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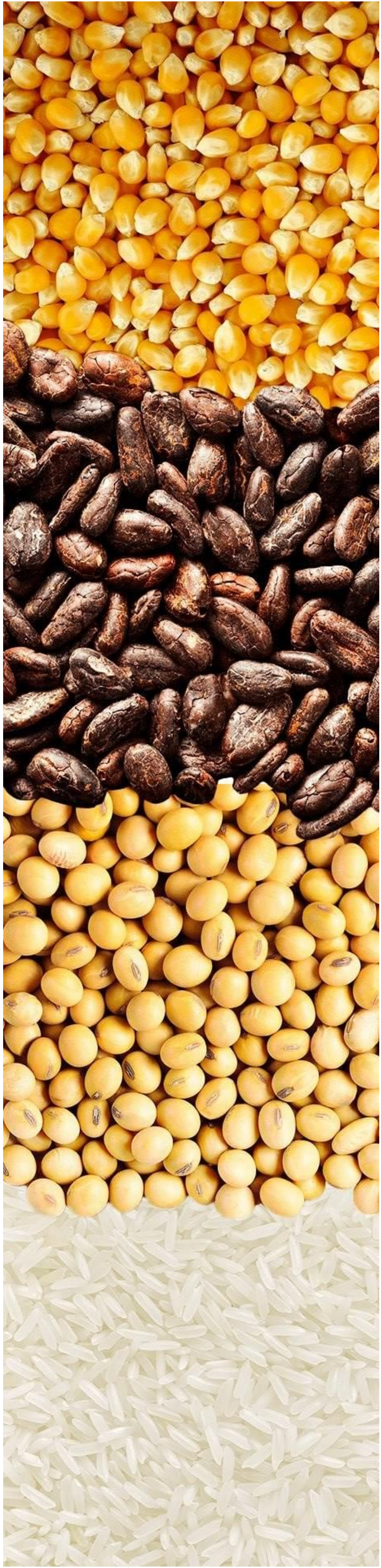
AFEX COMMODITIES EXCHANGE LIMITED

ANNUAL COMMODITY REVIEW 2019

Content



Executive Summary

Globally, commodity prices have witnessed wide fluctuation as the combined effects of trade wars, geopolitical tensions and the global economic slowdown pressured commodity perfo-rmance in 2019. Specifically, the US-China trade war and the global economic slowdown induced risk of off sentiments on the commodities markets as investors and producers grappled with tariffs and reduced access to key export markets.

Importantly, agro commodities; wheat, soybean, maize, paddy rice and cocoa experienced diverse outcomes with maize, soybean and wheat settling at 0.24%, -0.08% and 3.32% respectively. On the other hand, paddy rice and cocoa experienced significant appreciation as production concerns drove gains of 7.74% and 4.90% at the end of October 2019.

Moving forward, the risks facing the commodities market have moderated as the recent signing of Phase one agreements seeking to roll back some of the tariffs placed on Chinese and American goods opened the lee-way for more imports on both sides. Also, forecast expectations as specified by central bank governors in Europe and the United States indicated that global slowdown might have bottomed out, increasing the likelihood of further commodity imports in countries across the world.

In the last four years, the agriculture sector in Nigeria has received significant attention, rivalling that witnessed in the 2011-2013 period. The renewed drive has been broad-based with virtually all sub-sectors (Livestock, Crop and Fishery) benefitting from the public, private and developmental investments in the sector. At the end of Q3 2019, Sesame, Cocoa and Cashew led the non-oil export charts, grossing $41.19 million, $30.03 million and $13.75 million over the period.

Structurally, the domestic commodity markets were structured as a spectrum of players got involved in a variety of activities necessary for seamless transactions in the industry. The spectrum spanned from the producers to final off-takers with trader, merchants and other marketing agents serving as the backbone of the industry and helping to provide the much-required linkage services. Despite the export potential of cocoa and other cash crops, maize and soybean remained the most liquid commodities in the country owing to the much wider use for industrial and household consumption across the country.

In addition to these commodities, paddy rice and sorghum have begun to assume more importance in the local landscape while sesame and ginger gain more traction in the international consumption markets.

Interestingly, the renewed interest in agriculture has stimulated substantial integration of domestic commodity markets in the supply chain of local and international manufacturing companies. This has been evident in the increased aggressiveness in commodity aggregation witnessed in the markets.

Commodity prices in the domestic market followed earlier established trends with prices exhibiting the seasonal fluctuation characteristic of the commodities market.

