SECURITIES AND EXCHANGE COMMISSION NIGERIA

Can Companies' Fundamentals Justify Current High Growth of Nigerian Stocks?

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The Nigerian stock market has drawn attention recently as one of the fastest growing markets in the world. At the end of July 2017, the All Share Index (ASI) has grown by 34.67% year-to-date (YtD) and 27.97% year-on-year (YoY) while the market capitalization grew by 34.89% YtD and 28.30% YoY. It should be recalled that this impressive growth became pronounced from May, 2017 since negative growth of -3.22% YtD was recorded up till April, 2017. Many have wondered if this is 'too good to be true' and others have cautioned on the likely build-up of new bubbles in the market. A question that is worth asking therefore is: '***can the growth in the fundamentals of Nigerian companies really justify the current stock market performance?'*** This is what this edition of OCE Policy Brief seeks to answer.

1. Recent Growth

Figure 1 shows the trends of the ASI between January 2016 and July 2017. The sharp increase in performance after April, 2017 is evident in the figure. The ASI closed January, 2017 at 26,036.24 points and fell to 25,758.51 points in April. It however rose to 35,855 points at the end of July, 2017. Likewise, the equities market capitalisation rose from N8.97trn to N12.35trn in the same period. Table 1 presents further details on the YtD and YoY performance of the ASI in this period.

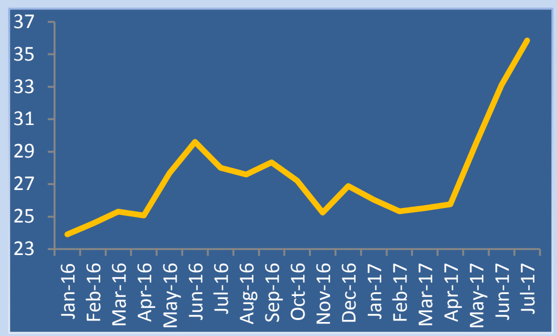

Figure 1: All Share Index (ASI'000)

Source: NSE, SEC

2. What Factors Drive this Growth?

There are various factors that can explain the recent growth in the Nigerian equities market and these drivers were identified in a previous OCE Policy Brief of June 2017. They include:

a) improved global growth,
b) low interest rate in many developed countries,
c) declining inflation rate,
d) relative stability in crude oil price,
e) the e-dividend scheme alongside other initiatives to boost investors' confidence,
f) improved results of quoted companies
g) CBN intervention in the foreign exchange market.

As identified in the June edition of the Policy Brief, the major determinant of this rapid growth in the market is the Investors' and Exporters' FX Window (IEFW) introduced by CBN in April, 2017. This programme has restored the confidence of foreign investors in the Nigerian capital market leading to an increase in foreigner's participation. Table 2 provides further evidence on the flow and distribution of transactions by foreign and domestic investors on the NSE.

Table 1: ASI Growth (end of month values)

Month	Equities Cap. (N'trn)	ASI	YtD (%)	YoY(%)
Jan-2016	8.23	23,916.15	-15.70	-19.10
Feb-2016	8.46	24,570.73	-13.39	-18.38
Mar-2016	8.71	25,306.22	-10.80	-20.28
Apr-2016	8.63	25,062.41	-11.66	-27.79
May-2016	9.51	27,663.16	-2.49	-19.37
Jun-2016	10.17	29,597.79	4.33	-11.53
Jul-2016	9.63	28,009.93	-1.27	-7.19
Aug-2016	9.49	27,599.03	-2.72	-7.03
Sep-2016	9.73	28,335.40	-0.12	-9.23
Oct-2016	9.36	27,220.09	-4.05	-6.71
Nov-2016	8.69	25,241.63	-11.03	-7.83
Dec-2016	9.26	26,874.62	-5.27	-6.17
Jan-2017	8.97	26,036.24	-2.18	8.86
Feb-2017	8.77	25,329.08	-4.84	3.09
Mar-2017	8.84	25,516.34	-4.13	0.83
Apr-2017	8.91	25,758.51	-3.22	2.78
May-2017	10.20	29,498.31	10.83	6.63
Jun-2017	11.46	33,117.48	24.42	11.89
Jul-2017	12.35	35,844.00	34.67	27.97

Source: NSE, SEC

The table shows a sharp increase in total transactions between April and May from N54.9bn to N205.6bn, an increase of 274.5%. A major driver of this is foreign transaction which rose by 324%. While foreign inflow increased by 403.1%, outflow rose at a lower rate of 178.6%. This led to a positive inflow of foreign capital and increase in the share of foreigner transactions from 40.9% to 46.3%. Also, transactions by domestic investors rose from N32.5bn in April to N110.4bn in May, rising by 240.3%. Investment by domestic institutions rose by 272.3% and domestic retail by 199.1%.

