NAVIGATING HOPEFUL AMBIGUITY

CSL

2024 Outlook

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INVESTMENT SUMMARY

- FX regime changes and the elimination of the longstanding subsidy on Petroleum Motor Spirit (PMS) were the catalysts that initiated a series of events propelling the Nigerian equities market to an impressive 45.90% gain by the year's close. This marked the fourth consecutive year of positive returns for the market. Despite the strong macroeconomic headwinds that characterized the year, the reforms renewed investor confidence and resulted in massive revaluation gains for many banks. The positive momentum was further fueled by several corporate actions and expectations of renewed foreign inflows. The market has begun 2024 on a positive note and we believe the momentum can be sustained especially if the broader economy starts to realize gains from the implemented reforms.

- Generally, our 2024 economic forecasts paint a slightly better picture relative to 2023. We forecast GDP growth of 3.37%, up from 2.55% in 2023, driven by both the oil and non-oil sectors as we expect the oil sector to exit a 4-year recession in 2024. We anticipate an enhancement in oil production to reach 1.56 million barrels per day (mbpd) in 2024, driven by the government's proactive initiatives to reactivate inactive oil terminals and revive dormant oil wells. Despite the significant devaluation of the Naira in June 2023, we expect headwinds to the Naira to persist as foreign inflows remain uninspiring, and demand pressure remains heightened, but we do not expect as steep a devaluation as seen in 2023. We forecast the exchange rate at the I&E window will depreciate to N1016.20/US$ from a 2023 closing rate of 907.11/US$ but we expect the wide parallel market premium to persist.

- The Central Bank of Nigeria (CBN) maintained its hawkish stance throughout 2023, implementing a policy rate hike of 225 basis points, bringing it to 18.75%. The CBN governor has emphasized the necessity of a continued hawkish approach due to the prevailing inflation trajectory. Consequently, we anticipate a potential increase of 100-200 basis points in the first half of 2024, followed by a decision to hold the rate steady in the second half of the year. In 2024, we expect inflation to average 22.22%, slightly lower than 24.52% in 2023. Our disinflation expectation largely emanates from a favorable base effect and the decelerating impact of energy and currency pressures. In terms of the external sector, the current account is projected to remain positive, settling at 0.80% of GDP in 2024.

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In 2024, Nigeria appears poised to realize its goal of achieving self-sufficiency in the local oil refining sector. This optimism stems from the commencement of operations at the Dangote refinery, the successful refurbishment of the Port Harcourt refinery, and the completion of several modular refineries. While the attainment of self-sufficiency may not lead to a substantial reduction in the cost of petrol, However, sufficient local refining capacity and potential for export should enhance the availability of the product and have a positive impact on foreign exchange (FX) liquidity.

News of attacks on some villages in Plateau state during the Christmas festivities and kidnappings at the start of the new year suggest the high level of insecurity in the country will remain a theme in 2024 and continue to have severe negative implications for investment flows and food supply. From nomadic Fulani Herdsmen killings to Boko Haram/ISWAP insurgency, to kidnappings and IPOB-related activities in the southeast regions, it is likely that Nigeria will grapple with problems of insecurity in 2024.

The disposable income of the average Nigerian has faced substantial pressure in recent years, exacerbated by the subsidy removal and currency depreciation implemented last year. Anticipated hikes in utility costs, particularly in electricity and fuel, are expected to further constrain the consumer wallet in 2024. This scenario is likely to impact the earnings of consumer goods companies. While the private sector implemented wage increases in 2023, and the government is set to follow suit in 2024, these expected raises may not sufficiently alleviate the challenges posed by the rising cost of living. The increases in wages are anticipated to be overshadowed by the broader and more significant surge in living costs.

In recent years, foreign investors have displayed a lack of enthusiasm towards Nigerian equities, and we do not anticipate a significant resurgence in their participation this year. This sentiment is likely to persist until there is a notable improvement in clarity and transparency within the foreign exchange market. As of November 2023, total market transactions amounted to N3.2 trillion, with a substantial 88.8% attributed to domestic investors, leaving foreign investors with only 11.2% contribution. However, we acknowledge the potential for a shift in this trend towards the latter part of the second half of the year. This could be prompted by positive outcomes from the Tinubu reforms and a reduction in foreign exchange tensions.

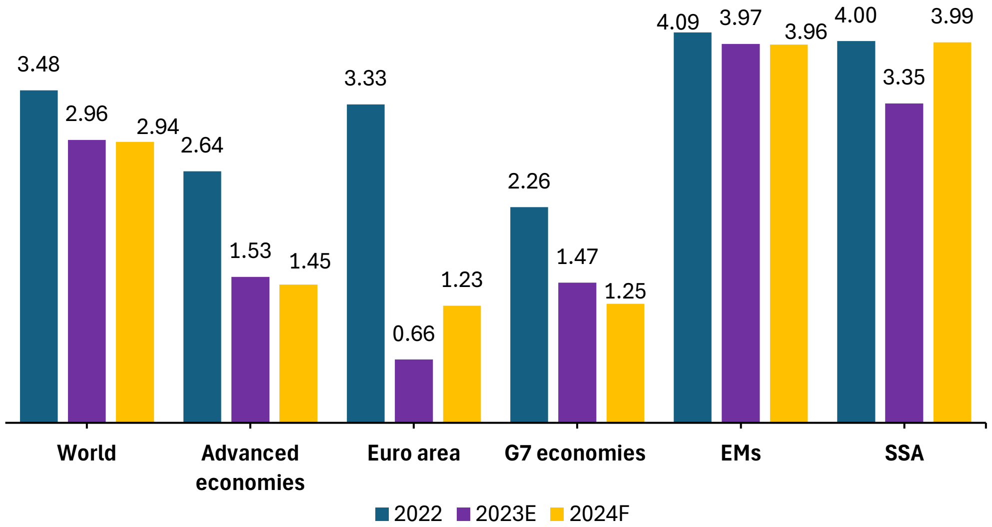
We see the equities market heading for another positive close in 2024 but we struggle to see the NSE's 2024 returns matching those of 2023. Pricier equity valuations (particularly for the more liquid stocks) will most likely undermine the attractiveness of quoted stocks and potentially limit upside movements in the index. Valuations of many stocks are stretched in our view, given 2023's steep price appreciations. Nevertheless, we believe the market has yet to fully recognise the mid to long term earnings potential of Access (Buy), GTCO (Buy), Zenith (Buy), UBA (Buy), MTNN (Buy), Guinness (Buy), Okomu (Buy), Flourmills (Buy) and Nestle (Buy).

For the fixed income market, in 2024, our expectation is for rates to trend higher, as the CBN governor has guided that the current inflation trajectory requires further tightening. In addition, the liquidity narrative also strengthens our prognosis. For context, save for March 2024, when we are expecting bond maturities of c.N720.0 billion, liquidity will likely remain low in the year, fanning higher yields. To wit, we expect the 365-day NTBs and the 10-year Bond market yield to settle at 10.5% and 16.0% by year-end.

GLOBAL ECONOMY REVIEW AND OUTLOOK

Global Economy: growth to remain constrained

Weaker growth expectations for 2024

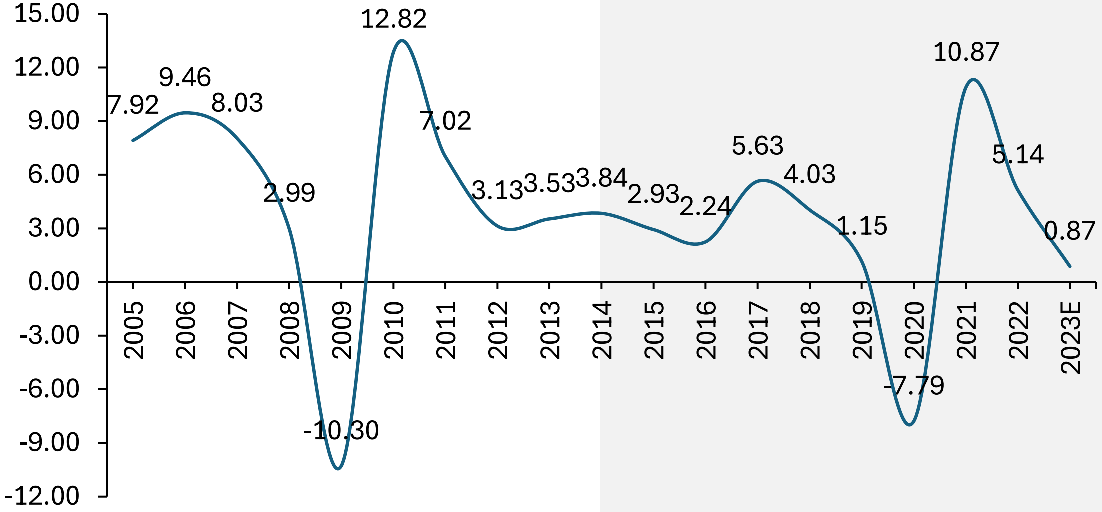


- The global economic landscape experienced sustained weakness in 2023, influenced by the impacts of stringent monetary policies, constrictive financial conditions, and weak global consumption. Though the US economy surprised positively due to the resilient job market, inherent weakness in China, due to the property market crises, and weaker-than-expected outturn in Europe dampened sentiments.

- Consequently, the IMF projected growth to settle at 2.96% for 2023 from 3.48% in 2022, with the biggest growth moderation expected from the advanced economies.

- The weakened economic momentum was also evident in global trade, owing to squeezes in household spending in Europe and uninspiring industrial activities in China.

Global trade was depressed in 2023



- Following a notable slowdown in 2022 and a subsequent downturn last year, the trajectory of global output growth is poised to diminish in 2024, marking the third consecutive year of deceleration. The recent conflict in the Middle East has heightened geopolitical uncertainties and increased volatility in commodity markets, potentially adversely affecting worldwide growth.

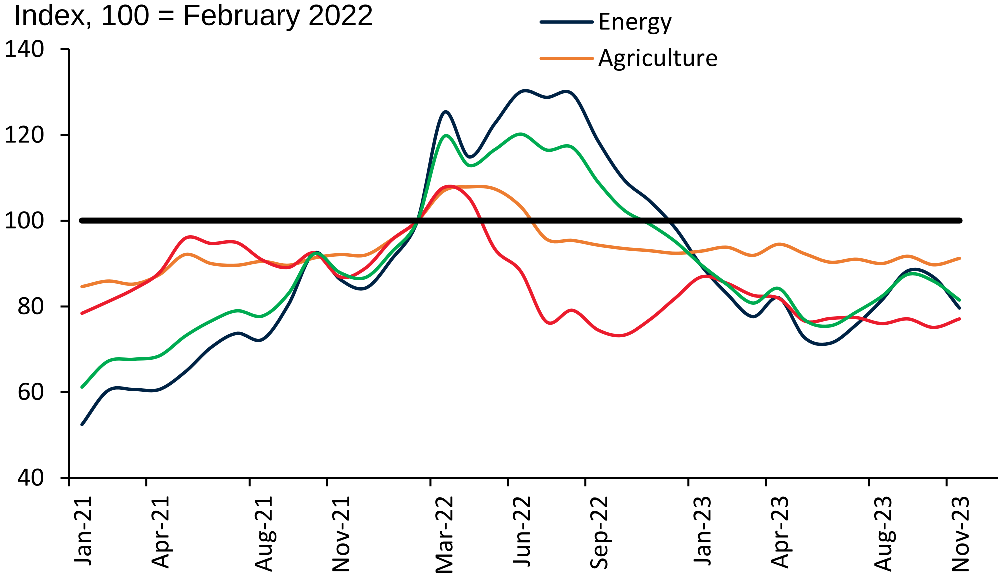
- The Chinese market is expected to face challenges stemming from a consumption slowdown, persistent pressures in the property market, and an increase in local government debt. The US economy could also struggle slightly in 2024, reflecting expected softening in labour markets, reduced savings buffers amassed during the period of the coronavirus pandemic, and the lagged effects of monetary tightening.

- In light of the above, global growth is projected to print 2.94% in 2024, almost at par with the 2.96% recorded in 2023.

Sources: IMF, World Bank, CSL Research

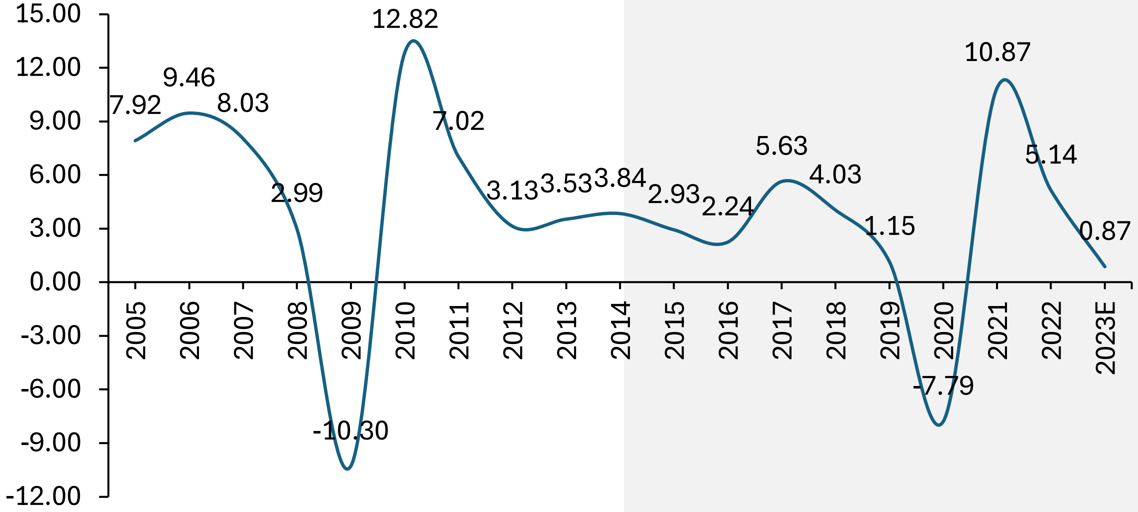
Global Inflation: Price continues to moderate

COMMODITY PRICES



Sources: NBS, IMF, World Bank, CSL Research

Inflation to further moderate in 2024



Sources: NBS, IMF, World Bank, CSL Research

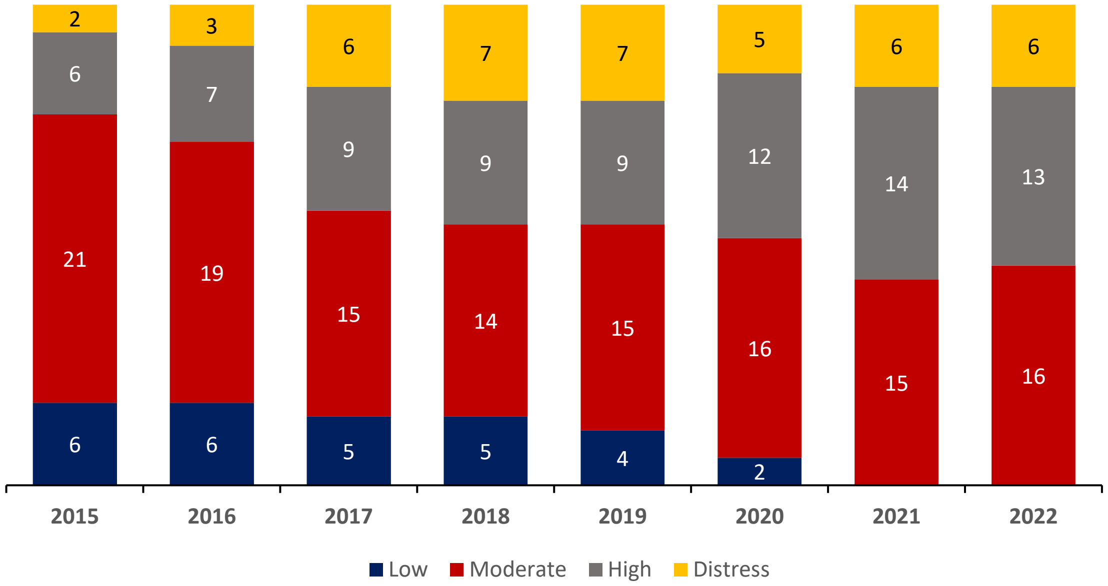
- Global inflation continued its descent in 2023, largely on the back of moderating commodity and food inflation. For example, crude oil prices moderated from US$100.00/bbl in 2022 to an average of US$80.00/bbl in 2023, reflecting OPEC's deepened and extended production cut. In addition, other commodities like natural gas and metals also witnessed a material price moderation in the review period.
- In addition, slower global domestic demand due to the monetary tightening and protracted slowdown in China also helped provide some comfort for prices. We expect prices to continue to moderate in 2024, largely aided by most of the 2023 factors.

- The dissipating inflation has fueled the optimism that global monetary authorities will likely pivot in 2024 by adopting a dovish stance. In fact, according to the World Interest Rate Probability (WIRP), as captured by Bloomberg, market consensus is expecting rate cuts as quickly as the first quarter of 2024.
- In our perspective, considering that inflation remains significantly higher than pre-pandemic levels and exceeds the inflation targets set by numerous developed countries, maintaining policy rates seems more prudent than opting for rate cuts. We believe that we are more likely to see a rate cut if any in the second half of the year.

SUB-SAHARAN AFRICA REVIEW & OUTLOOK

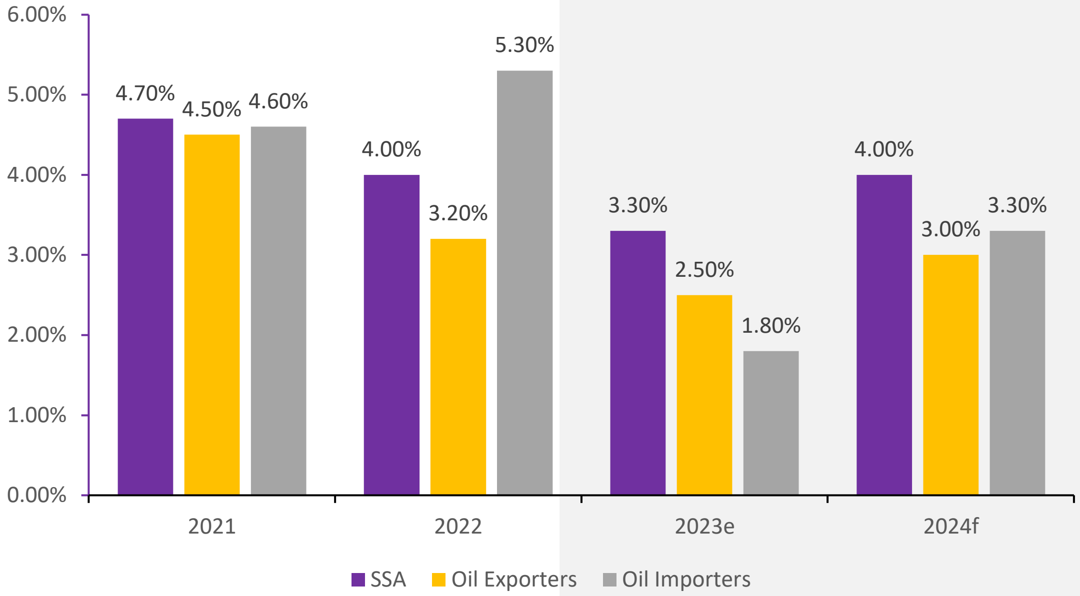
GROWTH TO GATHER PACE IN 2024

INCREASING RISK OF DEBT DISTRESS IN THE SSA REGION



Sources: IMF, World Bank, CSL Research

Growth outlook for the African region



Sources: IMF, World Bank, CSL Research

- In 2023, the ongoing need for external assistance in the Sub-Saharan Africa (SSA) region was primarily driven by the lingering effects of the pandemic and the consequent increases in the cost of living. A number of nations in the region are grappling with substantial import bills, escalating debt levels, and growing debt-service obligations. Tightened external financing conditions, coupled with reduced donor support in several nations, have compounded the challenges of meeting financial demands, heightening fiscal risks.

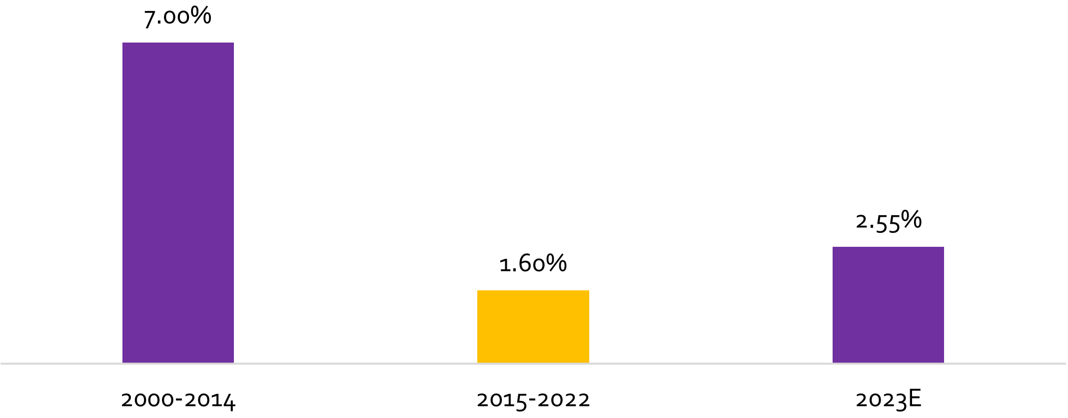
- According to the IMF, over 20 countries within the SSA region were in distress or at a high risk of debt distress as of the end of 2022. We believe the number must have increased in 2023, following defaults from Ghana and Ethiopia.

- Despite rising conflict across the region fueling economic fragility, the reduction in inflationary pressures and recovery in exports bode well for the outlook. IMF forecasts growth to settle at 3.99% in 2024 from 3.35% in 2023.

DOMESTIC ECONOMY REVIEW & OUTLOOK

GDP: Consolidating on Reforms for Long-Term Gain

Embattled growth in 2023



Sources: NBS, CSL Research

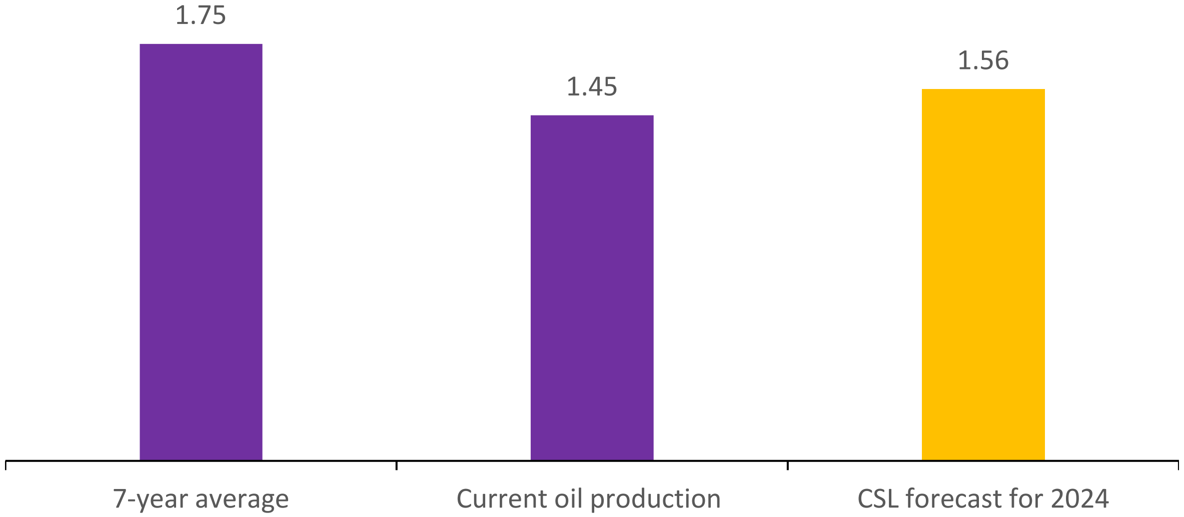
- In the last 8 years, the Nigerian economy has been embattled, stemming from external shocks and weak political will to implement necessary economic reforms.
- 2023 ushered in a new set of reforms (discontinuation of subsidy and currency unification), the first in many years. These reforms could offer some renewed hope for the economy in the long run, but not without short-term brunts, as economic activities slowed materially in 2023.
- Other downsides to growth in the review period were the Naira redesign in the first quarter of 2023 which led to a cash crunch, and electioneering activities.
- In the light of the above, we project 2.55% real GDP in 2023.

2022	2023
Real GDP 3.10%	Real GDP 2.55%
Oil GDP -19.22%	Oil GDP -1.77%
Non-oil GDP 4.84%	Non-oil GDP 2.81%
Agric GDP 1.88%	Agric GDP 0.82%
Manufacturing GDP 2.45%	Manufacturing GDP 1.44%
Services GDP 6.66%	Services GDP 4.02%

Sources: NBS, CSL Research

GDP: Consolidating on reforms for long-term gain

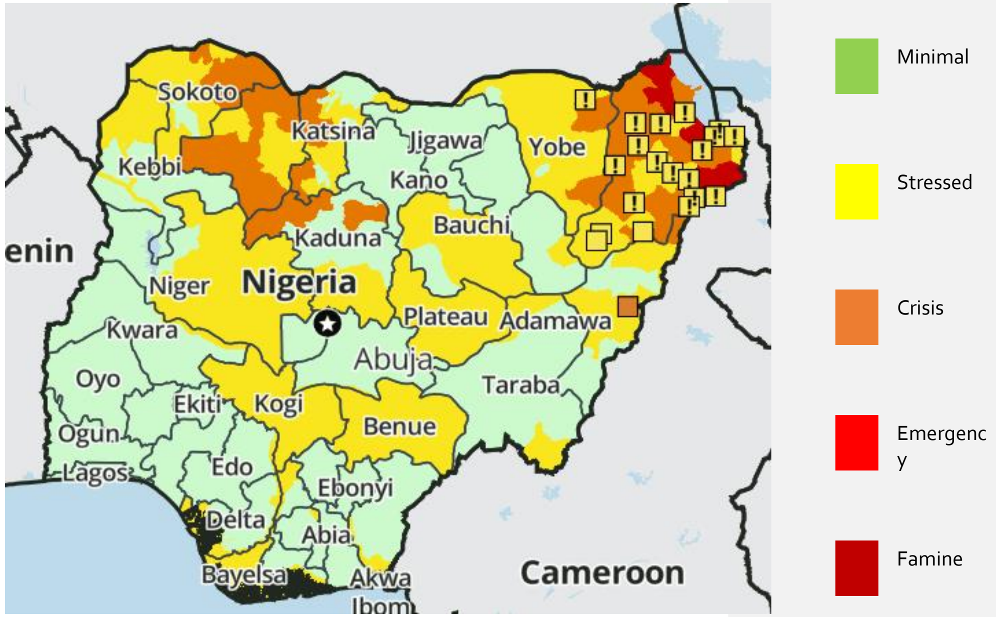
4 years of recession, any glimpse of hope for the oil sector in 2024?



Sources: NBS, FEWSNET, CSL Research

- The oil sector remains in recession, as underinvestment and elevated theft have squeezed Nigeria's oil output from around 2mbpd five years ago to about 1.45mbpd in 2023..
- In our assessment, it appears that the oil sector has reached a bottom, and there are indications of potential growth in 2024. We anticipate an enhancement in oil production to reach 1.56 million barrels per day (mbpd) in 2024, driven by the government's proactive initiatives to reactivate inactive oil terminals and revive dormant oil wells. Our overall projection suggests a 6.90% growth in the oil sector for 2024, marking a notable improvement compared to the 4-year average of -9.55%.
- In the medium term, the Nigeria Upstream Petroleum Regulatory Commission (NUPRC) has set an ambitious plan of 2.6mbpd by 2026. If achieved, this could define oil growth and possible FX inflows.

Nigeria acute food insecurity

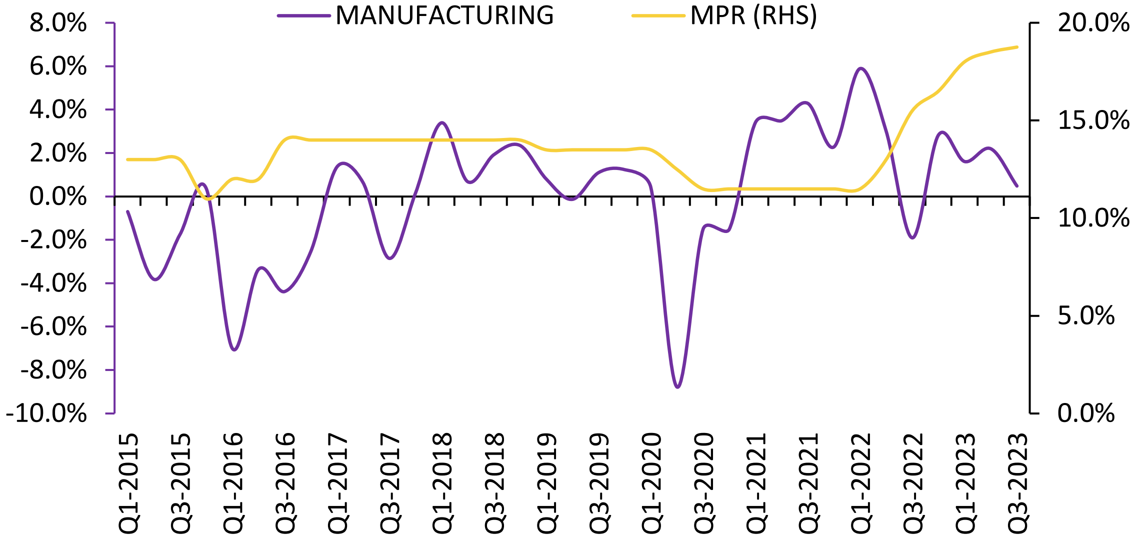


Sources: NBS, FEWSNET, CSL Research

- Agric output slumped to an all-time low in 2023 largely on the back of the naira redesign and idiosyncratic risks like insecurity, weak rainfall and high input cost.
- In 2024, we expect the sector's growth to improve, aided largely by base effect and improved rainfall conditions. We forecast growth of 1.62% in 2024 from 0.82% in 2023.
- The downside risk to our outlook is the CBN's decision to stop all developmental finance, of which over 30.0% is skewed towards the Agric sector.

GDP: CONSOLIDATING ON REFORMS FOR LONG-TERM GAIN

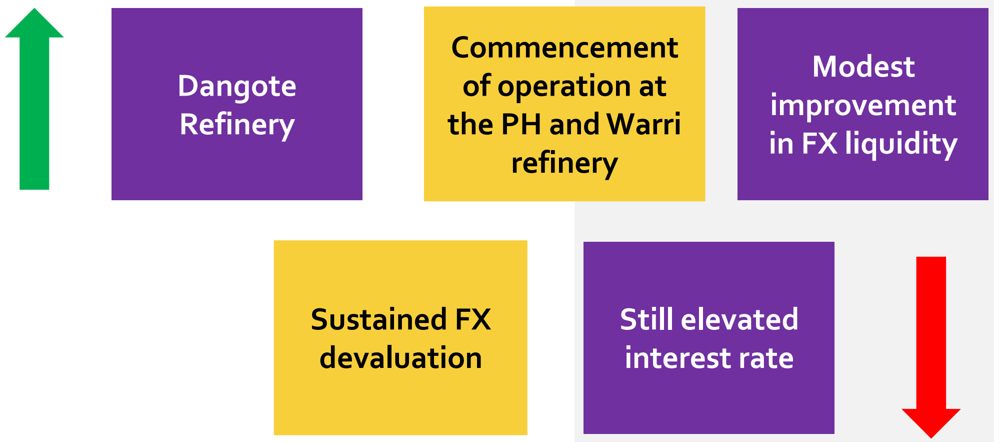
WEAKER CURRENCY AND ELEVATED INTEREST RATES CAPPED THE MANUFACTURING SECTOR'S GROWTH



Sources: NBS, CSL Research

- The manufacturing sector was rattled by troika factors in 2023. First, the 49% (June-December 2023) currency devaluation by the CBN and FX scarcity dampened the import capacity of the manufacturing sector. For context, we highlighted that about 60.0% of companies on the NGX30 have significant FX needs either for import or foreign debt services. In fact, FMCGs (over half of the manufacturing sector) were badly beaten, with many of the listed players recording a negative equity position after the devaluation.
- Secondly, in 2023, interest rates reached unprecedented levels, leading to elevated finance costs for numerous manufacturing companies. Additionally, the high borrowing costs significantly constrained the expansion of manufacturing activities.
- Thirdly, inflation introduced an additional layer of pressure, as diminished purchasing power resulted in lower sales volumes and output. Consequently, we anticipate manufacturing growth to stabilize at 1.44% in 2023.

