

Equity Research

Nigeria: Market Watch

Proposed 2012 budget: Likely to be margin negative for flour millers

19 December 2011

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Stocks to watch this week	Current price (NGN)	Target price (NGN)	Upside (%)
First Bank plc	8.40	19.62	134
Zenith Bank plc	11.85	19.88	68
Guinness Nigeria plc	228.90	252.00	10

Sources: NSE, Stanbic IBTC Research, Prices at cob 16 December 2011

2011 likely to end on a negative note

The market closed last week on a positive note at +1.2% after five consecutive weeks of negative returns. The slight recovery and the uninspiring -19% YTD performance are strong indications that the market will close 2011 on a negative note, in our view. Besides, we believe that there is lack of constructive catalysts that could reverse the negative return before the end of the year. Going into Q1:12e, we see the overhanging Euro zone crisis, relatively low global risk appetite, and weak global economic growth outlook as constraints to a recovery of the market. Valuations of fundamentally strong stocks, in our view, remain compelling for long term investors.

2012 budget: Flour millers FY12e-13e margins are likely to contract, in our view

We think that profit margins of Nigerian flour millers are likely to come under pressure over FY12e-13e on the back of the policy content of the proposed 2012 budget. According to the proposed budget, flour millers will pay 20% import duty on grain wheat from H1:12 vs. 5% previously. This combined with a possible increase in global wheat prices over FY12e-13e should fan input cost increases if implemented, in our view. Further, the government requires bakers to increase the blending of cassava with wheat flour up to 40% cassava from previously 5% within an 18-month period. This could cut bakers' demand for wheat-based flour if they fully comply with the directive which could earn them a 12% tax rebate from the government. In addition, it may be challenging for the millers to pass increased input costs to consumers in the near term given that they raised prices by 20% this year on the back of high wheat prices. That said, we think millers with strong market positioning and high milling efficiency should be less negatively impacted.

The secondary market

The market capitalisation of the 186 first-tier equities closed 1.2% up at N6.33 trillion. Turnover rose by 20% to 1.27bn shares last week from 1.06bn the previous week while value rose 38% to N11 billion last week from the N8bn recorded the previous week. Zenith Bank, First Bank and UBA drove volume in the banking sector which accounted for 76% of total NSE traded volume last week.

The market	16-Dec-11	09-Dec-11	% Change
during the week			
NSE ASI	20025	19785	1.22%
NSE market cap (N'tn)	6.331	6.255	1.22%
NSE value traded (N'bn)	11.030	8.020	37.55%
NSE val. traded (\$'bn)	0.07	0.05	37.55%
NSE vol. traded (bn)	1.27	1.10	19.67%
Banking sector val. traded (N'bn)	7.10	4.92	44.30%
Banking sector val. traded (\$'bn)	0.05	0.04	25.00%
Banking sector vol. traded (bn)	0.99	0.73	35.62%
Gainers	Close (N)	Change (%)	Vol ('000)
Lafarge WAPCO	44.00	9.64	3,216
Fidelity	1.32	8.20	37,151
Access Bank	4.67	8.14	74,017
Nestle	424.46	6.11	975
Guinness	228.90	5.97	2,163
Losers	Close (N)	Change (%)	Vol ('000)
Diamond Bank	2.08	-16.80	13,055
Oando	21.45	-13.68	9,364
Dangote Flour	4.53	-11.18	6,045
Dangote Sugar	4.02	-10.67	25,055
Ecobank	1.70	-10.53	1,284
Exchange rate	16-Dec-11	09-Dec-11	% Change
USD/NGN	156.70	156.70	0.00%
EUR/NGN	240.25	210.08	-14.36%
GBP/NGN	243.43	246.25	1.15%
Commodities, US\$/bbl	16-Dec-11	09-Dec-11	% Change
Brent crude	103.54	107.95	-4.09%
Bonny light crude	107.30	110.47	-2.87%