Despite the less than expected performance of Maize, prices closed the season at 3.64% above the opening price of N90,000 for the 2018/19 marketing year with a volatility of 33.60% over the marketing year. In the 2019/20 season, a combination of favourable weather conditions and reduced hectarage allocated to maize resulted in preliminary estimates of 5% in total production. On the contrary, demand has spiked in the present season, with an increased volume of aggregators and off-takers playing in the market. We anticipate that the price will increase by as much as 19% from the first trading day of the season owing to the net effects of demand and supply actors.

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Soybean remained a star commodity all through the marketing year, closing at a season to date of 20.44% from season open price of N120, 000. The key driver of the commodity was the increasing demand for the commodity from industrial off-takers in the animal feed and baby food business. The commodity reflected the typical high risk/ high return profile with seasonal volatility of 50.69% in the 2018/19 marketing year. As experienced in the maize production areas, soybean production was favourable as conducive weather condition stimulated an expectation of higher production in the country. On the demand side, however, activities have been heightened as more players participate in the domestic sourcing of the commodity. Prices in the 2019/20 season are expected to spike with conservative estimates as high as 25-30% as the season progresses.

Performance of paddy rice in the 2018/19 marketing year was lacklustre as the commodity had a season-to-date return of -4.98%. Notwithstanding the subpar performance, paddy rice resumed the new season on a stellar note with the season open price climbing up to N133,000 at the end of November. Production in core producing areas treaded similar trajectory as other commodities with favourable weather condition prompting a boost in harvest across producing areas. Preliminary estimates indicate that national output is expected to increase by as much as 10% to reach 9.24 million tonnes. Despite the gains in supply, price levels in the rice markets are expected to trend upwards by 15% owing to the ongoing border closure implemented by the Federal Government of Nigeria.

Export crops; cocoa and ginger, posted positive returns over the period with a season to date performance of 4.90% and 75.33% for cocoa and ginger respectively. The net effect of demand and supply actors in the market triggered the return posed with ginger enjoying the greater benefits of heightened demands from India, EU and other export markets. Volatility was highest in the ginger market with daily volatility of 7.01%.

Production in the ginger market has been free from the disease infestations witnessed in previous years, and the favourable weather condition witnessed also spurred production in key areas. According to our expectation, tailwinds such as the increased demand for ginger of Nigerian origin will be important in determining price movements and fueling price rally to about N600, 000 at the peak of the season.

On the other hand, excess rainfall in cocoa-producing areas triggered widespread speculations of production declines and hence output shortfalls in the domestic markets. The intensity and aggressiveness of aggregation witnessed post-harvest of the main crop has stimulated a massive price rally. From early aggregation evaluations, the number of participants sourcing cocoa from Nigeria has spiked with a cocoa-aggregator ratio increasing from 1T – 3/4 aggregators to 1T – 6/7 aggregators. We anticipate a price increase of almost 40% as the season progresses.

In this edition of the commodity review, maize is the focus commodity with a total production of 10.42 million tonnes (FAO 2017) and consumption of 11.10 million tonnes, indicating a deficit in the country. The maize value chain spans from the farmers who majorly own less than 1 hectare and with a productivity of about 2.5 tonnes per hectare through marketers who facilitate the linkage of farmers (producers) to the final industrial and household consumers in the country. Across the country, Kaduna, Niger and Taraba remain the largest producers of maize with an estimated production of 937,820 tonnes, 745,110 tonnes and 608,730 tonnes respectively. On the consumption side, the animal feed and baby food companies consume the largest quantities driven by burgeoning demand for animal protein, increasing population and an expanding dietary awareness amongst the population.

Moving forward, the consumption of maize is expected to grow with the fundamental drivers remaining strong. We anticipate that production growth will continue to lag consumption growth by at least 1.2% per annum, raising the prospects of continued imports of maize to cushion the domestic supply deficit.

Global Commodities Markets

2019 has been a tumultuous year for agricultural commodities as prices gyrated due to a combination of political, environmental, demand and supply related factors. The price volatility has been broad-based, cutting across all agricultural commodity classes with the grains and oilseeds taking the heaviest blows. On a generic level, the synchronized global economic slowdown as occasioned by reducing government and household expenditures and the lingering US-China trade war has contributed significantly to the dip in demand for commodities, thus serving as the background for the swings witnessed in commodity prices.

