Proshare Confidential

AMCON and Financial Services Debt Burden in Nigeria

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Business Cycle and Policy Response

The history of economies is best captured by business cycle. It reflects the grim reality that the seed of every burst is sown in its bubble. Every prosperity leads to an uptick in asset prices and with time moral hazards are piled up.

Though, monetarist over the years have consistently harped on the notion that prosperity must be effectively managed to avoid being caught up in a hard landing scenario.

Recently, tilting towards a more forward-looking approach Central Banks all over the world have come to terms. In their own way, they are creating mechanisms on how best to combat the next bubble that have become especially in a period of boom.

The grim reality is that bubbles have become a grim reality. Stunningly, both spleen of economics and finance have come to terms that such bubbles turn out to be a necessary correction to asset prices.

Recently, the cycle of bubbles and burst has become shorter. In reality, financial stability has become more cumbersome in the long run. No doubt, this tale brings back the memories of the 2008 banking crisis coupled with the policy response in reaction to the systemic shock.

Therefore, this edition of Proshare Confidential takes an in-depth study on the systemic shock that led to the formation of an Asset Management Company (AMC). The kind of AMC, Nigerian at this point, is practicing and the grey areas patterning the eclipse of the going concern of the AMC.

However, policy response at that time was intended to avoid an inflammation in the downturn which could result in short term problems becoming a long term one.

Such response gave birth to an Asset Management Company, which was named as the Asset Management Company of Nigeria (AMCON). Certainly, like all asset management company, AMCON is also a child of consequence, one born with the intent to detoxify the system.

AMCON was poised with the responsibility of taking away bad loans out of the system. Such action calm nerves around the standing lending facility corridor. In a follow up, the overnight rate was tampered down a bit as the AMC untangled the existing liquidity crunch.

In addition, AMCON was given the responsibility to restructuring through re- discounting capital base of bank to nil. Thus, AMC acted as a leg room for the economy by bolstering credit to the private sector, eventually ensuring that money not dented by the shock.

The intermediate objective of averting wider contagion by increasing money supply and providing a breather for pro-cyclical lending which allowed the GDP to grow by 7.2% a year after the creation of the AMC.

The AMCON Act 2010 was established and empowered with the ability to tap into money market. Therefore, AMCON raised a N2.3 trillion bond, which was to be refinanced at a rate of 12%. Such amount raised was referred to as a sinking bond, thus putting the corporation in a position of substantial financial leverage. The Federal Government and the Central Bank injected N10 billion and N500 billion respectively

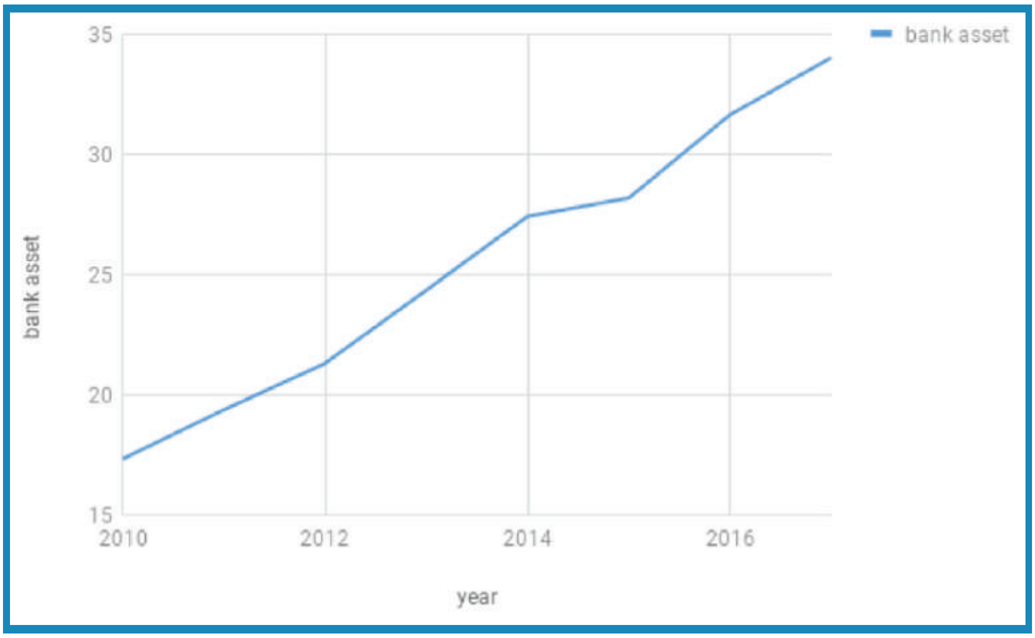
Even though such act further encouraged supply following finance after the bond was raised. Although, it was not fully guaranteed by the Federal Government which in return also increased the total Public Debt to GDP.

The sinking fund was tied with the margin of growth in the asset base of the Deposit Money Banks (DMBs) modelled around a historically growth pattern of 20% over the years, however the thin growth in GDP has slimmed down the growth in the asset of banks.

Sinking Fund Explained

More importantly, the super-normal growth level experienced have largely faded off thus threatening the ability to fill the sinking fund. One thing was certain that the model failed to take into account the diminishing marginal return to scale.

Fig 1: Bank Assets from 2010 to 2017 (N'trillion)



Source: CBN

Certainly, the marginal growth levels of banks will dip at some point and diminishing returns will play out. Ignoring revenue in the model, no doubt made the sinking fund a "quick sand scenario."

What is even more disturbing is that the model failed to consider macro imbalances and structural break-out. According to our estimates, our optimistic position based on the purported model showed that it will take 18 years to fill the hole.

No doubt this model highlighted the limitation of asset-based model. The prompt repayment of such loan in accordance with the given framework is obviously blurred; there is a need to redeem such loan by the Apex Bank in tranches.

Thereby, levying it on the profit of the Deposit Money Banks in piecemeal provides headroom for the AMC balance sheet. With the exhaustion of asset for sale and rising debt issuance, financial leverage has shot up to 80%.

Banks Transfer

Deposit Money Banks are institution entrusted with the hope and fate of ordinary folks. They are regarded as the trustee of their hard-earned income and sweat, there is no greater honour than that.

Thus, the transfer of financial institutions must go beyond the highest bidder. Besides they are not durable items nor luxury items like paints works. Obviously, they are not bought for fancy, but to save guard deposit, maximize existing shareholders' wealth, create fresh wealth and deepen financial inclusion.

In reality they are livid columns of any economy. Thus, it is pertinent that the transfer of banks must go beyond the bidding price. It must include the micro prudential, capacity and track record of the buyer.

Sometime price could be a smoke screen, which could leave the financial system in a more delicate position than it was. Our inability to allow a balance approach that involves both quantitative and qualitative indicators have created a scenario whereby dead wood still persist.

Truth be told, the cobwebs still hang in our financial system. In addition, there is need to strengthen the Nigerian Deposit Insurance Corporation (NDIC) Act as the banking system have gone through substantial evolution since 1991. After all, empowering the NDIC in the first place would have reduced the occurrence of grey areas or avoid committing the phenomenon of the original sin in the first place.

One wonders if a law that empowers the Nigerian Deposit Insurance Corporation (NDIC) the ability to give licence to bridge bank. Obviously why can't the Nigeria Deposit Insurance Corporation wean such bridge bank to stability? Besides it limits the room for multiplicity of roles and avoid accumulated losses being witnessed.

In climes like Turkey where the savings deposit fund played a big role in averting deposit runs and also stabilizing the economy. Certainly, having an NDIC that can live up to such billing will be in the best interest of the economy.

Financial Statement

The huge leverage position of the firm has continued to put net income of the corporation under severe pressure, thereby resulting into a negative net interest position . The limited fee due to diminishing scale, macro imbalances and the tight monetary policy has made the gulf between interest free and interest expense inevitable.

The AMCON scenario clearly point out the damage of huge leverage position coupled with high cost of debt and transferred macro imbalances on net interest income.

Although other income is a major source of income, given its wide mandate. The buffering in net trading, accretion in fair gain value and bolstering net gain, crystallized a departure from the norm of net operating loss.

Therefore, recording N26 billion in net operating profit. However, the surge in operating expenses triggering a N56.2 billion negative Earnings before Income and Taxes (EBIT) reflective of a 33% dip in loss. However, the disposal gain of N46 billion depresses the headline loss to N16.4 billion.

The firms cost of equity according to the net income approach puts it at 0.26% and a negative weighted cost of capital at -0.1%. Even though the corporation recorded positive net operating profit, the high financial dragged down WAAC.

Although, the corporation has served as a macro stabilizer, but the opportunity cost to the firm has been raising losses. It also shows that for an AMC birthed to detoxify the financial system, there is a very dim possibility of the corporation having positive Economic Value Added (EVA).

Therefore, the Economic Value Added so far has been negative. Certainly, the corporation is dwindling it balance sheet and reducing its losses. However, a more aggressive approach so as to diverge from the usual trend accumulating loss. More importantly, it has to dilute its leverage, it's not healthy for the earnings, especially when current asset meant for disposal is not.

