

## Learning to Love Lagos?

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*“The art of being wise is the art of knowing what to overlook”*

William James, *The Principles of Psychology*,  
Chapter 22, 1890

After a ten hour night flight from Atlanta, I drew some water in my hotel sink to shave. I glanced at the water and thought of the “toilet to tap” programs at home in California where water is in short supply. Generally, however, they involve a water purification process between the toilet and the tap.

Having limited options in Lagos, I resolved to keep my mouth shut in the shower and to brush my teeth with bottled water.

On the second afternoon at the Standard Bank



conference in Lagos, however, I was suffering jet lag and desperate for something other than stale hotel coffee. I reached in my bag and pulled out a fresh pack of Starbucks Via Instant Caramel Coffee. Pouring hot water from a pitcher in the conference room, I saw that it was the same color as the tap water – but I shook in the Starbucks powder and drank it anyway. Perhaps it had been boiled.

Nigeria has problems beyond its dubious tap water:

- 1). The country has struggled with the 50% drop in oil prices in mid-2015. It has been described as a large oil company with a small economy attached, and while the curse of black gold fed eye-watering levels of corruption, it also funded 90% of the government’s budget.

2) Boko Haram has committed atrocities including kidnapping schoolgirls in the northeast states of Borno and Yobe in the name of Islamic extremists.

3) The Niger Avengers in the Delta have been blowing up oil installations and brewing their own petroleum products in homemade refineries using open bonfires in the bush.

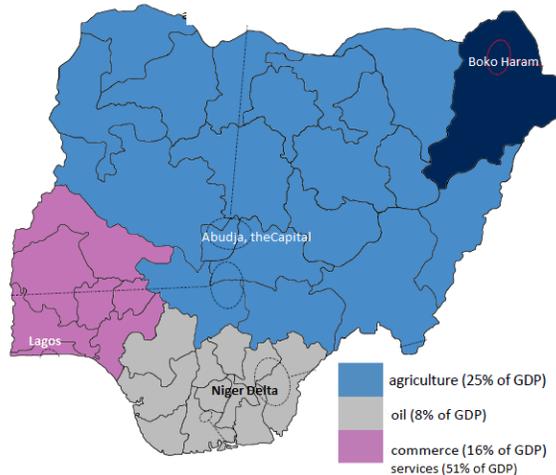
4) Nomadic Fulani herdsmen in the middle agricultural belt have turned to violence against Christian communities to protect their herds and way of life.

In addition, Nigeria has some self-inflicted challenges:

President Maj. Gen. (ret.) Muhammadu BUHARI (since 29 May 2015) was elected on a reform platform, but earned the nickname of “Baba-goslow” because he was slow to pull together his policymaking team and even slower to implement anti-corruption reforms. In addition, he suffered from health issues that kept him in London for much of 2017.

On the monetary front, things have been murky for some time. In 2008, the nation’s banks imploded because of a bubble in margin lending to their own employees to speculate in bank stocks. Finally, Lamido Sanusi, the Central Bank Governor, cleaned house and imprisoned a score of bankers - which delivered a strong message. However, after he audited the national oil company and found \$20 billion missing, he was expelled by politicians who couldn’t stand the heat. They replaced him with Godwin Emefiele, from Zenith Bank, who has

been inert and resisted an open foreign exchange market.



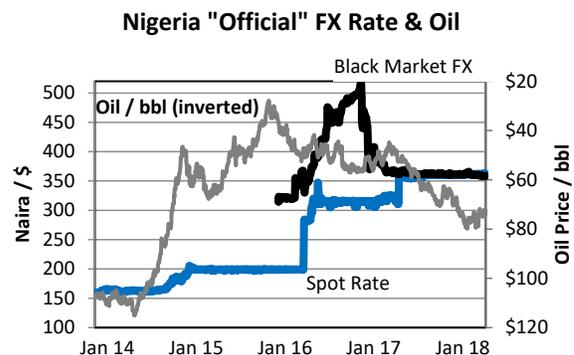
Source: “Nigeria – A Rising Tide,” Cardinal Stone, March 2018

This has been reflected in the behavior of the currency relative to oil prices as shown in the Naira versus oil chart below. Oil prices plunged in 2014, yet instead of allowing the currency to float, it was frozen at an artificially high rate, stalling the economy by cutting FX

availability to purchase needed imports of raw materials and even finished goods such as toothpaste.

