CORONATION
ASSET MANAGEMENT

Navigating the Capital Market: The Investors' Dilemma

A report on Nigerian Investments

Navigating the Capital Market: The Investors’ Dilemma

A report on Nigerian Investments

For 10 years up until the end of 2019, Nigerian investors and savers had it good. By investing in Nigerian Treasury Bills they could get an inflation-beating return.

In 2020 the situation is very different, with yields far below inflation. How how should investors and savers react? If risk-free Treasury Bills no longer deliver adequate returns, then they must re-acquaint themselves with risk-taking, investing in a range of securities including equities.

But what benchmarks should they use and what returns should they demand? Based on a wealth of historical data from Nigerian markets, we set out our answers here.

Key Contact

Guy Czartoryski

Head of Research

gczartoryski@coronationam.com

Contents

Executive Summary

Executive Summary

How much should our Naira investments return?

When we talk with investors two concerns frequently come up. One is inflation: "How can our investments beat inflation?". The other is Naira devaluation, not so much because of its direct impact (devaluations do not directly impact Naira investments) but because of the business disruption that devaluations cause.

In this report we treat these two problems as essentially the same thing. It is the difference between US dollar inflation and Naira inflation that drives periodic Naira devaluations. Therefore, the first job of a Naira investment is not to beat inflation as such, but to beat the difference between US dollar inflation and Naira inflation. This creates a return which, in the long run, is the equivalent of a zero return in US dollars.

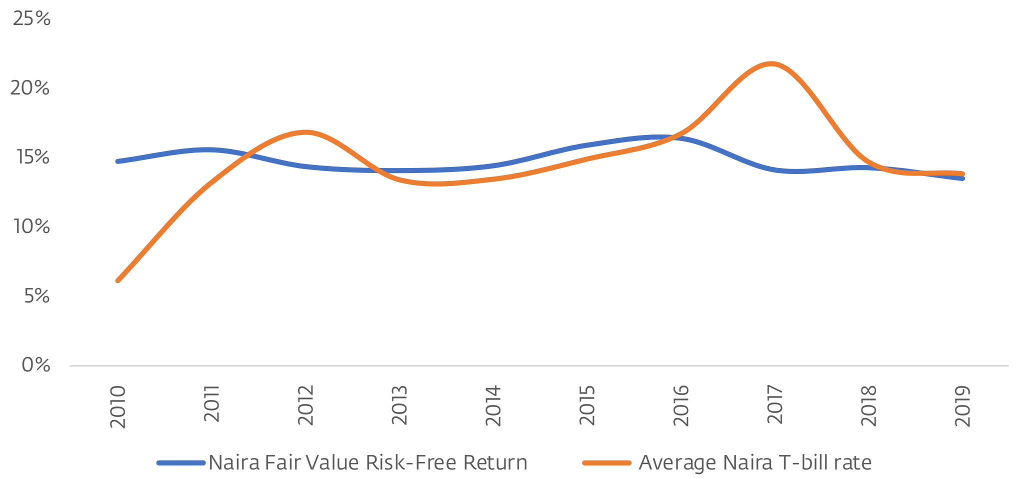
Once an investment can do that, the next task is to provide a US dollar return, which is conveniently provided by Nigeria's sovereign Eurobonds. Add the two rates together and we come to the following conclusion for Naira investors:

You should start by insisting on a 14.70% per annum risk-free return.

Do Nigerian T-bills return enough?

T-bills come remarkably close to delivering our desired risk-free return, at least over the long term. They only fall a little way short of it. And, to the satisfaction of inflation-focused investors, they beat inflation over the long term (though that is not the point, in our view).

Our desired Risk-Free Return of 14.70% and Average Naira T-bill rates



Source: Bloomberg, Coronation Research

Why do T-bills come so close to delivering a sovereign US dollar return? It may be the case that Naira-based investors have been able to access US dollar-denominated Nigerian sovereign Eurobonds for long enough that a close yield relationship has been established. Or some other invisible hand may be at work. At any rate, the T-bill rates seen during the first half of 2020, like those in 2010, appear to be an aberration – very different to the long-term pattern.

What should Nigerian equities return?

Nigerian equities have not been an inspiring story, and it is easy to show how poorly they have underperformed other equity indices around the world. All the same, it is worth digging into why this is so. Clearly, there must be a benchmark, in terms of profitability, which listed Nigerian companies fail to match (in general - there are always exceptions).

What is this benchmark? Following on from our desired 14.70% risk-free return, we add an equity risk premium (equities are risky) and come to the following conclusion:

The Return on Equity (RoE) of Nigerian companies should average at least 20.53% per annum, over time.

Do listed companies have 20.53% RoE?

For the most part, the major listed companies of the Nigerian Stock Exchange All-Share Index (NSE ASI) do not return what we consider an adequate – 20.53% - RoE. There are notable exceptions and several bank stocks deliver returns above this level, while other bank stocks are trending towards this level.

By contrast, many industrial companies have reported steeply declining returns over the past 10 years, disappointing a generation of investors in Nigerian industry. If, 10 years ago, we had adopted the maxim 'Invest in industrial companies with high RoEs', we would have lost a sizeable part of our investment. Lack of growth destroyed RoEs and stock prices.

Stock price returns

Therefore, strong stock price performances have been like hen's teeth over the long term. While in each year there are usually a few strong performances driven by corporate finance activity (takeovers, recapitalisations and the like), over the long term – and we chose the 10 years from 2010 to 2019 inclusive – stock performance has been hard to find.

And there is something sinister going on. We would expect a consistent 20.53% per annum RoE to be rewarded with roughly commensurate 20.53% stock price appreciation. But many companies with high shareholder returns have failed to deliver stock price returns of the same order. This is because the market has been de-rating these stocks, over time paying lower and lower multiples for their earnings. We cite several bank stocks as examples.

This either means that Nigerian companies will continue to de-rate, or that a slew of Nigerian bank stocks are outstanding value, assuming that the market will in future rate them as highly as they have been in the past. Given the post-2008 decline in bank ratings, and the threat of FinTech to the sector, this assumption is open to challenge.

Nothing for it but to trade

All is not lost. Investors have enough faith in the earnings of several NSE-listed companies (not just banks but telecoms and some industrials) to buy them when economic recovery and rising future earnings are in prospect, and to sell them when prospects worsen. Buying those stocks with strong RoEs when their valuations are depressed is still a reasonable, and potentially money-making tactic. The current period is a good example.

So, we set out our stall. Understand the importance of receiving a 14.70% risk-free rate; look for equities to have a RoE of 20.53%; buy good stocks when their valuations are depressed. There is no guaranteed formula for making money: these are our guidelines.

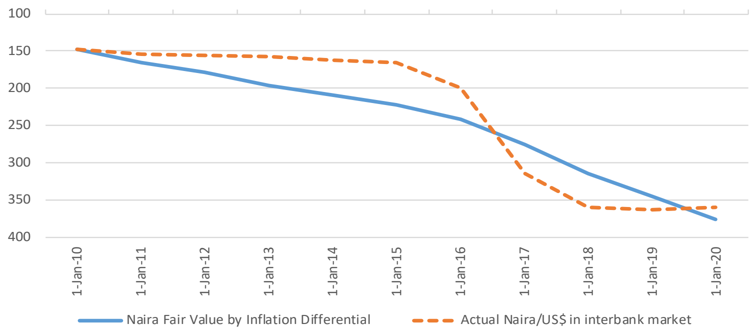
How much should T-bills return?

How much should our Naira return?

What return should investors demand from their Nigerian equities, T-bills and bonds?

Before looking at how to generate investment returns, we want to define what an investment return actually is. After all, we are surrounded by information about returns – the return on the Nigerian Stock Exchange, the return on T-bills and bonds, the return on Naira deposits and on US dollar bonds – but what do they all mean? When we are told that us that a return on investment is 15.0% per annum, for example, is that a good or bad thing? Is a nominal Naira-denominated 15.0% per annum adding value or destroying it?

Naira/US$ exchange rate versus inflation-derived Naira Fair Value



Source: Bloomberg, Coronation Research

The first thing we notice is that the data surrounding us is nominal. And yet we do not live in a nominal world. The 5,000 Naira in my wallet will not buy the same amount of goods and services in 12 months' time which it buys today. So, the first thing to do is to re-set our investment demands for inflation. We need to get back at least what inflation is taking away from us. Even if data for inflation is sometimes questioned (and inflation varies from place to place in any large country like Nigeria), nevertheless official National Bureau of Statistics data for inflation is a good place to start.

One of our core observations that inflation is, pretty much, the same thing as currency devaluation. The difference between Naira inflation '(12.40% y/y in May 2020) and US dollar inflation (2.30% y/y) over the long term matches – if not determines – long-term outcomes in the Naira/US dollar exchange rate. Far from being something exotic to Nigerians, US dollar returns are quite familiar to us. After all, 40% of deposits among the top-eight listed banks are in US dollars.

The difference between the erosion of value through devaluation is that it is constant, while the Naira/US$ exchange rate can hold steady for long periods before devaluing. This report is not the place for a discussion of exchange rate policy: our point is that investors begin with wanting to defend themselves against inflation, and in doing so they are effectively – even if they do not know it – targeting a US dollar return.

Devaluation is usually seen as an occasional, or even cyclical, event. To the Naira investor who steadily accrues savings, it comes as a bolt from the blue. But it does not come out of the blue. It is part and parcel of inflation because the inflation differential between Naira and US dollar is driving devaluation. In this report we make Naira/US dollar devaluation integral to the calculation of Naira investment returns. Once we do that, we can calculate the required Naira return for T-bills, bond and equities. They all have to beat the devaluation risk, or the difference between US dollar inflation and Naira inflation, first.

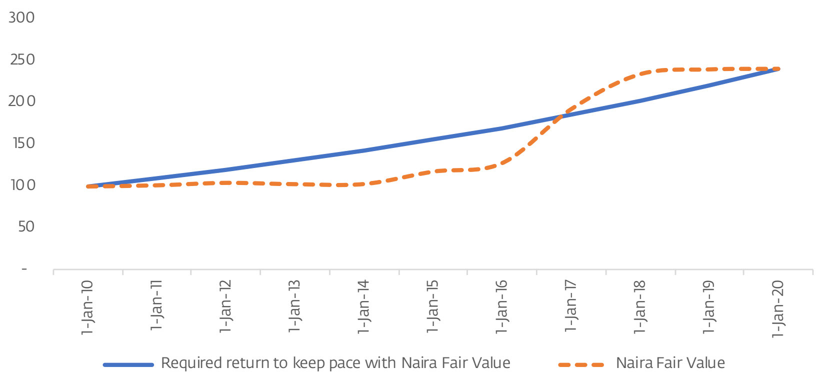
How much should our Naira return?

Because of Naira inflation, it makes sense to benchmark US dollar risk-free returns

Once we understand that Naira / US dollar depreciation and the long-term effects of inflation on the Naira are essentially similar, then we get an idea of how much Naira investments should return. Note that we are using, as our benchmark, not Naira inflation but the inflation differential between Naira and US dollar, which is about two percentage points lower than Naira inflation itself.

It is not enough to receive an investment return that merely makes up for inflation: why would we accept a zero inflation-adjusted return, or a zero US dollar return? We need a positive return, either way. Therefore, we use the risk-free returns on US-dollar denominated Nigerian government bonds to arrive at our required fair value risk-free return (FVRFR). There are plentiful data on the risk-free return of US-dollar denominated bonds issued by the Federal Government of Nigeria (FGN).

Required nominal Naira return of 9.20% per annum to match Naira Fair Value



Source: Bloomberg, Coronation Research

The fair value of Naira/US dollar at 1 January 2010 was N163.53/US$1 (and the actual rate, in the interbank FX market, was N150.93/US$1). Ten years later the fair value of Naira/US dollar, according to our calculation, was N393.34/US$1 (and the actual interbank exchange rate was N363.50/US$1). So, an investment of N100,000 on 1 January 2010 would have had to have grown to N241,020 by 1 January 2020 just to keep up with the fair value adjustment of the Naira. That would have meant a 9.20% compound annual nominal return in Naira, as shown in the chart.

And, at this point, the fair value return, and the US dollar return, would be zero. We have only described how fast you have to run in order to stand still when inflation (or more accurately, the Naira/US dollar inflation differential) is pushing against you. Given the long-term connection between the fair value of the Naira and the Naira/US dollar exchange rate we can call this a Fair Value Zero Return (FVZR). And, as stated above, a zero return is not acceptable to investors. Real-world US dollar investors in Federal Government of Nigeria sovereign bonds demand quite a considerable return when they invest in Nigeria.

We can map this return by examining the average yields on US dollar-denominated bonds issued by the FGN over the past 10 years.

