CARDINALSTONE

Nigeria: Half Year Outlook 2021

THE BIG BOUNCE

July 2021

Executive Summary

The second half of 2021 is expected to bring some cheer to macro watchers globally, with the most robust growth projected for Emerging Markets and Advanced Economies. Sub-Saharan African Economies may have to make do with milder out-turns, given the reality of their low fiscal & monetary bandwidths and lingering regulatory-cum structural impasses. Yet, base effects could instigate the most significant macro bounces across these markets in years. In our view, Nigeria could record its paciest GDP growth in over 32 quarters in Q2'21, with construction, trade, manufacturing, real estate, and crude petroleum & natural gas moving from pull to push sectors on the impact of their low bases.

The jury is out on whether the expected recovery has been priced in by markets, despite pointers to the likely impact on monetary policy previously hinted by the MPC. These pointers, and our macro assessments, inform our projection for a tighter yield environment as the country edges close to the pre-election year 2022. We, therefore, favour the same short duration fixed income strategy that proved broadly successful for short-sellers, who were not caught out by the discontinuation of the 2045 bond instrument in H1. Savvy equity investors would also have to ferret the market for opportunities amidst expected broad market weakness driven by elevated yields and tighter liquidity. We expect this class of investors to opt for fundamentally sound stocks trading at deep discounts to market and boasting consistently high dividend yields. In addition, investors could watch out for opportunities likely to be created by strong rebound in sectors like Oil and Gas and Brewery that were battered by the pandemic.

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Summary of recommendations

Company Ticker	Rating	TP (N)	Ref Price[1] (N)	Upside/ (Downside)	Market Cap (N'Bn)	2021F P/E	2021F D/ Y
Financial Services							
ACCESS	HOLD	**9.87**	9.15	**7.9%**	325.00	2.4x	10.4%
ETI	BUY	**6.28**	5.10	**23.1%**	93.58	1.9x	0.0%
FBNH	HOLD	**8.17**	7.50	**8.9%**	269.20	3.9x	5.4%
FCMB	SELL	**2.55**	3.00	**-15.0%**	59.41	3.4x	5.0%
FIDELITYBK	BUY	**2.77**	2.39	**15.9%**	69.25	2.1x	10.4%
GTCO	BUY	**40.50**	29.60	**36.8%**	871.16	4.3x	10.2%
STANBIC	HOLD	**46.70**	40.70	**14.6%**	452.01	6.6x	6.9%
UBA	BUY	**9.19**	7.80	**17.8%**	266.76	2.2x	9.3%
ZENITHBANK	BUY	**29.86**	24.85	**20.2%**	780.20	3.2x	12.6%
Consumer Goods							
DANGSUGAR	BUY	**21.08**	17.65	**19.4%**	214.39	6.3x	9.7%
FLOURMILL	HOLD	**34.10**	29.85	**14.2%**	122.40	4.7x	6.2%
GUINNESS	HOLD	**31.65**	31.65	**0.0%**	69.33	16.0x	5.8%
NB	BUY	**70.14**	58.00	**20.9%**	463.82	24.7x	5.8%
NESTLE	HOLD	**1541.15**	1540.00	**0.1%**	1,220.70	26.4x	3.7%
UACN	HOLD	**11.17**	10.50	**6.4%**	30.25	5.7x	6.6%
Industrial Goods							
DANGCEM	HOLD	**253.80**	248.00	**2.3%**	4,226.05	11.8x	8.4%
WAPCO	BUY	**28.21**	21.75	**29.7%**	350.34	10.2x	4.6%
Agriculture							
OKOMU	HOLD	**111.25**	110.00	**1.1%**	104.93	7.1x	7.3%
PRESCO	HOLD	**74.59**	70.00	**6.6%**	70.00	6.7x	2.6%
Telecoms & Utilities							
MTNN	BUY	**213.24**	165.00	**29.2%**	3,358.49	12.3x	6.4%
TRANSCORP	HOLD	**1.03**	0.94	**9.6%**	38.21	6.5x	1.7%
Oil & Gas							
ARDOVA	BUY	**18.98**	15.90	**19.4%**	20.71	8.7x	1.7%
SEPLAT	BUY	**927.33**	770.00	**20.4%**	453.10	11.2x	4.4%
TOTAL	HOLD	**231.97**	203.00	**14.3%**	68.99	3.9x	7.7%

[1]Close price as at 23/07/2021

Growth and Economy

Getting back on track

Getting back on track

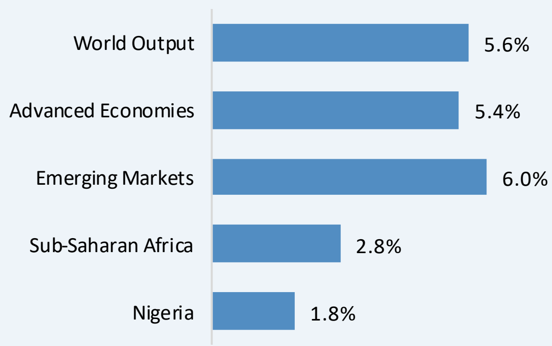
The second half of 2021 is expected to bring some cheer to several economies around the globe, following the most significant economic fallout since the 2008-2009 financial crisis. The World Bank forecasts the global economy to grow by 5.6% in the year, supported by the gradual reopening of key economic and industrial centres as covid-19 infection rates wane, fiscal and monetary policies remain supportive, and global demand improves. Although the highly infectious coronavirus delta variant appears to threaten the reopening of most economies, there is increasing optimism that vaccination programs are tilting the balance positively. However, according to the World Bank, growth in Sub-Saharan Africa is likely to be slower at 2.8% (1.8% for Nigeria) due to relatively slower vaccine rollouts, policy uncertainty, and weaknesses in investment.

Base effect to lead growth charge

For us, we see the potential of a 3.1% YoY GDP growth for Nigeria in 2021. Our optimistic growth expectations reflect more substantial recoveries in the second and third quarters with expansions of 7.9% and 3.4%, respectively, while growth in the fourth quarter could be modest at 1.1%.

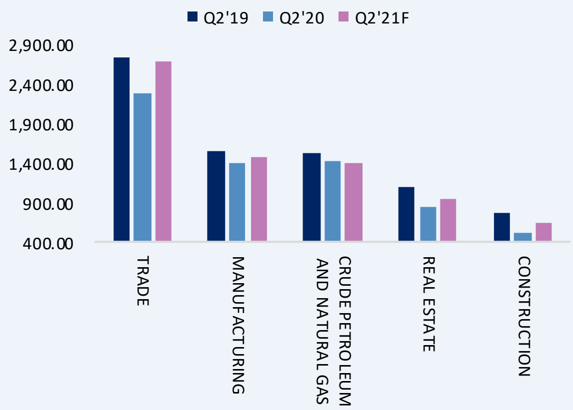
Imperatively, we highlight that our seemingly optimistic growth outlook reflects the low base effect of the previous year due to the impact of the COVID-19 pandemic on economic activities. Q2 and Q3 were the most hurt as lockdown measures stifled production and disrupted the supply chain, leading to inflationary pressure. In addition to the high rate of job losses, this inflationary pressure strained domestic consumption and led to a recession. Notably, we highlight the severe weaknesses in Trade (-16.6%), Manufacturing (-8.8%), Crude Petroleum & Natural Gas (-6.6%), Real Estate (-22.0%) and Construction (-31.8%) sectors in Q2'20. While we believe that a rebound in these sectors could lead to the highest quarterly GDP growth in over 25 quarters, we note that actual activity levels are likely to underperform Q2'19, indicating a lingering pandemic-induced output gap.

Figure 1: World bank growth 2021 growth projections



Sources: World Bank; CardinalStone Research

Figure 2: Output to recover sharply from 2020, but remain below pre-pandemic level



Sources: NBS; CardinalStone Research

Growing insecurity remains the biggest threat to Nigeria's attainment of potential GDP growth

Beyond the accelerated recovery expectation of 2021, Nigeria's possible return towards a level of sustainable growth remains the perennial concern. In our view, post Q3'21, the economy is likely to slow down its pace of growth to around 2.0% levels, highlighting the lingering macro vulnerabilities that last year's low base may have masked. In fact, before the 2016 recession, the economy grew by 4.7% on average in the preceding thirteen quarters. Since then (over twenty-five quarters), the country has only once recorded growth above 2.5%. Damage to already frail economic structures, alongside weaker consumption and investments, have dented the economy with high unemployment an unsurprising fallout. Consequently, agitations have risen just as quickly as living standards have deteriorated, and these, worryingly, may have cascaded into severe growth-constraining security concerns for the country.

Figure 3: Conflict hot zones in Nigeria (last 5 years)

North East	Boko Haram, alongside splinter groups, has accounted for over 50% of conflict-related deaths in Nigeria
North West	The region accounts for 20% of conflict –related deaths mostly linked to banditry, cattle-rustling and kidnapping
North Central	Herdsmen-farmer clashes have persisted in the region, leading to 14% of conflict-related deaths in the country
South South	Infamous for militant attacks on oil infrastructure, the region accounts for 8% of conflict-related deaths on average
South West	Relatively less volatile, the region has seen incidences of cult clashes, armed robberies and kidnapping. Accounts for 4% of conflict-related deaths on average
South East	Despite the recent IPOB-related crisis, the South East has accounted for the lowest conflict-related deaths (3%) in the country on average in the last 5 years

Sources: Council on Foreign Relations; CardinalStone Research

High base effect, harvest season likely to soften the impact of security concerns on inflation

An unsurprising economic fallout of the pandemic was the surge in inflation driven partly by supply chain disruption. The pent-up demand from stockpiling of necessities over lockdown fears may have also heightened the supply-demand gap. These, in addition to the impact of multiple FX devaluations, PMS price hikes and electricity tariff hike inevitably accentuated the inflationary pressures witnessed in 2020. In 2021, inflation may have continued its uptrend in the first quarter, but has begun to show signs of moderation since the start of the second quarter.

Our model forecasts inflation downtrend to continue through H2'21, closing at 15.3% with an overall average of 17.2% for 2021 vs 13.2% in 2020. Our projected moderation possibly relates to the high base effect of the previous year, propelled by structural elements that are unlikely to repeat. To this point, while there remains the likelihood of further PMS price hikes as oil prices stay elevated and the subsidy burden bites, it is tough to see any price increases that would replicate those of 2020 as political will, in our view, remains low. Furthermore, the electricity tariff review, which came into effect in November 2020, is expected to remain static, while FX devaluation could be relatively muted versus 2020. To the latter point, there is increasing wariness that monetary policy moves could force an appreciation in the parallel market – which appears to have the strongest pull on inflation vs the NAFEX window.

Notwithstanding, we see an upside risk emerging from food inflation. Insecurity remains a bane to food production in the country. To this point, the Famine Early Warning Systems Network (FEWS NET) warns that widespread conflict arising from increased banditry, cattle rustling, kidnapping, and militancy could lead to the increased displacement of food-producing communities. At the same time, the likelihood of above-average rainfall could lead to flooding detrimental to seasonal output in the closing part of the year. According to the Nigerian Meteorological Agency, the country would likely experience its first La Nina[1] year in ten years in 2021, which could negatively impact output from the main harvest season.

[1]La Nina: La Niña is characterized by lower-than-normal air pressure over the western Pacific. These low-pressure zones contribute to increased rainfall. - National Geographic

Currency: A few more steps to convergence

The apex bank's decision to reduce the number of foreign exchange windows in the country is likely to be positive despite perceived FX illiquidity. Over the next few quarters, our base case FX outlook is less pessimistic (3.3% depreciation to N425) than was initially feared. This view is premised on our expectation of an improvement in the current account (CA) deficit position, alongside the country's Eurobond issuance plans, which could potentially improve the CBN's ability to defend the currency and boost the financial account.

How far will the unorthodox measures go?

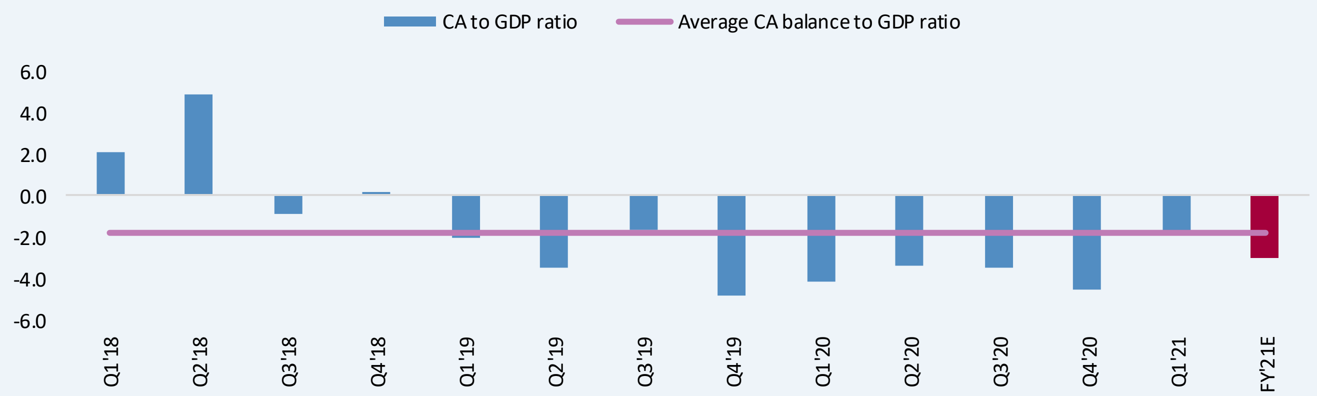
The Central Bank of Nigeria (CBN) has employed a plethora of unorthodox measures to defend the naira in recent times, such as the creation of multiple foreign exchange markets, restriction of access to FX for the importation of select items, and limitation of FX supply since the start of the pandemic. However, the monetary authority took a step towards FX rate unification in May 2021 after its erstwhile official rate was replaced by the relatively more transparent I&E FX rate. However, it appears that this latest drive towards currency unification, alongside higher oil prices, is yet to translate to tangible currency gains, with complaints of FX shortages persisting. To this point, we note that several manufacturers and investors have continued to resort to the parallel market to meet their FX needs irrespective of the c.23.0% premium over the rate attainable at the I&E window.

Positively, the FX outlook appears less pessimistic in the second half on the back of 1) the expected improvement in current account deficit position (CBN's Q1'21 provisional data of C.$1.8 billion represents the lowest deficit in 9 quarters); 2) the plan to raise c.$6.0 billion in foreign borrowings; and 3) a possible clampdown on speculative FX demand after robust GDP rebound.

To the first point, the year on year Q1 current account improvement reflected the impact of tamer services and income deficits, which tapered the effect of trade deficit. Expressly, breakdowns indicated that gradual re-opening of the economy was yet to drive FX outflows from transport and travels to pre-COVID levels. At the same time, dollar illiquidity continued to restrict the scope for significant repatriation of dividends and distributed profits.

To the second point, Nigeria's plan to raise $6.2 billion in foreign borrowings in H2'21 may support its financial accounts (FA) and act as a reprieve to foreign investors as FX reserves improves, enhancing CBN's ability to support the currency.

Figure 4: Current account pressures to moderate from 2020 levels (in percentages)

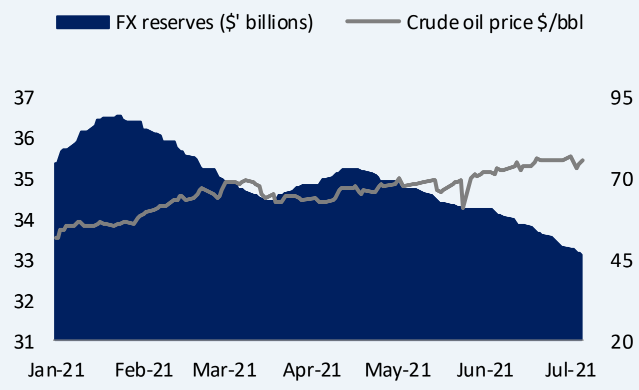


Source: CBN; CardinalStone Research

On the whole, we forecast a current account deficit to GDP ratio of 3.0% for 2021 (vs 3.9% in 2020). This projected moderation supports our prognosis for a relatively mild repricing of the naira to N420-430/$ band by year end. Our base case of N425/$ is lower than CBN's RPPP estimate of N465/$ and the NGN/USD 6-months forward rate of N433.81 as per FMDQ numbers. However, we note a few risks to our outlook:

1. a faster than expected surge in services and income deficits to pre-pandemic levels
2. more material increases in imports as activity levels normalize
3. a sharp reversal of oil price gains—following OPEC+ planned supply increases—and (or) force majeure on domestic oil production
4. postponement and (or) cancellation of some or all of the planned foreign borrowing
5. increased FPI apathy on inordinate delays in Eurobond program (or other foreign borrowings), better carry trade in peer countries, and inflation-induced rate increases in developed markets.

Figure 5: Gross reserves continued its free fall despite oil price rebound



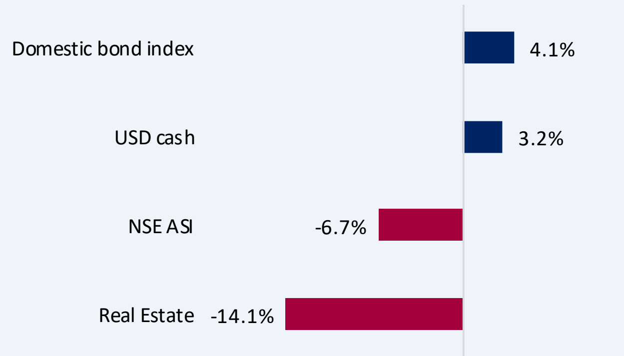
Source: CBN; CardinalStone Research

Are parallel market rates worth the risk?

Moderating domestic inflation (vs rising CPI in the USA) impacts NGN/USD FVEs, and could, in time, influence rates at the parallel market. Should the market delay a repricing to near FVE, the apex bank may have a justification to step in to provoke the correction. In addition, rising CBN FX supply to the I&E window (39% of total supply in May vs 9.3% on average in the previous four months) could also ease demand pressures at the parallel market and improve rates convergence in the coming months.

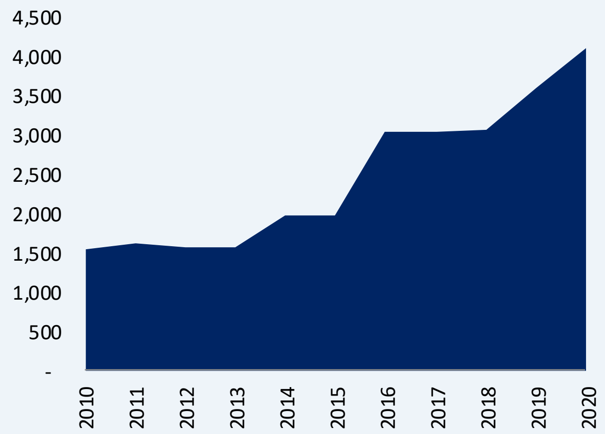
As a hedge against domestic inflation, we note that the USD has outperformed most domestic asset classes over the last 10 years. However, our prognosis for a likely appreciation in the parallel market rate suggests that investors may be better off holding off dollar purchases through this window till a correction pans out.

Figure 6: Asset class real returns (2011- 2020). Holding USD has been a good hedge against domestic inflation



Source: CBN; UNIONHOMES REIT; CardinalStone Research

Figure 7: Historical change in value of the $10 in naira over the last 10 years



Source: CBN; CardinalStone Research

Investment Views

Trudging along a slippery path

Fixed Income: Short duration play still relevant

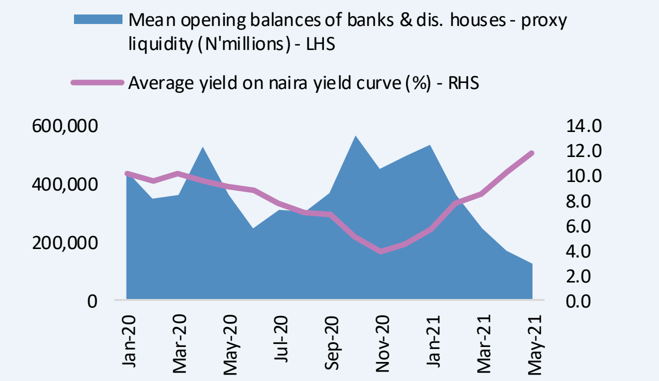
In our FY'21 outlook report published in January, we identified expected lower liquidity, GDP recovery, rising inflation, and substantial budget deficit as pointers to yield uptrend in H1'21. We also posited that, of the four factors, lower liquidity would have the most dominant influence on the yield trajectory. Indeed, our thesis panned out, with the naira yield curve expanding by c.7.46ppts in H1'21, following a plunge in liquidity levels, a notable increase in OMO stop rates, consecutive net issuances on the NTB front, intermittent CRR debits, and a few hawkish signals from the MPC. Thus, staying short proved a masterstroke over the first six months of the year. In this section, we delineate our yield outlook for the rest of the year and suggest a suitable FI strategy to navigate the space.