Only in late 2016, did the Central Bank budge and then only to an official rate of 310 while the black market rose as high as 500 Naira / USD.

Finally, while maintaining the “official” rate, the Central Bank created a Nigerian Autonomous Foreign Exchange Fixing (NAFEX), which became the de-facto FX rate, which has settled out around 360.



Source: Bloomberg

## The Macro Picture

To put things in perspective, here is economic data for Nigeria, compared to some representative developing countries:

	Nigeria 2017	Peer Average	Bangladesh 2017	Pakistan 2017	South Africa 2017	India 2017
GDP Growth	-1.6%	5.0%	7.1%	5.5%	0.3%	7.1%
GDP/ Cap (PPP)	\$5,861	\$7,146	\$3,580	\$5,235	\$13,197	\$6,571
Population (mil)	186	434	163	193	56	1,324
% Literate Female	41%	67%	70%	44%	93%	59%
% Literate Ages 15-24	66%	88%	92%	73%	99%	86%
% Under Age 15	44%	30%	29%	35%	29%	28%
% Child Labor (7-14)	35%	7%	5%	13%	NA	2%
Infant Mortality , 5 yrs/1,000	104	50	34	79	43	43
% Urban	49%	43%	35%	39%	65%	33%
% Banking Penetration	40%	55%	50%	21%	69%	80%
% Drinking Water	67%	90%	97%	89%	85%	88%
% Safe Drinking Water	19%	46%	56%	36%	NA	NA
Electricity %	59%	86%	76%	99%	84%	85%
Electricity/Cap kWh	144	1,446	310	471	4,198	806
Gini Ratio	43	40	32	31	63	35
Market Cap (\$ bil)	\$37	\$935	\$86	\$92	\$1,231	\$2,332
Economic Freedom (13-18)	59	57	55	54	63	55
Ease Doing Business (14-18)	52	55	41	52	65	61
Corruption (Transparency Intl)	27	36	28	32	43	40

*Source: World Bank WDI database, 2018*

Many of Nigeria's weaknesses are glaringly evident in the table. The green cells show where the country ranks better than its peers and the violet colored cells show where it is poorer.

Female literacy, for example, is only 41% versus the peer average of 67%. And literacy of 15-24 year olds is higher at 66% but still below the others.

Child labor (ages 7-14) is reported at 35%, much higher than the others (assuming their figures are accurate).

Only 19% of the population has access to safe drinking water versus 46%, on average, among peers. Only 59% have electricity versus 86% among peers.

The Gini ratio, a measure of statistical dispersion intended to represent the income distribution of a nation's residents, is 43 versus

the peer average of 40, reflecting the fact that the wealthy upper class in Nigeria has a bigger share of the pie (by comparison, the Gini ratio is 21 in Sweden, 42 in the US and 51 in Brazil).

Nigeria's Corruption Perceptions Index rank from Transparency International is worse than its peers and hasn't budged in five years. On the other hand, Jay Ireland, CEO of GE Africa, has said that, from his perspective, corruption in Nigeria has improved.<sup>1</sup>

Worst of all, however, is infant mortality - an appalling 104 babies die in their first five years out of 1,000 live births, compared with 34 in Bangladesh and 22 in Vietnam. While Nigeria has improved from 245 deaths / 1,000 in 1975 to 104, Bangladesh has gone from 217 to 34, while India is down from 194 to 43.

On the positive side, Economic Freedom in

<sup>1</sup> Doing Business in Africa – a View from GE, 20-20 Investment Association, April 24, 2018

Nigeria, measured by The Heritage Foundation, is better than the others at 59 versus 57. This is a composite of factors including rule of law, government, regulation and open markets. Nigeria's score has improved 6% over the past five years, while it has fallen in Pakistan and India.

Also the World Bank measure of the "Ease of Doing Business" for Nigeria has improved 8% over four years while it has dropped in Bangladesh and Pakistan.

### On the Ground

Four hours on jammed roads and four hours in the Lagos Free Trade Zone, provide an immersion in both the obstacles and the opportunities of Nigeria. The picture of a battered cement truck and a young worker on a rubble-strewn road is typical.