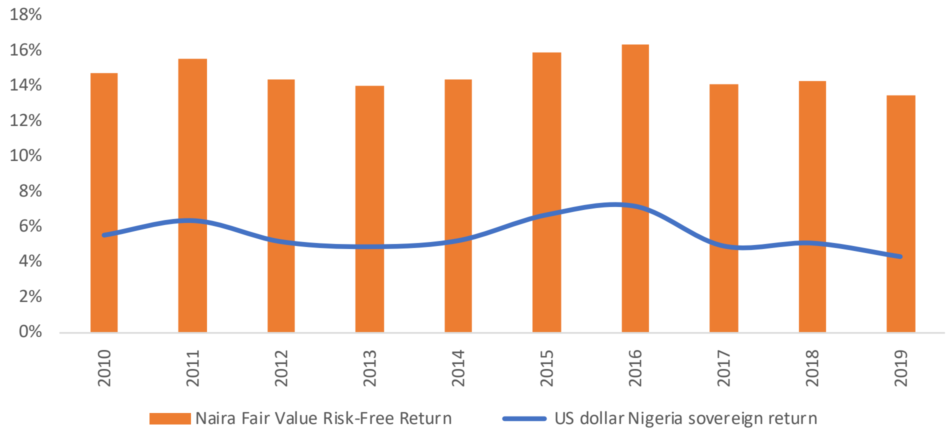
How much should our Naira return?

Want a risk-free return in Naira? You should insist on 14.70% per annum

Our next task is, therefore, is to measure the average yield on US dollar-denominated bonds issued by the FGN over the past 10 Years, which will give us a risk-free yield to add to the Fair Value Zero Return (FVZR) we have already calculated. This will get us to the Naira Fair Value Risk-Free Return (Naira FVRFR), which is what investors should demand from their risk-free Naira investments.

There are a few issues with calculating average US dollar bond returns for Nigeria (e.g. the number of issues and their durations). But the hard data exist and these represent what real-world investors demand.

Sovereign US dollar return plus long-term Naira depreciation = the Naira Fair Value Risk-Free Return (Naira FVRFR)



Source: Bloomberg, Coronation Research

How much should our Naira return?

Over the past 10 years investors in FGN US dollar-denominated bonds have demanded a return of 5.51% per annum (pa) on average, and in the chart we break this down by each year 2010-2019. To these US dollar returns we now add our Fair Value Zero Return of 9.20% pa to arrive at our Naira Fair Value Risk-Free Return (Naira FVRFR). The Naira Fair Value Risk-Free Return has averaged 14.70% pa over the past 10 years.

What does this represent? The Naira Fair Value Risk-Free Return (Naira FVRFR) measures the nominal return in Naira which, during the 10 years 2010-2019 inclusive, would have:

Compensated for Naira/US dollar depreciation implied by fair values (and, over time, actual Naira/US dollar depreciation);
Gives a risk-free return equivalent to what US dollar investors receive from the FGN.

What could be more fair than that? The Fair Value Risk-Free Return (FVRFR) is our benchmark against which to measure nominal Naira-denominated risk-free annual returns. By 'risk-free' we mean Naira bills and bonds issued by the FGN and bills issued by the Central Bank of Nigeria (CBN), such as its Open Market Operation (OMO) bills.

(Against this, it can be argued that we do not factor in the effect of duration on the pricing of US dollar-denominated bonds, and that these are not appropriate returns to be comparing with annual Naira returns from T-bills. We plead in response that, to make an adjustment for duration, there are insufficient data for US dollar-denominated bonds issued by the FGN. We follow, within reason, the data when those data are available.)

We will use the Fair Value Risk-Free Return (FVRFR) to measure the returns on Naira-denominated income instruments. When we have added an equity risk premium, we will then measure returns on equities.

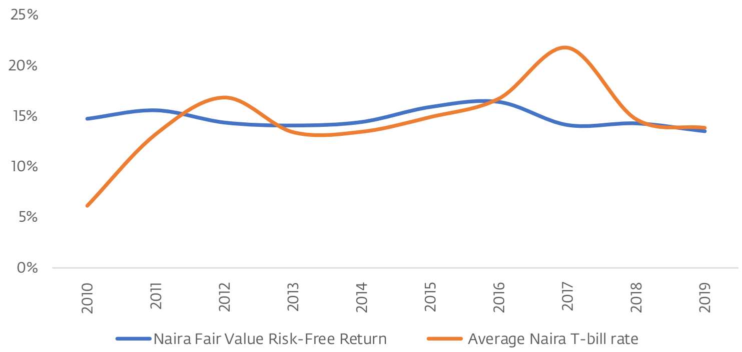
Do T-bills return enough?

Do T-bills return enough?

Assessing Nigerian fixed income returns using the Fair Value Risk-Free Return (FVRFR) of 14.70%

The Naira Fair Value Risk-Free Return is our hurdle rate for Naira-denominated nominal fixed income returns. Have the nominal returns of FGN-issued T-bills matched the Fair Value Risk-Free Rate over the past 10 years? Most of the time they have come pretty close to it.

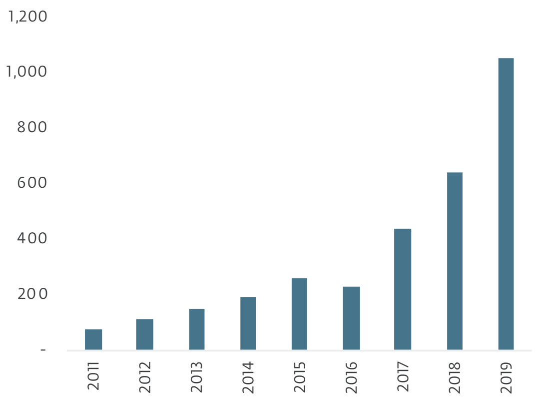
Naira Fair Value Risk-Free Return and Average Naira T-bill rates



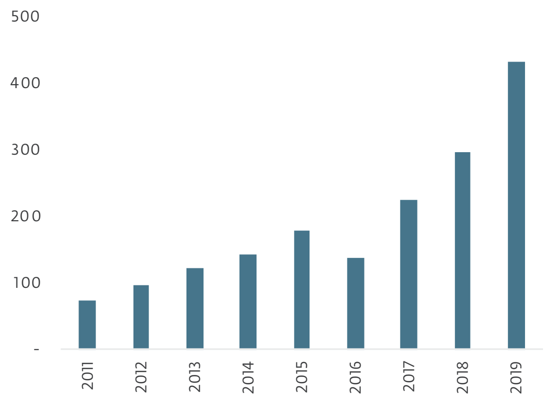
Source: Bloomberg, Coronation Research

Does this matter in practice? Of course, it does. For example, when the return on Naira-denominated T-bills rose far above the Fair Value Risk-Free Return in 2017, investors rushed to put their savings into money market funds. The surge continued into 2018, because rates were still high in the early part of the year (until mid-April). Investors know when the odds are stacked in their favour. Falling interest rates brought in yet more money in 2019 as capital gains on bonds were realised.

Total assets of Nigerian mutual funds, Naira billions



Total assets of Nigerian mutual funds, in 2011 prices, Naira billions



Source: Securities and Exchange Commission of Nigeria (SEC), Coronation Research

Nigerian T-bills get quite close to our required return

The proximity of the Naira Fair Value Risk-Free Rate (Naira FVRFR) to T-bill returns . . .

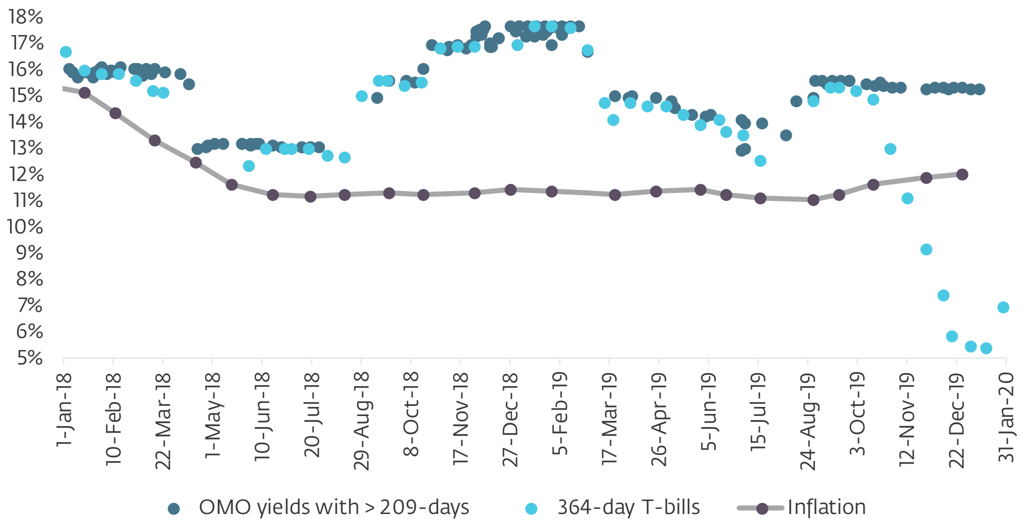
What amazes us about the two lines in the chart showing the Fair Value Risk-Free Return and average T-bill returns, is how close they are, most of the time. We did not expect this result when we began our FVRFR calculation. The average difference is 21 basis points (bps), the median is 15bps. These measures include periods when the difference was large, for example in 2010 when T-bill rates were low.

Over the period 2010-19, investing in T-bills only meant a slight erosion in value. Investors, by and large, received compensation for the effects of inflation on their Naira plus a small – and only slightly insufficient, by our calculation – risk-free return. They accepted this situation most likely because of a shortage of alternatives, notably the weak total returns available in the equity market (which we will look at later). Other reasons include: a somewhat flat Naira yield curve (for most of the period 2010-19), which means that there was little reward for buying duration; a small supply of corporate bonds (whose risk premiums are often not far above the risk-free rate, in any case); and difficulties in converting Naira to US dollars in order to purchase FGN-issued US dollar bonds (which would have given a satisfactory Naira FVRFR, by definition), especially when exchange controls came into play.

. . and to OMO bill returns

During much of the period 2010-2019 yields on Open Market Operation (OMO) bills issued by the CBN were close to T-bill yields. Investors treated T-bills and OMO bills almost interchangeably. Since October 2019, however, almost all Nigerian corporates (including pension and mutual funds) have been barred from buying new OMO bills with the effect that OMO and T-bill rates have diverged. We will not examine the investment implications here, though they are explored in Coronation Research Naira Rates for a Credit Boom, 20 December, and Year Ahead 2020, 16 January.

Recent divergence of T-bill and OMO bill yields



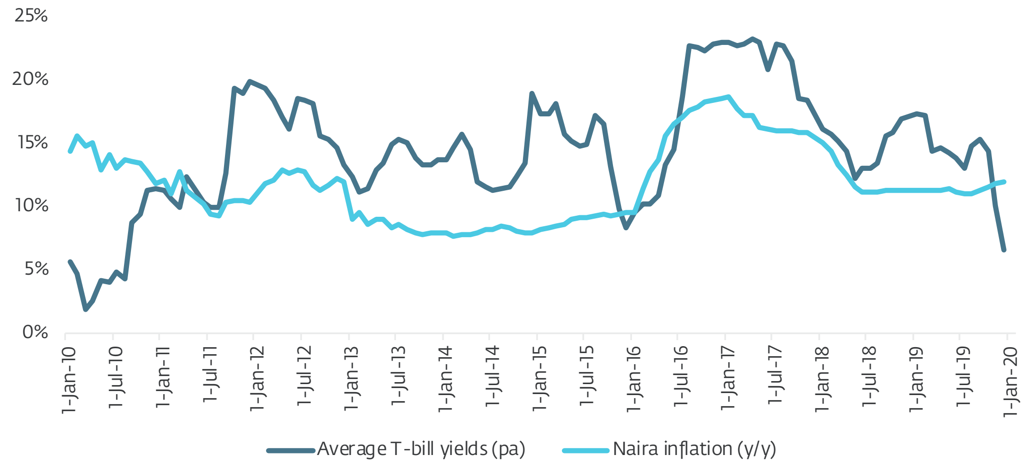
Source: Bloomberg, NBS, Coronation Research

Most of the time Nigerian T-bills beat inflation

Assessing Nigerian fixed income returns against inflation

It is often said that the real motivation of Naira-based investors is to compensate for inflation (even though, as we have argued, merely making up for inflation is not enough – US dollar investors get so much more). Professional money managers in Nigeria, particularly pension fund administrators (PFA), tend to focus on matching inflation and even getting ahead of it.