Sources: NSE, CBN, Bloomberg, Stanbic IBTC Research

Our top picks

Our top three picks for the week are First Bank plc, Zenith Bank plc and Guinness Nigeria plc. Based on our computed 12 – month target price, all three shares imply upside potential of 134%, 68% and 10%. respectively to their current market prices. Our brief investment cases on each of the aforementioned shares are listed below:

First Bank plc, Buy (current price: N8.40; target price: N19.62);

- Increased focus on efficiency should drive returns. We expect its ROAE to improve to 16.1% in FY:11E and 17.7% in FY:12E, from 10.3% in FY:10.
- First Bank expects the commercial/ tier II corporate segment to be the major driver of loan growth with lower focus on tier I corporates. A diversified loan book should help maintain margins, in our view.
- A diversified customer base should maintain market share.
- To arrive at our target price, we have used an equally weighted average price of the DDM and the residual income valuation method. We apply a terminal growth rate of 6%, risk premium of 6% and a cost of equity of 17.18%.
- Risks to our valuation are: In our view, the Sea Wolf loan remains a key risk to First Bank's earnings outlook given its high concentration in its loan book. Even though the loan is still classified as a performing project finance loan based on the new prudential guidelines, First Bank might have no choice but to take a haircut on the value of the loan if it is forced to sell the loan in order to manage concentration risk.

Zenith Bank plc, Buy (current price: N11.85; target price: N19.88)

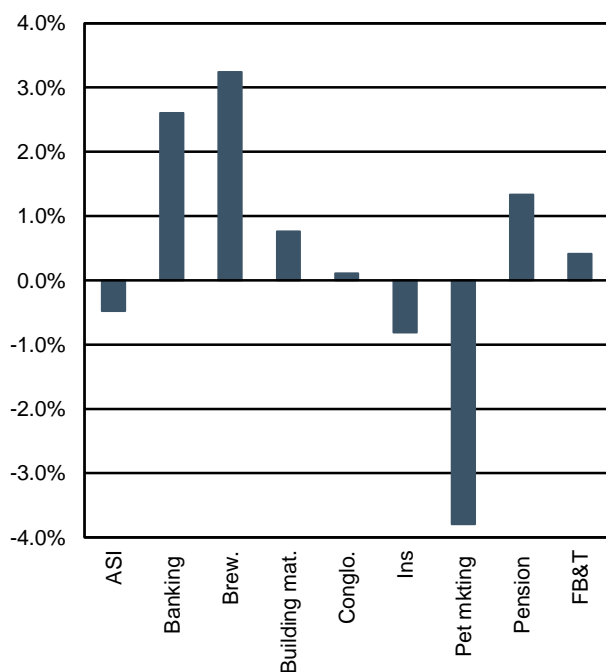
- Better-than-expected profitability – Annualized Q2:11 ROE increased to 17.0% from 15.8% in Q1:11. We expect FY11e and FY12e ROE to improve to 14.2% and 19.5% respectively from 11.1% in FY10.
- Unparalleled asset quality – H1:11 NPL ratios declined to 3.3% from 5.4% in Q1:11 and 5.9% in FY10. We expect cost of risk to reduce to 1% and 0.9% in FY12e and FY13e respectively from 1.2% in FY11e.
- Improving NIMs – Zenith Bank's net interest margin has continued its upward trend. NIMs improved to 7.5% from 6.96% in Q1:11 and 5.95% in FY10.
- To arrive at our target price, we have used an equally weighted average price of the DDM and the residual income valuation method. We apply a terminal growth rate of 6%, risk premium of 6% and a cost of equity of 17.56%.
- Risks to our valuation are: In our view, continued focus on low risk assets will keep Zenith Bank's net interest margins lower than its peers. Zenith continues to focus on the high end of the credit curve where yields are lower than the commercial and retail clients.