For the first half of 2017, table 3 also puts the cumulative total transactions at N935.26bn as against N624.41bn in the corresponding period of 2016; an increase of 49.8%. It is shown that foreign investment rose 59.8% and domestic investment 42.2%. While investment by domestic institutions rose 75.6%, that of domestic retail investors rose 5.4% in the first half year 2017 compared to the corresponding period in 2016. This depicts domestic institutional investors as almost equally taking advantage of the growth in the market along with foreign investors while domestic retail investors are less responsive.

3. Fundamentals and Stock Prices

Fundamentals are expected to influence stock market behaviour; and there is evidence to support the existence of equilibrating forces boosting or dampening the performance of the stock market during deviations from these fundamentals. There are company-specific and non-company-specific fundamentals. While the former include factors such as a company's management, governance and financial performance, the later comprises the general macroeconomic and industrial environments in which a company operates.

These factors, coupled with investors' sentiments and psychology, determine the trend of the stock market. There are many phases of such trends which are briefly explained below:

a) ***Bear market:*** *This occurs when a stock market sustains a loss of 20% and above; lasting for a period of more than two months. In this situation, investors believe prices will continue to fall; usually during economic contraction/recession*

b) ***Bear Rally:*** *Less than 20% gain usually during a bear market. The gains are often temporary lasting for few days or weeks. Investors may misinterpret a rally as the beginning of a bear trend.*

c) ***Bull market:*** *When a market gains over 20% during a period of more than 2 months. In this case, investors believe prices will continue to grow*

d) ***Correction:*** *This entails a maximum loss of 10% often to adjust for overvaluation during a bullish trend. It is usually temporary, lasting for less than 2 months.*

e) ***Bubble:*** *Consistent increase in prices by over 50% within a period of time preceding the bubble crash. Asset prices grow faster than their fundamental value usually due to low interest rate, economic expansion and irrational exuberance displayed by investors*

f) ***Crash:*** *A situation of at least 10% decline in stock prices in a single day, lasting for several days. It is a sudden occurrence leading to large wealth loss usually caused by public panic*

3.1. Macroeconomic Fundamentals

Table 3 shows some selected macroeconomic fundamentals vis-à-vis the behaviour of the ASI between January, 2014 and June, 2017. It is observed that in 2014, the difference between the interbank exchange rate and Bureau-de-Change (BDC) was small, inflation rate was single digit at around 8% and the Treasury bill (TB) rate was around 10%. This period can be described as one of relative stability and the ASI was around 40,000 points.

During the 2015/2016 period, the difference between the two exchange rates became more pronounced and inflation rate crept up to double digit. Although the TB rate fell at a period, it gradually rose again to close 2016 at 14%. This is also a period of gradual fall in the ASI to below the 30,000 points.

Table 2: Analysis of Transactions for the Period Ended 30 June 2017.

Period	Total (N'b)	Foreign (N'b)	Foreign (%)	Domestic (N'b)	Domestic (%)	Foreign Inflow (N'b)	Foreign Outflow (N'b)	Domestic Retail (N'b)	Domestic Institutional (N'b)
Jan 2017	95.32	44.01	46.17	51.31	53.83	22.61	21.40	20.12	31.19
Feb 2017	74.11	34.54	46.61	39.57	53.39	16.10	18.44	15.22	24.35
Mar 2017	285.05	132.51	46.49	152.54	53.51	23.64	108.87	23.77	128.77
Apr 2017	***54.90***	***22.45***	***40.89***	***32.45***	***59.11***	***14.54***	***7.91***	***14.20***	***18.25***
May 2017	***205.61***	***95.19***	***46.30***	***110.42***	***53.70***	***73.15***	***22.04***	***42.47***	***67.95***
Jun 2017	220.27	101.53	46.09	118.74	53.91	65.93	35.60	62.40	56.34
2017 YTD	***935.26***	***430.23***	***46.00***	***505.03***	***54.00***	***215.97***	***214.26***	***178.18***	***326.85***
2016 YTD	***624.41***	***269.22***	***43.12***	***355.19***	***56.88***	***121.29***	***147.92***	***169.03***	***186.16***
Growth-% (Apr–May)	**274.52**	**324.01**	**5.41**	**240.28**	**-5.41**	**403.09**	**178.63**	**199.08**	**272.33**
Growth-% (2016–2017)	**49.78**	**59.81**	**2.88**	**42.19**	**-2.88**	**78.06**	**44.85**	**5.41**	**75.57**

Source: NSE, SEC

However, mid-year 2017, the gap between the exchange rates is beginning to narrow and inflation falling. This now corresponds to the period of the recent growth in the Nigerian stock market as shown in the value of the ASI rising from 26,036.2 in January, 2017 to 33,117.5 in June 2017.