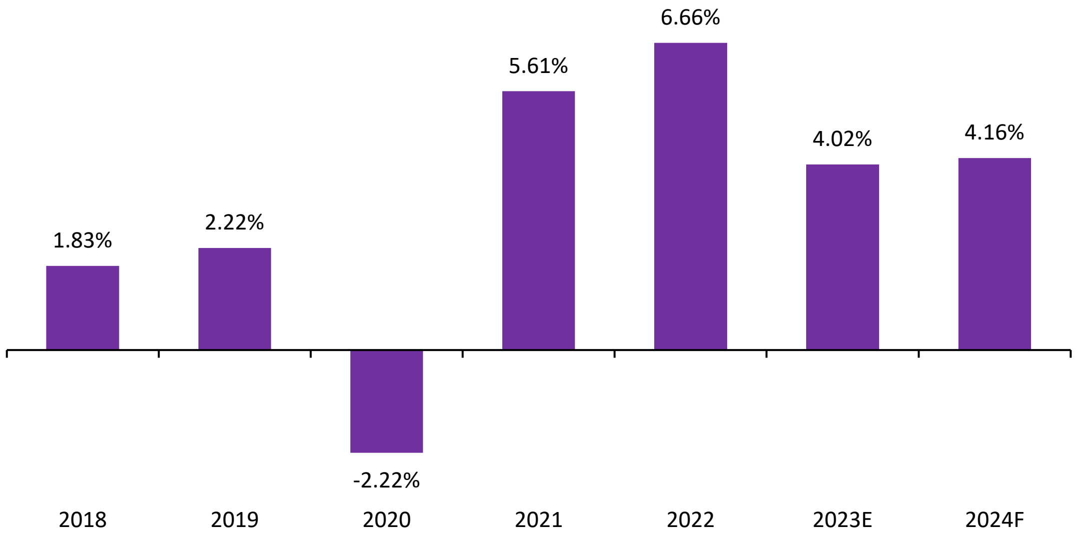
Drivers of the manufacturing sector in 2024



- In 2024, we are optimistic about the manufacturing sector, largely stemming from the commencement of the Dangote refinery. The facility could add over 0.7% to the GDP of Nigeria and save the country about US$8.00 billion annually in FX.
- In addition, we see legroom for higher oil refining, as the 60,000 barrels Port Harcourt Refinery is anticipated to come on stream in the first quarter of 2024. Also, mechanical completion of the 125,000 barrels Warri Refinery has been slated for Q1-2024 and operation will begin fully in Q2-2024. That said, we are quite skeptical about the ability of these refineries to produce given several previously failed resuscitation attempts.
- We forecast 2.01% for the sector in 2024 from 1.44% in 2023.

GDP: Consolidating on reforms for long-term gain

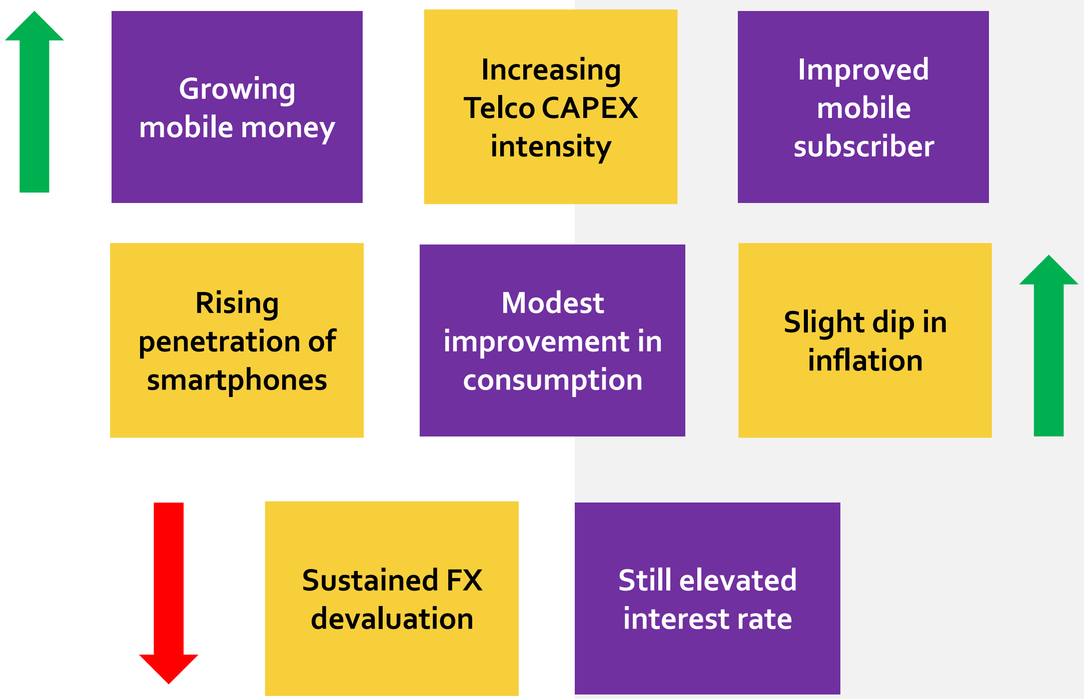
Services growth to remain stable in 2024



Sources: NBS, CSL Research

- The services sector is projected to remain relatively stable, improving in 2024 to 4.16% from 4.02% in 2023. We expect the sector's biggest value to skew from the ICT sector, profiting from the uprise of payment service banks (PSB) activities, rising penetration of smartphones and sustained traction for data and voice services.
- Elsewhere, we expect improvement in the trade sector, as slightly lower inflation and improved cross-border trade bodes well for outlook.
- On the downside, we expect the still elevated interest rate environment to continue to dissuade activities in the real estate sector.

Drivers of the Services sector in 2024



GDP: Consolidating on reforms for long-term gain

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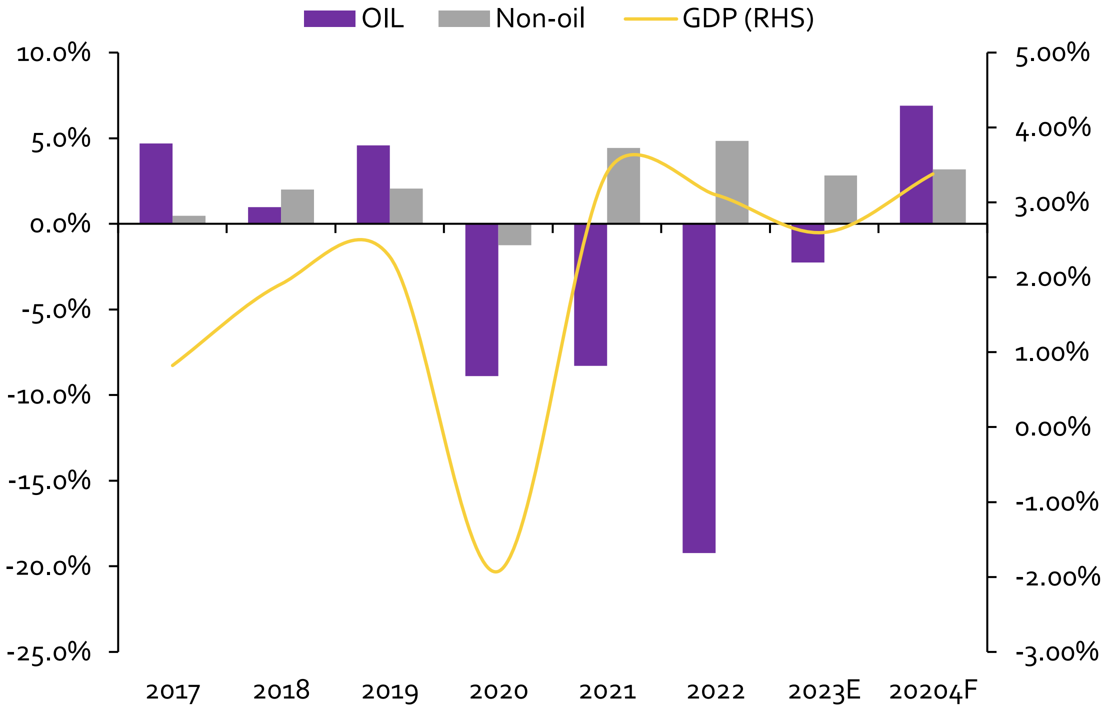
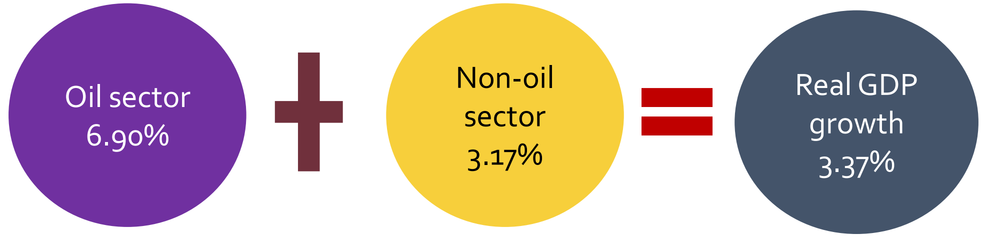
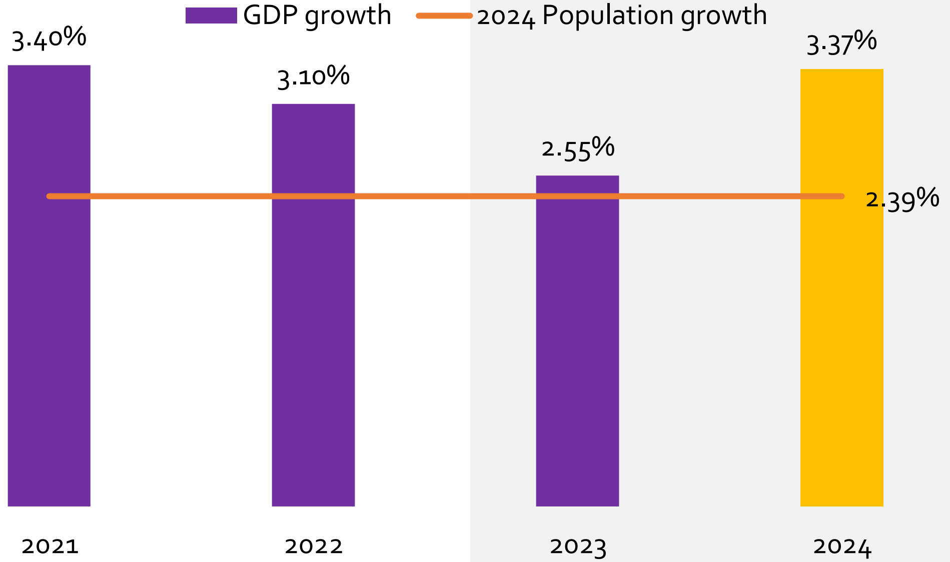
GDP to improve to 3.37% in 2024 from 2.55% in 2023

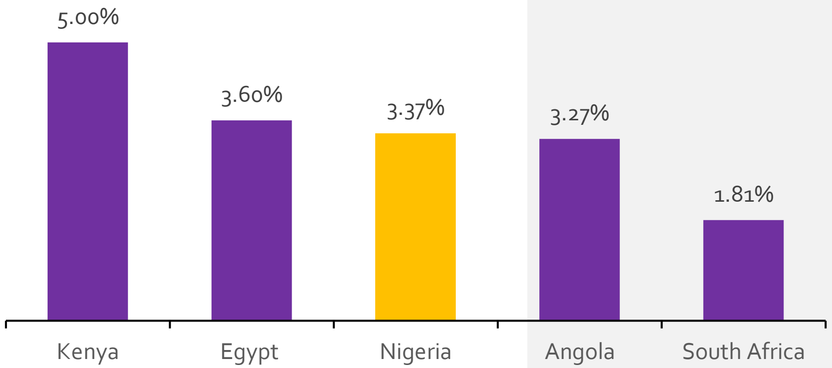




Sources: NBS, CSL Research

Nigeria's Real GDP growth rate outpaced population growth, strengthening the country's GDP per capita



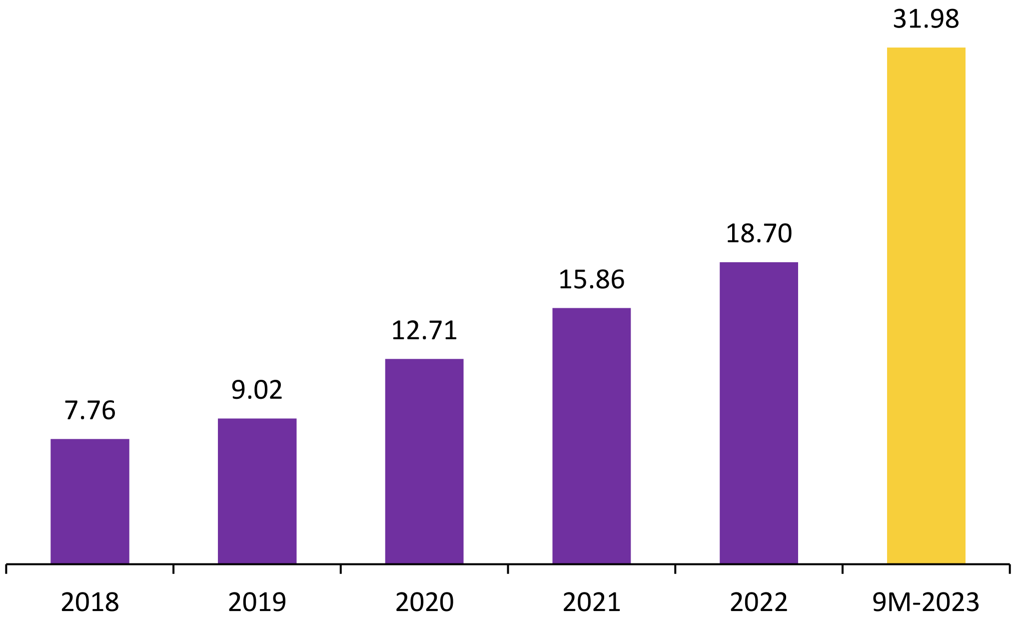


Nigeria's 2024 GDP compared to African peers

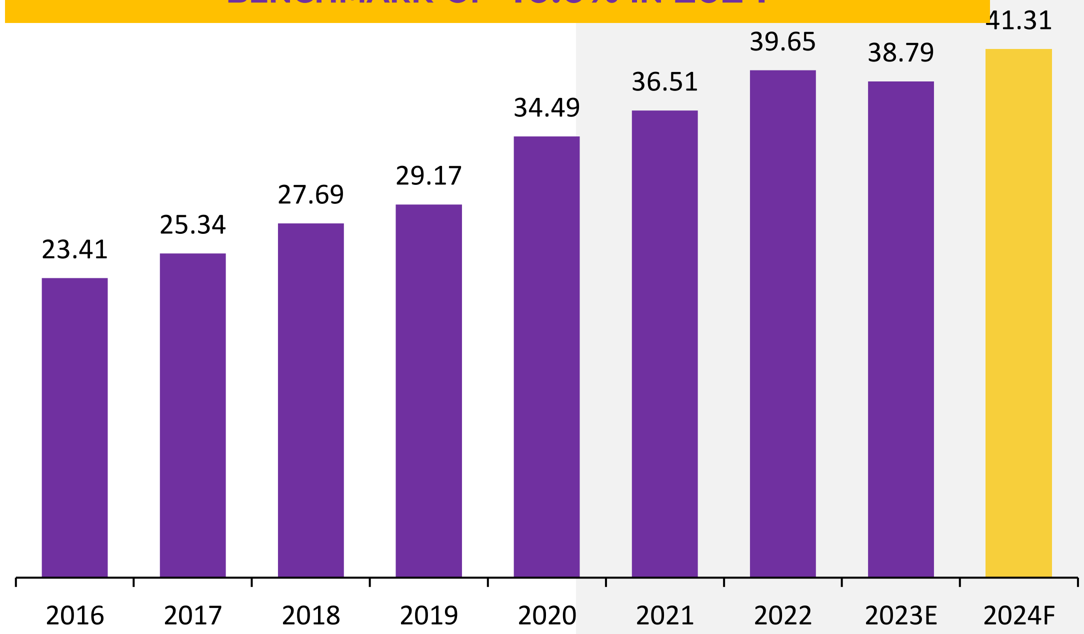
Sources: WB,NBS, CSL Research

Fiscal Position: A call for fiscal prudence and accountability

Rising debt level (N' trillion)



Debt/GDP will likely surpass the DMO benchmark of 40.0% in 2024



The rising debt level reflects the securitization of Ways and Means facility

The impact of currency devaluation also added another layer of pressure on debt

Debt-to-GDP could cross the 40.0% benchmark set by the DMO

IMF still views Nigeria's debt sustainable, with minimal risk of default

Sources: NBS, CSL Research

Fiscal Position: A call for fiscal prudence and accountability

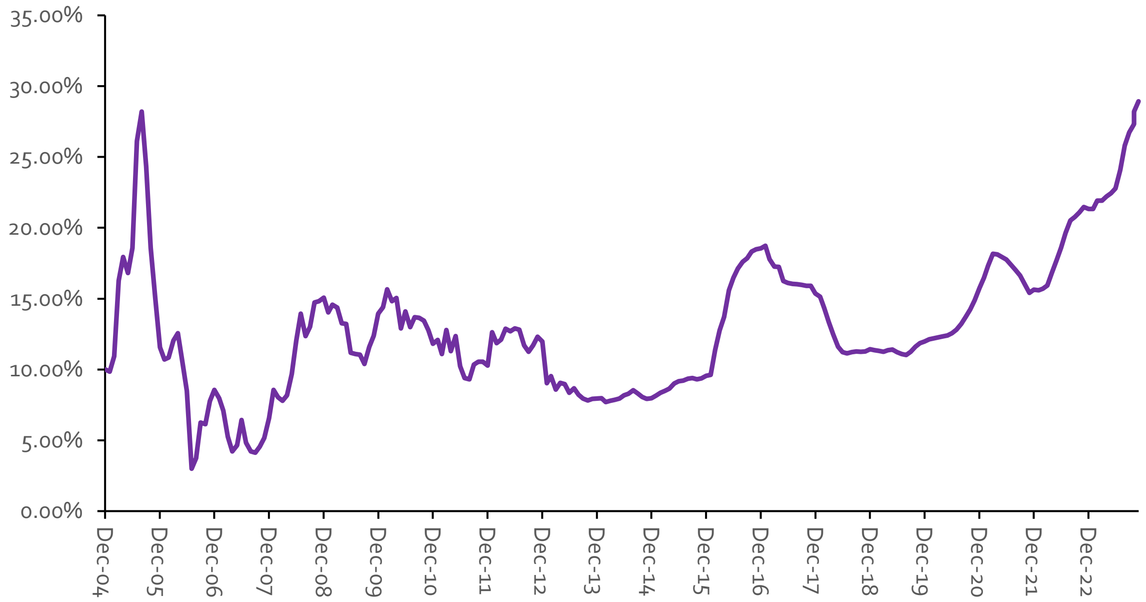
Fiscal balances (N' trillion)	2024 Proposed Budget	2023 Budget
Total Expenditure	**(27.50)**	**(24.80)**
Recurrent non-debt	(9.90)	(9.30)
Debt service	(8.30)	(6.30)
Capital expenditure	(8.70)	(7.30)
Others	(0.60)	(1.90)
Total Revenue	**18.30**	**11.10**
Oil-related sources	7.90	2.30
Non-oil tax revenue	3.50	2.40
Others	6.90	6.30
Fiscal Deficit	**(10.50)**	**(13.80)**
Fiscal Deficit (% of GDP)	**4.60%**	**5.10%**

Sources: NBS, CSL Research

- Recurrent non-debt expenditure (34.44% of total proposed spending) was up by 6.44% y/y, reflecting higher provisioning for personnel costs, which may be linked to a potential increase in the minimum wage.
- Debt servicing cost continues to rise, partly due to the weaker currency on external debt financing and the still elevated interest rate environment.
- With higher CAPEX provision for 2024, it appears that the government intends to improve infrastructure development and construction projects.
- On the revenue front, the government is pushing for higher oil revenue, with the budget premised on a 1.78mbpd oil output and oil price benchmark of US$77.96/barrel. We believe the oil estimate is ambitious, given that oil production remains constrained by theft and Nigeria might not be able to pump oil beyond 1.56mbpd in 2024.
- We are optimistic on taxes, aided by buoyant economic momentum, increasing tax mobilization initiatives, clamp down on tax evasion, and enhanced transparency in the tax system.
- Elsewhere, we expect other revenues (independent revenue, dividends, share of minerals & mining, and other sources of financing) to come in lower than the government expectations based on historical data.

Inflation: Slight moderation expected in 2024

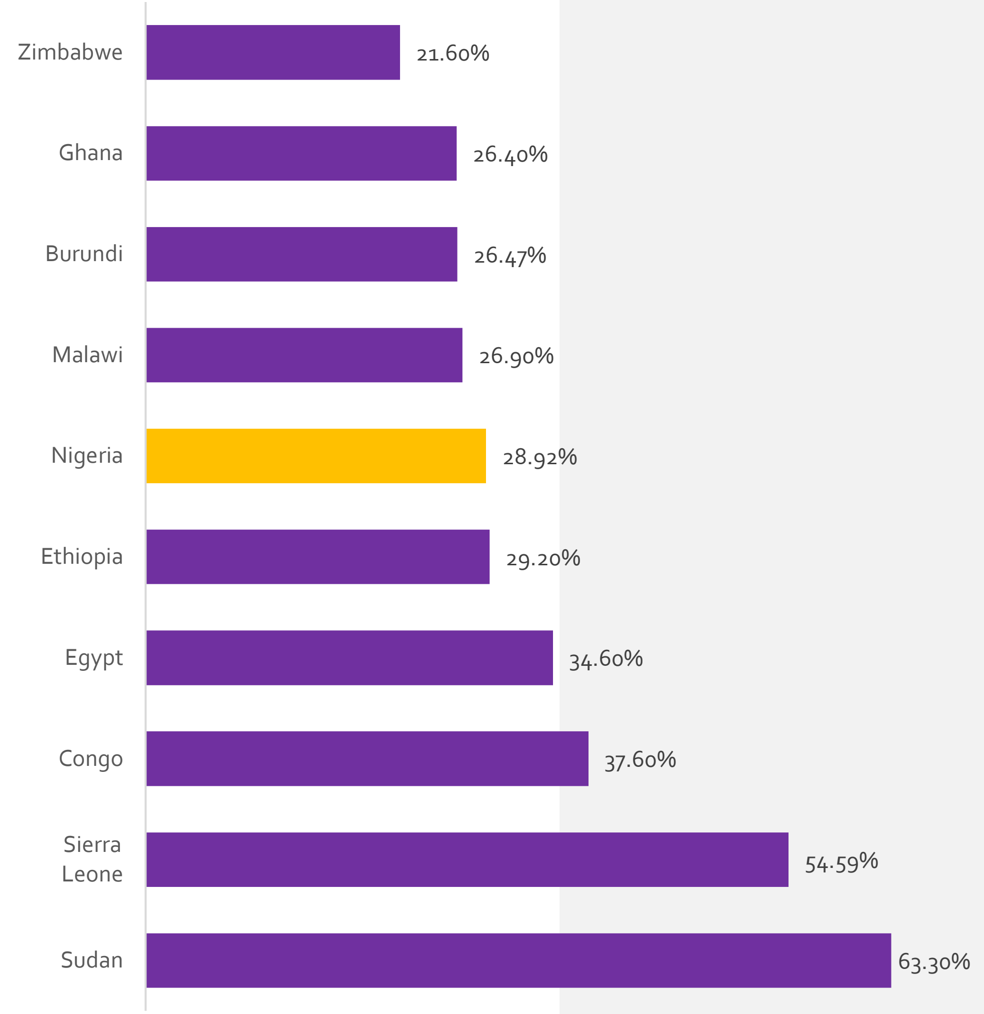
Inflation touched new highs in 2023



- Inflation in 2023 scaled to an 18-year high, largely on the back of reforms – 49% currency devaluation and subsidy removal – initiated by the new administration. More pressures also stemmed from the below-average rainfall and lingering security challenges in the food-producing states.
- According to the World Bank, due to the elevated inflation, the number of poor people rose from 79 million in 2018 to 104 million in 2023, with urban poor—more exposed to inflation—increasing from 13 to 20 million, while the number of poor people in rural areas increased from 67 to 84 million.

Sources: NBS, CSL Research

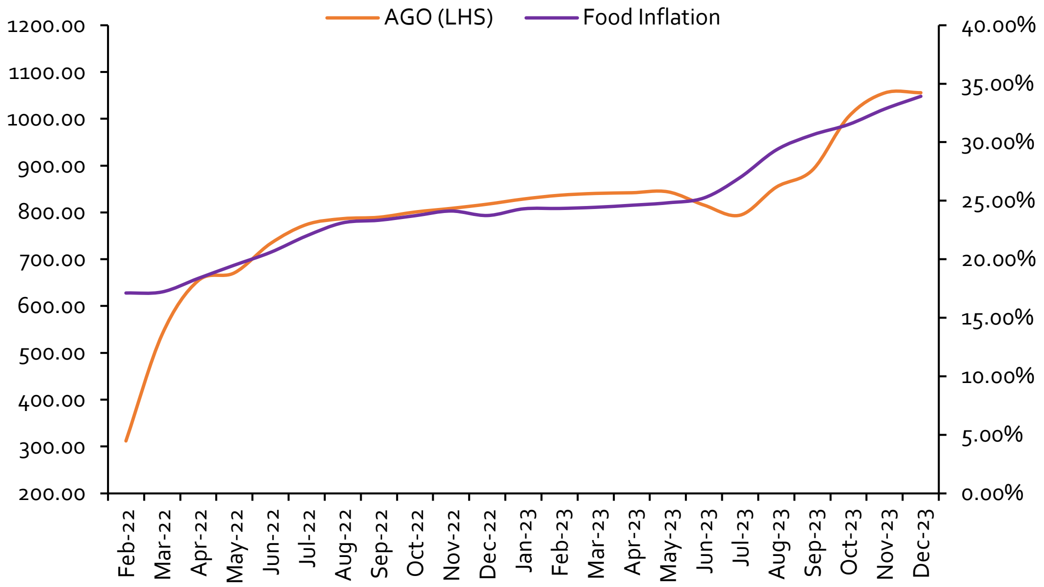
Nigeria has one of the highest inflation rates in the African region



Sources: Bloomberg, CSL Research

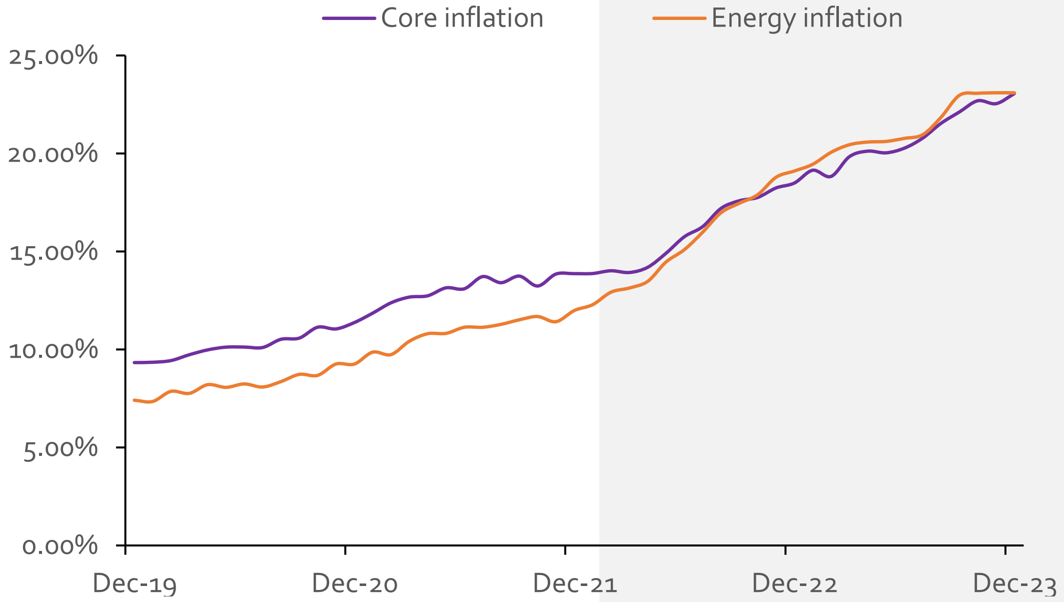
Inflation: Slight moderation expected in 2024

Food inflation scaled the most in 2023



Sources: NBS, CSL Research

Core inflation soared on energy cost pressures



Sources: NBS, CSL Research

- Food inflation jumped by 10.18ppts to 33.93% in 2023, reflecting risks like insecurity and high input costs. On the latter, Nigeria primarily relies on imports of Muriate of Potash (MOP), a crucial ingredient for blending agricultural inputs, which is sourced from Russia. However, due to the web of sanctions imposed on Russia, this essential supply chain has been disrupted.

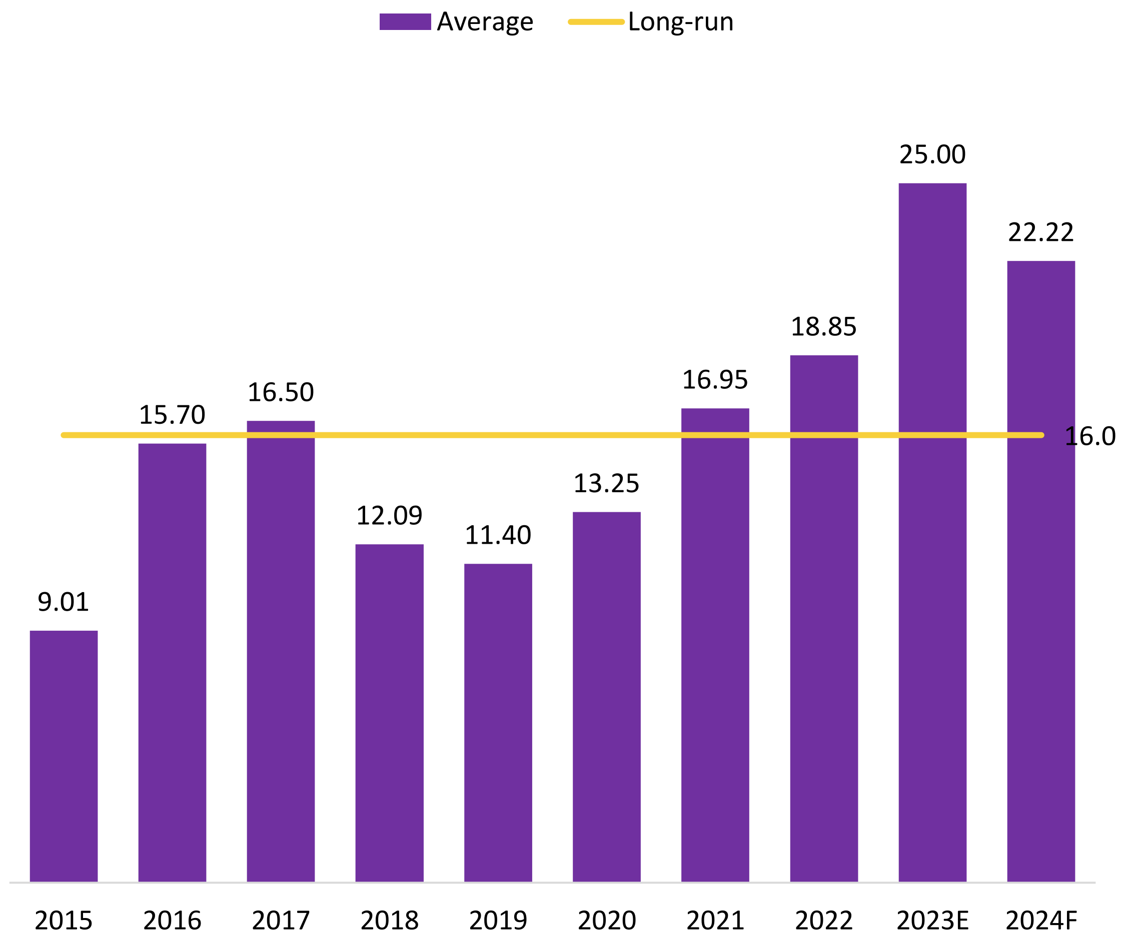
- Another layer of pressure stemmed from the elevated AGO prices, which touched an all-time high. From our research, we understand that most types of Agric equipment and trucks are AGO-powered.