Lean liquidity & hawkish remarks

The reduction in liquidity mostly mirrored materially lower OMO maturities of c.N420 billion in Q2'21 (vs N2.7 trillion in Q1'21), aggressive net issuances on the NTB front, and intermittent CRR debits. Although leaner liquidity was a dominant driver of yields, the shock 467bps increase in average OMO stop rates in February—to encourage FPIs to roll over maturing investments amid a worrying dollar shortage—stoked bearish expectation in the domestic market. These sentiments were further fueled by the hawkish rhetoric of the MPC in March, which was triggered by the earlier than expected exit from recession in Q4'20 amidst surging inflation numbers. Notably, the average yield on the implied naira yield curve expanded by 325bps between the March MPC meeting and the 24th of May 2021 (vs the cumulative dilation of 358bps in the preceding three months). However, the committee eventually reverted to dovish rhetoric on the 25th of May on temperance in inflationary pressures, frail Q1'21 GDP reading, and, perhaps, the desire to align with notable global central banks who opted for inertia despite rising inflation.

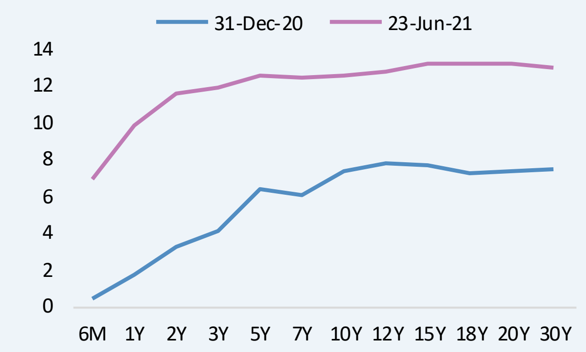
The H1'21 dilations across the short, mid, and long ends of the curve were roughly the same, but higher duration instruments expectedly saw more significant price declines. In the 'short end', the market remained segmented into foreign investors and banks (with the exclusive privilege to partake in OMO issuances) and domestic investors who focused on T-Bills and bonds but remained susceptible to the second-order effect of developments in the OMO space. To this point, we note that the shock increase in OMO stop rates in February fast-tracked repricing of yields across the T-Bill and bond space in H1'21. This repricing mainly reflected the activities of banks that rotated out of the relatively unattractive T-Bills & bonds into OMOs and inadvertently stoked bearish sentiments in the former market.

Figure 8: Lean system liquidity had a strong impact on yields in H1



Source: FMDQ; CBN; CardinalStone Research

Figure 9: Implied naira yield curve expanded by over 700bps



Source: FMDQ; CardinalStone Research

H1’21 may have been “heaven on earth” for short sellers

The mostly universal expectation of material yield correction in H1’21 sparked increased short-selling in Nigeria’s fixed income space. A few institutions with access to client portfolios (i.e. custodians) and foreign institutions who used dollars as collateral for borrowing long term domestic bonds were notable short sellers in the earlier part of the year. Indeed, the surge in yields between January and May justified the investment play, and astute participants now looked to cover short positions in June, amidst fears of material yield moderation in July (even though some short sellers may have been caught out by the cancelation of the 2045 paper). Those who held long positions through to June were hit hard by negative price returns, which eroded most of the accrued interests earned in the period.

Figure 10: Short sellers: 1st leg on 4th Jan & 2nd leg on 22nd June

FGN Bonds	Price return	Owed accrued interest	Total return
14.50 15-JUL-2021	6.3%	-6.3%	-0.1%
16.39 27-JAN-2022	8.0%	-6.6%	1.4%
12.75 27-APR-2023	15.3%	-2.0%	13.3%
14.20 14-MAR-2024	18.5%	-3.9%	14.7%
13.53 23-MAR-2025	20.2%	-3.4%	16.9%
12.50 22-JAN-2026	20.8%	-5.2%	15.6%
16.28 17-MAR-2027	23.3%	-4.3%	19.0%
13.98 23-FEB-2028	26.9%	-4.6%	22.3%
14.55 26-APR-2029	24.6%	-2.3%	22.3%
10.00 23-JUL-2030	26.8%	-4.1%	22.7%
12.1493 18-JUL-2034	27.8%	-5.2%	22.6%
12.50 27-MAR-2035	31.4%	-3.0%	28.4%
12.40 18-MAR-2036	32.6%	-3.2%	29.4%
16.2499 18-APR-2037	35.3%	-2.9%	32.4%
9.80 24-JUL-2045	35.2%	-2.3%	32.9%
14.80 26-APR-2049	33.5%	-2.3%	31.2%
12.98 27-MAR-2050	41.1%	-3.1%	38.1%

Source: FMDQ; CardinalStone Research

Yield direction for H2’21?

In our view, the drivers of H2’21 yield outlook may include:

- Fiscal deficits and planned domestic borrowing
- System liquidity
- Inflation & growth trajectories
- Monetary policy

Fiscal issuance may exceed N1.3 trillion in H2’21: The MTEF estimates the 2021 budgetary deficit at N5.6 trillion, which is to be partly funded by domestic and foreign borrowings in equal proportion. This distribution implies that targeted local borrowings approximates c.N2.3 trillion, or c.N3.1 trillion if you account for the domestic portion (N722.5 billion) of the new supplementary budget of N895.8 billion. In H1, the combined net issuances of bonds (N1.4 trillion) and NTBs (N350.9 billion) amounted to c.N1.8 trillion (c.57.6% of proposed domestic fiscal borrowings for 2021). At that rate, a combined net issuance of c.N1.3 trillion in H2'21 would be needed to meet the domestic budgetary borrowing target for 2021. However, we note that the 2035 and 2050 instruments (conduits for c.80.4% of the last FGN bond raise in H1) are discount bonds, suggesting that the net issuances may have to be much higher than N1.3 trillion. Assuming the 35.2% excess issuance over maturities in H1 subsists, our overall prediction for gross issuance at the NTB and bond fronts is c.N2.2 trillion and c.N1.3 trillion, respectively, for H2.

System liquidity is likely to remain tight in H2’21, with expected OMO maturities of N1.2 trillion, 61.6% lower than in H1'21 and bond maturity at a low N561 billion for the rest of the year. We also note the likelihood of sustained intermittent and unpredictable CRR debits. Latitude for continued net issuances on the NTB and bond fronts, to meet high fiscal borrowing needs, are also likely to reduce system liquidity. That said, improved FAAC disbursements on higher oil prices could slightly offset some liquidity pressures.

Inflation and growth trajectories could spark a dilemma: In our view, solid growth recoveries in Q2'21 and Q3'21 should create scope for yield increases as one primary justification for MPC's dovish rhetoric falls off. While a base effect-induced plunge in inflation could slightly complicate decisions, concerns over the possible impact of an increase in PMS price (assuming the politically hot "subsidy game" is extended) on CPI could justify a bias for tightening. In any case, YoY inflation is likely to remain above CBN's target range of 6.0% to 9.0% by year-end (CardinalStone Research December 2021 forecast: 15.3%), and MoM pressures are likely to extend even without subsidy removal or pump price increase.

MPC's body language will be crucial: MPC's stance may be hard to call in H1'21, but unfolding developments could provide some roadmaps. First, given broad expectations for strong base effect-induced economic recovery in Q2 and Q3, the apex bank's attention is now likely to shift to currency and how to combat the widening spread between the parallel and I&E rates. Notably, even though the current inflation differential suggest an NGN/USD FVE of N460/$ (vs N505/$ previously), parallel market rates have remained well above $500/$. This deviation from FVE could justify a CBN tightening to force a re-alignment in 2021 akin to that in 2011, which was sparked by the apex bank's response to liquidity-induced FX speculation despite high oil prices. All in, we see scope for an indicative 50bps increase in MPR before the end of 2021.

Strategy? Just stay out of duration

On balance, we expect yields to close the year within +100bps and +200bps of current levels. Our prognosis is strengthened by the latent need for rate normalisation, especially for short-dated instruments. For one, we see the sustained illiquidity-induced divergence between placement rates (maximum of c.13.9% for most of H1) and closing T-bill yields across tenors in recent months as unsustainable, especially bearing in mind the need for enormous issuances for NTB rollovers in H2. As of the end of June, up to three deposit money banks had time deposit rates higher than the yield across all T-bill tenors (vs one in March, April, and May), possibly corroborating our thesis on the impact of tightening liquidity squeeze.

Also, we expect interest on bonds to rise partly to compensate for projected yield increases in T-bill given their maturity risks and as a result of high fiscal borrowings, general illiquidity, and the other previously mentioned factors. While the N561 billion bond maturity and buying pressure from short-sellers looking to cover their positions could stoke some yield moderation in early H2, we expect this to reverse due to the combined impact of the factors above. We, therefore, favour a short-duration strategy for the second half of the year.

Equities: The dark clouds could linger

The trajectory of yields, the pace and extent of economic recovery, and the quality of companies' earnings' growth are likely to be the critical drivers of equity market sentiments in the second half of the year. Oil price has had a positive correlation with the market, but with foreign players unhappy about the CBN's FX policy stance, they have largely remained on the sidelines leading to a distortion of the trend. With oil prices reaching new highs (with the latest OPEC+ imbroglio suggesting that prices may remain elevated in the near term), it is likely that the market could lose out on any potential implication. Over the next year, pre-election year political risks could come to bear. Add to that, the likelihood of a lull in oil prices following a much anticipated easing of OPEC+ production cuts. Yields could also remain elevated to account for a potentially higher country risk premium (from socio-political stability fears), keep FX in check and combat inflation from a politically-induced surge in spending. These indicators are likely to weigh on the overall market sentiment going into 2022.

Yields to have biggest say in equities

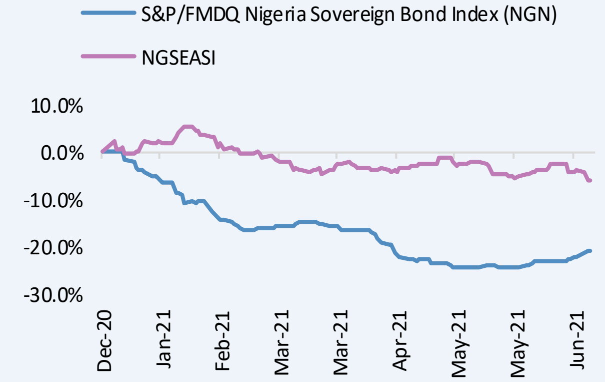
Following the fast rise in yields since the beginning of the year (for instance, the 10-year bond yield has jumped 520 bps since the start of the year), there are indications that bond yields will remain elevated through H2'21, which could portend further concern for equities in the near term. Already, equities have lost c.6.0% this year, and the recently observed bond yield moderation has hardly had a positive impact on risk asset prices. As highlighted in the fixed income section of this report, there are indications that the moderation in yields could be short-lived, leaving for a somewhat bleak outlook for equity valuations.

However, there is the consideration that robust economic growth figures for Q2'21 could lift the overall mood in the market. While this is plausible, we fear that the market impact may not be equally as drastic. Our cautious optimism presumes that the market may have already priced in the substantial growth expectation given the apparent near-normal return of economic activities in the last few months. It appears that this view is evinced by the relative outperformance of equities over bonds in H1'21, with our reference bond index (the S&P/FMDQ Nigeria Sovereign Bond Index) dropping 21.1%. In contrast, equities have only shed a comparably modest 6.0%, despite the attractiveness of the bond market. Besides, we view a sustained economic expansion as a prelude to monetary policymakers easing the prevailing dovish stance set in motion since the onset of the pandemic, with negative consequences for valuations. We assess that this likelihood, as aforementioned, could outweigh the potential gains that could emerge as a result of a growth-induced equity market excitement.

Figure 11: Market returns have plummeted following rise in yields

Source: FMDQ; NGX; CardinalStone Research

Figure 12: Equites have outperformed bonds in the first half

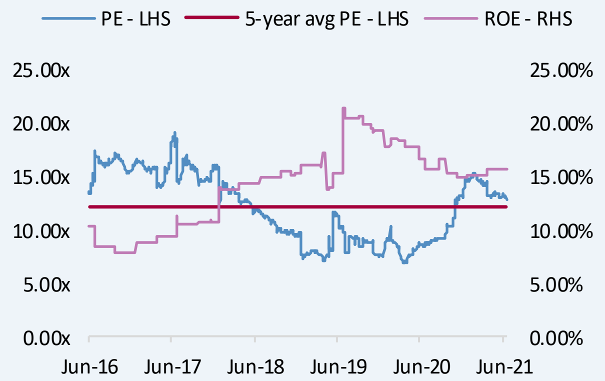


Source: S&P; FMDQ; NGX; CardinalStone Research

Yields to have biggest say in equities direction

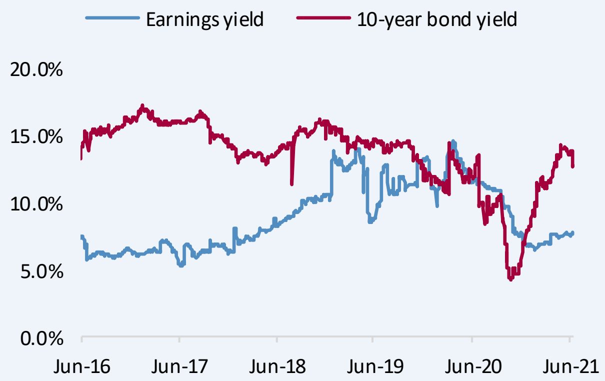
The relative outperformance of equities over bonds may also hint at some degree of implicit overvaluation of the equities market. Firstly, the market PE at 14.3x has accelerated beyond its 5-year historical mean of 12.1x. Secondly, the market's current earnings yield at 7.8% trails the 1-year t-bill yield and 10-year bond yield of 9.9% and 12.8%, respectively. Thirdly, we evaluated the market's historical PE versus its historical ROE (our derived R-squared for this evaluation was high at 73.8%), and our regression returned an implied PE of 11.5x (on current ROE of 14.9%), much lower than the market's current PE of 14.3x. When compared to peer markets across Middle East and Africa, our regression also returned a lower implied PE of 14.1x (versus 14.3% currently) – though we note that the R-squared in this instance was much lower at 11.2%.

Figure 13: Market PE is at a premium to its own historical average



Sources: Bloomberg; CardinalStone Research

Figure 14: Earnings yield has trailed bond yields since January



Sources: FMDQ; Bloomberg; CardinalStone Research

Sector specific fundamentals could be the key driver of value

In the short term, however, it is likely that earnings yield may eventually outpace bond yields leading to some potential respite for the equities market if investors react in tandem. This view is premised on two factors: 1) bond yield moderation could persist through a fraction of Q3'21 and 2) Q2'21 corporate earnings are likely to be robust compared to the substantially weak company numbers reported in Q2'20. On the later point, we note that across our coverage, earnings plunged in the Brewery (-66.7%), Downstream Oil and Gas (-36.7%) and Upstream Oil & Gas (our coverage, SEPLAT, recorded a loss in FY'20) sectors, owing to the pandemic induced slump in economic activities.

We favour an active strategy to be in the green

Time and time again, the market has proven that a passive strategy often outperforms an active one. However, our assessment that the ASI may likely end the year in the red suggests that investors may need to actively cherry-pick stocks to win. On the whole, we like stocks that we believe have sound fundamentals and are trading at deep discount to their historical and peer averages. We believe that, unlike the broader index, these stocks have inherent upside potential and could be a tilling ground for capital gains. We also favour stocks that have the tendency for higher dividend yields in excess of 5.0% (slightly higher than the market dividend yield of 4.8%) and earnings yield in excess of 12.5% (higher than the yield on the 10-year bond yield).

Sector Opportunities

Sieving for winners

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

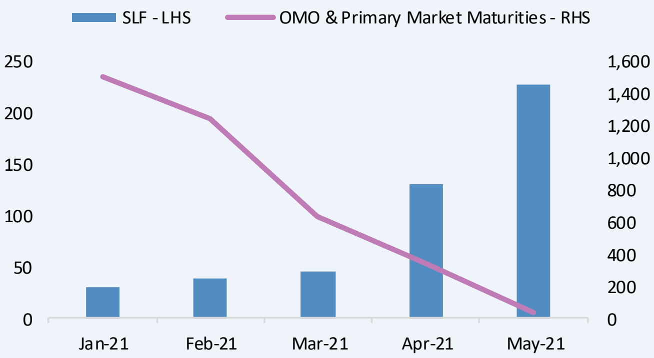
Nigerian Banks: Playing for touchdown

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

Are liquidity worries back on the horizon?

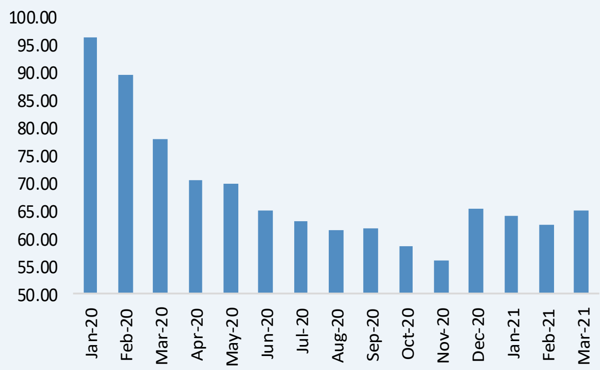
Since the start of the year, Nigerian banks have increasingly resorted to CBN's Standing Lending Facility (SLF) as OMO and primary market maturities dry up. For context, data from the CBN database suggest that the average monthly SLF rose by over seven-fold between January 2021 to May 2021, just as combined OMO and primary market maturities crashed by 98.0%. In addition, the average daily traded value of the apex bank's Special Bills rose to N167.5 billion in March 2021, compared to a mean of N14.8 billion in December 2020. For us, the increased reliance on SLF and growth in the average traded value of the Special Bills may imply that a few Nigerian banks have been proactively responding to liquidity-related threats since the start of the year. Notably, even though the sector liquidity ratio recovered sharply after Special Bills were introduced in December 2020, it subsequently moderated in January and February, respectively. This moderation in the "regulatory ratio" may have informed the scamper for SLF from the CBN amidst narrowing OMO and NTB maturities.

Figure 15: Banks are increasingly accessing SLF as maturities thin out (N'billions)



Source: CBN; CardinalStone Research

Figure 16: Liquidity ratio was boosted after CBN introduced special bills in December 2020, but are we seeing new pressures?



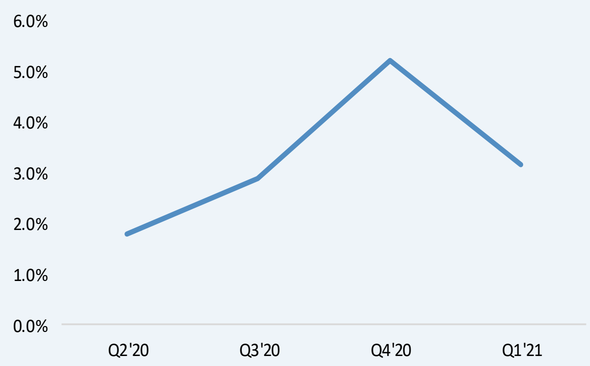
Source: CBN; CardinalStone Research

Assets could suffer from heightened liquidity pressure

The highlighted concerns on sector illiquidity may negatively impact banks' capacity to grow asset in FY'21. In FY'20, our coverage banks grew total assets by 26.2% on average compared to a 4-year CAGR of 13.6%. The accelerated asset growth in FY'20 was fuelled by a liquidity deluge amidst creeping interest rates and limited alternative investment outlets. The significant jump in banks' deposits (+30.9%) during FY'20 vs a 4-year CAGR of 12.1% further buttresses our point.

We believe that a potential slowdown in banks' funding is on the cards and that the likely implications for credit creation in FY'21 are not far-fetched. On the one hand, an improving economic environment amidst easing COVID-19 concerns supports the argument for substantial loan growth. On the other hand, however, a slowdown in funding could inhibit the prospect for significant lending.

Figure 17: Credit growth moderated in Q1'21 contrary to expectations



Source: CBN; CardinalStone Research

Bridging the liquidity gap could come at a cost

We see recovery-induced deposit growth as an upside risk to credit creation and overall asset growth. Yet, rising inflation and yields informs our less sanguine base position. Firstly, rising inflation could worsen cost of living and cascade to lower savings deposit growth rate vs FY'20. Secondly, rising yields are likely to drive a redirection of retail and institutional funds towards investments with superior returns than those on banking sector deposit products (though this could be slightly muted by the lack of depth in Nigeria's fixed income space).

Nonetheless, we believe that the recently observed moderation in banks' deposit and funding costs could slow down in FY'21 catalysed by: 1) tight liquidity that could instigate increased competition for funds (deposits and debt issuance proceeds) among banks; 2) upwards yield trajectory, especially in H2'21 and; 3) likelihood of an increase in MPR on the back of accelerating inflation, which could propel savings deposit rate higher.

Alternatively, sustained disposal of special and conventional bills to service obligations could further strain interest earnings assets, negatively impacting interest income.

ACCESS BANK PLC

Does size really matter?

