Nairobi Satellite Towns Settlement Characteristics, & Cytonn Weekly Report #6

Executive Summary

- **Fixed Income:** Yields on government securities continued on their downward trend for the second week. In a bid to boost revenue collection, the Kenya National Highways Authority (KeNHA) plans to introduce road tolls on four major roads;
- **Equities**: The market was on an upward trend during the week with NASI, NSE 20 and NSE 25 gaining by 0.6%, 1.1 % and 0.2 %, respectively. TransCentury has partnered with Velocity Group of UK to launch a new pothole patching technology through its subsidiary Avery East Africa Limited;
- **Private Equity:** Private Equity investments in Africa continue to be on the rise. This week has seen a number of private equity deals in the Kenyan market with key focus on Energy, Financial services, Healthcare and Technology sectors;
- **Real Estate:** Developers focus on Nairobi's satellite towns in a bid to reduce the housing deficit for the low and middle income class;
- **Focus of the Week:** Motivated by the need and desire to own a home, households in Nairobi's satellite towns, mainly within the middle income class, take on average 3 years or less to settle down.

Company Updates

- Our Senior Investment Analyst, Duncan Lumwamu discussed the Rift Valley Railways' appointment of a new chief executive officer. Duncan Lumwamu on CNBC Africa
- Our Investment Manager, Maurice Oduor discussed the enactment of a new law to prevent local units of foreign multinationals from using transfer pricing to avoid taxes. Maurice Oduor on CNBC Africa
- We continue to beef up the team with other ongoing hires: Careers at Cytonn

Fixed Income

Yields on treasury bills declined for the second week with the 91-day, 182-day, and 364-day T-Bills down to 10.8%, 13.3% and 13.6%, compared to 11.4%, 13.9% and 14.0% last week due to continued high liquidity in the money markets. The subscription rate reduced to 281.9% compared to 313.0% last week with investor preference still at the six month. The government is trying to lengthen duration as they accepted less bids of Kshs 3.4 bn, in the 91-day T-bill compared to the amount offered of Kshs. 4 bn despite huge subscriptions. The liquidity remained high in the market but we have seen an improvement in the liquidity distribution, given the intervention of the central bank through reverse repos of Kshs 8 bn. The high liquidity, better distribution of liquidity and government efforts to lengthen duration have led to a reduction in the interbank rate to 4.5% from 5.1% last week.

For the month of February, the government shall be reopening 5 and 10-year bonds (FXD1/2015/5 and FXD1/2012/10) with time to maturity of 4.4 and 6.3 years, respectively. The bonds are currently trading at a yield of 14.5% and 14.2%, respectively, in the secondary market compared to the coupons of 13.2% and 12.7%, respectively. We shall recommend more concrete bidding ranges next week.

The Kenyan Shilling strengthened against the dollar during the week, by 0.4%, closing at Kshs 101.8 from Kshs 102.2 last week due to expectations that the US Fed will not raise the Fed Funds rate next month, a move that would strengthen the dollar. The shilling is expected to remain steady against the dollar in the short term due to (i) sufficient dollar reserves of USD 7.0 bn, an equivalent of 4.5 months of import cover, and (ii) the fact that the US Federal Reserve is unlikely to raise its Fed Funds rate next month.

In a bid to raise extra funds for road maintenance, the government, through the Kenya National Highways Authority (KeNHA) plans to introduce road tolls on four major roads. Already, KeNHA has notified motorists of the impending charge through billboards as it aims to boost its fuel levy collection. If implemented, the move is likely to end up in court as consumer advocates maintain that it would amount to double taxation of motorists who have had to endure more than eight major levy increases in the past two and half years. Despite the high probability of this move being opposed by the public, it stands to benefit the country to a great extent in: (i) maintenance of roads, (ii) managing traffic, (iii) reducing pollution from emissions, and (iv) improving public transportation. The government needs to tap into the vast informal sector if they are to boost their revenue.

