MARKETFOCUS

NIGERIA

Ranked 30th in the world in terms of purchasing power parity-measured GDP, and the second largest economy in sub-Saharan Africa, Nigeria is one of the most preferred investment destinations in the continent

BY ANNA LYUDVIG

UNVEILED POTENTIAL

Nigeria's long term-aspiration, outlined in the government's policy framework, is to be among the top 20 economies in the world by 2020. Whereas some believe this is unlikely to happen before 2050, others have had the country on their radar for a while: Goldman Sachs included Nigeria in its "Next 11" economies as far back as 2005. Whatever the timescale, however, few doubt the country's potential to become a major player in the global economy.

Investment sentiment towards Nigeria has improved significantly over the past five to 10 years, as positive structural changes in the governance of companies and in the stock market have accompanied encouraging signs in the underlying economy.

"Nigeria is a country we have been interested in for quite a while. This is a country with pretty significant growth potential," comments Alex Ashby, research analyst at Global X funds, a New York-based provider of exchange-traded funds (ETFs), which has recently launched the Nigeria ETF.

"People view Nigeria as an oil-and-gas type of play, and as they are looking at other ways to invest in energy, it is something that has been considered. But I think Nigeria shows up on people's radars also because of the favourable demographics and the growing middle class," he says.

Mark Mobius, executive chairman at Templeton Emerging Markets Group, is also bullish on Nigeria, saying that the most compelling reason to invest in frontier markets such as Nigeria is their long-term growth potential. "Sources of growth can evolve in a positive way. We have seen many businesses doing well there as the country appears to be forging ahead. We currently plan to continue to look for opportunities in Nigeria," he says.

However, the hype surrounding Nigeria's equity market has not been supported by material investment inflows, says Greg Barker, director of research at Sustainable Capital.

"There has been much talk and very little action on the part of international investors. Based on the current allocations to Nigeria from international investors, it seems probable that these investors will need to realign their portfolios to incorporate greater weightings to Nigeria in the future. Even so, we continue to believe that it is domestic institutional investors such as Nigerian pension funds that will be the meaningful buyers of Nigerian equities at the margin over the next two to three years."

Getting the right exposure

Most funds which invest in Africa have some sort of exposure to Nigeria. However, there are only a handful of country-focused products currently on offer.

One of these, offering 100% equity exposure, is the Sustainable Capital Nigeria Fund, a $11.2m long-only, 15-stock Nigerian equity portfolio diversified across sectors and companies. The fund has returned 58.3% in USD (net of trading costs) since its inception in May 2012, while the Nigeria all-share index has returned 52.6% over the same period and the S&P Select Nigeria index has gained 65.7%.

Despite the fund's overweight in the banking sector (59.7%) and beverages (17.1%), Barker points out that the sector allocation is purely the outcome of the stock selection process. "The opportunities that we see are really just stock-specific investment decisions where our research leads us to believe that we can secure above-normal returns for our investors on a risk-adjusted basis," he says.

A more varied mix of asset classes can be achieved through the $9.7m Imara Nigeria Fund, managed by Imara Group, which can purchase not only listed equities, but also government and corporate debt. Another option along similar lines is the Stanbic IBTC Nigerian Equity Fund, which invests a minimum of 75% of its assets in equities of blue chip companies listed on the NSE, while retaining a maximum of 25% of its total assets in fixed income securities. Launched in 1997, the fund has outperformed the All Share index of the Nigerian Stock Exchange (NSE) in eight out of the last 11 years of operation and remains the country's largest open-ended mutual fund.

On the fixed income side, investors might opt for the Nigeria International Debt Fund (NIDF), an open-ended fund with assets just above NGN2bn ($8.2m). Established in 1997 by Afrinvest, the NIDF was created as a closed-end fund, but followed a restructuring process in 2009 to diversify risk and bring greater value to a wider range of investors, says Emmanuel Ikpo, associate at Afrinvest West Africa.

"We have more than 60 investors. Obviously, anyone can invest, but as the minimum investment amount is quite high, we aim at corporates, pension funds and high-net-worth individuals. Investors can be based anywhere in the world," he says.

The NIDF is particularly suited for pension fund administrators as it is in line with the National Pension Commission's investment guidelines and invests in both domestic and international debt obligations of the federal government of Nigeria. "We do not have any corporate bonds in the portfolio; we have typical government bonds and money market investments because of liquidity. The fund is regulated by trustees, allowing us to invest 20% to money markets to accommodate our financial obligations," explains Ikpo.

"When choosing the bonds to invest in, we look at bond yields, coupon rates and maturity dates. We tend to look for bonds with good high coupon rates. It is a really big factor for us, as we have a benchmark to beat, which is 2% above the five-year bond."