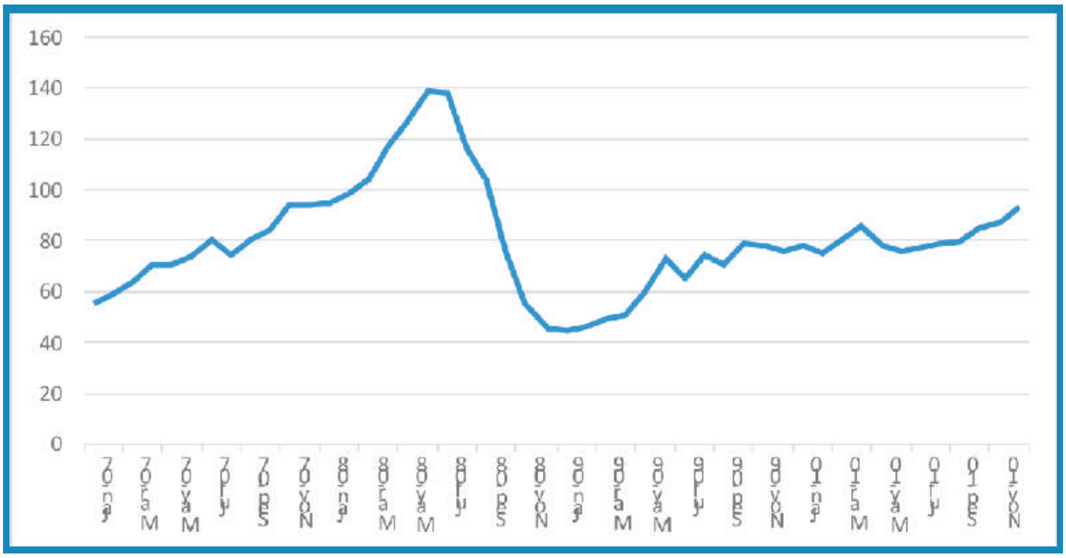
Conclusion: White Noise of Eclipse

In fairness, there is no 10 years eclipse in the AMCON Act, rather such perception is drawn from the National Asset Management Agency (NAMA) of Ireland which has a 10 year lifeline. AMCON is similar to NAMA, besides they were birthed around the same time. While we do admit the reality of business cycles, with the revolving door scenario and the existing macro imbalance, more than ever before there is a need for an AMC.

However, a two-case scenario, the tail scenario is one whereby the value of the AMCON ends up been an arm of NDIC. Just like Resolution Trust Corporation which later became a division of the Federal Deposit Insurance Corporation. The head scenario revolves round the corporation becoming more independent and winding down its balance-sheet. Moreover, rather than reward moral hazard, it must restructure its capital and be more profit oriented. Anything less will be self-injurious in the long term.

Business cycles captures spells and breaks in market economics, at the same time it reflects the grim reality that the seed of every bubble is sowed in period of prosperity. Therefore, after sustained period of growth, the Nigerian economy experienced a bump as oil prices shrunk in 2010.

Fig 2: Oil Price (Brent Crude)



Source: CBN

The bandwagon effect was a sharp decline in the equity market which fell sharply leading to an astronomical increase in non-performing loan as the financial sector began to bleed. Return on Asset (ROA) stood at -8.9% by the end of 2009 and Non-Performing Asset had swollen to 28.8%.

The deterioration in asset quality became inevitable given the direct relationship between oil price and banks' balance sheet. More importantly, it underpin the grim reality that it doesn't take too long for macro imbalances to manifest, especially under a cycle whereby fiscal deficits are ballooning, export concentration are high and export value to GDP is dwindling.

Fig 3: NPL and Return on Asset

Source: CBN

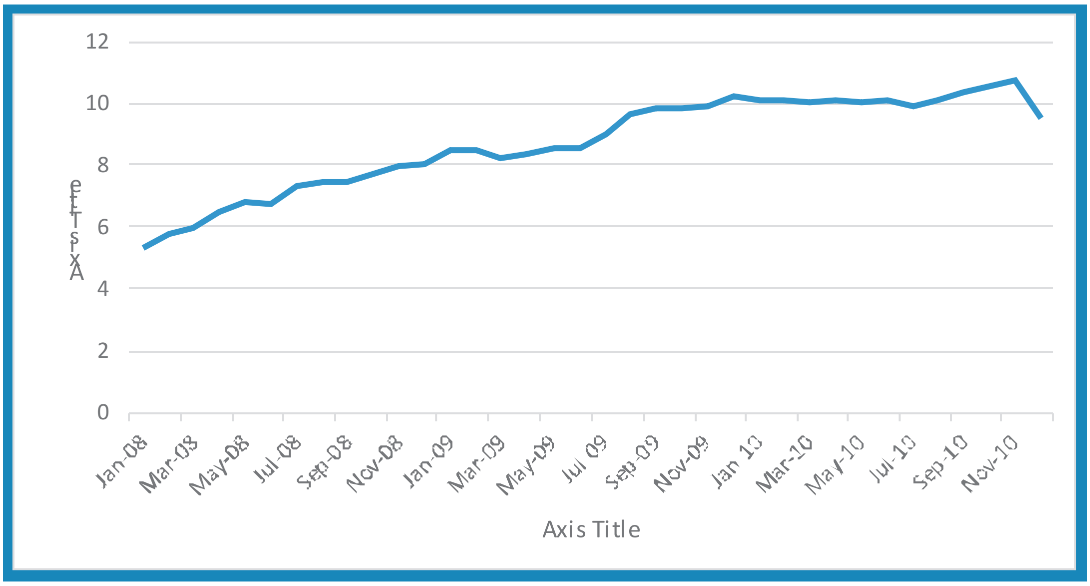
The high exposure to the oil sector by banks fused with substantial margin loan led to a dampening in asset quality. Evidently, the level of non-performing loans (NPL) in the system posed substantial threat to financial stability.

Moreover, the pace of rising NPL net of provision to capital rose 289% as at 2009 triggering deterioration in the Return on Equity (ROE) by 228%.

Evidently, the bloodshed was widely felt by equity base indicators than that of asset base indicators. Moreover, the pressure witnessed in the interbank rate and the growing demand on the standing lending facility led to a liquidity drought.

The ripple effect was a cool off in credit to private sector as supply plummeted and bank lending began more selective. In order to avoid piling up more moral hazard.

Fig 4: Credit to The Private Sector



Source: CBN

Thus, pinpointing to the fact that monetary aggregate was gradually becoming less stable; one could argue that a completed recovery in money aggregate would take some time. Besides, such will depend largely on economic management, thereby the bank hinged more on interest rate and exchange rate as an anchoring tool.

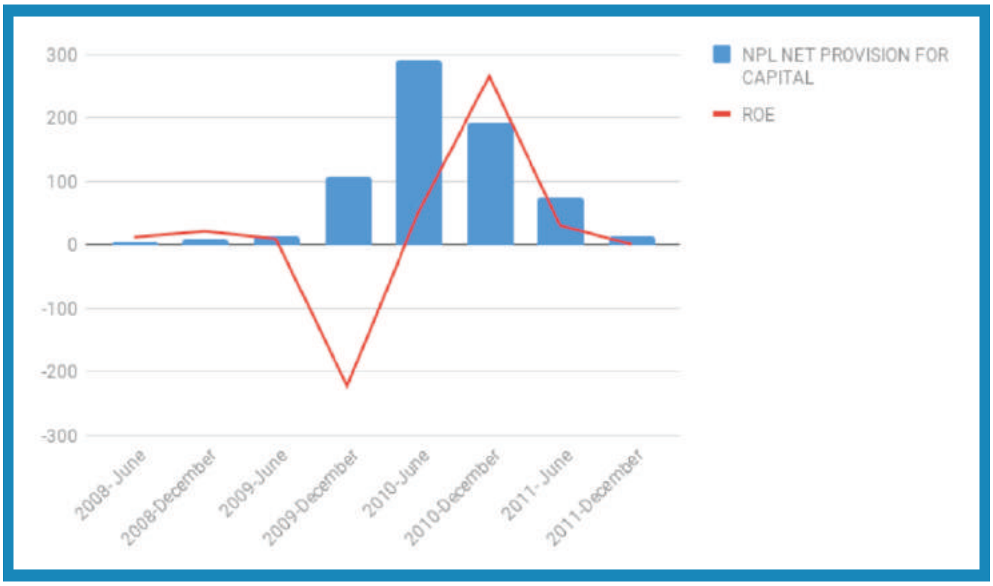
Therefore, the urge to restore financial stability and confidence in economic management became dire. In a follow up, equity base indicator was quicker to recover from the bump than that of asset base indicators for certain reasons.

The volatile nature of equity indicators supported the upside after heavy erosion had taken place in value. Moreover, policy response did not just support asset recovery but also provided a leg room for equity in terms of technical: it calmed the nervy reaction witnessed in the market.

One of such policy was the creation an asset management company by the central bank of Nigeria, an entity posed with the responsibility of recovering assets of distress bank. In reality such attempt was to avoid short term problems fast evolving into long term ones, the monetary authority set up an asset management company (AMC).

Therefore, the AMC became a special economic cum financial vehicle that absorbs bad loan from the financial system, thereby taking off bad money out of the system.

Fig 5: Return on Equity and Net Provision for Capital



Source: CBN

History of AMC Elsewhere

The policy of setting up AMC not just as a measure of ridding the system of bad money but rather as a macro stabilizer was not alien to Nigeria alone. Such measures have been replicated in other climes.

Fig 6: History of AMC

Institutions	Country	Year Established
Resolution Trust Corporation	American	1989
Securum	Swedish	1990
Korea Asset Company	South Korea	1999
Indonesia Bank of Restructuring Agency	Indonesia	1995
Daharta	Malaysia	1998
Savings deposit insurance fund (SDIF)	Turkey	1993
National asset management agency (NAMA)	Ireland	2009
Soceite de cesation activities procedures de la restruction de banca	Spain	2012

Source: Wikipedia

One thing was certain AMCON, just like the all other AMCs before it was also a child of consequence, and was mandated to safeguard existing wealth and also create new one.

