Cytonn Weekly Update

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Kenya Market Update & Outlook?

Kenya?s National Treasury is seeking Parliament?s approval to raise the ceiling for external debt from KES 1.2 trillion to KES 2.5 trillion in order to fund projects in energy, water and roads. As at 30th September 2014, total disbursed external debt stood at approximately KES 1.05 trillion against the ceiling of KES 1.2 trillion. Funds received will support ongoing government projects in the Medium Term Plan 2013-2017 such as the Standard gauge railway, the 1000 km road annuity programme, the LAPPSET project and the 5000 Megawatt electricity project among others, to assist the country in attaining a 10.0% annual economic growth.

The National Treasury missed its target in the reopened KES 15 billion, 15-year bond by KES 3.2 billion as it raised KES 11.8 billion following the close of sale this week. Demand has been weighed down by the recent sale of an infrastructure bond. Auction results published by the Central Bank of Kenya show that the 15-year bond had a 79% subscription rate, compared to the 258% rate seen for the KES 15 billion, 12-year infrastructure bond?s primary sale last month. We feel the additional advantage also arises from the fact that the infrastructure bond does not attract a withholding tax charge, unlike the 15-year bond.

The most recently floated one-year and six-month Treasury bills also failed to meet their targets as the continued liquidity mop-up has also affected the market for the government securities. The mop-ups, meant to assist strengthening of the Kenya Shilling, have the effect of limiting resources at hand for investors to invest. The Central Bank of Kenya has been coming into the market almost on a daily basis and using Repos and term auction deposits in support of the Shilling, to a tune of KES 35 billion this week.

Stock Market Update?

The Nairobi All Share Index remained relatively stable at 162.06, largely attributable to low market turnover seen throughout the week. We feel that Investors could be timing their moves in the market, as earnings releases set expectations for performance at the bourse in the remainder of 2014 and Q1 2015.

I&M Bank announced Q3 2014 results, posting a 10.1% growth in net income to KES 3.8 billion. The increase was driven by a 37.7% year-on-year reduction in operating expenses, combined with a growth of the loan book by 12.4% to KES 98.6 billion. Net interest income grew marginally by 1.9% year-on-year to KES 6.6 billion, however was hampered by a spike in interest expenses by 17.1% form the previous year. Gross Non Performing Loans (NPL?s) rose 81.8% year-on-year to KES 1.4 billion, which saw the bank increase its loan loss provisions by 22.6% to KES 422.0 million. The NPL ratio increased 60bps to 1.4%. We are still buoyed by the performance of the Bank, as their NPL remains one of the lowest in the industry with the average at 5.0%, combined with attractive trading multiples, with P/E and P/B multiples of 9.7x and 2.6x and a ROE of 23.6%.

Centum announced H1 2015 results posting a 37.9% growth in Profit After Tax to KES 1.2 billion, driven by a 58.3% growth in investment income to KES 1.9 billion. Portfolio costs were however 209.0% higher due to increased costs following the creation of income generating service subsidiaries in FY 2014 as well as the consolidation of Genesis Kenya Investment Management whose acquisition was completed in December 2013. The company has also announced the completion of its acquisition of an additional 66.0% shareholding in K-REP Bank Limited to bring its total shareholding to 67.54%. Centum?s diversified acquisitions within the Investment management and micro-finance industry will set them up for stronger earnings, more resilient to market shocks.

NIC Bank announces 3Q14 results recording an 18.3% y/y rise in Profit After Tax to KES 3.3 billion. This was attributable to an 8.3% growth in total income to KES 8.5 billion and further boosted by an 8.3% decline in operating expenses to KES 3.5 billion. NIC Bank?s Loan book grew 26.3% year-on-year to KES 96.8 billion while customer deposits increased 21.8% in the same period to KES 98.5 billion. Net interest income appreciated 7.3% year-on-year to KES 5.8 billion, boosted by an interest income growth of 18.0% to KES 10.1bn.

ARM cement has set to roll out its medium- term investment programme from next year where it will complete its ongoing projects and initiate new ones with the funding drawn from its retained earnings and debt. The company has set to complete the clinker plant in Tanga that was commissioned in October this year making it the largest cement producer in East Africa. The cement industry has seen new entrants and huge capital investments from the industry players that have reduced margins, and we hence view the expansion as positive, with the expectation that sales volumes will be boosted and contribute directly to the top-line performance.

Institutional Investors in Real Estate?

Investor confidence in private real estate has increased over the last six months, with 32% of investors stating that their investments have exceeded expectations over the last 12 months, an increase from the 10% of respondents that stated so in August 2013, a recent report by PREQUIN shows. Looking ahead, 29% of investors plan to commit more capital to the asset class over the next year than they did over the previous 12 months, compared to 18%, which stated so in December 2013. Encouragingly, those investors that will be active are likely to commit to several funds, with 50% of active investors stating that they plan to invest in four or more private real estate funds in the next year, compared to just 16% of investors which stated so in August 2013. In addition, the value of African private equity deals doubled during the first six months of 2014 to its highest level since the financial crisis, as per a report from law firm Freshfields says. Although the value is much lower than in other parts of the world, it represents a 137% increase on the USD 621 million worth of deals clinched in the first half of 2013.

With many of the opportunities in East Africa centered on Real Estate investments, we feel Cytonn is well positioned to capture the opportunities available, through partnerships with leading real estate developers and the Team?s strong track record of execution in the Kenyan market.

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