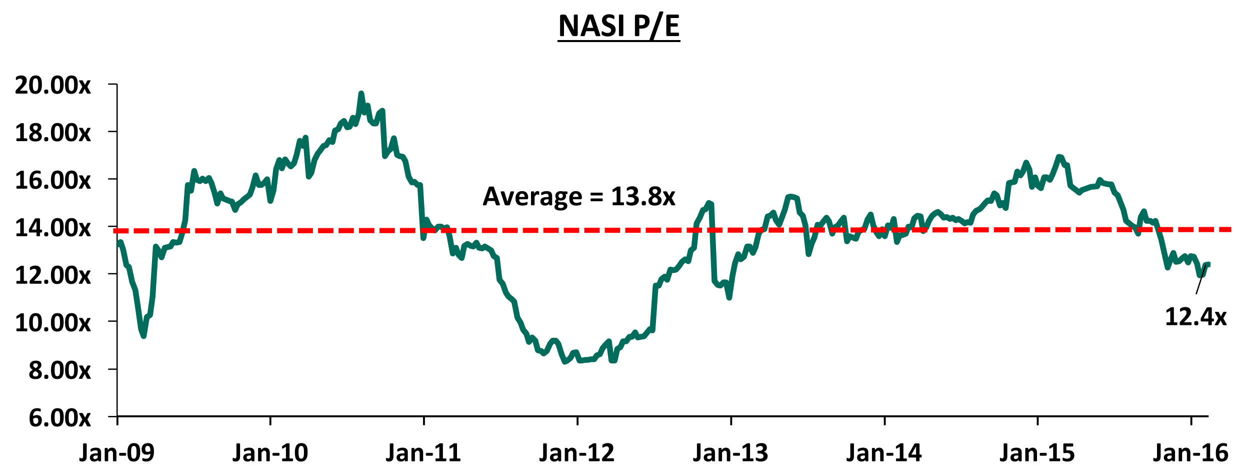
The government is ahead of schedule with its borrowing programme, having borrowed Kshs. 149.9 billion for the current fiscal year compared to a target of about Kshs. 136.9 billion (assuming a pro-rated borrowing throughout the financial year of Kshs. 219 billion budgeted for the full financial year). Interest rates have dropped during the week due to (i) reduced pressure on government borrowing; and (ii) high liquidity in the market. However, with the budget policy statement awaiting approval we continue to advise investors to be biased towards short term fixed income instruments with a key focus on the developments on the draft budget proposal.