Hundreds of heavy trucks are underway at last to fulfill the ten-year old vision of the Zone and artificial harbor in Lekki, 60 km east of Lagos. It is being built by Tolaram, an Indonesian conglomerate, with help from a Shanghai port operator and tons of Dangote cement.

The spotless Kellogg cereal plant in the Lagos Free Trade Zone was completed in only 11 months for \$30 million and will sell \$30 million of cereal in its first year. A snack bag of cornflakes costs only 50 Naira (less than 20 cents) and is a hit with schoolkids.

Nearby, in the Lekki Free Zone, Aliko Dangote, Nigeria's richest man, is building a much needed oil refinery, with capacity for 650,000 barrels a day at a cost of \$12

billion.<sup>2</sup> This will receive a third of Nigeria's oil output and lead to self-sufficiency in refined products beginning in 2020. If successful, this will end the import burden of refined products and eliminate the costs added by importers and dealers.

Meanwhile, the landscape of Lagos is being changed by the ambitious EKO Atlantic project (EKO is the tribal name for Lagos) where luxury apartments, office towers and a shopping mall will be built on a vast tract of reclaimed

land. It is a bit reminiscent of the man-made islands in Dubai and Abu Dhabi.

In addition to the infrastructure reforms, there are important governmental reforms underway. One is the "Voluntary Assets & Income Declaration Scheme (VAIDS)", which is designed to expand Nigeria's abysmally low tax base and provide more funds for government support to

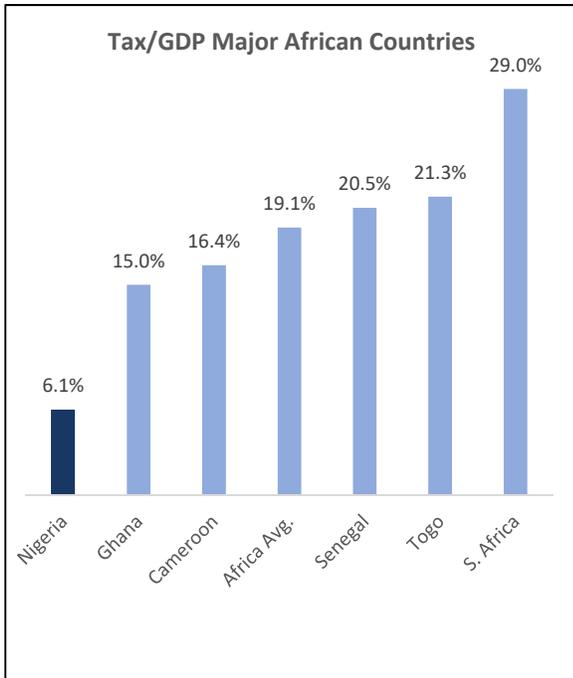


Lekki, Nigeria, Photo Larry Speidell



EKO Atlantic project from the rooftop bar of the EKO Hotel Lagos, Nigeria, Photo Larry Speidell

<sup>2</sup> Nigerian economy: Why Lagos works - FT, March 24, 2018



Peer Comparison of Tax Data		
Tax Data	Nigeria	South Africa
Population (2016)	182.2M	55.6M
Labor Force (2016)	79.9M	21.8M
Unemployment	13.9%	26.6%
Registered taxpayers	14M	19M
Top taxpayers (\$28k or more)	943	950,000
Total tax revenue	\$16.7B	\$75B
Personal income tax revenue (2016)	\$2.2B	\$26.9B
Tax to GDP ratio	6%	263.2%
Personal income tax to GDP ratio	0.8%	9.5%
Ease of paying tax ranking (2017)	182/190	51/190

