Cytonn Weekly Update: Kenya's Growth Potential

Cytonn Weekly

Executive Summary

- *Fixed Income: Rates for government securities remained unchanged, even though investor interest remains strong. The Kenya Shilling was relatively stable during the week. Continued strong interest in government securities is expected to further support the Kenya shilling*
- *Equities: The NSE experienced a decline, with NASI down 2.1%, mainly attributed to banking stocks earnings reported so far missing expectations*
- *Real Estate: Two significant announcements highlight the investment opportunity in middle class housing; Phatisa?s one-bedroom projects and Jamii Bora?s polystyrene house*
- *Private Equity: Centum exiting most of their current investments in order to focus on Real Estate and Infrastructure*
- *Focus of the week: among the economies projected to register the fastest growth this year, Kenya has been ranked third globally, after China and Philippines with a projected growth rate of 5 to 6%, which in our opinion is well within reach*

Weekly rates for our Cash Management Solutions Private Placements

Date	Currency	3 Months	6 Months	12 Months
March 9, 2015	KES	12%	13%	14%
	USD	5%	5%	5%

Fixed Income Update

During the week, government securities received over-subscriptions at 259% for the 91 day T-bill, while the 182-day and 362-day T-bills had 150% and 516% subscription rates, respectively. The yields however remained relatively unchanged at 8.5% for the 91-day paper while the yields on 182-day and 364-day papers were 10.4% and 10.8% respectively.

The CBK announced that it would sell a 12-year amortized infrastructure bond of Kshs 25 billion, with a coupon of 11%, on 25th March 2015. Proceeds from the sale will be used to fund various government projects in the transport and energy sectors. This comes at a time when increased government expenditure on infrastructure has been attributed to better economic performance. We will have a better view on the attractiveness of this bond as we come closer to the issue date.

The Kenya Shilling gained marginally against the U.S. Dollar (USD) to trade at Kshs 91.17/USD as compared to last week?s rate of Kshs 91.42/USD.

The issuing of the government infrastructure bond is expected to increase foreign inflows and hence provide support for the Shilling. However, despite investor appetite for long dated paper (as evidenced by the 364 day subscription), rates remain unchanged.

Equity Market Update

The NASI was characterised by bleak performance with the index falling 2.1% during the week to close at 172.3 points; this was mainly driven by a drop in banking sector stocks as they started reporting earnings, which have so far mainly disappointed investors? expectations. There was increased activity in the banking counters as the release of financial results entered its second week. NIC Bank and National Bank (NBK) became the latest banks to announce their results with NIC posting a rise in profit of 27%, helped by growth in its interest income. In contrast, NBK recorded a profit decline of 21.7% due to an increase in operating expenses as well as a one-off restructuring cost. However, the lender also announced plans to expand into South Sudan with funding from its upcoming rights issue. Among the media counters, Nation Media Group (NMG) was the week?s biggest loser, falling 11.9% on perceived loss of revenue due to the digital migration standoff with the Communications Authority that led to a nationwide television blackout. With leading television stations set to resume digital broadcasting, we believe an upward correction in share prices of communication services like Standard Group and NMG will occur in the upcoming weeks.

Derivatives? trading at the NSE is scheduled to start by June 2015 providing a platform for investors to hedge against financial risks. The bourse intends to start with single currency and index contracts that allow settlement in cash. This will attract more foreign investor participation at the bourse as well as an increase in risk taking. Though a welcome step, we believe risks are still skewed to the downside, as participants in the derivatives market require a certain level of sophistication and understanding of these financial instruments. In addition, Kenya?s capital market is currently not as liquid to allow the ease in execution of the contracts which is enjoyed in more developed markets.

In global markets, European Central Bank president Mario Draghi committed to start his 1.1 trillion Euro bond buying program next week sending Stoxx Europe 600 to its highest level in 7 years on optimism that the stimulus will spur the Euro zone?s fastest economic growth since 2007. In Japan, the Nikkei 225 also closed the week at new highs of 18971 points on this positive Euro zone sentiment and a weaker Yen that touched 120 per Dollar.