- The core inflation was also pressured in the review period, up 4.9ppt to 23.06%. The outturn stemmed largely from the material jump in PMS prices following the subsidy discontinuation by the government. The subsidy removal, coupled with elevated AGO prices, negatively impacted the energy inflation and Housing Water, Electricity, Gas and Other fuels (HWEGF).

- Furthermore, the 49% currency depreciation in the NAFEM window added another pressure on the core basket.

Inflation: Slight moderation expected in 2024

Trend of Nigeria's average inflation (%)



Outlook for 2024

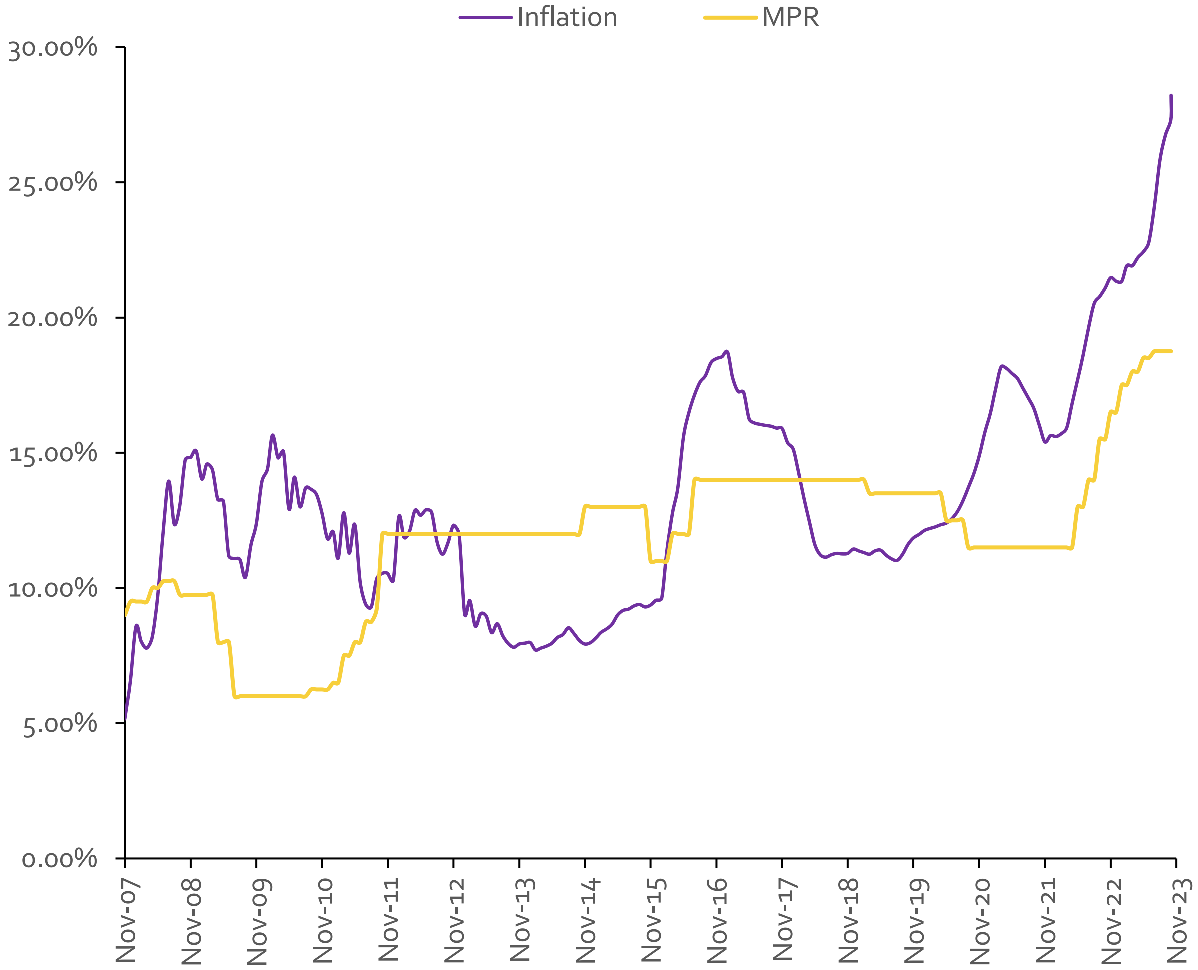
- In 2024, we expect inflation to average 22.22%, slightly lower than 24.52% in 2023. Our disinflation expectation largely emanates from the base effect and the decelerating impact of energy and currency pressures.
- Despite the observed moderation, our expectations for inflation remain significantly higher than the long-run inflation average of 16.0%. This suggests that the Central Bank of Nigeria (CBN) may need to implement additional measures to exert downward pressure on prices.

Upside risk to our outlook

- The implementation of a new minimum wage by the federal government could boost consumption and translate into higher prices. However, this prognosis is arguable, as our model suggests there has been a weak correlation of only 0.28 between inflation and changes in income between 2011 and 2023. Our view is consistent and corroborated by the result from a regression model, whose t-test shows that higher wages do not translate to higher inflation.
- Another upside risk is the likely increase in electricity traffic due to the lack of a cost-reflective electricity tariff and electricity subsidy, which cost Nigeria c.N375.8 billion as of 9M-2023. In our view, we see little legroom for higher prices, as the NERC has dispelled electricity tariff hike rumours.
- Despite the fluctuations in global oil prices and pressure at the FX market, PMS has been relatively stable, suggesting partial subsidy might still be in place. If the government increases PMS prices in 2024, we see a pass-through to inflation.

Monetary Policy: The return to orthodoxy

Inflation and MPR



Sources: NBS, CBN, CSL Research

- ❑ On the back of the rising inflation, the CBN has aggressively hiked the monetary policy rate in the last 2 years. Following the appointment of the new CBN governor, there has been the adoption of more tightening measures, such as removing the cap on banks' SDF deposits and increasing the volume and rates of OMOs.

- ❑ The CBN governor has guided that the current inflation trajectory requires further hawkish rendition. Hence, we see legroom for about a 100-200bps hike in the first half of the year before a hold stance in the second half of the year is considered.

- ❑ The CBN has also signaled an end to all developmental finance, refocusing on lower and stable inflation, with plans to adopt an inflation-targeting strategy.

- ❑ In addition, the CBN has clearly stated the need to improve MPR transmission, which explains the recent use of traditional monetary policy tools in contrast with the unorthodox measures adopted by the prior administration.

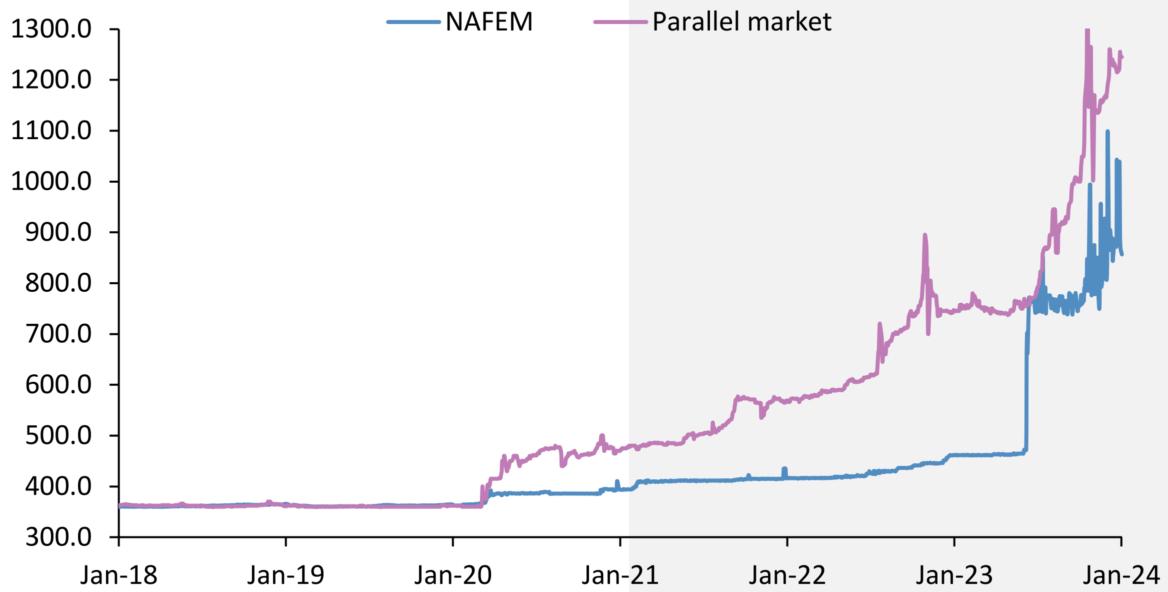
FX: Liquidity will likely improve in 2024, as CBN began clearing backlogs

Current account in the positive territory

- Despite the limitations on oil production, Nigeria's current account has stabilized in positive territory, supported by the ongoing high oil prices. Additionally, the decrease in imports has contributed positively to the external position. We believe that the substantial devaluation by the CBN, along with elevated interest rates, may have adversely affected the import capacity of businesses.

- The current account is projected to remain positive, settling at 0.80% of GDP in 2024. Our prognosis is supported by improved oil production and still elevated oil prices (IEA forecast of US$82.0/bbl), which bode well for export. Conversely, imports could be lower, aided by reduced PMS consumption following the PMS subsidy removal.

Parallel market premium subsist in the FX market



- A mix of PPP and IRP, currency valuation methods indicates that Naira will likely depreciate by 12.01%, closing the year at N1016.12/$.

- We expect improved FX liquidity in 2024, aided by anticipated inflows from the World Bank, and proceeds from dividend securitization from the NLNG.

- Furthermore, in the last 3 months, the CBN has paid about US$2.00 billion of the US$7.00 billion outstanding FX forwards. This commitment of the CBN to clear all backlog could send strong signals to foreign investors and improve FPI inflows by year end.

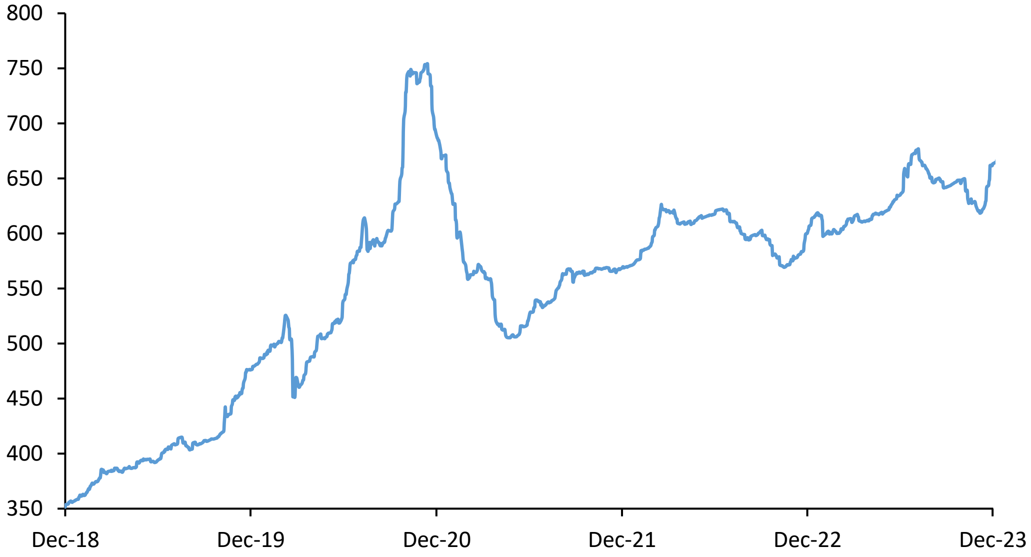
Sources: NBS, CBN, IMF, CSL Research


FIXED INCOME

Fixed Income: Legroom for higher yields

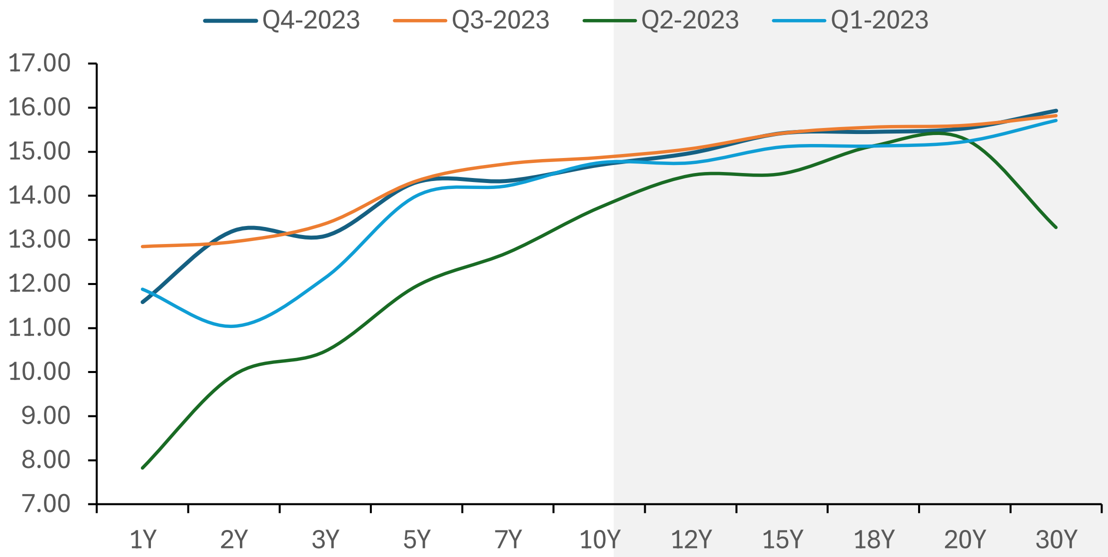
CSL

S&P/FMDQ BOND INDEX



Sources: CBN, IMF, CSL Research

THE NIGERIA YIELD CURVE

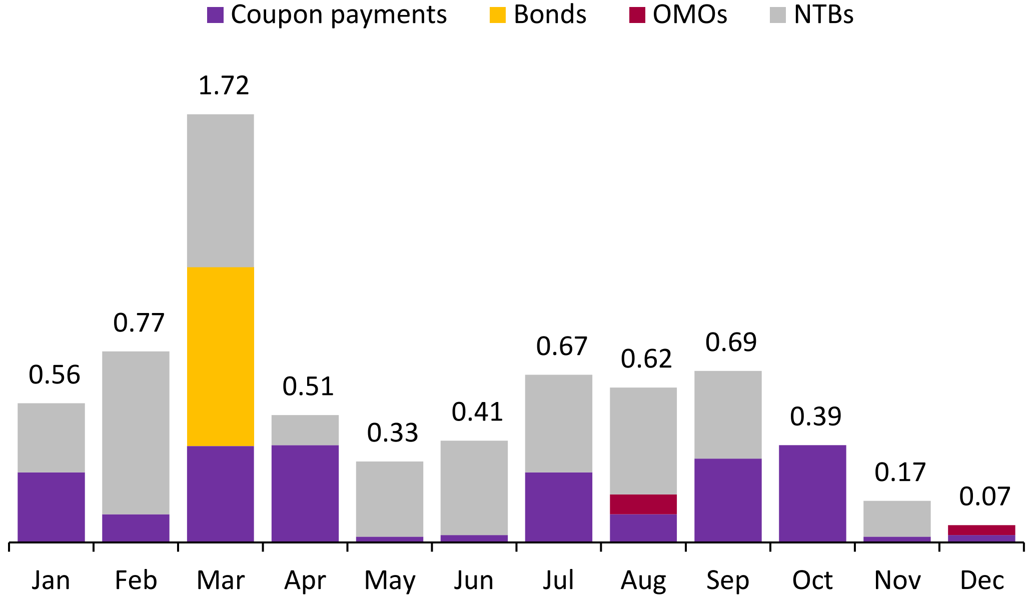


Sources: CBN, IMF, CSL Research

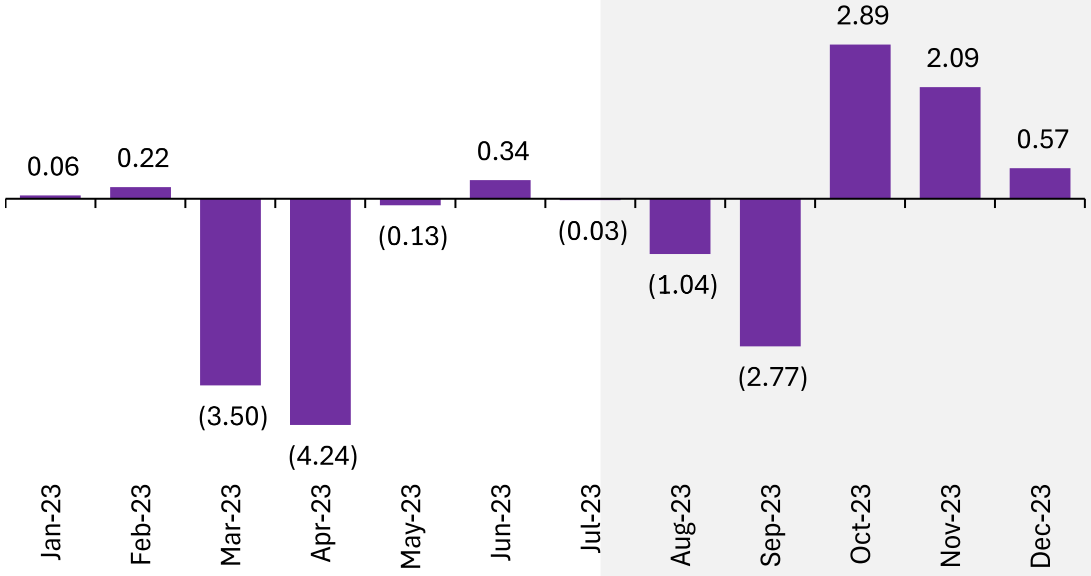
- The Nigerian fixed-income market traded with a bearish bias for most of 2023, as the average yield across the curve increased by 1.54bps. At some point in 2023, the yield curve was inverted, as short-term yields coasted around 21.0% vs the 17.0% at the long end of the curve. In our view, the bearish market sentiment largely stemmed from low liquidity tolerance by the CBN and a gradual return of the MPC to traditional monetary policy.
- Nevertheless, some gain surfaced in December 2023, as asset managers locked in at an elevated rate.
- In 2024, our expectation is for rates to trend higher, as the CBN governor has guided that the current inflation trajectory requires further tightening. In addition, the liquidity narrative also strengthens our prognosis. For context, save for March 2024, when we are expecting bond maturities of c.N720.0 billion, liquidity will likely remain low in the year, fanning higher yields.
- In terms of movement, we will likely see OMO rates outpacing NTBs by wider margins as the CBN seeks to attract foreign inflows into the economy. The First auctions in 2024 already provided some credence, as the 1-year OMOT stop rate settled at 17.75% (c. 20.0% effective yield) compared to the 1-year NTBs of 8.40%.
- To wit, we expect the 365-day NTBs and the 10-year Bond market yield to settle at 10.5% and 16.0% by year-end.

Fixed Income: Legroom for higher yields

Liquidity (N' trillion) will likely thin out from April 2024



Banks became net-depositors at the discount window from Oct 2023



The The CBN removed the cap on banks' deposits at the SDF window in Oct 2023

5.56 Trn

Banks net-deposited N5.56 trillion at the CBN discount window from Oct to Dec

20% Higher than SDL Rate of 15.75%

With OMO rate (c.20.00%) higher than SDL rate of 15.75%, we expect reduce traction in 2024

Sources: NBS, CBN, IMF, CSL Research

SOCIO-ECONOMIC AND POLITICAL

2023 brought with it new **difficulties**...

for an already impoverished populace

The nation's inflationary challenges have been intensified by the devaluation of the Naira, the removal of fuel subsidy, and the surge in commodity prices. Consequently, the average Nigerian consumer is adapting to the escalating living costs by opting for more affordable alternatives amidst generally low income levels.

Fuel Subsidy Removal

- President Bola Ahmed Tinubu announced the removal of subsidy on Petroleum Motor Spirit (PMS) at his inaugural address. He stated that the 2023 budget made no provisions for it and funds for subsidy will be diverted for other uses such as infrastructure, education, and job creation.
- The pump price of PMS rose considerably across states, from N185 before the removal of the subsidy to around N530-N650, and the price has been unstable due to the volatility of other price determinants such as crude oil prices and the currency.
- The removal of the fuel subsidy and the FX unification policy which led to the devaluation of the Naira pushed an estimated 14.2 million people below the poverty line according to the World Bank

- The government has pledged to provide palliatives to mitigate the effects of the subsidy removal. This includes the launch of CNG buses and monthly cash transfers to 12 million of the country's poorest households.
- As of the time of going to the press, the CNG buses are yet to be launched

More Nigeria's pushed
Below the poverty line

Consumer companies to continue to face weak demand

- Given the failing macroeconomic conditions in the country, more Nigerians were pushed below the poverty line in 2023. According to the World Bank, sluggish growth and rising inflation in Africa's biggest economy have pushed an additional 24 million Nigerians into poverty in the last five years. Data from the bank shows that 14.2 million Nigerians became poor in 2023.

- Nigeria's inflation rose to a 20-year high of 28.92% as of December 2023, making it one of the highest in the world. The removal of the subsidy on petrol and the unification of the FX rates at the various official windows worsened inflationary pressures in 2023. Despite the CBN's aggressive monetary policy stance, the country's inflation rate has continued to rise unabated.

- The World Bank believes targeted measures, including cash transfers, can mitigate the impact on the poor and prevent them from falling into intergenerational poverty traps. We however note that long-term solutions such as tackling insecurity to encourage food production in rural areas are more sustainable ways to reduce poverty.

It is imperative for the federal government to formulate policies geared towards fostering economic recovery and mitigating inflation as the anticipated sustained decline in consumer demand, is expected to impact consumer goods companies in 2024.

Food Insecurity; Nigerians May Face Acute Hunger In 2024

Around **84 million**

Nigerians out of 220milion

37% Live below poverty line in Nigeria

- According to the World Food Programme, 26.5 million people across the country are projected to face acute hunger in the June-August 2024 lean season. This is a significant increase from the 18.6 million food insecure people at the end of 2023.
- Food supply has over the years been impacted by violent conflicts, including the insurgency in the North East; armed banditry in the Northwest; perennial farmer–herder conflicts in the North Central and South West.
- Other factors contributing to the food insecurity situation include rising inflation which has led to increases in input costs, poor implementation of agricultural policies, rising poverty, and rising unemployment, engendering and compounding a cost-of-living crisis, with deleterious effects on the living conditions of citizens, and their ability to access food.
- Climate change, in particular, the rising incidence and frequency of floods, has also continued to affect food production and the availability and affordability of food. According to the National Emergencies Management Agency [NEMA], the 2022 floods led to the destruction and washing away of over 675,000 hectares of farmland.
- In a bid to stem rising food prices, President Bola Tinubu declared an immediate "State of Emergency" on food insecurity in the country. We believe that in 2024 the government must take proactive steps to improve food production in order to avert a food crisis which could impact the health of the working population and further drag growth.

CONSUMER WALLET

Expected to remain constrained in 2024

We believe that the following factors will continue to pressure the Consumer Wallet in 2024;

Electricity tariffs

We believe there will be electricity tariff hikes in 2024, as NERC has stated that the electricity tariffs do not reflect current economic conditions given the steep devaluation of the Naira.

Fuel price increases

The removal of fuel subsidy amidst the continuous devaluation of the Naira and expected rise in crude prices means the costs of major fuels will likely continue to rise in 2024.

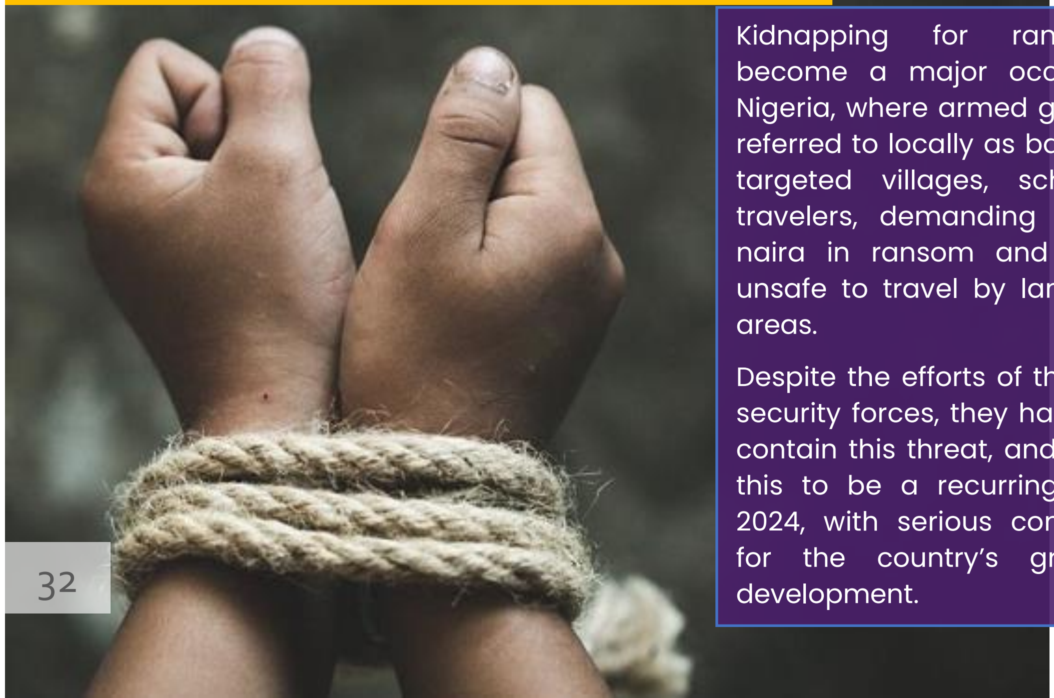
Minimum wage

There were increases in wages by the private sector in 2023 and the government is set to increase wages in 2024. However, we believe the expected increases pale in significance when compared to the rise in living cost.

INSECURITY:
Nigeria's Archilles Heel

News of attacks on some villages in Plateau state during the Christmas festivities suggest the high level of insecurity in the country will remain a theme in 2024 and continue to have severe negative implications for investment flows and food supply. Incidences of insecurity range from the activities of unknown gunmen, banditry, armed robbery, kidnapping, and child abduction/human trafficking.

Kidnapping Activities On the Rise



Kidnapping for ransom has become a major occurrence in Nigeria, where armed gangs, often referred to locally as bandits, have targeted villages, schools, and travelers, demanding millions of naira in ransom and making it unsafe to travel by land in some areas.

Despite the efforts of the country's security forces, they have failed to contain this threat, and we expect this to be a recurring theme in 2024, with serious consequences for the country's growth and development.

ISWAP attacks expected to persist

The incursion of ISWAP into the country was unarguably the most potent threat to the country's security as ISWAP is primed to emerge as the deadliest group in the country if not nipped in the bud.

The group have continued to launch attacks unabated in the northern region. Scores of fighters from ISWAP were reported to have stormed the remote farming and herding village of Kayayya in Yobe in November 2023, killing an estimated 17 people.

Activities of Boko Haram fighters, bandits and herdsmen are also still rife and will likely continue in 2024.

Since 2011, recurring violence between pastoralist and agricultural communities, fueled by competition over limited resources, has escalated in central and north-west Nigeria. In direct response to these escalating tensions, various armed groups and gangs, often referred to as "bandits," have emerged.

The rising state of insecurity in the North has continued to affect the economic growth of the region and has been weighing significantly on local food production as many farmers are reluctant to go to their farms for fear of being killed or kidnapped.

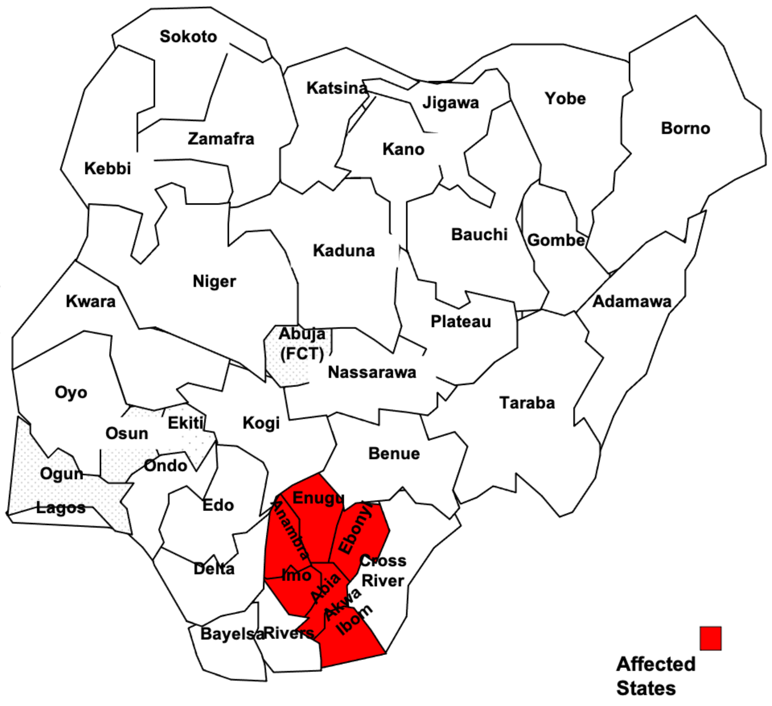
IPOB; largely tamed but
Concerns remain

- The continued detention of the embattled leader of the separatist organization, Indigenous People of Biafra (IPOB) has prolonged agitations in the region

- In response to the continued detention of its leader Mazi Nnamdi Kanu, IPOB continued its Monday sit-at-home order in 2023 with the negative impact on the region's economy. Latest figures suggest the southeast has lost about N4trn in 2 years because of the IPOB sit-at-home protests.

- On 10 June 2023, the Governor of Enugu State, Peter Mbah, sworn in on May 29, declared an end to the sit-at-home order. Mbah's move comes after the earlier orders seeking to end the sit-at-home protest by other South-East governors have failed.