Factors Shaping Global Commodities Markets

The commodities market in 2019 have been influenced by two major events; the synchronized global economic slowdown and the US-China trade war. The combination of these has had broad-based effects on assets across all classes of the commodities universe.

Global Economic Slowdown: In 2019, the global economy was characterized by a widespread slowdown, affecting all regions of the world. The slowdown which trails the global financial crisis is fueled by the reduced investments in Emerging and Developing Economies (EMDEs), narrowing household expenditures in developed economies, trade policies and other idiosyncratic risks confronting economies across the world. At the end of October 2019, the IMF and World Bank projected global growth of 3.1% and 2.6%, down from earlier estimates of 3.5% and 2.9% at the beginning of the year. The risks to global growth remain tilted towards the downside as structural gaps in the European Area, US-China trade war and political lockdown in the UK continue to take centre stage. In response, central banks across the world have pivoted towards accommodative policies with the US Fed dropping its policy rates to 1.50 – 1.75% in October and the European Central Bank (ECB) maintaining the -0.5% deposit rate and announcing a bond repurchase program to stimulate spending in the economy.

US-China Trade War: The 22-month long trade debacle between the two largest economies in the world has rattled the global economy with disruptions in supply chains and increased cost of production. More importantly, the trade war has triggered a slowdown in China, which has, in turn, dampened the demand for commodities globally. Needless to say, the bilateral increase in tariffs placed on goods emanating from both countries has reduced the imports of key agricultural produce and hence, weakened the prices of commodities as Chinese agricultural imports from the US slumped by 45% to USD13.2 billion. Despite the positive sentiments surrounding recent rounds of trade talks, the risks are still high with the prospect of all of the USD500 billion Chinese exports to the US exposed to tariff hikes by December 2019.

Commodity Price Performance

Prices of grain crops have declined considerably following crop specific factors influencing the price-performance witnessed so far in 2019. The overarching theme however stimulating the current market conditions include the US-China trade war and declining household expenditures

Maize

After reaching a 12-month low of USD6,191/MT in September 2019, maize prices recovered to USD6,580, indicating a year to date return of 0.24%. Maize prices have become more volatile in 2019 with monthly standard deviation reaching USD11.45 from USD8.06 in the same period in 2018. The increased volatility comes on the back of tensions surrounding the US-China trade war and a bleak output expectation in the United States and Argentina due to weather-related lower plantings. Despite the bleak production outlook in the US, positive production expectation in other major producers such as the European Union, South Africa and Russia will counterbalance global production figures.

Positive developments surrounding the US-China trade war are expected to buoy the levels currently witnessed in maize prices.

Paddy Rice

Rice markets have remained largely stable in 2019, with Thai 5% long grain contract settling at USD424/MT, indicating a gain of 3.41% at the end of October 2019. This represents a reversal from the loss of 7.47% witnessed in the same period in 2018 and a drop of 10.49 in the monthly price volatility in the rice markets. The initial appreciation in the price of rice on the global markets followed the expectation of poorer production in major producing countries such as India, Vietnam and Bangladesh. On the contrary, weather outcomes have proven to be more favourable than expected and as such, output outlook has been revised upwards in October.

Wheat

Wheat prices settled at USD7, 820/MT, recovering from the 13 month low witnessed in April 2019. The commodity returned a YTD (October 2019) of -3.32%, dragging significantly behind the 17.25% made in the same period of 2018. The monthly volatility in the price of the commodity also trended downwards by 1.25 at the end of the period. The see-saw movement in the price of wheat has been primarily influenced by the production expectation in Australia, EU, Central Asia and the United States. Following a recent assessment of production by the USDA, end of season output is expected to climb by 5%.

Soybeans

Soybean prices have witnessed the largest volatility amongst the grains and oilseeds in 2019 as it is whipsawed between the US-China trade war and the outbreak of the Africa Swine Virus in China. To put in perspective, China is the largest importer of Soybean and the outbreak of the Africa Swine virus which has wiped out almost 70 million heads of pigs significantly dampened the demand for soybean in China. Notwithstanding the challenges, soybean posted a YTD return of -0.08% at the end of October, better than -5.54% posted in the same period in 2018. Monthly volatility has also reduced to 12.34 from 27.69 during the peak of the tariff hikes under the US-China trade war.

Moving forward, the prospects of a resolution on the part of the US and China raise the possibilities of resumed imports in China and increased prices in the commodity. Also, the effects of substitution from soybean to other crops (maize especially), is likely to add to the pressures on soybeans, driving the price up in the 6-9 months horizon.