Guinness Nigeria plc, Buy (current price: N228.90; target price: N252.00)

- Prospect of adding the spirits business is a positive to Guinness vs. peers.
- Strong expected earnings growth – 15% p.a. growth in EPS over FY11-13E. Growth drivers include strong beer volume growth (12% p.a. to 6.9mn hl) and recovering profit margins (23.9% average EBITDA).
- Robust cash flow and dividend yield.
- Our valuation methodologies include 1.) Discounted cash flow; 2.) P/E and EBITDA multiples of emerging market peers. We use the average of these to determine our TP. We apply a terminal growth rate of 6%, risk premium of 5%.
- Risks to our valuation include: 1.) high raw material prices – particularly barley; 2.) FX volatility – on average, Guinness imports 27% of raw material requirement; 3.) increasing competition and limiting pricing realization; 4.) changes to government policy

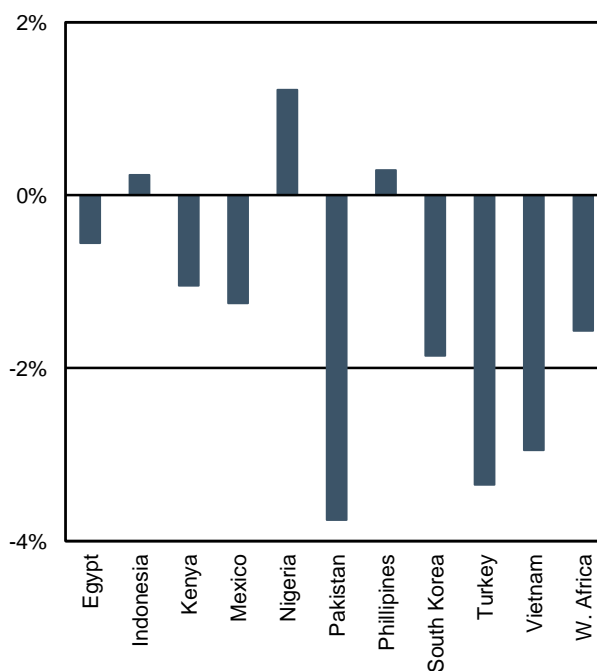
Picture gallery

Chart 1: Sector performance vs. ASI, 09 – 16 Dec. 2011



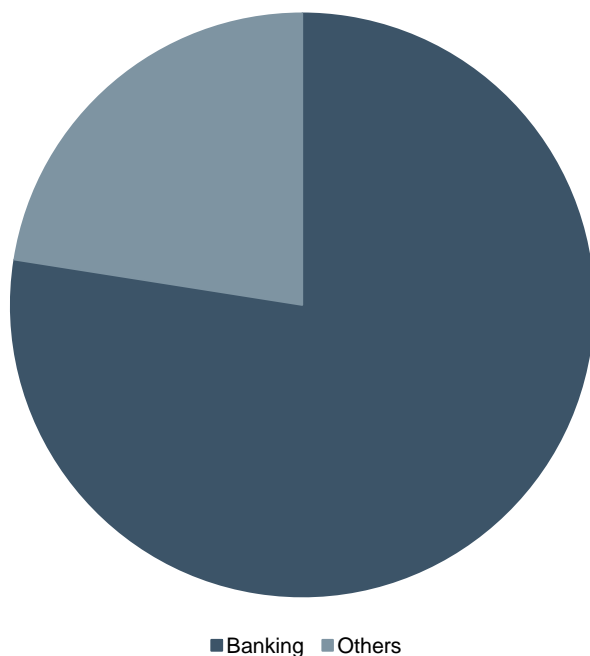
Sources: NSE, Stanbic IBTC Research

Chart 2: NSE values trades, 09 – 16 Dec. 2011



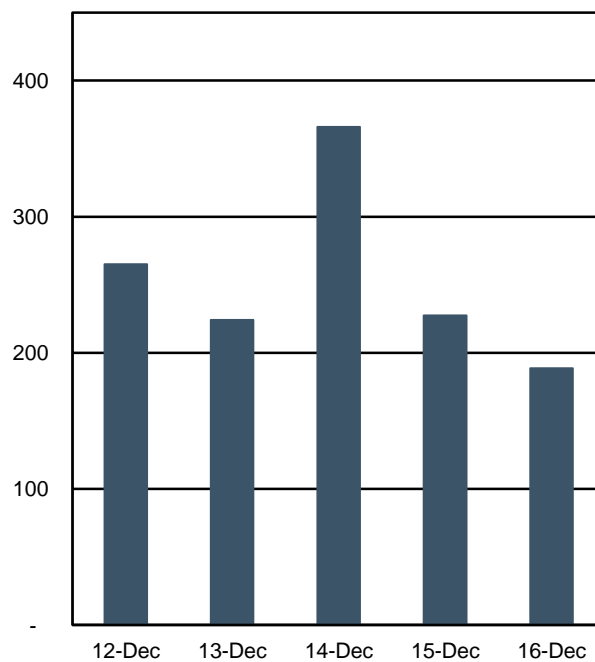
Sources: NSE, Stanbic IBTC Research

Chart 3: Vol. by sector, 9 – 16 Dec. 2011



Sources: NSE, Stanbic IBTC Research

Chart 4: Vol. traded (m), 09 – 16 Dec. 2011



Sources: NSE, Stanbic IBTC Research

Research publications

Date	Company	Title	Recommendation
15/11/2011	UAC of Nigeria plc	9M:11 earnings review – fair Q3:11 performance	BUY
15/11/2011	United Bank for Africa plc	N50bn capital raise – Downgrading to a Hold	Hold
14/11/2011	CCNN plc	Stronger Q3:11 earnings than we expected	BUY
11/11/2011	Guinness Nigeria plc	Q1:12 earnings update	BUY
10/11/2011	Costain (W.A) plc	Discontinuation of coverage	NA
07/11/2011	UACN plc	9M:11 earnings review	BUY
02/11/2011	Presco plc	9M11 results - bottom line underperforms in Q3	BUY
02/11/2011	Okomu Oil Palm plc	9M11 results - impressive performance	HOLD
02/11/2011	Dangote Cement plc	Stronger Q3:11 earnings than we expected	BUY under review
02/11/2011	Mobil Oil Nigeria plc	9M:11 results marginal improvement in profitability	BUY
02/11/2011	Dangote Sugar Refinery plc	9M11 results - Disappointing earnings	BUY
