

## Investing in Nigeria: Discipline is key

By Rami Hajjar 5 May 2021

The end of quarter one 2021 marks one year since markets bottomed following the Covid-19 global outbreak. Most major equity indices had fallen between 20% and 30% in US dollar terms, and the African markets were not spared the wrath. The mood was so dire back then that it required a strong degree of discipline to look through the noise and focus on the long-term picture.



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A commitment to a disciplined, long-term-oriented investment strategy is key in times like these. Our approach to the Nigerian stocks we own is a good example. As Covid-19 struck and the oil price collapsed, the share prices of our main holdings, particularly the banks, halved in Nigerian naira terms. The correlation between Nigeria's stock returns and the oil price is very high, and it is worth highlighting the reason: Besides being a large direct contributor to economic activity, oil represents nearly two-thirds of government revenue and almost 90% of Nigeria's foreign exchange income. Close to 50% of banks' loan books are exposed to oil (directly or through funding the supply chain). Furthermore, a high oil price increases the supply of foreign exchange, supporting the sustainability of other non-oil sectors that rely on imports to operate, and also prevents the currency from blowing out.

## Investors dismissed Nigeria investment case

As the oil price collapsed to a multi-year low, many investors dismissed the Nigeria investment case, causing the share prices of Nigerian stocks, and banks in particular, to collapse. Guaranty Bank, which is generally regarded as the highest-quality Nigerian bank, was trading at 2.5 times price-to-earnings (PE) ratio and 0.8 times book value at some point versus a 10-year average of 6.7 times PE and 1.9 times book value – a distressed valuation. Our outlook was based on a normal oil price of at least \$55 per barrel, which meant that our valuations for the banks were much higher than what the market was pricing in. This thesis has played out: the weighted average return on our Nigerian bank holdings is up 73% in US dollar terms since the March 2020 lows.



Year-to-date, the African equity markets were much more stable, on average, with some of the trends that we have seen during the 2020 recovery phase persisting. Gold is down 11%, while Brent crude is up 23%, signalling an improved investor sentiment and a recovery in global demand.
Valuations have rerated substantially since the Covid-19 bottom, but remain at undemanding levels, especially when
compared to global stocks. We have high conviction in the positions we hold and are very excited about the potential long-term returns of the future.
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