BLOOMBERG: ACCESS NL

Recent acquisitions in Zambia, Mozambique, Kenya, Botswana, and South Africa indicate the bank's quest to conquer the continent's financial landscape. While these strategic incursions may make ACCESS one of the biggest banks by asset size, it is unlikely they will have an impact of the calibre realised from the merger with Diamond bank. That transaction had significant implications for the bank's funding cost (fell from 5.5% pre-transaction to 3.3% in FY'20), and the asset quality concerns appear to have been managed (NPL ratio rose from 2.5% to 5.8% following the deal but fell to 4.3% in FY'20).

Nevertheless, we highlight that access to these important markets gives the bank opportunity to boost its transaction-based income. Unsurprisingly, the bank is restructuring into a HOLDCO with a payments business as a key operating segment. A payments business with strategically located hubs could seamlessly facilitate financial transactions across the continent. A second critical implication of the bank's expansion drive is the regional diversification benefit. While this could lower the volatility of the bank's earnings, it could also imply consistent earnings growth and resilience. Hence, while near term return on assets is likely to suffer, we expect that this would gradually rebound over the next few years. However, a key risk is the potential for higher operating expenses arising from integrating new acquisitions and restructuring the current business.

Our target price for the counter is N9.87, reflecting a 7.9% premium to our reference price of N9.15. As a result, we rate the counter a HOLD. Our TP implies an exit PB of 0.42x. ACCESS is currently trading at a forward PB of 0.39x.

HOLD

Target Price: N9.87

Ref Price: N9.15

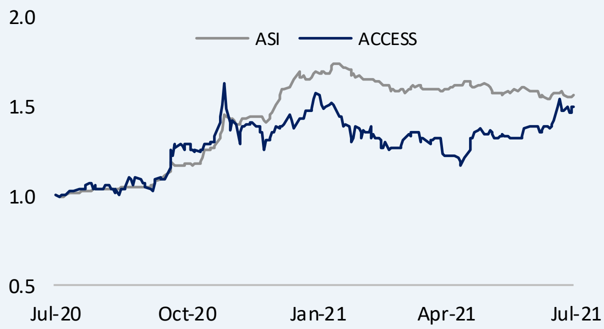
Upside/(Downside):+7.9%

Market Cap: N325.0bn

Financial ratios	FY'20	FY'21	FY'22
NIM	4.7%	5.2%	5.1%
Cost of risk	1.9%	1.2%	1.0%
Cost to income	63.4%	65.0%	65.0%
ROE	15.6%	15.5%	14.6%
ROA	1.3%	1.4%	1.4%
NPL ratio	4.8%	5.3%	5.3%
Loan to deposit	60.3%	62.7%	67.9%

Multiples	FY'20	FY'21	FY'22
P/E	3.12x	2.66x	2.53x
P/B	0.44x	0.39x	0.35x
Div yield	8.7%	9.4%	9.9%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Net interest income	277,229	262,950	308,615	308,527	675	640	751	751
Non-interest income	112,109	252,374	232,023	243,167	273	614	565	592
Net impairments	(20,189)	(62,893)	(43,234)	(39,631)	(49)	(153)	(105)	(96)
Operating costs	(253,770)	(326,509)	(351,415)	(358,601)	(617)	(794)	(855)	(873)
Profit before taxes	115,379	125,922	145,989	153,461	281	306	355	373
Loans to customers	2,911,580	3,218,107	3,412,007	3,753,207	7,084	7,830	8,302	9,132
Deposits from customers	4,255,837	5,587,418	5,741,653	5,837,347	10,355	13,595	13,970	14,203
Total assets	7,146,610	8,679,748	9,113,735	9,569,422	17,388	21,119	22,175	23,283
Total liabilities	6,536,417	7,928,707	8,270,089	8,628,939	15,904	19,291	20,122	20,995
Shareholders funds	610,193	751,041	843,646	940,482	1,485	1,827	2,053	2,288

ECOBANK TRANSNATIONAL INCORPORATED

Recovering from a painful blow

BLOOMBERG: ETI NL

BUY

Target Price: N6.28

Ref Price: N5.10

Upside/(Downside):+23.1%

Market Cap: N93.6 bn

We slash our TP for ETI to N6.28 (N6.75 previously) but retain our BUY rating. We believe that investors may have overreacted to the bank's weak performance in FY'20, which saw a 68.5% decline in earnings to $85 million following a material impairment charge. In FY'21, we expect the bank to bounce back from the impact of the c.$165 million goodwill impairment charges, with earnings likely to grow 174.3%. Other than the low base effect, our optimism for ETI also lies in the strength of its regional diversification, reducing the impact of volatile markets on overall performance, and the strength of its growing digital business.

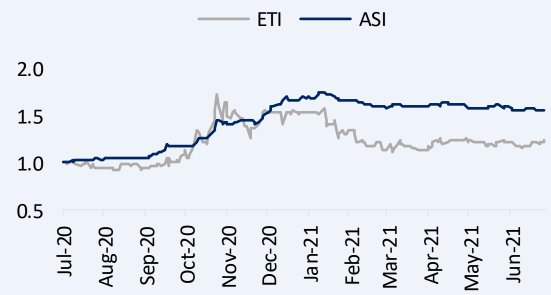
However, we do not like the persistent decline in risk asset creation, which has fallen 3.7% on average in the last 5 years, and the implication for interest income. To this point, interest income has crashed by a CAGR of 4.5% over the same period. A key downside to ETI's investment case is the consistent lack of dividend payments which management has attributed to the need to shore up capital buffers.

Nonetheless, ETI is currently trading at a forward PB of 0.18x (on an ROE of 14.3%), a 61.2% decline to its 4 year average of 0.47x (on average ROE of 9.6%). Our target price implies an exit PB of 0.23x.

Financial ratios	FY'20	FY'21	FY'22
NIM	4.8%	4.4%	4.3%
Cost of risk	2.3%	2.0%	1.7%
Cost to income	62.7%	65.0%	64.0%
ROE	4.1%	14.7%	15.6%
ROA	0.3%	0.9%	1.0%
NPL ratio	7.6%	9.5%	8.6%
Loan to deposit	53.6%	52.5%	51.0%

Multiples	FY'20	FY'21	FY'22
P/E	4.99x	1.83x	1.54x
P/B	0.20x	0.18x	0.16x

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Net interest income	271,227	346,605	361,109	364,625	750	907	879	887
Non-interest income	315,652	295,148	306,576	317,641	873	773	746	773
Net impairments	(48,317)	(84,735)	(80,943)	(69,145)	(134)	(227)	(197)	(168)
Operating costs	(388,313)	(402,695)	(433,995)	(436,650)	(1,073)	(1,054)	(1,056)	(1,062)
Profit before taxes	146,544	66,598	127,750	151,473	405	174	311	369
Loans to customers	3,383,179	3,699,028	3,795,108	3,828,914	9,277	9,240	9,234	9,316
Deposits from customers	5,924,960	7,328,819	7,711,117	7,970,721	16,246	18,297	18,762	19,393
Total assets	8,621,940	10,384,349	11,087,568	11,531,071	23,641	25,939	26,977	28,056
Total liabilities	7,934,197	9,572,595	10,233,109	10,595,143	21,755	23,912	24,898	25,779
Shareholders funds	687,743	811,754	854,459	935,928	1,886	2,028	2,079	2,277

FBN HOLDINGS PLC

In search of tailwinds

BLOOMBERG: FBNH NL

We are increasing cautious on the outlook for FBNH. While we note progress in asset quality and capital adequacy ratios, we are worried that the momentum may have stalled. Our analysis of Q1'21 numbers and projections for subsequent quarters suggest that FBNH is unlikely to match last year's financial performance.

We like the earnings generating capability of the bank, given its asset size and its ability to generate robust transaction-based incomes. Nonetheless, we worry that the bank's costs burden—particularly related to operating expenses and provision for loan losses—has consistently capped its scope for sustainable earnings accretion. To this point, we note that despite loan write-offs of nearly N884 billion since FY'16, impairment charges have not moderated as much as we had hitherto anticipated, despite repeated management guidance, with cost of risk hovering at 2.2% in Q1'21 vs tier 1 bank average of 1.5%. Likewise, the bank's cost to income ratio at 69.6% (the highest among tier 1 banks) remains a drag.

Positively, we note that the recent reconstitution of the boards of the parent and the bank may have elicited some sense of calm concerning the direction and strategy going forward. On the whole, we continue to keep an eye on FBNH. Our leave our target price at N8.17 (8.9% premium to our reference price of N7.50) and retain our HOLD rating on the stock. Our TP implies an exit multiple of 0.36x. FBNH is currently trading at a forward PB of 0.32x.

HOLD

Target Price: N8.17

Ref Price: N7.50

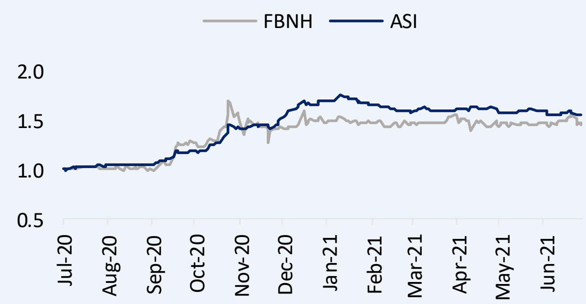
Upside/(Downside): 8.9%

Market Cap: N269.20 bn

Financial ratios	FY'20	FY'21	FY'22
NIM	5.1%	4.9%	4.4%
Cost of risk	2.3%	2.2%	2.0%
Cost to income	68.6%	69.0%	67.0%
ROE	12.6%	8.8%	9.3%
ROA	1.3%	0.9%	1.0%
NPL ratio	8.4%	6.9%	6.1%
Loan to deposit	46.8%	48.2%	47.7%

Multiples	FY'20	FY'21	FY'22
P/E	2.94x	3.87x	3.42x
P/B	0.34x	0.31x	0.30x
Div yield	6.3%	5.4%	9.1%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Net interest income	279,592	251,615	260,305	255,217	679	611	632	619
Non-interest income	137,882	174,703	158,972	171,925	335	424	386	417
Net impairments	(51,093)	(50,596)	(52,579)	(53,535)	(124)	(123)	(128)	(130)
Operating costs	(291,182)	(292,501)	(289,301)	(286,185)	(707)	(710)	(702)	(695)
Profit before taxes	75,286	83,703	77,396	87,421	183	203	188	212
Loans to customers	1,931,321	2,291,545	2,389,973	2,676,770	4,688	5,562	5,801	6,497
Deposits from customers	4,019,836	4,894,715	4,957,131	5,607,259	9,757	11,880	12,032	13,610
Total assets	6,203,526	7,689,028	7,750,793	8,594,170	15,057	18,663	18,813	20,860
Total liabilities	5,542,401	6,923,857	6,929,897	7,718,198	13,452	16,805	16,820	18,733
Shareholders funds	661,125	765,171	820,896	875,972	1,605	1,857	1,992	2,126

FCMB GROUP PLC

Dragged from both ends

BLOOMBERG: FCMB NL

SELL

Target Price: N2.55
Ref Price: N3.00
Upside/(Downside):-15.0%
Market Cap: N59.4 bn

The recent announcement of the acquisition of a 60.0% stake in AIICO Pensions marks the completion of a critical stage of the overall deal structure. Subsequently, we expect that a full merger between FCMB Pensions and AIICO Pensions will be actualized, in line with extant PENCOM rules. Management is hopeful that a definitive merger deal can be completed between Q3'21 and Q4'21.

We assess this deal as positive on a few fronts: 1) a more than 40.0% increase in AUM (FCMB Pensions: N350 billion; AIICO Pensions: N140 billion), could bode well for the Group's non-interest income; 2) AIICO's relative strength in the South West and among corporates is likely to compliment FCMB's popularity in the North and among public sector; 3) Cost synergies, contingent on the completion of a full merger.

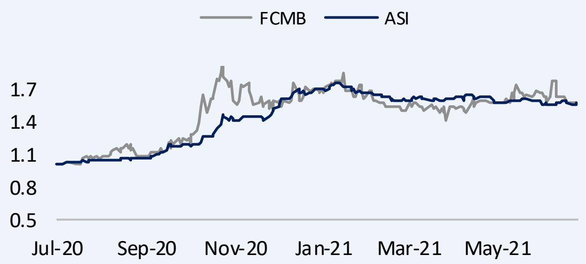
Nonetheless, our base case impact assessment is a potential 70-100 bps improvement in ROE post-merger. Our modest post-merger ROE impact reflects two key considerations: 1) The PBT contribution of FCMB's Investment Management division, which will absorb the AIICO acquisition, seems low (13.8% of Group PBT as at Q1'21). In our view, it is unlikely that this deal will translate into above mid-teens PBT contribution that will materially propel ROE; 2) Potential cap to the pension business's growth prospect following the recent opening of the RSA transfer window by PENCOM. Following conversation with management, we assess that the transfer window has had a net neutral impact on the PFA so far.

All in, our 12-month TP for FCMB is N2.55, a 15.0% discount to our reference price of N3.00. We retain our SELL rating on the counter. The ticker is trading on a forward PB of 0.24x (on FY'21E ROE of 8.1%) that appears expensive relative to our target PB of 0.21x and its four-year historical average of 0.22x.

Financial ratios	FY'20	FY'21	FY'22
NIM	5.1%	4.5%	4.6%
Cost of risk	2.6%	1.7%	1.8%
Cost to income	65.6%	70.0%	69.0%
ROE	9.2%	7.8%	8.3%
ROA	1.1%	0.9%	0.9%
NPL ratio	2.9%	3.2%	3.1%
Loan to deposit	69.1%	69.7%	72.7%

Multiples	FY'20	FY'21	FY'22
P/E	3.02x	3.24x	2.84x
P/B	0.26x	0.24x	0.23x
Div yield	5.7%	5.2%	6.3%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Net interest income	75,976	90,758	90,899	101,178	185	221	221	246
Non-interest income	34,802	37,808	31,129	34,866	85	92	76	85
Net impairments	(13,747)	(22,308)	(15,812)	(18,417)	(33)	(54)	(38)	(45)
Operating costs	(76,901)	(84,347)	(85,419)	(93,870)	(187)	(205)	(208)	(228)
Profit before taxes	20,130	21,911	20,796	23,757	49	53	51	58
Loans to customers	754,391	869,283	930,133	1,023,146	1,836	2,115	2,263	2,489
Deposits from customers	943,086	1,257,131	1,333,839	1,408,148	2,295	3,059	3,245	3,426
Total assets	1,668,505	2,058,393	2,223,065	2,378,680	4,060	5,008	5,409	5,788
Total liabilities	1,467,840	1,831,272	1,980,788	2,119,296	3,571	4,456	4,819	5,156
Shareholders funds	200,665	227,121	242,277	259,383	488	553	589	631

FIDELITY BANK PLC

Pushing through the barriers

BLOOMBERG: FIDELITY NL

We like the consistency in the bank's strategy following the appointment of a new CEO. At 7.3%, the bank recorded the strongest Q1'21 loan growth among our coverage, despite the broad slowdown across the sector (sector loan growth was 3.1% in Q1'21 vs 5.2% in Q4'20).

Furthermore, gains from a drastic reduction in cost of funds have proven critical to uplifting bottom line and, we believe, this could linger through FY'21. For context, the bank's cost of funds have crept to a low of 2.5% in Q1'21 from as high as 7.2% and 6.3% in FY'18 and FY'19, respectively. More specifically, the recent refinancing of its 16.5% N30.0 billion bond with an 8.5% N41.2 billion bond could potential lead to cost savings of N1.4 billion in interest expense per annum. Overall, the moderating funding cost benefit has led to a stable NIM of 6.3% for the bank in the last four quarters, despite asset yields falling from 11.8% to 9.4% in the same period.

We also like the improvement in efficiency as cost of funds moderated to 59.3% in the last 2 quarters compared to 67.2% in the preceding 3 quarters. All in, we raise our target price to N2.77 (previous: N2.68) and retain our BUY rating for the counter. FIDELITYBK is trading at a forward PB of 0.23x vs a 4-year average of 0.26x. Our TP of N2.77 implies an exit PB of 0.27x and an upside of 15.9% to our reference price of N2.39.

BUY

Target Price: N2.77

Ref Price: N2.39

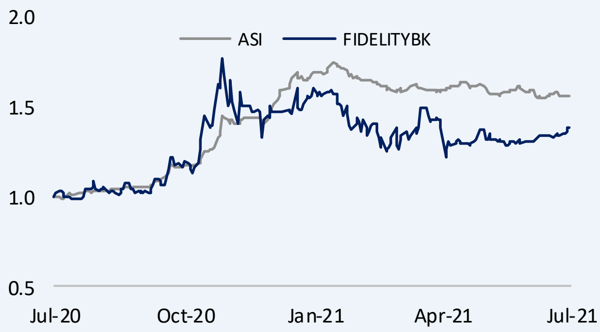
Upside/(Downside): 15.9%

Market Cap: N69.3 bn

Financial ratios	FY'20	FY'21	FY'22
NIM	5.8%	5.3%	5.4%
Cost of risk	1.0%	0.7%	0.7%
Cost to income	68.3%	73.7%	68.4%
ROE	10.5%	10.9%	11.4%
ROA	1.1%	1.1%	1.2%
NPL ratio	3.8%	4.6%	4.4%
Loan to deposit	82.0%	88.3%	89.8%

Multiples	FY'20	FY'21	FY'22
P/E	2.49x	2.12x	1.88x
P/B	0.24x	0.22x	0.20x
Div yield	9.6%	10.4%	12.3%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Net interest income	83,055	104,123	111,835	124,526	202	253	271	302
Non-interest income	28,703	24,422	21,510	29,943	70	59	52	73
Net impairments	587	(16,858)	(10,731)	(11,804)	1	(41)	(26)	(29)
Operating costs	(81,992)	(83,633)	(89,341)	(105,039)	(199)	(203)	(217)	(255)
Profit before taxes	30,353	28,054	33,273	37,626	74	68	81	91
Loans to customers	1,178,935	1,393,624	1,532,986	1,686,285	2,861	3,383	3,721	4,093
Deposits from customers	1,225,213	1,699,026	1,735,446	1,877,836	2,974	4,124	4,212	4,558
Total assets	2,114,037	2,758,148	2,951,218	3,187,316	5,131	6,695	7,163	7,736
Total liabilities	1,880,007	2,484,615	2,653,334	2,862,207	4,563	6,031	6,440	6,947
Shareholders funds	234,030	273,533	297,884	325,108	568	664	723	789

GUARANTY TRUST HOLDING COMPANY PLC

BLOOMBERG: GTCO NL

Still firmly positioned to lead

BUY

Target Price: N40.50

Ref Price: N29.60

Upside/(Downside):+36.8%

Market Cap: N871.2 bn

The conclusion of the restructuring to a Holdco paves way for GTCO's strategic expansion into key business areas to allow for more earnings flexibility and resilience. While details of the likely sizes of the component businesses remain sketchy, we infer some likely impact assessments.

Firstly, we see scope for better regional earnings diversification, with GTCO pursuing strategic inorganic expansion opportunities across the continent. Already, management has disclosed plans to acquire a Kenyan lender, ultimately hoping to increase regional PBT contribution to 30.0%, from 15.3% currently, within the next 3 years. By comparison, UBA's Africa-wide diversification contributed 57.0% of the Group's PBT in FY'20.

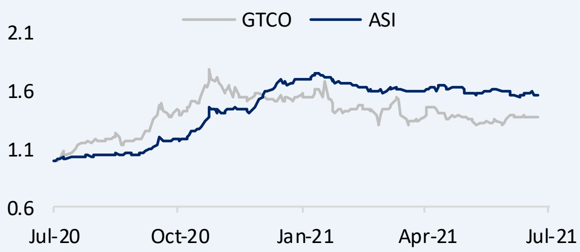
More so, a likely consequence of the Holdco transition is an improvement in non-interest revenue (NIR), supported by the new payments, asset management and pension fund businesses. In our view, NIR contribution to gross earnings is likely to increase to 45% through our forecast period, vs a 5-year average of 30%, leading to a possible 200 bps increase in forecasted ROE. Of our coverage, only STANBIC boasts a greater NIR to gross revenue contribution at 50%. Given that GTCO currently has one of the least volatile earnings in our coverage, this transition presages the potential for stronger near-term ROE sustainability.

We expect that the bank will make money in FY'21. However, the associated costs to the restructuring exercise is one downside risk to earnings we are unwilling to ignore, in addition to the likely slow accretion of restructuring synergies to bottom line. Our 12-month TP for GTCO is N40.50, implying a 36.8% upside to our ref price. Our TP also suggests an exit PB of 1.30x, a 14.4% discount to the bank's 4-year average. We retain our BUY rating.