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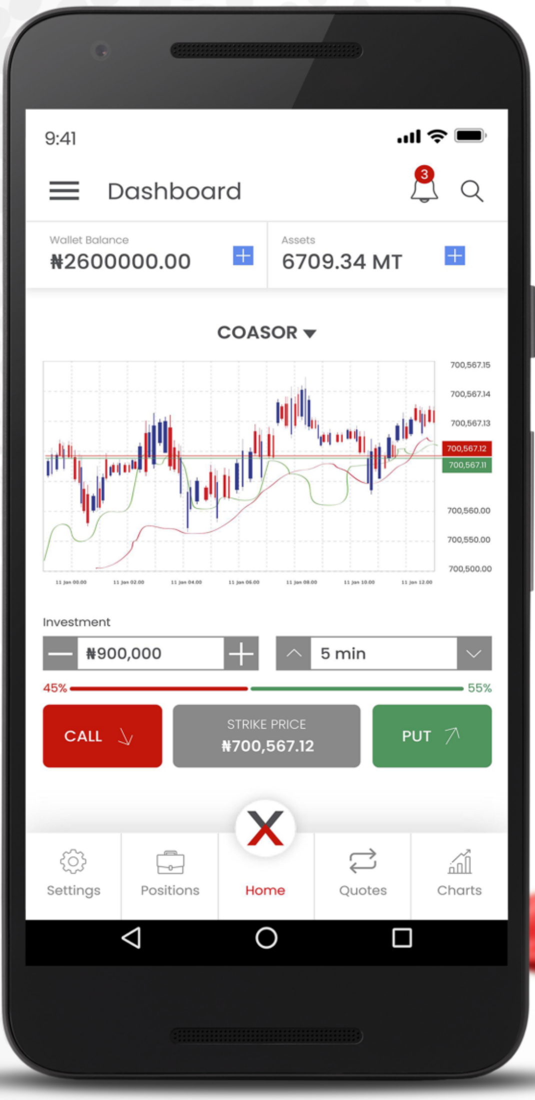

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Domestic Commodity Markets

Commodity markets in Nigeria are largely informal with open markets representing the majority of the trades executed. For the commodities traded, grains (Maize, Rice, Sorghum) and oilseeds (soybeans) remain the most liquid and tradable commodities with year-round demands necessary to stimulate trades. Under the production dynamics employed in Nigeria, (Rainfed Agriculture), the supply of the commodities into the market is seasonal and results in significant gyrations before a considerable stabilization as the season progresses. The local commodity markets are disproportionately skewed towards the northern part of the country where the majority of the supply of annual crops emanates. This skewness, although not absolute for all commodities, positions the region as the hotbed of commodity trading activities in the country. Besides, the local market helps to serve the trans-Saharan trading routes to neighbouring countries.

The structure of the commodities market in Nigeria reflects the business limitations faced by farmers and off-takers, and the production dynamics in the country. This provides viable ventures for the aggregators, traders and merchants who serve as the backbone of the markets. The commodity markets consists of several actors ranging from the primary producers who serve as the ultimate supply points in the markets, the aggregators, traders and brokers who provide the marketing functions and serve as the skeletal framework for the system and the off-takers (industrial and retail) who serve as the ultimate demand points in commodities markets.

Domestically, maize and soybeans remain the most liquid commodities owing to the diverse use of the commodities across industries in the country. Despite the historical importance of cocoa, trades have declined significantly with the international market spurring the greater proportion of trades. In addition to the three commodities mentioned, sorghum, paddy rice, sesame and ginger have become economically important as the increased demand by industrial users; locally (Sorghum and Paddy rice) and internationally (Sesame and Ginger) prompt the attention of stakeholders along the value chain.