02/11/2011	Chemical and Allied Products plc	Bottom line ahead of our FY:11E expectations	SELL
02/11/2011	Julius Berger Nigeria plc	PAT growth tracking below our FY:11E growth expectations 9M:11 results in line with our FY11e PAT growth expectations	BUY under review
02/11/2011	Fidelity Bank		BUY
01/11/2011	Starcomms plc	Starcomms plc: 9M:11 earnings update 9M:11 results – tracking behind our FY11E earnings growth expectation	SELL under review
31/10/2011	Diamond Bank plc		BUY under review
31/10/2011	Ashaka Cement plc	Q3:11 earnings disappointing; but volume growth remains robust	BUY
31/10/2011	UAC plc	9M11 earnings preview 9M:11 results – tracking behind our FY11E earnings growth expectation	BUY
28/10/2011	United Bank for Africa plc		BUY
27/10/2011	Lafarge Cement WAPCO plc	Stronger Q3:11 earnings as we expected	BUY
17/10/2011	Nigerian Banking Sector	Banking sector overview: confluence of positives not reflected in the sector's market valuation in our view 9M:11 results – efficiency declines q/q but still on course to outperform in FY11E	N/A
14/10/2011	First Bank of Nigeria plc		BUY
14/10/2011	Nigerian Banking Sector	Banking sectors overview: asset mix likely to remain stable despite CRR increase, in our view	N/A
13/10/2011	Oil and gas sector	Oil and gas sector overview: weakening naira: Oando plc seems more vulnerable than pure downstream players	N/A
13/10/2011	Guinness Nigeria plc	Upgrading to buy on valuation grounds	BUY
12/10/2011	PZ Cussons Nigeria plc	Weak Q1:12 earnings: we expect another tough year	SELL
11/10/2011	Nigerian Banking Sector	Monetary tightening or devaluation, we believe that tier I banks are best positioned	N/A
11/10/2011	Nigerian Consumer Sector	We expect earnings to weaken as naira devalues; consider cheap packaged food producers	N/A
06/09/2011	Costain West Africa	NSE places Costain on full suspension	Hold
30/08/2011	Nigerian Cement Sector	An attractive proposition?	N/A
02/09/2011	Dangote Sugar Refinery plc	H1 11 results	N/A
23/08/2011	Dangote Cement plc	Hampered cement despatch negative for FY:11E earnings growth	Buy
23/08/2011	Ashaka Cement plc	H1:11 performance below our expectations – earnings forecasts under review	Buy
18/08/2011	CCNN plc	H1 11 results	Hold
17/08/2011	Access Bank	H1 11 results	Sell

