Cytonn Weekly Update

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Fixed Income Update

The week began quietly, until on Tuesday when the Treasury?s request to effectively double the amount it can borrow externally from KES 1.2 trillion to KES 2.5 trillion was approved by MPs. The Treasury had already almost fully borrowed the amount that had been provided for. The rationale proposed on the borrowing is positive, driven by the need for external funding to bankroll key infrastructure projects such as the Standard Gauge Railway, oil pipeline from Turkana to Lamu and a power line through Kenya from Ethiopia to Tanzania.

However, we have a less optimistic view on the raising of the debt ceiling. The re-basing of the GDP took Kenya?s GDP to KES 4.6 trillion, and with debt levels of KES 2.3 trillion, we would be operating at a 50% external debt-to-GDP ratio, which opens up the local economy to external global shocks.

Kenya?s total external debt currently stands at Sh1.05 trillion, and the Kenyan government has also borrowed KES 1.26 trillion from the domestic market, taking the overall public debt to KES 2.3 trillion. With the increase in corporate debt activity in the local market, the domestic debt market may be untenable for raising debt, and with the increased levels of borrowing from the foreign debt markets, Kenya is continually exposed to negative shocks in Developed markets.

Equity Market Update

NIC Bank indicated that it had raised KES 2.1 billion through a rights issue, a key part of its plan to raise more funds to increase lending to businesses and individuals.

In our view, we will continue to see Banks in Kenya and the East Africa's biggest economy take such significant steps, either through a rights issue or a corporate bond to increase their earnings, driven by increased lending on the back of steady interest rates and forecasts for strong economic growth and development.

In other news, the largest corporate listed on the Nairobi Securities Exchange, Safaricom, recorded an all-time high valuation of KES 600 billion after its share price rose to KES 15 in weekly trading, the highest price since its listing seven years ago. In our view, this is driven by the diversification Safaricom has employed since listing seven years ago; to create different business lines centered on mobile services i.e. the payments industry space with M-Pesa.

We continue to see Safaricom out-performing the mobile services market through regional expansion and further diversification ? evident from their launch of the 4G network in Nairobi and Mombasa giving it a chance to deliver broadband internet to homes ? a market that has previously been dominated by high profile internet suppliers such as Faiba and Zuku.

Real Estate Update

Kenyan real estate developers, Peninsula Development Company is making progress in their aim to roll out apartment blocks worth KES 1.5 billion over the next year, with units costing as low as KES 1 million, and a maximum of KES 8 million. The first block in Machakos will be ready by January 2015, and the project on Ngong Road will be ready by end 2015.

This news affirms our strategy, with Peninsula targeting first-time homebuyers. Developers have previously focused on the high-end market that is slowly becoming saturated with stagnating house prices, which still price more than 80% of Kenyans out of the market.

The real estate opportunity lies in the middle and lower segments, in providing affordable units that still offer high quality features, supported by strong demographics such as the growing middle class and rapid urbanization in Kenya.

Private Equity Update

Investment firm Centum is set to invest over KES 100 million to acquire an extra 3% stake in Almasi Beverages, the holding company of Coca-Cola bottlers. The transaction is set to give Centum 50.95% stake, resulting in Almasi becoming a subsidiary of Centum.

We view the transaction as similar to the acquisition of a stake in Brookside Milk by French firm Danone, a strategy where institutional investors are expanding their presence in the fast moving consumer goods (FMCG) sector in the East-African region. With the ever-expanding middle class driving the FMCG sector, and greater transparency in the capital markets, activity in the Private Equity space should continue to heighten in 2015.

Focus of the Week

The Kenyan Government Tuesday released their economic forecast of 6.1% growth in the year ending June 2015, and 7.0% in 2015/16. Treasury Economic Secretary Geoffrey Mwau pointed to infrastructure developments such as the Standard Gauge Railway and increased energy generation, even as key sectors continue suffering over insecurity.

Our view is that Economic growth will be mid-single digit over the next two financial years, averaging 5.5% per annum. The forecasted growth by the Treasury is slightly optimistic as it assumes a 5% inflation target, reflecting further easing of both food and oil prices, and stability of the Shilling versus major international currencies. We continue to see inflation at 7% over the medium term, and fundamentals show Shilling depreciation of approximately 4% by 2016 given current purchasing power parity ? both of which will affect earnings from the export sector and increase the real cost of our foreign debt obligations.

Shiv Arora is an Investment Associate with Cytonn Investments

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