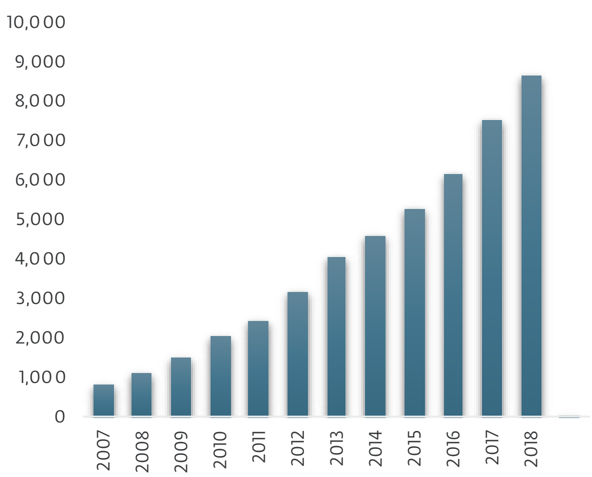
Nigerian T-bill yields and inflation



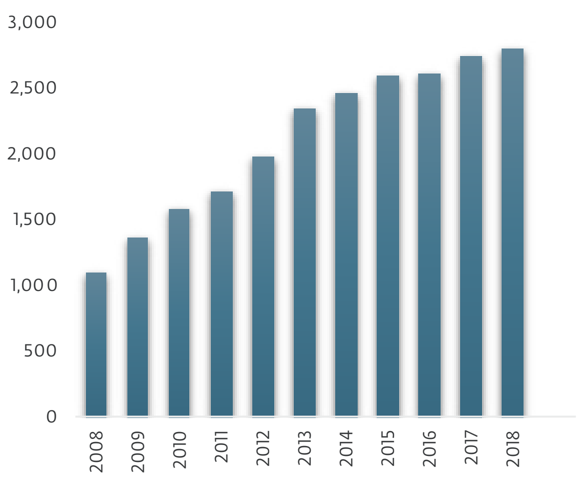
Source: Bloomberg, CBN, NBS, Coronation Research

The good news for PFAs, and for managers of money market mutual funds, is that T-bill yields beat inflation for most of the time during the period 2010-2019. The average outperformance of T-bills over inflation was 257 basis points (bps) over this period, and the median was 367bps. In other words, investors have received a small inflation-adjusted return on their T-bill holdings. Even though our FVRFR calculation shows that this is not quite enough, this is, nevertheless, reasonably good news for Nigeria's 8.6 million holders of retirement savings accounts. Pension funds' total assets under management (AUM) recently stood at N10.22 trillion (US$26.21bn).

Pension fund assets in billions of Naira



Inflation-Adjusted* Pension Assets, Naira Billions



Source: National Pension Commission (PENCOM), Coronation Research, NB: *in 2011 prices

What should Nigerian equities return?

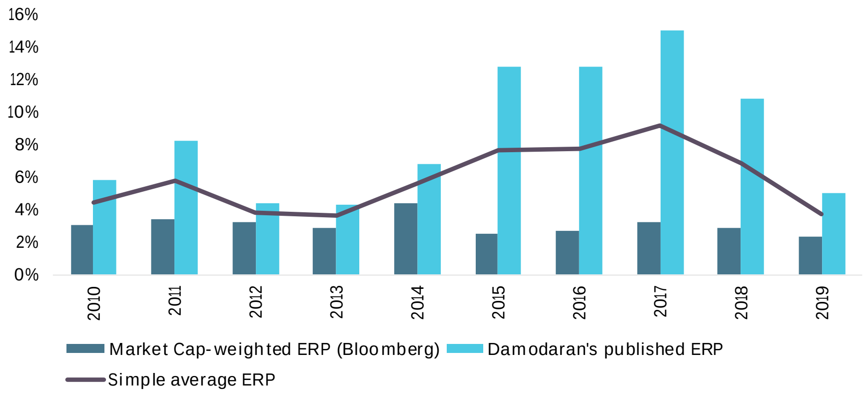
What should Nigerian equities return?

Look for a Naira-denominated equity return of 20.53% per annum

We have established our hurdle rate – the Fair Value Risk-Free Return (Naira FVRFR) – for nominal risk-free Naira fixed income returns. And we have seen the FVRFR's happily close relationship with T-bill rates, and how these together affect investor behaviour. What about Naira equity returns? The nature of equities is very different to fixed income. There are risks for which investors demand an extra return, the equity risk premium (ERP). The classic illustration of the ERP to is to measure by how much listed equity out-performs fixed income over long periods of time.

This is not possible in Nigeria (and, in fact, many emerging markets) where – as we shall see – risk-free fixed income out-performs listed equity (this produces a negative equity risk premium, which makes no sense). To work this out we have turned to Bloomberg for 10 years' data on equity risk premiums for the nine stocks that each have a current index weight of over 2.0% in the Nigerian Stock Exchange All-Share Index (NSE ASI). (Our selection unfortunately excludes MTN Nigeria, which was listed in 2019, and Seplat, which was listed in 2014, as there are not 10 years' data for them.)

An equity risk premium (ERP) for Nigeria



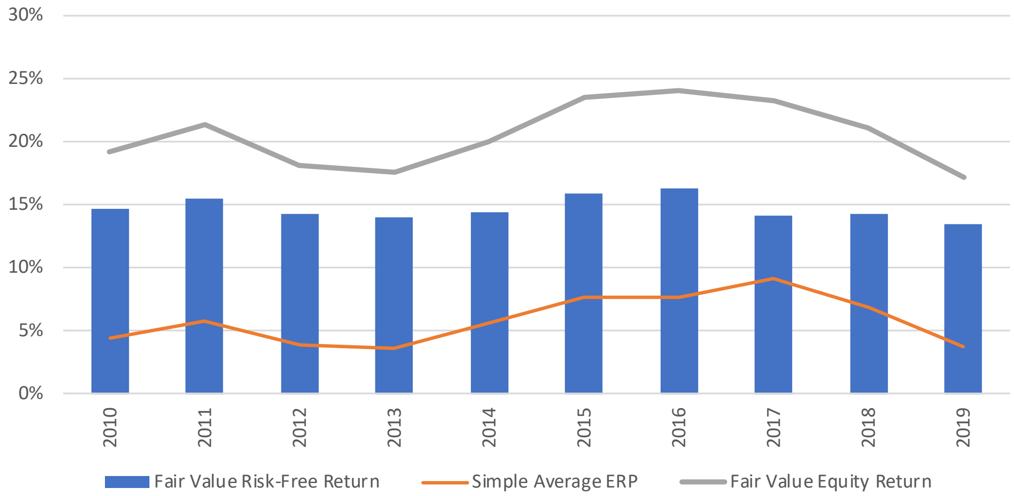
Source: Bloomberg, Coronation Research

The equity risk premiums (ERP) we have generated from Bloomberg are quite consistent over time and tend to differ little from stock to stock. They are also somewhat low compared with other ERP calculations we have seen. So we also take the ERPs from the published work of Professor Aswath Damodaran of New York University (known at 'The 'Dean of Valuation') which are a lot higher than those we derive from Bloomberg, and which do vary over time. To simplify matters, and with sincere apologies to both Bloomberg and to Professor Damodaran (see Appendix II for those of his publications we have used), we use the simple average of these to arrive at our ERP.

Our ERP has averaged 5.83% over the past 10 years. We simply add this ERP to our Fair Value Risk-Free Return (FVRFR) of 14.70%, to arrive at our target Fair Value Equity Return (FVER). The FVER has averaged 20.53% over the past 10 years. We will use FVER in two ways: first, as a yardstick to measure return on equity (RoE) of listed companies; second, as a yardstick to measure actual equity returns of the shares of the largest companies listed on the Nigerian Stock Exchange (NSE).

They should return 20.53%

Look for a Naira-denominated equity return of 20.53% per annum



Source: Bloomberg, CBN, FMDQ, Coronation Research

To recap: the Naira Fair Value Equity Return (FVER) measures the return required to make up for loss of fair value in Naira/US dollar exchange rate, plus the Nigerian sovereign bond return in US dollars, plus the Nigerian equity risk premium. The Naira Fair Value Equity Return varied between 17.18% and 24.07% over the 10 years 2010-2019, with an average value of 20.53% over this period.

As mentioned above, now that we have arrived at a Fair Value Equity Return, the two tasks ahead of us now are to:

a) Measure how Nigerian listed companies stack up in terms of return on equity (RoE) versus the FVER;

b) Measure how Nigerian listed companies stack up in terms of stock price performance versus the FVER.

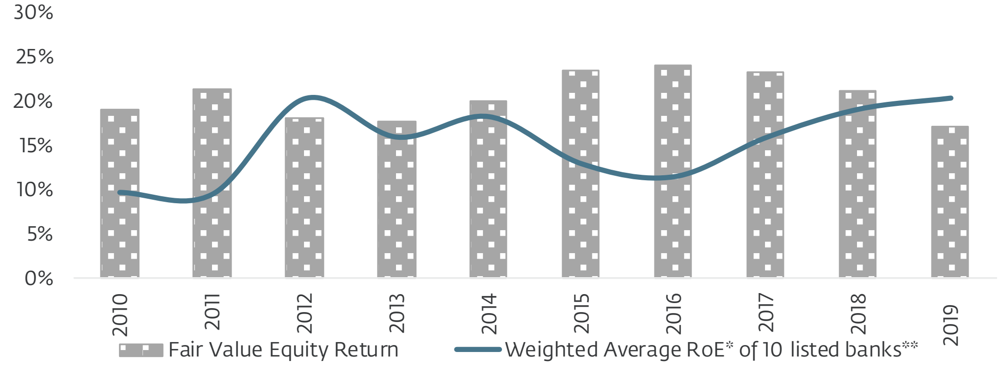
Do listed companies achieve our Return on Equity hurdle rate?

Do listed companies achieve 20.53% RoE?

Some banks do but, with some notable exceptions, most of the large listed stocks fall short

So, how do the Returns on Equity (RoE) of listed companies compare with the Fair Value Equity Return (FVER)? The question is aimed at the largest and most-traded companies on the Nigerian Stock Exchange, because later we will examine their RoEs relative to their total share price returns. There are 153 listed companies, the majority of which only trade in thin volumes. We look at 26 companies here, starting with the banks. For the most part the RoEs of the listed banks over time (we have taken the top 10 by shareholders' funds) have not matched our benchmark Fair Value Equity Return.

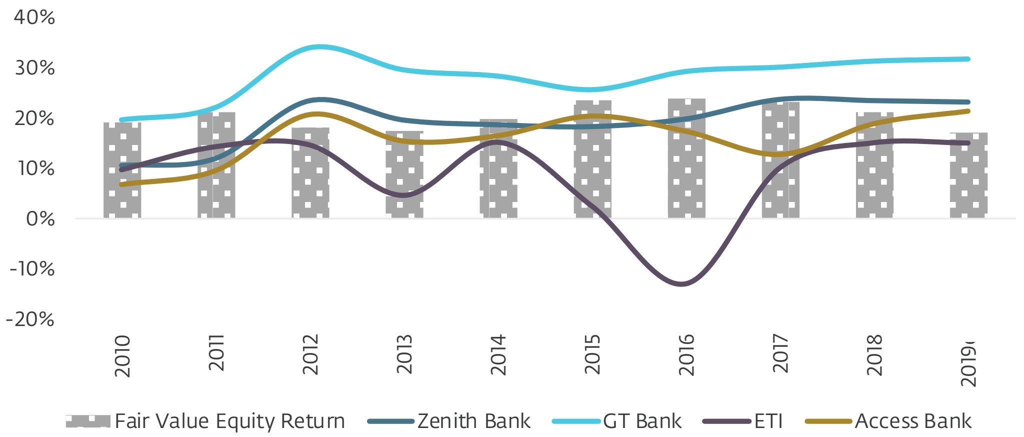
Listed banks' RoEs versus the FVER



Source: Companies, Coronation Research. *for Return on Equity we calculate Return on Average Equity (RoAE) **These are Zenith Bank, GT Bank, ETI, Access Bank, FBN Holdings, UBA, Stanbic IBTC, Union Bank, Fidelity Bank and Sterling Bank (in descending order of total shareholders' funds)

The good news is that the trend since the recession year of 2016 (when banks were caught out by currency devaluation and high exposure to oil companies' debt) has been steadily upwards. The trend suggests that, on aggregate, listed banks are becoming worthwhile investments (though certain recent restrictions on their ability to charge fees & commissions puts a question mark over this). Among the listed banks RoEs vary considerably, we break them down, starting with the top four by total shareholders' funds.

Listed banks' RoEs versus the FVER – the top four by total shareholders' funds

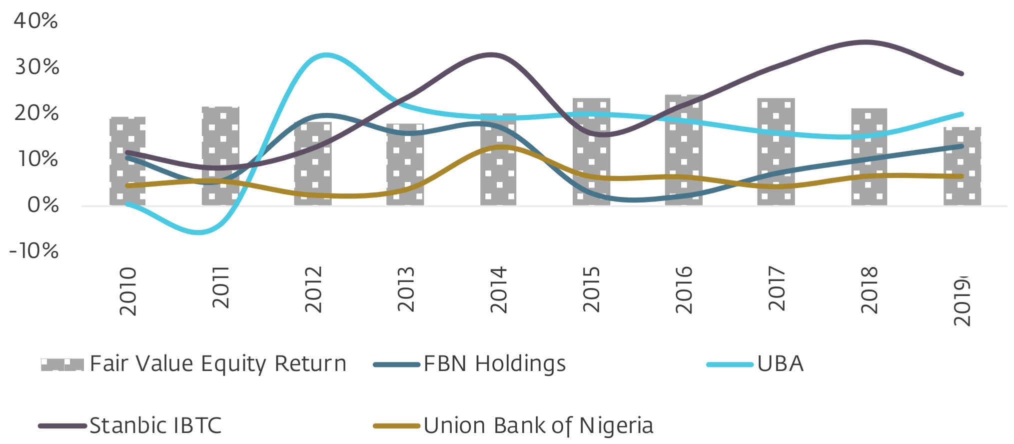


Source: Companies, Coronation Research

Do listed companies achieve 20.53% RoE?