Source: Stanbic IBTC Research

Directory

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Companies mentioned *(Price as of 16 December 2011)*

First Bank of Nigeria plc, (FIRSTBANK NL, PRICE: N8.40, BUY, TP: NGN19.62)

Zenith Bank plc, (ZENITHBANK NL, PRICE: N11.85, BUY, TP: NGN19.88)

Guinness Nigeria plc, (GUINNESS NL, PRICE: N228.90, BUY, TP: NGN252.00)

United Bank for Africa (UBA NL, PRICE: N2.36, HOLD, TP:N3.38)

Lafarge Wapco (WAPCO NL, PRICE: N44.00, BUY, TP:56.50)

Nestle (Nestle NL, PRICE: N424.46,SELL, TP: N377.00)

Access Bank (ACCESS NL, PRICE: N4.65, BUY, TP:N8.56)

Diamond Bank (DIAMONDBNK NL, PRICE: N2.50, BUY, TP:N9.03)

Dangote Sugar Refinery plc (DANSUGA NL, PRICE: N4.02, BUY, TP:N11.00)

Fidelity (Fidelity NL, PRICE: N1.32, BUY, TP:N2.84)

Ecobank Nigeria (Ecobank NL, PRICE: N1.70, BUY, TP:N3.84)

Oando (Oando NL, PRICE: N21.45, BUY, TP:N44.01)

Dangote Flour (Dangflour NL, PRICE: N4.53, NR)

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Prices are valid as at cob 16 December 2011.

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Disclosures*

Company	Disclosure
Guinness Nigeria plc	D, G
First Bank of Nigeria plc (FBN)	D, G
Zenith Bank plc	D, G

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* Disclosures are correct as of 28 November 2011

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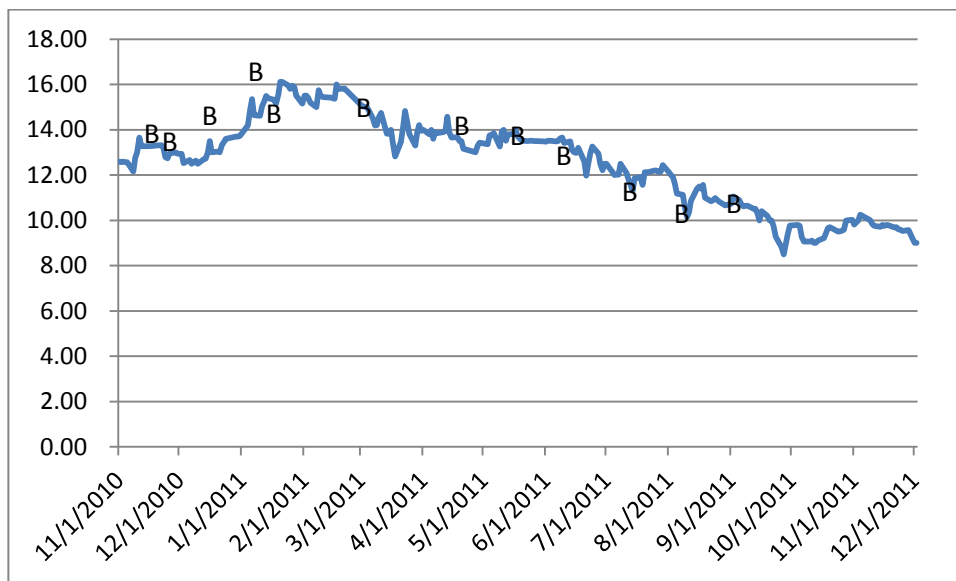
Rating	Buy	Hold	Sell
All Recommendations (%)	68	7	25