"The Original Sin"

As earlier established, that an AMC was certainly needed due to the erosion in wealth that occurred within a short period of time and such has been replicated in other climes. In this scenario the AMC was set up by the monetary authorities, Central Bank of Nigeria.

We must also point out that the idea of an AMC and Bridge Banks were not entirely alien to the Nigerian constitution as at that time neither was the Nigerian law as at that time was ignorant regarding, managing and restructuring of failed banks. In specifics, the Nigerian Deposit Insurance Act of 1988 S.38 (d) stated thus:

The corporation may acquire, manage and dispose the asset of a failing insured institution directly or through an asset management company or the board of failing institution for sale to the corporation or the asset management company or as a security for loan from the corporation or the asset management company.'

Moving further the law gave powers to the NDIC to even set up bridge banks underpinning the powers of the bank in terms of managing and resolution of debt.

For instance, the role of the Savings Deposit Insurance Fund (SDIF), in the wake of the 2001 turkey crisis. As an institution responsible for managing and restructuring failing banks, such role cannot be underemphasized.

While many might argue that the NDIC act might not have all the spanner in tool kit but one thing was certain thing the act have long been in need of an amendment.

Besides, within every crisis management existing legislation are improved upon and the mandate of such institution is widened to accommodate the new reality. One must agree that the current NDIC act needs to be amended and why?

The banking institution has completely evolved and for the NDIC to meet its responsibility fully it needs to be amended.

Borrowing a leaf from monetarist like David Holeisch and Marc Quintyn, there is no right model in crisis management. Rather it all about principles and less about steps. Even till today the questions bordering about principles are left unfettered.

It's every bit about principles and less about steps, when policy ignores principles and it's more driven by step, you end up plastering mosaic or fail to provide the necessary conditions for an AMC to clean up its balance sheet.

On the long run, the AMC will be inadequately prepared whenever the next bubble emerges, given its bloated balance sheet.

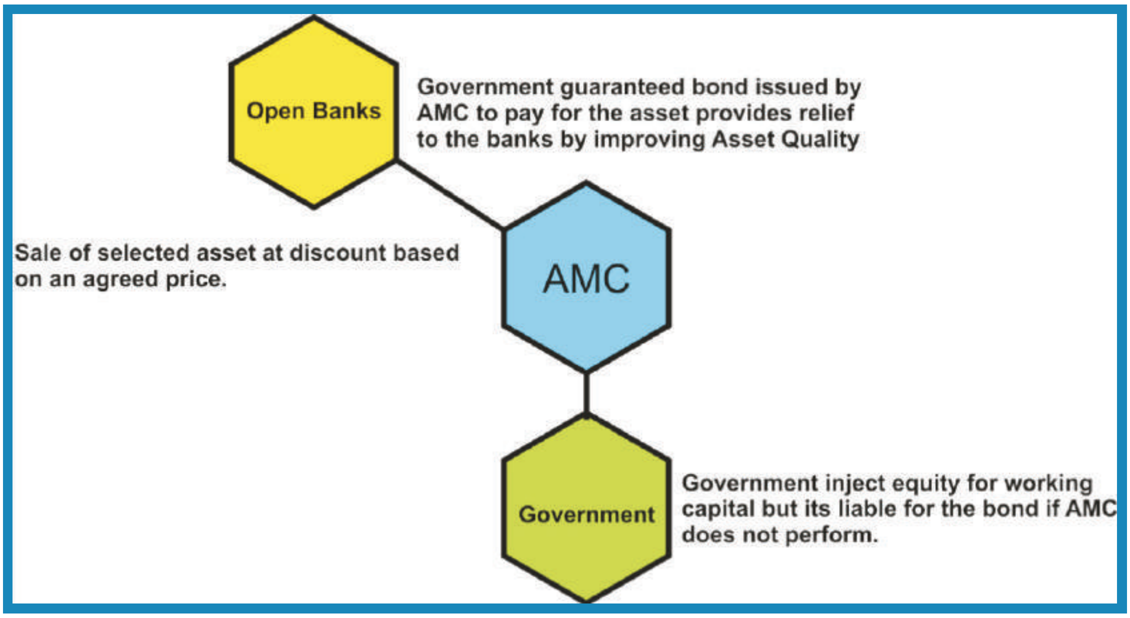
The fall out point to the reality, the pre-condition for an AMC to be effective largely illusive. In reality the span of web was never cleared but it kept growing; how true is that when viewed from both the lens of macro imbalances and institutional flaws?

In most circumstances, an asset management company is of two types - the first type involves the AMC acting as a trustee posed with the responsibility of liquidating or restructuring insolvent bank. Like that witnessed in the Indonesia whereby the Indonesia Bank of Restructuring Agency acted as a trustee.

Therefore under such circumstance the AMC does not select or purchase assets from distress banks. At the same time there is no real financial transaction that takes place under such scenario. However, the assets amassed by the AMC are relatively large and diverse in nature. It considered to be more of a bank resolution AMC scenario

However, the Central Bank of Nigeria adopted the second option whereby the AMC buy assets from banks that are still operating. According to the AMCON Act 2010, the current AMC has the ability to buy such asset which must meet certain criteria which is stipulated in AMCON act 6(1) b.

Fig 7: Schematic of Asset Management Company Of Nigeria



Source: World Bank

Therefore, the asset management company was given a centralized role coupled with a broad mandate compared to the Resolution Trust Company of the United States and societe de cessation activities procedures de la restruction de banca of Spain and Korean asset
Management Company with such broad mandate was well spelt out in the AMCON Act of 2010: the functions include

- Assist eligible financial institutions to efficiently dispose of financial asset
- Efficiently manage and dispose of eligible bank assets acquired by the corporation in accordance with the provision of the act
- Obtain the best financial return on eligible bank asset or other asset acquired

The monetary authorities who engineered the process of AMCON contributed N500 billion to the pool also The Federal Government contributed N10 billion to the pool, which was more of a takeoff fund. On the other hand, AMCON raised N2.3 trillion from the money market at a rate of 12%.

Just like its sister AMC, National Management Agency in Ireland shifted the bad loans from the balance-sheet of target banks, in order to foster future investment and provide a breather in terms of credit to deposit ratio of such banks. More importantly it allowed Deposit banks to provide loans.

The leeway provided by the AMCON Act 2010 provided an ample room for the AMC to tap into the money market, at the same time government injected equity for working capital. It, in real term, was not completely liable for the bond.

The coupon was largely raised to fill the hole that emanated from huge moral hazard.

Importantly, such hole was to be filled in 10 years, which will be financed by 5% of bank asset. Certainly, it gave the AMC ample time to wean banks under their purview and avoid undercutting themselves in selling such asset.

More importantly, the AMC avoided a scenario whereby the corporation was caught up in a "fire sale" while the downside risk was rising depreciation and accumulated loss.

Face Value and Purchasing Value Syndrome

Expectedly, as the cycle took a reversal the face value of asset fell, thus denting the value of asset. In response, AMCON discounted the value of asset of banks which had its capital base eroded to zero:

Therefore, in reality the face value of such asset was considered. Many of those banks emerged as bridged banks that emerged through the process. However, in the process of shifting bad loans from targeted banks to AMCON, such loans were bought at their actual price.

They were redeemable in the process of recovery; moreover many had the potential of a revaluation when the normalization of the cycle began.

For assets considered to be equity trio of oil price increase, wolf pack scenario and improved earnings from firms could provide the catalyst for a revaluation gain in such financial asset. Thereby purchasing bad loans seem more of a fair game after all a fire sale was not in play at the same time off set pull backs in the books of banks

The Bridge Banks and Puzzling Myths of Valuation

In accordance to the broad and centralized mandate of AMCON stipulated in the AMCON Act 2010, the AMC took over the following banks in a follow up restructured the management of such banks by appointing new managing directors for such banks.

Fig 8: Restructured Banks

BANK	Name
Oceanic Bank	Mr John Aboh
Intercontinental Bank	Mr Mahmumud Alabi
Afribank	Mrs Nebolisa Ara
Union Bank	Mrs Funke Oshiodu
Spring Bank	Mrs Susane Iroche

Source: Vanguard

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Fig 9: Transfers of Banks

	NEW OWNERS
Intercontinental Bank	Access Bank
Main Street Bank	Skye Bank
Keystone Bank	Sigma and River Bank Capital
Enterprise Bank	Heritage Bank
Union Bank	Atlas Mara

Source: Proshare

Firstly, we admit there are no magical number or clear cut position in valuation, especially in this particular circumstance. However, a 3-month moving average can be super imposed by technical analysis indicators given the existing dynamic and why? The period under consideration is too short especially in a frontline economy.

It is limited to identify the intermediate trend more, it provide more room for minors to dictate the trend which would not actually reflects the true picture of fundamentals at that point. The fact is a fire sale have been put off the table and after the cycle has normalized. Besides detoxification of the balance sheet which has occurred, thus pricing a higher premium above 50% is in place.

Moreover, the sale of a particular bridge bank to a deposit money bank which has failed to meet the statutory prudential ratio. Such scenario only complicates the scenario on long run.

Bank transfer must go beyond the highest bidder, it must include the track record of the and capacity of the buyers is every bit important. Especially for an institution like a bank, a lot more is needed when it comes to selling a bank; a well-rounded approach is needed

The in ability to take up a well-rounded approach, has left ripples in the market . Certainly the capacity and track record of atlas Mara and Access bank, no doubt has made the difference.