The most noticeable thing about the chart for the top four banks is GT Bank's superior and consistent RoE. And (apart from ETI's unfortunate loss in 2016), the overall trend in RoE appears to be upwards. Zenith Bank has joined GT Bank as a strong performer (i.e. its RoE exceeds the FVER) over the past three years, while Access Bank joined this fortunate group last year.

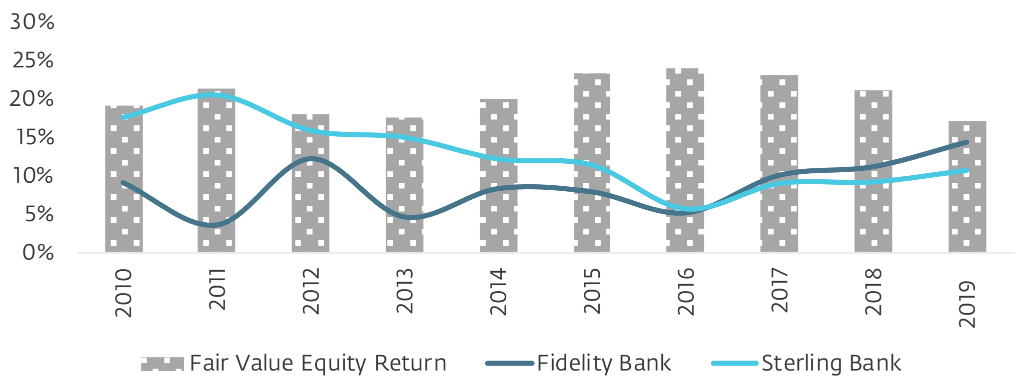
Listed banks' RoEs versus the FVER – the second group of listed banks



Source: Companies, Coronation Research

The same cannot be said about next four largest (by shareholders' funds) listed banks. The data is volatile (largely thanks to big swings in the RoEs of UBA and Stanbic IBTC), and much of the group fails to reach our benchmark during the period between 2010-2019e. Stanbic IBTC, which is as much an asset manager and an investment bank as it is a commercial bank, has consistently out-performed the benchmark over the past three years, as it did in 2013 and 2014. It is significant, in our view, when Stanbic IBTC has outperformed the FVER, that its margin of out-performance has been large.

Listed banks' RoEs versus the FVER – Fidelity Bank and Sterling Bank



Source: Companies, Coronation Research

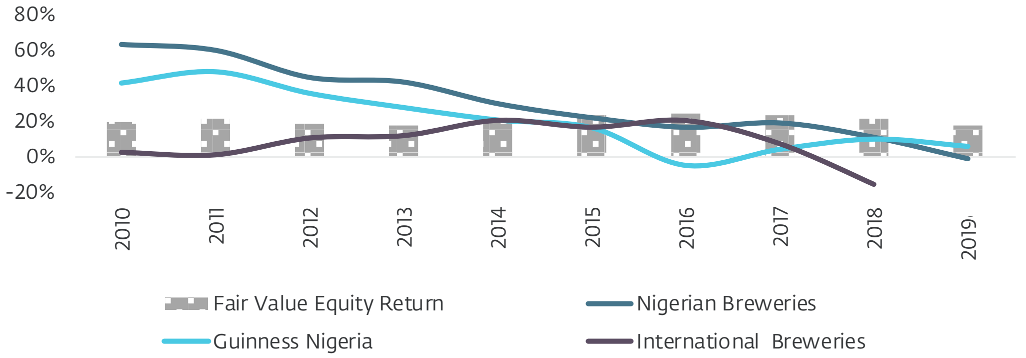
And when it comes to the last two banks on our list, the story is different again. Neither of them have outperformed our benchmark over the ten years 2010-2019e. However, both have made rapid gains in profitability since the recession year of 2016, with Fidelity Bank some way ahead of Sterling Bank.

Do listed companies achieve 20.53% RoE?

And now for some non-banks, starting with the brewers

Why did we start this section with banks? One reason was to present the good news first, because much of the rest of our examination is a sorry tale of declining RoE. Many years ago (roughly 10 years ago) the most-traded and sought-after stocks on the Nigerian Stock Exchange were brewers, food manufacturers and fast-moving consumer goods (FMCG) companies. These were going to chart the rise of the Nigerian consumer. They have not done. See Coronation Research, Power to the Price Point, 16 May 2019 for an explanation of the fall from grace suffered by listed food manufacturers and FMCG companies.

Listed brewers' RoEs versus the FVER

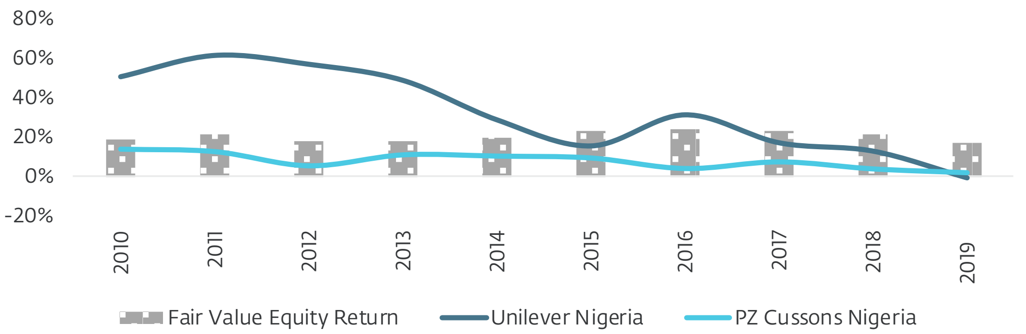


Source: Companies, Coronation Research

The RoEs of the listed brewers, in two out of three cases, have declined steeply over the past ten years. Neither the two largest brewers, Nigerian Breweries and Guinness Nigeria, have posted RoEs in excess of the FVER during the past five years. A student of shareholder returns might not be surprised at these falls during the period between 2010-2014. After all, very high RoEs are difficult to sustain as competition enters the market. Indeed this happened as International Breweries stepped up its offering of value brands around 2013 and the larger brewers found top-line growth difficult to sustain in the face of weakening consumer incomes. But International Breweries' own RoE has only once broken through out FVER benchmark (in 2014).

A similar decline in RoEs has been evident in the RoEs of the two major listed FMCG companies, Unilever Nigeria and PZ Cussons Nigeria. (To be accurate, Unilever Nigeria's business mix is a 50/50 split between food and FMCG.)

FMCG companies' RoEs versus the FVER

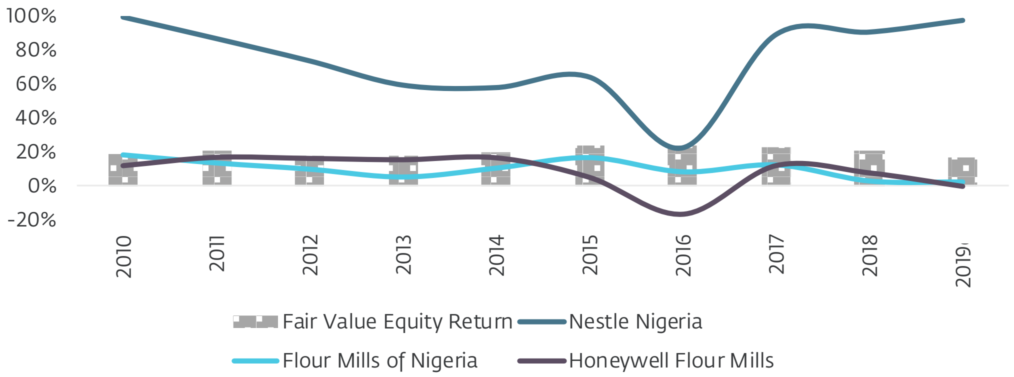


Source: Companies, Coronation Research. NB Unilever Nigeria has a 31 Dec year-end while PZ Cussons Nigeria has a 31 May year-end

Do listed companies achieve 20.53% RoE?

Among the pure-play food manufacturing companies there is the remarkable exception of Nestle Nigeria, which has recorded an average RoE of 74% over the past 10 years. It is hard to know exactly why, but three factors come to mind. First, its product portfolio has won consistent loyalty from Nigerian consumers (although there was some slackening in the growth rate of inflation-adjusted sales in 2019). Second, its operating margins have been high and consistent thanks to a high degree of local sourcing. Third, it pays almost all its Net Profits as dividends, keeping its equity level low.

Food manufacturers' RoEs versus the FVER



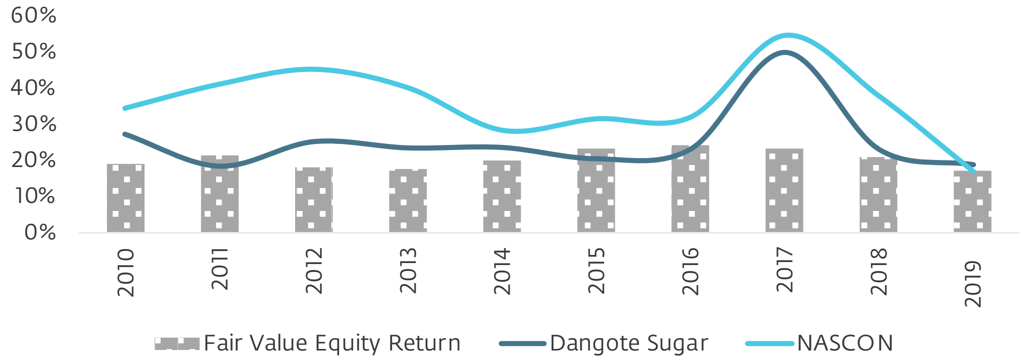
Source: Companies, Coronation Research. Nestle Nigeria has a 31 December year-end while both Flour Mills of Nigeria and Honeywell Flour Mills have 31 March year-ends.

The RoE of Flour Mills of Nigeria and Honeywell Flour Mills, by contrast, have seldom matched, let alone exceeded, the Fair Value Equity Return over the period 2010-19.

Two producers of basic food staples, Dangote Sugar and NASCON, have generated long-term RoEs comfortably in excess of our Fair Value Equity Return.

The average RoE over the 10 years 2010-19 for Dangote Sugar has been 25% while that of NASCON has been 36%.

Food staple producers' RoEs versus the FVER



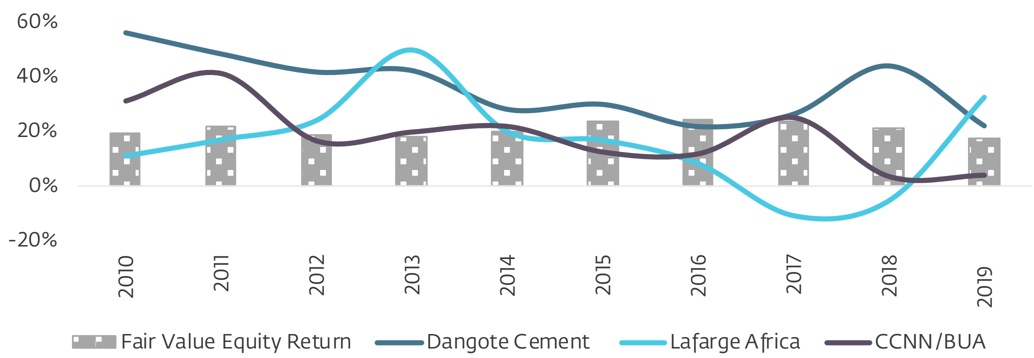
Source: Companies, Coronation Research

However, and as the chart suggests, both their RoEs have fallen quite sharply over the past two years, according to 2018 results and recently-reported 2019 results. This poses questions over their future long-term value unless earnings rebound.

Do listed companies achieve 20.53% RoE?

In the listed cement sector the leading player by market share, Dangote Cement, has generated an average RoE comfortably above our Fair Value Equity Return over the 10 years 2010-19e, with an average of 36%. Dangote Cement, as is well known, is the dominant cement company in Nigeria as well as having an expanding footprint across Sub-Saharan Africa and in other countries.

Cement companies' RoEs versus the FVER

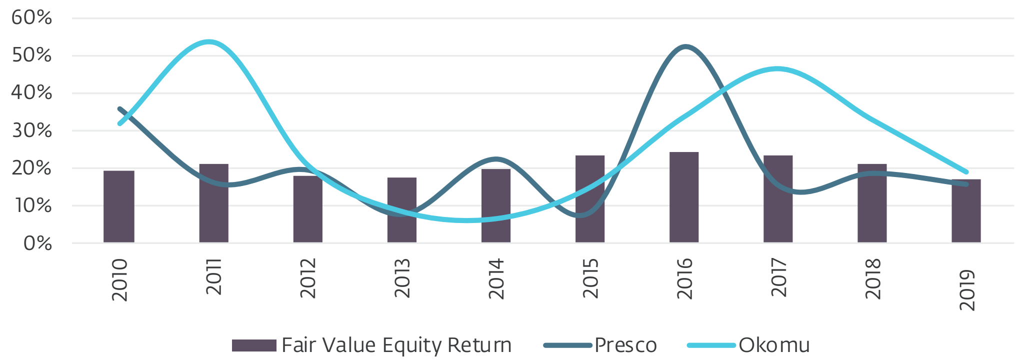


Source: Companies, Coronation Research.

