

Cytonn Weekly Update #11 with a focus on increased High Net-Worth Investor ("HNWI") allocation to Real Estate

Cytonn Weekly

Executive Summary

- **Fixed Income:** Kenya Shilling touched a three-year low of 92.1 against the Dollar, as the Dollar rallied on expectations of a rate hike soon; and government securities continued to receive oversubscriptions even as yields remain relatively unchanged
- **Equities:** The NASI remained largely flat, gaining only 0.26% as companies continue to report earnings
- **Real Estate:** Rents in Nairobi are the most expensive in the Country, as highlighted by the 2014 Lands and Urban planning report
- **Private Equity:** Private Equity continues to be the financing option of choice for high growth companies, as evidenced by Chase Bank seeking an equity private placement to inject additional capital to finance its fast growth. The Halton's deal with Tuskys together with the recent Catalyst deal with Mimosa indicates a quiet transformation in the Kenyan pharmacy / chemist business from fragmentation to chain stores business akin to, say, Boots Pharmacy in the UK
- **Focus of the week:** Kenya is set to see a significant growth in wealthy Kenyans who are increasingly investing a substantial slice to real estate in Kenya
- **Cytonn Company Updates:** This week we increased our team with Hetal Nathwani joining us as Business Development Analyst and Rose Kibe as Investment Analyst, both are graduates of the Cytonn Young Leaders Program; we take a class of top graduates fresh from universities into a 3-month training and then recruit the best of the class to join the team. Next program begins in May 2015.

Fixed Income Update

During the week, the yields on T-bills were unchanged, with the 91-day T-bill remaining at 8.5% while the 182-day and 364-day papers had yields of 10.3% and 10.6% respectively. The government was seeking to raise a total of Kshs 8 billion from the issuance of T-bills, and the market was willing to provide liquidity, as evidenced by general oversubscription across the board. There was, however, a tendency by investors to favour longer dated paper, which supports our view that investors expect a future decline in interest rates hence the need to lock in attractive rates now.

The Kenya Shilling touched a three-year low of 92.1 against the Dollar on Wednesday, but later gained marginally to close at 91.9 on Friday. The weakening of the Shilling could be attributed to a global Dollar rally on expectation that the Fed will hike interest rates soon. With the FOMC statement in the US removing the word 'patient' from their forward guidance, pushing forward expectations of a rate hike, at least in the near term, we expect the Dollar rally to pause and the Kenya Shilling to stabilize in the coming weeks.

Equity Market Update

The NASI gained 0.26% during the week as performance was lifted by price rallies in blue chip stocks including EABL and Safaricom. EABL rose 4.8% on the announcement of the launch of Chrome Vodka, a low-priced vodka that targets the lower end of the market and will be priced at Kshs 460 for a 750ml bottle. The brand is expected to boost sales, making up for the reduction in sales of its Senator Keg that was subjected to a 50% excise tax. With a recent PwC report citing Nairobi's 12.5% growth in entertainment and media expected to continue until 2018 on the back of rising disposable incomes, we expect EABL to outperform and enjoy a period of increasing sales; this is already evidenced by the brewer experiencing double digit growth in each of its product categories, except its mainstream category, where Chrome vodka is classified and expected to give a boost.

Co-operative Bank posted a 12% decrease in Profit after Tax to Kshs 8 billion, making it the only listed bank to declare a dip in profits from last year. The fall was attributed to a staff retrenchment cost of Kshs 1.3 billion and a higher taxation rate of 30% after their 5-year tax holiday expired. However, Co-op bank reported impressive loan growth of 30% and an increase in net interest income that met market expectations. The bank has been expanding into other regions, but most of its subsidiaries are yet to breakeven. Furthermore, its advisor McKinsey pointed out that 73% of the bank's 5 million customers use one product of the bank compared to an estimated 60% by its rivals. With the bank targeting further regional expansion on the same growth model, it will have to aggressively push its alternative channels like mobile banking, agency and internet banking to its customers and leverage on the expected Kshs. 500 million in cost savings from the staff retrenchment process to rebound from its profit dip.