- Many Southeasterners are however still afraid to go about their daily activities on Mondays for fear of being harassed by IPOB agitators. Given the Supreme Court's desire that Nnamdi Kanu stand trial for treason, we anticipate the IPOB story may still rear its ugly head in 2024. That said, we believe the activities of the group have been largely tamed and we do not anticipate the agitations will spread beyond the South East region.



Crude Oil Refining; Positive expectations In 2024

Nigeria's hope of attaining self-sufficiency in the domestic oil refining space looks bright in 2024, with the expected commencement of operations at the Dangote refinery, the newly refurbished Port Harcourt refinery and a number of completed modular refineries. While we believe achieving self-sufficiency in local refining might not reduce the cost of petrol significantly, sufficient local refining/export capacity would at least boost the availability of the product and have a net positive effect on FX liquidity in our view.

Dangote Refinery; Still expected to be a Game Changer

- The Dangote refinery is an integrated petrochemical refinery situated in the Lekki Free Zone, Lagos State. It has the capacity to process about 650,000 barrels of crude oil per day. This project is Africa's biggest oil refinery and the world's biggest single-train facility.
- Dangote Petroleum Refinery can meet 100% of Nigeria's requirement of all refined products, gasoline, diesel, kerosene, and aviation jet, with surplus for export.
- To jump-start operations, NNPC, which owns a 20% stake in the refinery has an agreement to supply 6 million barrels of crude oil as feedstock to the Dangote refinery in December, which has been delivered.
- The Management of the company has announced it would commence operations at 350,000 bpd capacity, and is scheduled to start production of diesel and aviation fuel by mid-January 2024, after which Premium Motor Spirit production will follow. The refinery is expected to reach its full 650, 000 barrels per day capacity by the end of 2024.
- We expect local refining to significantly impact Nigeria's foreign exchange market through import substitution in the long term. Additionally, a notable influx of foreign exchange is expected through export activities from the refinery.

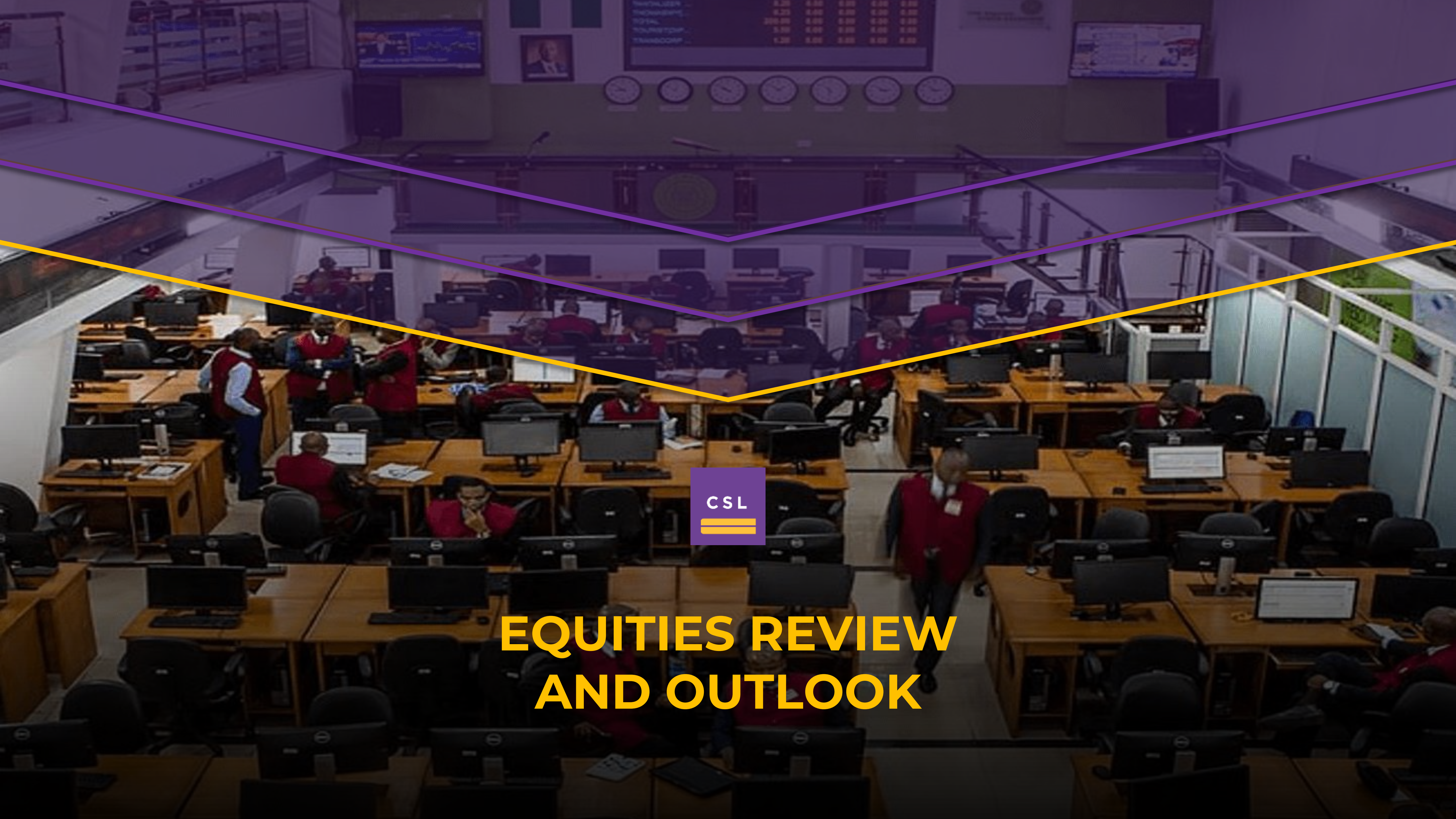
More refineries to come Online in 2024

- The Federal Government recently announced the mechanical completion of rehabilitation work on the Area-5 Plant of the Port Harcourt Refining Company in Rivers State. Reports say the first phase of the project has been completed, and the facility would begin refining 60,000 barrels of crude oil.
- The Nigerian National Petroleum Company Limited, the manager of the refinery, revealed that the second phase of the facility will be completed in the fourth quarter of 2024 and will enhance the capacity to 150,000 bpd. The Warri and Kaduna refineries are also expected to come onstream before the end of 2024.
- Whilst there are positive expectations around the impact of achieving local refining capacity, we believe the availability of feedstock (crude) may present a major challenge. Nigeria had average crude oil production of 1.46mbpd in 2023 (January – November 2023), with a significant amount of that production encumbered through swap agreements.
- The lack of crude has stalled the operations of several modular refineries, with the likes of Duport Edo Refinery, Walter Smith Refinery, and Niger Delta Refinery reported to be producing limited volumes due to inadequate feedstock.
- Whilst the nuances around how the refinery will impact FX liquidity remain difficult to assess, we believe achieving local refining capacity will at least ensure availability of the product. We are more focused on the export side of the business which should support FX liquidity.

Looking Ahead; Tinubu's Plans For Nigeria

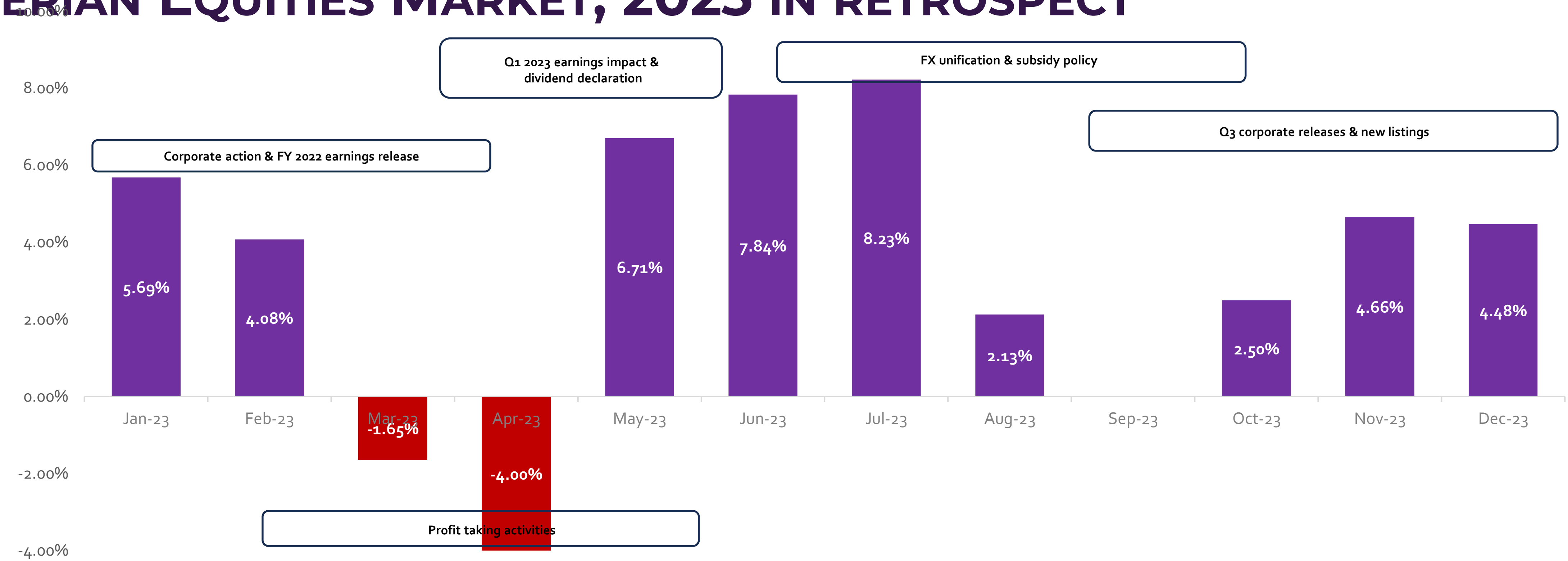
Key Areas	Tinubu's Renewed Hope Agenda
Fiscal Policies	➢ Address the problems of pipeline vandalism and oil theft to significantly increase the nation's production of oil and gas and increase its revenue. ➢ Enforce a policy directive stipulating that all proceeds from asset sales must be allocated to settling existing Federal Government of Nigeria (FGN) debt obligations. ➢ Enhance tax collection by restructuring and automating key revenue-generating Ministries, Departments, and Agencies (MDAs) to streamline the process and increase efficiency. ➢ Optimize the country's operational expenditures to minimize costs and prevent leakages in financial resources. ➢ Unlock the untapped potential of the solid minerals sector to diversify revenue streams and stimulate economic growth.
Monetary Policies	➢ Initiate a shift towards a transparent and unified foreign exchange rate system. ➢ Explore avenues to enhance the governance structure of the Central Bank of Nigeria (CBN) and streamline its operating model for increased efficiency and reduced costs. ➢ Position Nigeria as Africa's foremost trading nation by implementing transformative measures. ➢ Execute the National Single Window Trading Platform Project to streamline import and export processes, fostering trade growth..

Key Areas	Tinubu's Renewed Hope Agenda
Industry (Manufacturing) and Trade	➢ Enhance the Non-oil export share in the country's GDP by fostering the expansion of the manufacturing sector's contribution. ➢ Introduce incentives, such as strategic partnerships with key trading allies, to expedite the development of crucial sectors like Light Electronics Assembly, Garments, Fertilizer, Refined Sugar, Oil Palm, and Automotive. Aim for a targeted annual output surpassing US$50 billion. ➢ Position Nigeria as a premier investment destination by instigating a comprehensive reform of the regulatory environment to facilitate business operations.
Capital Markets	➢ Introduce long-term, high-yield debt securities, such as Special Purpose Bonds, earmarked for specific projects and initiatives in sectors like Agriculture and Industry. ➢ Promote increased involvement of pension funds and insurance companies in the capital market, enhancing their participation. ➢ Encourage the issuance of and participation in Environmental, Social, and Governance (ESG) compliant financial products by offering incentives. ➢ Utilize SUKUK bonds to raise capital for government projects and collaborate with the SEC to enable the tradability of Certificates on the stock market. ➢ Collaborate with Fund Managers to develop investment products, fostering the attraction of Diaspora and retail investments in local securities.



EQUITIES REVIEW AND OUTLOOK

NIGERIAN EQUITIES MARKET; 2023 IN RETROSPECT

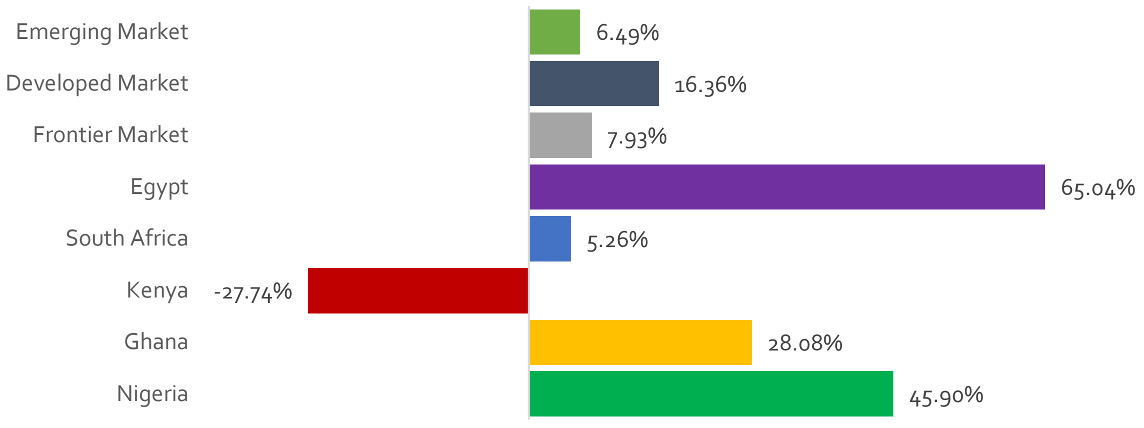


Sources: Bloomberg, NGX, CSL Research

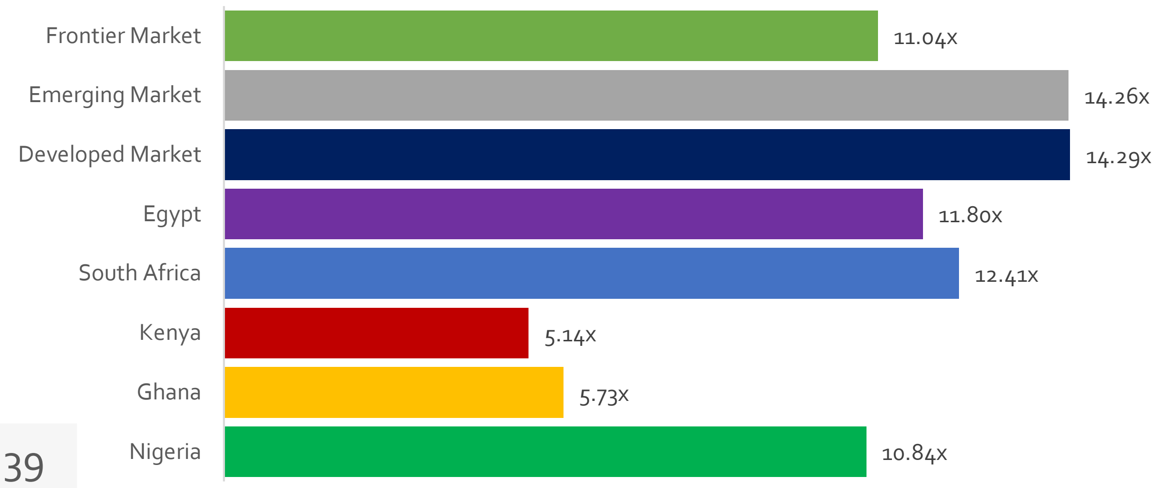
- The domestic stock market concluded the year 2023 with the NGX All Share Index (ASI) recording a remarkable 45.9% increase, surpassing the 19.5% growth observed in 2022. This marks the fourth consecutive year of positive momentum for the bourse.
- The upswing in market performance can be attributed to renewed investor confidence, driven by favorable sentiments surrounding two key macroeconomic policies. As a result, the NGX-All Share Index achieved a historic milestone by crossing the 70,000 points threshold in 2023, for the first time in the market's history.
- Noteworthy is the active involvement of local investors, which played a pivotal role in safeguarding the market from occasional steep downturns often triggered by capital flight associated with dominant Foreign Portfolio Investments (FPIs). By November 2023, total transactions in the market reached N3.2 trillion, with a substantial 88.8% contributed by domestic investors, while foreign investors accounted for 11.2%.
- This shift towards a more pronounced local investor presence signifies a robust and resilient domestic market, as it successfully mitigates the impact of external fluctuations. The positive trajectory over the past four years underscores the strength of the domestic bourse and reflects the growing confidence of investors in the Nigerian market.

Performance and Valuation Across Markets

Stock Markets Performance (2023)



Stock Markets Valuation (P/E)

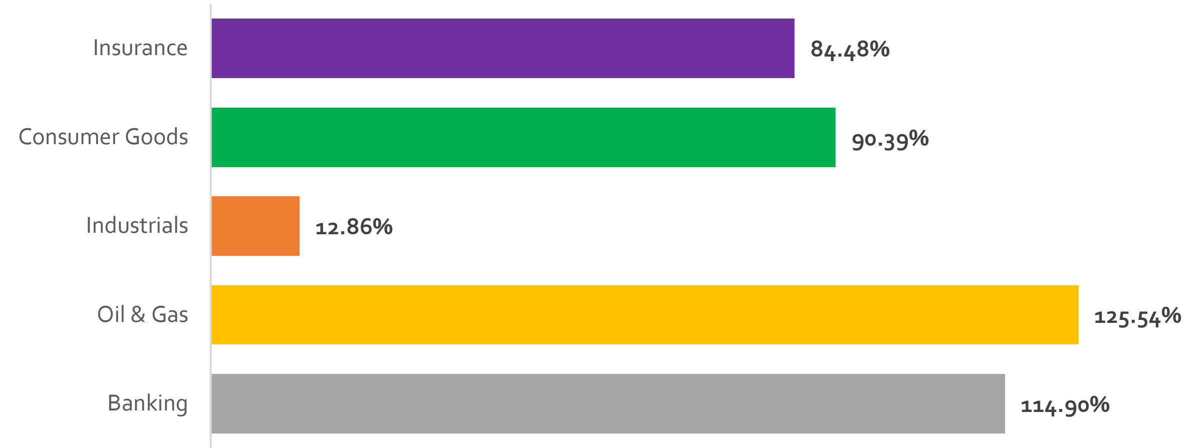


Sources: Bloomberg, CSL Research

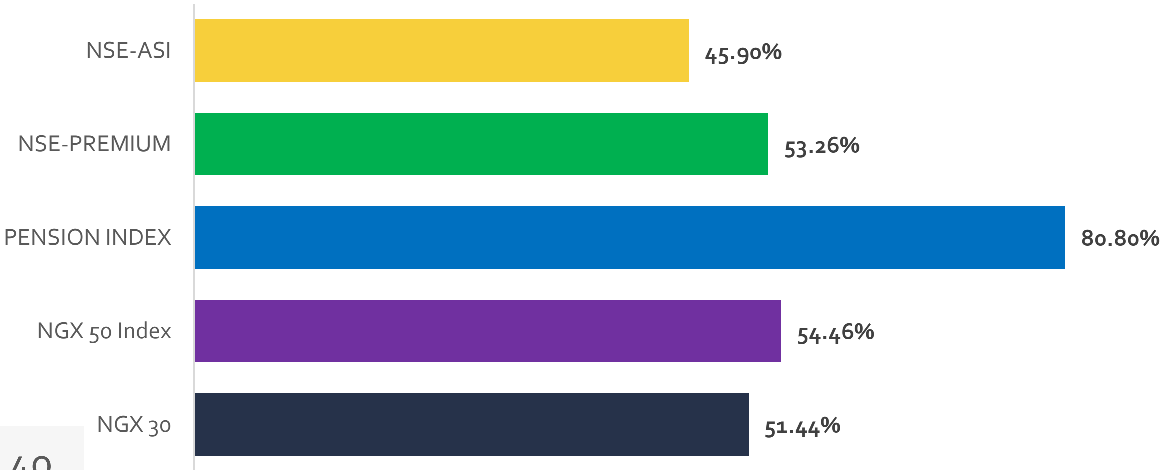
- In 2023, the Nigerian equities market demonstrated exceptional performance, surpassing its African counterparts, except for Egypt, which recorded a substantial 65.04% year-to-date (YTD) increase. Notably, Kenya experienced a downturn of 27.74% YTD, while Ghana exhibited a positive trend, up by 28.08% YTD, and South Africa recorded a modest 5.26% increase.
- Furthermore, the Nigerian market outperformed global benchmarks, exceeding the Frontier, Emerging, and Developed Market Indices, which returned 7.93% YTD, 6.49% YTD, and 16.36% YTD, respectively.
- Various factors influenced the global equity markets in 2023, including robust financial system liquidity, the performance of technology stocks, notably the "Magnificent 7," and reduced inflationary figures contributing to a semblance of normalcy across markets.
- As of the end of 2023, the Nigerian equities market maintained competitiveness in terms of valuation, boasting a Price-to-Earnings (P/E) ratio of 10.84x. While this places it favorably relative to Egypt (P/E: 11.80x) and South Africa (P/E: 12.41x), it appears comparatively pricier when contrasted with the Ghanaian and Kenyan markets, which closed with P/E ratios of 5.73x and 5.14x, respectively.
- Comparing the market performance to the developed (P/E: 14.29x), frontier (P/E: 11.04x) and emerging market indices (P/E: 14.26x), the Nigerian market appears more attractive in terms of valuation (P/E: 10.84x).

Impressive Sectoral Performances

Sectoral Indices Performance (2023)



Generic View of Sectoral Performance (2023)



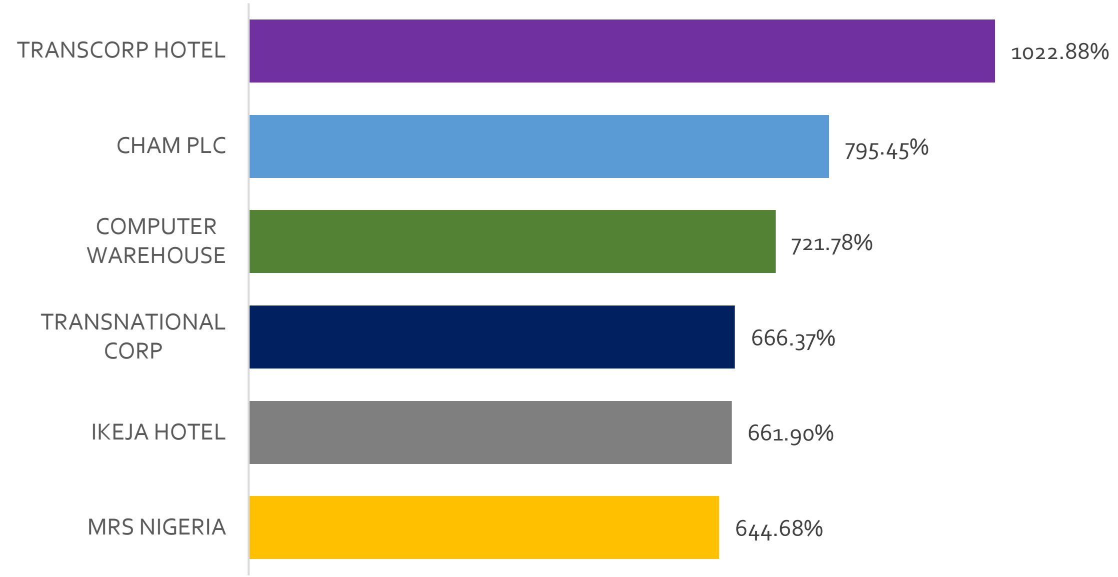
Sectoral Performances were outstanding in the year.

- In 2023, the oil and gas sector experienced a remarkable surge, posting a substantial 125.54% increase, primarily propelled by anticipated gains from the removal of the PMS subsidy. This surge was notably driven by significant upticks in the value of key players such as MRS (up 644.68% YTD), ETERNA (up 222.46% YTD), and CONOIL (up 213.21% YTD).
- The insurance sector witnessed robust growth, with an 84.48% YTD increase. This expansion was fueled by a series of corporate actions, including share recapitalization, that have characterized the sector since 2020. Additionally, the implementation of an increase in insurance premiums in January 2023 contributed to enhancing both the top and bottom lines of insurers.
- The banking sector, primarily fueled by the activities in Tier 1 banks and select Tier 2 banks such as ZENITH, UBA, STANBIC, FBNH, ACCESS, and Fidelity, demonstrated a remarkable performance with a 125.25% YTD increase. The steep devaluation of the Naira resulted in massive revaluation gains which boosted earnings of many banks significantly, especially the Tier 1 banks.
- Contrastingly, the industrial goods sector reported a modest YTD performance of 12.86% in 2023. This subdued performance resulted from mixed outcomes among constituent stocks, with leading stocks like BUA Cement, which positively influenced the index in 2022, dragging it down in 2023, posting a YTD loss of 0.77%.
- Among the generic indices, the Pension Index led the way with an 80.80% increase, followed by the NGX 50 Index (up 54.46% YTD) and NSE Premium (up 53.26% YTD). The NSE-30 (up 51.54% YTD) and the NGX All Share Index (up 45.9% YTD) also exhibited significant growth in 2023. These diverse performances across sectors underscore the dynamic nature of the Nigerian financial landscape during the year.

Sources: Bloomberg, CSL Research

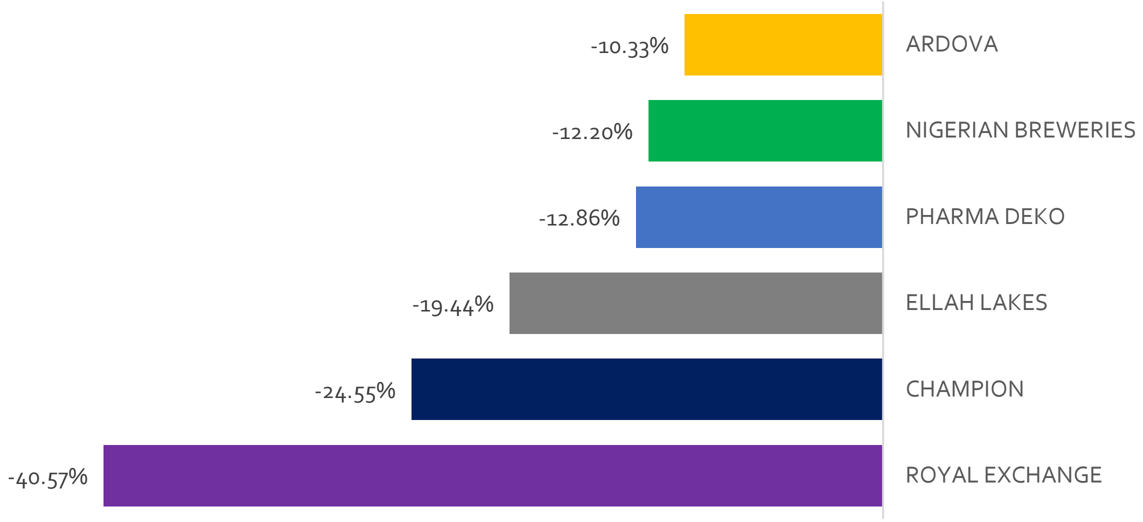
Leaders and Laggards; Corporate Actions drove Performances

Top Six Gainers for the Year



Sources: Bloomberg, CSL Research

Top Six Losers for the Year



Sources: Bloomberg, CSL Research

- The year 2023 witnessed a series of corporate actions that had a profound impact on the stock market. Some stocks experienced substantial surges, driven by factors such as mergers and acquisitions, improved earnings, and pro-market policies. Conversely, a few others faced declines in their share prices.

- Notably, Transcorp Hotel and Transnational Corp saw significant leaps in their stock prices, primarily propelled by strategic investments and an ownership/control tussle among deep-pocketed individuals. These dynamics not only moved the prices but also created substantial value for shareholders. MRS Nigeria's stock price was influenced by the deregulation of the downstream sector and the removal of price fixing.

- Conversely, Champion plc faced a lackluster financial performance during the year. Apart from grappling with competition from other brewers, the company struggled against the backdrop of low consumer purchasing power. This scenario adversely affected both volumes and the financial bottom line, resulting in diminished investor interest in the stock.

- The diverse performances of these stocks underscore the nuanced landscape of the market, where specific corporate actions and external factors play pivotal roles in shaping the trajectory of individual tickers. Investors navigated through a dynamic environment, reacting to the strategic moves and challenges faced by companies across various sectors.

Nigerian Equities Outlook; What to watch out for in 2024

External Conditions

The direction of policy rates established by major global central banks is expected to have significant implications for fund movements into developing markets, including Nigeria. A decrease in rates may encourage capital inflows into developing markets. Conversely, an increase in rates could result in capital flight out of emerging markets. Additionally, developments in the oil sector play a crucial role in influencing foreign exchange (FX) liquidity in Nigeria, especially with the elimination of subsidy and can be a key attraction for foreign portfolio investments.

Corporate Actions, New Listings

The stock market performance in recent years has reflected the impact of corporate actions and announcements on the market's direction. Expectations of announcements around Transnational Corp and Transcorp hotels moved their share prices from N1.13/s & N6.25/s as of 30 March 2023 to close the year at N8.66/s and N70.18/s, returning 7.66x & 11.23x respectively. The announcement of an intended merger between Dangote Sugar, Dangote Rice, and Nascon resulted in a steep appreciation of the prices of Dangote Sugar and NASCON

Possible recapitalization of the banks as indicated by the Central Bank governor would likely spur capital raising activities.

Subsequent possible listing of companies like Dangote Foods, IHS Towers, NNPCL, VERITASI and INDORAMA should further contribute to the deepening of the market.

FX Liquidity

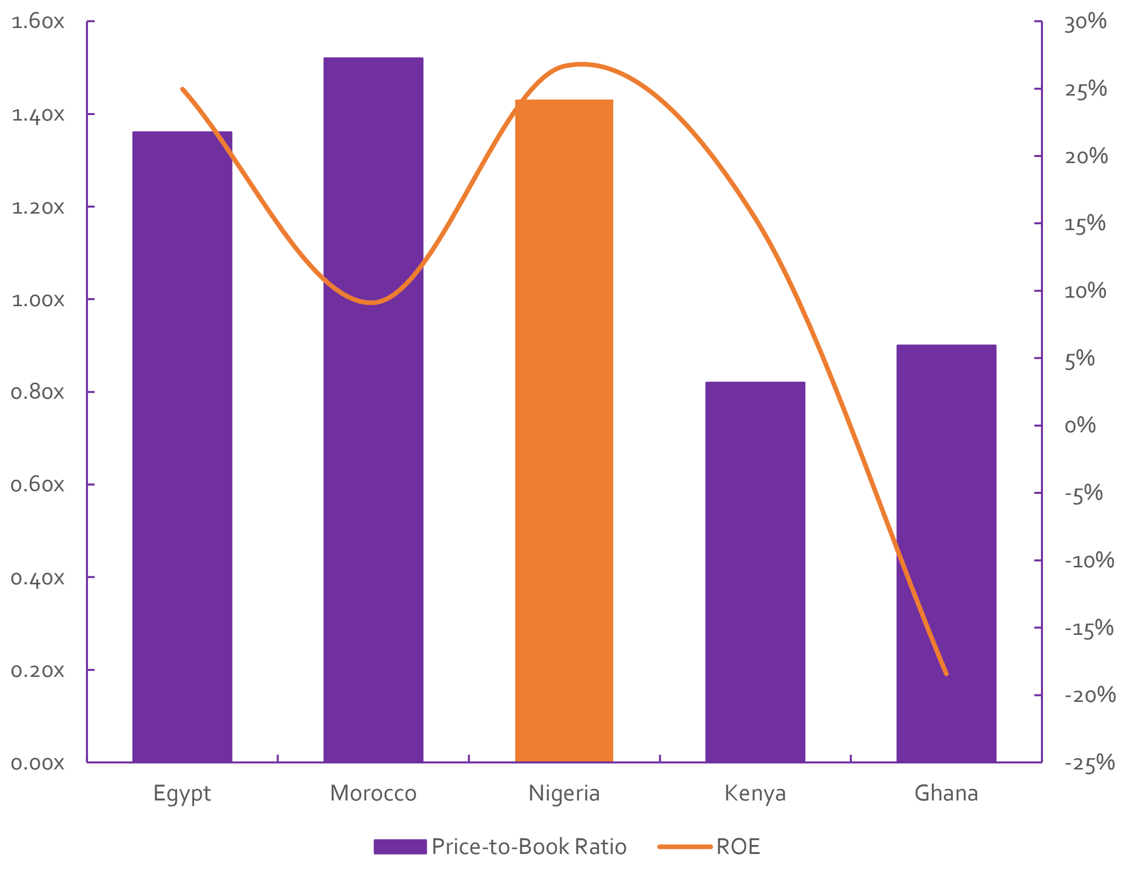
Enhanced clarity and transparency within the Nigerian foreign exchange market are anticipated to stimulate increased Foreign Portfolio Investor (FPI) engagement. Anticipated supply chain disruptions, along with improved production agreements within the OPEC+ alliance should lead to oil price stability which is expected to bolster FX earnings. Again, expectations of achieving local refining capacity is expected to enhance FX liquidity. This, in turn is likely to attract foreign portfolio investments.