Recommendations with Investment Banking Relationship (%)	80	4	16
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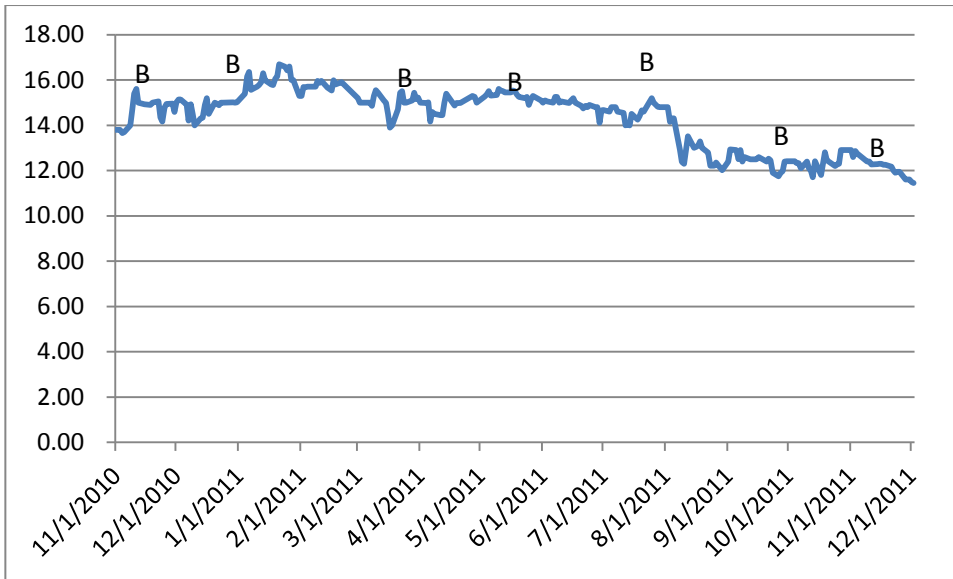
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Previous Ratings

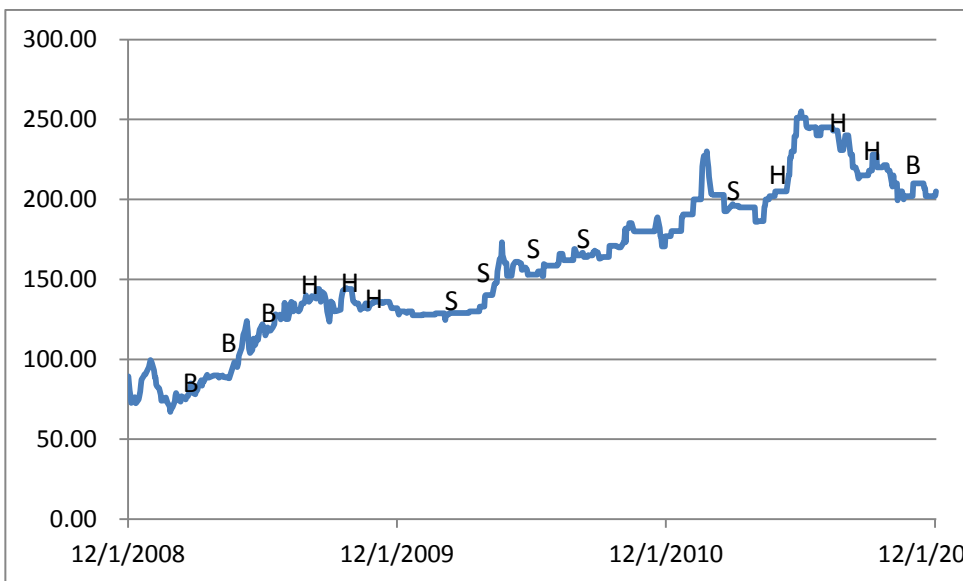
First Bank of Nigeria plc: We maintained our Buy rating of 5 August 2008 in our reports of 1 September 2008, 7 November 2008 and 7 February 2009. We downgraded the company to a Hold on 3 July 2009, a rating we maintained in our report of 13 July 2009. We upgraded the company to a Buy on 18 September 2009. We maintained this Buy rating in our reports of 2 October 2009, 5 October 2009, 4 November 2009, 24 December 2009, 20 January 2010, 18 March 2010, 21 April 2010, 20 July 2010, 6 September 2010, 1 November 2010, 10 November 2010, 17 December 2010, 14 January 2011, 21 January 2011, 25 January 2011, 22 March 2011, 18 April 2011, 28 April 2011, 13 May 2011, 7 June 2011, 13 June 2011, 27 June 2011, 4 July 2011, 6 July 2011, 11 July 2011, 18 July 2011, 22 July 2011, 26 July 2011, 1 August 2011, 8 August 2011, 15 August 2011, 22 August 2011, 29 August 2011, 5 September 2011, 12 September 2011, 14 September 2011, 19 September 2011, 24 September 2011, 26 September 2011, 4 October 2011, 10 October 2011, 14 October 2011, 17 October 2011, 24 October 2011, 31 October 2011, 9 November 2011, 14 November 2011, 21 November 2011, 29 November 2011, 5 December 2011, and 12 December 2011.



