ALITHEIA CAPITAL

Market Update

Friday, November 28, 2008

HIGH CEMENT COST DRIVES UP CONSTRUCTION COST

A major constraint to real estate development in Nigeria is high construction cost. Cement accounts for more than 35% of the cost of construction. The price of cement is highly sensitive to market demand and supply, as well as macroeconomic factors such as energy prices and inflation. **B**etween January and February 2008, the price of a bag of cement rose 63% from $11.25 to $18.33. This was partly due to the take off of more than 20 major projects comprising of housing estates, luxury apartment blocks and commercial buildings in the Ikoyi and Victoria Island areas of Lagos.

In Q 2 the price of cement dropped significantly to $11.35 but rose again to ($13.75) in Q3 2008. The drop in oil prices in November 2008 is not expected to have a corresponding effect on the price of cement. However, the depreciation of the Naira is expected to push up the price of cement in the course of the year.

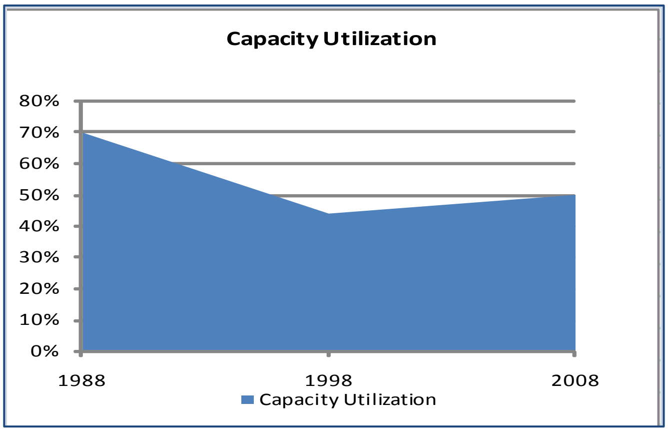
Cement Companies	Installed Capacity (kg/annum)	
Ashaka	1,321,914	23%
Unkpilla	795,395	14%
Benue	795,395	14%
Calabar	75,455	1%
Nkalagu	204,654	4%
Sokoto	392,547	7%
WAPCO	2,247,002	39%
Total	**5,832,362**	**100%**

The Nigerian Cement Industry is the largest in West Africa. Based on information from Cement Manufacturers Association of Nigeria (CMAN) local capacity is in the region of 5 million metric tonnes. However, the local cement manufacturing companies are not producing at installed capacity. Information from CMAN indicates that between 1981 and 1990 the capacity utilization of the industry fluctuated between 70% and 58%. As at June 2008, capacity utilization had dropped to below 50%.The low capacity utilization has been blamed on the power outages and anemic natural gas supply.

Currently, Nigeria's consumption pattern for cement is 75kg per capita; Ghana's is 175kg per capita whilst South Africa's is 280kg. Nigeria's relatively low consumption indicates that the Nigerian cement market is short-supplied. The total national demand for cement is estimated at 15 million metric tonnes while local production is in the neighborhood of 3 million metric tonnes, leaving a gap of 8 million metric tonnes. Between 2000 and 2006, Nigeria imported about 40 million metric tonnes of cement at a cost of over $3bn, according to manufacturers.

Nigeria's policy on cement importation provides that waivers be given to only those industrial firms that have plans to manufacture locally. The policy was designed to augment the supply and protect the local manufacturers. The companies that responded favorably to the government's invitation to import in March 2008 were Flour Mills of Nigeria Plc; Eastern Bulk Cement Company, Port Harcourt; Nigerian Spanish Cement Company, Apapa Management Enterprise Limited, Lagos. Recently, Dangote Group and Ibeto were added to the list. All of these companies combined had only utilized approximately 60% of their import quotas by end of October 2008.

Dangote Cement in October 2008 announced plans to invest $3.5bn in the cement industry in Nigeria and over $5bn across Africa. It plans to reach installed production capacity in Nigeria of 26 million tonnes by 2010 and 50 million tonnes across Africa by 2012. The Dangote group's Obajana Cement factory, in Kogi State of Nigeria, was initially conceived as a 5 million tonnes per year capacity facility. Phase 1 of the project launched in 2007 is yet to take off.



WAPCO, a major manufacturer of cement in Nigeria (40% local market share), is planning to increase capacity by 2 million tonnes per annum over the next 2 years. A new entrant, Otedola Portland Cement is expected to begin production before the end of 2008 and is expected to sell cement at $5.60 per 50kg bag, about 40 percent less than the current market price.

Considering the volume of new and existing construction projects, demand for cement will continue to exceed supply in 2009, in spite of manufacturers' efforts to expand capacity. Thus, the likelihood of cement prices dropping significantly in 2009 is low. Also, given the volime of cement that is imported, the price of cement will also be negatively affected by the depreciation of the Naira in Q4 2008.

NEWS FLASH

- **THE CBN ISSUED ITS REVIEW OF THE MONETARY POLICY COMMITTEE (MPC) DECISION in September 2008.Below are the key issues:**
  - Rise in headline year-on-year inflation in October to 14.7% from 13%.
  - Core inflation rose to 7.9% in October from 6.9% in September.
  - GDP growth rate for 4 is 8.69% according Nigeria Bureau of Statistics.
  - Interest rates have stabilized, thought a slight increase was noticed in early November 2008.

  MPC decided as follows:
  - Leave the MPR unchanged at 9.75%
  - Reduce banks' foreign exchange net open position from 20% to 10% of shareholders' funds with effect from December 15, 2008.

  The MPC's decision is expected to stabilize the economy despite the ensuing Naira depreciation. For the real estate market, construction cost will likely increase, which will negatively increase the profitability of ongoing projects. In addition, the pressure on banks is expected to lead to a 2% to 4% upward review of rates on outstanding loans and mortgages.

- **2009 BUDGET PROPOSAL PRESENTED TO THE SENATE**
  The 2009 Budget is to give priority to the completion of ongoing projects, which will quickly deliver tangible results in service delivery. Accordingly, rather than embarking on new projects, this Administration has opted to devote more resources to completing existing projects and discharging outstanding obligations from the 2007 and 2008 fiscal years. This could result in a dip in the rate of construction, which has previously followed an upward trend.