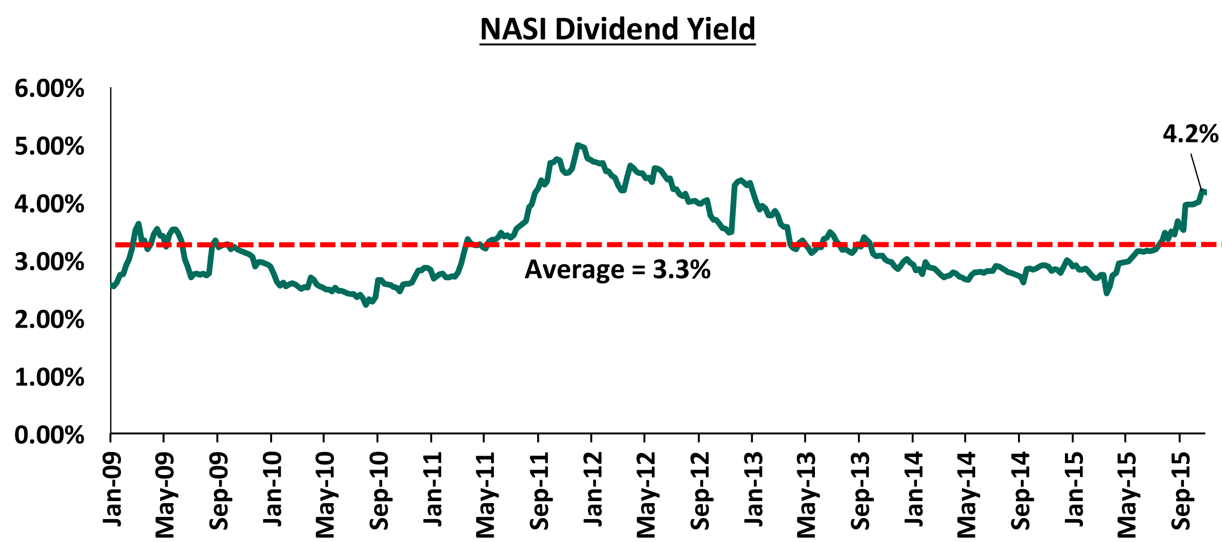
Equities

During the week, the market registered gains, with the NASI, NSE 20, and NSE 25 indices rising 0.6%, 1.1 %, and 0.2 %, respectively. This was on the back of gains in EABL, Equity, and Bamburi that rose 2.9%, 1.9% and 2.9%, respectively. On an YTD basis, the three indices are down 3.6%, 6.2%, and 3.2%, and from the peak in February 2015 the NASI and NSE 20 are down 23.1% and 31.1% respectively.

Equities turnover declined by 17.6% during the week to Kshs 2.8 bn from Kshs 3.4 bn the previous week. Foreign investors were net sellers, with net outflows of Kshs 193.6 mn, compared to net inflows of Kshs 1.2 bn the previous week that had been the highest in four and a half months.

The market is currently trading at a price to earnings (PE) ratio of 12.4x versus a historical average of 13.8x, and with a dividend yield of 4.2% versus a historical average of 3.3%. Last week we did analysis comparing the current market levels with 2011, [Cytonn weekly report #5](). The charts below indicate the historical PE and dividend yields of the market.





Avery East Africa Limited, a subsidiary of TransCentury has partnered with Velocity Group of UK to launch a new pothole patching technology to take advantage of booming road maintenance business in Kenya. The country's budget for construction of new roads and repairs is currently above Kshs 90 bn and TransCentury hopes to benefit from the on-going road maintenance projects by the government. The launch of this new technology comes at a time when TransCentury is struggling owing to the 2011 convertible Kshs 8 bn debt repayment due on March 25. The company's stock has dropped 87% to all-time lows of Kshs 6.40 against a listing price of Kshs 50 in July 2011.

In our continued plan to offer our investors actionable recommendations on listed equities, we have finalized our valuation on Centum Investments. We looked at the company's growth prospects, hinged on the following key businesses:

i. **Real Estate:** Through Two Rivers Development Ltd, Pearl Marina and Vipingo, Centum has positioned its foot firmly in the real estate market in Kenya. The developments will add a new line of steady income supported by the fast growing real estate market in Kenya and Uganda
ii. **Private Equity:**
    a. **Financial Services**: Centum's investment in financial services sector continues to drive growth as the company increased its stake in K-Rep bank to 65% in a move to firm its position in the Kenyan banking sector
    b. **FMCG:** With the growth in the FMCG sector, Centum's increased stake in Almasi breweries will further be the impetus for growth, driven by a supportive consumptive demographic framework
    c. opportunity, since utilities are poised to earn in the long term. Both Akiira and Amu Power will deliver growth in the long term for Centum hinged on government's support to increase power generation to 5000MW
    d. **Agribusiness:** Centum has ventured into agribusiness in a way to diversify its revenue lines. Through participation in farming and indirectly through agribusiness value-chain, the company seeks to further grow its business and leveraging on its other arms among them financing (K-Rep), logistics (GM East Africa) and end use supply (Almasi)
    e. **Education:** Centum in partnership with SABIS and Investbridge Capital, is setting up several schools across Africa, beginning with Kenya. The Company has already acquired land and is in the process to start construction

However, there are various risks associated with Centum such as:

i. **Funding:** The venture into power and infrastructure could face funding difficulties since this project requires long term funds. Investors would prefer short term funding therefore creating an operational hitch
ii. **Execution capabilities in new focus sectors:** With the stride to education and agriculture, Centum may be faced with an execution risk as it currently lacks the in-house capacity to deliver. However, the firm has in the recent past recruited individuals to fill this gap
iii. **Regulatory risk:** Venture into new sectors will attract increased regulatory screening particularly in tertiary education and financial sectors. This could delay the turnaround time expected in the returns

We arrived at a BUY recommendation on Centum, with a target price of Kshs 57.2, a 33% upside from its current price of Kshs 43.0, see [Centum valuation report.]