Financial ratios	FY'20	FY'21	FY'22
NIM	10.5%	9.7%	8.8%
Cost of risk	0.3%	0.8%	0.7%
Cost to income	35.6%	36.4%	38.0%
ROE	30.9%	26.6%	22.7%
ROA	5.6%	4.6%	3.8%
NPL ratio	6.5%	6.4%	6.5%
Loan to deposit	61.9%	49.7%	51.0%

Multiples	FY'20	FY'21	FY'22
P/E	4.42x	4.33x	4.39x
P/B	1.26x	1.06x	0.94x
Div yield	9.5%	10.2%	10.5%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Net interest income	231,363	253,668	257,000	295,096	562	616	624	716
Non-interest income	136,228	151,438	136,800	168,601	331	368	332	409
Net impairments	(4,912)	(19,573)	(13,182)	(12,429)	(12)	(48)	(32)	(30)
Operating costs	(130,971)	(147,438)	(149,644)	(185,479)	(318)	(358)	(363)	(450)
Profit before taxes	231,708	238,095	230,974	265,789	562	578	561	645
Loans to customers	1,567,757	1,743,709	1,883,206	2,071,526	3,805	4,232	4,571	5,028
Deposits from customers	2,532,540	3,509,319	3,693,999	4,063,399	6,147	8,518	8,966	9,863
Total assets	3,758,918	4,944,653	5,340,226	5,874,248	9,124	12,002	12,962	14,258
Total liabilities	3,071,580	4,130,258	4,422,536	4,831,570	7,455	10,025	10,734	11,727
Shareholders funds	687,338	814,396	917,690	1,042,678	1,668	1,977	2,227	2,531

STANBIC IBTC HOLDINGS PLC

BLOOMBERG: STANBIC NL

New outlets for ROE accretion needed

HOLD

Target Price: N46.70

Ref Price: N40.70

Upside/(Downside):+14.7%

Market Cap: N452.0 bn

STANBIC currently models our expectations for our coverage banks, vis a vis: 50-50 NIR/NII earnings contribution, almost twice the CAR requirement, liquidity ratio over 100%, and NPL ratio at 3.6%, below the regulatory requirement. Nonetheless, we see limited scope for significant earnings growth in FY'21, partly due to a possible slow down in non-interest revenue and higher operating expenses. For us, it is likely that the bank's capital market business, which has been a mainstay for bottom line, could be hit by weaker trading revenue due to jump in yields. Consequently, we see a possible ROE decline in FY'21 to 16.5% (FY'20: 24.4%).

Positively, we highlight the continued growth in the wealth business, partly supported by the PFA transfer window (management noted to us that Stanbic Pensions has been a net gainer of accounts since the opening of the window). The bank is also growing its retail footprint which could potentially support earnings in the mid-term. These are upside risks to our expectation.

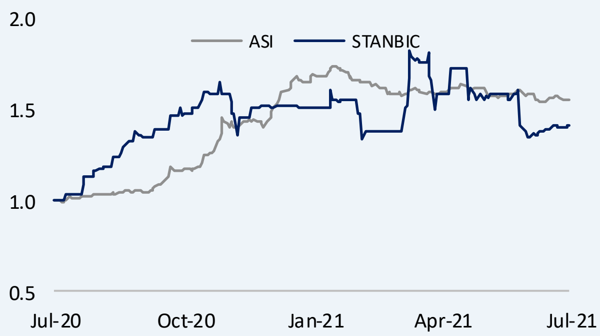
Nevertheless, we believe that additional channels for earnings accretion are needed for STANBIC. Already, we note the recent onboarding of the life insurance business, though we expect the earnings impact to be muted in FY'21.

Out TP for the counter is N46.70, which implies a 14.7% upside to our reference price of N40.70. Hence, we retain our HOLD rating on the counter. STANBIC is trading at a forward PB of 1.1x and our TP implies an exit PB of 1.2x.

Financial ratios	FY'20	FY'21	FY'22
NIM	3.8%	3.8%	3.1%
Cost of risk	1.5%	1.5%	0.8%
Cost to income	47.4%	47.4%	52.8%
ROE	24.3%	24.3%	16.5%
ROA	3.8%	3.8%	2.5%
NPL ratio	4.0%	4.0%	3.7%
Loan to deposit	79.9%	79.9%	90.3%

Multiples	FY'20	FY'21	FY'22
P/E	5.18x	6.59x	5.60x
P/B	1.16x	1.06x	0.96x
Div yield	8.8%	6.8%	8.0%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Net interest income	77,831	74,215	72,992	82,095	189	181	178	200
Non-interest income	108,755	124,709	102,080	114,928	265	303	248	280
Net impairments	(1,632)	(9,935)	(5,767)	(6,343)	(4)	(24)	(14)	(15)
Operating costs	(94,029)	(94,272)	(92,464)	(100,222)	(229)	(229)	(225)	(244)
Profit before taxes	90,925	94,717	76,841	90,458	221	230	187	220
Loans to customers	556,383	655,292	720,821	792,903	1,354	1,594	1,754	1,929
Deposits from customers	637,840	819,944	798,104	877,915	1,552	1,995	1,942	2,136
Total assets	1,876,456	2,486,306	2,660,347	2,926,382	4,566	6,049	6,473	7,120
Total liabilities	1,574,227	2,107,705	2,248,140	2,471,886	3,830	5,128	5,470	6,014
Shareholders funds	302,229	378,601	412,207	454,496	735	921	1,003	1,106

UNITED BANK FOR AFRICA PLC

BLOOMBERG: UBA NL

Diversification benefits to linger

BUY

Target Price: N9.19

Ref Price: N7.80

Upside/(Downside): +17.8%

Market Cap: N266.8 bn

In FY'21, we expect earnings to rise by 6.6% supported by net interest income (+14.4% YoY). The higher net interest income should reflect an estimated 10.0% growth in risk assets amidst flattish cost of funds. In contrast, non-interest revenue could potentially slowdown on weaker FX revaluation gains.

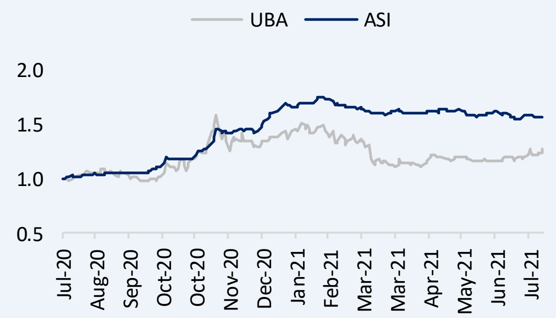
We are optimistic about UBA given that it is unlikely to be materially hit by the projected illiquidity-induced slowdown in asset growth in Nigeria in 2021, owing to its presence in other African markets (57.0% of the FY'20 PBT). This diversification away from Nigeria also explains the bank's low earnings volatility (average of 9.6% over the last five years vs 49.3% for coverage mean). On the flip side, it also had the least five-year earnings CAGR of 13.2% compared to tier 1 banks' average of 16.6%. While this resonates performance steadiness, it also suggests that new near to mid-term initiatives could be critical to earnings growth for the bank, in our view.

We revise our 12-month TP for UBA lower to N9.19 (vs N10.97 previously), primarily due to the impact of our adjustments to risk-free rate and equity risk premium. The bank is also cheap from a relative valuation standpoint, with its current PB of 0.34x (4-year average: 0.52x) at a 52-week low.

Financial ratios	FY'20	FY'21	FY'22
NIM	5.5%	5.3%	5.8%
Cost of risk	0.8%	0.8%	0.8%
Cost to income	61.3%	62.7%	62.2%
ROE	17.2%	15.8%	15.9%
ROA	1.7%	1.5%	1.7%
NPL ratio	4.8%	5.5%	5.2%
Loan to deposit	47.0%	51.8%	53.3%

Multiples	FY'20	FY'21	FY'22
P/E	2.30x	2.15x	1.88x
P/B	0.35x	0.31x	0.27x
Div yield	7.1%	9.3%	11.7%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Net interest income	221,875	259,467	296,955	339,573	539	630	721	824
Non-interest income	124,418	148,178	148,250	158,813	302	360	360	385
Net impairments	(18,252)	(27,009)	(23,464)	(25,810)	(44)	(66)	(57)	(63)
Operating costs	(217,167)	(249,847)	(279,038)	(310,127)	(527)	(606)	(677)	(753)
Profit before taxes	111,287	131,860	142,703	162,449	270	320	346	394
Loans to customers	2,147,283	2,666,322	2,932,954	3,226,250	5,212	6,472	7,119	7,831
Deposits from customers	3,832,884	5,676,011	5,658,015	6,054,076	9,303	13,777	13,733	14,694
Total assets	5,604,052	7,697,980	8,082,879	8,648,681	13,602	18,684	19,619	20,992
Total liabilities	5,006,074	6,973,832	7,265,243	7,726,802	12,151	16,927	17,634	18,754
Shareholders funds	597,978	724,148	817,636	921,878	1,451	1,758	1,985	2,238

ZENITH BANK PLC

BLOOMBERG: ZENITHBA NL

Making the most of its retail foray

BUY

Target Price: N29.86

Ref Price: N24.85

Upside/(Downside):+20.2%

Market Cap: N780.2 bn

In FY'21E, we see scope for earnings uptick (+5.1% YoY), principally backed by growth in net interest income (+9.2% YoY). The improvement in net interest earnings is likely to be driven by increased lending volumes (+8.0% YoY) and improved yield on investment securities, given the bank's huge asset base.

Also, we like Zenith's recent penetration into the retail space and the strengthening of its transaction-based income. In Q1'21, net fees and commission income grew two-fold over Q1'20 (which appeared to be the strongest quarter for banks' fee-based income during the pandemic year). This principally drove the bank's 3.8% PAT growth in the quarter, offsetting the impact of a 36.3% decline in trading gains. For context, the rest of our coverage banks grew fee-based income by 17.1% on average. We also see the retail impact in the bank's cost of funds, which dropped to 1.1% from 2.1% in December 2020, reflected in the N54 billion growth in savings deposit which, according to management, was solely retail.

Our adjustments reflect a 12-month Target Price (TP) of N29.86, which implies a 20.2% upside to our ref price of N24.85. Our TP also suggests an exit PB of 0.74x (ROE: 20.4%), a 10.5% discount to the bank's four year average of 0.83x (ROE: 23.2%). We retain our BUY rating on the counter.

Financial ratios	FY'20	FY'21	FY'22
NIM	6.5%	6.2%	6.3%
Cost of risk	1.3%	1.2%	1.0%
Cost to income	46.4%	46.8%	46.5%
ROE	22.4%	20.4%	20.3%
ROA	3.1%	2.8%	3.0%
NPL ratio	6.4%	6.6%	6.5%
Loan to deposit	54.7%	53.9%	56.0%
Multiples	**FY'20**	**FY'21**	**FY'22**
P/E	3.33x	3.17x	2.81x
P/B	0.69x	0.61x	0.54x
Div yield	12.3%	12.6%	14.2%

1-year price performance (rebased)

Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Net interest income	267,031	299,682	327,397	355,361	650	729	797	865
Non-interest income	232,120	251,745	248,629	277,135	565	613	605	674
Net impairments	(24,032)	(39,534)	(37,835)	(34,682)	(58)	(96)	(92)	(84)
Operating costs	(231,825)	(256,032)	(269,374)	(294,403)	(564)	(623)	(655)	(716)
Profit before taxes	243,294	255,861	268,817	303,410	592	623	654	738
Loans to customers	2,462,359	2,919,342	3,152,889	3,468,178	5,991	7,103	7,671	8,438
Deposits from customers	4,262,289	5,339,911	5,854,315	6,197,213	10,371	12,992	14,244	15,078
Total assets	6,346,879	8,481,272	8,905,336	9,528,709	15,443	20,636	21,667	23,184
Total liabilities	5,404,993	7,363,799	7,642,739	8,102,064	13,151	17,917	18,595	19,713
Shareholders funds	941,886	1,117,473	1,262,597	1,426,645	2,292	2,719	3,072	3,471

Consumer Goods: Hopping off a springboard

After plunging by 10.1% YoY in Q2'20, nominal consumption expenditure experienced materially lower decelerations in the last two quarters of the year that partly justified the slight recovery in consumer goods sector output (proxied by food, beverage, and tobacco GDP). Indeed, CBN surveys recently confirmed material improvements in consumer sentiment/ expectations for the rest of 2021, bolstered by expectations of improved household income and sharp recovery of the broad economy. In addition to the base effect stoked by heightened COVID worries, naira depreciation, and trade route disruptions of the previous year, the positive consumer sentiment and our expectation of sustained recovery in the sector are supported by an expected ramp-up of government and private spending.

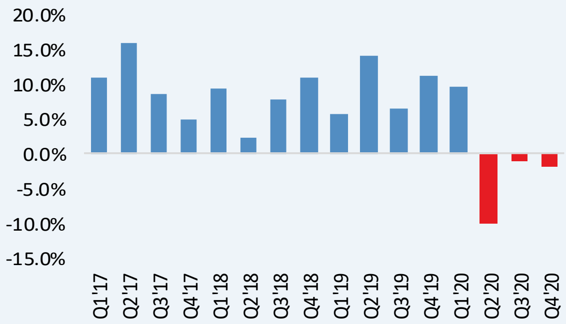
Commodities prices may be a bane for margins in FY’21

There are indications that agricultural commodity prices are reaching levels not seen since 2014 following the rebound from the COVID-19 pandemic induced lows. According to the World Bank, agricultural prices are expected to average 14% higher than 2020 levels, buoyed by supply shortfalls, stronger demand and US dollar depreciation.

Across our coverage, the impact could be strained margins as most firms remain dependent on international raw material supply, despite efforts to boost local raw material utilisation in their production processes. Besides, local commodity prices appear to have mostly tracked global commodity prices directionally, in our view, with FX exposure being the key differential. That said, we estimate that our coverage names import about 50.5% of their inputs, with DANGSUGAR the most dependent on international commodity supply (mostly raw sugar which has risen 23.5% in prices YtD).

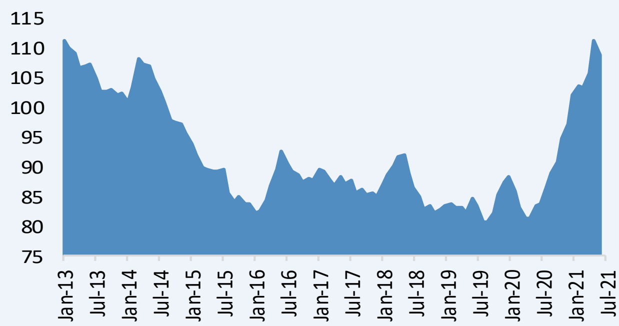
Already, in Q1’21, despite growing revenues by 36.5%, gross margin for our coverage names weakened by 4.3 ppts on average, a likely indication that higher commodity prices may already be biting. Although these firms could counter by raising prices, we believe that fear of possible customer backlash and cut-throat competition in the sector caps scope for a commensurate increase in prices.

Figure 18: Household consumption weakened in 2020, but is likely to recover in subsequent quarters



Source: NBS; CardinalStone Research

Figure 19: World Bank Commodity Index—Prices have reached 7 year highs

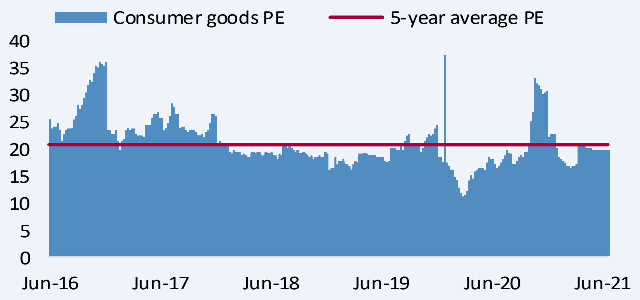


Source: World Bank; CardinalStone Research

Source: NBS; CardinalStone Research

Sector valuation: The consumer goods sector is currently trading near its 5-year mean level of 20.7x after material repricing from the overvaluation experienced at the start of the year. However, its fair valuation appears inconsistent with its ROE discount of 11.3ppts to the historical average. That said, we see legroom for cherry-picking within the space, especially for cheap fundamentally sound stocks with track records of robust real total return and good earnings quality.

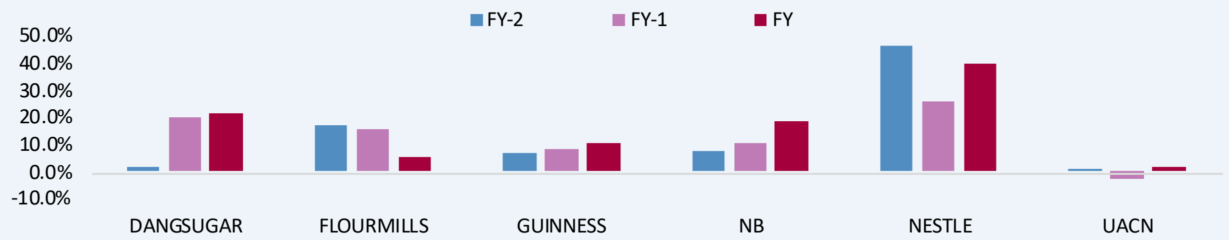
Figure 20: Fairly valued, but ROE discount is concerning



Source: Bloomberg; CardinalStone Research

On assessing earnings quality, we adopt our equally-weighted rating system that considers cash return on assets, CFO to core EBIT, and cashflow-based accrual ratio for our coverage. The weighting system revealed that NESTLE, which also boasted the highest ROE in its turf, led our coverage names on the earnings quality front in the last three years. A sieve through the subcategories of this rating system also revealed that NESTLE and DANGSUGAR demonstrated remarkable capacities to generate money from existing assets, with average cash returns on 'assets' of 37.1% and 14.5% apiece. GUINNESS and NB also showed consistent growth on this front over the review period, aided by aggressive improvements in cash collections even during the peak period of the pandemic spread. Elsewhere, NESTLE and FLOURMILLS reported more significant cash components of earnings to bolster their cases for earnings sustainability.

Figure 21: Cash return on asset over the last 3 years



Source: Capital IQ; Bloomberg; CardinalStone Research

Figure 22: Ranking of earnings quality ratios (last 3 years)

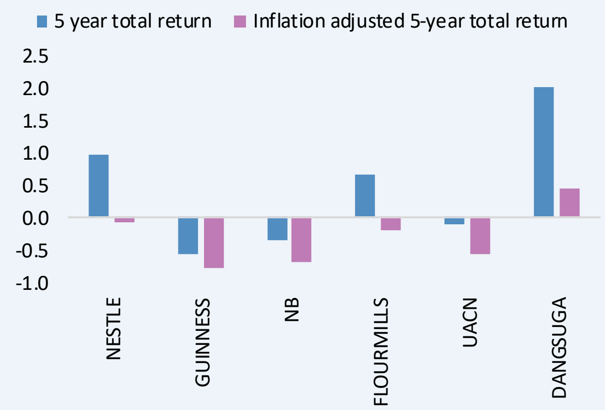
	Cash flow based accrual	Cash return on asset	CFO to Core EBIT	Total rank
NESTLE	1	1	3	1
FMN	2	3	1	2
NB	4	4	2	3
DANGSUGAR	6	2	4	4
UACN	3	6	5	5
GUINNESS	5	5	6	6

Source: S&P Capita IQ; CardinalStone Research; FMN *is FLOURMILLS

Worried about cumulative inflation? DANGSUGAR may appeal to you

Over the last 5-years, only DANGSUGAR was able to out-perform cumulative inflation. The ticker's inflation-adjusted 5-year total return printed at 42.8%. NESTLE fell slightly short with a negative 6.8% real total return, while GUINNESS offered the least protection to cumulative domestic inflation in the period.

Figure 23: DANGSUGAR— a proven hedge against inflation



Source: Bloomberg; S&P Capita IQ; CardinalStone Research

DANGOTE SUGAR PLC

Earnings to remain buoyant in FY’21

BLOOMBERG: DANGSUGA NL

BUY

Target Price: N21.08

Ref Price: N17.65

Upside/(Downside): 19.4%

Market Cap: N214.39 bn

We project that DANGSUGAR could grow FY’21 earnings to N33.7 billion from N29.8 billion, and raise our target price to N21.08 (previously 20.72). This translates to a potential upside of 19.4% to our reference price of N17.65, as a result, we upgrade our recommendation to a BUY (from HOLD previously).

Our optimism for DANGSUGAR is reflected in our projected 14.5% YoY top line growth to N245.2 billion in FY’21. This projection accounts for stronger volume output and pricing impact. To this point, we note that the firm is likely to continue to benefit from favorable regulation in its market space. Firstly, although the borders appear to have been opened, tighter controls against smuggled products, which have been a bane to the company, are likely to portend positively for its market share and product pricing. Secondly, the CBN’s recent disclosure restricting FX access for sugar importation to only 3 companies (DANGSUGAR inclusive) presages possible top line growth. Already, in its Q1’21 result, DANGSUGAR posted a 41.5% growth in revenue, supported by a 5.7% increase in volume sales and higher pricing.

Notwithstanding the robust top line growth expectation, we note concerns for margins arising from higher global sugar prices and FX challenges (despite its backward integration efforts, DANGSUGAR still exports circa 80% of its raw sugar requirement). Domestically, management laments that the Apapa gridlock remains a logistical constraint, while insecurity continues to hamper some of its efforts at the BIP sites, leading to higher than comfortable operating expenses.