Finally, those investors preferring passive investments can plump for Global X's Nigeria ETF, which tracks the Solactive Nigeria Index, a free-float market capitalisation index comprising

NIGERIA NATIONAL STATISTICS

Source: Trading Economics

	Last	Date
Markets		
Government bond 10Y	11.38%	Apr 2013
Stock market (NSE 30)	1580.97	Apr 2013
GDP		
GDP growth rate	6.99%	Dec 2012
GDP per capita	$565.99	Dec 2011
Labour		
Population	162.47m	Dec 2011
Unemployment rate	23.9%	Dec 2011
Prices		
Consumer price index	141.9	Jan 2013
Inflation rate	8.6%	Mar 2013
Government		
Debt to GDP	18.3%	Dec 2012
S&P credit rating	BB+/Stable	Nov 2012

28 companies. "Some people prefer the passive management side because it is rule-based and it is not dependent on the performance of a fund manager," says Ashby. "Investors in ETFs can see on a daily basis all the holdings and percentage allocation to each company that is in the fund. There is also some cost effectiveness, tax efficiency and cost benefits compared to a similar mutual fund," he says.

The product is listed on the New-York Stock Exchange (NYSE) and is aimed at US investors, but potentially anyone who has access to funds listed on the NYSE can invest. While the oil & gas sector is a big part of the Nigerian economy, it is not well represented on the NSE, so the ETF is currently more heavily weighted towards financial companies (41.3%).

Opportunities, challenges, risks

The financial sector and banks in particular is where managers see the most value to be made: they tend to believe that high-quality commercial banks continue to trade at discounts to their fair values, despite excellent long-term growth prospects and dramatic improvements in asset quality. "Based on their financial fundamentals, certain Nigerian Banks continue to trade at levels that indicate chronic mis-pricings," explains Barker.

He says that a common investment mistake is underestimating the extent of pricing power gains and profitability improvements that can materialise when an industry consolidates – one example being Nigerian Banking, which has undergone a major restructuring and benefited as a result.

For Mobius, the reformed banking system in the country has provided an attractive means to invest. However, he also points to "industries and sectors tied to the rising power of the consumer". "Consumers are gaining clout, and they are embracing new products and services. Food and beverage companies have also piqued our interest. There is a growing middle class in Africa, with evolving tastes," he says.

For Ashby, Nigeria is not without frontier market risk, but that risk comes with a lot of potential upside. "As the government tries to privatise certain industries and companies, there will be a greater representation of different sectors available in the short term," he says.

In particular, Ashby outlines reforms in the power sector as a positive development. "If the competitiveness in that sector can be improved, not only will there be potential investment opportunities, but more effective power sector will benefit other industries such as manufacturing," he says.

Gary van Staden, senior political analyst at NKC Independent Economists, shares similar views, saying that the privatisation of the power sector in Nigeria "opens a series of new opportunities for fund managers to examine prospects not only in the power sector but in the economy as a whole".

"Nigeria is clearly on the pathway to deregulation and significantly greater market and private sector involvement. Opportunity knocks; there is little doubt about that," he says.

Almost all of the sectors of Nigeria's economy are still undermined by the lack of basic infrastructure, such as electricity shortages, and the poor state of transport and communications. "Nigeria, however, has tremendous potential for the development of infrastructure and, indeed, it certainly is one of the current administration's foremost priorities to do so," says Thalma Corbett, head of research at NKC Independent Economists.

Among infrastructure projects, power generation stands central. In tandem with government spending, the government is also encouraging and implementing public-private partnership (PPP) schemes as a means of financing infrastructure projects. "This policy has started to pay off in certain sectors, but challenges remain," she adds.

Anna Rosenberg, senior analyst for Sub-Saharan Africa at Frontier Strategy Group, agrees, saying that a lot is being done to address infrastructure challenges and high levels of corruption. However, she points to the "growing security challenges on the back of the country's acute social disadvantages and widening wealth gap".

"The government allocated the lion's share of this year's budget to security, indicating that tackling security challenges is a key priority. However, we are seeing that violence is increasing as badly managed security forces crack down brutally on dissent," she says.

Nigeria has an ongoing problem with the civil unrest in the north, adds Mobius. However, most of that risk has been discounted by the market. "Otherwise, the country has a vibrant democratic structure but the challenge of unemployment and inflation can be sources of civil unrest. We must watch that carefully even though currently it is not a major problem," he says.

Whereas corruption is a problem found in nearly all markets, it can be magnified in those markets where power and resources are concentrated in the hands of a few and penalties are not uniformly enforced. "The good news, from my perspective, is that today corruption is openly discussed, which is a good first step toward achieving a more fair and equitable system," adds Mobius.

In regards to political risk, Barker says that in the medium-term the Nigerian election cycle will inevitably introduce succession risk. "We still have some runway in terms of timing before that political process unfolds, during which time Nigerian companies are getting down to business."

"We prefer to spend our time figuring out how political risk scenarios affect specific industries and companies. Ethical companies that are apolitical and do not gain or maintain their licence to operate from political affiliations tend to emerge relatively unscathed from political risk events. In contrast, corrupt companies who benefit from artificial benefits such as subsidies or political favours are highly exposed to political risk." ■