Debt and Recovery

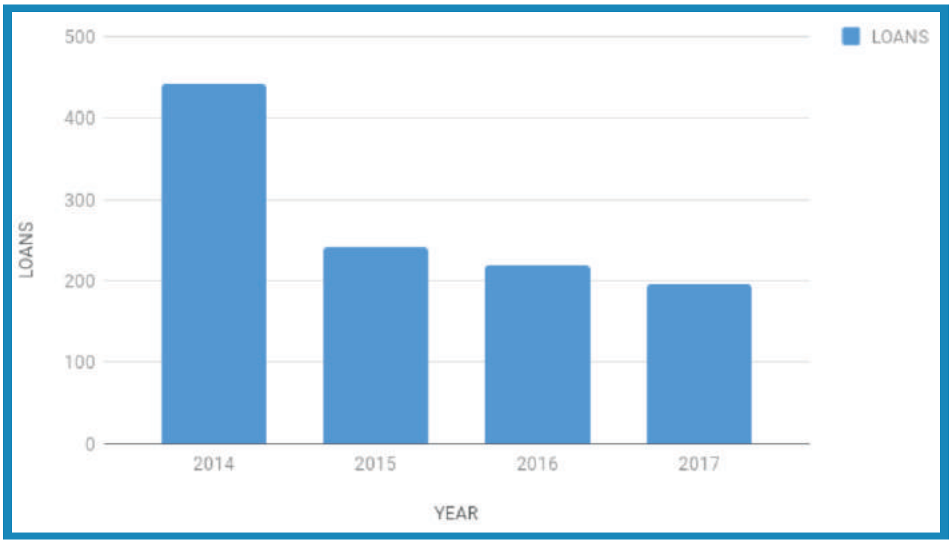
More importantly it took over debts which were largely considered to be bad and under it stewardship did slow the momentum in unemployment. More importantly the AMC has reduced the size of loans in its book.

AMCON have reduced the loan and advances to customers from the initial heist of N444.1 billion in 2014, which was to N161.1 billion in 2016, therefore underling a massive debt recovery approach by the AMC. The ability to drastically reduce the chunk of debt in their balance sheet was also largely supported by the asset management partners (AMP).

Intermediaries helped in part to clean up the balance sheet of AMCON, more importantly they help to retrieve loans that had huge cost expense . The AMP conduit served as mechanism to reduce operating cost of the corporation, especially litigation cost.

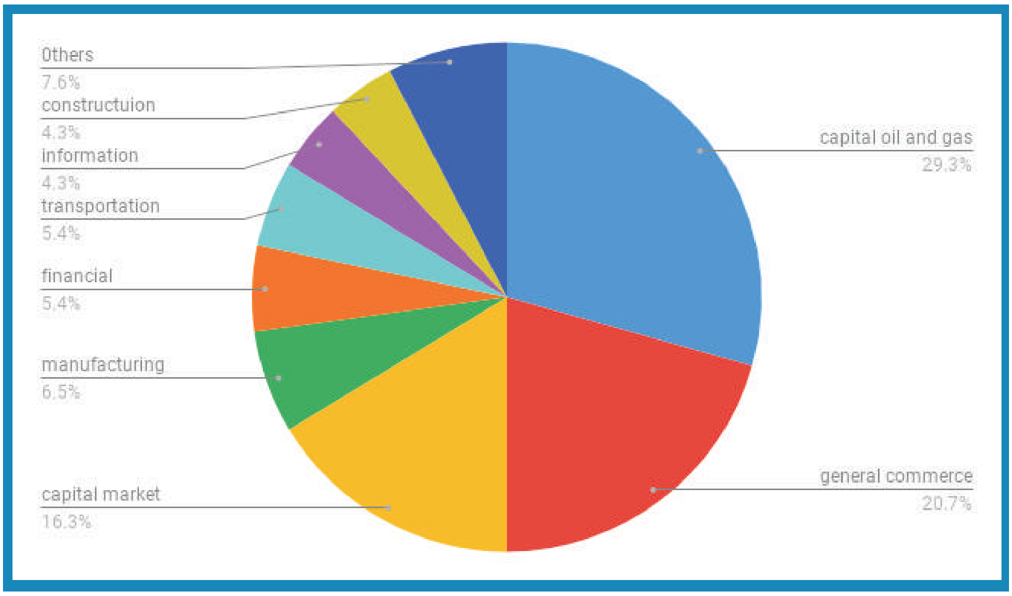
Moreover the AMP leg provided room for flexibility and concessions, especially for debts that had high gone substantially bad.

Fig 10: Loan and Advances to Customers from 2014 to 2017



Source: AMCON

Fig 11: Debt Structure as at 2017



Source: AMCON Website

Even though the bank has its balance sheet by reducing its loans, the oil and gas sector still constitute the largest chunk of its debt. Pointing out that the macro imbalances are large still in place and the present structural composition will play a substantial in completely winding down of the balance sheet of the AMCON.

The Role of Asset Management Partner: The Side Chick

Functions of AMP

AMP, as partners in asset recovery had specific and well spelt out responsibility. Which include the following:

- Analyze and administer the Eligible Asset of Bank (EBA)
- Trace the asset and the obligors
- Negotiate with the obligors
- Litigate for the recovery of EBA
- Enforce the realization of the EBA
- Grant concession to the obligors

Insight into the AMP Process

Step 1: Asset Tracing – Our model is as follows:

a. Serving of demand letter
b. Physical visit to the location of the asset
c. CAC Search which involves identifying Directors, lawyers, registered address and their service providers
d. Name search at the Credit registry or online

However, these efforts are time consuming and require huge financial commitment which becomes of no merit without the required documents/support from AMCON.

Step 2: Execution – Upon tracing the assets the following steps are executed:

a. Negotiation with responsive obligors
b. Requesting for Loan Purchase Agreement (LPA's)
c. Filing of a foreclosure Suit
d. Receiving Court Judgement granting property forfeiture (interim/permanent) or freezing of bank account.

In the areas where AMPs succeeded the success factor was majorly the responsiveness of the obligors to the demand letter. While for cases where they experienced delay in payment, was as a result of obligors default in payments for which foreclosure suit was filed/re-filed. For the cases where we are having challenges, Loan Purchase Agreements (LPA) to carry on with a foreclosure suit were not received sequel to our request (Kindly see the list in Appendix 1.3 & 1.4).

However, there were certain framework that determined how concessions were granted to the obligor

Fig 12: Factors Affecting Determination of Concession

S/N	FACTORS THAT COULD LEAD TO THE GRANTING CONCESSION	SHARES	MOVABILE ASSET	REAL ASSET
1	EBA is supported by any credit document or information			
2	EBA balance is in disputed or Obligor has evidence to back up same, the granting of concession	25	25	30
3	Proven cases of fraud and irregularities on the loan and underlying security			
4	The obligor otherwise has not have the capacity			
5	EBA resolution is undergoing or could undergo protracted and non-beneficial legal tussle			
6	The events that led to customer inability were market driven and were outside their control			
7	The collateral is impaired			
8	it is cost beneficial to the corporation to grant a resolution and achieve one quickly			
9	where is ascertained that a delay in resolution of EBA in terms of accepting, could lead to a loss or recover a higher amount for the organization			
10	where is willing to make a bullet payment of 180 days			
11	The need to recover some or all of financial intervention of banks			
12	Where the interest component of banks is more than the interest payment value (100%)			
13	where outstanding amount is more than 120% of collateral vote			
14	where the obligor is dead incapacities or out employment			

Source: AMP

Although AMP has partly played a key role in asset recovery, however they are faced with several challenges such as;

a. Not supplying AMPs proper documentation in respect to Eligible Bank Assets (EBA)

b. Delay in getting the Loan Purchase Agreements (LPA) to carry out a foreclosure suit.

c. Interference in negotiations with obligor

d. Delay in funding for execution of an interim order

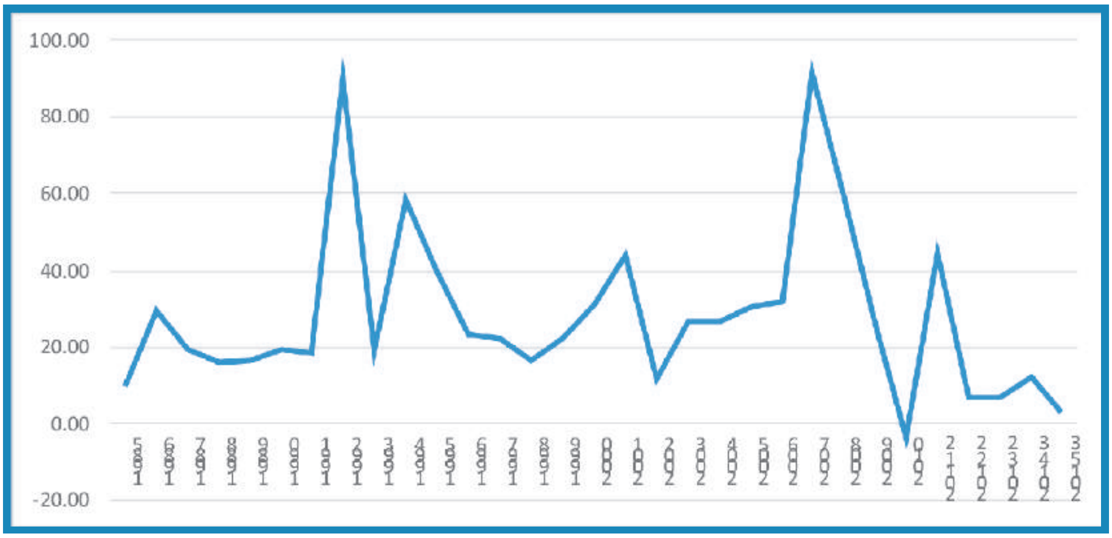
e. Obligors not fulfilling the settlement terms.