Nevertheless, we believe that gains from the firm’s top line push can more than offset the pull from other aspects of its operations. Hence, our upward TP revision to N21.08 and BUY rating. Our TP implies an exit PE of 7.6x which is at a 13.5% premium to the firm’s 4-year average PE of 6.7x.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	25.1%	25.0%	24.6%
Net margin	13.9%	13.7%	13.7%
RoA	12.6%	11.4%	11.4%
RoE	12.6%	11.4%	11.4%
Asset turnover	90.9%	83.4%	83.2%
Current ratio	124.1%	124.1%	116.1%
Quick ratio	79.8%	79.8%	75.7%
Debt to equity	1.8%	1.8%	1.3%

Multiples	FY'20	FY'21	FY'22
P/E	6.96x	6.30x	5.74x
EV/EBITDA	3.14x	2.84x	2.34x
EV/Sales	0.71x	0.69x	0.58x
Div yield	8.6%	9.7%	10.9%

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N’millions				$’millions			
Revenue	161,086	214,298	245,295	269,417	393	522	598	657
EBITDA	38,285	53,746	61,434	66,359	93	131	150	162
Profit before taxes	29,820	45,622	49,536	53,191	73	111	121	130
Income taxes	(7,459)	(15,847)	(15,891)	(16,281)	(18)	(39)	(39)	(40)
Profit after taxes	22,361	29,775	33,646	36,909	55	73	82	90
Total assets	193,706	278,032	310,117	337,436	472	678	756	823
Total liabilities	85,569	153,321	169,980	178,974	209	374	414	436
Shareholders funds	193,706	278,032	310,117	337,436	472	678	756	823

FLOUR MILLS OF NIGERIA PLC

Are you worried about sustainability?

BLOOMBERG: FLOURMILL NL

HOLD

Target Price: N34.10

Ref Price: N29.85

Upside/(Downside):+14.2%

Market Cap: N122.4 bn

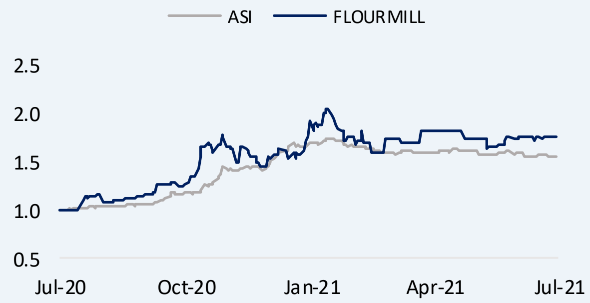
FLOURMILL's stellar FY'20/21 rode on expansions in high margin B2C segments, increased regional distribution centres primarily targeted at B2Cs, the launch of new product offerings (e.g. Amazing Day, Auntie B Spaghetti Slim and SKUs in key categories), and cost optimisations such as the replacement of the company's expensive short term debt with cheaper long term borrowings in 2020. Expectedly, ROE and EPS more than doubled to c.15.6% and N6.30 to leave investors thrilled. Albeit, we worry about the sustainability of the record-breaking performance, especially given the potential high base effect from the Agro-Allied division, which experienced its first notable profit in 5 years in FY’20/21.

Indeed, Agro-Allied accounted for 17.1% of revenue increase, and an impressive 45.3% of PBT accretion in FY'20/21, which underscored material improvement in operating efficiency. We note that the segment's cost-cutting measures like the streamlining of raw material aggregation process and reduction of wastes appear sustainable. The expansion of blending plants and sales outlets in the northern and eastern markets and the introduction of Omega Catfish Feeds are also likely to contribute to FY'21/22 performance. Elsewhere, the Food business is reportedly set to benefit from 800 hectares of domestic wheat grain production next season, on the back of its strategic partnership with the Flour Milling Association of Nigeria (FMAN). This initiative is likely to reduce reliance on foreign wheat and taper risk of FX losses.

All in, our new 12-month TP of N34.10 reflects an FY'21/22 ROE of 15.1% (vs 4-year mean of 9.1%). Our TP implies a total return of 20.4%, comprising a capital appreciation of 14.2% and a dividend yield of 6.2%. We have a HOLD recommendation on the stock.

Financial ratios	FY'21	FY'22	FY'23
EBITDA margin	13.8%	13.0%	11.0%
Net margin	3.3%	3.1%	2.3%
RoA	5.3%	4.9%	3.5%
RoE	15.6%	14.4%	9.5%
Asset turnover	157.9%	157.0%	151.4%
Current ratio	145.9%	157.3%	165.5%
Quick ratio	30.3%	46.0%	52.2%
Debt to equity	76.0%	66.4%	61.8%

Multiples	FY'21	FY'22	FY'23
P/E	6.62x	4.71x	6.16x
EV/EBITDA	2.53x	2.16x	2.42x
EV/Sales	0.30x	0.20x	0.19x
Div yield	5.5%	6.2%	3.4%



Financial Summary	2020A	2021A	2022E	2023F	2020A	2021A	2022E	2023F
		(N’million)				($’million)		
Revenue	573,774	771,608	887,349	913,970	1,396	1,877	2,159	2,224
EBITDA	65,787	106,757	115,355	100,537	160	260	281	245
Profit before taxes	174,968	371,937	409,092	307,676	426	905	995	749
Income taxes	(6,120)	(11,477)	(13,466)	(9,811)	(15)	(28)	(33)	(24)
Profit after taxes	11,377	25,717	27,443	20,957	28	63	67	51
Total assets	432,454	544,733	585,613	622,107	1,052	1,325	1,425	1,514
Total liabilities	276,646	370,119	378,047	390,326	673	901	920	950
Shareholders funds	155,808	174,614	207,566	231,781	379	425	505	564

GUINNESS NIGERIA PLC

BLOOMBERG: GUINNESS NL

Rebounding from a material performance correction

HOLD

Target Price: N31.65

Ref Price: N31.65

Upside/(Downside):0.0%

Market Cap: N69.3 bn

We expect that GUINNESS will bounce back from its FY'19/20 earnings performance, which management describes as a "correction" necessary to reposition the business. Recall that in FY'19/20, the firm recorded a loss before tax of N17.1 billion, led by N16.2 billion impairment charges on PPE, financial assets and export expansion grant receivable. Positively, these charges appear to be one-off, reflected in the company's current performance (FY'20/21 earnings could surge to N4.0 billion).

Over FY'21/22, we forecast that the brewer's bottom line could surpass N6.0 billion, a first in four years, mainly driven by pricing. We note GUINNESS's ability to take prices, especially on its Spirits and Ready-to-Drink (RTD) segments. Already, management has affirmed that its margin expansion strategy involves taking advantage of every price taking opportunity it gets in these segments. The sustained pivot away from margin-dilutive lager towards the more margin-accretive Spirits and RTDs further buttresses this point. For context, beer/lager revenue contribution fell from 43% in FY'17/18 to 37% in H1'20/21, while Spirits contribution improved from 15% to 25%.

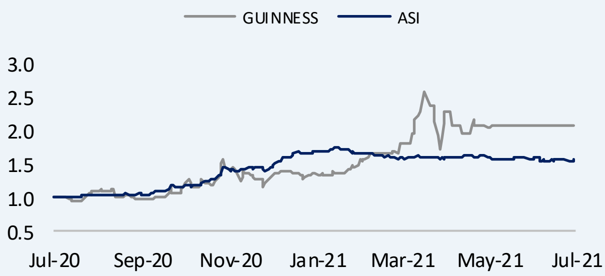
More so, despite cost concerns arising from excise tariffs, FX devaluation and packaging expenses, GUINNESS's gross margin has steadily improved in the three quarters of FY'20/21 (from 23.4% to 32.5%), likely supported by the increased focus on Spirits and RTDs. Elsewhere, we expect operating margins to benefit from lower depreciation and other fixed and running costs following the elimination of idle and sub-optimal assets in the previous year.

All in, we raise our TP for the counter to N31.65 and revise our rating to a HOLD from SELL. Our TP reflects a 0.0% upside to ref price of N31.00.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	-1.80%	10.27%	11.25%
Net margin	-12.05%	2.52%	3.73%
RoA	-8.73%	2.47%	3.60%
RoE	-17.22%	5.08%	7.16%
Asset turnover	72.41%	97.98%	96.58%
Current ratio	89.07%	110.31%	120.64%
Quick ratio	45.46%	77.50%	82.65%
Debt to equity	25.95%	20.00%	22.90%

Multiples	FY'20	FY'21	FY'22
P/E	NM	16.01x	10.30x
EV/EBITDA	NM	6.17x	5.37x
EV/Sales	1.40x	0.93x	0.89x
Div yield	6.07%	5.80%	9.16%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	(N'million)				($'million)			
Revenue	131,498	104,376	157,562	165,440	320	254	383	403
EBITDA	19,060	(1,876)	16,185	18,607	46	(5)	39	45
Profit before taxes	7,104	(17,074)	5,669	8,810	17	(42)	14	21
Income taxes	(1,620)	4,495	(1,701)	(2,643)	(4)	11	(4)	(6)
Profit after taxes	5,484	(12,579)	3,968	6,167	13	(31)	10	15
Total assets	160,793	144,146	160,816	171,296	391	351	391	417
Total liabilities	71,732	71,107	82,632	85,115	175	173	201	207
Shareholders funds	89,060	73,038	78,184	86,182	217	178	190	210

NESTLE NIGERIA PLC

Nestlé to rebound from COVID-19 induced slowdown in 2021

BLOOMBERG: NESTLE NL

HOLD

Target Price: N1,541.50

Ref Price: N1,540.00

Upside/(Downside):+0.1%

Market Cap: N1,220.7 bn

Our views for NESTLE remain broadly unchanged, though we have slightly moderated our year-end EPS expectation to N58.30 from N62.15 previously, down to increased production cost pressure on margins. Notwithstanding, this represents a potential 17.8% increase over FY'20 reported earnings.

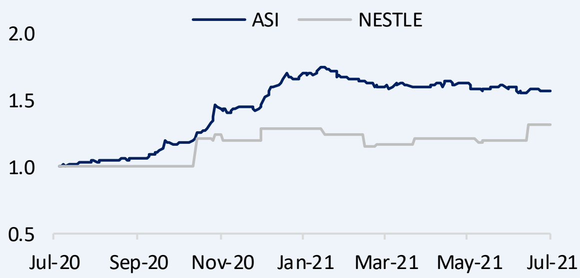
On the whole, we like the resilience of NESTLE's business model, which has continued to outperform even under unlikely circumstances. In the last two decades, the firm has consistently grown top line, thanks to the depth and diversity of its product portfolio, as well as market reach. In FY'21, we expect that top line will improve following better household consumption and less restricted distribution channels relative to FY'20.

However, we worry about margins for NESTLE on the back of rising raw material costs. The company employs a mix of domestic and international sourcing for its materials and we believe that rising commodity prices and continued FX constraint, alongside domestic food cost pressures could weigh on its gross margin in FY'21. To this point, while we note the broad improvement in revenues, gross margin has consistently declined from 45.0% in Q1'20 to 39.8% in Q1'21.

Updates to our model only reflect a modest change in our target price to N1,541.50 (previously: N1,575.42), which implies a fairly valued counter relative to our reference price of N1,540.00. Consequently, we retain our HOLD rating on the stock. NESTLE is trading at a forward PE of 26.4x and our target price portends an implied PE of 26.2x (on ROE of 155.2%) compared to the 4-year PE average of 27.8x (average ROE of 94.9%)

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	25.4%	26.7%	26.8%
Net margin	13.7%	14.6%	14.4%
RoA	17.8%	19.1%	20.2%
RoE	104.8%	155.2%	158.5%
Asset turnover	130.6%	130.9%	140.1%
Current ratio	91.2%	84.1%	81.9%
Quick ratio	59.8%	63.7%	63.7%
Debt to equity	137.3%	100.0%	88.8%

Multiples	FY'20	FY'21	FY'22
P/E	31.13x	26.42x	25.05x
EV/EBITDA	11.22x	14.10x	25.07x
EV/Sales	3.29x	3.82x	1.61x
Div yield	3.9%	3.7%	3.9%



Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Revenue	284,035	287,084	316,894	337,336	692	700	773	822
EBITDA	80,842	72,816	84,693	90,269	197	178	206	220
Profit before taxes	71,124	60,638	68,992	74,654	173	148	168	182
Income taxes	(25,441)	(21,426)	(22,796)	(25,916)	(62)	(52)	(56)	(63)
Profit after taxes	45,683	39,212	46,195	48,737	111	96	113	119
Total assets	193,375	246,185	238,047	243,387	471	600	580	593
Total liabilities	147,818	216,888	207,810	212,129	360	529	507	517
Shareholders funds	45,557	29,297	30,237	31,259	111	71	74	76

NIGERIAN BREWERIES PLC

Leading the market through premiumisation

BLOOMBERG: NB NL

We revise our earnings forecast for NB in FY'21 to N18.8 billion, representing a 2.5x increase compared to the earnings posted in FY'20. We also project that ROE could more than double to 10.9% from 4.6% in FY'20. Our optimistic bottom-line expectation reflects studier revenue growth and lower FX translation losses. We also raise our TP to N70.14 and revise our recommendation to a BUY (from SELL previously). Our higher TP also reflects the company's market leadership strides, the success of its premiumisation strategy and the parent company's assertion that the Nigerian business no longer instigates operational concern for the global brand.

On top-line growth, we believe that volume expansion and pricing will be vital to driving performance due to improved economic activities. Already, management has noted the impact of robust volume growth in the firm's Q1'21 numbers, particularly in the international premium brands (which grew more than 40.0% in Q1'21, led by Heineken and Tiger), and the mainstream and non-alcoholic portfolio (which grew 30.0%, led by Maltina). The December 2020 launch of a new international premium beer brand – Desperados – further adds to our optimism for the brewer. Additionally, there is talk of a potential acquisition of Distell Group by its parent company (Heineken N.V) which, if actualised, could expand NB's product portfolio to include additional cider brands. We believe that the potential of a high margin spirits business could help uplift the firm's strained beer margins in the mid to long term.

Elsewhere, we see potential respite for bottom-line arising from lower FX translation losses on the back of muted currency devaluation relative to FY'20. We also project lower interest costs on likely lower leverage. To this point, we note that the company's debt to equity ratio rose to 56.7% in FY'20 (as the company sought more financing to cushion the pandemic impact on operations) compared to an average of 18.6% in the prior 4 years.

BUY

Target Price: N70.14

Ref Price: N58.00

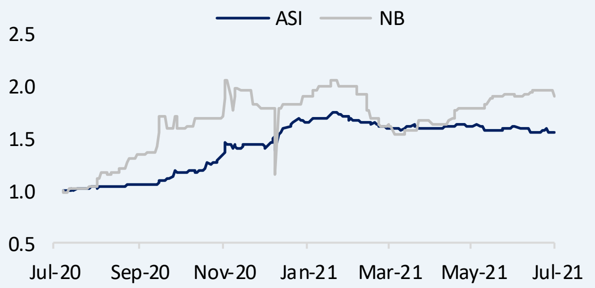
Upside/(Downside): 20.8%

Market Cap: N463.82 bn

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	20.14%	21.40%	22.56%
Net margin	2.19%	5.07%	5.73%
RoA	2.60%	6.14%	6.75%
RoE	4.57%	10.94%	11.77%
Asset turnover	75.60%	82.74%	80.31%
Current ratio	44.28%	49.80%	59.96%
Quick ratio	27.13%	27.86%	39.38%
Debt to equity	56.74%	38.50%	42.82%

Multiples	FY'20	FY'21	FY'22
P/E	62.95x	24.69x	21.40x
EV/EBITDA	10.70x	9.15x	8.51x
EV/Sales	0.48x	0.43x	0.42x
Div yield	6.07%	5.80%	9.16%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N'millions				$'millions			
Revenue	323,008	337,046	370,741	378,065	786	820	902	920
EBITDA	67,930	67,873	79,336	85,283	165	165	193	208
Profit before taxes	23,352	11,576	27,532	31,769	57	28	67	77
Income taxes	(7,246)	(4,208)	(8,744)	(10,090)	(18)	(10)	(21)	(25)
Profit after taxes	16,106	7,368	18,788	21,679	39	18	46	53
Total assets	382,777	445,857	448,096	470,738	931	1,085	1,090	1,145
Total liabilities	215,027	284,678	276,413	286,491	523	693	673	697
Shareholders funds	167,750	161,179	171,683	184,248	408	392	418	448

UAC of Nigeria PLC

From pull to push

BLOOMBERG: UACN NL

HOLD

Target Price: N11.17

Ref Price: N10.50

Upside/(Downside):6.4%

Market Cap: N30.3 bn

After suffering a 35.3% plunge in profits from continuing operations, UACN now looks set to experience a base effect-induced rise in earnings in FY'21. Our prognosis for a bounce-back is supported by expected milder naira depreciation, the lifting of restrictions on "non-essential" businesses, and increasing focus on higher-margin edible categories. The base effect could be more pronounced in the paints business, whose status as the most exposed to FX risk (raw material FX exposure of c.80.0%) and a "non-essential" drove its earnings to over six-year low in FY'20. Another obvious candidate for sharp recovery is the packaged food segment (c.50.0% raw material FX exposure), which suffered from restrictions to trading and market opening hours during the lockdown. Given its FX exposures, continued frontloading of the purchase of some essential raw materials could be pivotal in FY'21.

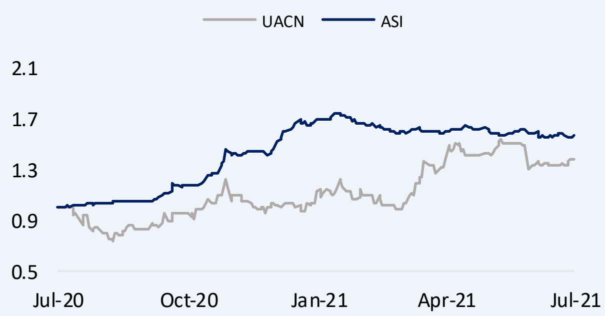
The ongoing quest for streamlining operations and strict screening of new projects are also positive in the near-to-medium term. For one, the former is expected to taper weaknesses from investment in UPDC due to UACN's reduced exposure (c.42.0%) to the business and the reality that the subject is now a less leveraged company (debt-to-equity: -9.0ppts YoY to 0.6x as at FY'20). UPDC's series one bond of c.N4.36 billion was also called on 26 April 2021 to reduce finance costs further. The Festival Hotel asset is also held for sale as hospitality is no longer part of UPDC's long-term strategy centred around core real estate. On the other hand, only projects with expected ROIC of between 20.0% to 25.0% are likely to be considered.

Valuation: All in, our new 12-month TP of N11.17 reflects an FY'21 ROE of 5.8% (vs 4.3% in FY’20) and net cash of N18.9 billion. Our TP implies a capital appreciation of 6.4% and an exit PE of 6.4x. We have a HOLD recommendation on the stock.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	1.29%	9.96%	8.95%
Net margin	4.83%	6.91%	7.04%
RoA	4.26%	5.80%	6.40%
RoE	5.80%	6.40%	4.96%
Asset turnover	88.27%	83.89%	90.92%
Current ratio	210.96%	205.91%	192.12%
Quick ratio	127.58%	112.76%	95.00%
Debt to equity	8.90%	9.01%	9.40%

Multiples	FY'20	FY'21	FY'22
P/E	10.87	5.72	5.25
EV/EBITDA	14.36x	7.95x	8.60x
EV/Sales	0.48x	0.44x	0.41x
Div yield	6.50%	6.60%	6.70%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	N’millions				$’millions			
Revenue	79,202	81,358	88,174	94,624	193	198	215	230
EBITDA	5,666	3,597	6,495	6,010	14	9	16	15
Profit before taxes	7,456	5,121	8,082	9,036	18	12	20	22
Income taxes	(2,111)	(1,663)	(2,457)	(2,840)	(5)	(4)	(6)	(7)
Profit after taxes	(9,256)	3,928	6,094	6,665	(23)	10	15	16
Total assets	107,595	92,167	105,108	104,075	262	224	256	253
Total liabilities	47,054	30,795	44,605	45,114	114	75	109	110
Shareholders funds	60,541	61,372	60,503	58,961	147	149	147	143

Telecoms sector: Resilient than most

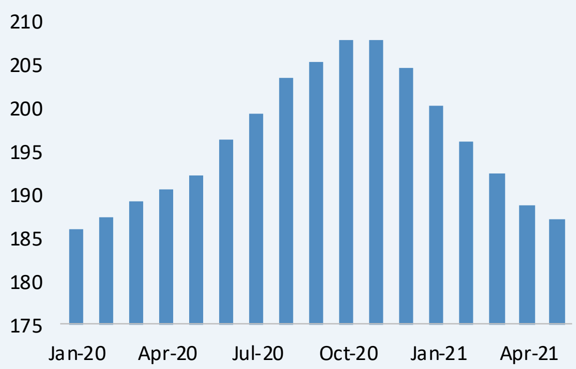
Nigeria's favorable demographics, rapidly growing population (population growth is expected to come in at c.5.2 million people per annum), and low mobile penetration suggest legroom for an increase in subscriber base. This, coupled with the recent spike in data demand, is expected to keep growth in the sector positive amidst regulatory uncertainties.