Source: "Nigeria – A Rising Tide," Cardinal Stone, March 2018

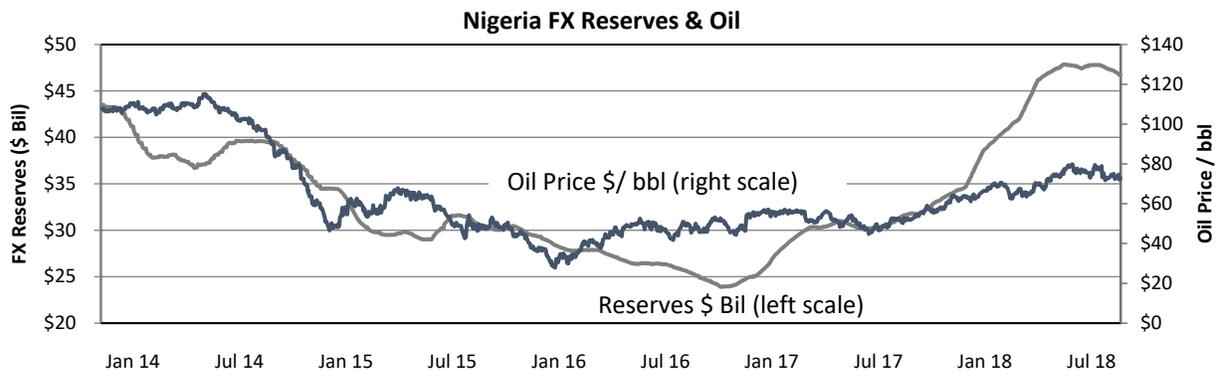
the economy.

According to the Minister of Finance, Mrs. Kemi Adeosun, "VAIDS is a very simple formula. It takes you through a process where you look at your assets and your lifestyle, and if there is a disconnect, that means your tax status is irregular."

As shown in the table above, there are presently only 14 million taxpayers out of a labor force of 80 million. And only 943 individuals pay more than \$28,000 in tax.

Through the VAIDS campaign, the government raised N30 billion (\$83 million) from more than 262 Nigerians before the amnesty program ended in June.

Another positive is the recovery in Nigeria's foreign exchange reserves on the back of the modest recovery in oil prices and a reduction in imports. FX reserves are up 54% in a year and 94% since the low in September 2016, suggesting the country has the financial resources to maintain currency stability.<sup>3</sup>



Source: Bloomberg

<sup>3</sup> "War chest? (Nigeria), Investec, April 11, 2018

## Conclusion

*"I was lookin' for love in all the wrong places"*

– Looking for Love, Johnny Lee, 1980

Nigeria has a long way to go, but it has been through a lot.

As for investment opportunities, the Nigeria Stock Exchange has a long list of many liquid companies across the consumer, industrial and financial sectors, and I met with 14 of them on this trip.

Unfortunately, many consumer companies are expensive based on their estimated Price Earnings (PE) ratios: Unilever 34x, Guinness 34x and Nestle 34x. Meanwhile, PEs of cement companies are pricing in a bonanza: Dangote Cement 18x and Lafarge Africa (cement) 18x. And cheaper conglomerates like Flour Mills and Forte Oil are bent on doing a little bit of everything but not very well – more focus would help.

In the banking sector, the 50% Naira devaluation ballooned the USD loan books in local currency terms, increasing loan/deposit ratios to nosebleed levels. Even now, there is further risk to the capital structures of some banks because of the artificial FX rate they are using. Only recently did the Central Bank of Nigeria (CBN) tell banks to use a Naira/USD rate of 331 rather than the "official" 310. When they

eventually go to the "real" NAFEX rate of 360, they will take a further hit. Despite this, we believe that some of the better banks, at PE ratios of 6x to 9x, have good opportunities to grow, especially since banking penetration is only 40%, compared with 50% in Bangladesh and 80% in India.



*On the road in Lekki, Photo Larry Speidell*

More than ten years ago, Goldman Sachs introduced the concept of the Next Eleven (N-11)<sup>4</sup> to identify countries that could have a "BRIC-like"<sup>5</sup> impact on the world. The eleven are Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam. Over the past

thirteen years, each of these countries has experienced political and economic upheavals, but they remain contenders in the global economy. Among the current frontier countries of Bangladesh, Nigeria and Vietnam, Nigeria has a functioning democracy while the others do not, and Nigeria is the cheapest.

But like the tap water in Lagos, our crystal ball is murky.

Lagos is dirty and scrappy, with an energy and attitude that I have to admit I have come to love. I believe the city's 20 million people are the ones who will drive the whole country forward. The road will be bumpy, but Nigeria is on the right road at last.

<sup>4</sup> Goldman Sachs, Global Economics Paper No:153, The N-11: More than an Acronym, March 2007

<sup>5</sup> BRIC countries are Brazil, Russia, India and China

## About Frontier Global Partners

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