Fixed Income Yields

A chief driver of the stock market performance is the direction of yields in the fixed income market. When fixed income yields rise, investors divert funds from the equities market to the fixed income market, resulting in a decline in share prices, and when fixed income yields fall, the reverse happens. However, there was a convergence in 2023, such that as yields increased in the fixed Income market, equity prices continued to rise, this we believe is because there was no real growth in yields as inflation grew in tandem.

BANKING SECTOR REVIEW & OUTLOOK

Banking Sector; valuations stretched but still attractive



Source: Bloomberg, CSL Research

- We expect a moderate increase in average yields in 2024 driven by our expectations of moderate growth in Monetary Policy Rate (MPR) and fixed income yields. We also expect a moderate increase in funding costs to reflect current market realities.

- Banks have invested significantly in digital channels, and we expect they will continue to look to Non-Interest Revenue to enhance earnings, especially as opportunities for collaboration with Fintechs and Telcos increase.

- We expect a moderate rise in Cost of risk (COR) in 2024e, considering the prolonged downturn in the economy. However, we do not expect Impairments to significantly erode earnings. Again, banks have not been too aggressive in loan creation. Real loan growth excluding the impact of devaluation remains moderate.

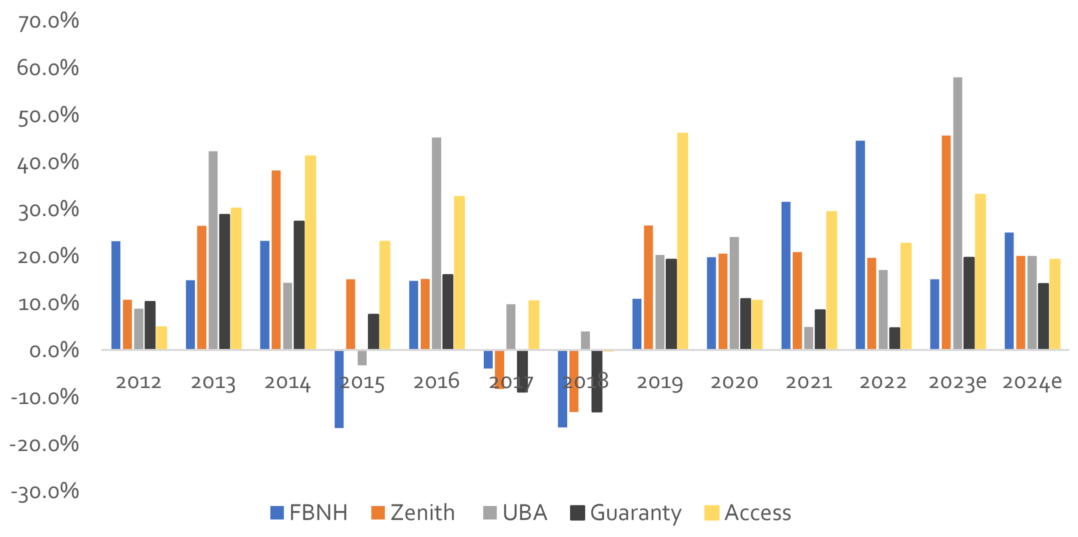
- We believe banks will continue to struggle to improve efficiency to support bottom-line growth so, we forecast moderate growth in OPEX in 2024e despite inflationary pressures. The high inflationary environment means costs have been growing. However, in 2023, windfall revaluation gains by banks moderated cost to income ratio considerably across the sector. We forecast an average cost to income ratio (ex-provisions) of 48.4% for FY 2024e given expectations of significantly lower revaluation gains in 2024e.

- The steep devaluation of the Naira resulted in massive revaluation gains which boosted the earnings of many banks significantly, especially the Tier 1 banks, making us forecast lower 2024 earnings due to expectations of significantly lower revaluation gains. However, prompted by adequate capital, stable asset quality and in some cases, stable dividend yield, we maintain a Buy recommendation on Zenith, GTCO, Access, and UBA.

- Despite steep price appreciations seen in 2023 and into 2024, Current P/BV valuations of the banks remain relatively attractive.

Loan growth; loans to rise moderately

Loan Growth



H1 2023	FCY Loans	LCY Loans
GTCO	55%	45%
Acccess	55%	45%
UBA	78%	22%
Zenith	60%	40%

Loan growth; moderate growth expected but lower than 2023

In the 9 months of 2023, Zenith Bank recorded a net loan growth of 44.0% relative to December 2022. Also, Access (+31.4%), UBA (+57.4%), GTCO (+17.7%) FBNH (+41.1%) recorded net loan growths when compared with December 2022. The relatively high loan growth reflects the impact of devaluation of foreign currency loans, which make up a significant portion of total loans. We project moderate growth in customer loans in 2024, albeit a decrease from 2023, as we do not expect as steep a devaluation as seen in 2023 in 2024.

Factors that will limit loan growth

- ❑ We expect banks to continue to restrict lending to preserve asset quality amidst poor macroeconomic conditions especially as rates in the fixed income market remain relatively attractive.
- ❑ We also expect loan demand to remain modest given the fragile macroeconomic conditions and high borrowing costs

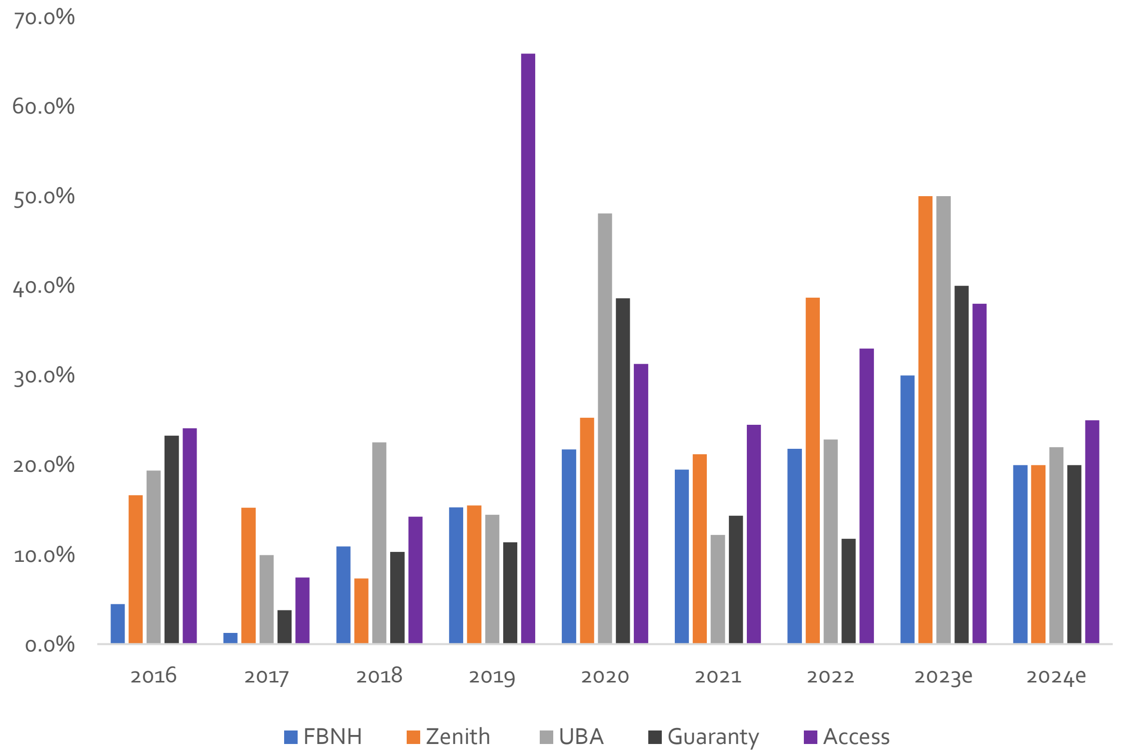
Factors that will support loan growth

- ❑ While it is not certain that the capital raise spoken of by the CBN will take effect in 2024, we believe many banks will begin to source funds to increase capital and this will likely ignite loan growth. A few banks have seen CAR decline following the devaluation in 2023.
- ❑ Planned sale of national assets should ignite loan growth and the government may intensify privatization efforts

We forecast average loan growth of 19.8% y/y in 2024e compared with 38.32% as of 9M 2023. Foreign currency-denominated loans, which account for a significant part of total loans and deposits saw a significant boost in 2023 and we do not anticipate as steep a devaluation as seen in 2023 in 2024.

Deposit Growth- reasonable growth expected

Deposit Growth



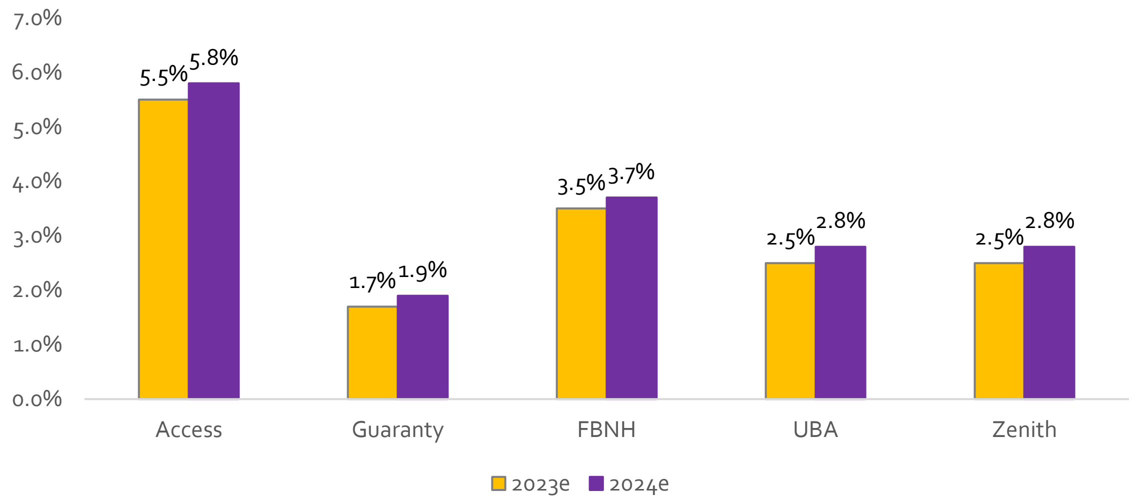
Deposit growth: Reasonable growth but still lower than 2023

- In 9M 2023, the tier 1 banks grew deposits by an average of 40.9% (inclusive of the impact of devaluation on foreign currency deposits). Overall, we forecast average deposit growth rate of 21.4% for the tier 1 banks in 2024e, lower than the 9M average as we do not expect as steep a devaluation as seen in 2023.

- High interest rate may support deposit growth, but we expect domestic deposit growth to slow as household and corporate deposits are hurt by strained purchasing power and slower economic activities.

Marginal Uptick in cost of funds anticipated

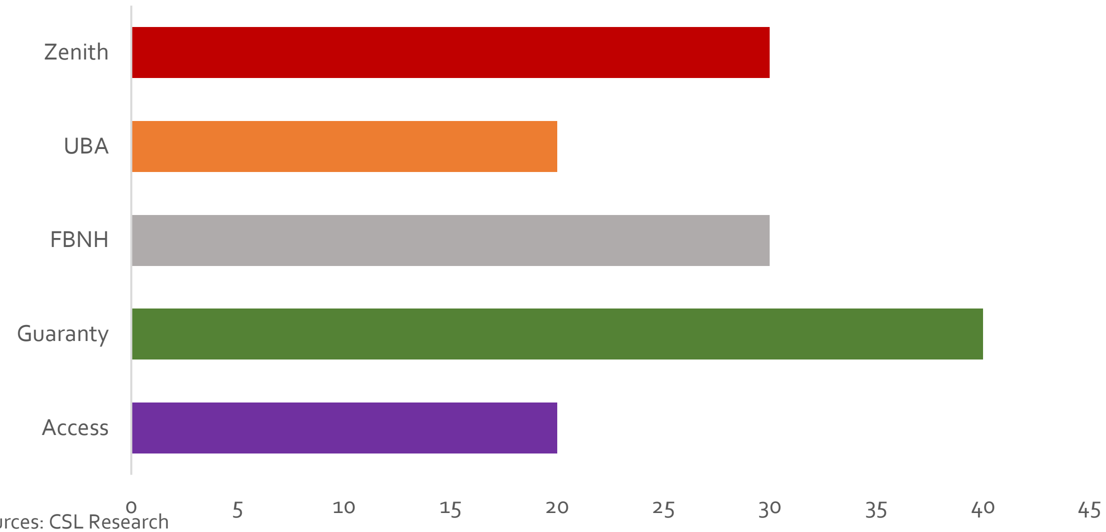
Cost of funds – To grow marginally



Sources CSL Research.
*

- Rising inflation prompted the Central Bank to continue tightening monetary policy in 2023 and we do not expect a loosening in 2024. We believe the CBN will raise rates by a moderate 100bps-200bps in the first half of the year and then hold rates constant in H2.
- Cost of funds declined in 2020 due to CBN's policies but has been rising gradually since H2 of 2021 in tandem with the general growth in the interest rate environment
- We forecast average cost of funds of 3.4% for the big banks in 2024e from a 2.9% average in 9M 2023 as many of the Tier 1 banks have a high percentage of cheap retail deposits which helps keep funding costs minimal

Yields – Marginal uptick anticipated



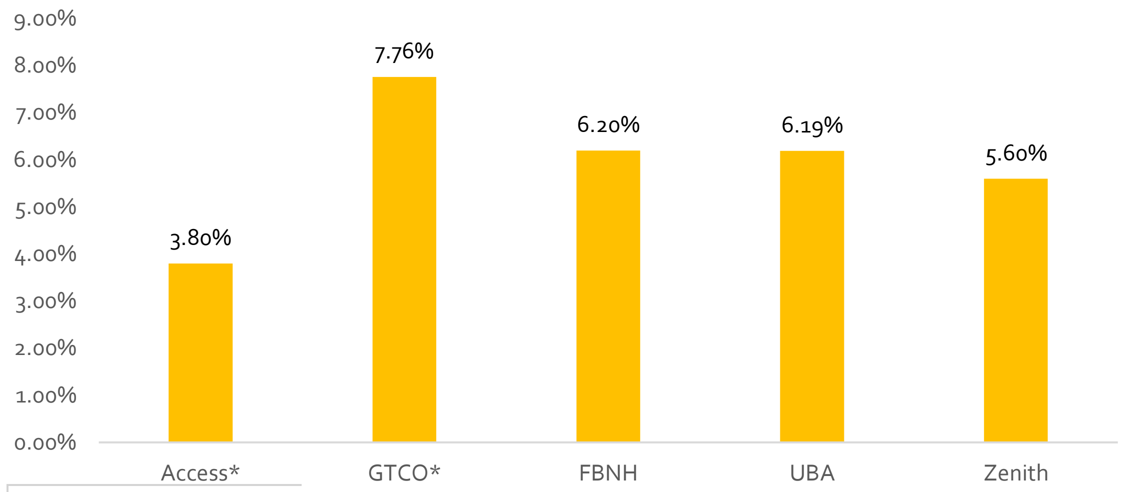
Sources: CSL Research

- Yields on money market instruments grew moderately in 2023 and we expect current levels can be sustained into 2024. We however, forecast a moderate increase in the assets yields of banks in 2024.
- We expect the removal of the limit on the SDF window to aid interest income growth
- We model an average 28bps rise in assets yield of the big banks above FY 2023 levels

Non-Interest Income: Transaction volumes to increase

- The growing investment by many banks in digital technology have significantly contributed to growth in Non-Interest Income.
- We believe banks can increase non-interest income from increased treasury and capital market activities.
- We believe banks will persist in leveraging their competitive edge, particularly in terms of scale and established customer relationships, to effectively compete with players in the fintech sector. The dynamics between banks and fintech companies are rapidly evolving, and fintechs are now widely viewed as collaborators rather than competitors.
- Nevertheless, we posit that banks endowed with robust advisory, underwriting, and corporate banking franchises are poised to expand their fee income more substantially.
- Non-interest income is projected to experience significant growth in the coming years, with the only potential limitation being regulatory scrutiny. Such scrutiny could lead regulators to impose fee caps, thereby impacting fee income growth.

NET INTEREST MARGINS 9M 2023

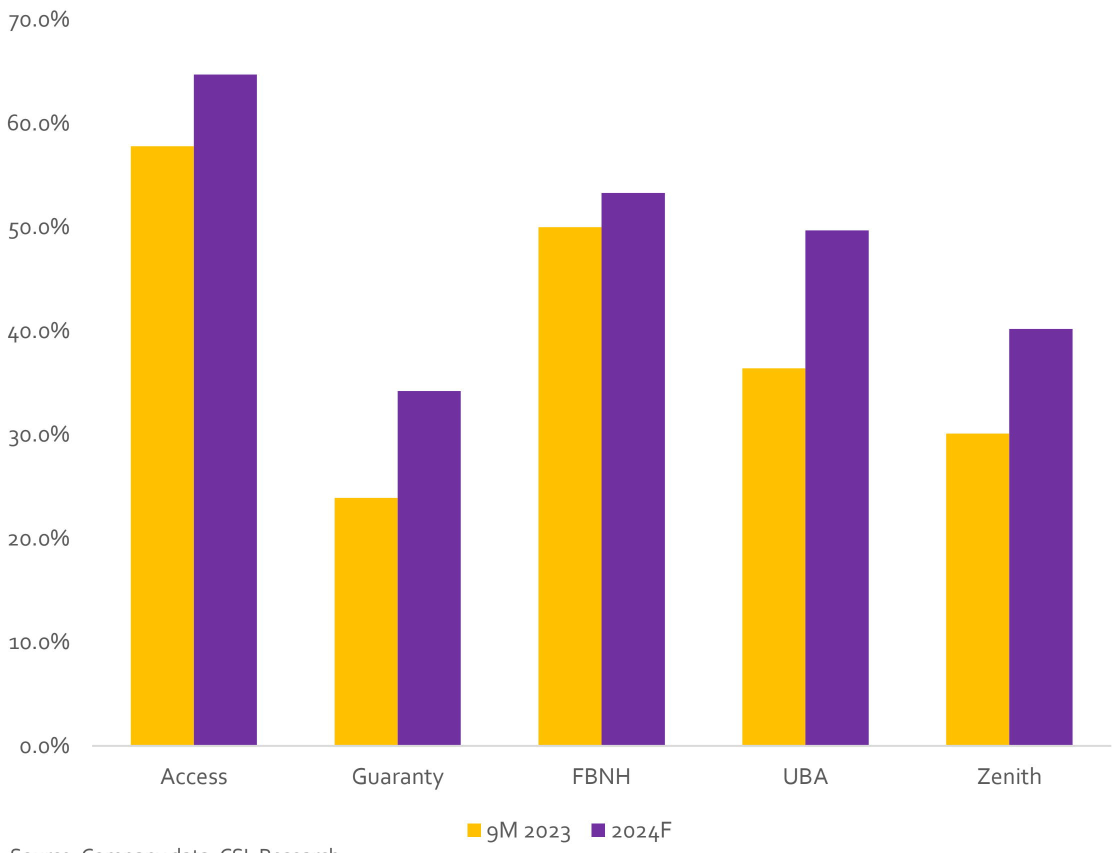


*H1 2023

- The confluence of slight growth in cost of funds, moderate growth in policy rates, and a somewhat restricted capacity for loan expansion may pose challenges to banks in achieving robust net interest margins (NIM) in 2024. We forecast a marginal uptick in NIMs in 2024.

Banks to continue to manage opex lines within their control

Cost to Income Ratio



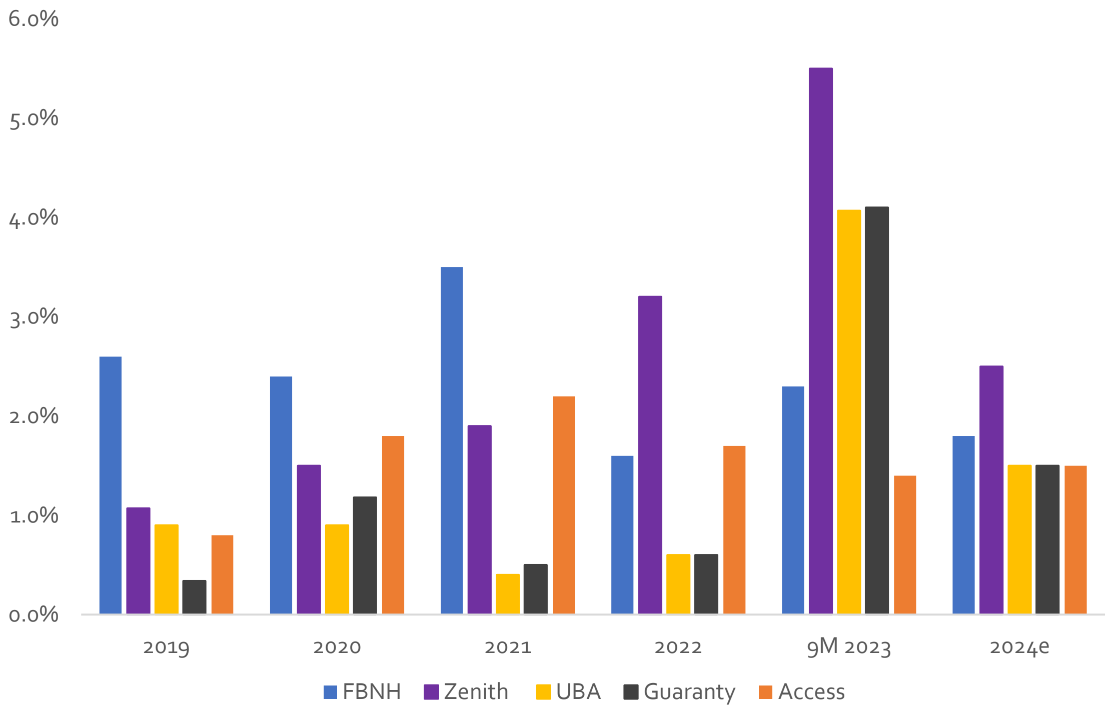
Source: Company data, CSL Research

CIR to deteriorate relative to 2023

- The high inflationary environment means costs have been growing. However, in 2023, windfall revaluation gains by banks moderated cost to income ratio considerably across the sector.
- The tier 1 banks reported an average cost to income ratio (ex provisions) of 39.6% as of 9M 2023. We forecast average cost to income ratio (ex-provisions) of 48.4% for FY 2024e given expectations of significantly lower revaluation gains in 2024.
- Though we expect regulatory costs (AMCON and NDIC) to continue to pressure opex, especially with growth in balance sheet occasioned by the devaluation, we believe banks will continue to make efforts to reduce the opex lines within their control.
- One expense line we expect to continue to grow is personnel cost given the high rate of emigration attrition and the high cost of replacement. Attracting talent in specialized areas could increase compensation expenses significantly even as banks rationalize in other areas.
- We also expect a rise in the general OPEX line amidst a high inflationary environment

Cost of Risk to rise moderately

COST OF RISK



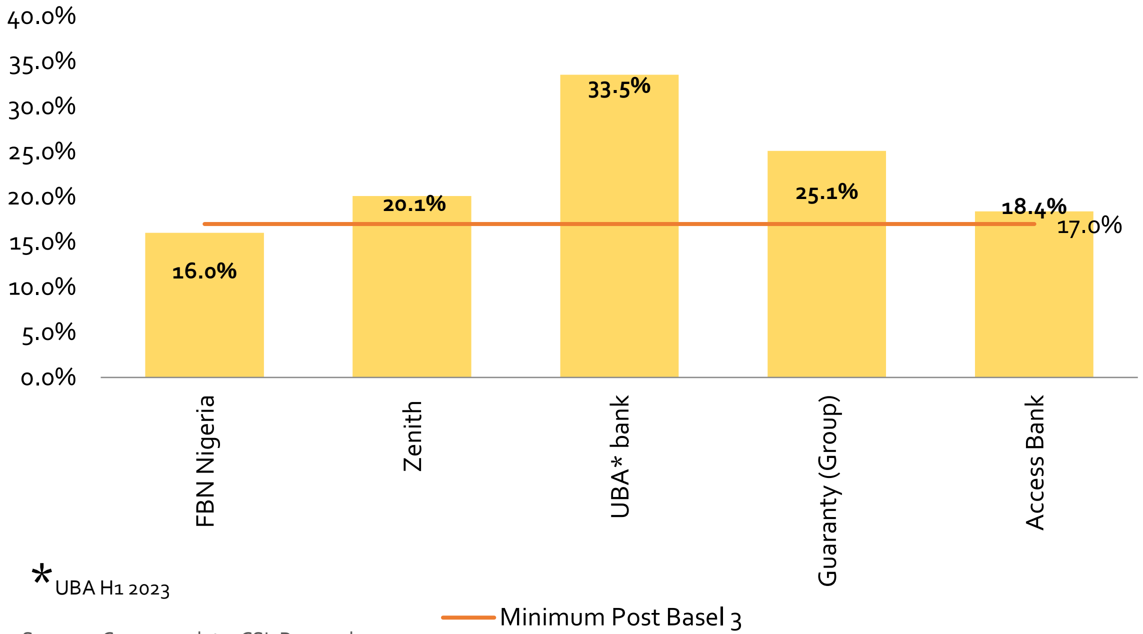
Source: Company data, CSL Research

MODERATE DETERIORATION IN ASSET QUALITY EXPECTED

- Asset quality risks remain prominent.
- Asset quality ratios have been very good for many banks in recent years, we expect to see a moderate growth in non-performing loans (NPLs), as the steep deterioration in macroeconomic indices make it difficult for individuals and businesses to meet their loan obligations.
- Cost of risk (COR) was an average of 3.5% for the tier 1 banks in 9M 2023 reflecting increased impairments due to the impact of devaluation on FX impairments and Management's conservative stance on provisioning as the macroeconomic condition worsened. We forecast an average COR of 1.8% for the tier 1 banks in 2024e.
- We anticipate a moderate decline in the quality of bank loans, attributed to elevated inflation, rising interest rates, heightened unemployment, and a weakened national currency

CAR– MORE CAPITAL RAISING ACTIVITIES

Capital Adequacy Ratio 9M 2023



*UBA H1 2023

Sources: Company data, CSL Research

- Poor asset quality can also affect CAR value. If a bank suffers an unexpected rise in cost of risk (COR) that exceeds the capacity of one year's profits to absorb it, then that bank will be looking at writing down capital. For the tier 1 banks we cover in this report, we estimate that they will make sufficient profit to absorb Impairments within the year and would not require any write down in capital

- Overall, we believe the Tier 1 banks will not face capital constraints in 2024e. For one, we expect only a moderate devaluation and in the event of a steep devaluation, we expect windfall gains to make up for the impact on RWAs. That said, we will likely see capital raising efforts in anticipation of the CBN's planned recapitalization.

NO FEARS WITH TIER 1 BANKS

- The CBN requires that banks with international subsidiaries maintain a capital adequacy ratio (CAR) of 15.0% while banks without international subsidiaries maintain a CAR of 10.0%. The minimum requirement for systemically important banks is 16.0% (although CBN is still giving a forbearance).

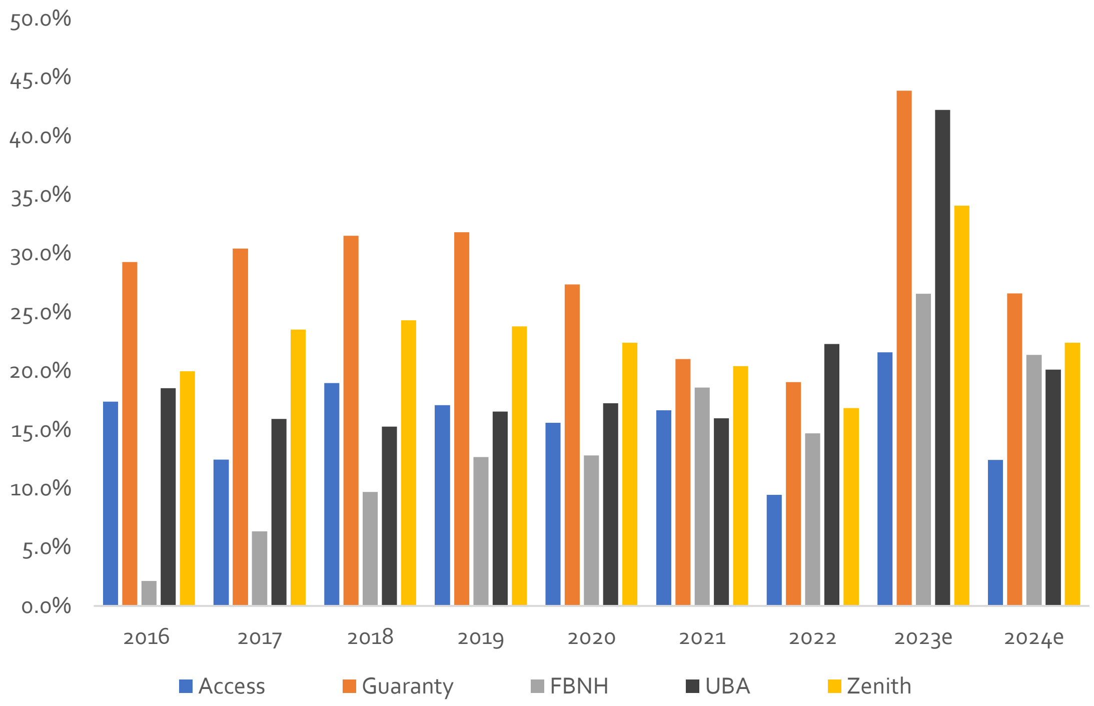
- Following the implementation of BASEL III, an additional tier 1 capital is required for a Capital Conservation Buffer (CCB1) of 1.0% of TRWA. A Countercyclical Capital Buffer (CCB2), to be determined by the CBN periodically taking into consideration the prevailing macroeconomic conditions and developments within the financial sector may also be required. Banks have been running this in parallel with current Basel II requirements.

- Given the steep devaluation of the currency, we expect that some of the banks will require more capital in order to create sufficient buffers for their growth plans as well as unforeseen problems. A naira devaluation, in theory, challenges CAR because the naira-equivalent value of risk-weighted assets (RWAs) rise given that these include foreign currency loans. The impact of foreign currency loans on RWAs are however offset by windfall gains (which almost all of the banks covered in this report make) from net long FX positions, which, in turn, boost capital. We note that FBNH which appears to be below regulatory is yet to capitalize profits and should reasonably be above minimum when its books are audited.

