

Why PFAs Should Return to Equities



Presentation by:

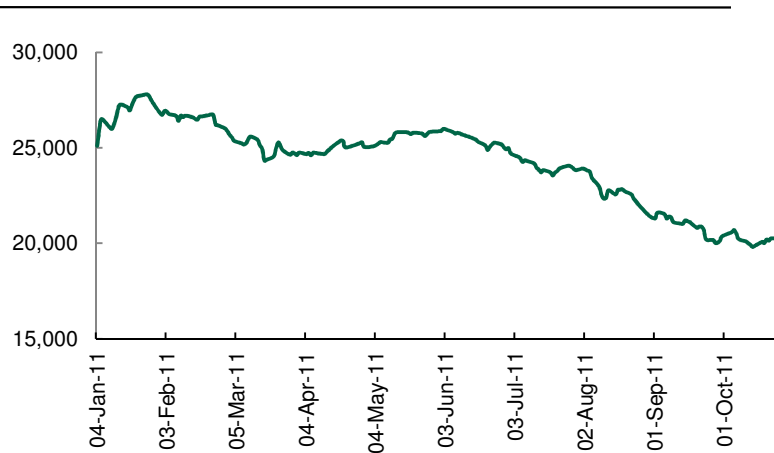
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Table of Contents

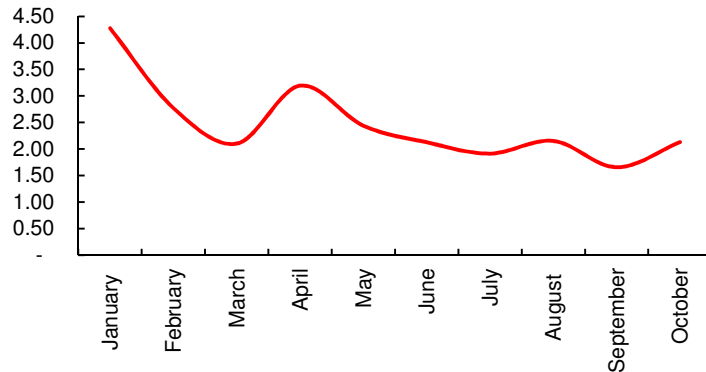
1. Nigerian Equity Market: Inching Towards the Bottom
2. Current Investment Mix of PFA's
3. Nigeria Pension Fund Industry vs. Emerging Market Peers
4. Maxing Out on Equity Allocation: A Potential Market Trigger
5. Depressed Valuations Present Bargain Opportunities
6. Beyond The Numbers