Neither of its smaller competitors have done as well. The RoE of Lafarge Africa has been volatile and has averaged 16% over the period 2010-19. That of CCNN/BUA has averaged 19%, a percentage strongly influenced by the CCNN/BUA merger in 2018 which lead to a significant increase in its assets and total shareholders' funds.

We also examine the RoEs of two listed agricultural companies, Presco and Okomu Oil. Presco farms palm oil while Okomu Oil farms palm oil and rubber. Both companies generate long-term returns superior to our Fair Value Equity Return. Over the past 10 years the average RoE of Presco has been 21% while that of Okomu Oil has been 27%. Both these companies benefit from selling crude palm oil and rubber at international prices, and therefore have US dollar-related earnings.

Agricultural companies' RoEs versus the FVER



Source: Companies, Coronation Research.

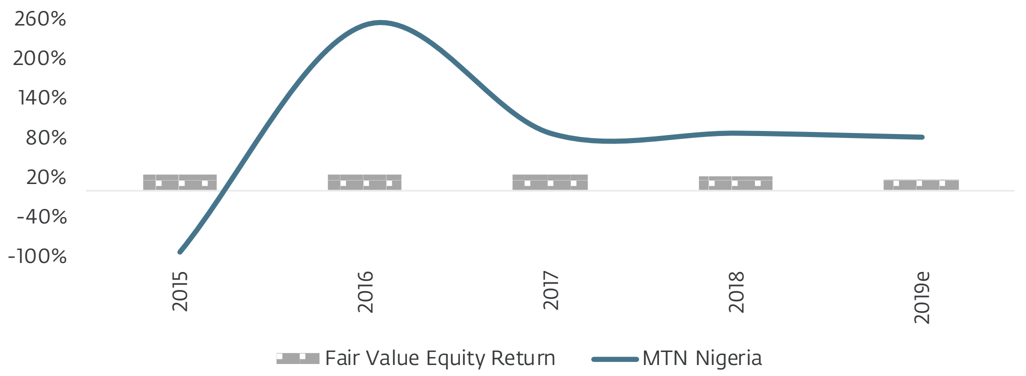
Do listed companies achieve 20.53% RoE?

However, the RoEs of both Presco and of Okomu Oil have been volatile. Volatility in crude palm oil prices translates directly into their earnings. By contrast, weakness in the Naira exchange rate tends to reduce the inflow of foreign-sourced product while reducing some of their Naira-based costs relative to their US dollar-based sales. So periods of Naira foreign exchange weakness, such as the years 2016 and 2017, have been periods of high returns for them.

As with Nestle Nigeria, another factor in their high RoEs is a high dividend payout ratio. Both companies pay dividends of 70% or more of their Net Income. And, as with Nestle Nigeria, this leads to high long-term total returns on their listed shares (see Stock Price Total Returns).

In the recently-listed Nigerian telecoms sector (both MTN Nigeria and Airtel Afreica were listed in 2019) there is insufficient information to establish a long-term trend. Airtel Africa reported losses for the years 2017 and 2018 before return to a moderate Net Income level in 2019 and 2020 (it has a March year-end). It also recorded negative equity for the years 2017 and 2018, and consequently we leave it out of this study of RoE.

MTN Nigeria's RoE versus the FVER



Source: Companies, Coronation Research

MTN Nigeria's RoE has been volatile, the result of having to pay fines imposed by its regulator for non-registration of phone lines. its RoE over the past three years has trended in the range of 81% to 87%, which would make it a very interesting stock if such returns can be sustained. However, we repeat the point we have made before (when discussing Nigerian Breweries, Guinness Nigeria and Unilever Nigeria), namely that high RoEs tend to attract competition over time. For now, however, MTN Nigeria is performing well, with a fortunate combination of subscriber growth and high RoE.

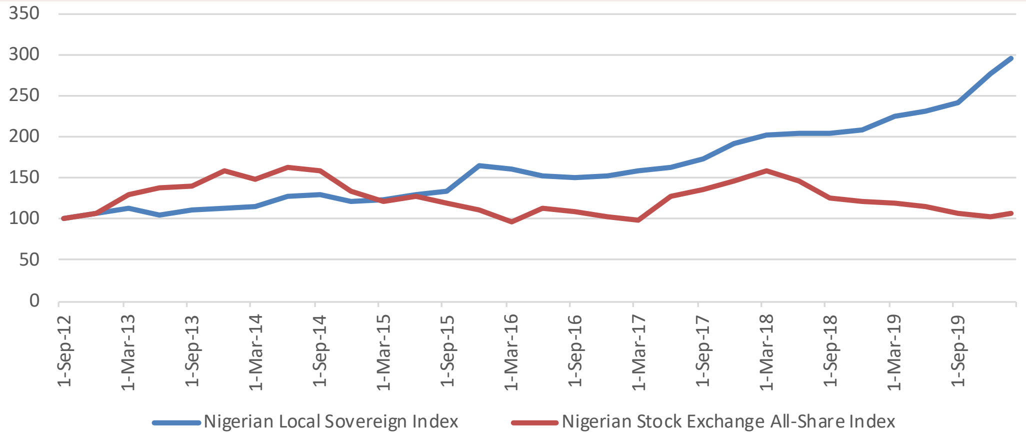
How to measure stock price returns?

How should we measure stock market returns?

Don't forget the role of dividends when counting stock price returns

Given what we have said about the level of RoE of listed equities compared with the Fair Value Equity Return, we would not expect the Nigerian equity market to deliver much. Indeed, at the beginning of this year (28 January) Bloomberg featured this interesting graph showing the performance of the Nigerian Local Sovereign Index (i.e. what can be earned in risk-free fixed income in nominal Naira) against the Nigerian Stock Exchange All-Share Index (NSE-ASI). The fixed income data series started in September 2012, and up until the end of last year outperformed the equity index by 174% (helped by a strong run in Q4 2019 when T-bill and bond rates fell sharply).

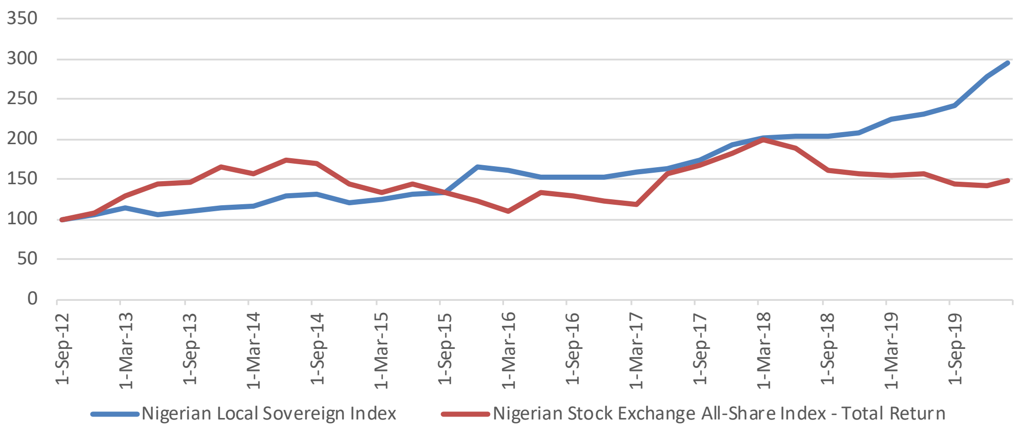
Naira Local Sovereign Index vs NSE-ASI Index, 1 Sep 2012=100



Source: Bloomberg, Coronation Research N.B. This data is presented quarterly: Bloomberg originally presented it weekly

This comparison is a little unfair, in our view. A total return in fixed income should be compared with a total return in equities. Fortunately Bloomberg also has total return data for the NSE ASI and this generates what we consider a reasonable comparison between risk-free fixed income returns and equities. Risk-free fixed income outperformed the total return on equities by 100% - still an enormous difference. Needless to say, the total return for the NSE ASI came nowhere close to the Fair Value Equity Return.

Naira Local Sovereign Index vs NSE-ASI Index Total Return, 1 Sep 2012=100



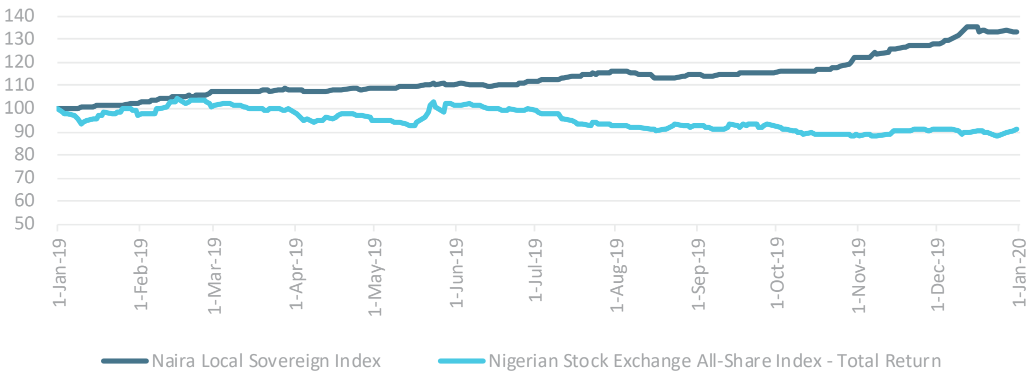
Source: Bloomberg, Coronation Research

How should we measure stock market returns?

The Nigerian equity market is bad, but not that bad

In a single year the difference between the measure of the total return of the NSE-ASI and the risk-free fixed income return can be a lot. In 2019 the total return of the NSE-ASI was, according to Bloomberg, negative 14.63% while the index of the risk-free income return was positive 33.17% (helped by capital gains on long-dated FGN bonds as Naira rates tumbled in the last quarter).

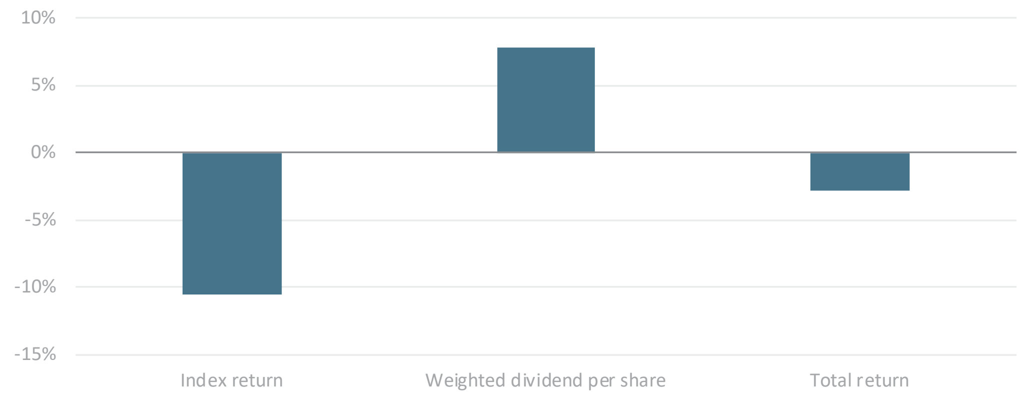
Naira Local Sovereign Index vs NSI-ASI Total Return, 1 Jan 2018=100



Source: Bloomberg, Coronation Research

If we narrow the equity return down to the banking sector sub-index of the NSE-ASI, we can see the process of total returns at work. The banking sub-index, not counting dividends, fell by 10.55% in 2019. But, once we add back the dividends (i.e. full-year dividends for 2018 plus interim 2019 dividends) the picture is different. Nevertheless, the sector still had a negative total return in 2019 of 2.8%.

NSE Banking Sub-Index Performance in 2019



Source: Bloomberg, Coronation Research

It is this difference between a pure stock price return and a total return which we wish to carry forward into our study of stock market returns. After all, some listed companies pay a high proportion of Net Income as dividends, other pay little. So, in our next section we will consider the total return of equities. We will measure total equity returns against our Fair Value Equity Return (FVER).

Do listed stocks return enough? Banks

Do listed stocks return enough? Banks

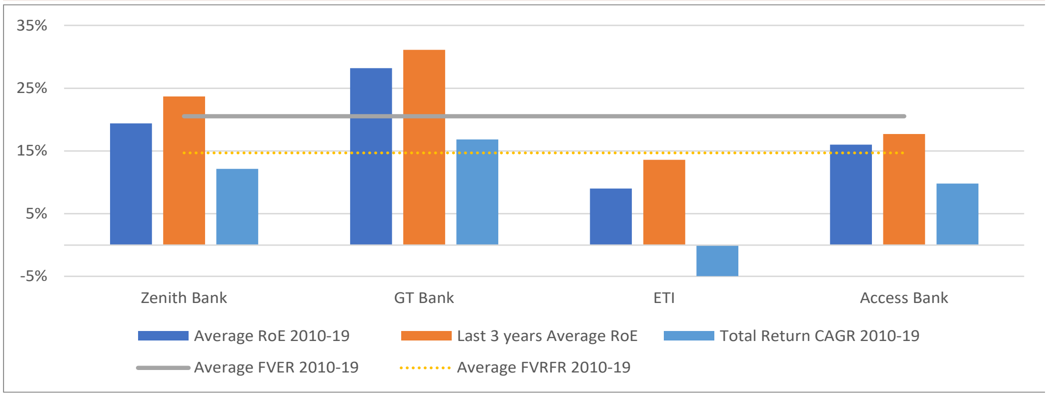
The injustice of share price returns

Given what we have said about the Return on Equity (RoE) of the largest companies listed on the Nigerian Stock Exchange (NSE), what are their actual stock returns like? The answer is "not very good". Remember that we need our equity investments to return 20.53% per annum, compounding, to match our Fair Value Equity Return (FVER) benchmark. The market should reward 20.53% RoE with the same level of stock price appreciation.