Stability: Averting Collapse in Money Supply

In an attempt to shift bad loans from balance-sheet of targeted banks, it was inevitable to bear the macro imbalances in the balance sheet of the bank. The largest chunks of the debt shifted were actually from the oil sector given direct relationship between bank balance sheet and the oil sector.

More importantly credit to the private sector grew by 59.4% compared to the previous year, thus hitting its highest momentum as at the beginning of democracy.

Fig 13: Credit to the Private Sector

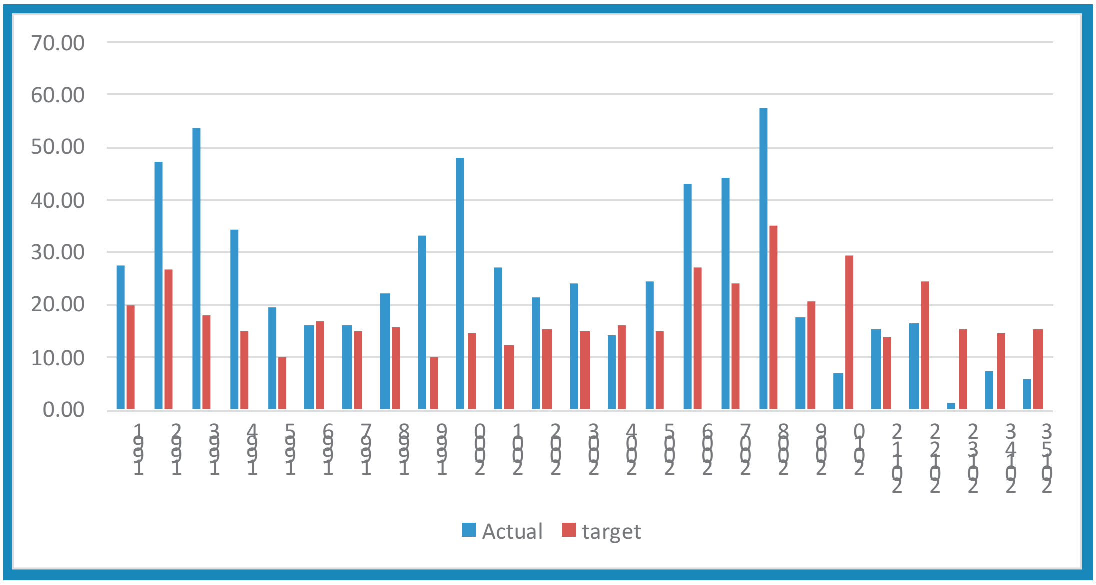


Source: CBN Quarterly Economic Report

Holistically the bank on one hand averted short term problems from becoming long term one by slowing down in unemployment. The reflation of the economy through an AMC intervention has spurred money supply beyond its target.

Thus such action forced broad money (M2) to rise sharply by 52% compared to the previous year, also 22% beyond the bank's target. Even though targets in subsequent years fell undercuts the bank targets, as the bank began to rein on the supply of M2. The ability sustain the money supply, permeated through the cycle, thus averting a collapse in money supply

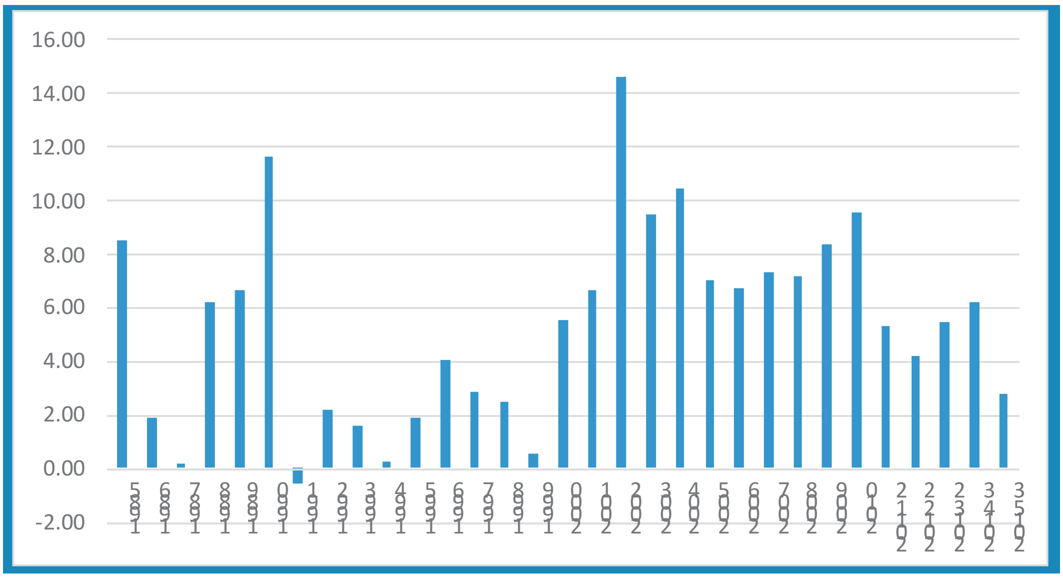
Fig 14: Money Supply



Source: AMCON

Even though banks remain largely risk conscious of the real sector and tamed down their appetite for moral hazard. Regardless, the intervention prevented further denting in animal spirit, even though growth fainted slightly from 7.2% to 7.3%. Growth remains largely robust compared to peer countries.

Fig 15: Growth



Source: NBS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Profit And Loss

Net Interest Income: The Same Old Story

Over the years there have been a gulf between the interest income and interest expense of asset Management Company of Nigeria. Thus, pinpointing to the consistent ballooning in interest expense has made negative interest income inevitable, 2017 was not an exception.

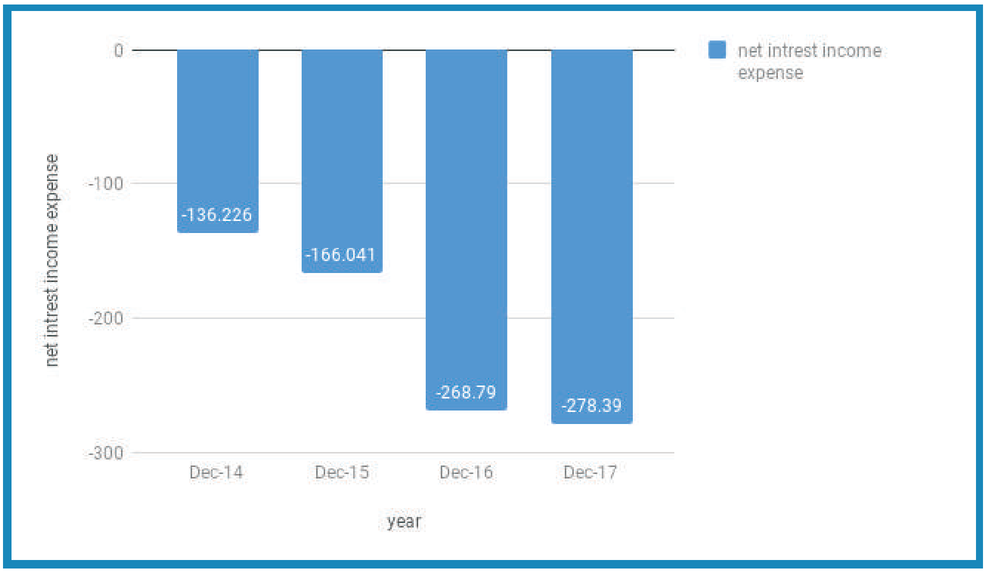
The negative interest income at the end of 2017 rose from N233.48 billion to N233.742 billion, evidently underlining a 3.4% increase in negative interest income compared to the previous.

Although interest income rose from N11.44 billion 2014 to peak at N45.44 billion: regardless, it still point out the limitation of interest fee as a major source of income for an AMC.

There is a prolonged undercut in the asset base of banks coupled with the rising interest expense from the initial coupon raised via the Sinking fund which is strangulating the net interest. It also highlight the slim room for a leg room in for net interest, especially when the firm is highly levered

In reality, asset disposal still remain the major source of income for most AMC, given their core mandate. However in attempt to avoid caught

Fig 16: Negative Interest Income



Source: AMCON

Non-Interest Income: Stronger Valuation to the Rescue

up in a fire sale, the room for other income was limited as the AMC was occupied with the responsibility of weaning most asset at its disposal to stability.

Non-interest income alone stood at N299.21 billion in 2017, whereby other income made up 80% of AMCON ancillary income. Certainly, underlining a 26% increase in non-interest income compare to the

Fig 17: Non- Interest Income (million)

item	2016	2017
Net Trade	-257	125
Net Traded Value	-5,4227	22,856
Net Gain Value	17,389	26,875
Fair Value	-116	8,157
Other Income	225,875	241,237

Source: AMCON

- Thereby the improvement in other income was largely due to the disposal of asset.
- The fair value of asset seem to have appreciate due compare to when asset were largely discounted to zero in the infusion period of the firm; thereby providing the necessary fulcrum as fair value move from negative territory to a relatively strong profit position
- The position of Net traded value hinges on valuation and the current systematic risk. Inflows from net traded value dipped due to the slide in the business cycle in 2016. However the improvement in valuation coupled with relatively tinted risk premium served as the needed fulcrum to pull net trade from negative territory to positive position.
- Thus the rise in net traded value from a loss of N5.42 billion to N26.875 billion was largely in line.

Net Operating Income (NOI): A Flash in a Pan

Although AMCON pruned down its credit losses by 8.25% in 2017, thus shrinking credit losses from N19.78 billion in 2016 to N18.145 billion 2017. However the uptick in operating expenses (OPEX) rose by 22% to eventual from N49.21 billion in 2016 to N 60.343 billion 2017.