The foregoing suggests that the Nigerian stock market responds to macroeconomic fundamentals; especially foreign exchange rate, its availability and management, inflation rate and rates of fixed income instruments like the TBs.

Table 3: Selected Macro Fundamentals

Period	NSE ASI	Interbank Ex-rt ($/N)	BDC Ex-rt ($/N)	Inflation (%)	TB Rate (%)
Jan-14	40,571.6	160.23	171.71	7.98	10.8
Jun-14	42,482.5	162.82	167.17	8.17	10.0
Dec-14	34,657.2	180.33	188.45	7.98	10.8
Jan-15	29,562.1	181.78	196.13	8.16	11.2
Jun-15	33,456.8	196.92	218.98	9.17	10.0
Dec-15	28,642.3	196.99	258.30	9.55	4.6
Jan-16	23,916.2	197.00	289.78	9.62	4.1
Jun-16	29,597.8	231.76	351.82	16.48	8.3
Dec-16	26,874.6	305.22	455.26	18.55	14.0
Jan-17	26,036.2	305.20	493.29	18.72	14.0
Jun-17	33,117.5	305.72	366.25	16.10	13.5

CBN, NSE, SEC

3.2. Companies' Fundamentals

Companies' fundamentals include the revenue, earnings and price-earnings ratio. Table 4 presents the distribution and growth of the companies' earnings (profit after tax) for the second quarter of 2017. The last row of the table shows that generally, the average PAT in the market was N2.48bn and this represents an increase of 46.11% over the Q2'2016 (YoY) and 45.3% over Q1'2016 (QoQ).

This growth was spurred by the increase in sectors like Other financial services, Consumer goods, Industrial goods, Agriculture and Insurance which grew by 416.31%, 284.42%, 218.06%, 119.29% and 45.76% year-on-year respectively. Quarter-on-quarter, sectors like Oil and Gas, Services, ICT and Industrial goods accounted majorly for the average PAT growth as they increased by 15,232.22%, 530.52%, 357.2%, 285.1% and 169.72% respectively.

Table 4: Average Profit after Tax (PAT) Per Sector (N'm)

Sectors	2016:Q2	2017:Q1	2017:Q2	Y-o-Y	Q-o-Q
Agriculture	1,297.74	1,721.61	2,845.80	**119.29**	**65.30**
Conglomerates	(1,692.56)	855.32	785.33	(146.40)	(8.18)
Construction/Real Estate	59.19	(531.97)	(845.41)	(1,528.25)	**58.92**
Consumer Goods	1,617.79	1,614.90	6,219.04	**284.42**	**285.10**
Financial Services: Banking	19,956.14	11,602.30	4,388.80	(78.01)	(62.17)
Financial Services: Insurance	430.07	323.90	626.89	**45.76**	**93.55**
Financial Services: Others	144.95	395.81	748.39	**416.31**	**89.08**
Healthcare	(510.19)	42.96	46.82	(109.18)	**8.98**
ICT	129.04	10.66	48.72	(62.24)	**357.20**
Industrial Goods	5,197.40	6,128.88	16,530.70	**218.06**	**169.72**
Natural Resources	(56.53)	(31.71)	56.95	(200.73)	(279.62)
Oil and Gas	(4,330.73)	3.88	595.51	(113.75)	**15,232.2**
Services	(212.64)	22.26	140.38	(166.02)	**530.52**
Total Market	**1,694.59**	**1,704.52**	**2,475.99**	**46.11**	**45.26**

Source: Listed Companies Financials, SEC

Implications

This Policy Brief shows that the current bullish trend in the Nigerian stock market can be justified by both company-specific and macroeconomic fundamentals. The major macroeconomic factors are foreign exchange rate stability, lower inflation rate and fixed income rate. These factors affect the participation of foreign investors in the market, the perception of uncertainty in the economy and substitutability of fixed income products for equities. Macroeconomic fundamentals also affect the company-specific fundamentals in terms of ability of companies to obtain foreign exchange for importation of inputs and the purchasing power of the citizens; ultimately affecting companies' profitability.

Hence, the efforts of the CBN at constantly intervening in the foreign exchange market and the introduction of the Investors' and Exporters' FX Window (IEFW) appear beneficial to the market. As the economy finally exits recession and the stability in the forex market is sustained, there is the likelihood that the stock market will gradually approach the level seen in the early 2014 and then maintains a moderate and sustained growth level.

Therefore, the stock market is currently responding to companies' fundamentals which in turn are responding to macroeconomic fundamentals. It is critical that the country should continue to strive at improving its macroeconomic fundamentals and the capital market regulator should maintain its current efforts at working with other stakeholders to grow the market. Efforts should be made to ensure that information flows much freely in this time of growth while attempts to inefficiently exploit the market should be discouraged as these may cause unnecessary panic.