Real Estate Update

The new 2014 housing survey by the Lands and Urban planning ministry highlighted Nairobi as the most expensive county to rent a house followed by Mombasa then Kiambu. Nairobi returns the highest rents in the rental market with more than 58,000 houses fetching a rent north of Kshs. 20,000. 75% of the most expensive homes are in Nairobi with 12% and 7%, respectively, in Mombasa and Kiambu. Kenyans spend almost half their income on rent and related expenses according to the same report.

Jones Lang LaSalle, an international Real estate firm specializing in commercial properties, is planning to open an office in Nairobi. With established offices in Egypt, Morocco, South Africa and Nigeria, JLL believes the first three markets are already mature and so is seeking greener pastures in Kenya to consolidate its reach in the SSA markets; this supports our view of strong prospects for real estate investments in the region.

Private Equity Update

Chase Bank seeks to raise an additional Kshs 2.5 billion through a private placement following its fast paced growth that has strained its financial ratios. Its capital ratios have grown thin with Total Capital as a ratio to its loan book standing at 15.3% compared to a minimum ratio of 14.5% set by CBK. This news followed the lenders announcement of a growth of 38% in its loan book to Kshs 57.2 billion and a 53.3% increase in profit to Kshs 2.3 billion last year. Chase remains one of the fastest growing, innovative and client focussed banks, it will most likely see very strong demand in the private placement, hence it should have no problems at all raising the amount it is seeking to raise.

Pharmacy chain Haltons, partially owned by Private Equity firm Fanisi Capital, will be opening drug stores in Tuskys supermarkets. The deal gives Haltons exclusive rights to put up mini pharmacies at all of Tuskys' 50 outlets, with the initial target to open 25 stores by the end of this year. The deal is expected to double Haltons network as well as giving it access to a larger number of customers. This

is Fanisi Capital's second investment in the pharmaceutical industry, initially investing using a wholesale business model in Rwanda before the retail business model in Kenya. Fanisi's Halton Pharmacy deal together with Catalyst's recent Mimosa Pharmacy deal indicate that there is a quiet but strong change going on in the pharmacy industry; we believe that these two deals indicate the beginning of the consolidation of a fragmented industry into drugs and beauty products chain akin to boots in the UK or CVS in the US.

Key Focus for the Week is increased High Net-Worth Investor (?HNWI?) allocation to Real Estate

The burgeoning growth in GDP, increasing affluence and urbanisation seem to have been the favourite investment phrases in the last few years, but with a reason. The Knight Frank Wealth Report ratifies Africa's growing economy with an expected 54% increase in Ultra High Net worth Individuals (UHNWI), those defined as having a net-worth of at least USD 30 million, compared to a global average of 31% in the coming decade. Infrastructure is improving and reforms are taking place, and this has not gone unnoticed by foreign investors.

East Africa, and particularly Kenya, shows good prospects with Tanzania's UHNWI set to double while Uganda is among the top 100 countries in growth of UHNWI. Kenya's UHNWI are expected to grow to 209 by a whopping 82% in a decade. 364 Kenyans also joined the dollar millionaire league adding on to the 8,400 in 2013.

The world's prime investment type is in real estate, and this also applies to Kenya. Kenya is attracting investment in real estate supported by its position as a regional hub. Indians are Kenya's largest real estate investors with a preference towards residential properties and are followed closely by the Chinese. Wealthy Kenyans allocation to real estate in Kenya is 70%, while around 30% is invested overseas with a bias towards London's commercial and the retail real estate sector. Demand for Grade-A offices is also expected to rise due to an influx of international companies in Kenya and have a potential for increased rental yields as the current prices are generally considered good value.

With all the attention Kenyan real estate is receiving on the back of sound economic drivers, we expect to see an increase in middle income residential and good quality commercial blocks as more international companies set base in Kenya.

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