Domestic Commodity Performance

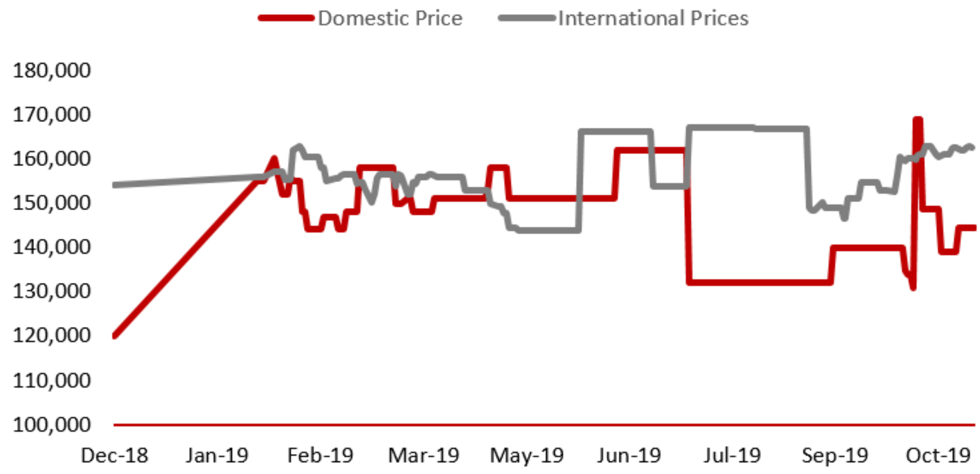
Soybeans

Soybean production in the 2019/20 season has been characterized by a significant amount of rainfall and temperature. Across key producing areas like Benue, Taraba and Katsina, average rainfall fell within the required band for soybean production, albeit with pockets of flooding Benue and Taraba. Post-harvest activities have however raised concerns as the delayed rains to prolong the drying period, prompting fears of aflatoxin development. Sequel to rainfall receding in the last two-three weeks, we anticipate that new harvests will hit the market by mid to ending of November, formally initiating the procurement season for soybeans. Already, we observe the influx of 13-14% moisture content (MC) beans and expect the MC to decline further as the harmattan season intensifies.

Price Performance in 2018/19 Marketing Year

Prices of soybean in the 2019/18 marketing year have flip-flopped as demand and supply elements influence the prices over the period. At the end of the period (October 2019), soybean prices settled at NGN144,530 (Ex-Ibadan), indicating a season to date return of 20.44%. Over the period, the price reached a season-high of NGN162,000 in June 2019 due to significant demand pressure witnessed in the markets.

Chart 1: Soybean Price Trend 2018/19 Marketing Year



Source: AFEX Market Data

Price Outlook

The demand for soybeans remains strong as more players flock into the demand creating industries. The demand dynamics in this season is more complicated as the closure of land borders with neighbouring countries increase the demand for poultry products which in turn place some pressure on the soybean market. We anticipate a conservative growth of 5 – 6% growth in soybeans consumption in Nigeria.

The interplay between the demand and supply forces are already visible in the market as farm gate prices are set to support levels at NGN115,000, NGN100,000 and NGN110,000 respectively in Benue, Taraba and Kaduna states. This provides a glimpse of the price appreciation expected in the soybean market this year. We hold the opinion that prices will rise by as much as 25% - 30% following the factors described above.

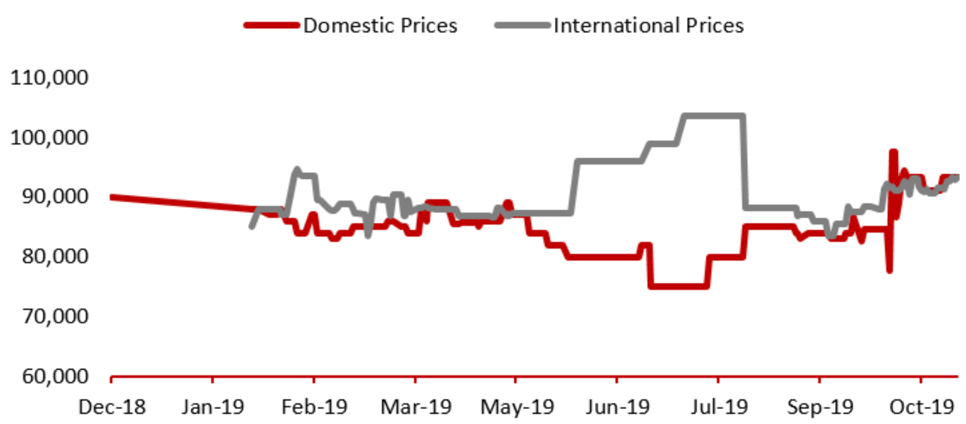
Maize

The 2019/20 season has been particularly bountiful with temperature and rainfall remaining within the conducive range for maize production across the country. The downside affecting production, however, has been the late-season rains which extended into November and prevented the commencement of post-harvest activities. In addition to the delayed rainfall, flooding in some key producing areas such as Saminaka, Soba and Zaria in Kaduna state raises the tendency for post-harvest losses as matured crops on the field are exposed to mould formation and regermination in some cases. Harvests of maize in Nigeria occurred later than usual this year as the extended rainfall period mandated a delay. The supply of maize in the 2019/20 marketing year is expected to decline due to the incidences of flooding witnessed in key producing areas of Kaduna and Taraba states. We anticipate that harvests will extend from mid-November to mid-December when virtually all farmers across the country would have concluded the harvests.