It is important to note the divergence between the astronomical increases in Operating expenses as inflation gradually dwindles. There was an elevation in personnel cost, as personnel cost rose from N13.8 billion to N13.9 billion, the slight increase was a product of rising. Depreciation for the horizon under review stood at N4.22 billion compared to the previous year of 2016, reflective of a reduction.

Asset Management Company of Nigeria was immune from impairment losses on financial asset in 2017, compared to 2016 and 2015. Whereby impairment on financial asset stood at N1.93 trillion and N7.22 trillion.

Regardless there was no write back in asset to give inflow, a bite. However the market Impairment losses asset reached its peak in four years, as it rose to N25.6 billion, the uplift in impairment losses was partly due to the emergence of rising NPL in real sector .

In reality erosion in asset quality witnessed in 2016 had taken its toll on the quality of certain assets, especially those in the oil and gas.
Even though the valuation of asset under the purview of the AMCON, especially financials had a price beat up. Regardless asset quality experienced erosion as cyclical headwinds left its mark on the real sector.

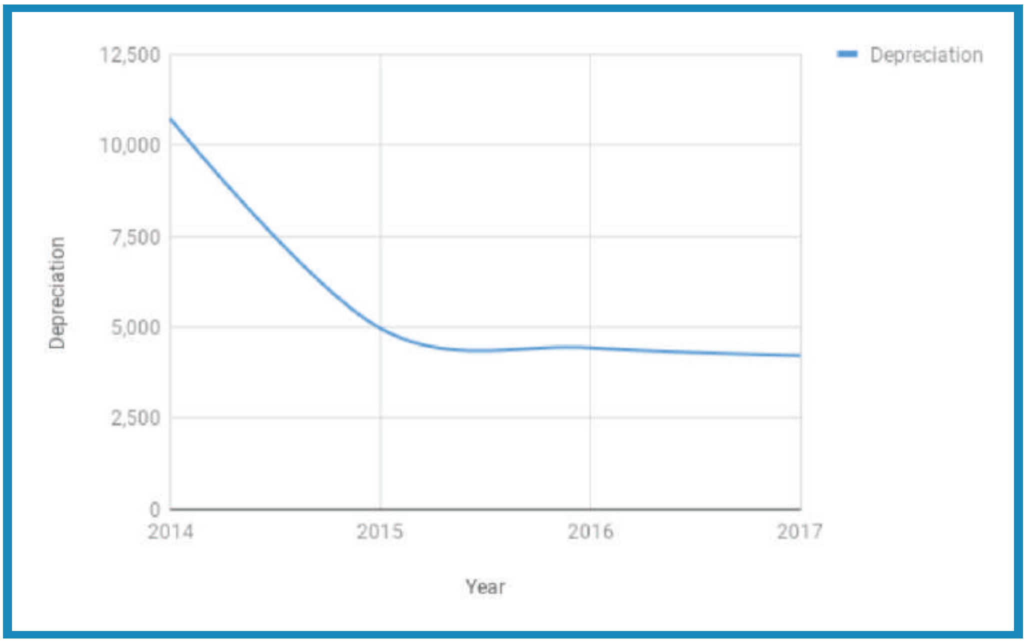
Fig18: Net Operating Income

Cost	2017	2016
Net Operating profit	65.08	3.97
Credit loss	-18	-20
Impairment losses to financial asset		-1.934
Impairment losses/ write back	-26	-1.832
Net operating income	21.756	-15.96

Source: AMCON 2017 Financials

On the other hand asset depreciation reached its lowest ebb in 4 years, largely due to the gradual disposal of asset and a reduction in the amount of property under the purview of the government. Thereby forcing depreciation to decline

Fig 19: Depreciation from 2014 to 2015



Source: AMCON

The escalation in total operating expenses from N68.333 million to N78.568 billion, led to a worn out in earlier net operating profit.

Eventually the corporation recorded N56.812 billion loss before taxes, compared to the previous quarter, loss before taxes was lean by 32.59%. Holistically loss from continued operation was amplified by N 67 billion tax's to stand at N56.875 trillion at the end of the year.

However, N40 billion inflows from the disposal compressed debt to N16 billon. The trio of rising net interest income coupled with disposal of asset led to a depression in debt compared to the previous year. Regardless of the compression in loss by asset disposal, the relatively high leverage have continue to hinder the possibility of magnifying returns

Asset:

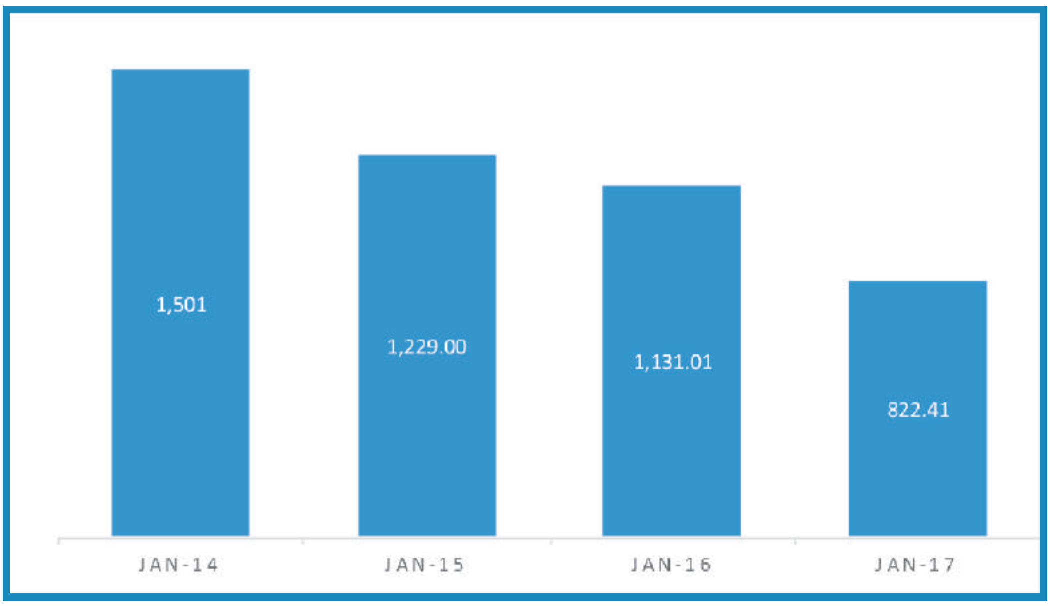
As earlier stated AMP is largely referred to as a child of consequence due to the fact that it was established as a result of financial crisis. More importantly the balance sheet reflects the actual cost of intervention. In such, circumstance the weighted cost of capital, economic added value (EVA) and the growing liability serve as the best gauge of cost of intervention.

Although financial investment rose by 29% from N59 billion in 2016 to N46 billion in 2017. In the same vein financial asset also rose by 91% from N24 billion in 2016 to N46 billion 2017. The growing operating cost have led to a decline in the cash by 37% from N67 billion in 2016 to N43 billon 2017.

Regardless of the bolstering in financial asset and investment, the total asset under the purview of AMP grew lean by 37% from N1.13 trillion in 2016 to 822.41 billion in 2017 and why?

The decline in loan and advances to customers combined with exestuation in non-current asset for disposal has led to a drastic fall in asset. Asset decline becomes inevitable as asset disposal take off.

Fig 20: Total Asset from 2014 to 2015 (billion)



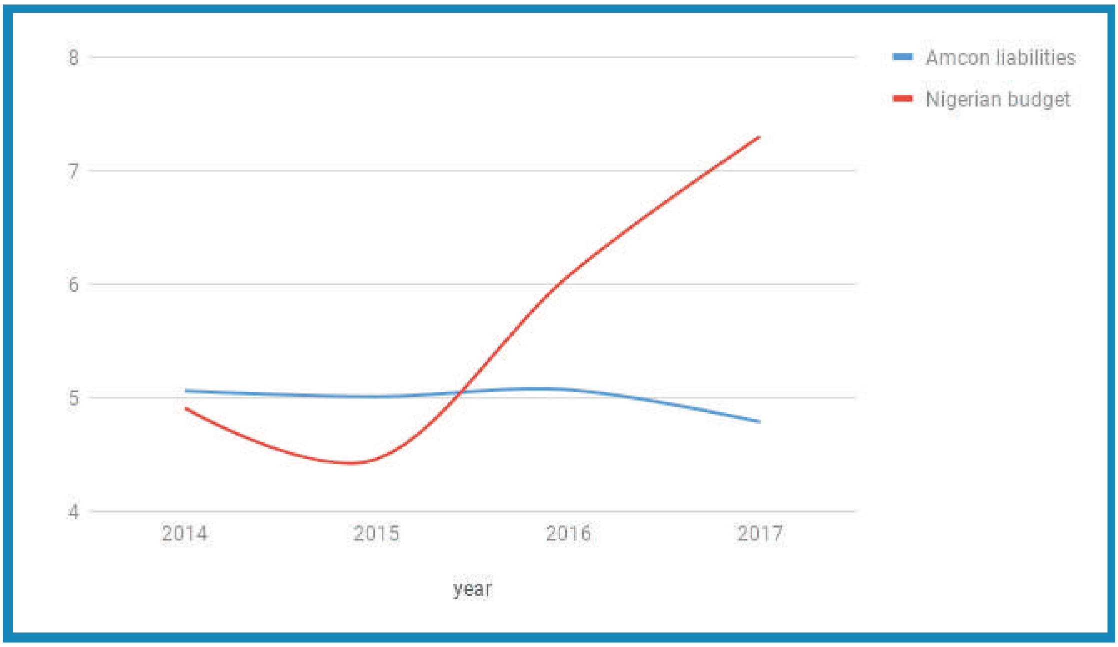
Source: AMCON

Liability: Departure from the Norm

The massive reduction in the retirement benefit from N6.4 billion in 2016 to N1.4 trillion in 2017. In addition there was a no liability associated to the sale of asset thus providing a breather, the combination of the duo triggered a departure from the earlier norm, whereby have been on a upward tick.