Nigerian Equity Market: Inching Towards the Bottom

NSE All Share Index: Jan 2011 to Date



NSE All Share Index: Average Daily Value Traded: Jan 2011 to Date

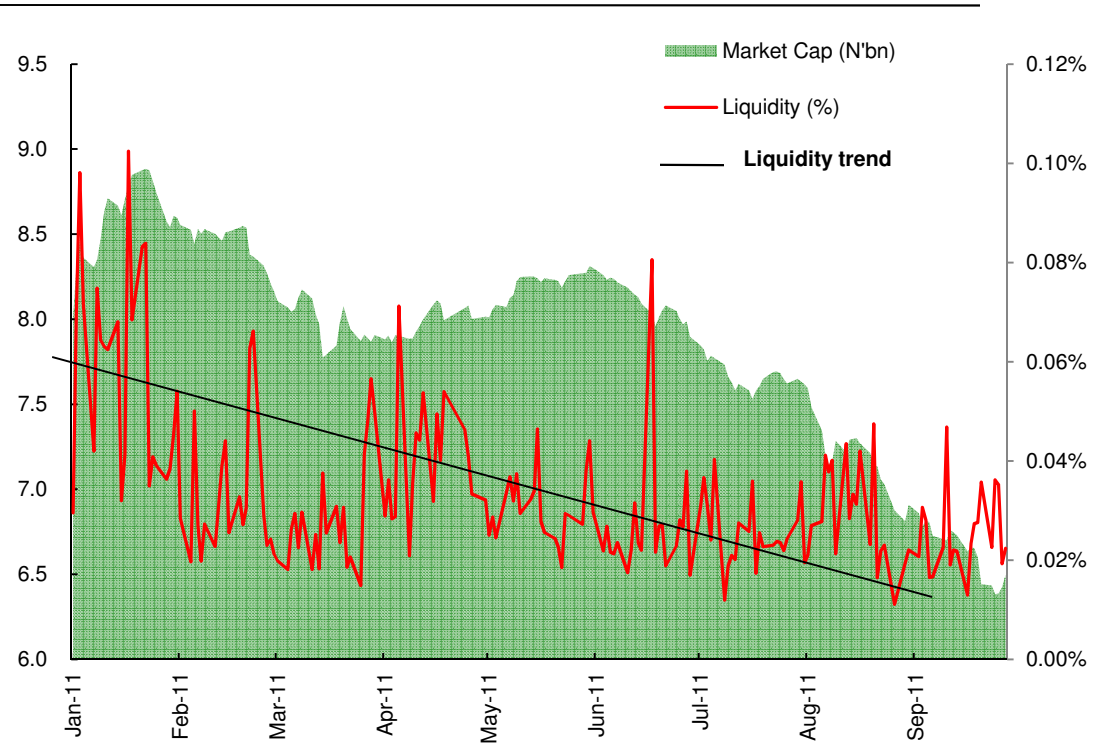


- The Nigerian equity market has seen a marked reduction in activity levels, due to persistently low investor confidence and a considerable decline in trading liquidity all through the course of 2011.
- As at Wednesday, October 26, 2011, the NSE All Share Index was down by 18.1% (year-to-date) to 20,278.16, having opened the year at 24,770.52
- This is however in line with the trend in global equity markets as the sovereign debt crisis in Europe and the US have sparked massive sell-offs .
- Although stocks are currently trading at attractive valuations, supported by impressive corporate earnings releases, market sentiments remain negative due perhaps to fear of contagion from the global economic slowdown.

NSE Market Cap vs Trading Liquidity

- Significantly reduced interest by domestic institutional investors has ceded over 70.0% of trading to foreigners investors leading to dull and uninspiring activities on the bourse
- Average daily value traded dropped from N3.4bn in Q1 2011 to N2.7bn in Q2 2011 and further to N1.9bn from July to date.
- Liquidity (measured by the ratio daily value traded to market cap) has tapered off considerably although there appears to be green shoots of life emerging since September.

NSE Market Cap vs. Trading Liquidity Jan 2011 to Date



Source: NSE, Afrinvest

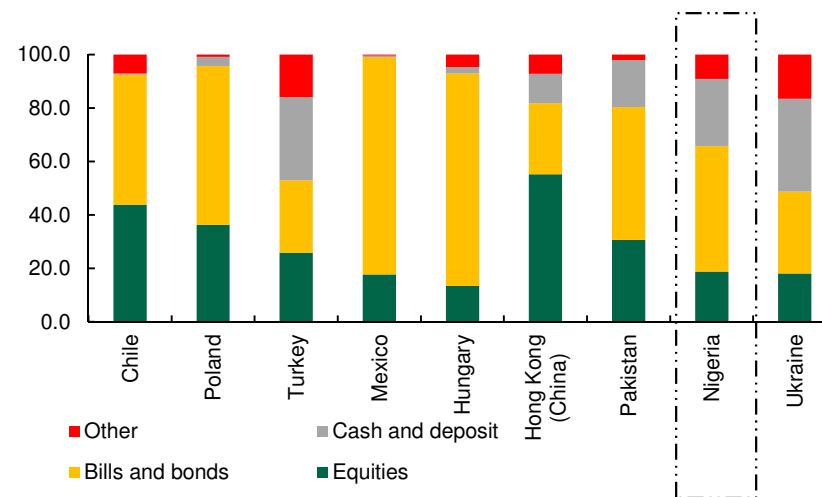
Current Investment Mix of PFAs

PFA Asset Allocation in 2010

Asset Classes	N'bn	%
Local Ordinary Shares	358.9	17.6
Foreign Ordinary Shares	24.1	1.2
FGN Securities	829.2	40.9
State Govt. Securities	69.6	3.4
Corporate Debt Securities	50.7	2.5
Local Money Market Securities	489.3	24.1
Foreign Money Market Securities	7.4	0.4
Open/Close-End Funds	8.6	0.4
Real Estate Properties	170.5	8.4
Unquoted Securities	8.2	0.4
Cash & Other Assets	14.2	0.7
Total	2,029.8	100.0