We would not expect much performance from our industrial companies, given their generally poor RoEs , but we would expect at least some strong, i.e. 20%+ per annum, performance among the bank stocks. Let us see.

It makes sense, as we discussed in the last section, to add back gross dividend payments to our purely stock price equity returns and to measure these returns over a long period, in this case the 10 years between 2010 and the end of 2019 inclusive.

Total stock price returns of top-four banks versus their long-term RoE*



Source: Companies, Coronation Research. *for Return on Equity we calculate Return on Average Equity (RoAE). The top-four listed banks are Zenith Bank, GT Bank, ETI, Access Bank (in descending order of total shareholders' funds)

Do listed stocks return enough? Banks

Sadly, the listed banks with strong RoEs over the past 10 years have not been rewarded with commensurate stock price performance.

As the chart shows, Zenith Bank has achieved an average RoE over the period 2010-19 of 19.4%, with RoE improving to 20.5% over the last three years. What has been the reward, in terms of total share price returns? A compound annual growth rate (CAGR) of 12.1%. This is well short of our Fair Value Equity Return (FVER) and even short of our Fair Value Risk-Free Return (FVRFR). GT Bank's story is very similar to Zenith Bank's story. Access Bank has improved its RoE in recent years, and is approaching our benchmark RoE, but this improvement has not been reflected in its total share price return. ETI, with generally lower RoEs than its peers, has experienced negative total share price performance.

What is going wrong?

Share prices depend on confidence. Total share price returns that fall short of RoEs demonstrate that confidence has waned. This means either that investors will continue to under-rate banks, even when those RoEs are sufficient, or that banks stocks are very cheap at these levels, because their ratings will be restored in future. If the latter is the case, then we should be buying bank stocks.

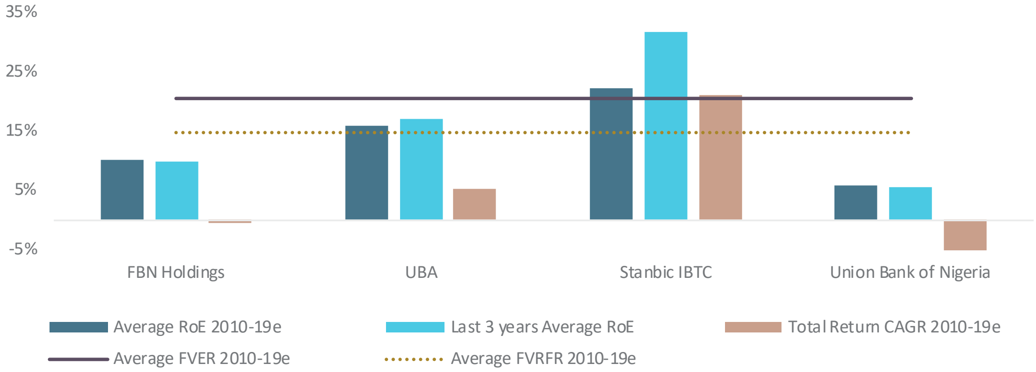
In technical terms we can describe this as an erosion of price-to-book (P/BV) and/or the price-to-earnings (PE) ratio over the long term. It does not matter which we chose since PE = P/BV / RoE. We choose P/BV as it is a much less volatile data series than PE, and we chart the decline in P/BVs later in this section.

Do listed stocks return enough? Banks

When it comes to the next four banks (ranking them in terms of total shareholders' funds) then the picture is, with the exception of Stanbic IBTC, worse than the examples given above. The RoEs of FBN Holdings, UBA and UBN do not measure up to our hurdle rate of 20.53%, over the long term, and shareholders have received poor returns as a result.

But spare a thought for Stanbic IBTC. This bank, which is more of an investment manager and an investment bank than a purely commercial bank, has delivered, an average RoE of 22.1% over 10 years, above our hurdle rate of 20.53%, and has significantly exceeded this level over the past three (averaging 31.6%). And the result has been a 10-year total shareholder return CAGR of 21.0%, well short of the its internal returns.

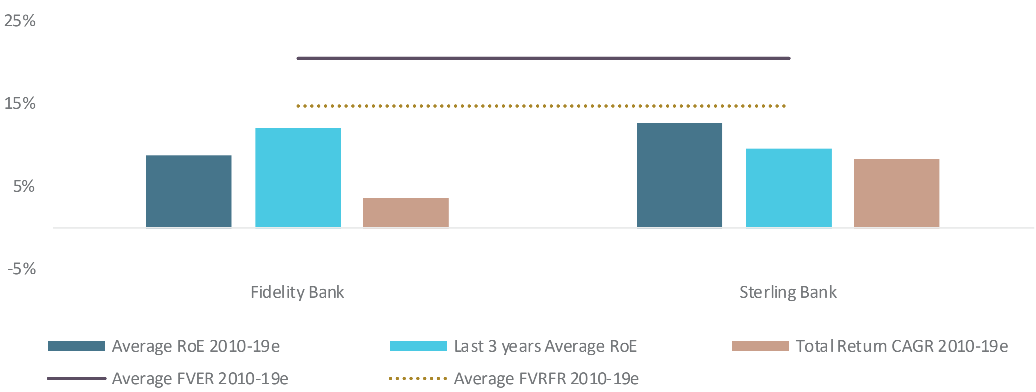
Total stock price returns of FBN Holdings, UBA, Stanbic IBTC and Union Bank of Nigeria



Source: Companies, Coronation Research. *for Return on Equity we calculate Return on Average Equity (RoAE)

Of the smallest banks in our study, Fidelity Bank and Sterling Bank, the story is at least consistent, even if not very encouraging. Over a 10-year period neither had delivered, on average, a Return on Equity close to our Fair Value Equity Return of 20.53%, and neither has delivered much in terms of stock price performance.

Total stock price returns of Fidelity Bank and Sterling Bank



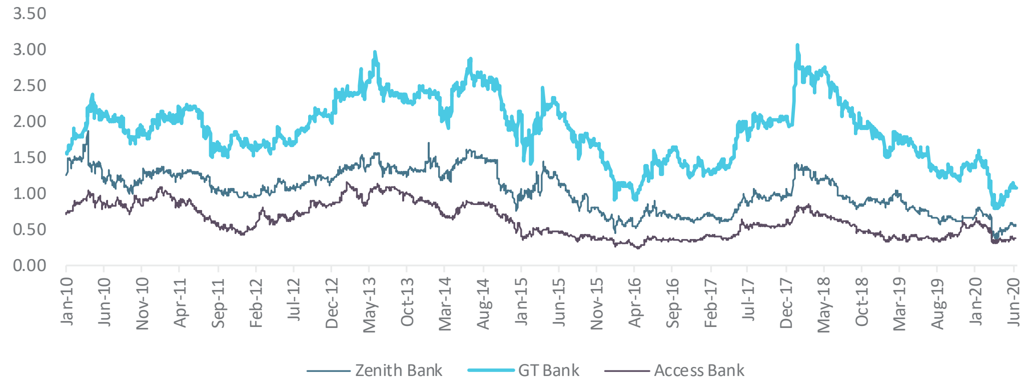
Source: Companies, Coronation Research. *for Return on Equity we calculate Return on Average Equity (RoAE)

Do listed stocks return enough? Banks

The de-rating of bank stocks

As described above, it is frustrating, if not downright unjust, that listed banks with a Return of Equity comfortably above 20.53% over the past three years are not rewarded by share price performance (measured by total stock return) of the same sort. The market has been de-rating equities, even when the returns are good. We measure this by the remarkable fall in P/BV (Price-to-Book Value, or Market Capitalisation to Total Shareholders' Funds) over the long term.

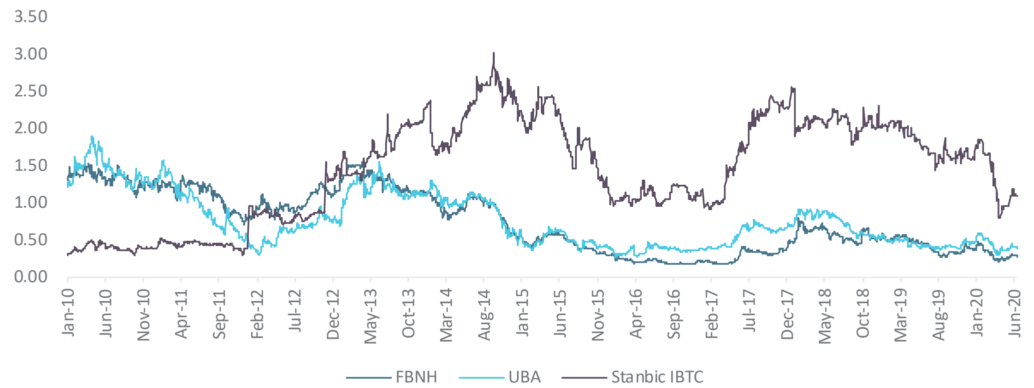
P/BV of Zenith Bank, GT Bank and Access Bank



Source: Companies, Coronation Research. Historic book values are re-set quarterly

The decline has been shared across the various groups of banks, though naturally (and justly) it has been worse among the banks with weak RoEs. With some banks the decline in RoE has been so great, and the lowering of the P/BV rating has been so great, that one wonders whether there is any realistic prospect of a return to the average of their historic P/BV levels. In some cases we doubt it.

P/BV of FBNH, UBA and Stanbic IBTC

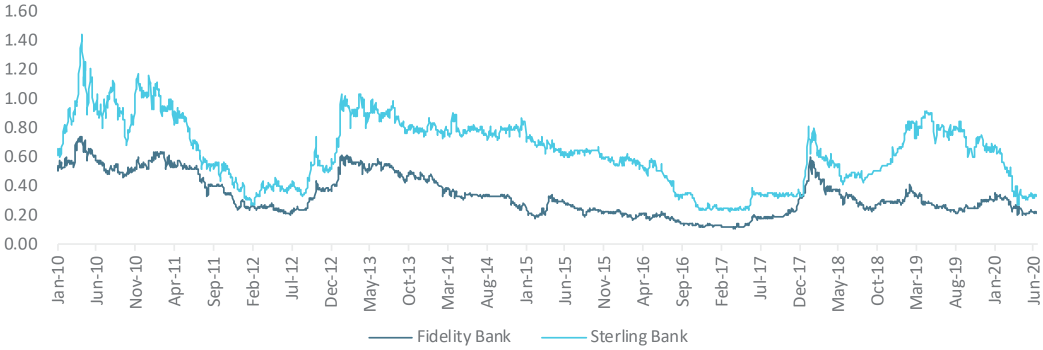


Source: Companies, Coronation Research. Historic book values are re-set quarterly

The two smallest listed banks in our study have also seen significant declines in their P/BV ratings over the long term.

Do listed stocks return enough? Banks

P/BV of Fidelity Bank and Sterling Bank

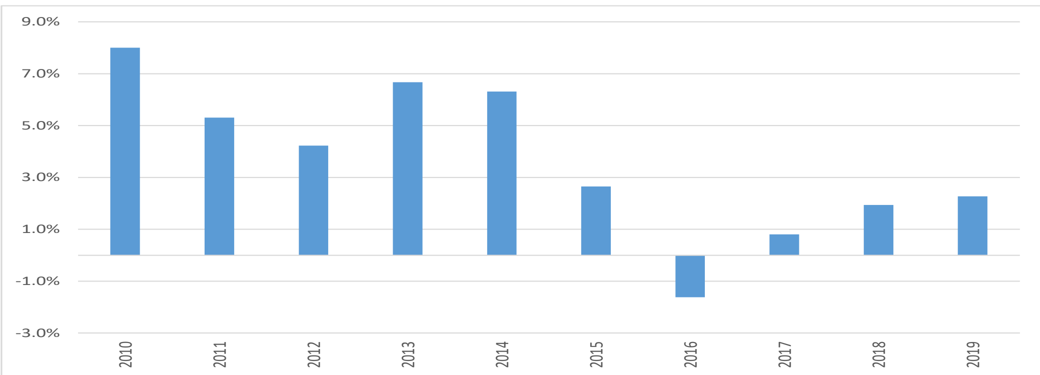


Source: Companies, Coronation Research. Historic book values are re-set quarterly

The economic growth question

Another way of looking at the de-rating of banks is from the angle of economic growth. Growth gives equity investors confidence and the decline in banks' P/BV ratings has taken place when growth rates have slowed down.

