition, a 310-day T-bill currently yields 2.96% (as of 4th August). Primary market rates do not fare any better with the recent bond issuance closing at a yield of 11.0% for the 15-year bond while the Primary Market Auction for T-bills saw 364-day T-bill close at a yield of 3.52%. Furthermore, inflation rate at the end of June stood at 12.56% which implies the entire FGN yield curve is below the inflation rate. Lastly, the depth of the fixed income auctions would be too small to accommodate reinvestment of these maturing funds. For example, the June bond auction absorbed just N100.0bn. In May, the bond auction absorbed a meagre N296.2m. In our opinion, we think the increasing unattractiveness of risk-free FGN assets will bolster risk-on appetite among investors to the benefit of the equities market.

Nigerian equities are cheap…despite macroeconomic concerns

Domestic equities have had to pay the price for weak macroeconomic conditions in Nigeria as oil price volatility continues to define the economy's fortune. Our macroeconomic team forecasts that the economy will contract by 4.6% in 2020. Nigeria experienced a recession between 2016 and Q1 2017 when decline in oil price and slump in oil production resulted in severe macroeconomic instability. In that period, Nigerian equities traded at an average PE ratio of 14.60x. As we highlighted earlier, at the end of July 2020, Nigerian equities traded a PE ratio of 8.59x which is a steep 41.2% discount to the average between 2016 and Q1 2017. In addition, the weak macroeconomic conditions is not fully reflective of the performance of Nigerian listed corporates. While the economy has continued its tepid recovery, EPS of the benchmark NSEASI has grown by 88.2% between Q1 2017 and July 2020 (although with some support from additional listing). As a result, we think equities would represent an interesting consideration for investors seeking new asset classes for excess liquidity. Our view is that investors may have over-reacted by selling down Nigerian equities massively.

Which stocks should investors focus on?

We expect a rally in the equities market in the coming months, we think investors should pay attention to stocks that have recorded impressive financial performance as of June 2020 particularly dividend paying stocks. We think these stocks will attract institutional and big-money investors in the coming months. In addition, we highlight a few sectors that are worth considering:

Agriculture: The agriculture sector remains resilient despite pressure from COVID-19 on supply chains and demand. This is evident in listed oil palm firms like Okomu Oil and Presco. These companies have had significantly impressive H1 2020 results and they pay healthy dividends. In addition, they are very defensive in nature which helps to protect portfolios in the event of a market wide downturn. Thus, these companies rank at the top of our list.

Healthcare: In our May investor note ("Charting the course of Nigerian economic sectors amidst the pandemic"), we highlighted how we expected the pharmaceutical & healthcare sector to benefit from CBN's stimulus intervention. Recent financial reports from FIDSON, NEIMETH, and MAYBAKER has been very impressive. Thus, for more speculative investors we think these stocks are worth considering.

Banking: Nigerians banks have continued to be resilient in the face of a harsh regulatory environment. Despite frequent CRR debits, LDR constraints and unfavourable yield environment, banks have turned to improved fee & commission income, gains on sale of investment securities and revaluation gains on net long FX positions to boost earnings. While most of the big banks (FUGAZ) are yet to publish their audited results, FBNH's positive H1 2020 results offered an indication of what to expect. Nevertheless, we recommend investors keep their focus on healthy dividend paying banks such as GTB, Zenith, UBA, Access and Stanbic. For risk-on investors, there are also small-cap banking stocks with attractive valuations and fair dividend yields (such as FCMB & Fidelity etc.) that are worth considering.

Investment & Non-Traditional Banking: Here stocks in this category are small-cap stocks but still do attract the attention of big-money investors. Our choicest picks are United Capital (UCAP) and Jaiz Bank due to the overly impressive H1 2020 performance. Jaiz Bank has been a big beneficiary of the recent Sukuk bond issuance from the Federal Government. Rental income (which are higher than typical government securities) on these assets have helped boost earnings. We note Jaiz Bank recently paid its first dividend to investors since its listing in 2017.

Food Processing: This sector (along with the oil palm sector) is the biggest beneficiary of the 2019 land border closure. With smuggling of sugar and flour largely curtailed, food processors like Dangote Sugar and Flour Mills have recorded a significant upturn in performances. Furthermore, they sell products that are not severely elastic and are gradually recovering control over pricing of their products. Thus, we expect these companies to continue to deliver healthy numbers through the year. In this sector, our favourite picks are Dangote Sugar and Flour Mills.

Cement: Cement producers are included on our list because their H1 2020 results confounded analyst expectations. Lafarge Africa and Dangote Cement produced healthy performance despite limited construction activities in Q2. While we think demand for cement may remain weak in the near term, we expect these companies (Lafarge and Dangote Cement) to post decent performance due to company specific events like cost-cutting measures & improving leverage position in Lafarge and tax advantages in Dangote cement.

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
GT BANK	23.60	34.40	16.70	57.00	0.85	3.4x	5.37	1.1x	1.57	11.9%
ZENITH BANK	16.95	23.00	10.70	34.20	5.30	2.5x	3.8x	0.6x	0.8x	16.5%
UBA	6.30	9.25	4.40	21.55	1.25	2.5x	3.0x	0.4x	0.5x	15.9%
FBN HOLDINGS	5.00	7.85	3.60	30.40	2.27	2.4x	6.5x	0.3x	0.4x	7.6%
LAFARGE AFRICA	11.75	17.60	8.95	114.25	7.80	8.2x	n/m	0.5x	2.2x	8.5%
DANGOTE CEMENT	136.90	180.40	116.00	290.00	86.36	11.2x	15.1x	3.2x	3.9x	11.8%
FLOUR MILLS	19.40	24.00	12.10	96.05	5.68	15.1x	8.7x	0.5x	0.6x	7.2%
OKOMU OIL	71.95	77.40	40.15	94.70	1.43	9.8x	8.9x	2.2x	2.3x	2.9%
MAY & BAKER	3.00	3.40	1.79	13.57	0.80	6.0x	n/m	0.9x	0.53	8.3%
FIDSON	3.15	4.50	2.21	9.55	0.61	9.3x	n/m	0.5x	0.66	4.7%
JAIZ BANK	0.59	0.82	0.34	1.47	0.34	n/m	n/m	1.1x	n/m	5.2%

Email: research@fsdhgroup.com • www.fsdhgroup.com