Source: PENCOM

Pension Fund Asset Allocation Nigeria Vs Emerging Market Peers 2010

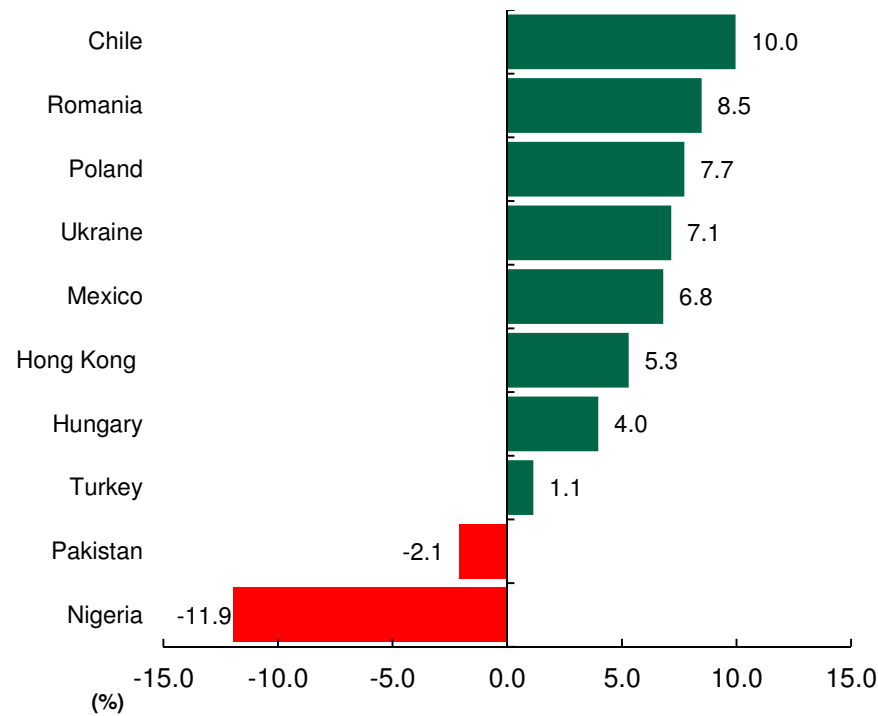


Source: OECD

Nigeria's Pension Funds Administrators are, by regulation, required to hold no more than 25.0% of total asset invested in equities. Other emerging economies have, on the other hand, considerably higher proportion of pension AUM invested in equities.

Nigeria Pension Fund Industry vs. Emerging Market Peers

2010 Real Net Returns of Select Pension Industries of Nigeria and Emerging Market Peers

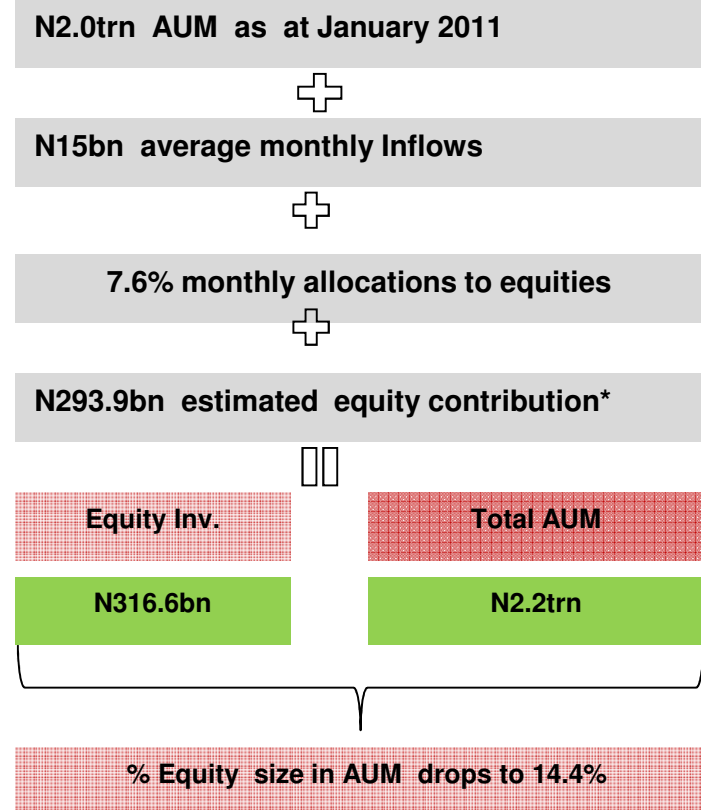
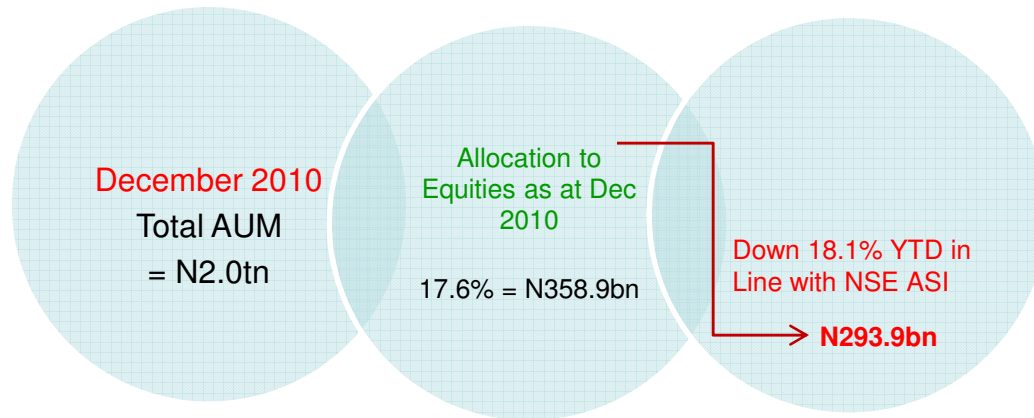


Source: OECD

- According to the Organization for Economic Co-operation and Development (OECD), real net returns by Nigeria’s Pension industry was (11.9)% in 2010
- However, PENCOM data indicates (0.16)%, a much lower negative real return than our OECD source.
- This is nonetheless a poor performance when compared to the recovery in other developed and emerging market countries, evidenced by the impressive growth in pension AUMs.