Long-term Economic Growth 2010 - 19, Annual Data



Source: National Bureau of Statistics (NBS), Coronation Research

The future ratings of listed banks

Having given all this gloomy data on the P/BV ratings of banks, there are nevertheless some hopeful aspects to the story.

The first is that the banks with the highest RoEs are good to trade. Their stocks do not just de-rate: rather their P/BV ratios oscillate according to their earnings outlook and the outlook of the equity market as a whole. And investors in the Nigerian Stock Exchange know very well that banks stocks generally more volatile (hence better to trade if you get it right) than the market as a whole.

Second, they pay superior dividends to most other stocks. In other words, the bank stocks with the best RoEs (and those with RoEs approaching the critical 20.53% level) will continue to be traded. Other banks stocks, those with long-term low RoEs, are likely to receive limited investor interest, in our view.

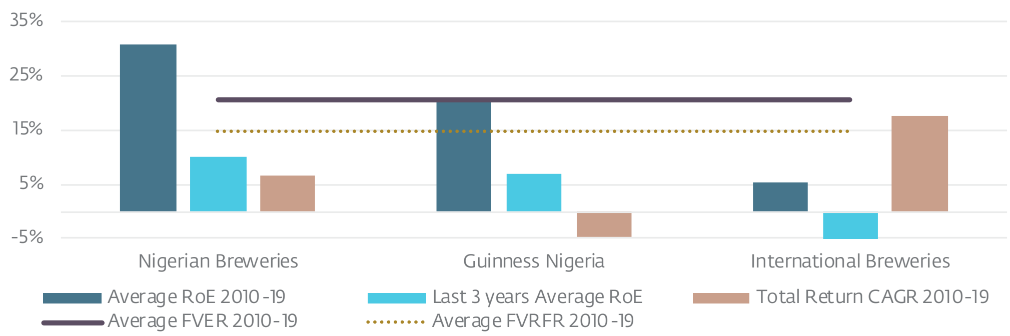
Do listed stocks return enough? Industrials

Do listed stocks return enough? Industrials

In the last section we showed that the banks stocks that deliver our benchmark 20.53% RoE, or more, have not returned the same in terms of total shareholder returns over the long term, due to the unfortunate process of de-rating. But the market recognises the swings in the earnings and prospects of the principal banks with sufficient responsiveness to make them good trading stocks. How true is this of the principal industrial stocks listed on the Nigerian Stock Exchange?

The answer is that, with a few notable exceptions and as discussed above, the principal listed industrial companies do not meet our benchmark 20.53% RoE. Some of those that achieve or exceed our benchmark return RoE are not rewarded with equivalent total shareholder returns: but some are, and these make good stocks to invest in and to trade.

Total stock price returns of listed brewers versus long-term RoE*

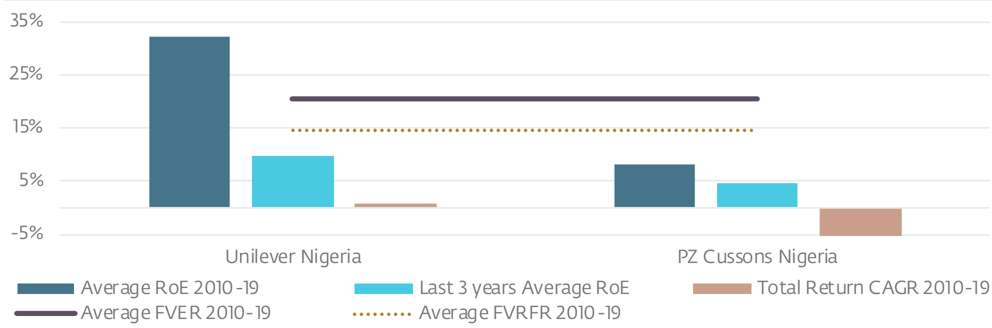


Source: Companies, Coronation Research *RoE is given as annual return of average equity (RoAE)

For examples of companies that do not meet our benchmarks, we start with the listed brewers. The most noticeable aspect of the returns of Nigerian Breweries and Guinness Nigeria over the past 10 years is their decline. Whereas their average RoEs over the past 10 years were good (very good in the case of Nigerian Breweries), the average RoEs over the past three years have fallen well short of our benchmark. Their sales growth slackened as their customers turned to value-segment products, among which were the brands offered by International Breweries. But even International Breweries has not delivered high RoEs. Brewing, in our view, remains a challenged sector.

In the fast-moving consumer goods (FMCG) industry there is, unfortunately, a similar story to tell. Consumers, as we described in Coronation Research, Power to the Price Point, May 2019, are under pressure to find value-segment alternatives to the brands that once held sway. The RoEs of Unilever Nigeria (whose business, we should state, is 50% FMCG and 50% food) and PZ Cussons Nigeria, have been falling as a result. Consequently their total shareholder returns have been weak.

Total stock price returns of Unilever Nigeria and PZ Cussons Nigeria versus long-term RoE*

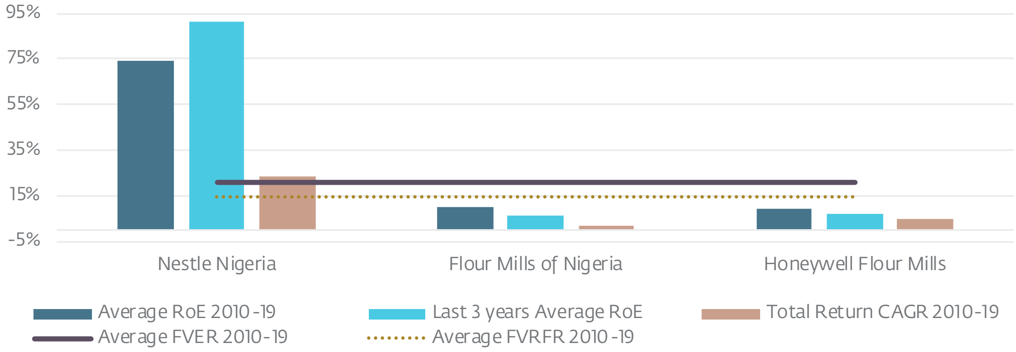


Source: Companies, Coronation Research *RoE is given as annual return of average equity (RoAE)

Do listed stocks return enough? Industrials

What of the food manufacturers? Both Flour Mills of Nigeria and Honeywell Flour Mills have generated RoEs far lower than our required 20.53% per annum hurdle rate. And their long-term total shareholder returns have been poor. The remarkable exception has been Nestle Nigeria, which not only has generated RoE that are multiples of our required 20.53% hurdle rate, but has managed (but only just, a 23.7% total return CAGR) to deliver a total shareholder return that beats our Average Fair Value Equity Return benchmark of 20.53%.

Total stock price returns of food manufacturers versus long-term RoE*



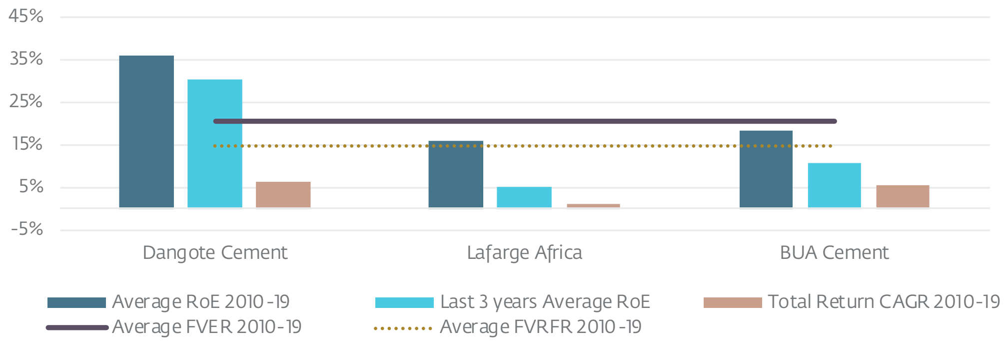
Source: Companies, Coronation Research *RoE is given as annual return of average equity (RoAE)

But why is Nestle Nigeria's total shareholder return so much lower than its long-term RoE? One possible reason is that its overall sales growth, when adjusted for inflation, is not particularly high (and in fact was negative in 2019). We believe the equity market responds best to a combination of high RoE and Sales growth. When Sales growth weakens investors can be suspicious of where the business is heading – as was the case with the principal brewers – and consequently may wonder about the sustainability of historic RoEs.

Cement companies

What of the cement companies? Two of these, Lafarge Africa and BUA Cement, have not delivered RoEs up to our 20.53% benchmark and their stocks have not delivered much in terms of total shareholder returns. But Dangote Cement has delivered excellent RoE over the long term. So why have its listed shares not delivered a similarly superior total shareholder return?

Total stock price returns of cement companies versus long-term RoE*



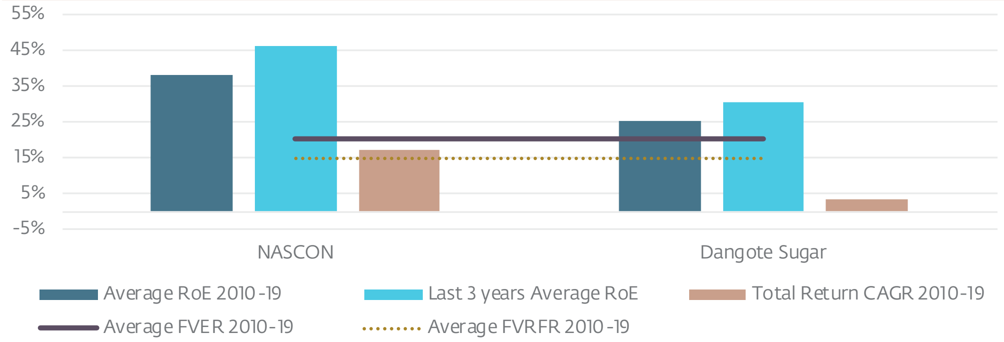
Source: Companies, Coronation Research RoE is given as annual return of average equity (RoAE) N.B. BUA cement was listed as Cement Company of Northern Nigeria prior to its 2018 merger with BUA

Do listed stocks return enough? Industrials

It is difficult to explain Dangote Cement's unjust treatment at the hands of the market, which must be frustrating for a company that intends to make an international listing. The best explanation is that the ratings of international cement companies have been adjusting downwards over a period of time, and therefore this is a sector-driven issue as much as it is a Nigerian market one.

Within the Dangote group of companies are two specialised food producers, NASCON and Dangote Sugar, that have not only produced RoEs well in excess of our target 20.53% but that have actually improved their RoEs in recent years. The result, unfortunately, has been total shareholder returns below our benchmark return. This is a case of unjust treatment by the market, quite likely a case of investors not paying attention to fairly small and not-very-liquid stocks.

Total stock price returns of NASCON and Dangote Sugar versus long-term RoE*



Source: Companies, Coronation Research *RoE is given as annual return of average equity (RoAE)

Agricultural companies

Shareholders in two of Nigeria's listed agricultural producers have enjoyed much better total shareholder returns compared with many of the companies featured above. Palm oil producer Presco and palm oil and rubber producer Okomu Oil have delivered RoEs close to (in the case of Presco) and above (in the case of Okomu) our benchmark over the long term. Both these companies grow, produce and sell commodities that have an equivalent international price in US dollars, so to a large extent benefit from US dollar-related revenues while paying largely Naira expenses. The results have been a high level of total shareholder returns (RoE) in the case of Presco and a slightly below-benchmark return in the case of Okomu Oil, 19.80% CAGR to be precise.

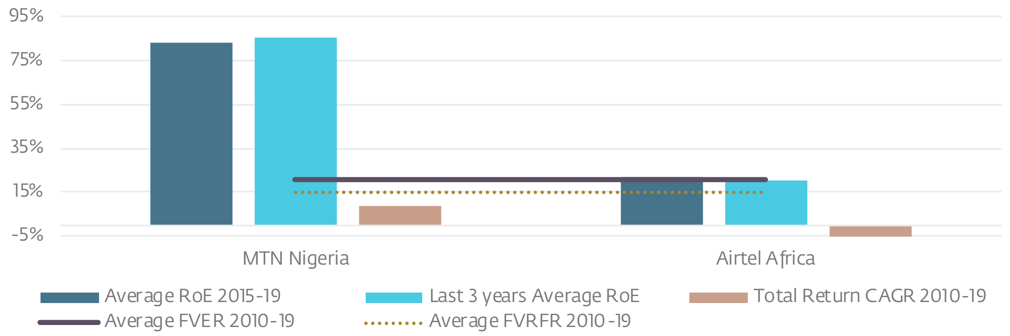
Total stock price returns of Presco and Okomu versus long-term RoE*

Source: Companies, Coronation Research *RoE is given as annual return of average equity (RoAE)

Do listed stocks return enough? Industrials

Last of all we consider the recently-listed telecoms companies, Airtel Africa and MTN Nigeria. Since these were listed recently (Airtel Africa in 2019 and MTN Nigeria in 2019) there is insufficient data for either their long-term RoEs or their total shareholder returns to make a valid study. However, we present the data which we do have.

