Cytonn Monthly ? May 2015, with a focus on the launch of Cytonn Real Estate

Cytonn Weekly

Executive Summary

- **Fixed income:** MPC to hold policy meeting four weeks earlier, on 9th June. We expect a rate increase at that meeting to address shilling volatility. We remain biased towards short duration investments;
- **Equities:** NASI lost 6.4% during the month. From the peak in February, indices are now down by about 10%, signalling market correction territory. However, we still remain neutral due to stretched valuations amid weak earnings growth;
- **Private equity:** East Africa remains most favourable destination for private equity investors with preference for financial services, retail & FMCG, real estate & infrastructure, and manufacturing;
- **Real Estate:** Rapid urbanization, coupled with on-going infrastructural development continues to spur real estate development activities in Kenya;
- **Focus of the Week:** Cytonn launched its affiliate development company, Cytonn Real Estate, unveiled a Kshs. 49 billion deal pipeline in joint venture partnerships with land owners, and highlighted a distinctive project: Amara Ridge, a gated community in Karen. ***Next week we will focus on the real estate investment opportunity that Karen area offers.***
  - Amara Ridge concept
- **Company Updates:** Taaleritehdas of Finland discusses partnership with Cytonn: ?In Cytonn we have found a partner that is aligned to our international, institutional investment approach? says Taaleritehdas Private Equity Funds: Taaleritehdas Partnership with Cytonn
  Cytonn Real Estate?s launch received significant coverage during the week:
  - Cytonn real estate fund seeks Sh10bn
  - Firm unveils Sh50 billion real estate project
  - Cytonn drops previous deal pipeline, starts own firm

Fixed Income

Treasury bills auction witnessed lower subscription rates in the month of May due to (i) corporate tax remissions, (ii) reopening of 2-year and 10-year bonds, which raised Kshs 25 billion, and (iii) lower maturities of government securities. However, T-bill yields remained relatively unchanged at 8.1%, 10.6% and 10.8% for the 91-day, 182-day and 364-day papers, respectively, with investors inclined towards shorter durations.

The Kenya shilling posted a loss of 3.3% during the month of May (7.8% YTD) against the dollar, to close at a three and a half year low of Kshs 98.2/USD. The depreciation is attributed to (i) increased speculation on the currency, (ii) declined foreign exchange earnings from tourism and agricultural exports, (iii) demand from local corporates repatriating dividends. The Monetary Policy Committee?s (MPC) next meeting will be held on 9th June 2015, which is four weeks ahead of schedule. This could be a signal that the Central Bank may raise the CBR rate from 8.5%, where it has been since May 2013, in a bid to support the volatile and depreciating shilling.

Even though inflation eased slightly in May to 6.9% from 7.08% in April, with the government?s revenue collection at Kshs 195 bn below target as at 30 th April, coupled with the depreciating shilling, we see risks of rate increase. We therefore remain biased towards shorter durations.

Equities

During the month, NASI and NSE 20 continued on a downward trend, falling 6.4% and 6.0%, respectively, with foreign investors being net sellers. The decline was led by profit taking in some of the large capitalization stocks like Safaricom, EABL and KCB, which lost 8.9%, 6.5% and 9.6%, respectively.

The month saw a number of companies announce results for Full year 2014 and Q1?2015 for banking stocks. Most of the Bank?s reported slower growth in the first quarter driven by shrinking net interest margins and an increase in the bad loans provisions. High interest rates, as indicated by the recently issues government bonds, coupled with volatility of the currency may make it challenging for the banks to register accelerated growth this year. Most companies that have expanded into the region are yet to realize the promised growth from regional expansion strategies and indeed most expansion initiatives has so far registered negative profit contribution, such as Crown Berger?s whose 2014 earnings were down 90.8% due to the expansion costs into Tanzania. The market will wait to see how Equity Bank?s acquisition of ProCredit Bank in Congo will impact its earnings, especially coming after the acquisition of Uganda Micro Finance, an acquisition that has never delivered on its growth promises.

From the market highs in February, the market has been on a downward trend with NASI and NSE 20 down 9.1% and 12.8%, respectively. Declines of more than 10% are usually considered to be market corrections prompting investors to start looking closely for value. However, given the relatively lower earnings growth prospects and stretched valuations, we remain neutral on equities and are of the view that active money managers will be able to derive returns through prudent stock picking. Notwithstanding the projected high GDP growth rate in the country and Kenya?s good rating in global markets, we expect the stock market to underperform in the near term due to interest rate and currency volatility. We have been neutral to bearish equities in the first half of 2015. We continue to maintain our neutral to bearish stance. However, we are watching two main indicators: (i) the balance between valuations versus earnings growth prospects, and (ii) interest rates and currency volatilities, in order to reassess our stance.