We remain neutral on equities given the low earnings growth prospects for this year. The market is now purely a stock picker's market, with few pockets of value.

Below is our equities recommendations table.

all prices in Kshs unless stated

EQUITY RECOMMENDATIONS - for the week ending 12/02/2016								
No.	Company	Price as at 29/01/16	Price as at 12/02/16	w/w Change	Target Price*	Dividend Yield	Upside/ (Downside)**	Recommendation
1.	KCB	38.3	39.5	3.3%	59.1	5.5%	55.0%	Buy
2.	Stanchart	193.0	191.0	(1.0%)	247.9	5.5%	35.3%	Buy
3.	Centum	46.0	43.0	(6.5%)	57.2	0.0%	33.0%	Buy
4.	Barclays	12.4	12.7	2.4%	15.5	8.2%	29.9%	Buy
5.	DTBK	188.0	197.0	4.8%	250.1	1.3%	28.3%	Buy
6.	Equity	38.5	39.8	3.2%	48.6	5.2%	27.4%	Buy
7.	Kenya-Re	19.8	19.3	(2.3%)	23.5	3.3%	25.1%	Buy
8.	National Bank	16.3	14.5	(11.3%)	16.8	0.0%	16.5%	Accumulate
9.	Britam	11.5	12.0	4.4%	13.4	1.3%	13.4%	Accumulate
10.	I&M	98.0	100.0	2.0%	110.5	2.6%	13.1%	Accumulate
11.	NIC	38.0	41.5	9.2%	45.4	2.7%	12.1%	Accumulate
12.	Safaricom	15.2	15.8	4.3%	16.6	5.1%	10.2%	Accumulate
13.	Co-operative	16.6	17.0	2.7%	18.0	3.7%	9.8%	Hold
14.	Uchumi	7.6	7.2	(5.9%)	7.5	0.0%	4.9%	Lighten
15.	Liberty	17.7	16.0	(9.6%)	16.7	0.0%	4.9%	Lighten
16.	Pan Africa	59.0	50.5	(14.4%)	52.8	0.0%	4.6%	Lighten
17.	CfC Stanbic	79.5	74.5	(6.3%)	77.2	0.0%	3.6%	Lighten
18.	HF	20.0	20.8	4.0%	20.1	5.7%	2.6%	Lighten
19.	Jubilee	462.0	472.0	2.2%	440.7	1.5%	(5.1%)	Sell
20.	CIC Insurance	5.4	6.2	14.8%	5.8	1.3%	(5.3%)	Sell

**Target Price as per Cytonn Analyst estimates*

***Upside / (Downside) is adjusted for Dividend Yield*

Accumulate – Buying should be restrained and timed to happen when there are momentary dips in stock prices.

Lighten – Investor to consider selling, timed to happen when there are price rallies

Data: Cytonn Investments

Private Equity

Drug maker Strides Shasun Ltd has announced the acquisition of a 51% stake in Kenyan drug manufacturing and marketing company Universal Corporation Ltd for an undisclosed amount with an initial pay-out of USD 11 mn. The deal includes a performance-related payment capped at USD 3 mn for achieving an operating profit of USD 2.95mn in 2015. The transaction to be facilitated through wholly owned subsidiary Strides Pharma (Cyprus) Ltd is expected to close by June 2016 after statutory and customary closing conditions. The funds will be deployed to help the Indian company get a foothold in East African markets and compliment the six existing plants in Africa.

UK tech investor, Amadeus Capital Partners, is leading a USD 40.0 mn growth investment round in Travelstart in its first direct investment venture into Africa. Travelstart is an online travel booking website offering flights, hotel bookings, car rental, vacation packages and other travel services in Africa. The deal also involves mobile communications provider MTN Group. Travelstart will benefit from both the capital and access to MTN's mobile network to support its expansion into new markets as well as consolidate its position in existing markets. The company which has operations in South Africa, Nigeria, Kenya and Egypt had revenues of USD 200 mn in 2015 and has a 75% market share in South Africa. The deal is one of South Africa's largest venture investments for the past 5 years. Travelstart provides travellers with real time access to thousands of flights from all carriers and serves 2 million monthly users in 16 countries.