- Also, considering the CBN governor's comments late last year about recapitalization, we expect to begin to see capital raising efforts. Unsurprisingly against this background, we have already seen moves by some banks to raise additional capital. This brings up the issue of earnings dilution in the case of tier – one equity and increased funding costs in the case of tier – two subordinated debt

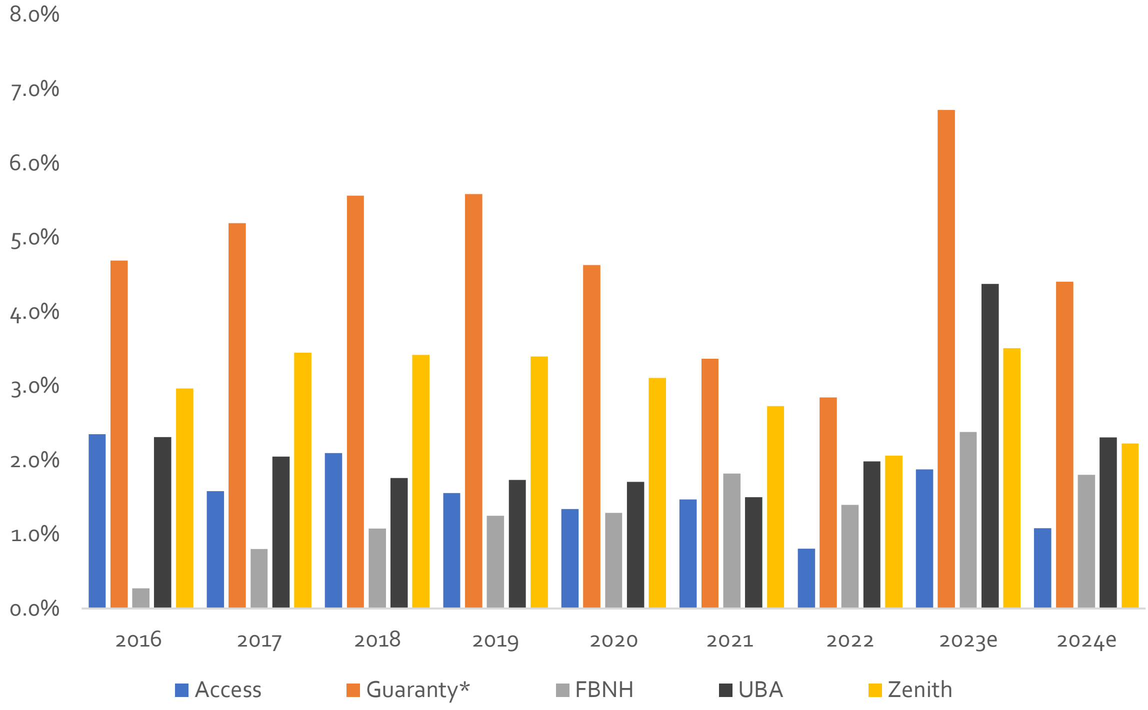
PROFITABILITY: PROFITS TO DECLINE Y/Y

ROAE



Sources: Company data, CSL Research

ROAA



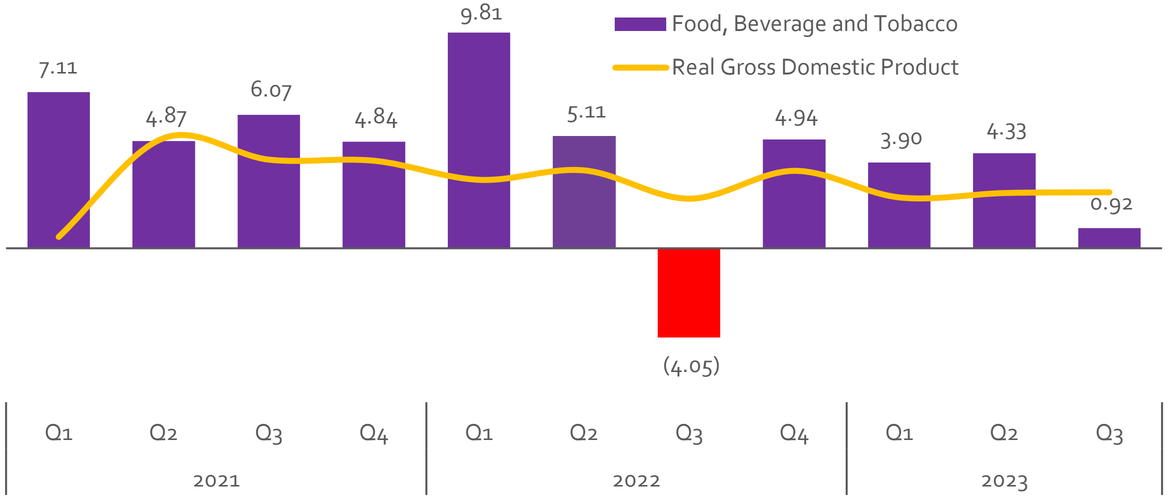
Sources: Company data, CSL Research

- The confluence of these dynamics means that we expect average profitability to slow in 2024e. We model a decrease in Pre-tax profits for all Tier 1 banks in 2024e mainly attributed to significantly reduced revaluation gains in 2024e.

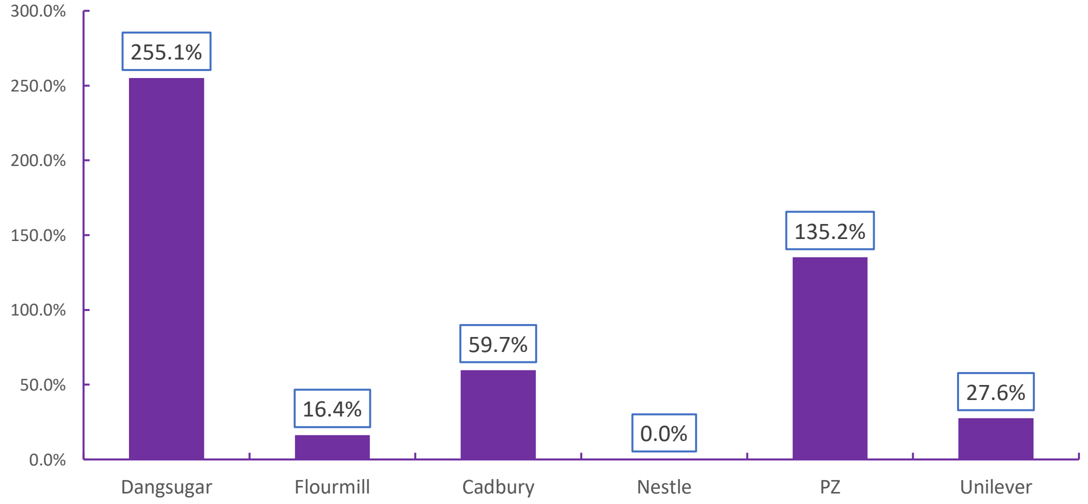
CONSUMER GOODS SECTOR REVIEW & OUTLOOK

Consumer Goods Sector: A Tale of Two Halves; Strong Growth Meets Rising Challenges

FOOD, BEVERAGE AND TOBACCO (2021- 2023)



RETURNS ON COVERED COMPANIES



Source; NGX, CSL Research

FBT subsegment GDP slows

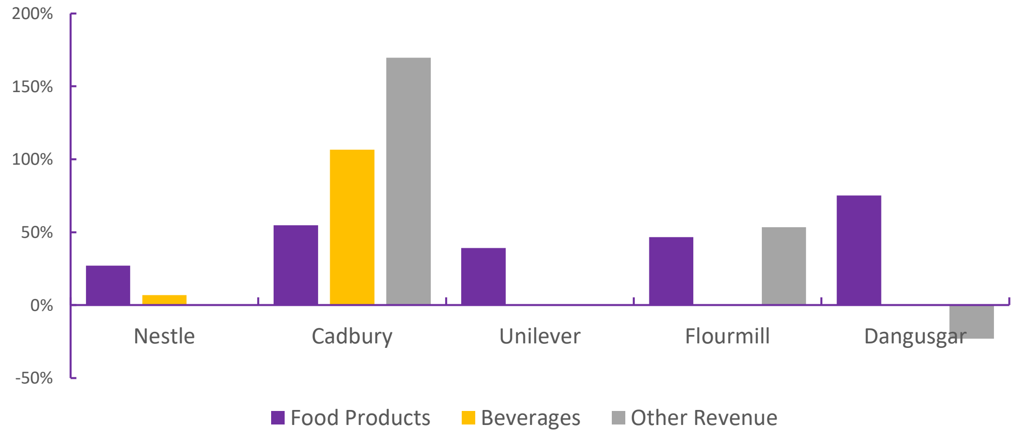
- The Food, Beverages, and Tobacco (FBT) subsegment has been a long-time large contributor to the manufacturing sector in the Nigerian economy.
- The FBT subsegment saw the biggest drop in the year as its real GDP advanced weakly by 0.92% y/y in Q3 2023, 341bps lower than the 4.33% y/y reported in Q2 2023. However, it advanced by 497bps from a contraction of 4.05% in Q3 2022. Overall, the FBT subsegment contributed 4.13% to the total real GDP in Q3 2023 which is 35bps and 7bps less than its contribution of 4.48% and 4.19% in Q2 2023 and Q3 2022 respectively.
- With the high cost of import duties (the exchange rate for computing import duty was changed from N422.00/US$ in June 2023 to N951.94/US$) and other input costs such as elevated energy and fuel prices and the depreciation of Naira, prices of food, beverages and Tobacco have been on the increase as the Imported Food inflation, Food inflation and Non-Alcoholic and Alcoholic Beverage, Tobacco and Kola inflation rose exponentially to 24.90%, 33.93%, and 33.72% and 16.62% respectively as at 2023.

The NGXCNSMRGDS remained bullish despite dwindling profitability

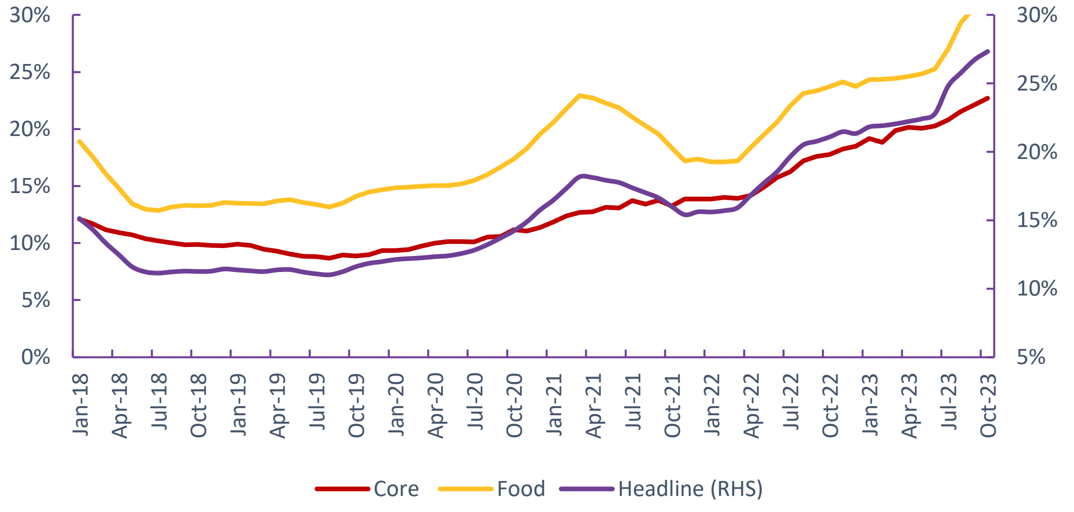
- The Consumer Goods sector on the Nigerian Stock Exchange (NGXCNSMRGDS) has experienced mixed reactions in recent months, with periods of share price declines followed by periods of growth. Our outlook for the FMCG sector in 2024 is positive as we forecast an uptick in their bottom-line performance in Q1 2024e due to expectations of lower FX losses.
- Expectations of a fruitful merger between Dangsugar, Dangote Rice, and Nascon propelled the surge in Dangsugar and Nascon's share price. Furthermore, the share prices of Unilever, Cadbury, and Flourmill thrived in 2023 as investors took advantage of their discounted prices in expectation of higher returns when their financial performances improve. Nestle bore the brunt of investors' bearish sentiments in 2023 in reaction to its heavy losses.
- Noteworthy, the upcoming delisting of PZ triggered buy interest in the stock as the company is obliged to buy shares back from its minority shareholders at a premium to its market price.

Consumer Goods Sector: A Tale of Two Halves; Strong Growth Meets Rising Challenges

SEGMENT GROWTH ACROSS FMCG COMPANIES



CONSUMER PRICE VARIATION (2018 -2023)



Source; World bank, National Bureau of Statistics, CSL Research

Topline revenue boosted by demand

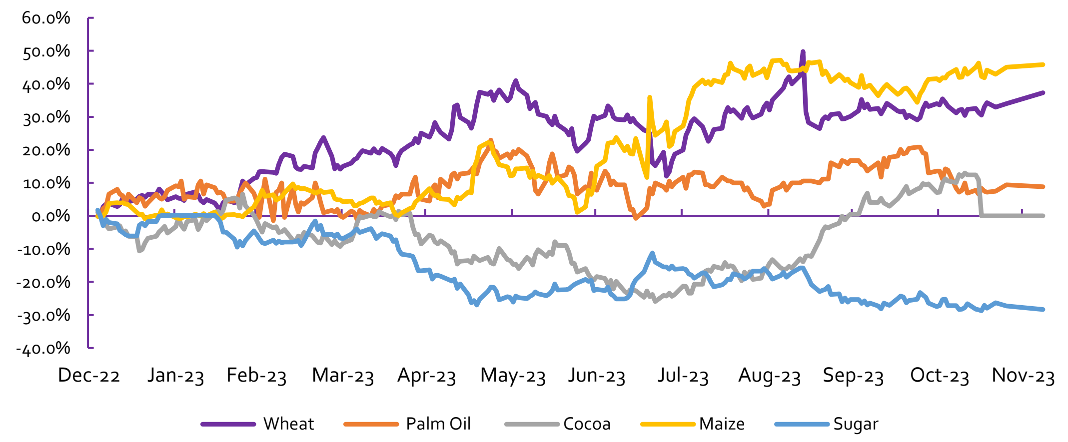
- The robust sales growth observed in these companies can be attributed to the inelastic demand for their products, underscoring the essential nature of their offerings. Even with increases in prices, consumer demand remained strong, emphasizing the non-discretionary nature of these products. Unlike some sectors constrained by income dynamics, the market for these companies experienced sustained growth.
- The food, beverage, and sugar divisions of these businesses accounted for the majority of the revenue inflow for FMCG firms. The trickle effect of rising input costs along the value chain of these companies resulted in higher production costs which were passed on to end consumers through increases in prices.
- New product launches from Cadbury and Flourmill have expanded their revenue segments and generated additional sales. A diverse production of essential goods has been the strategy keeping the revenue from FMCG companies elevated in 2023.

Moderate growth in cost of sales amid inflationary pressures

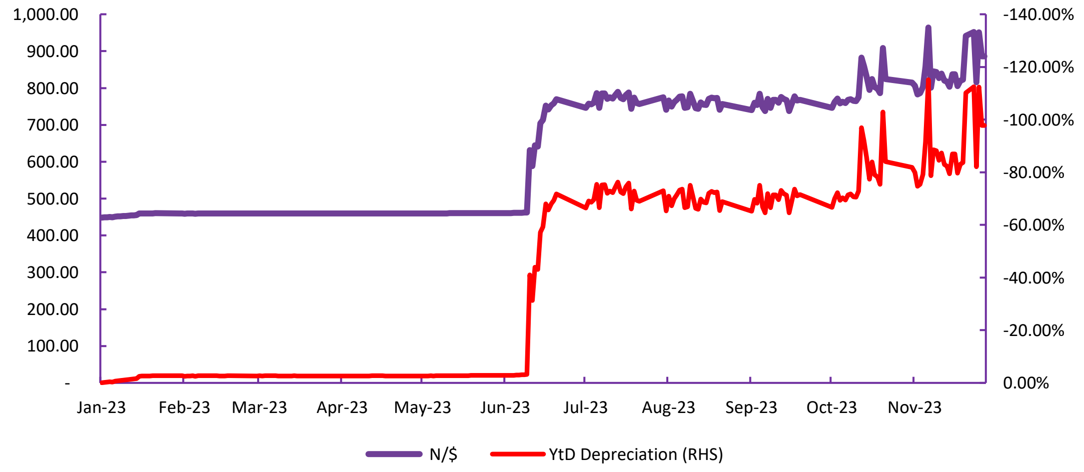
- Growth in cost of sales for companies in the FMCG sector was moderate due to efficient cost management. FMCG companies switched to alternative inputs and locally sourced materials without significantly impacting production quality
- Supply chain disruptions have posed a significant challenge for businesses, leading to increased cost of sales and other operational difficulties such as higher transportation costs caused by the rising cost of fuel and other lubricants..
- As we enter 2024, we anticipate that the upward trajectory in the cost-of-sales will persist, driven by expected increases in the costs of raw materials, labor, energy, and other essential inputs. This projection is influenced by the prevailing inflationary pressures that are likely to impact various sectors.

Consumer Goods Sector: A Tale of Two Halves; Strong Growth Meets Rising Challenges

Commodities Spot Prices for 2023



Exchange Rate and YTD Depreciation



Source; World bank, National Bureau of Statistics, CSL Research

Depreciation of the Naira affecting commodity prices

- After their notable surge in 2022, commodity prices declined in 2023. This downward trend is attributed to the global deceleration of inflation, which is expected to reach 5.9% year-on-year in 2023, down from 9.2% in 2022. The primary driver behind this decline is the implementation of monetary tightening measures by sovereign nations.
- However, the decrease in international commodity prices has not translated into lower costs domestically. The persistent depreciation of the Naira against major currencies has substantially increased the cost of imported commodities in the local market. Despite the global downtrend, local consumers are grappling with elevated prices due to currency devaluation.
- This has resulted in heightened food inflation, emphasizing the complex interplay between international and domestic economic factors. The ongoing foreign exchange risk poses a continued challenge to mitigating the impact of rising commodity prices in the local economy.

FX losses- To reduce materially in 2024

- Increases in the Monetary Policy Rate (MPR) to 18.75% (+255bps) from 16.50% in 2022 increased cost of capital.
- The technical devaluation of the Naira following the collapse of all official FX windows into the Importers & Exporters (I&E) window caused consumer goods companies to report exchange losses on foreign currency loans.
- Though the exchange rate risk still lingers as the Naira weakens with low foreign capital inflow and low crude oil production, we do not anticipate as steep a devaluation as seen in 2023 in 2024, making us anticipate significantly lower FX losses in 2024.

2024 Outlook

FOOD PROCESSORS:

Backward integration to save food processors?

The backward integration scheme, which many food processors have committed to embark on, should mitigate exposure to future exchange rate fluctuations. However, companies will still need to import some of their production materials. Hence, the rising cost of import duties will weigh on the operating expenses of the companies.

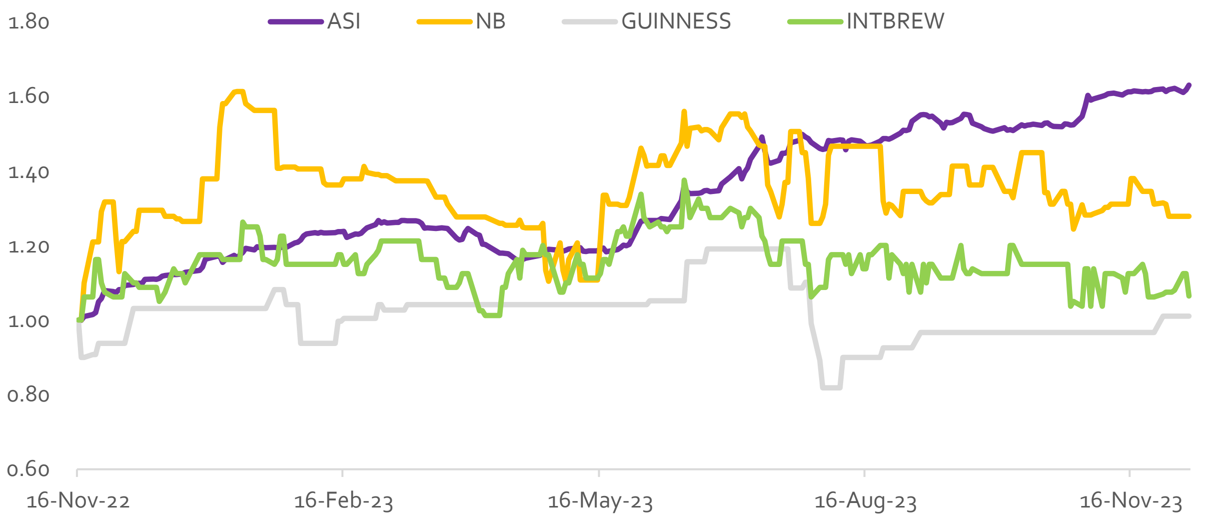
FMCGS– FX Losses to reduce

The heavy FX losses made in H1 2023 is expected to erode profitability of companies in the FMCG sector for FY 2023 despite recovery made in the subsequent quarters. However, we envisage a strong come back in their bottom-line performance in 2024 as FX losses decline.

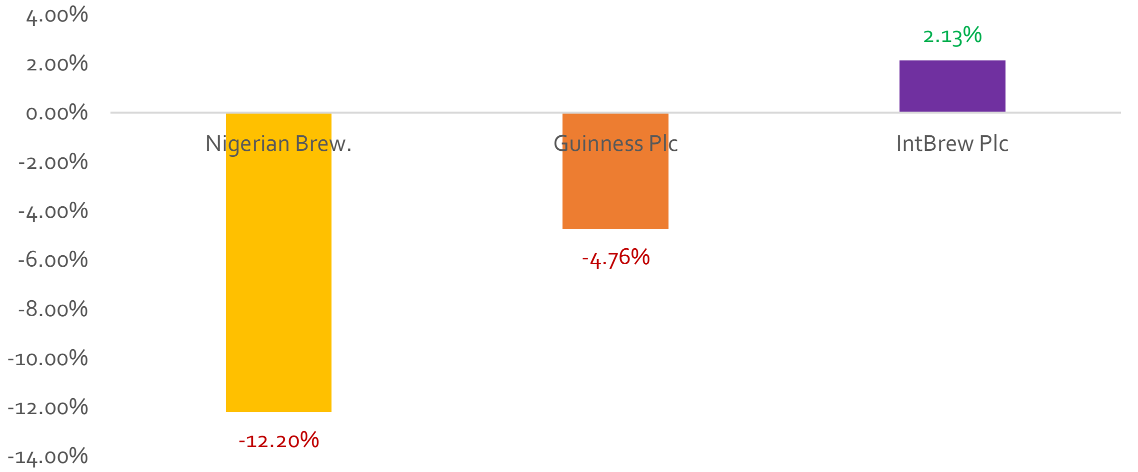
BREWERS REVIEW AND OUTLOOK

2023 In Retrospect

YTD Share Price Performance



Returns On Covered Companies (%)



Source: NSE, Bloomberg, CSL Research

A TALE OF TWO MACRO HEADWINDS

- ❑ The brewing industry, like many other sectors, faced unforeseen macroeconomic challenges in the past year, altering the profitability trajectory for brewers.
- ❑ The removal of fuel subsidy and the unification of the foreign exchange rate at official windows exacerbated the difficulties within this already constrained sector. The industry grappled with low volume sales amidst a highly inflationary environment, witnessing a significant decline in consumers' purchasing power.
- ❑ Sales volumes continued to thin due to intense competition, coupled with a notable shift in consumer purchasing patterns toward essential goods.

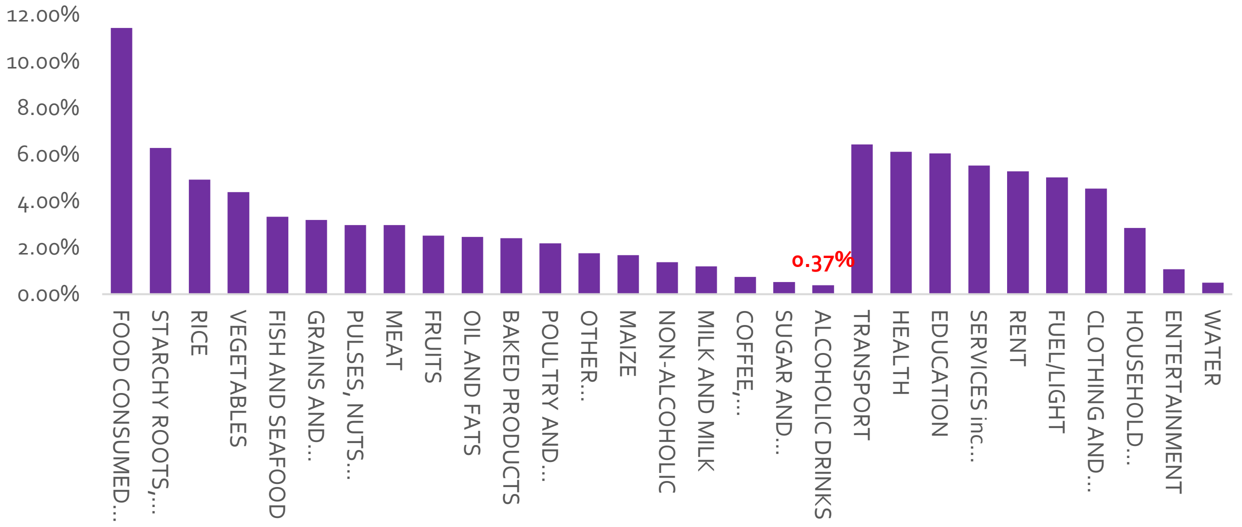
A SECTOR CHARACTERIZED BY MIXED RETURNS

In the period, there were mixed performances across our coverage universe

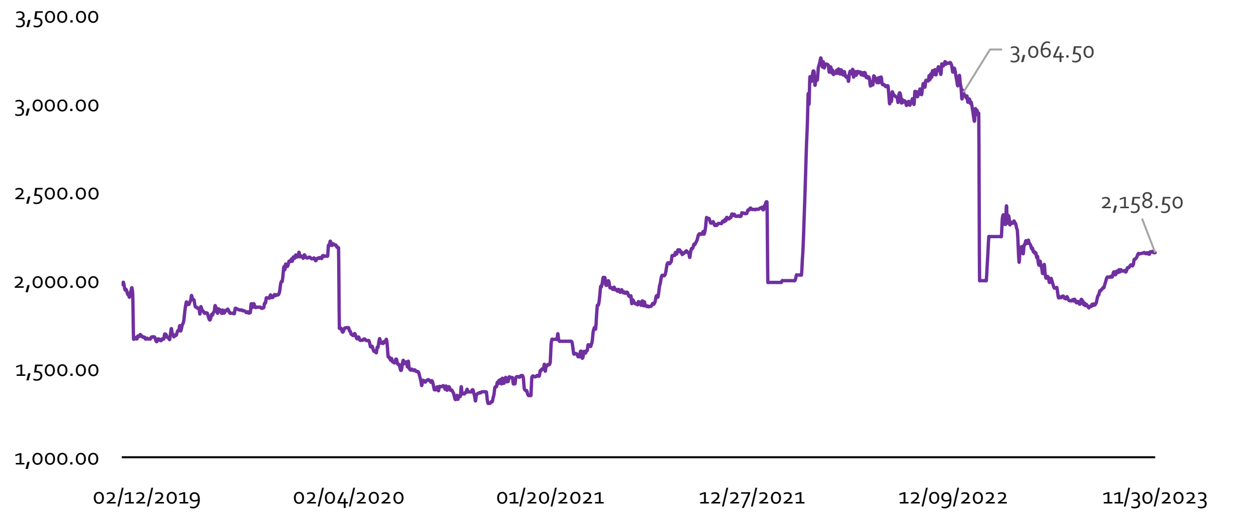
- ❑ The Market leader – Nigerian Breweries failed to capture investors' interest with its lackluster financial performance due to FX losses. The share price declined 12.2% in 2023 but we still maintain a HOLD recommendation.
- ❑ Guinness Plc share price almost stayed flat while reporting fair earnings result in the period despite FX losses. The share price was down 4.76% in the year. We maintain a Buy Recommendation
- ❑ International Breweries' share price grew by 2.13% in 2023.

2023 In Retrospect

Household Consumption Expenditure Pattern



Barley Price (INR/Metric Tonne)



Source: NBS, Bloomberg, CSL Research

INCOME & EXPENDITURE DEPENDENT SECTOR

- ❑ Based on the latest National Bureau of Statistics (NBS) household consumption expenditure pattern report released in 2020, the portion of household income allocated to alcohol consumption is less than 1%, implying this spending category is likely to be reduced when household incomes come under pressure.
- ❑ An application of Porter's five forces framework to analyse the sector, suggests an industry that is fragile, with high consumer bargaining power, multiple substitutes, and intense competition.

EXOGENOUS AND ENDOGENOUS VARIABLES

- ❑ The period witnessed a material moderation in barley prices (-40.28% y/y), owing to increased harvest from major producers (EU, US & Canada), masking the effect of the halt in the grain export deal between Russia and Ukraine.
- ❑ The 10% Green tax on single-use plastics introduced at the beginning of May 2023 was suspended, mitigating the negative effects of tax adjustment on businesses, especially the brewing sector
- ❑ Incessant insecurity and sit-at-home orders in one of the sales hotspot (Eastern Nigeria) of beer products, negatively impacted sales volume y/y.

2024 Outlook

BREWERS – POSSIBLE RECOVERY?

- Concerns are still rife around the impact of the foreign exchange scarcity on inputs within the sector. This, coupled with the difficulty in passing the burden to consumers would pressure margin.

- We forecast increment in prices (c.20%) on all the premium-brand products, this will serve as new impetus to cushion margins pressure and drive revenue growth in the year.

- Barring increase in price of Barley in the global market and abrupt re-introduction of excise tax in the year, we envisage a better recovery in brewers' earnings in 2024, especially GUINNESS Plc – as the company's cost-cutting strategy is expected to support its bottom line performance.

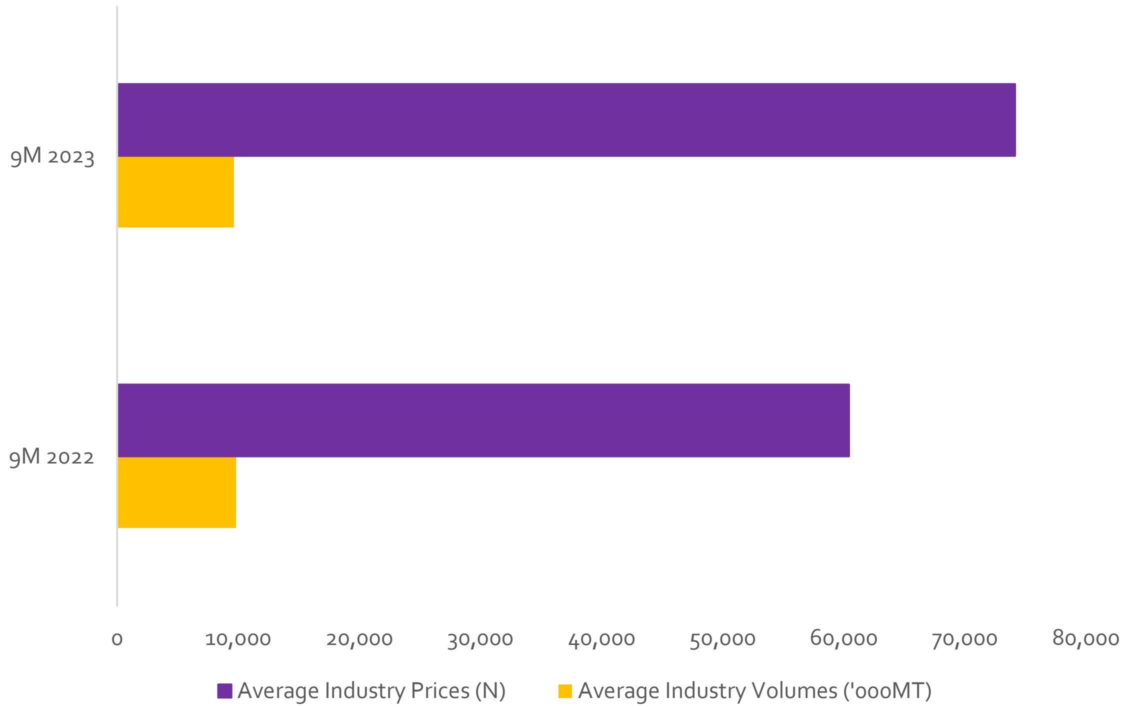
- While we expect household income to taper due to inflation, we expect a rebound toward the end of Q2 as inflation becomes less intense.