The dynamic created the needed fulcrum to force liabilities to slump from N5.077 trillion in 2016 to N 4.778 trillion in 2017, evidently causing 5.9% dampening in liability.

Fig 21: AMCON Liabilities and Nigerian Budget



Source: AMCON and Budget Office

The persistent fiscal stimulus that has led to a boggling budget size coupled with the dent in liabilities has led to a depression in the ratio of AMCON liabilities to the budget. Therefore it is not surprising to see the AMCON liability to national budget ratio fell from 0.85 to 0.65.

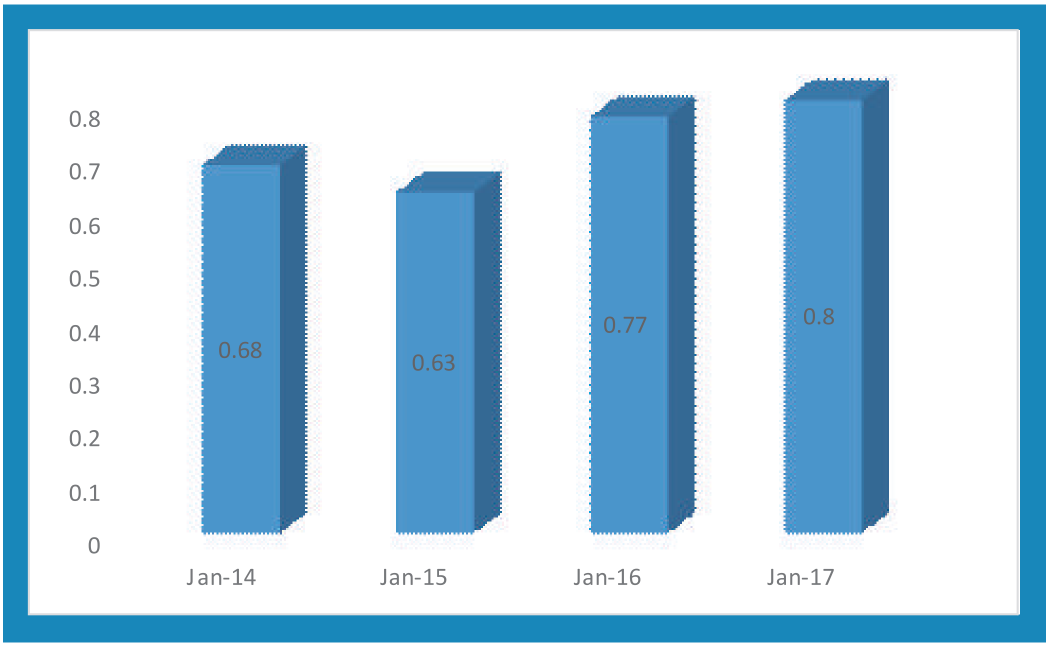
Although liabilities has fallen but the smoking elephant is largely in place and remain steaming, debt issuance. More importantly a double whammy of rising debt issuance and rising other liabilities still pose a threat to winding down liabilities and balance sheet cleaning

The Smoking Elephant

Even though liabilities shrieked as earlier mentioned, regardless debt issuance have continued to rise. Debt issuance rose from N3.7 trillion in 2016 to N3.8 trillion in 2017, a deviation from the previous path. The rising cost of corpus money market supported debt issuance.

Therefore, debt issuance to liability at the end of 2017 has risen from 0.777 to 0.80, which is 28% of money market instrument.

Fig: 22: Debt Issuance to Total Liability



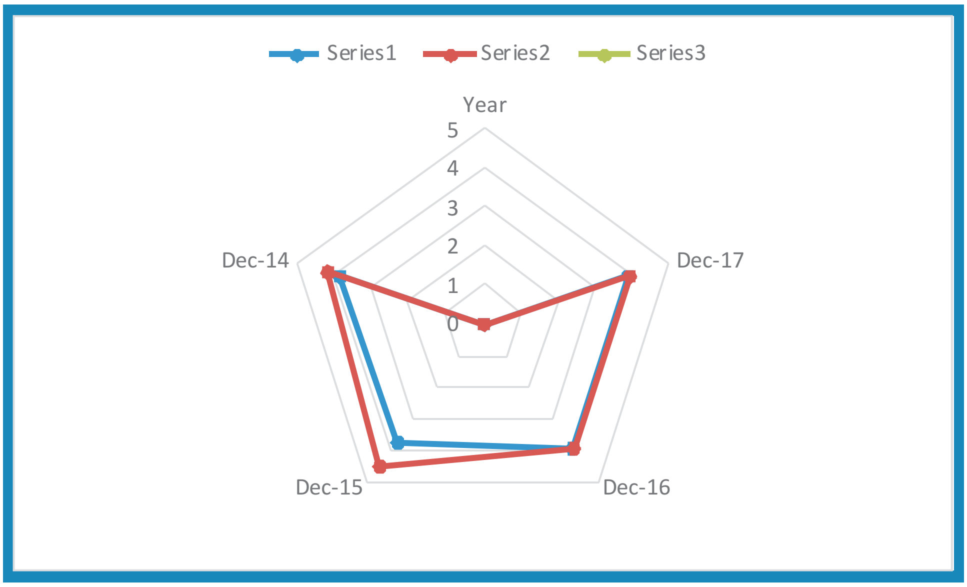
Source: AMCON

The actual cost of debt tilted downwards from 7.4% to 7%, due to the thinner interest expense incurred in 2017. The financial leverage position of AMCON rose from 320% to 460%, the rising leverage position was as a result of growing exhausting of asset and rising issuance. Underling the reality that magnifying leverage in high interest rate environment erode affect the margin of safety.

The high financial leverage position of AMCON point out the following:

- The sinking fund form the core of the AMC's liabilities
- Filing the hole that emerged from the sinking fund plays a major role in cleaning the balance sheet and improving the financial position
- At the same time the ability to either redeem or quickly wind down the balance sheet is tied down to the growth of the assets of banks and macro growth.
- The AMC is highly leveraged, the high cost of debt will continue to remain a major brick wall to net interest income
- The firm relatively has a negative equity position largely due to accumulated loss
- moreover the firm has not issued any form of shares , apart from 10 billion injection by federal government which is considered as issued capital .
- However MM approach puts cost of equity at 0.26, regardless the weighted average still remain in a negative due to erosion in equity.
- The economic value added value is the spread between return on asset and capital, however ROA have been negative over the years . On the other hand there have been continuously bearing accumulated loses. Thus the corporation has a negative EVA

Fig 23: Accumulated Loses and Equity



Source: AMCON

The Going Concern

First of all, Deposit Money Banks are institution of trust and their role in weaning an economy cannot be underemphasized, thus the transfer of banks must go beyond just the ability of the highest bidders syndrome.

The capacity and track record of the buyer must play a substantial role. After all such action goes beyond the sale of durables items like art paintings. They are institutions which form the basis of financial stability, more than ever before they are pseudo trustee of hard earning of ordinary folk. We must not lose sight of that, certainly the highest bidder might not be the most preferable buyer.

Secondly allowing the model of the sinking fund to hinge only on the asset of the bank creates flaws. In an economy with macro imbalances and largely deficient structural composition, slowdown is inevitable.

Certainly, the bandwagon effect forces a slowdown in the assets of banks. Moreover, when banks have grown beyond their super normal stage and a normal stage even in a robust growth environment, the margin of growth in asset is low.

Lastly, we are in an electronic age, such transformation is a disincentive to bank asset: who really need a big building to transfer money? Holistically revenue has not declined, thus a more robust model that include revenue and cost should be included so as to fill the hole created by the bad debt.

Thus, the mix of revenue and asset base is more appropriate, especially given the sectorial composition of the economy and policy response of the Central Bank. In reality it allows

The history of economics is best captured by business cycles, even though in the face of stronger regulation and improved both and micro prudential. The possibility of bubbles still lingers on.

At the same time the AMCON act never stated an eclipse time frame. While we must come to terms that interventions are considered as a tool of last resort, at the same time we cannot completely do without them, because at some time it will be needed.

Moving forward, AMCON has shown that accumulated loss at some point is inevitable especially for an AMC. At the same time the cost of high leverage affects the ability of the firm reduces its loses, thus there is a need to consciously deleverage.

We are also aware that the ability to fill the hole created by the sinking fund is tied to the asset base of banks, however with rate expected to remain high for some time and with the current pro-cyclical approach by the bank. The growth in the asset base of will be limited for some time: therefore, we are up against a head and tail scenario

Tail Scenario

There is a need to bolster the NDIC, so as to reflect the current economic evolution. More importantly strengthening of the NDIC so as to meet up effectively its responsibilities have become a necessity. The NDIC must come to terms it's a regulatory authority and neither is the apex bank superior.

While the latter is concerned with ensuring financial stability but the NDIC provides cover for the depositors. Thus, while one tend to be more preventive in nature, the other provide the pills after prevention has failed

Secondly, the current AMCON has to wind down its liabilities by redeeming some of its debt through the CBN. While such cost can be levied on Deposit Money Banks through the Central Bank. Evidently, the position reduces both the financial leverage of the corporation and the public debt to GDP ratio

The next step is to allow the asset management corporation of Nigeria to become an arm of the NDIC. After all, the corporation collects premium on deposit money banks.