Total stock price returns of telecom companies versus 2015-19 RoE*



Source: Companies, Coronation Research *RoE is given as annual return of average equity (RoAE) N.B. Airtel Africa data is for 2019 only (March year-end)

However, their RoEs for the past three years have been encouraging, with Airtel Africa matching our required hurdle rate in 2019 (though not in 2020 – March year-end) and MTN Nigeria exceeding it several times over. However, as we have seen with examples such as Nigerian Breweries and Guinness Nigeria, high RoEs are not everything: they need to be combined with business growth (notably, consistent inflation-adjusted growth in sales) if they are going to be translated into adequate long-term total shareholder returns.

Conclusions

We now understand, in detail, why the Nigerian Stock Exchange All-Share Index (NSE-ASI) has not provided adequate returns for investors. It is very simple. For the most part the principal companies listed on the Nigerian Stock Exchange (NSE) has not delivered the return on equity (RoE) of 20.53% which is what equity investors demand (the Fair Value Equity Return – FVER).

At the same time, and due to a decline in confidence in overall growth prospects, which is mirrored by declining GDP growth rates over the long term, even those stocks with strong RoEs are not rewarded with equivalent total stock market returns (i.e. share price returns plus dividends). The process of de-rating has robbed early-stage investors of the returns which they would reasonably expect.

And it is important to recall that RoE is not everything. Companies need to grow their businesses if they are going to sustain their RoEs, and decline in the trend in total sales is often a harbinger of declining RoEs (the two major listed brewers provide, unfortunately, perfect examples of this). When we look sales growth we need it adjust it for inflation to see if it really is a positive trends.

Yet, investors buy and sell stocks, and clearly have some success in doing do (otherwise they would not return to the market). Our view is that it is best to buy stocks with high RoEs, preferably ones with underlying growth, and only to buy them when valuations are depressed. These stocks tend to oscillate in value and canny investors will trade between low and high valuations.

Disclosures & Disclaimers

The analyst(s) and/or Head of Research has (have) produced this report independently of the company or companies, and independently of the issuer of security or securities, covered in this report, and (has) have done so using publicly-available information. Information used in the preparation of this report is believed to be accurate at the time of going to press, though not verified independently. No liability is accepted for errors nor omissions of fact, nor is any warranty given for the reasonableness, accuracy or completeness of the information presented. Market information may have been gathered from different sources, including official and government sources, and processed in arriving at the opinion(s) expressed in this report.

This report is intended as background information for clients of Coronation Merchant Bank Ltd, and clients of its subsidiaries and affiliates, and is not to be read as a solicitation, approval or advice to buy or sell securities.

Neither Coronation Merchant Bank Ltd, its directors, employees and contractors, nor its subsidiaries and affiliates, nor the directors, employees and contractors of its subsidiaries and affiliates, accept(s) responsibility for losses or opportunity costs, whether direct or consequential, that may be incurred as a result of trading, or not trading, in securities covered in this report, or other securities, as a result of any decision taken after reading this report. Clients of Coronation Merchant Bank Ltd, and of its subsidiaries and affiliates, who read this report, should not rely on it for the purposes of making investment decisions and should make their own evaluation of: the potential performance of securities; the risks involved in buying or selling securities; the volatility and liquidity of securities; and of other factors such as interest rates, exchange rates, exchange rate liquidity, trading costs, settlement and custody. Clients of Coronation Merchant Bank Ltd, and of its subsidiaries and affiliates, who read this report, should assess their own investment objectives and financial capacities when taking investment decisions and should consult a relevant financial adviser in these respects.

This report is intended for the clients of Coronation Merchant Bank Ltd, and of its subsidiaries and affiliates. Copying and reproduction of this report, and onward forwarding, is only allowed with the specific permission of Coronation Merchant Bank Ltd, its subsidiaries and affiliates. Receipt of this report does not qualify you as a client of Coronation Merchant Bank Ltd, its subsidiaries and affiliates. If you are in unauthorised receipt of this report you are requested to notify Coronation Merchant Bank Ltd, or one of its subsidiaries or affiliates, and to return or delete the report.

This report is intended for corporate and institutional clients of Coronation Merchant Bank Ltd, and of its subsidiaries and affiliates, where those clients are regulated and professional investment customers and market counterparties. This report is not intended for individual investors.

This report is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulations.

Coronation Research is a department within Coronation Asset Management Ltd which supplies research services to Coronation Merchant Bank Ltd, and is ring-fenced with regard to the activities of Coronation Asset Management Ltd. The Head of Research, contractors and employees of Coronation Research do not receive any non-public information regarding the investments or investment objectives of Coronation Asset Management Ltd and do not take part in its internal meetings.

Coronation Merchant Bank Ltd and its subsidiaries are incorporated under the laws of the Federal Government of Nigeria and are licensed by the Central Bank of Nigeria and by the Securities and Exchange Commission of Nigeria.

Your attention is brought to the fact that the analyst(s), and/or Head of Research, mentioned at the beginning of this report is (are) employed by Coronation Merchant Bank Ltd in the Federal Republic of Nigeria, and while subject to the laws of the Federal Republic of Nigeria is (are) not subject, as author(s) of this report, to the laws of other countries, notably the United States of America ('US'), the member states of the European Union ('EU'), or the United Kingdom ('UK', during and after its membership of the EU) as these laws may affect the production, publication and distribution of this report.

Disclosures & Disclaimers

Your attention is brought to the fact that the analyst(s), and/or Head of Research, mentioned at the beginning of this report, is (are) not registered or qualified as research analysts with the Financial Industry Regulatory Authority in the US, nor registered with the Financial Conduct Authority of the United Kingdom. No liability for compliance with those laws, with respect to this report, is accepted by Coronation Merchant Bank Ltd, its directors, staff and contractors, or those of its subsidiaries and affiliates.

Where this report is distributed to clients and potential clients of Coronation Merchant Bank Ltd, and of its clients and affiliates, in the European Union ('EU'), including the United Kingdom ('UK'), during and after its membership of the EU, this report is either: a) distributed by virtue of a contract between Coronation Merchant Bank Ltd, its subsidiaries and affiliates, and the client for research services, or: b) distributed as a free sample, for a given period of time, pursuant to a future contract for the sale of research services.

The opinions expressed in this report concerning the company(ies) and securities covered, accurately represent the personal views of the analyst(s) and Head of Research whose names are given at the beginning of the report. No part of the compensation of the analyst(s) and Head of Research mentioned at the beginning of this report is, or will be, related to the views or recommendations(s) given in this report.

Conflicts of Interest

The compensation of the analyst(s), and/or Head of Research, mentioned at the beginning of this report is not linked to the recommendations, forecasts, estimates or opinions expressed in this report, nor to commissions or spreads or other gains generated in trading securities, whether covered in this report or not.

This report is produced by the Research Department of Coronation Merchant Bank Ltd and may be used, after its publication, by other departments of Coronation Merchant Bank Ltd for advisory or trading purposes, or otherwise for the assessment of companies and securities. However, it is the policy of Coronation Merchant Bank Ltd that no department influences the opinions, estimates, forecasts or recommendations of the Research Department, nor is privy to the contents or recommendations of the Research Department's reports and recommendations ahead of their publication. It is also the policy of Coronation Merchant Bank Ltd that members of the Research Department are not privy to knowledge of advisory mandates, or other fiduciary relationships, engaged in by other departments. Coronation Merchant Bank Ltd, its directors, contractors and staff, and its subsidiaries and affiliates and their directors, contractors and staff, and connected parties, may have positions in the securities covered by this report, and may have advisory and/or other fiduciary relationships with companies covered in this report. As such, this report should not be considered free from bias.

Disclosures for companies cited in report

The table below outlines currently known conflicts of interest that may unknowingly bias or affect the objectivity of the analyst(s) with respect to an issuer that is the subject matter of this report. Disclosure(s) apply to Coronation Merchant Bank or any of its direct or indirect subsidiaries or affiliates with respect to any issuer or the issuer's securities.

The analyst(s) responsible for the preparation and content of this report (as shown on the front page of this report) holds personal positions, directly or indirectly, in securities of the company(s) to which this report relates.

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

Coronation Merchant Bank or its affiliates have recently been the beneficial owners of 1% or more of the securities mentioned in this report.

Coronation Merchant Bank or its affiliates have managed or co-managed a public offering of the securities mentioned in the report in the past 12 months.

Coronation Merchant Bank or its affiliates have received compensation for investment banking services from the issuer of these securities in the past 12 months.

Disclosures & Disclaimers

Coronation Merchant Bank or its affiliates expects to receive compensation for investment banking services from the issuer of these securities within the next three months.
The company (s) covered in this report is a client of Coronation Merchant Bank or its affiliates.
Coronation Merchant Bank has other financial or other material interest in the Company

Security Name	Available Disclosure
Nestle Nigeria	
Flour Mills of Nigeria	G
Unilever Nigeria	G
PZ Cussons Nigeria	G

Coronation Research's equity research rating system
Coronation Research's Investment ratings are a function of the research analyst's expectation of a stock's performance relative to relevant indices or peers. The benchmark used in deciding our stock rating is the trailing three-year average yield of the 12-month T-Bill plus one standard deviation rounded to the nearest percent.
Coronation Merchant Bank uses the following rating system:

Buy: The analyst considers the stock undervalued and expects the stock to outperform the Benchmark over the next 12 months or the stated investment horizon.

Hold: The analyst considers the stock to be fairly valued and expects the stock to perform in line with the Benchmark over the next 12 months or the stated investment horizon.

Sell: The analyst considers the stock overvalued and expects the stock to underperform the Benchmark over the next 12 months or the stated investment horizon.

Under Review (UR): Where the company covered has a significant material event with further information pending or to be announced, it may be necessary to temporarily place the investment rating Under Review. This does not revise the previously published rating, but indicates that the analyst is actively reviewing the investment rating or waiting for additional information to re-evaluate the expectation of the company's performance.

Not Rated: This applies when the stock is either not covered by Coronation Research or the rating and price target has been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Coronation Merchant Bank is acting in an advisory capacity in a merger or strategic transaction involving the company or due to factors which limits the analysts' ability to provide forecasts for the company in question.

Price targets: Price targets reflect the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings fall short of estimates.

Disclosures & Disclaimers

In cases where issuing of research is restricted due to legal, regulatory or contractual obligations, publishing investment ratings will be restricted. Previously published investment ratings should not be relied upon as they may no longer reflect the analysts' current expectations of total return. While restricted, the analyst may not always be able to keep you informed of events or provide background information relating to the issuer.
If the investment rating on a stock has not been reviewed for a period of one year, coverage of the stock will be discontinued by Coronation Research. Investment decisions should be based upon personal investment objectives and should be made only after evaluating the security's expected performance and risk. Coronation Research reserves the right to update or amend its investment ratings in any way and at any time it determines.

Ratings and Price target history

	Date	Recommendation	Date	Recommendation	Date	Recommendation	Current price, Naira/s	Target price, Naira/s
Zenith	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	21.80	27.50
GT Bank	02-Jan-19	Hold	08-May-19	Hold	08-Jan-20	Buy	31.25	37.50
Access	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	10.30	11.25
FBNH	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	6.50	12.50
UBA	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	8.85	11.50
Stanbic IBTC	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	42.50	61.35
Fidelity	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Hold	2.02	2.50
Sterling	02-Jan-19	Hold	08-May-19	Hold	08-Jan-20	Hold	2.00	1.90

	Date	Recommendation	Current Price, Naira/s	Target price, Naira/s
Nestle Nig.	17-May-19	Hold	1,300	1,213.89
Flour Mills of Nig.	17-May-19	Hold	13.50	18.29
Unilever Nig.	17-May-19	Hold	29.45	28.39
PZ Cussons Nig.	17-May-19	Hold	5.90	8.22

This documents marks the initiation of coverage by Coronation Research for Nestle Nigeria, Flour Mills of Nigeria, Unilever Nigeria and PZ Cussons Nigeria.

Coronation Research Investment Rating Distribution	
Buy	66.7%
Sell	0%
Hold	33.3%
Under Review	0%

Coronation Asset Management,
10 Amodu Ojikutu Street,
PO Box 74853, Victoria Island
Lagos, Nigeria.

Appendix I: list of sources

Bloomberg

Central Bank of Nigeria (CBN)

FMDQ (FMDQ Group)

National Bureau of Statistics (NBS)

National Pension Commission (PENCOM)

Securities and Exchange Commission of Nigeria (SEC)

Appendix II
References for published work on the ERP

Aswath Damodaran 2010, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2010 Edition

Aswath Damodaran 2011, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2011 Edition

Aswath Damodaran 2012, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2012 Edition

Aswath Damodaran 2013, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2013 Edition

Aswath Damodaran 2014, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2014 Edition

Aswath Damodaran 2015, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2015 Edition

Aswath Damodaran 2016, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2016 Edition

Aswath Damodaran 2017, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2017 Edition

Aswath Damodaran 2018, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2018 Edition

Aswath Damodaran 2019, Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2019 Edition Updated: April 2019

Coronation Asset Management

10, Amodu Ojikutu Street,
Victoria Island,. Lagos
T: 01 279 7640 -43