Private Equity

Private Equity in Sub Saharan Africa is on the rise as international investors are looking into emerging markets of East and West Africa with Ethiopia, Ghana, Kenya, Nigeria, Tanzania and Uganda providing the destination of choice. The African Private Equity and Venture Capital Association (AVCA) noted that 983 African Equity transactions were done with combined value of USD 34.5 bn between 2007 and 2014. The upside potential and growth prospects in the burgeoning economies has caught the eye of international private investors. East Africa has had an increase in investments, recording a 38.0% growth from 2011-2014, while West and North Africa recorded an 18.0% decline in investments over the same period. In East Africa, PE activities are expected to increase in the food and beverage industry, financial services and manufacturing and industrial sectors with an expected increase of 57%, 57% and 45% respectively in the next 12 months as per the PE confidence survey in Africa 2015, by Deloitte.

In May, major PE deals that made headlines in Kenya were Fanisi Capital?s USD 3.0 mn investment in Live Ad Limited amounting to a 35.0% stake. This was a diversification in Fanisi?s portfolio that now includes retail, media, health, agro-business and education. Also this month, Trapos Limited announced a partnership with Kenya Ferry Services to introduce a cable car service, which will link Mombasa Island with the main south coast.

Given (i) the abundance of global capital looking for opportunities in Africa, (ii) the attractive valuations in private markets compared to public markets, and (iii) the better economic growths in sub Saharan Africa compared to global markets, we remain bullish on PE activity in financial services, real estate, retail and FMCG, services, and manufacturing. At Cytonn, we are making a big and aggressive bet on real estate given the lack of many institutional players in this sector hence the launch of our development affiliate, Cytonn Real Estate.

Real Estate

Kenya?s real estate sector is on the rise. According to the Economic Survey data, the building and construction industry is doing extremely well with the sector growth in 2014 of 13.1%, exceeding that of 2013 by 7.3%. It also experienced an increase in contribution to overall GDP growth in 2014 to 8.5% as compared to 2013?s 6.0%. Continued growth of credit to private sector (with increasing credit allocation towards real estate), shortage of residential housing due to rapid urbanization, and a shortage of good quality commercial & retail space, are the key factors driving the strong growth in real estate. The sector however faces some risks due to insecurity in the region and a volatile shilling.

Last week the IFC in collaboration with a Chinese multinational construction company, CITIC, set up a Kshs 27 billion fund that will focus on the provision of housing units in the region and Kenya will be a key beneficiary. IFC estimated the housing deficit in Kenya at more than 2mn units, a clear indication that the real estate opportunity is significant.

Focus of the Week

We launched our development affiliate, Cytonn Real Estate to couple up fundraising capabilities of Cytonn Investments with development capabilities of Cytonn Real Estate. The coupling ensures that developments meet the return expectation of investors, making it easier to attract development financing.

Rapid urbanization has outpaced development of both infrastructure and housing. A platform that brings together and aligns capital providers, development expertise and landowners is the most effective and efficient way to address the housing deficit.

Cytonn?s innovative approach brings together capital through Cytonn Investments, land through joint ventures with landowners, and development expertise through Cytonn Real Estate, onto one platform where each party is aligned and focussed on aspirational real estate developments.

- Cytonn Investments is the investment management company that sources capital, especially from global markets. We have recently formed a partnership with Taaleritehdas, one of the leading European real estate investors in this region, with projects in Mozambique, Kenya and Rwanda. Taaleritehdas, headquartered in Finland, is a NASDAQ OMX listed company managing over USD 4 billion / Kshs 400 billion in assets under management.
- Cytonn Real Estate will bring development expertise by providing the necessary vision and direction for development and coordinating an experienced and world-class team of real estate development consultants.
- Our tested joint venture template for partnership with land-owners will enable landowners unlock the development potential of their land and realize greater value than just selling their land.

Beyond delivering returns to financial investors and creating value for landowners, our innovative approach will also create jobs, grow the economy and raise standards of living.

Disclaimer: The views expressed in this publication, are those of the writers where particulars are not warranted- as the facts may change from time to time. This publication is meant for general information only, and is not a warranty, representation or solicitation for any product that may be on offer. Readers are thereby advised in all circumstances, to seek the advice of an independent financial advisor to advise them of the suitability of any financial product for their investment purposes.

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com
Generated By Cytonn Report

A product of Cytonn Technologies