More importantly such act re corrects the original sin committed. Besides an institution that can provide license for a bridge bank, such institution must begin to live to the responsibility of weaning such bank to stability.

The model becomes more of the resolution trust corporation, whereby it partially winded down and became a division federal deposit insurance corporation of Nigeria

Head Scenario

In a country where politics takes the front role, the tail scenario could be less likely. The head scenario lies more on the corporation addressing its wagging weighted effective capital by reducing its high leverage corporation. The only way out is to allow the Central Bank to redeem such debt in tranches and those levy them on the revenue of the deposit money banks.

At the same time the corporation should become can then gradually turn the clock from accumulated loss to profit. Therefore, the corporation can also have a fighting chance at making profit.

While it is understandable that the firm has been making loses, while reflating the economy. In reality after 9 years, there room for loses are growing dim. It further cements the idea that regardless of the growing moral hazards, the corporation will bear the loss.

It encourages bolsters deposit money banks to take on more moral hazards and flusters bad corporate governance. The corporation must come terms that it has to fine-tuned and improve its EVA

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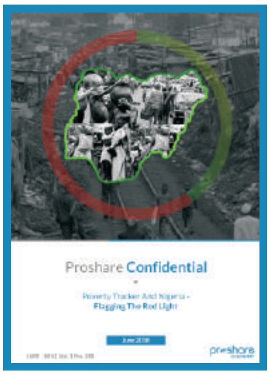

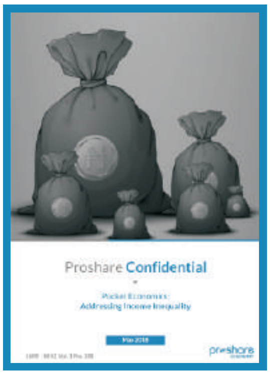

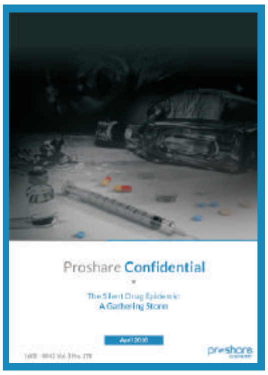

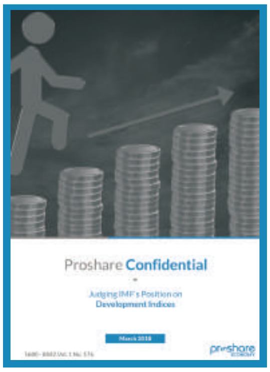

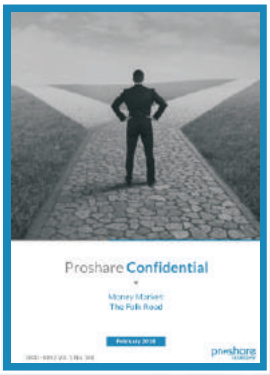

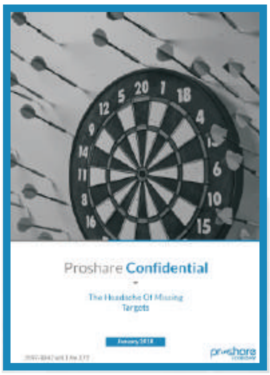

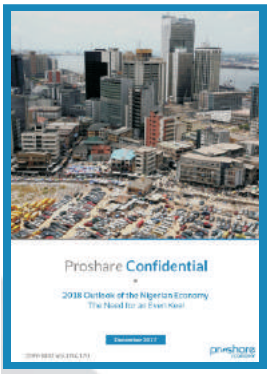

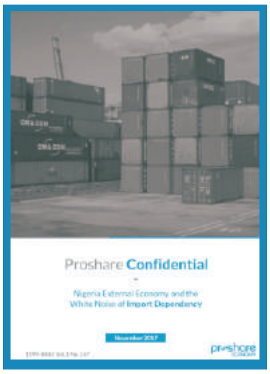

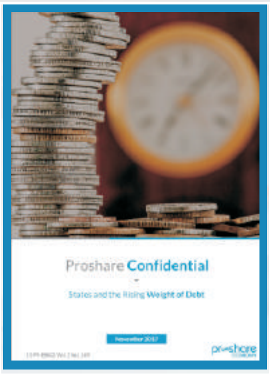

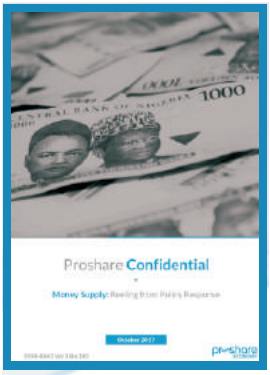

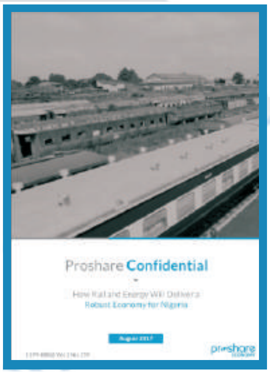

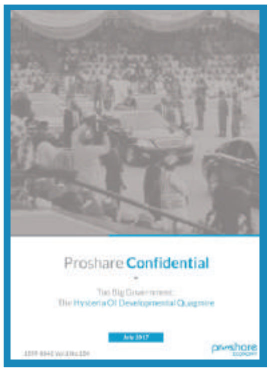

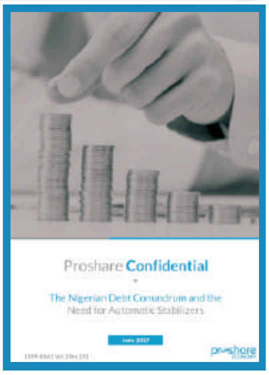

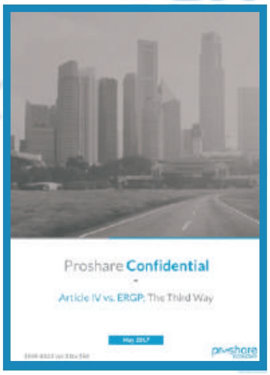

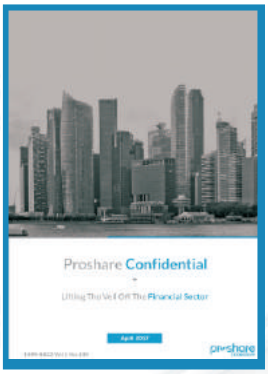

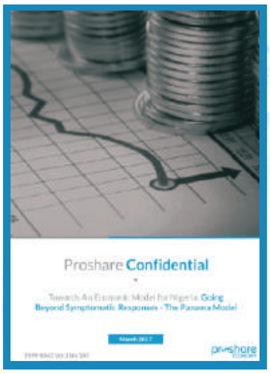

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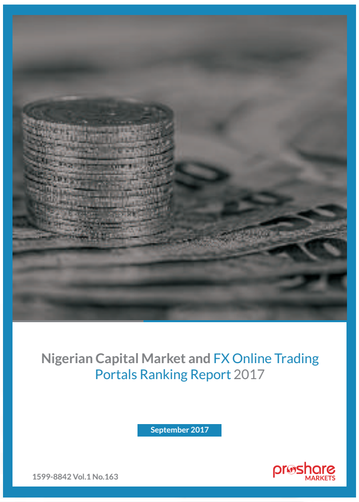

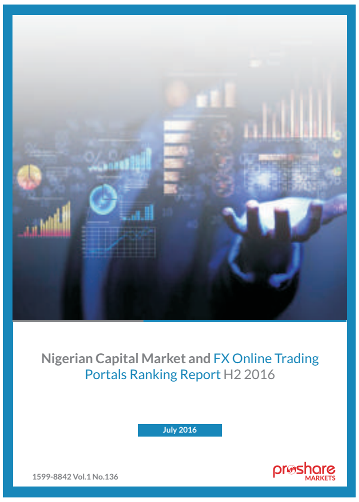

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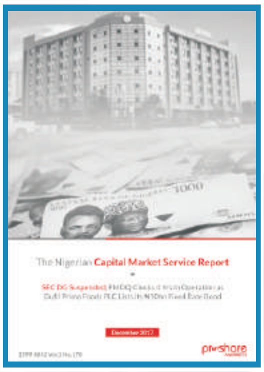

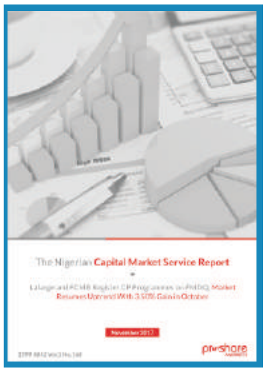

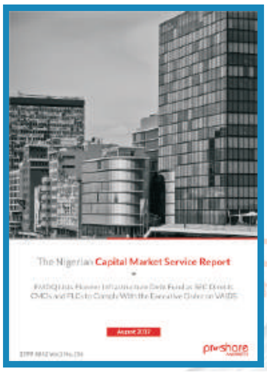

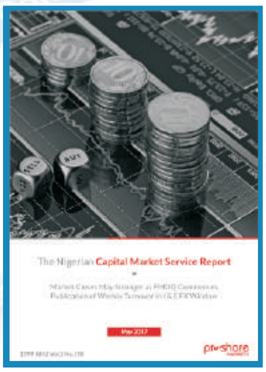

proshare ECONOMY

Previous National Bureau of Statistics (NBS) Report (s)