MTNN and AIRTELAFRI are currently trading at a forward EV/EBITDA of 4.4x and 4.5x, compared to the peer average of 5.6x. The duo's forward P/E are similarly at 12.3x and 14.0x lower than MEA peer average of 19.0x.

Data to remain Telecoms front-runner

Telecommunications was one of the fastest-growing sectors in Q1'21, despite notable regulatory setbacks that ordinarily should have hampered major mobile network operators (MNOs). The government's initial KYC directive in December 2020 to link NINs to subscriber data, alongside a restriction on new sim registrations, led to a significant decline in telco subscribers. For context, mobile subscribers declined by 20 million across the four major MNOs between November 2020 and May 2021. Nonetheless, listed telecom providers—MTNN and AIRTELAFRI—reported strong revenue growth in the first quarter of 2021, powered by material increase in data usage. For both firms, data revenue rose by an average 34.5% during that period, compared to a modest 7.6% growth in voice revenue.

Figure 24: Telephony subscribers (in millions)

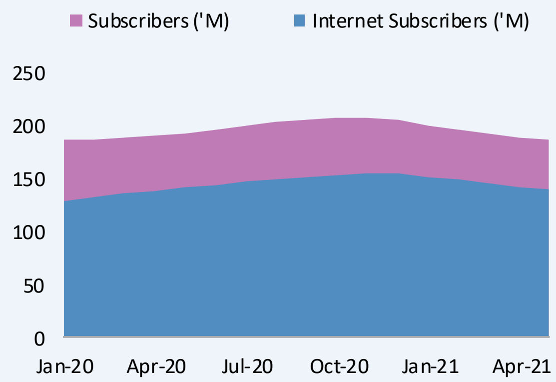


Source: NCC; CardinalStone Research

We expect the data drive to linger for the rest of 2021, given the observed shift away from traditional voice communication. This view is also buttressed by the fact that, per NCC data, only 75% of mobile subscribers are internet users, indicating a potential internet gap of about 40 million users.

Elsewhere, the lifting of the sim registration embargo in March 2021 could also prove positive for MNOs in the second half of the year on likely reversal of the prevailing downtrend in subscriber base. In addition, telcos have continued to ramp up investment in network infrastructure to increase penetration and enhance service quality. In 2020 alone, MTNN increased its 3G and 4G coverage by 2 ppts and 16 ppts, respectively, while AIRTELAFRI introduced home broadband packages in more than 150 towns. We believe these investments bode well for the mid to long term earnings outlook of the companies.

Figure 25: Subscribers vs Internet subscribers



Source: NCC; CardinalStone Research

MTN Nigeria PLC

BLOOMBERG: MTNN NL

Stable topline growth to continue

BUY

Target Price: N213.24

Ref Price: N165.00

Upside/(Downside): 29.2%

Market Cap: N3,358.5 bn

We forecast a sales growth of 16.2% YoY in FY'21, ahead of the company's 4-year CAGR of 14.1%, on sustained increase in data (+38.0%) and voice (+8.0%) revenue. The former is likely to result from continued growth in data usage for OTT social media apps and teleconferencing. Likewise, the recommencement of sim sales could boost subscriber base and grow its voice revenue. We also expect revenue from roaming fees (c.10% of revenue in the last three years) to grow strongly due to the gradual lifting of travel restrictions.

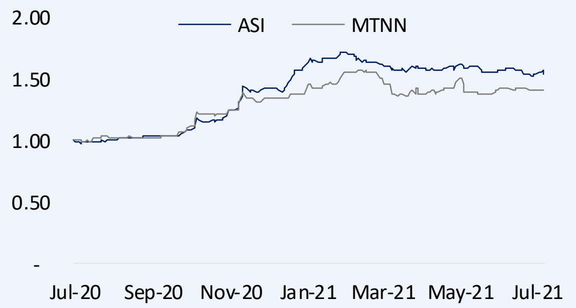
Currency pressure is expected to impact the company's expenses negatively. The pass-through effect has already been seen in the 25.0% spike in interest expense on leases in Q1'21. However, management expects that its debt optimization strategy could potentially offset these concerns. All in, we expect the company's net finance costs to worsen in FY'21, while direct network operating costs are expected to surge by 23.0%.

Nonetheless, we project a 31.0% growth in EPS in FY21 on solid sales growth, while the strong cash generation capacity of the company should enable it to retain its dividend payout ratio. Consequently, we raise our 12-month target price by 20.0% to N213.24, which translates to a 23.9% upside relative to our reference price. We retain our BUY rating on the counter.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	50.9%	48.8%	48.8%
Net margin	15.2%	17.2%	17.3%
RoA	11.84%	12.95%	13.62%
RoE	126.6%	131.2%	118.2%
Asset turnover	77.9%	68.6%	71.3%
Current ratio	66.6%	70.3%	68.0%
Quick ratio	70.0%	67.5%	52.4%
Debt to equity	137.9%	112.3%	115.5%

Multiples	FY'20	FY'21	FY'22
P/E	16.2x	12.3x	10.7x
EV/EBITDA	5.0x	4.4x	3.8x
EV/Sales	2.5x	2.1x	1.9x
Div yield	5.9%	6.4%	7.4%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	(N'million)				($'million)			
Revenue	1,169,832	1,346,390	1,565,311	1,804,265	2,842	3,271	3,802	4,383
EBITDA	629,919	685,740	764,422	880,461	1,530	1,666	1,857	2,139
Profit before taxes	290,611	298,874	396,154	457,751	706	726	962	1,112
Income taxes	(87,993)	(93,660)	(126,769)	(146,480)	(214)	(228)	(308)	(356)
Profit after taxes	202,618	205,214	269,384	311,271	492	498	654	756
Total assets	1,502,283	1,963,543	2,195,861	2,374,050	3,649	4,770	5,334	5,767
Total liabilities	1,356,426	1,785,157	1,963,598	2,079,533	3,295	4,336	4,770	5,051
Shareholders funds	145,857	178,386	232,263	294,517	354	433	564	715

Cement: A cyclical that defied COVID downturn

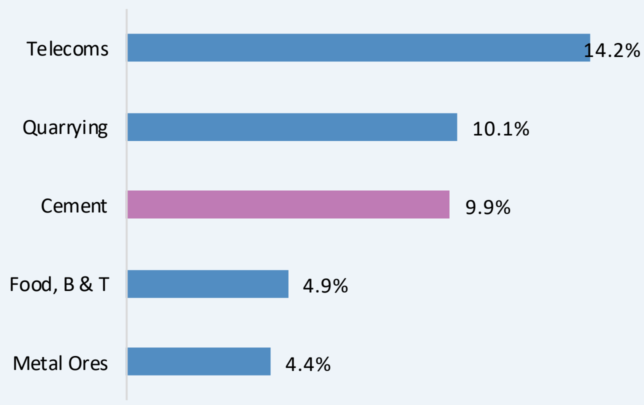
We envisage a solid year for cement manufacturers as government and private infrastructure drive domestic demand. However, market demand is likely to slow down in the second half of the year due to projected higher rainfall and its impact on construction projects. Rising costs also remain a concern, but sector players can mitigate the impact on margins by raising prices or tapering sales rebates to distributors.

Public, private consumption to drive volumes in 2021

Remarkably, the cement sector was resistant to the COVID-19 induced setbacks in 2020, as it grew by an average of 9.9% YoY in the last three quarters (vs overall economic growth of -0.43%). The rise in demand was partly driven by government infrastructure projects such as the 156km Lagos-Ibadan Standard Gauge Railway and the Dangote Group driven 35km Apapa-Oshodi-Oworonshoki Expressway. Coverage firms also attributed the sturdy demand to increased private sector patronage. To this point, we note that the real estate sector experienced a second consecutive GDP growth in Q1'21.

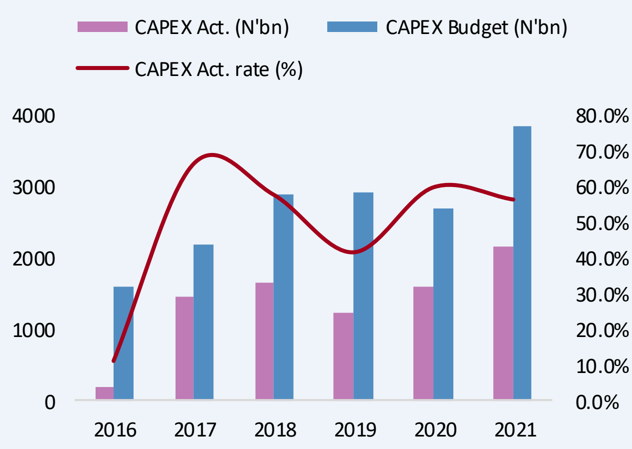
In our view, the sector is likely to maintain this momentum with a c.10.0% growth in 2021 (vs 9.1% in 2020) on continued economic recovery. Although the government's 2021 CAPEX projection of N4.1 trillion appears ambitious, improved government revenues occasioned by the rebound in oil prices supports our CAPEX implementation forecast of 56.0%. Even though this forecast implementation is lower than the five-year average of 58.0%, the implied higher absolute value of expected spending should support cement volumes in FY'21.

Figure 26: Cement emerged one of the fastest growing sectors in the last three quarters



Source: NBS; CardinalStone Research

Figure 27: FG is likely to post record CAPEX in 2021



Source: Budget Office; CardinalStone Research

Impact of La-Nina could cap demand growth in H2'21

Our full-year demand growth forecast is notably lower than the cement outturn in Q1'21 due to expectations of normal to above-average rainfalls in the second half of the year. Specifically, the Nigerian Meteorological Agency predicts that 2021 would be the first La-Nina in ten years. The increased rains associated with La-Nina could restrict construction activities in Q3'21 and early Q4'21. That said, a few areas overtaken by new climate realities are likely to be mostly unaffected by the La-Nina. Rainfall amounts are forecasted to range between 300mm in the North and 3000mm in the South. Extreme northern climes such as Kebbi, Sokoto, Katsina, Yobe and Borno are expected to experience the least rainfall (300mm to 700mm). States along the country's coastline (e.g. Delta, Rivers, Edo, Cross River and Akwa Ibom) could see total rainfall amount exceed 2300mm.

Margins may defy cost pressures

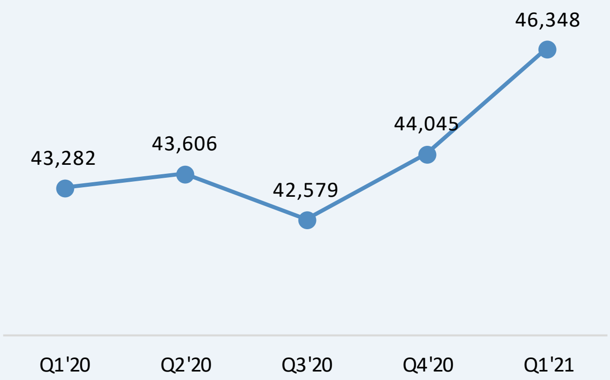
As with several industrials, cement manufacturers experienced currency-induced margin compression in 2020. Similarly, the weaker naira resulted in a c.15% increase in average energy costs across the three leading cement manufacturers in Q1'21. However, the players ensured there was no negative passthrough to margins by improving energy mix optimisation and adopting more effective pricing (by lowering sales rebates and lifting bonuses and distributors' discounts). On the back of this, DANGCEM, BUACEMENT and WAPCO reported 7.7 ppts, 2.9 ppts and 0.6 ppts increases in EBITDA margins to 53.5% and 48.5% and 30.9%, apiece.

Although we envisage a re-introduction of some of these sales incentives later in the year, as cement demand slow down due to higher rainfalls, we expect FY'21E margins to remain resilient year on year on the effect of robust H1'21.

+3.7 ppts

The year-on-year increase in Industry EBITDA Margin in Q1'21

Figure 28: Rising Industry Rev/tonne (N'000) (Q1'20—Q1'21)

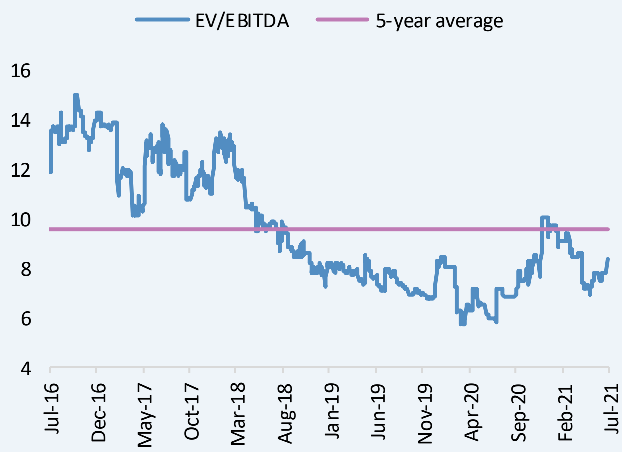


Source: Company Financials; CardinalStone Research

DANGCEM to be resilient

We expect DANGCEM to remain dominant on core operating metrics (FY'21E ROE: 36.3% vs a 5-year average of 28.4% and 11.6% for industry peers), given its edge on the economics of scale front and ability to influence the market price. In addition, the company has a stable dividend policy and a share buyback program for the repurchase of up to 10.0% of its total issued shares. The company repurchased 0.87% of its shares in the first tranche of the programme in December 2020 and has announced shareholders special resolution to renew the program, subject to required regulatory approvals. We believe the potential for a second tranche share buyback could be a catalyst for the company's share price in the near term.

Figure 29: DANGCEM is trading below 5-year EV/EBITDA average

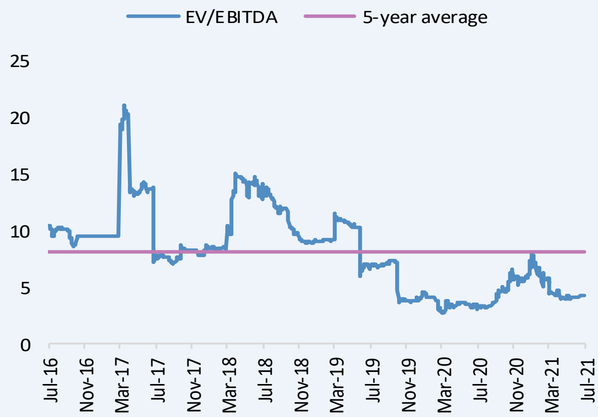


Source: Capital IQ; CardinalStone Research

...But WAPCO remains the bargain pick

That said, WAPCO remains our top pick in the cement sector due to its more apparent mispricing relative to intrinsic value. Specifically, WAPCO is trading on FY'21E P/E and EV/EBITDA ratios of 10.2x and 4.2x, compared to peer averages of 25.3x and 9.7x apiece. These ratios are also in stark contrast to the stock's 5-year averages of 14.7x and 8.2x, respectively. We also believe the ticker's market price pullback since the second half of the year is not justified, considering its impressive first-quarter, which re-enforces our expectation for a 66bps YoY increase in ROE growth FY'21.

Figure 30: At forward EV/EBITDA of 4.2x, WAPCO appears underpriced relative to its 5-year average of 8.2x



Source: Capital IQ; CardinalStone Research

DANGOTE CEMENT PLC

Rare catalyst may keep investors interested

BLOOMBERG: DANGCEM NL

HOLD

Target Price: N253.80

Ref Price: N248.00

Upside/(Downside): 2.3%

Market Cap: N4,226.0 bn

DANGCEM achieved its best quarterly performance since inception in Q1'21, driven by solid cement sales locally and across the continent. Nigerian volumes rose by 22.2% YoY, following the production ramp-up in the relatively new and efficient 3MTPA Obajana Line 5. DANGCEM recorded an even higher domestic revenue growth of 33.7% on higher realised prices. The solid top-line growth completely masked the impact of higher energy costs, leading to a 7.7 ppts jump in EBITDA margin to 53.5%. Across Pan-African operations, volumes also increased by 13.4% YoY, and EBITDA margin improved to 25.5% (vs 20.9% in Q1'20) aided by solid performances in Senegal and Cameroon.

In our view, group sales should expand by 18.6% YoY to N1.2 trillion in FY'21, with related volume growth likely to be capped at 11.9% YoY. The projected temperance in full-year output growth (vs Q1'21 level) is premised on the anticipated increase in Q3 rainfalls in Nigeria. However, mean sales growth across Pan African operations (+`15.0% YoY) is likely to be relatively higher on improved vaccinations. We estimate a 1.3 ppts YoY rise in group EBITDA margin to 47.2%, with higher realised prices in Nigeria and Pan Africa bolstering the impact of output increases. PAT is projected to expand by 20.6% YoY, despite higher net interest expense expectations. Notably, DANGCEM replaced its commercial papers with bonds in H1'21 and the attendant higher rates on longer-maturity instruments (bolstered by the contrasting yield reality in H1) is likely to drive finance expense pressures.

Adjustments to our estimates translate to a new 12-month TP to N253.80 (previous: N241.29), representing a 2.3% premium to our ref price of N248.0 and a HOLD recommendation on the ticker. Notably, our TP implies a conservative exit PE of 12.9x (vs the 5-year average of 14.1x).

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	45.9%	47.2%	47.0%
Net margin	26.7%	27.2%	27.4%
RoA	14.7%	15.7%	15.9%
RoE	30.9%	36.3%	36.9%
Asset turnover	55.0%	57.9%	58.0%
Current ratio	66.3%	69.2%	65.5%
Quick ratio	22.4%	37.2%	33.5%
Debt to equity	55.4%	57.0%	50.3%

Multiples	FY'20	FY'21	FY'22
P/E	15.31x	12.69x	11.95x
EV/EBITDA	9.14x	7.49x	7.14x
EV/Sales	4.19x	3.53x	3.36x
Div yield	6.5%	7.8%	8.3%

1-year price performance (rebased)

Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	(N'million)				($'million)			
Revenue	891,671	1,034,196	1,226,478	1,290,557	2,170	2,516	2,984	3,140
EBITDA	395,356	474,208	578,780	607,067	962	1,154	1,408	1,477
Profit before taxes	250,479	373,310	450,383	478,225	609	908	1,096	1,164
Income taxes	(49,958)	(97,242)	(117,318)	(124,571)	(122)	(237)	(285)	(303)
Profit after taxes	200,521	276,068	333,064	353,654	488	672	810	860
Total assets	1,741,351	2,022,451	2,211,058	2,240,254	4,237	4,921	5,380	5,451
Total liabilities	843,414	1,131,481	1,264,777	1,268,388	2,052	2,753	3,077	3,086
Shareholders funds	897,937	890,970	946,281	971,866	2,185	2,168	2,302	2,365

LAFARGE AFRICA PLC

BLOOMBERG: WAPCO NL

History of collaborations in FG projects bode well for growth

BUY

Target Price: N28.21

Ref Price: N21.75

Upside/(Downside):+29.7%

Market Cap: N350.3 bn

Although WAPCO recorded a softer sales growth in Q1'21 compared to peers, it made up for it by lowering operating and finance costs. WAPCO's top line rose by 12.2% YoY in Q1'21 on higher volumes (c.9.0% YoY) and realized prices. However, EBIT surged 24.2% YoY on lower administrative expenses (-14.9% YoY) and an impairment write-back of N527 million. The company's robust cash balance and lower debt ensured a 24.9% decline in net interest expense and combined with the knock-on effect from solid core operations to drive PBT 36.1% higher YoY to N12.8 billion.

We expect WAPCO to consolidate its Q1'21 performance and grow revenue by c.10.0% YoY in FY'21. The company is also likely to benefit from high government CAPEX, with its partnership roles in past government projects such as the National Assembly Complex and the Third Mainland Bridge already well documented. In addition, the firm's cost-saving initiatives around admin expense and energy mix could offset the impact of higher gas prices on margins (FY'21E EBIT margin: +2ppts to 18.0%). However, according to management, Ashaka de-bottlenecking and captive power plant projects may spill into 2022.