Price Performance in 2018/19 Marketing Year

The 2018/19 marketing year has posed varying outcomes for the maize commodity market with prices trending downwards at the beginning of the season as oversupply witnessed at the early part of the season pushed down prices to a season low of NGN75, 000 in July 2019. The negative trend that dominated the season was however reversed at the tail end of the season as general price levels trended upwards, propping prices to settle at NGN93, 280, indicating a season to date of 3.64%. All through the season, price movements also witnessed slightly lower volatility with season volatility of 33.60% and daily volatility of 2.39%. Over the period, monthly volatility peaked at 11.00% in July as the end of season frenzy for dry maize drive up prices of the commodities. Maize prices bucked the characteristic movement of commodity prices, i.e price appreciation as the offseason progressed.

Chart 2: Maize Price Trend 2018/19 Marketing Year



Source: AFEX Market Data

Price Outlook; what's Different with the Cobs this Time

Already we have witnessed the increase in prices of maize with price settling at N90,030 at the beginning of the season. This indicates a higher price level as against the same period of 2018. We anticipate that the aggressive push by industrial users to procure as much maize as possible will push up prices of the commodity, spiking by 19% at the peak of trading this year.

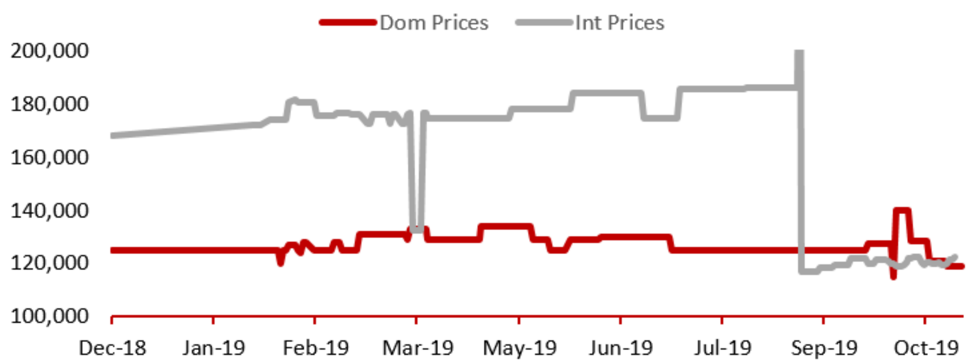
Paddy Rice

The 2019 production season has been bountiful for paddy rice production in Nigeria as the abundant rainfall and adequate sunshine all through the season set the pace for a rise in output at the end of the production. In addition to the conducive weather P this year, farmers in producing areas across the country have continued to allocate more lands to rice production owing to the aggressive efforts made by the government in promoting its rice import substitution drive. The downside, however, is the spike in demand witnessed as a result of the closure of all land and sea borders as implemented by the federal government of Nigeria. Despite incidences of flooding in rice-producing areas of Taraba state, preliminary estimates of national production are expected to rise by 10%, reaching 9.24 million tonnes.

Price Performance in 2018/19 Marketing Year

Rice prices in the domestic markets have swung widely throughout the season, reaching a peak of N140,000/T before settling at N118,770, indicating a Season-to-Date of -4.98% at the end of October 2019. The price movements have been mostly influenced by the fundamental cycle within each season as we have witnessed over the years. In addition to the fundamental cycle in prices, the closure of all land border has raised the fluctuations as local millers and processors jostle for the commodities available in the country. Intra-season volatility, as measured by the standard deviation of prices reached 29% during the season with October, February and May witnessing the highest volatility in prices. In comparison to the international prices, differentials followed the dynamics dominant on the various markets with the closure of the local borders pushing the differentials into the negative territory.

Chart 3: Rice Price Trend 2018/19 Marketing Year



Source: AFEX Market Data

Price Outlook

The closure of the borders has set the pace for a rather volatile price environment in the paddy rice markets with intra-month gains in October climbing up by 9.80%. This price behaviour has shifted the support for paddy rice prices from NGN125, 000/MT as witnessed at the end of the past marketing year (2017/2018) to NGN140, 000/MT which we currently experience (2018/2019). By implication, supply-side agents (farmers, traders and merchants) are faced with a more profitable year ahead.