- We do not expect significant FX losses in the year as we do not expect as steep a devaluation as seen in 2023 in 2024e.


INDUSTRIAL SECTOR REVIEW &
OUTLOOK

2023 In Retrospect

Increased Prices Protect Profit Margins Of Cement Players



Cement Sector impacted by low demand in 2023

- The cement industry was impacted by low demand in 2023. This was due to constrained consumer spending by private players and low CAPEX spending by the government.

- The cash shortage resulting from the Naira redesign program in the first quarter of 2023, coupled with political activities linked to the general elections, significantly disrupted commerce. This led to a temporary halt in crucial corporate and government infrastructure projects. As a result, there was a contraction in volumes, causing a slowdown in the growth of the sector.

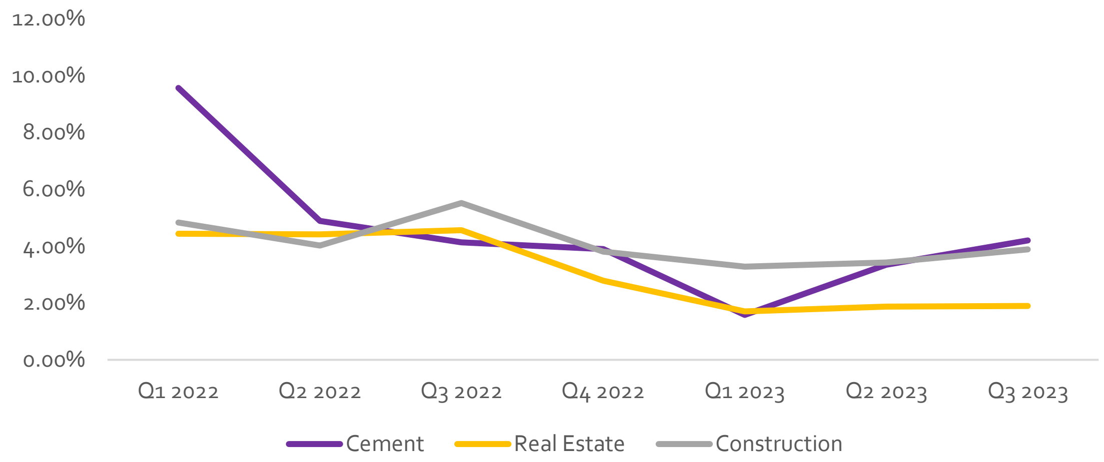
- The robust revenue performance within the sector was primarily driven by elevated cement prices. However, the industry faced challenges such as heightened input costs and distribution expenses, attributed to escalating inflation, Naira devaluation, and the removal of fuel subsidy. In response, cement players increased product pricing to safeguard their profit margins.

- The Naira devaluation in June resulted in substantial foreign exchange losses for industry participants, impacting overall profitability. Additionally, the expiration of the tax pioneer status for Lafarge Africa (WAPCO) translated to higher taxes and a subsequent reduction in net profit.

Sources: Company data, CSL Research

2023 In Retrospect

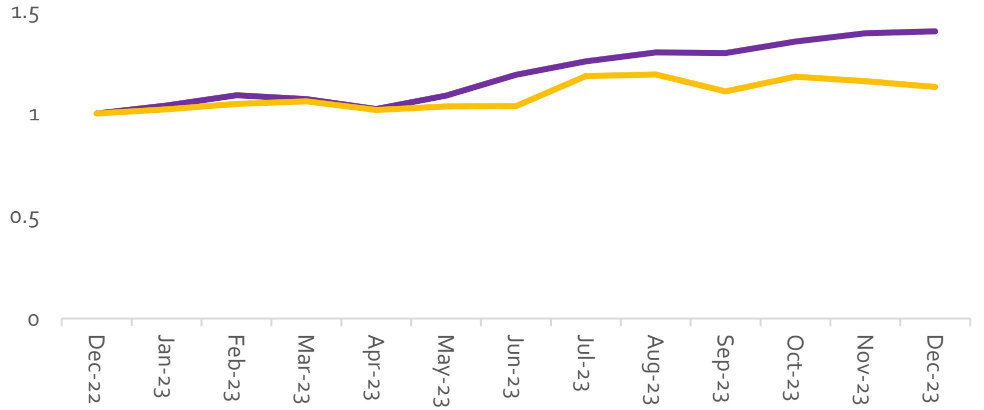
Sustained GDP Growth



Sources: NBS, CSL Research

- Despite the poor macroeconomic conditions, the cement sector sustained output growth, reflected in its 4.20% y/y growth in Q3 2023.
- Related sectors such as real estate and construction also grew by 1.90% and 3.89% respectively.
- The fiscal authorities' lack of urgency in executing CAPEX project spending amidst low private sector investments significantly hindered the growth of the sector.
- Also, the cash crunch in Q1 affected the sector significantly, given the distorting effect within the economy.
- The pick-up in sector growth is attributed to the recovery of commercial activities post inauguration of the new administration, as the economic environment stabilized.

Industrial Index Underperforms The Market

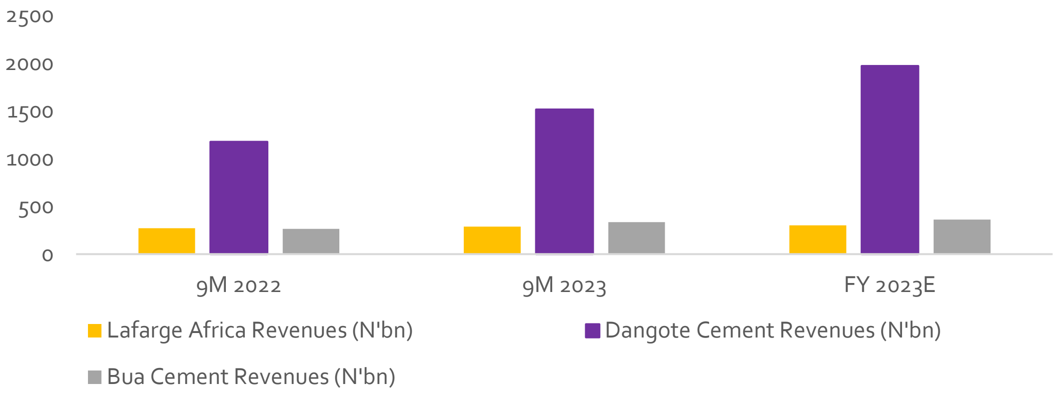


Sources: NBS, CSL Research

- The Industrial Goods sub-index of the Nigerian Exchange Group (NGX) delivered a 12.86% y/y return in 2023, well below the overall market return of 45.90% as measured by the NGX All Share Index. The sub-index was the least performing sub-index in 2023.
- The sector's performance was largely driven by buy interests in DANGCEM (22.5% y/y), and WAPCO (31.25% y/y).
- Despite the initial positive response to Dangote Cement Plc's share buyback in the early part of 2023, investor sentiment took a downturn due to the overall decline in sales volumes. Despite this, we maintain optimism that the positive developments surrounding the expansion of BUA Cement Plc will likely rekindle investor interest in its shares in 2024.

2023 In Retrospect

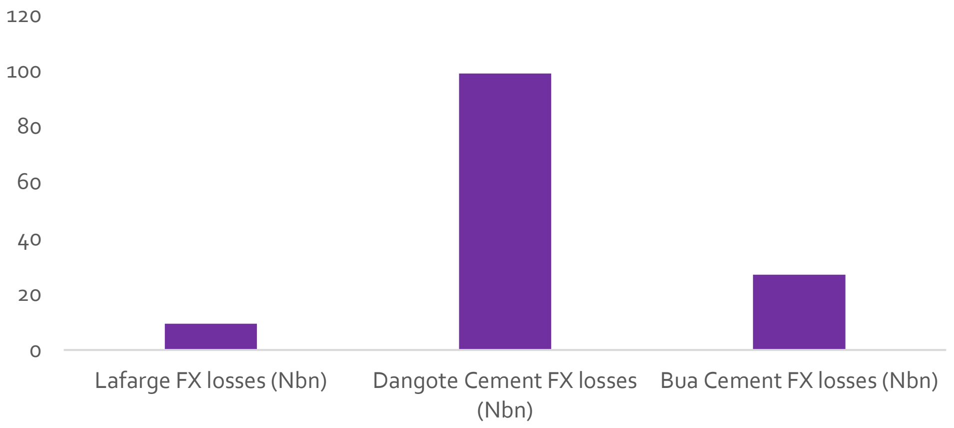
Prices Drive Topline Growth Of Cement Players



Sources: Company, CSL Research

- ❑ Demand for cement weakened significantly in 2023 due to constrained consumer purchasing power and low government expenditure.
- ❑ Cement price increases were the primary revenue drivers amidst declining volume sales.
- ❑ In 9M 2023, driven by the price hikes, Lafarge Africa, Bua Cement, and Dangote Cement grew revenue by 7.1%, 28.7%, and 27.92% y/y
- ❑ Y/y Dangote Cement, BUA Cement, and Lafarge Africa reported price hikes of 17.5%, 21%, and 23% respectively but while Bua Cement sales volume increased by 6.5% y/y, Dangote Cement and Lafarge Africa saw sales volume declines of 2.3% and 8.9% y/y respectively.
- ❑ In a bid to improve the demand for its product, BUA Cement reduced its ex-factory price in Q3 2023.

Forex Losses Affect Profitability Negatively



Sources: Company, CSL Research

- ❑ At the end of 9M 2023, BUA Cement, Dangote Cement, and Lafarge recorded significant increases in FX losses totaling about N135.38bn (441% y/y growth) due to the steep depreciation of the Naira. Lafarge had the lowest FX loss due to its lower FX-denominated liabilities compared to its competitors.
- ❑ Despite the losses, two of the three companies reported strong pre-tax profit growth. Dangote reported a pre-tax profit of N404.89bn (20.54% y/y) while WAPCO's pre-tax profit increased by 13.36% y/y to N61.17bn. BUA Cement recorded a marginal 3.5% y/y decline in Pre-Tax profit to N85.748 billion.
- ❑ We attribute the strong bottom-line performance among these cement companies to revenue growth driven by price increases in the face of diminishing sales volume.

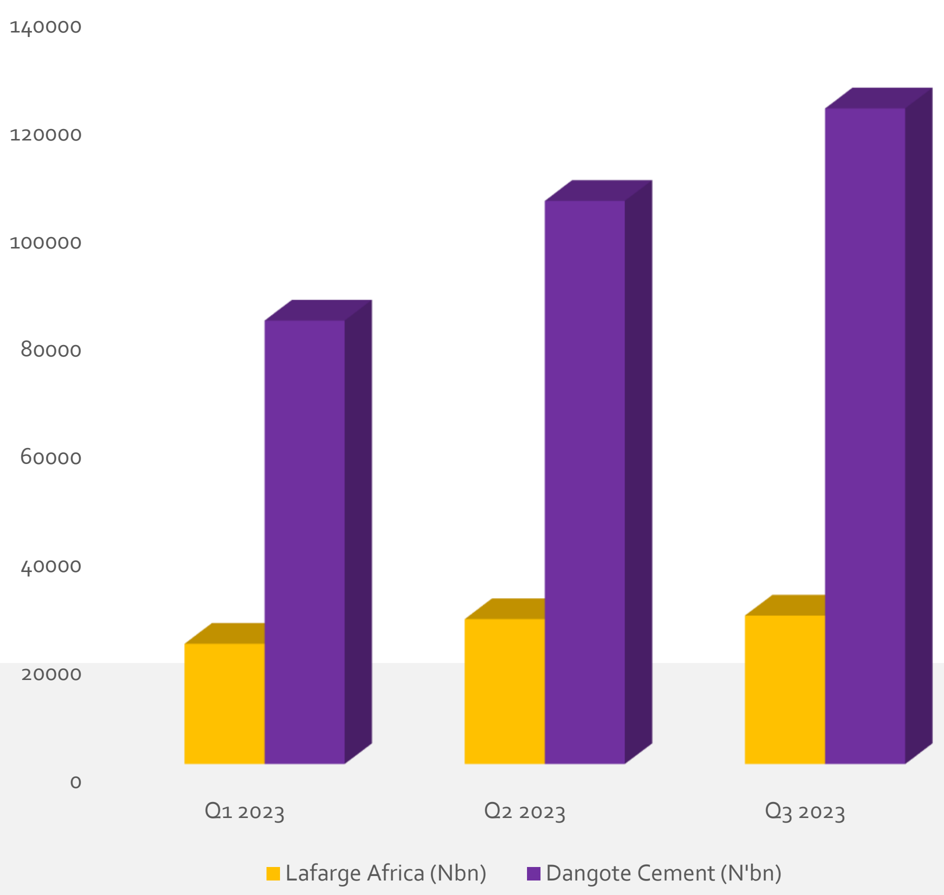
2023 In Retrospect

Effective Pricing Protects Profit Margins

	Price per tonne (9M 2023)		Volume (9M 2023)	
Dangote Cement	Growth 17.49% ↑	Closing price N77,628	Growth -2.3% ↓	Closing price N77,628
Lafarge Cement	Growth 23% ↑	Closing price N77,628	Growth -8.9% ↓	Closing price N77,628
BUA Cement	Growth 21.4% ↑	Closing price N77,628	Growth 6.52% ↑	Closing price N77,628

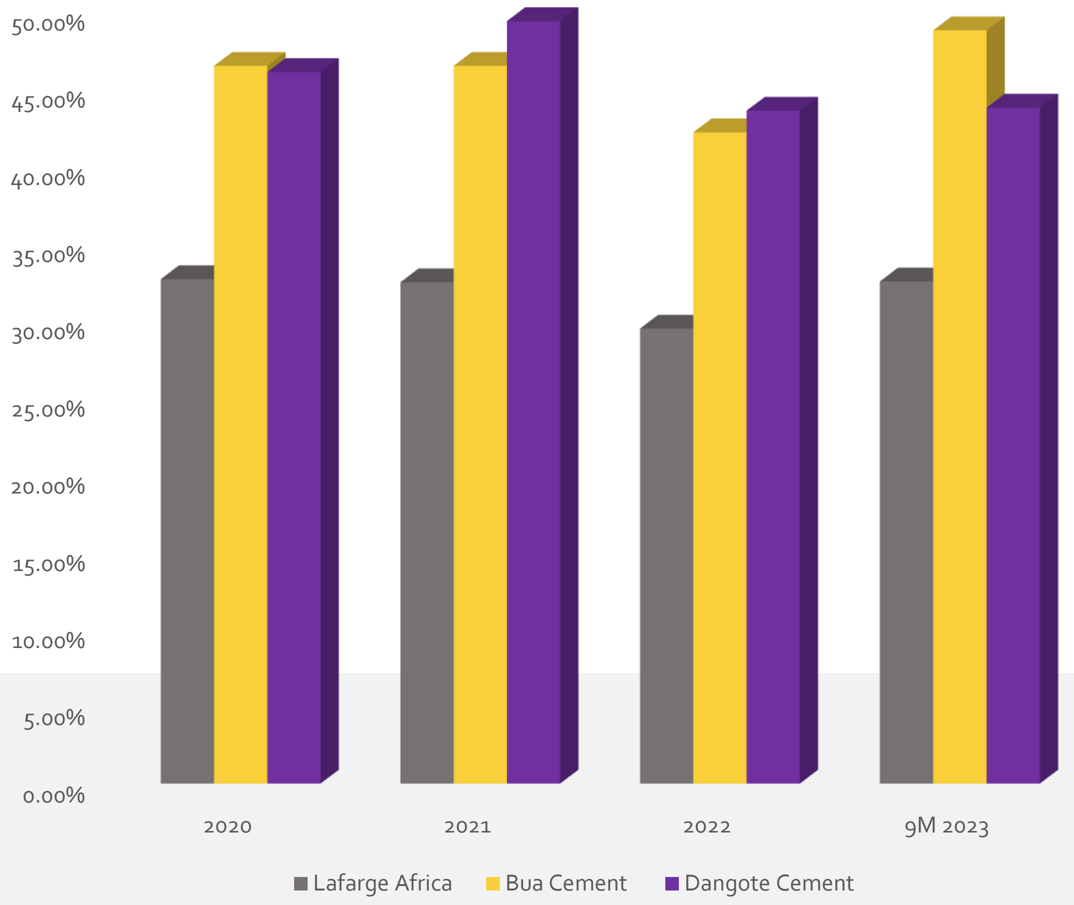
2023 In Retrospect

Elevated Inflation Pressures OPEX



Sources: Company data, CSL Research

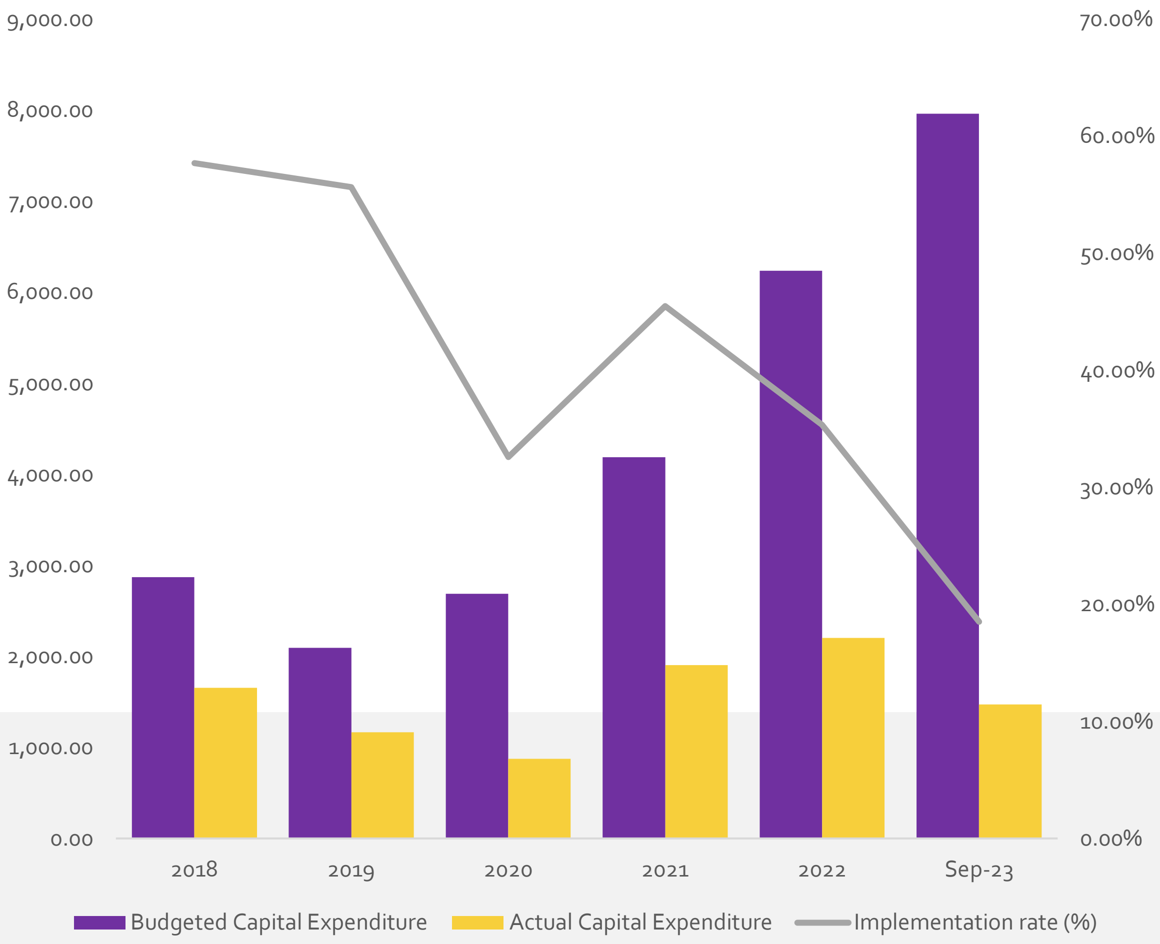
EBITDA Margin: Strong Topline Protects EBITDA Margins



Sources: Company data, CSL Research

2023 In Retrospect

FGN Capex (NBN) & Implementation Rate (RHS)



Sources: Budget Office, CSL Research

- The implementation rate for capital expenditures continues to be a cause for concern, especially considering the continual increase in budgeted figures. As of 9M 2023, approximately N1.47 trillion has been released for capital expenditure, representing only about 18.47% of the total budget allocated for capital expenditure (N7.96 trillion).

- Anticipated challenges stemming from the country's transition of power had led us to expect a subpar budget implementation rate.

- Additionally, it is worth noting that the challenging macroeconomic environment played a significant role in contributing to the low implementation rate of the 2023 capital expenditure budget.

Outlook for 2024: A Smoother Journey Expected

- Heading into 2024, we anticipate the cement sector will remain resilient, experiencing substantial year-on-year growth, particularly in Q1 2024, due to the favorable low base . This positions 2024 on a promising trajectory.

Activities in related sectors such as construction and real estate are projected to rise.

Despite persistent revenue shortfalls amid widening fiscal deficits, we anticipate an improvement in government spending on infrastructural projects in 2024. According to the 2024 fiscal plan, the estimated aggregate amount available for capital expenditures is N8.70 trillion, reflecting a 3.20% increase from the 2023 provision of N8.43 trillion. While historical patterns suggest a potential implementation rate ranging from 20% to 50%, optimism surrounds an improvement with the new administration.

Furthermore, there is an expectation of increased industry demand in the coming year, as consumer purchasing power is anticipated to be less constrained compared to 2023.

Private sector road constructions are also expected to increase in 2024, as companies increasingly accept government's offer of tax credits for road construction.

It is essential to note that challenges such as the high cost of raw materials, persistent inflationary pressures, and rising energy costs may pose downsides to the sector's growth, impacting profitability despite the anticipated higher economic activity levels.

Outlook for the performance of the listed players

- We anticipate that price and volume increases will drive topline growth in 2024. We expect that prices will continue to reflect the country's macroeconomic reality. We also predict that volumes will increase in 2024, based on the premise that certain impediments that slowed growth in 2023 will begin to ease in 2024.

- FX losses are expected to be minimal next year, as we do not expect to as steep a currency devaluation as seen in 2023 (49% June - December 2023) in 2024. Consequently, we expect profitability to pick up significantly in 2024.

- We anticipate that BUA Cement and Dangote Cement will further ramp up cost-cutting measures in other to improve profitability next year.

- The completion of the Ashaka Power Plant scheduled to come onstream in 2024 is expected to lead to a reduction in Lafarge Africa's energy cost.

- The deployment of Dangote Cement's 1.5Mta grinding plant in Cote d'Ivoire and the expected clinker export to Cote d'Ivoire in 2024 bodes well for the growth of the company's pan Africa region's production volumes and this is expected to support Revenue growth in 2024.

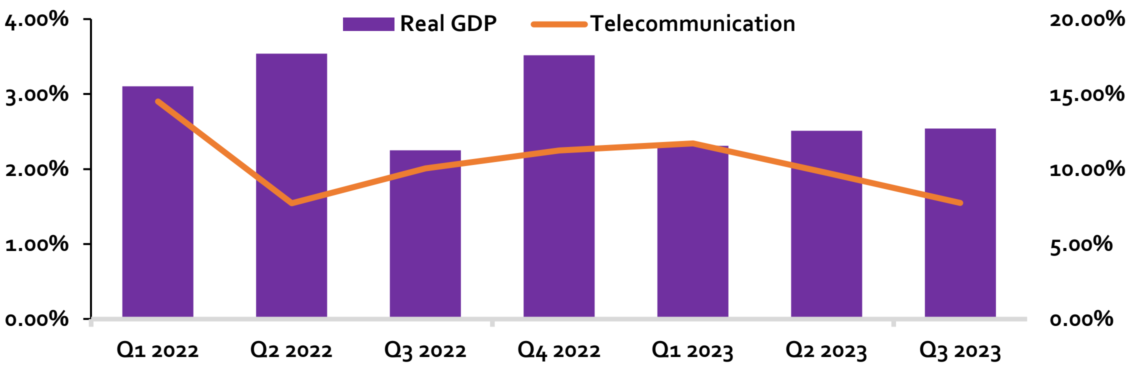
- The expansion drive of Bua Cement with the construction of lines 3 and 5 at the Obu and Sokoto plants should boost the firm's earnings. The lines are planned to begin operations in Q1 2024, adding another 6 MT to the company's production capacity, and raising the total production capacity to 17 MT from the present 11 MT. However, given the industry-wide decline in demand levels, an increase in production capacity may not automatically lead to an increase in sales volume, making us worried about Bua Cement's ability to maximize its production capacity. As of 9M 2023, the company's sales volumes were 4.90 million MT, implying a capacity utilization of around 55.5% of the company's total production capacity of 11 million MT. Also, due to consumers' preference for its competitors' products, Bua Cement may not be well-positioned to benefit immediately from an increase in demand.

- In a bid to drive demand for its product, Bua Cement reported a reduction in its ex-factory prices in Q3 2023 to N3,500/ per bag from roughly N4,200 sold previously. In the short term, we believe volume growth from the commencement of the company's new plants in Q1 2024 might offset any potential loss that may be associated with the Q3 2023 price reduction.

TELECOM SECTOR REVIEW & OUTLOOK

2023 In Retrospect: Telecom Sector struggles to maintain growth momentum.

Gloomy Growth in 2023



Source: NBS, CSL Research

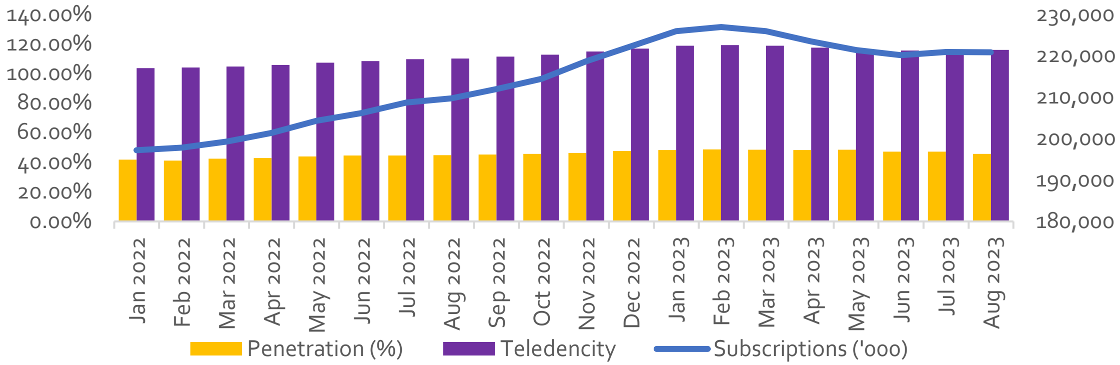
- The Information and Communications Technology (ICT) sector's growth rate declined to a five year low of 6.69% y/y in Q3 2023 compared with 10.53% recorded in Q3 2022 and 8.60% recorded in Q2 2023. The telecommunications subsector growth rate fell by 23.06% y/y to 7.74% in real terms

- In Q3 2023, the sector contributed 15.97% to Nigeria's total GDP, higher than 15.35% in Q3 2022 but significantly lower than the 19.54% contribution in Q2 2023.

- The ailing macroeconomic environment and government policies like the devaluation of the Naira affected the growth of the telecommunication sector significantly.

- We maintain our long-term positive outlook for the sector, driven by growth in mobile subscriptions. Nigeria's growing population, its growing shift to a digital economy, increasing smartphone usage, rising digital consciousness, rapid 4G expansion, and the recent rollout of the 5G spectrum should continue to contribute to the growth of the sector in the long term.

Strong Industry Numbers Remains A Positive For The Sector



Source: NCC, CSL Research

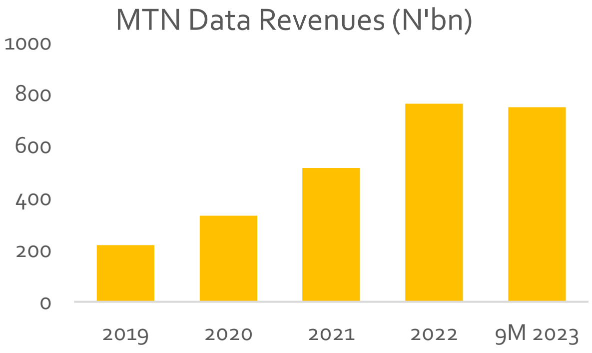
- As of August 2023, Nigeria's active mobile subscriptions increased by 5.13% to 220.7 million, compared to 209 million recorded in August 2022. This indicates that the country's mobile subscriptions database increased by 10.8 million subscribers y/y. According to the NCC, MTN is the largest operator by subscriber base, with total active subscriptions of 85 million as of August 2023.

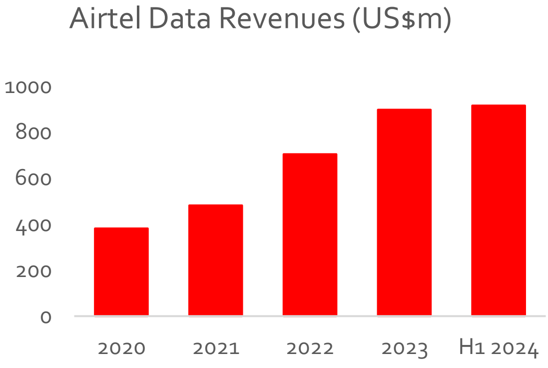
- The country's teledensity, which measures the number of active telephone connections per 100 inhabitants living within an area increased by 5.13% y/y to 115.63% in August 2023 from 109.99% in August 2022, while the country's broadband penetration increased by 2.06% y/y to 45.57% from 44.65% in august 2022. We believe that the rise in industry numbers shows the sector is reaping the dividends of the rapid investments made by sector players.

- Between March and August of 2023, mobile subscribers fell marginally by 2.26%. We note that the marginal decline in month-on-month mobile subscription numbers was due to the abandonment of SIMs that have not been linked with the National Identification Number (NIN) as mandated by the government. However, we note that these marginal declines have not and would likely not have a material impact on the industry numbers.

