Cytonn Weekly #01/2018

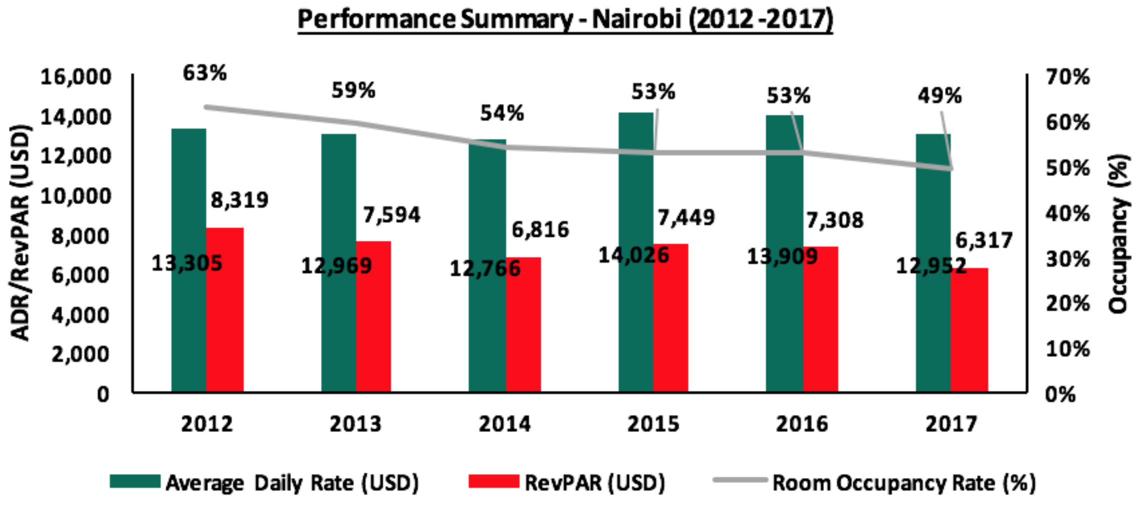
Real Estate

The retail sector is expected to record increased activity in 2018 as seen through retail chains unveiling expansion plans, with Tuskys announcing a 3-year plan to increase its foothold by 56.3% to 100 new stores in Kenya and Uganda by 2020, from 64 stores presently. The expansion plan, which will cost the retailer Kshs 3.0 bn, will anchor on technology, innovation and strategic partnerships with leading technology and related solutions providers. The move highlights the expansion trend by several retailers including Naivas and international retailers such as Manix Clothes Stores, French retailer Carrefour, Botswana retailer Choppies and South Africa retailer Game. It provides an opportunity for development of retail space, and is an indication of a positive outlook on the sector that is supported by (i) an expanding middle class in the region with high purchasing power in both countries, (ii) a conducive macro-economic environment with GDP growth at a 5-year average of 5.4% and projected by the International Monetary Fund (IMF) to come in at 5.0% in 2017 for Kenya and 4.4% for Uganda, and (iii) a low retail penetration rate of 35.0% in Kenya and 20.0% in Uganda (according to the Oxford Business Group Retail Sector Ranks) that incentivizes local retailers. Other activities in the retail sector this week include:

i. Rams Supermarket opened an outlet at Taj Mall, Embakasi, as its new anchor tenant. The retail store that originates from Commonwealth's, St. Kitts and Nevis is set to fill the gap left by struggling retail chain Uchumi,
ii. Botswana retail chain, Choppies, plans to acquire the retail space once occupied by Nakumatt at the Nanyuki Mall after it was evicted due to rent arrears. This follows other evictions at TRM, Garden City Mall, Lifestyle, Eldoret, Meru and Junction that continue to cast the future of the struggling retailer into doubt, and
iii. Naivas Supermarket, the country's leading retailer, is set to open a new 24hr retail stall in Naivasha along the busy Naivasha- Nairobi highway. The store that is set to open in June will be the 3rd in the region after Kubwa and Ndogo Naivasha.

The above is a clear indication of a bullish view on the sector as both local and international retailers continue to compete to gain traction in the Kenyan market. However, supermarkets need to address issues on corporate governance and ambitious expansion projections to avoid challenges faced by the struggling retailers, Nakumatt and Uchumi.

In the hospitality sector, with funding from Equity Bank, the Nairobi Institute of Business Studies (NIBS) plans to set up a 5-star hotel in the high-end surburb of Kileleshwa by 2019 at a construction cost of Kshs 400.0 mn (excluding the cost of land), with the hotel expected to serve commercial clients and offer practical knowledge and internship to the institute's hospitality students. The new development will add to the supply of 5-star hotel rooms that currently stands at 44.0% of the total top-rated (3, 4 and 5-star) hotel rooms in Nairobi and is likely to increase competition in the sector with at least 2,945 additional rooms expected to be complete by 2020, according to the Cytonn Hospitality Report 2017. Investors have continued to cash in on the hospitality sector supported by demand, evidenced by the increase in international arrivals by 13.5% in 2016 and in conference tourism by 16.5% in 2016. In terms of performance, the hospitality sector had stabilised in 2016, as shown in the graph below, following a 5-year decline between 2011 and 2015 mainly due to insecurity. In 2017, the sector was temporarily affected by the political tension leading to reduced demand, and thus is expected to recover in 2018 given the conclusion of the elections. The table below highlights performance for the sector:



Source: Cytonn Research 2017

Other highlights in the hospitality sector this week include the stoppage of the development of tourist facilities in the Maasai Mara Game Reserve by the Narok County Administration, with the Governor citing congestion by the facilities and further adding that they pose a risk to wildlife survival. The County Government also placed a moratorium within protected areas, breeding areas and wild animal gorges, as a cushion for the world famous game reserve.

Our outlook for the hospitality sector in 2018 remains positive supported by: (i) improved security and political calm with the conclusion of the elections, (ii) aggressive marketing by the Kenya Tourism Board that is expected to continue in 2018 thus generating buy-in from USA, Europe and emerging Asian and African markets, and (iii) increased government incentives such as the elimination of VAT charges on national park fees and removal of visa fees for children under 16-years, all factors that will boost demand for hotel services.

Other highlights in real estate this week include:

i. According to the dailies, Tatu City, a multi-billion master-planned project in Ruiru, terminated a local contractor, Ongata Works Ltd, who then moved to court to challenge their termination. We are of the view that the matter needs to be resolved expeditiously to prevent any delay of the master-planned project.
   Tatu City has since clarified that the contract was terminated due to non-performance and that Ongata Works is just one of the contractors on site, all construction works continue unhindered.

We expect the real the estate sector to pick up as developers try to recover the losses incurred during the turbulent 2017, given the stable macroeconomic environment after the conclusion of the general elections and increased appetite by developers to the sector indicating growth.