Our model adjustments translate to a 12-month Target Price (TP) of N28.21 and an unchanged BUY rating on the stock. WAPCO is trading on FY'21E EV/EBITDA and PE ratios of 4.2x and 10.2x, respectively, compared to peer averages of 9.7x and 25.3x apiece. Also, FY'21E ROE of 9.4% is considerably higher than the 5-year average ROE of 3.7%.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	32.7%	31.6%	30.2%
Net margin	13.4%	13.8%	14.7%
RoA	6.1%	6.9%	7.7%
RoE	8.8%	9.4%	9.9%
Asset turnover	45.9%	50.0%	52.1%
Current ratio	80.8%	102.5%	131.4%
Quick ratio	45.7%	58.6%	83.7%
Debt to equity	13.8%	5.2%	3.0%

Multiples	FY'20	FY'21	FY'22
P/E	11.31x	10.16x	9.15x
EV/EBITDA	4.34x	4.16x	4.20x
EV/Sales	1.42x	1.32x	1.27x
Div yield	4.6%	4.6%	6.9%

1-year price performance (rebased)

Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	(N'million)				($'million)			
Revenue	212,999	230,573	249,019	258,980	518	561	606	630
EBITDA	62,876	75,462	78,724	78,090	153	184	192	190
Profit before taxes	17,892	37,572	48,007	53,285	44	91	117	130
Income taxes	(2,374)	(6,730)	(13,682)	(15,186)	(6)	(16)	(33)	(37)
Profit after taxes	15,518	30,842	34,325	38,099	38	75	84	93
Total assets	497,152	507,214	488,594	506,412	1,210	1,234	1,189	1,232
Total liabilities	152,238	147,575	115,338	109,680	370	359	281	267
Shareholders funds	344,914	359,639	373,256	396,733	839	875	908	965

Oil Palm: Pricing could catapult producers higher

According to USDA, Nigeria is the 5th largest producer of palm oil in the world. The country currently boasts an annual production of c.1.3 million MT (vs 1.0 million in 2018), with c.42.0%, 27.0%, and 25.0% of the output coming from the South-South, South West, and South-East regions of the country. Despite being the most significant oil palm producer in Africa, Nigeria exports far less than Cote d'Ivoire, Benin, Kenya, South Africa, Togo, and Ghana. This relatively low export primarily reflects high domestic consumption (c.1.7 million MT annually), which necessitates an annual importation of c.0.45 million MT. Importers (c.26.5% of the market), as a block, therefore remain pivotal in the determination of domestic CPO prices in Nigeria, leaving OKOMUOIL and PRESCO (c.6.0% market share) primarily as price takers. We expect this dynamic to subsist in the medium-to-long term.

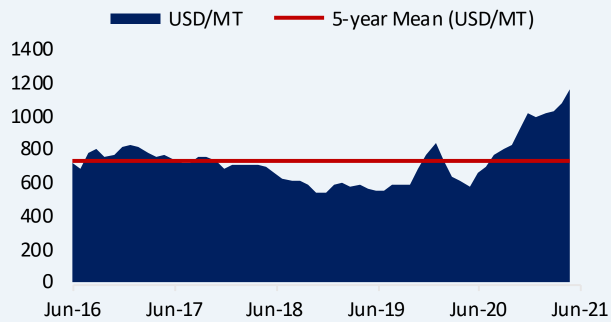
FY’21 could be stellar for coverage

The elevated CPO price level and aggressive expansion drive of listed players over the last 12 months partly inform our positive outlook on our oil palm coverage companies. Notably, even though domestic CPO prices slightly moderated in Q2'21, they have remained over 50.0% higher YoY on the impact of supply shortfalls in the largest producing countries (Malaysia and Indonesia), rising demand, pass-through from naira depreciation, and low base effect. Already, price uptick has provided support to OKOMUOIL and PRESCO, who witnessed sales growth of 81.2% YoY and 47.5% YoY, apiece, in Q1'21. Elsewhere, as per numbers from the world bank, rubber prices have also gained 35% YoY and this, comingled with the knock-on effect of naira depreciation, is likely to support export revenues for OKOMUOIL.

In addition to the above, we believe sector performance would continue to be supported by regulatory initiatives to achieve revenue diversification, FX conservation, self-sufficiency, and employment generation. We also note the provision of single-digit interest rate loans such as the 'real' sector support facility, commercial agric credit scheme, funds from differentiated cash reserve requirements, BOI loans, and ABP for shorter-term intervention suitable for plantation maintenances.

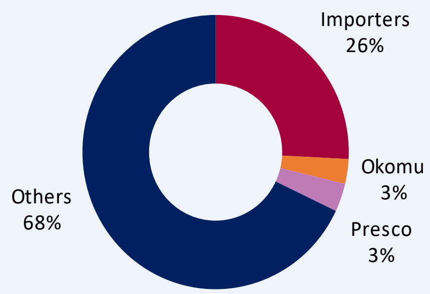
Across our coverage, OKOMUOIL appears to have been more successful at obtaining concessionary funding to implement projects or meet short term needs, with all of the company's debt obtained from BOI (c.N1.4 billion) and differentiated cash reserve requirement (N10.0 billion)

Figure 31: Global CPO prices are way higher than 5-year average



Source: Index Mundi; CardinalStone Research

Figure 32: CPO Market Share by Volumes



Source: USDA, Company Financials; CardinalStone Research as at FY'20. In contrast, concessionary borrowing accounted for 38.8% of PRESCO's debt obligation as at the end of 2020, with notable relatively expensive borrowings from a few commercial banks. This realization informs our relatively low FY’21 interest expense forecast for OKOMUOIL versus PRESCO. That said, we expect both companies to finish the year strongly with EPS growths of 88.7% and 97.8%, respectively.

Figure 33: Global Concessionary debt breakdown across coverage

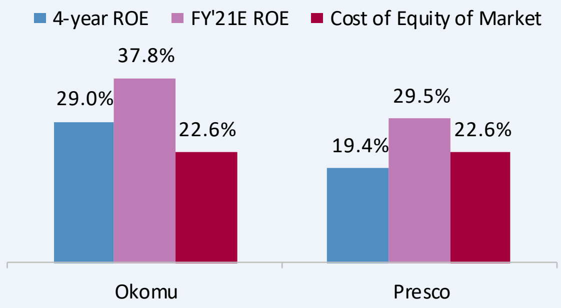
	OKOMU	PRESCO
Commercial Agricultural Credit Scheme (CACS)	0.0	0.2
Bank of Industry (BOI)	1.4	0.6
Differentiated Cash Reserve Requirement (DCRR)	10.0	4.3
Concessionary as % of total debt	100.0%	38.8%

Source: Company Financials; CardinalStone Research

OKOMUOIL to lead on ROE and FCFF

In our view, coverage ROE is likely to print at c.33.7% (vs the 5-year average of 24.2%) on price induced surge in operating income. This return is also set to dwarf the market cost of equity, which we estimate at 22.6%. Elsewhere, FCFF could improve to an average of N8.2 billion across coverage in FY'21 (vs N6.5 billion in FY'20), with OKOMUOIL leading the way with a projected c.450% FCFF surge. In addition, the growth in FCFF is likely to reflect more contained CAPEX in the review period, with our coverage notably wrapping up critical projects over the last few years. CAPEX-heavy projects due for completion in 2021 include OKOMUOIL’s 5Mw turbine, and PRESCO’s 500 ton/day refining plant at its Obaretin estate.

Figure 34: Sector ROE could remain ahead of market cost of equity



Source: Capital IQ; Company Financials; CardinalStone Research

THE OKOMU OIL PALM COMPANY PLC

Price and volumes to drive growth

BLOOMBERG: OKOMU NL

HOLD

Target Price: N111.25

Ref Price: N110.00

Upside/(Downside): 1.1%

Market Cap: N104.9 bn

Local CPO prices have tracked the global rally, with the average realized price in Q1'21 50% higher YoY on strong domestic demand and supply shortages in Indonesia and Malaysia. In addition, the expected commissioning of the new 30t/hr oil mill in extension 2 (slated for July 2021) should provide some support for volumes and market share, given that border enforcement have remained better than previously expected. Elsewhere, rubber sales are likely to improve in FY'21 after a slow 2020 on the back of a c.35.0% YoY rise in prices and impact of devaluation. The combined effects of prices and volumes changes should drive revenue 88.3% higher YoY to N44.1 billion in FY'21.

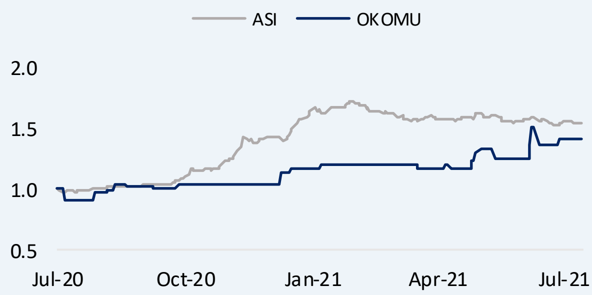
On the cost side of things, we expect high inflation to continue to pressure operating expenses. In addition, employee and direct costs could increase due to harvesting and planting in newly opened areas. However, the knock-on effect of robust top-line growth and energy savings projects (such as the 5mw turbine) is likely to offset pressures from admin expenses. The 5mw turbine, which was delayed because of COVID 19 related movement restrictions, is expected to completed in 2021 and could potentially reduce energy-related costs by c.25.0%.

All in, we forecast FY'21 ROE higher at 37.9% (vs the prior 5-year average of 30.0%). We also raise our 12-month TP to N111.25 (vs N91.07 previously), corresponding to a 1.1% upside relative to our reference price. We have a HOLD recommendation on the stock.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	47.9%	52.8%	52.9%
Net margin	33.2%	33.3%	32.1%
RoA	13.5%	23.3%	21.8%
RoE	24.3%	37.9%	32.6%
Asset turnover	47.5%	76.5%	74.8%
Current ratio	271.9%	345.8%	412.8%
Quick ratio	88.4%	134.8%	213.4%
Debt to equity	32.7%	25.8%	18.7%

Multiples	FY'20	FY'21	FY'22
P/E	9.5x	7.1x	6.9 x
EV/EBITDA	9.8x	4.7x	4.3x
EV/Sales	4.7x	2.5x	2.3x
Div yield	6.8%	7.3%	8.2%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	(N'million)				($'million)			
Revenue	18,867	23,411	44,074	47,232	46	57	107	114
EBITDA	9,016	11,212	23,264	24,979	22	27	57	61
Profit before taxes	7,490	8,846	18,122	18,697	18	22	44	45
Income taxes	(2,474)	(1,065)	(3,443)	(3,552)	(6)	(3)	(8)	(9)
Profit after taxes	5,016	7,781	14,679	15,145	12	19	36	37
Total assets	43,596	55,012	60,185	66,080	106	134	146	161
Total liabilities	14,416	20,234	17,405	16,007	35	49	42	39
Shareholders funds	29,180	34,778	42,780	50,073	71	85	104	122

PRESCO PLC

Higher commodity prices to drive performance

BLOOMBERG: PRESCO NL

HOLD

Target Price: N74.59

Ref Price: N70.00

Upside/(Downside): 6.6%

Market Cap: N70.0 bn

We forecast an EPS growth of 97.8% in FY'21 driven by moderate volume growth and robust price appreciation (FY'21E: N600,000/ton; FY'19: N361000/ton). The former is expected to reflect increased output from the Sokponba estate and improved refining capacity at the Obaretin estate. The company's margins are also likely to improve on scale effects from new CPO processing facilities. However, selling and distribution expenses are likely to mirror the overall cost inflation in Nigeria, and the reliance on expensive debt to finance acquisition plans could potentially leave borrowing costs elevated. To our minds, the possibility of assessing CBN's cheap Agric loans could limit the upside risk to the company's finance cost.

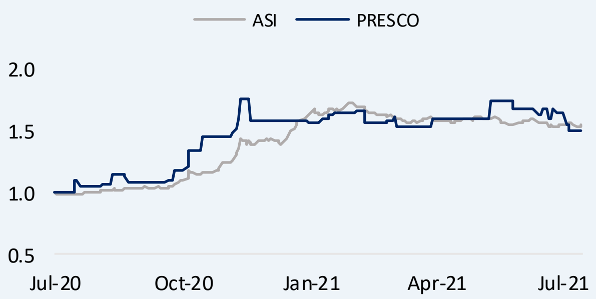
The company is also expected to report higher revaluation gains due to the increase in CPO prices. All in, we project a 97.8% YoY in after-tax profit to N10.4 billion, with ROA and ROE likely to see 13 ppts and 6 ppts appreciation to 29.5% and 13.6%, respectively.

A blended valuation of Free Cash Flow to Equity (FCFE), EV/ EBITDA and P/E for the company resulted in a 12-month target price of N74.65, implying a capital appreciation of 6.6% and a HOLD recommendation.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	59.1%	52.8%	52.9%
Net margin	22.0%	31.3%	30.0%
RoA	7.3%	13.6%	13.0%
RoE	16.4%	29.5%	24.9%
Asset turnover	33.1%	43.6%	43.5%
Current ratio	172.7%	200.0%	220.4%
Quick ratio	37.8%	58.4%	92.2%
Debt to equity	42.62%	29.16%	20.19%

Multiples	FY'20	FY'21	FY'22
P/E	13.3x	6.7x	6.4x
EV/EBITDA	5.7x	4.5x	4.2x
EV/Sales	3.8x	2.6x	2.3x
Div yield	2.6%	2.6%	2.6%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022E	2019A	2020A	2021E	2022E
	(N'million)				($'million)			
Revenue	19,724	23,892	33,298	36,421	48	58	81	89
EBITDA	8,570	14,130	19,971	21,611	21	34	49	53
Profit before taxes	6,060	8,690	14,874	15,596	15	21	36	38
Income taxes	(2,221)	(3,428)	(4,462)	(4,679)	(5)	(8)	(11)	(11)
Profit after taxes	3,839	5,262	10,412	10,917	9	13	25	27
Total assets	70,733	73,769	78,916	88,570	172	179	192	215
Total liabilities	37,790	42,718	39,453	40,189	92	104	96	98
Shareholders funds	32,943	31,051	39,463	48,381	80	76	96	118

Oil & Gas: Start of a new era?

In our view, the Petroleum Industry Bill (PIB) passage is likely to be one of the critical drivers of investment in Nigeria's upstream oil & gas space in the medium-to-long term. In the short run, exogenous factors affecting oil demand and supply are likely to remain essential determinants of ROI, rig counts, and linked CAPEX. On the downstream market, earnings should improve due to the COVID-induced low base effect from last year and rising air travel in 2021. We, however, note the likelihood of sustained low PMS margins in the sector, with the inclusion of subsidies in 2022 to 2024 MTEF document blurring hopes of imminent deregulation. Instead of outright deregulation, we believe the authorities are more likely to favour an adjustment of PMS pump price in H2'21 to reduce subsidy burden and keep the risk of potential public backlash contained ahead of the pre-election year 2022.

Upstream; the clear winners of PIB

After years of congressional delays, the PIB was passed by both houses of the National Assembly in July 2021. The document contains provisions targeted at improving transparency and accountability in the oil and gas sector, which will likely encourage healthy competition, deter unprofessional conduct, and attract investment in the domestic oil and gas sector. In our view, we believe the fiscal authorities, oil producers and host communities are poised to benefit the most if the bill assented to by the President.

Key PIB provisions for the upstream sector

- PIB provides for the establishment of the Nigerian Upstream Regulatory Commission, which would be in charge of upstream petroleum operations' technical and commercial regulation.
- It also advocates the commercialization and incorporation of the Nigerian National Petroleum Corporation (NNPC) under the new name Nigerian National Petroleum Company.
- The bill provides a Host Communities Development Trust, which will oversee all environmental, social and infrastructure projects in the oil and gas host communities.
- Oil producers are also charged to contribute a percentage of their actual operating expenditure in the preceding calendar year to develop host communities.

The PIB also provides host communities with the right to a 3.0% equity shareholding in the Host Communities Development Trust. Even though this provision is materially below the 10.0% share advocated for by the host communities, advocates of the bill hope that the equity share provision would reduce oil bunkering and attract more investments. For oil producers, improved transparency in the awarding Oil production licenses (OPL) and the reduced security threats to E&P assets due to the host communities fund provision is likely to attract more investments into the sector. In turn, these investments could increase royalties due to the fiscal authorities.

N852 billion

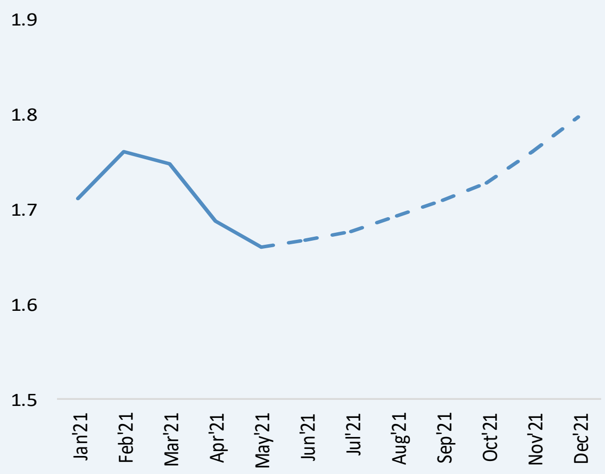
Estimated annual oil losses due to oil theft and pipeline sabotage— NEITI

Furthermore, the bill's provision on making the NNPC a limited liability company is likely to improve transparency around J.V. participation and eradicate documented delays in cash calls. According to Hamish McArdle and Tom Edwards of the Baker Botts law firm in London, IoCs - Shell, Exxon, Chevron, and Eni are all awaiting final investment decisions on oil exploration and production projects worth $47.6 billion of new investment in Nigeria. We believe that a passage of the PIB can expedite these decisions, which could cascade to a 40.0% increase in Nigeria's current petroleum production.

Conditions to be favourable in H2'21

Crude oil prices have skyrocketed over the last few months, aided by OPEC+ supply cuts and rising oil demand. Notably, Brent Futures has almost tripled from 2020 lows to c.$73/bbl in 2021, as economies gradually recover from the spread of the novel coronavirus. The rebound in prices also influenced OPEC+'s decision to return 2.1 million barrels per day (bopd) to the market from May 2021 through July 2021. Domestic rig counts will likely increase in the coming months due to improving oil economics after moving from 11 in Q2'20 to 6 in May 2021. In line with increased domestic drilling activities and expected easing of supply cuts, we expect annual daily oil production to steadily increase through the ember months to c.1.8 million bopd, averaging 1.72 million bopd in 2021 (+0.1% YoY). Elsewhere, despite talks of OPEC's plan to gradually unwind its record oil output curbs from August, we expect oil prices to remain resolute at the $65-70/bbl levels for the rest of the year on further economic re-opening.

Figure 35: Domestic production is expected to pick up in the ember months



Source: DPR; CardinalStone Research

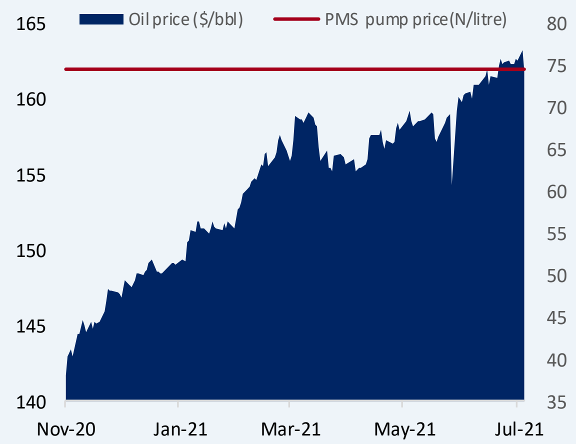
Downstream still foggy despite PIB

To our minds, a free market for petrol is unlikely in the near term given the politically sensitive nature of the topic and the reality that 2022 budget still has provision for subsidy. We recall that the recent draft of the PIB seeks to scrap the Petroleum Equalisation Fund (PEF) as well as the Petroleum Products Pricing Regulatory Agency (PPRA) and replace them with a new agency to be known as the Nigerian Midstream and Downstream Regulatory Authority.

Key PIB provisions for the downstream

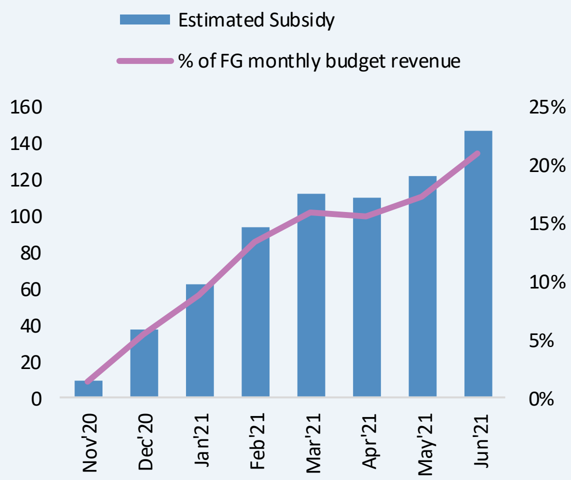
- Scraping of the Petroleum Equalisation Fund (PEF) and the Petroleum Products Pricing Regulatory Agency (PPRA)
- Replacing the above agencies with a new entity Nigerian Midstream and Downstream Regulatory Authority, saddled with the responsibility of carrying out technical and commercial regulation of the midstream and downstream petroleum operations in the industry

Figure 36: Petrol pump prices remain fixed despite rising crude oil prices



Source: NNPC; CardinalStone Research

Figure 37: Estimated subsidy payments (N'billion) since last price adjustment in November 2020



Source: PPRA, NBS, CardinalStone Research

Downstream continues to attract investments despite regulatory uncertainties

Despite the uncertainty in the sector, oil marketers continue to make strategic investments in the industry. Notably, in June 2021, ARDOVA announced its intention to acquire ENYO once the necessary regulatory approvals are obtained. Before this, the company had sought to de-risk revenues from the regulated PMS market in 2020. Initiatives on this front included the partnership with Mobile Power that was aimed at establishing a Battery as a Service (BaaS) solution company and the deal with Shell Trading International Limited to become the sole distributor for Shell Lubricant branded products in Nigeria.