Zenith Bank plc: We maintained our Buy rating of 14 August 2008 in our 14 November 2008, 2 February 2009 and 13 May 2009 reports. We subsequently downgraded the company to a Hold in our 3 July 2009 report, which we maintained on 29 July 2009. We upgraded the company to a Buy in our review of 18 September 2009, and we maintained this in our reports dated 2 October 2009, 5 October 2009, 22 October 2009, and 24 December 2009. We rated the company as a Hold on 20 January 2010. We upgraded the company to a Buy on 29 March 2010. We downgraded to a Hold on 19 April 2010, a rating we maintained on 22 July 2010. We upgraded Zenith to a Buy in our report of 6 September 2010, a rating we maintained on 26 October 2010, 10 November 2010, 25 January 2011, 22 March 2011, 28 April 2011, 7 June 2011, 6 July 2011, 19 July 2011, 8 August 2011, 19 September 2011, 24 September 2011, 26 September 2011, 4 October 2011, 10 October 2011, 14 October 2011, 19 October 2011, 24 October 2011, 31 October 2011, 9 November 2011, 14 November 2011, 21 November 2011, 29 November 2011, 5 December 2011, and 12 December 2011.



Guinness Nigeria Plc: We maintained our Buy rating of 17 December 2008 in our reports of 25 February 2009, 27 March 2009 and 15 May 2009. We downgraded the company to a Hold rating on 11 August 2009, which we maintained in our reviews of 30 September 2009 and 24 November 2009. We placed our Hold rating under review on 5 February 2010, and downgraded the stock to a Sell on 10 February 2010. We upgraded Guinness Nigeria plc to a Hold on 13 May 2010, a rating we maintained on 26 May 2010, 6 September 2010, 27 September 2010, 29 November 2010, 18 January 2011 and 25 January 2011. We downgraded to a Sell on 3 March 2011, a rating we maintained on 12 May 2011, 7 June 2011 and 20 June 2011, 12 September 2011. We upgraded the stock to a Hold on 24 September 2011, a rating we maintained on 11 October 2011. We upgraded the stock to a Buy on 13 October 2011, a rating we maintained on 11 November 2011, 5 December 2011, and 12 December 2011.



Risks to our Forecasts

First Bank plc

Risks to our valuation are; 1.) In our view, the Sea Wolf loan remains a key risk to First Bank’s earnings outlook given its high concentration in its loan book. Even though the loan is still classified as a performing project finance loan based on the new prudential guidelines, First Bank might have no choice but to take a haircut on the value of the loan if it is forced to sell the loan in order to manage concentration risk.

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Zenith Bank plc

Risks to our valuation are: In our view, continued focus on low risk assets will keep Zenith Bank’s net interest margins lower than its peers. Zenith continues to focus on the high end of the credit curve where yields are lower than the commercial and retail clients.

Valuation methodology

See text body in report.

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