Real Estate Update

South African based private equity (PE) firm, Phatisa is set to develop studio apartments in the heart of Lang?ata at a cost of Kshs 1.8 billion. The project will involve construction of multiple blocks containing of 1, 400 units on a six-acre plot located along Magadi Road, off Lang?ata Road. The executive studio flats will be rented out upon completion to young professionals as well as students living around the locality dominated by education institutions. The project will be funded through a mix of debt and equity from Phatisa?s Kshs 3.8 billion Pan African Housing Fund. In addition, the PE firm is also constructing a 14-storey residential apartment block in Westlands of 80 one-bedroom units each retailing at Kshs 9.9 million. Phatisa are building on the residential houses gap that exists and now that the Kenyan economy is projected to grow at 6%-7% we expect to see more demand for real estate and private equity and this further reiterates the existing opportunity to participate in the Alternative markets of the fastest growing country in SSA.

During the week, Jamii Bora Bank (JBB) and Koto Housing Kenya signed a Kshs 1 billion financing agreement in which houses made from polystyrene will be constructed within three weeks. The partnership stipulates that potential home owners will get funding from JBB and then choose a design from Koto Housing, a Mavoko based company that manufactures buildings materials and also constructs houses. The houses will be priced at Kshs 3 million for a three-bedroom house and Kshs 8 million for a five-bedroom house offered through a mortgage loan facility set at 18% over a period of between 5 and 20 years. The joint venture will benefit the home buyers by reducing the time between taking up a mortgage and moving into the completed house. It will also reduce the concurrent rent expenses incurred in addition to the monthly repayments made when the house is still under construction. The bank has heavily invested in the real estate sector having signed three deals worth Kshs 2.8 billion in 2014 as it seeks to take advantage of Kenya?s housing deficit that stand at 150,000 houses per year by offering affordable housing with flexible payment plans.

Private Equity Update

Centum Investments is planning to sell its stakes on various firms in the next 18 months to raise funds for new investments in power plants and real estate sectors. The firm has in the past few years increased its investments in real estate, which now account for 30% of its portfolio. Currently under construction is the mega Two Rivers mall which is set to host the largest mall in East Africa at a cost of Kshs 60 billion. The firm has also ventured into power generation with a 70 megawatt (MW) geothermal plant at a cost of Kshs 27 billion, after winning the bid for the 1,000 MW of the mega Lamu coal deal which will be completed in the next three years at a cost of USD 2 billion. This will avail cheaper fuel that will propel economic growth and industrialisation, and also provide investment opportunities for both local and foreign investors.

Focus of the week is Kenya's growth potential

The sluggish economic growth across the globe in the past few years has enabled frontier markets such as Kenya to cement their place as favorable destinations for investors seeking attractive, long-term and stable returns. This is evidenced by the paltry 1.3% that the Eurozone is projected to grow by this year. The U.S. economy expanded marginally in 2014, increasing by 2.4% up from 2.2% the previous year; while in Asia, the World?s number two economy, China, has admitted that downward pressure on its economy has increased significantly.

In stark contrast to the developed markets, most countries in Sub-Saharan Africa are poised to grow significantly. Evidence to this is the average regional growth rate of 5% in 2013 and an estimated 5.8% in 2014. Excluding South Africa, the figures are 6.1% and 6.8% respectively. Within Sub-Saharan Africa, East Africa is the most promising destination as West Africa grapples with poor growth, commodity shocks and insecurity. In East Africa, we can narrow down to Kenya, the country is poised to capture growth in East Africa. The opportunities were further highlighted in a recent report by the World Bank (*Anchoring High Growth: Can Manufacturing Contribute More?)* which highlighted that Kenya has emerged as one of Africa?s key growth centers with sound economic policies in place for future improvement. In addition, it estimated Kenya?s growth to be 6% for the year followed by 6.6% in 2016 and 7% in 2017, propelled by improved infrastructure, agriculture and manufacturing industries. This is further supported by the third place global ranking Kenya got in the Bloomberg survey of economies projected to register the fastest growth this year.

How will this affect Investing in Kenya?

Currently, the interest rates in developed markets are low given that the Eurozone just began its Quantitative Easing (?QE?) program and the U.S. Fed announced that interest rates would not be raised soon. (QE is the process by which central governments can jump-start the economy by pumping money into the economy by purchasing assets.) For investors seeking high returns, Kenya is a good destination especially in the alternatives sector where we expect to see more Private Equity firms injecting fresh capital into SMEs and family businesses that want to expand to meet the demands of the growing economy, supported by a favorable macroeconomic outlook.

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