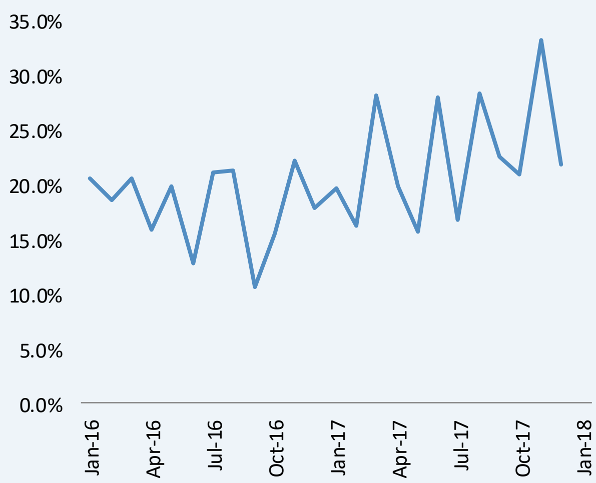
Along these lines of revenue de-risking, the company also completed a 600MT LPG tank station in Kano, revealed plans to construct a 20,000MT LPG storage facility, and indicated an interest in upstream oil & gas. On its upstream quest, we note that the company featured among the awardees of the F.G.'s 2020 marginal field bid rounds conducted last year. Similarly, TOTAL commissioned a third High Speed Filling Machine at its Lagos Blending Plant and a 1MWp hybrid solar plant – "a build and operate" model for Rite Foods Limited. MOBIL also continued to deepen its hospitality and real estate presence, acquiring a 3-star hotel at the heart of Lagos in 2020.

Although these drives can impact marketers' bottom line, we believe crude oil prices and developments on the air travel front are the fundamental drivers of sector profitability in FY'21. In our view, a ramp-up in air travel is likely to primarily benefit MOBIL and TOTAL as the duo control about 50.0% of the Aviation Turbine Kerosene (ATK) market. However, in passing, we note that operating margins are likely to be capped by the knock-on effect of higher oil prices on lubricants cost of sales.

Dangote Refinery may be critical in the long term

The operational take-off of the widely discussed Dangote Refinery is likely to be critically impactful for downstream businesses in the medium to long term. At the very least, the commencement may see the NNPC seize to be the sole supplier of refined crude products into the country. In addition, the recently passed PIB also provides legroom for holders of refining licenses in the country to pay for domestic "crude" oil supply in naira. In turn, the domestic refiners would only receive naira payments to deliver products to the local market. The above permutations are likely to reduce the FX burden stemming from the oil value chain (11.3% of total FX demand), eliminate the shipping cost component in PMS pricing (c.7% of total cost), and encourage the government to embrace flexible pricing better.

Figure 38: Historical proportion of FX allocation to refined products importation pre-2018



Source: CBN, CardinalStone Research

ARDOVA PLC

Unlocking value through core asset optimization

BLOOMBERG: ARDOVA NL

ARDOVA has emerged as the fastest-growing oil marketing and distribution company over the last three years, with revenues growing by an average of 30.2% YoY between FY'18 and FY'20. Although it posted a modest 3.9% revenue growth in 2020 due to COVID-19 setbacks in Q2'20, we expect a slightly better FY'21 (+5.8% YoY) on road and air travel improvements and low base effect. According to management, the PMS supply challenges that impacted volumes in Q1'21 are not expected to linger in subsequent quarters. Our forecast is also premised on the sustained growth rhythm of marginal revenue segments and the consummation of the ENYO acquisition in H2'21.

ARDOVA's margins (ex-one-off incomes) have also been resilient despite low PMS margins and inflationary pressure since the new management took over in 2019. ARDOVA's EBIT margin advanced by 0.5 ppts in FY'20, driven by lower lubricant costs and declines in distribution and administrative expenses. While the rebound in oil prices is likely to pressure cost of sales in subsequent quarters of FY'21, the firm's optimization of storage and distribution assets, as seen in Q1'21, is expected to lift FY'21 margins higher by 0.4 ppts to 3.2%, albeit below the 3.4% achieved in Q1'21. The company's product distribution has been supported by the relatively new haulage subsidiary – Axels and Cartage. We expect a 25.6% YoY growth in PAT to N2.3 billion in FY'21.

Our 12-month TP of N18.98 is at a 19.4% upside to the current market price of N15.90 and supports a BUY recommendation. ARDOVA is trading on an FY'21E P/E and EV/EBITDA of 9.9x and 4.8x compared to its 5-year average of 51.9x and 9.9x, respectively. These discounts are not justified by our FY'21E ROE of 12.2%, which is higher than the adjusted 5-year average ROE of 8.9%. The company's interest in upstream appears positive viewed through the lenses of current oil economics, but it also portends increased earnings volatility.

BUY

Target Price: N18.98

Ref Price: N15.90

Upside/(Downside): 19.4%

Market Cap: N20.7 bn

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	2.9%	3.3%	3.6%
Net margin	1.0%	1.2%	1.1%
RoA	3.3%	3.4%	3.1%
RoE	10.9%	12.2%	11.5%
Asset turnover	325.3%	283.2%	274.0%
Current ratio	101.0%	88.3%	77.9%
Quick ratio	69.1%	59.3%	53.3%
Debt to equity	49.7%	19.2%	29.1%

Multiples	FY'20	FY'21	FY'22
P/E	10.87x	8.65x	8.28x
EV/EBITDA	4.65x	3.84x	3.09x
EV/Sales	0.13x	0.13x	0.11x
Div yield	1.2%	1.7%	1.8%

1-year price performance (rebased)

Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
		(N'billion)				($'million)		
Revenue	176,551	181,939	195,744	217,155	431	444	477	530
EBITDA	7,076	5,268	6,378	7,923	17	13	16	19
Profit before taxes	4,654	2,905	3,482	3,639	11	7	8	9
Income taxes	(739)	(1,048)	(1,149)	(1,201)	(2)	(3)	(3)	(3)
Profit after taxes	3,915	1,858	2,333	2,438	10	5	6	6
Total assets	47,019	64,846	73,388	85,123	115	158	179	208
Total liabilities	30,856	46,825	53,281	62,928	75	114	130	153
Shareholders funds	16,163	18,021	20,107	22,195	39	44	49	54

SEPLAT ENERGY PLC

On course for a stellar year

BLOOMBERG: SEPLAT NL

BUY

Target Price: N927.33

Ref Price: N770.00

Upside/(Downside): 20.4%

Market Cap: N453.1 bn

The most significant investment case for SEPLAT is the sharp increase in oil prices over the last few months. Our FY'21 oil price expectation of $65/bbl exceeds FY'20 average oil price by 27.0%. In addition, the company's W. I production (FY'21E: +5.3% YoY) is likely to outperform last year's volumes due to increased global demand for oil and improved gas drilling activities. We expect SEPLAT to recover from the oil production setbacks in Q1'21 driven by delays in replacing the damaged MT Harcourt vessel at OML 40 and close FY'21 with a 5.0% YoY increase in liquid volumes to c.35,400 bopd. Gas volumes are also forecast to rise by 12.0% YoY to 113 MMMscfd on Oben-50 and Oben-51 gas well drillings. Overall, FY'21 revenues are projected to grow by 60.0% YoY to $934.4 million.

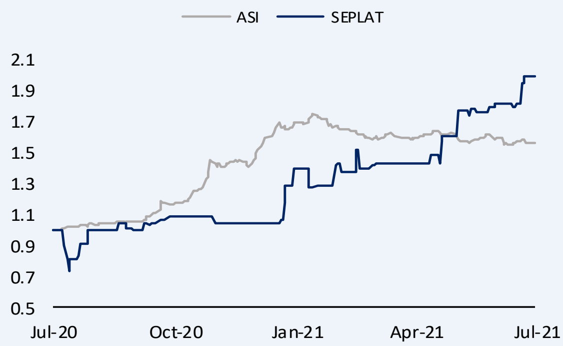
We also expect its EBITDA margin to increase by 20.9 ppts YoY on prudent cost management and low base effect from last year's $145.5 million IAS 36 impairment charge and one-off payments made to Eland directors. Overall, we project an FY'21E PAT of $111.5 million vs the $85.3 million loss registered in FY'20.

Following adjustments to key parameters – oil price and production, we arrive at a new TP of N927.33 (20.4% upside to our reference price) and retain a BUY rating on the stock. Our new TP captures the 5.0% devaluation of the naira since our last update on the company. We believe the company's newly introduced quarterly dividend policy could continue to catalyze the stock, as seen in Q2'21. Since the release of its Q1'21 results and dividend announcement, SEPLAT has gained 31.6%, highlighting investors' renewed interest amid improving fundamentals.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	19.7%	42.0%	45.2%
Net margin	-16.1%	11.9%	24.9%
RoA	-2.5%	2.9%	6.1%
RoE	-4.9%	6.1%	12.6%
Asset turnover	15.8%	24.5%	24.4%
Current ratio	126.8%	116.0%	114.2%
Quick ratio	111.0%	99.7%	99.9%
Debt to equity	42.0%	37.9%	26.6%

Multiples	FY'20	FY'21	FY'22
P/E	-13.60x	11.22x	5.15x
EV/EBITDA	8.40x	2.40x	2.15x
EV/Sales	1.66x	1.01x	0.97x
Div yield	4.4%	4.4%	4.4%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	(N'billion)				($'million)			
Revenue	214,157	214,157	357,357	370,820	698	530	872	904
EBITDA	123,701	40,077	150,113	167,770	406	105	366	409
Profit before taxes	89,914	(28,872)	70,653	153,948	293	(80)	172	375
Income taxes	(8,939)	(1,840)	(28,261)	(61,579)	(29)	(5)	(69)	(150)
Profit after taxes	80,975	(28,872)	42,392	92,369	264	(85)	103	225
Total assets	1,004,233	1,310,837	1,498,811	1,543,193	3,271	3,450	3,656	3,764
Total liabilities	450,425	678,500	798,081	773,940	1,467	1,786	1,947	1,888
Shareholders funds	553,808	632,337	700,730	769,253	1,804	1,664	1,709	1,876

TOTAL NIGERIA PLC

Cost savings to drive earnings growth

BLOOMBERG: TOTAL NL

HOLD

Target Price: N231.97

Ref Price: N203.20

Upside/(Downside): 14.2%

Market Cap: N68.99 bn

We forecast a 7x growth in TOTAL's EPS in FY'21E, hinged on projected solid sales growth and operating efficiency. Specifically, the low base effect from last year and resumption of air travel in 2021 could support a 46.2% YoY expansion in the company's topline. In addition, TOTAL is expected to sustain its dominance in the lubricant market (over 50.0% market share) in 2021 and build on the impressive 62.4% YoY increase in lubricant sales in H1'21. We believe the company's lubricant business benefits from a firm brand name and continued strategic investments, such as the third High-Speed Filling Machine commissioned at its Lagos Blending Plant in 2020. Our sales forecast also captures projected higher sales from the ATK market, where it commands the second largest market share.

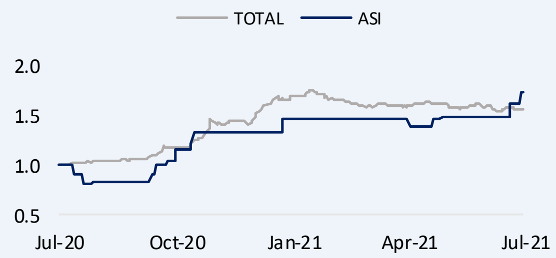
For us, the most significant support for earnings could come from the cost of sales savings expected in the current year. For context, the company reported a N3.9 ppts jump in gross margin in H1’21, with the corresponding half year profit higher than that of the entire full-year 2020. While we note the potential impact of higher oil prices on lubricant margins, passthrough from lower administrative expenses is likely to mask this concern completely.

We have adjusted our target price higher to N231.97 to reflect the projected surge in earnings and renewed earnings stability in the short term. The ticker is currently trading on an FY'21 EV/EBITDA of 4.7x compared to its MEA peer average of 8.5x. We now have a HOLD rating on the counter (vs SELL previously). Complete deregulation of the sector is an upside risk to our forecast.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	4.9%	9.5%	8.9%
Net margin	1.0%	4.9%	4.6%
RoA	1.5%	9.9%	9.5%
RoE	7.3%	42.7%	33.0%
Asset turnover	146.9%	200.6%	204.7%
Current ratio	87.7%	96.5%	103.6%
Quick ratio	65.9%	64.6%	69.1%
Debt to equity	115.9%	73.6%	67.9%

Multiples	FY'20	FY'21	FY'22
P/E	33.4x	4.7x	4.5x
EV/EBITDA	6.2x	2.2x	2.1x
EV/Sales	0.3x	0.2x	0.2x
Div yield	3.0%	6.4%	6.6%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
	(N’billion)				($’million)			
Revenue	292,177	204,721	299,229	329,152	713	499	730	803
EBITDA	16,257	10,060	28,305	29,319	40	25	69	72
Profit before taxes	3,071	2,909	19,837	20,529	7	7	48	50
Income taxes	(792)	(846)	(5,114)	(5,292)	(2)	(2)	(12)	(13)
Profit after taxes	2,279	2,063	14,723	15,237	6	5	36	37
Total assets	135,031	143,613	154,671	166,988	329	350	377	407
Total liabilities	106,711	115,462	113,861	115,358	260	282	278	281
Shareholders funds	28,320	28,151	40,810	51,630	69	69	100	126

Power Sector: FG re-awakening to boost investments

In our view, the investment case of the Nigerian power sector is hinged on its vast structural deficit, and ongoing rejig of government interventions aimed at better incentivising players in the value chain. Nigeria has a population of c.200 million, with only 45.0% of the populace accessing the national grid. On-grid demand is estimated at 25,790 MW, but only 4,800 MW of electricity can be transmitted despite an installed capacity of 13,700 MW. Thus, most Nigerians rely on expensive self-generation, which, in turn, leads to the emission of greenhouse gasses (GHC), pollution and increased living costs for households. There is also ample room to unlock value through diversification of energy mix, with 81.0% of the sector utilising unreliable gas and thermal plants. The government's commitment to improve grid capacity and provide an enabling environment also elicits favourable reactions from investors. Notably, Egbin already announced plans to more than double its generation capacity to 3,000MW by 2025, with TRANSCORP also targeting a total of 2,500MW.

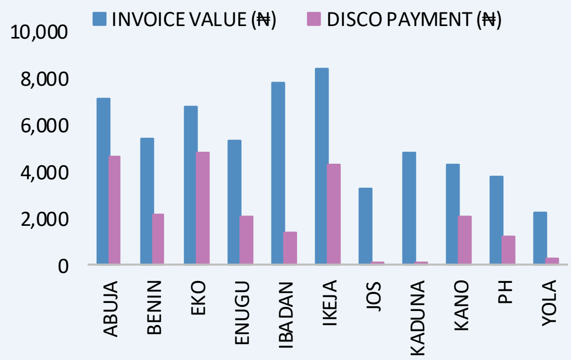
Still a long way to go

The Nigerian power sector has been perennially plagued by gas supply constraints, low energy production, high distribution losses, energy theft & low collection efficiency, non-cost reflective tariff, and network infrastructure challenges. These issues resulted in epileptic electricity supply, and a re-awakening of the government's interest partly through privatisations and subsidies to help GENCOs stay afloat. In late 2020, NERC introduced a Service Reflective Tariff (SRT), which is a pay as you use billing system aiming to create a self-sustaining electricity market in Nigeria. There was also the introduction of new guidelines for distribution franchising, capping of estimated billing, and national mass metering geared towards resolving some of the structural concerns in the sector. Thanks to the SRT and the Payment Assurance Plan (PAP), GENCOs now receive c.50.0% payments for invoices issued within 60 days for the first time in years.

Yet, improvements in gas supply to GENCOs and metering aimed at reducing incidences of estimated billings and boosting liquidity across the value chain could improve the medium-to-long term outlook of the industry. The Siemens deal is also expected to overhaul Nigeria's electricity grid by upgrading several power substations and distribution lines. The initiative aims to improve transmission capacity to 25,000 MW in 9 years (from 13.700 MW currently). However, this targeted capacity pales in comparison to the power need of Nigeria. This projected inadequacy supports the prognosis for more private sector investment

Resumption of economic activities is positive for sector: Elsewhere in the value chain, distribution companies (Discos) charge a lower tariff on residential users (64.0% of total consumption) than commercial and industrial users, who account for 19.0% and 9.0% of total consumption apiece. This arrangement implies that commercial and industrial users cross-subsidise the residential users, who often pay below the supply cost. During the COVID lockdowns of 2020, the format boomeranged into revenue losses and renewed difficulties in meeting invoices of GENCOs due to the reduction in demand from commercial and industrial customers instigated by restrictions. The low base implied by the conditions creates scope for a base effect induced increase in tariff receipts in 2021, even though they remain materially below expected thresholds.

Figure 39: Disco invoices and payments as at September 2020



Source: NERC; CardinalStone Research

Transnational Corporation of Nigeria Plc

Earnings to rebound from FY'20 woes

BLOOMBERG: TRANSCORP NL

HOLD

Target Price: N1.03

Ref Price: N0.94

Upside/(Downside):9.6%

Market Cap: N38.21 bn

We adjust our 12-month TP for TRANSCORP to N1.03 and rate the counter a HOLD. We see legroom for a slightly higher revenue CAGR of 13.1% over our 5-year horizon (vs +12.7% in the preceding 5-year period), with smoothened PAT growth of over 26.6%. Our positive outlook is aided by the successful activation of the Gas Supply and Aggregation Agreement (GSAA), which is now seeing the company receive c.124 MMSCF of gas supply per day and boosting energy revenue (Q1'21: +100.0% YoY). Over FY'21, the first quarter momentum could be bolstered by the coming on stream of 3 energy turbines with a combined capacity of 300MW (27.0% of current capacity). Thankfully, the growing international energy sale in West Africa justifies the business' ongoing expansions, with idle capacity likely to trend lower. We see legroom for improvement in occupancy rate to c.54.0% in FY'21 (vs 40.0% in FY'20 and 4-year mean of 62.0%) as re-opening economic activities boosts related revenue.

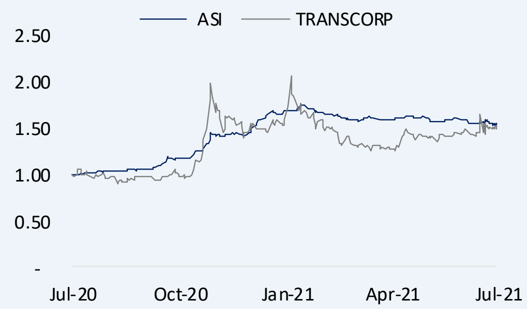
However, rising gas prices, double-digit inflation, and currency weaknesses could limit revenue growth passthrough to PBT margin (FY'21E: 8.6% vs mean of 15.6% between FY'17 through FY'19). Irrespective, margins are likely to represent material improvements from the weak levels of the prior year. The company's recovery could also reflect the impact of the Payment Assurance Plan (PAP) and the Service Reflective Tariff, which are likely to improve its liquidity, limit aggressive borrowing and support cash position.

Our TP implies a capital appreciation of 9.6% relative to our reference price. We forecast FY'21 ROE at 5.1% (vs 3.5% in FY'19 and 3.4% in FY'20), with mean payout ratio of 10.8% on improving earnings.

Financial ratios	FY'20	FY'21	FY'22
EBITDA margin	30.8%	30.0%	30.6%
Net margin	5.0%	6.0%	10.2%
RoA	1.2%	1.7%	3.6%
RoE	3.4%	5.1%	10.3%
Asset turnover	23.1%	28.3%	35.1%
Current ratio	109.2%	110.4%	109.4%
Quick ratio	104.8%	105.6%	104.4%
Debt to equity	104.1%	99.5%	85.3%

Multiples	FY'20	FY'21	FY'22
P/E	10.1x	6.5x	3.0x
EV/EBITDA	6.8x	4.0x	2.9x
EV/Sales	2.1x	1.2x	0.9x
Div yield	1.1%	1.7%	3.7%

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Financial Summary	2020A	2021E	2022E	2023E	2020A	2021E	2022E	2023E
	(N'million)				($'million)			
Revenue	75,271	98,234	126,084	129,641	183	239	306	315
EBITDA	11,497	14,611	19,137	19,470	28	35	46	47
Profit before taxes	1,609	8,460	18,401	17,368	4	21	45	42
Income taxes	2,184	(2,538)	(5,520)	(5,210)	5	(6)	(13)	(13)
Profit after taxes	3,792	5,922	12,881	12,157	9	14	31	30
Total assets	338,195	355,895	363,478	388,838	822	865	883	945
Total liabilities	223,786	236,206	232,305	246,826	544	574	564	600
Shareholders funds	114,409	119,689	131,173	142,012	278	291	319	345

Disclosure

Analyst Certification

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

Buy ≥ +15.00% expected share price performance

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

Sell < 0.00% expected share price performance

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

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

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

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

CardinalStone Research distribution of ratings/Investment banking relationships as of July 23, 2021

Rating	Buy	Sell	Hold	Negative Watch
% of total recommendations	46%	4%	50%	0%
% with investment banking relationships	0%	0%	0%	0%

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

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