Our outlook for paddy rice prices in 2019/2020 marketing year is that of a 15% rise in prices as the impact of demand spike is expected to be mitigated, albeit marginally, owing to improved weather conditions in core producing areas across the country.

However, if the trade stalemate remains till November, rice prices could go higher than 20% as processors ramp up procurement to fulfil the seasonal increase in rice demand witnessed in December.

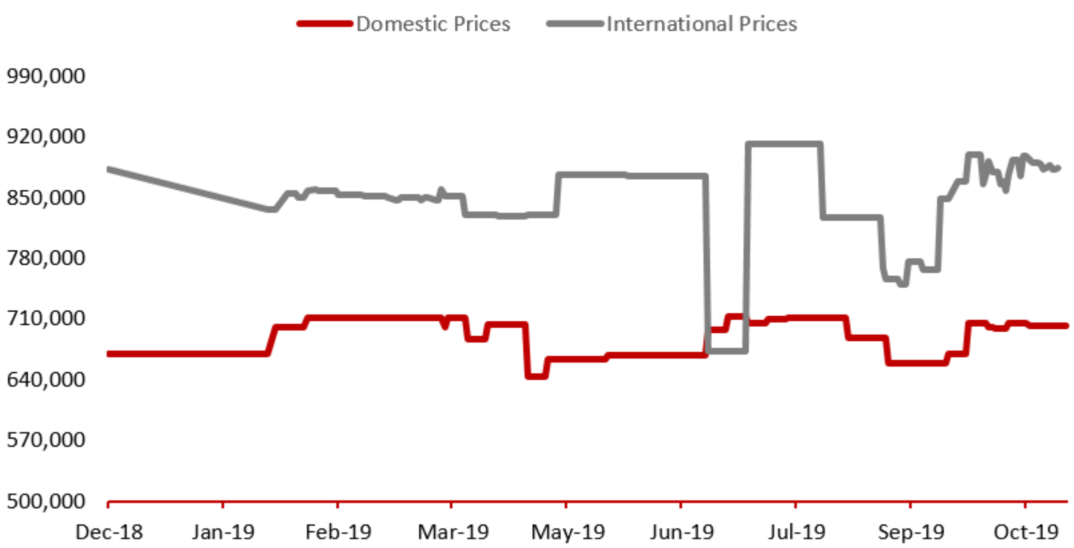
Cocoa

Production of cocoa in Nigeria has been downbeat in the 2019 season as the extended rainfalls along the cocoa belt impacted harvest and post-harvest activities, leading to increased occurrence of rotten pods and by that, lower production output. The situation has been more intense in the south-south region where rainfalls have been heaviest of all locations. The market position has induced a supply shortfall of almost 20-30% according to our preliminary estimates. Harvests of the main cropping which usually run from have also extended further into the end of the year as farmers across these core producing locations indicate that they still have pods ripening on plantations.

Price Performance in 2018/19 Marketing Year

All through the 2018/19 marketing year, cocoa prices remained largely favourable for local exporters with positive international – domestic price differentials holding for the better part of the season. Domestic prices reached a season-high of N713,000 in July owing to increased demand following the light crop harvest which ran from May to September 2019 and consequently settling at a season to date of 4.90%. The intra season volatility witnessed in the cocoa market was the second-highest of all the commodities traded on the exchange with a standard deviation of 43%. Demand elements have been responsible for the greater proportion of price movements witnessed in the cocoa markets in 2018/2019 marketing year as more international buyers invest in local sourcing mechanisms rather than leveraging on domestic exporters.

Chart 4: Cocoa Price Trend 2018/19 Marketing Year



Source: AFEX Market Data, ICCO

Price Outlook

Activities in the cocoa markets have reached multi-year highs with local buying agents, exporters, aggregation companies and local industrial users flocking the core producing areas for supplies. The market condition is further compounded by the less than stellar output witnessed at the end of the production season. Prices have appreciated by more than 10% so far with market participants anticipating further price increases in the coming weeks.

Preliminary evaluation of the demand-supply situation in the market indicates a spike in the number of demand agents – cocoa supply ratio. We observe a rise from the characteristic 3 agents – 1 tonne of cocoa to 6/7 agents – 1 tonne of cocoa. Also, the number of open contracts as measured by failed or declined sales have increased as more farmers hoard the commodity in anticipation of further price increases.