2023 In Retrospect

Data Drives Revenue Growth For Telcos

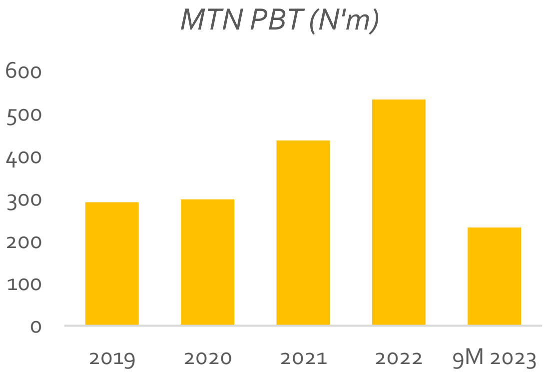


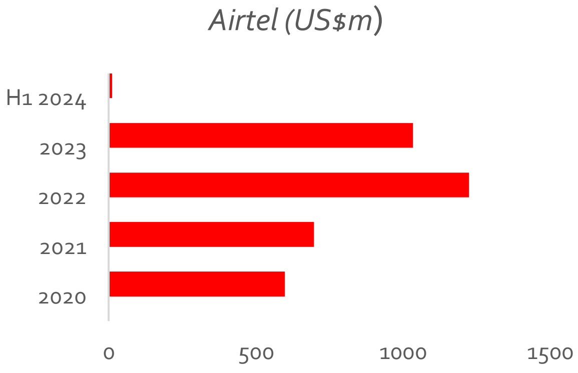


Sources: Company data, CSL Research

- In 9M 2023, telcos revenues increased. MTN and Airtel reported a 22% and 2.3% revenue growth y/y. This growth was driven by increasing data revenue, with both players recording a 36.4% and 6% y/y increase in data revenues in 9M 2023.
- Growth in data revenue could be attributed to significant investments made by players in the sector which has increased usage and enhanced capacity through network expansion and smartphone penetration.
- We note that we have continued to see growth in voice revenues (due to an increase in investments in infrastructure, especially in the rural areas), though at a slow pace. That said, we expect the contribution of voice revenues to total revenues to continue to moderate in 2024.

Inflation, FX losses and Increased Tax Wane Profitability





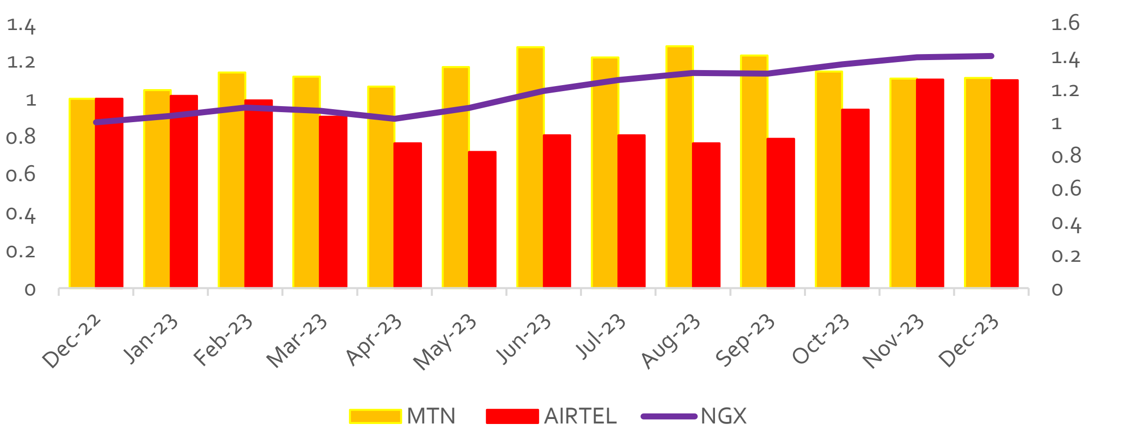
Sources: Company data, CSL Research

The telecommunications industry in Nigeria, faced several challenges affecting profitability in 2023

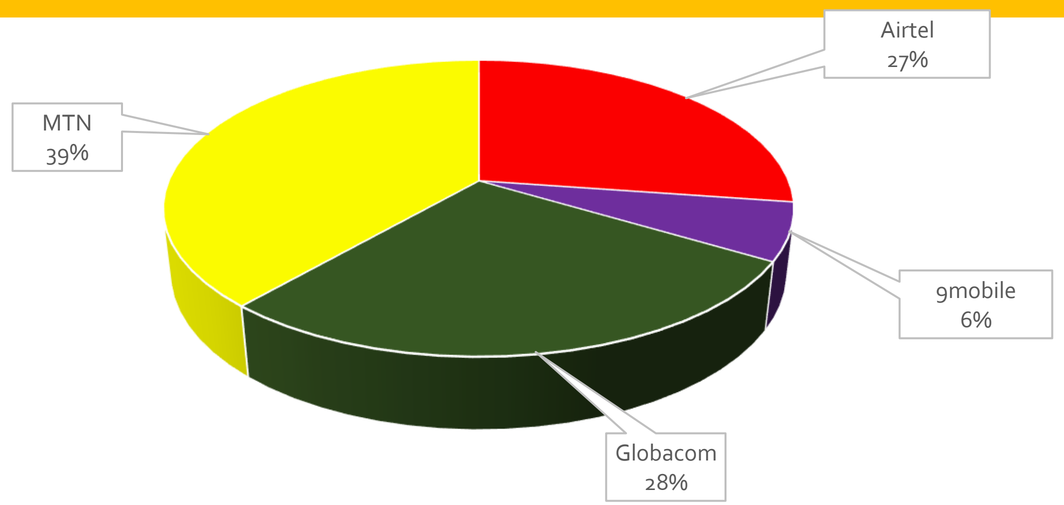
- **Currency Depreciation and FX Scarcity:** The depreciation of the Naira and scarcity of foreign exchange (FX) led to increased operating expenses (OPEX) for telcos which negatively impacted profit margins in 2023. The devaluation of the Naira also resulted in significant financial losses for both MTN and Airtel due to the revaluation of their balance sheets. As of 9M 2023, they reported a cumulative loss of N479 billion, contributing to a decline in profitability.
- **Taxation Challenges**: Increased tax expenses have further impacted profitability, with the implementation of the new Finance Act. The introduction of an additional 5% excise duty on telecoms services, coupled with existing multiple taxes, has added to the financial burden on telcos.
- MTN Nigeria has taken steps to mitigate costs by renegotiating tower contracts. American Tower Corporation has taken over these contracts, and the new agreements are negotiated in Naira, potentially providing protection against future volatility in the country's exchange rates.

2023 In Retrospect

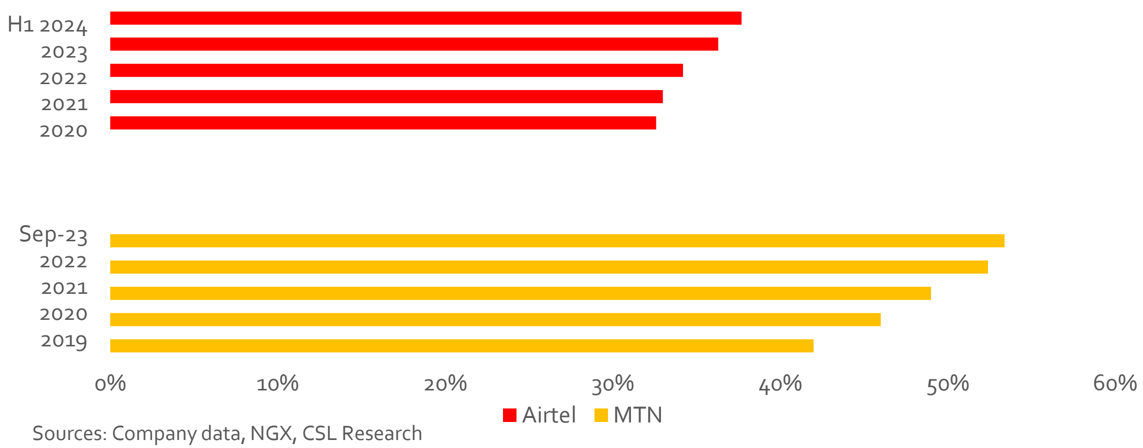
MTNN Outperforms Its peers, but Underperforms The Market



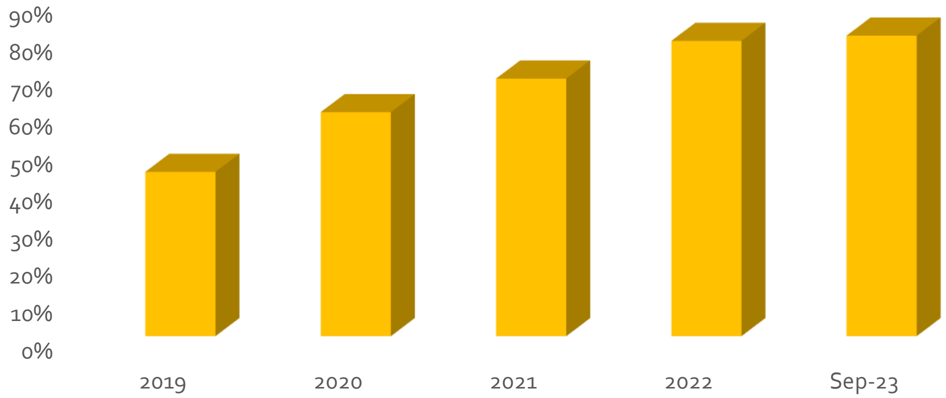
Market share by mobile subscribers across MNOs



Increased Data Usage Drive smartphone penetration



Rapid 4G Upscaling Drives MTNN's 4G population coverage



Sources: Company data, NGX, CSL Research

2024 Outlook – Despite Headwinds, Telecoms Sector Expected To Grow

Mobile Money expected to drive long term growth

- We expect mobile money to contribute significantly to the growth of the sector in the medium to long term.
- Transition from cash to digital payments across Nigeria bodes well for telcos as seen in the recent surge in mobile money users and agents.
- Considerable growth in telcos mobile money business to be sustained. As at 9M 2023, active mobile money (MoMo PSB) wallets for MTN grew by 53.1% y/y to 3.6 million.
- MTN's fintech transaction volume was up by 47.6% y/y. The company's MoMo agents grew by 55.7% y/y to 293,000.
- As at 9M 2023, Airtel Smartcash had 1.9 million active customers registered for mobile money services versus 1.5 million in the quarter ended June 2023.

USSD; Telcos and banks will likely continue their debacle

- There has been an ongoing struggle between banks and telcos concerning receivables from USSD charges amounting to an estimated N120billion accumulated over the past five years.
- Banks for a while have refused to pay, while telcos have continued to threaten to withdraw their services. Based on recent communications from the regulators on the issue, we believe telcos will in the best of situations, be forced to book a loss on a part of the exposure but this will likely not happen in 2024.

Data; Telcos Crown Jewel

- Revenues from data soared in 2023 this is due to the expansion of the 4G network across the country and the rollout of the 5G network.
- We expect data revenues to be supported by the expected high growth levels in subscriptions, consistent 4G LTE upscaling, and the continuous expansion of the 5G network.
- We expect the contribution of data to total revenues to grow faster than voice next year.

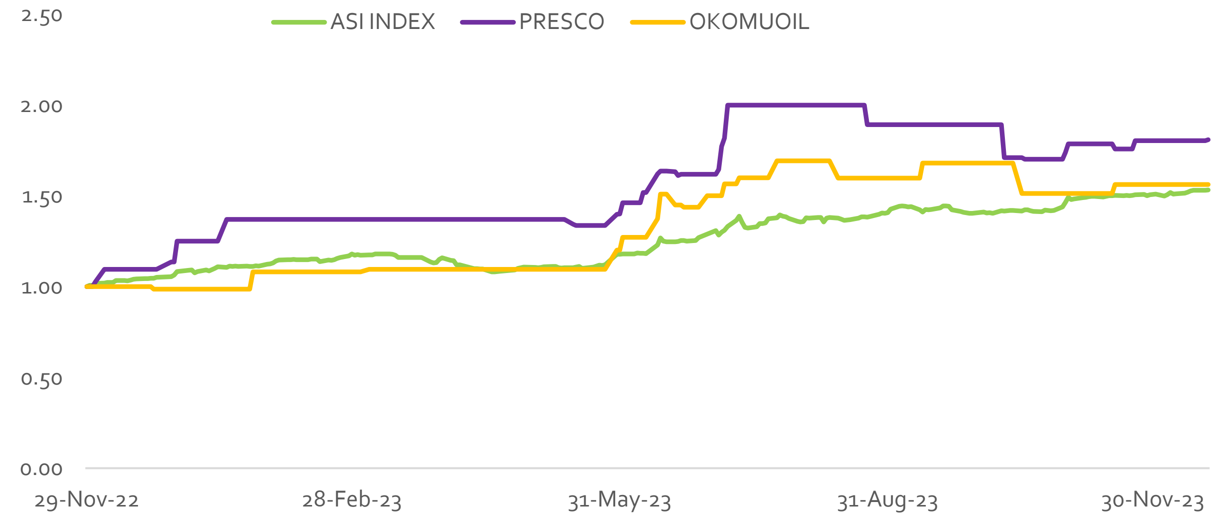
5G expected to spur growth in revenue

- We believe that the recent Nigeria's Fifth Generation (5G) rollout bodes well for the growth of the sector given the demand for faster and more reliable internet service.
- The rollout of 5G has been successful thus far, hitting half a million network subscriptions in a few months.
- MTN appears to be ahead of its peers in deploying the network, having deployed in 15 cities.
- We believe that the 5G spectrum will lead to significant growth in data subscriptions in the medium to long term given its ability to improve download and upload speeds, and notably lower latency.

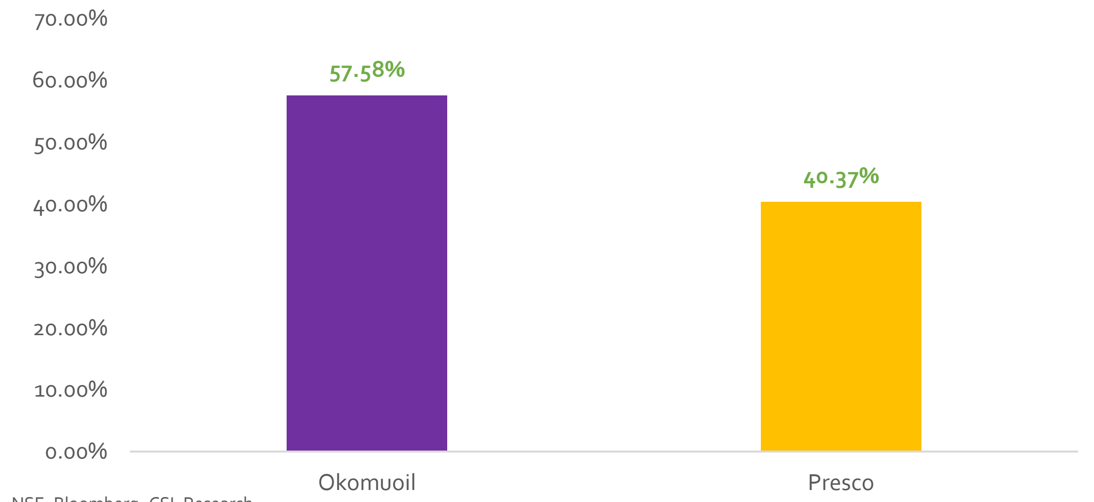

AGRO-ALLIED REVIEW &
OUTLOOK

2023 In Retrospect

YTD Share Price Performance (Index Of 1)



Returns On Covered Companies (%)



Source: NSE, Bloomberg, CSL Research

CPO, RBDO Demand Spurred Volumes

- In 9M 2023, the two major players (Okomu & Presco) in the sector recorded impressive topline growth of 20.9% & 29.8% respectively on the back of industrial (82%) & household (18%) demand for Crude Palm Oil (CPO) & Refined Bleached Deodorized Oil (RBDO) which spurred volumes: Okomu (40,875MT vs 9M 2022: 37,316MT), Presco (46,500MT vs 9M 2022: 39,610MT)

- The country's large population remains a major driver of demand. In 2022, approximately 350,000 MT of palm oil consumed in Nigeria was used for non-food industrial purposes, while 1.37 MMT was for consumption.

Sturdy Performance; Despite Macro Challenges

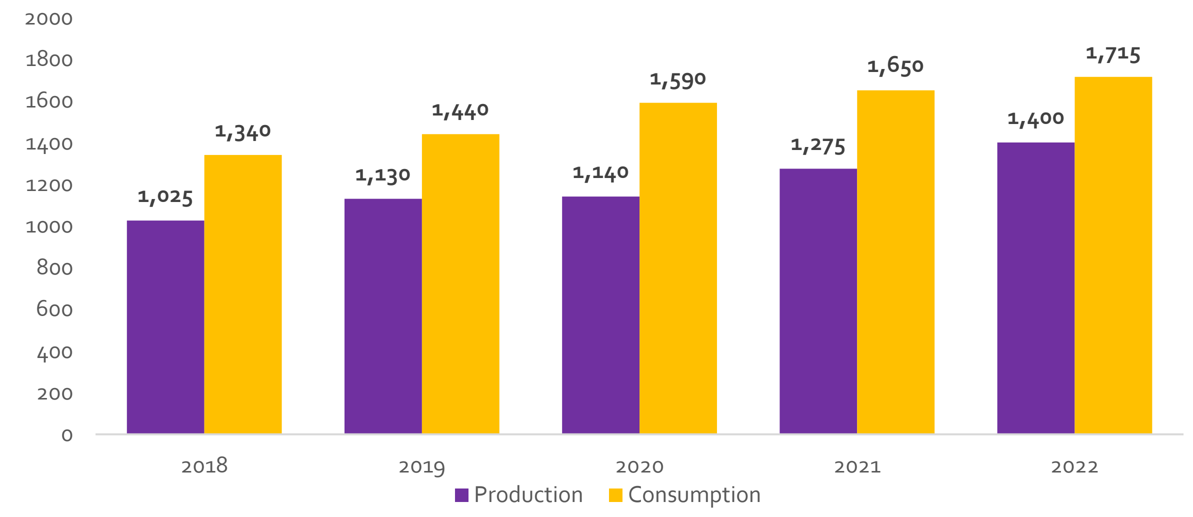
- Okomu reported FX loss due to the Naira devaluation that occurred during the year. The company recorded a 288% rise in finance cost to N2.1bn (9M 2023) from N537m (FY 2022), out of which 63%(N1.3bn) was foreign exchange loss.

- Cost of Sales and OPEX went up by 31.6% and 39.4% respectively due to the fuel subsidy removal, but the company still printed a profit after tax of N20.9bn (vs 9M 22: N18.1bn). Okomu's stock price grew 57.8% in 2023

- Presco in the same vein recorded FX loss of N3.89bn in 9M 2023. Also Cost of Sales and OPEX rose to N27.9bn (+35.8% y/y) and N3.89bn respectively, but the company still posted a profit after tax of N23.5bn(vs 9M 22: N15.9bn). Presco's stock price grew 40.36% in 2023.

2023 In Retrospect

Palm Oil Production VS Consumption In Nigeria ('000MT)



CPO Price (US$/Metric Tonne)

Source: Bloomberg, CSL Research

Opportunity & Capacity for Private Players

- With a population of c.210 million, Nigeria consumes over 3million metric tonnes (MMT) of fats and oils annually with palm oil accounting for approximately 48% of total consumption in 2022. Nigeria is the largest consumer of palm oil in Africa, consuming 1.75 MMT in 2022.
- Crop production (which palm oil plantation falls under), a subsector of Agriculture, recorded GDP growth rate of c.0.63% in Q3 2022 vs c.2.45% growth in Q3 2023
- The wide gap (315,000 MT) between CPO production and consumption in Nigeria presents the two major players in the sector an opportunity for capacity expansion.

Slight Divergence between Global and Local Price Movement

- Normally, when global prices of CPO fall, the local prices fall in tandem and vice versa. In 2023 we realised that the local market for CPO thrived when international price of CPO traded low (-20.1%y/y), putting producers (Okomu & Presco) at the risk of competition with CPO Importers.
- However, the liberalisation of the foreign exchange market in early June had unanticipated consequences for the parallel market, leading to a steep devaluation. As a result, CPO importers who rely on the parallel market for FX and act as price setters, raised prices (c.N1,100,000/ton vs c.N850,000/ton in H1'23) to pass on the added cost to end consumers.

2024 Outlook

INCREASED DEMAND BY INDUSTRY GIANTS TO BOOST VOLUME

- Heading to 2024, we expect the CPO business to remain resilient and maintain capacity in terms of quality seedlings, bounty harvest of Fresh Fruit Bunches (FFB), planting expansion, milling, and storage of inventories ahead of lean season.

- With incentives like Export Expansion Grant (EEG) still in place, we project an increase in export activities of the sector players particularly in their Rubber business segment.

- We also believe the sector will witness a boost driven by the N100 billion Food Emergency Fund implemented in the 2024 budget to tackle food scarcity and insecurity in the country. Major sector players will be beneficiaries in terms of reduced cost of inputs and government grants.

- If the decision on border closure for those who remain closed is not changed, then smuggling activities will likely remain minimal.

- Overall, we have a positive outlook for the CPO business as we expect volumes to increase on the back of increased demand for CPO by industrial giants like Nestle, Dangote Group in 2024 as these businesses plan to significantly reduce import and source raw materials locally.

BUY RECOMMENDATIONS

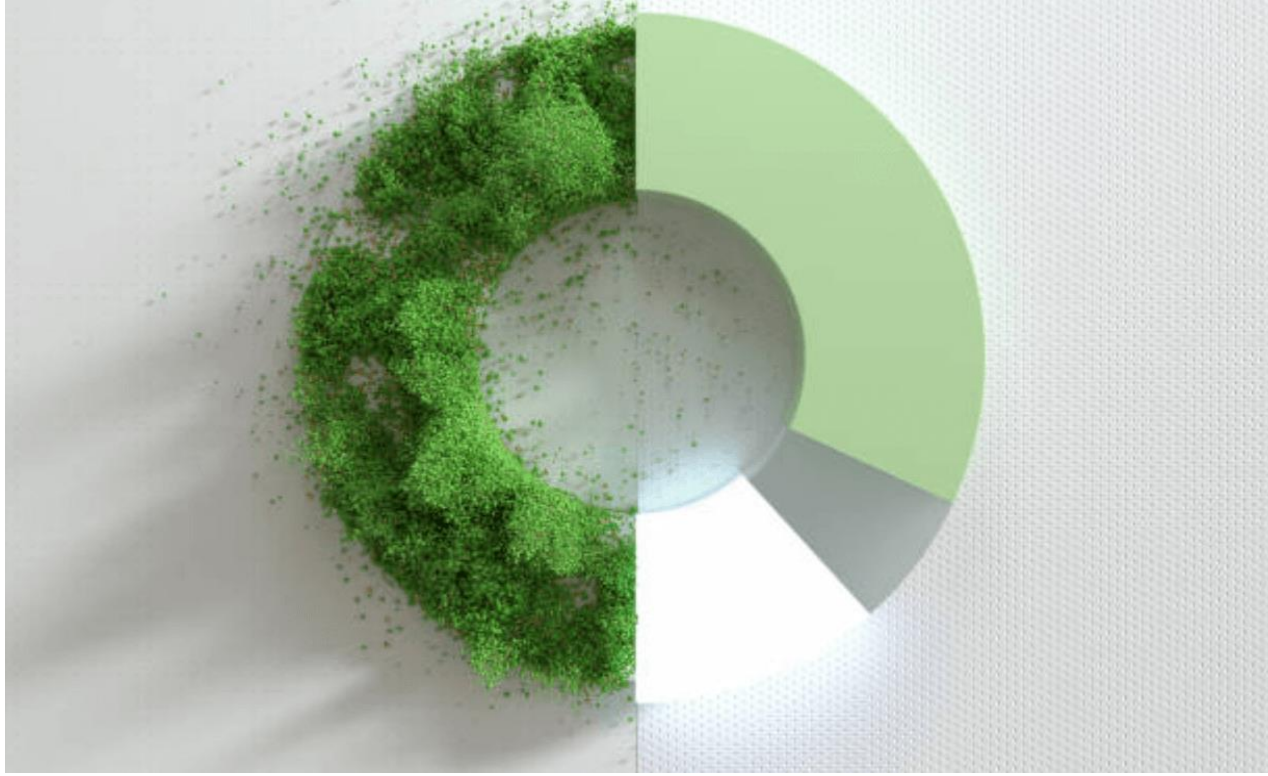
CSL

BUY RECOMMENDATIONS

ZENITH BANK: Zenith's 9M 2023 Capital Adequacy Ratio (CAR) of 20.1% remains comfortably above post Basel 3 regulatory minimum of 17.0%. Despite a steep price appreciation in 2023 and in the few days of January, we still find the valuation of the shares compelling (PBV: 0.75x). Though extensive revaluation gains aided earnings in 2023, core earnings growth remained strong. The bank rates well relative to peers based on capital sufficiency, asset quality, and sustainable long-term dividend yield. Asset quality also remains strong with an NPL ratio of 3.8%, 9M 2023 annualized Cost of Risk (COR) of 5.5%, and coverage ratio of 179.4% as of 9M 2023. The relatively high cost of risk in 2023 was related to the steep devaluation of the naira and we forecast a reduction in COR to 2.5% in 2024e. Though we expect a general deterioration in asset quality in 2024e due to the prolonged weak macroeconomic conditions, we believe COR will remain minimal in the near term. We have revised our target price up to N56.77/s. Current price: N45.85/s.

GTCO: We still find valuation attractive at current levels (PBV 1.1x) and see limited risk to the bank's capital from potential provisions arising from subdued macro conditions. One of the highest capital adequacies among our coverage (Group Capital Adequacy Ratio of 25.10% as at 9M 2023 with the full impact of IFRS 9). In the event of a significant deterioration in asset quality (which we think unlikely in the short term), we see little impact on the bank's capital adequacy. Guaranty's asset quality remains strong. We project FY 2024e Cost of risk of 1.5%. The bank rates well relative to peers based on capital sufficiency, asset quality and sustainable long-term dividend yield. We have revised our target price to N65.20/s. Current price: 47.35/s

ACCESS CORP: Operating performance has remained strong with growth in both Interest and Non-Interest Income. Asset quality ratios also show a healthy loan book (9M 2023 annualised Cost of Risk (COR) of 1.4%. We project FY 2024e COR of 1.5%. Despite a steep price appreciation in the past few months, we still see some leg room for price appreciation. Valuations remains attractive (PBV 0.67x). We have a target price of N36.97/s. Current price: N29.80/s



UNITED BANK OF AFRICA: The bank reports healthy asset quality ratios with annualized Cost of Risk (COR) of 4.1% for 9M 2023, NPL ratio of 3.6% and coverage ratio of 131.45%. The relatively high cost of risk in 2023 was related to the steep devaluation and we forecast a reduction in COR to 1.5% in 2024e. Growing contribution from its Pan African subsidiaries continues to give some versatility to the business and helps protect margins. Valuations remain compelling (PBV 0.67x). We have a buy rating on the stock with a target price of N41.25/s, current price: 33.95/s

NESTLE: An expected return to profitability in 2024 despite underwhelming 2023e losses. Nestle's 2023 financial performance was riddled with losses due to the devaluation of the Naira, which led to an increase in loan expenses on FX denominated loans and an increase in the cost of USD pegged raw materials. Q3 2023 result already show a recovery in its financial performance and we expect the company to return fully to profitability in 2024. Therefore, we have a BUY recommendation with a target price of N1,834.56/s. Current price: N1,196.00/s.

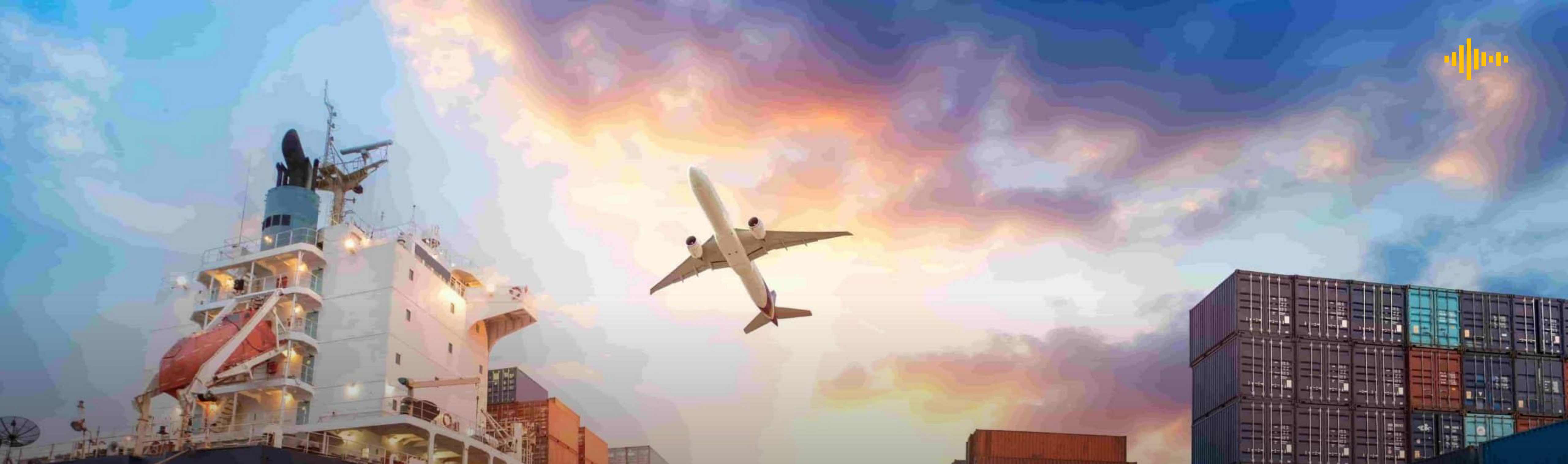
BUY RECOMMENDATIONS

FLOURMILLS OF NIGERIA: Backward integration to lessen company's reliance on foreign currency: Beyond flour milling, Flourmill is involved in the production of sugar, pasta, edible oils, and packaged foods. The continuous expansion of its revenue segments with the launch of Golden Penny Choco spread and the relaunch of golden bites ChinChin and the reintroduction of the Bagco Zerofly sacs is expected to support revenue growth. The company's acquisition of Sunti Golden Sugar Estates Limited with its 17,000 hectares of farmland is a favorable step in its backward integration efforts aimed at reducing its vulnerability to FX volatility. We have a BUY recommendation with a target price of N53.70/s. Current price: N45.10/s.

MTNN: Growth In Bottomline expected In 2024: Despite the negative impact of Forex losses on the company's bottom line, we anticipate a turnaround in 2024. MTN's FX losses are projected to be low next year, since we do not anticipate a currency depreciation as severe as that observed in 2023 in 2024. Also, the company has taken steps to reduce its FX liabilities by renegotiating its expiring tower contracts in Naira. We retain our BUY recommendation on MTNN with a target price of N325.3/s. The company has been consistent with dividend payments, with a current dividend yield of 6.55%. The company's shares currently trade at an EV/EBITDA of 5.39x compared to industry EV/EBITDA of 5.57x. Current price: N288/s.

OKOMU: COMPELLING FUNDAMENTALS: We have a **BUY** rating on the stock. Okomu trades at a FY'23 P/E of 12.25x which is at a discount to Bloomberg Middle East & North African peers of 14.65x. A combination of DCF and relative valuation enabled us reach a Target Price of N272 per share, Current price: N265.00/s. Okomu trades at an EV/EBITDA of 8.2x compared to its Middle East & African peer average of 13.5x Also, their wholly-export Rubber business is projected to support dollar earnings capacity.

GUINNESS: Shiny Fundamentals: The business has recorded a c.31.2% revenue growth rate in the last 3 years, with 10.9% y/y revenue growth in FY 2023 and a forecasted 17.2% y/y growth in FY 2024. Guinness's exit from the spirit importation business is expected to lower cost of sales and increase Gross Margin from 36% to 37.1% in 2024e. We retain a buy recommendation on Guinness with a price target of N95.41/s derived from 60/40 blend of a DCF valuation and sector relative valuation estimates (EV/EBIDTA). Guinness trades at an EV/EBITDA of 3.6x compared to its Middle East & African peer average of 9.8x. Current price: N65.00/s.



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