Maxing Out on Equity Allocation: A Potential Market Trigger

PFAs have significant headroom within their regulatory limit to increase their allocation to equities

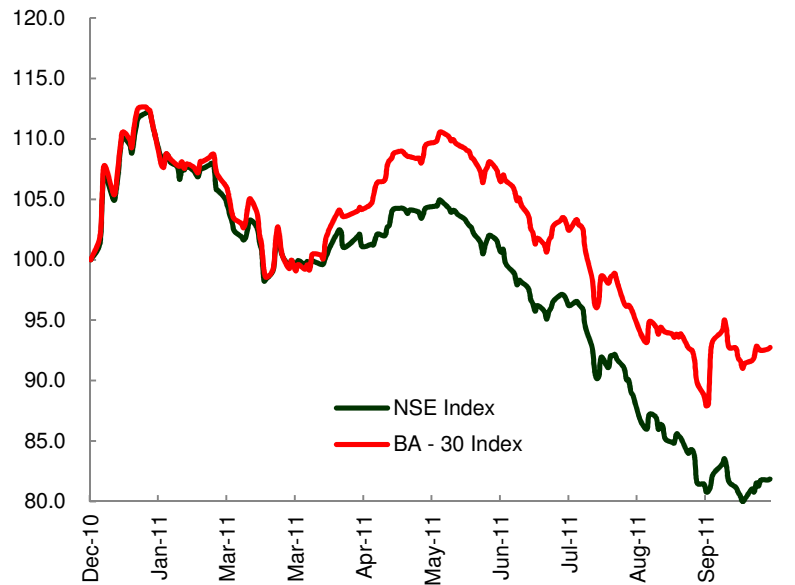


- Assuming that this was reversed, the impact of a 3.2% increase in the allocation (back to the 2010 year end levels) could potentially release N70.4bn of fresh cash by the PFAs for trading in the stock market.
- Based on an average daily value traded of N2.0bn, it will take 35 trading days for this support liquidity to be absorbed in the market.
- We believe that a consistent and sustained liquidity injection by PFAs would rekindle interest and greater participation by investors in the Nigerian stock market and will likely reverse all the losses sustained so far this year.

*accounting for possible sell-offs

Depressed Valuations Present Bargain Opportunities

Afrinvest –Business Day 30 Index



Source: NSE, Afrinvest Research

- Current market valuations imply deep discount from a fundamental perspective
- Using the BusinessDay **Afrinvest** 30 (BA-30) index¹ as a proxy, we note that market valuations have been on a steady decline from year-high P/E and P/BV ratios of 16.4x and 2.8x on 31 May 2011 to 11.8x and 2.0x respectively as at Wednesday, 26 October, 2011
- Dividend yield has also progressively inched up from 3.3% to 4.2%, over the same period
- The depth of the under-valuation is even more pronounced for Nigerian banks, whose valuation multiples have traded down significantly, from 14.8x and 1.4x for P/E and P/BV ratios to 8.8x and 0.9x respectively, over the same horizon.
- Current valuations present an opportunity to buy at considerably low prices rather than wait for an uptick.

¹ The BA-30 index represents the basket of the 30 most capitalized and liquid stocks on the NSE. These stocks account for over 80.0% of total market capitalization and more than 90.0% of trading liquidity.

Beyond the Numbers

- Anecdotally, foreign institutional investors have been credited with being the primary drivers of an estimated 60.0 - 70.0% of trading activity in the market, measured by liquidity.
- It is safe to assume that for this group of investors, the total portfolio allocation to emerging and frontier markets of Sub-Saharan Africa (SSA) would not exceed 5.0% of global equity flows
- Assume South Africa retains half or 50.0% of these flows, with the rest of SSA sharing the remainder. Nigeria would probably attract anything between 20.0% to 30.0% of this.
- By implication, this dominance by foreign investors is based on a marginal 1.0% to 1.5% of cash available for active trading. We do however note that this same class of investors possibly exercise no more than 20.0% collective ownership of Nigerian equities.
- This therefore justifies our call for greater active participation by domestic fund managers. With very little options for PFAs (the single largest constituent of the domestic fund manager) outside of Nigeria, the case for increased trading activity by domestic investors becomes all the more imperative in order to drive the desired market rebound.



THANK YOU