In addition to domestic market sentiments, increased grinding activities in Sub Saharan Africa and Asia as well the likelihood of price floor establishment by Ivory Coast and Ghana have stimulated the demand for cocoa beans.

We estimate that prices will increase by up to 40% from N650,000 witnessed at the beginning of the season.

Ginger

Ginger production in Nigeria is catching up to be included in the mainstream root crops produce in the country. The growth in production has been largely fueled by the profit levels attainable and the export perspective of the demand elements. The production of the crop in 2019 has been largely successful with the incidences of pest and disease infestation that plagued 2017 season, barely occurring and the agro-ecological conditions turning out to be favourable to support bountiful harvests. Harvests are expected to conveniently surpass 2018 output by c.20%. This estimate is prompted by the impressive crop performance witnessed in core producing areas in southern Kaduna; Kwoi, Kafanchan, Katchia and other communities present in the area. Under the estimate stated, national output in 2019 could safely reach 813,440 tonnes.

Price Outlook

Given the export potential of ginger and the influx of agents sourcing on behalf of international buyers, the ginger market has gained significant impetus closing the last season (2018/2019) at about 75.33% high. The trend is also shaping up in 2019 as the prices observed at the beginning of the season have remained elevated above those witnessed in previous years. Prices started the 2019/2020 marketing year at 430,000 – 450,000 for cleaned ginger, representing about 80-87% higher than prices at the beginning of the 2018/2019 marketing year.

From all indications, prices will appreciate significantly in the 2019/2020 marketing year with the possibility of hitting N600, 000 very rapidly. The increased demand elements from international buyers will dominate the outcome of the markets.

Sorghum

Without doubt, sorghum output from the 2019 production season will increase as the favourable weather conditions witnessed across multiple production locations in the country indicate bountiful harvests. Preliminary estimates from harvests reaching the markets so far show that national output is to increase by at 7-10% as cultivation across key locations in Katsina and Gombe showed improvement throughout the season. The downside, however, is a tempered demand environment as Alcohol and beverage industry, which serve as the highest demand source have remained lethargic in mopping up supplies as we have in other crop value chains like maize and soybeans. From our evaluation of market activities, end-year inventory levels will be higher than last year as demand agents hold back on the procurement drive.

Price Outlook

Following the demand-supply expectation for sorghum in the coming season, we anticipate that sorghum prices in the 2019/20 marketing year will be largely subdued with a meagre gain of 4-5%. This is due to the favourable weather condition which is expected to boost production and the lacklustre demand pattern building up so far. We anticipate this will limit the appreciation possible for the commodity.

Strategies to Beat the Pack

The 2019/2020 marketing year has proven to be highly competitive with a significant increase in the number and sophistication of buyer participating in the markets. To put in perspective, the demand-supply ratio of the cocoa market has increased from 3:1 to 6/7:1. The grains market also show similar demand-supply dynamics with maize, soybean and paddy rice increasing by 4.72%, 5.99% and 10.32% respectively. To increase the chances of fulfilling orders and achieving the procurement targets of off-takers and industrial users along the various value chains in the country, we outline the following strategies:

1. **Early Season Aggregation:** As established in previous sections of this review, commodities price movements are seasonal, indicating that prices will fundamentally rise as the season progresses and volumes traded in the open market dwindle. To mitigate exposure to this price and supply risk, we advise aggregation during harvest periods to ensure an adequate supply of commodities during the lean season. This strategy ensures that the supply of commodities is assured and price shocks mitigated.

2. **Exchange-based Aggregation:** Owing to the cash implications of the first strategy, an alternative aggregation strategy will be the use of the wide network of traders transacting on the exchange to pursue fast aggregation. This strategy leverages on the network effects of the exchange and ensures strict adherence to the quality and quantity parameters required to facilitate smooth transactions.

Both strategies suggested above will also provide the off-takers with the opportunity to aggregate based on the deep understanding of the commodities market in Nigeria. Also, the OTC contracts will allow for location-based aggregation to fulfil the peculiar need of factories across the country.

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Appendix

Reference Locations for Commodities Traded on the Exchange

Commodity	Reference Location
Maize	South West
Soybeans	South West
Ginger	South West
Cocoa	South West
Paddy Rice	North West
Sorghum	North West

Note: Reference locations are selected based on the volume of demand for domestic commodities and port cities for export commodities.