Private equity investment in Africa continues to improve, as evidenced by the increase in the number of deals and deal volumes into the region, and the closing of various fund raising activities by funds focused on investing in Africa. Infrastructure, real estate, and natural resources continue to be preferred by PE firms, but financial services, healthcare, education, and IT are gaining ground.

Real Estate

There has been a consistent housing deficit in Kenya, estimated at an average of 200,000 units annually. The largest part of this deficit is at the low and middle income segments seeking to acquire affordable housing. As a result, most new developments are situated in the satellite towns where land is relatively affordable. In a bid to address this, Shelter Afrique, a housing financier company is seeking partnerships with developers to construct affordable houses for the middle and low income housing segments. The company is responsible for the funding of Glenwoods Apartments, a 440-unit housing project in Ruaka. Safaricom Investments Cooperative has also ventured into this market and it has started the second phase of its Ruaka Ridge development within the same locality.

Our research indicates that Ruaka area has an average rental yield of 6% p.a. and potential average price appreciation of 17% p.a for residential developments and is thus a lucrative market for investment. With a vast majority of residents in this area being within the middle to lower middle class, uptake of housing units is expected to remain high. Our research indicates that Ruaka area has an average uptake of 93.5% in residential apartments. Attractiveness of residential property investments in this area is mainly due to its close proximity to the CBD and infrastructural developments such as the Northern Bypass. We expect the overall attractiveness of Ruaka as well as other satellite towns to continue on an upward trend as land prices remain relatively lower in comparison to land prices in Nairobi suburbs such as Kilimani, Kileleshwa, Westlands and Parklands. Increased infrastructural developments are also making these areas accessible and hence boost the demand for housing units. Below is a summary of the yields and occupancy in other select satellite towns.

Satellite Town	Yields	% Up-take
Ngong	5.0%	78%
Ruai	7.5%	73%
Kitengela	4.4%	71%
Rongai	4.8%	70%

Athi River	6.5%	71%
Kikuyu	6.0%	73%
Thindigua	4.9%	77%

Focus of the Week: Nairobi Satellite Towns Settlement Characteristics

The real estate sector continues to gain a lot of prominence in the economy contributing about 8% of the Kenyan GDP. In 2015, the real estate sector recorded an annual growth rate of 14%, the highest in the country. We have also seen a lot of global cement companies seeking to set shop in Kenya, with the most recent one being India based UltraTech Cement seeking to buy a stake in ARM. The growth in the sector can be attributed to increased demand for residential property with most realtors shifting focus to development of apartments, villas, maisonettes and bungalows in areas around Nairobi and other major town. The key drivers for real estate developments have been:

- Infrastructural developments in the country
- The growth in the middle class
- Population growth
- High rate of urbanization

I. No of years of acquisition

Year	O.Rongai	Utawala	Ruai	Ruiru	Kikuyu	Average %
Over 10 years	**14%**	**33%**	**14%**	**36%**	**60%**	**31.6%**
7 to 10 years	**21%**	**46%**	**50%**	**40%**	**26%**	**36.7%**
4 to 6 years	57%	4%	21%	22%	6%	21.9%
1 to 3 years	7%	0%	14%	0%	3%	3.4%
Unspecified	0%	17%	0%	2%	6%	4.9%

Key Takeaway: *Most households acquired land over 7 years ago.*

II. Time taken to settle

No. of years	O.Rongai	Utawala	Ruai	Ruiru	Kikuyu	Average %
1 year	**7%**	**13%**	**50%**	**30%**	**43%**	**28.5%**
2 years	25%	17%	14%	11%	9%	15.0%
3 years	**40%**	**17%**	**7%**	**13%**	**11%**	**17.5%**
4 years	7%	13%	7%	15%	11%	10.6%
5 years	4%	8%	21%	13%	9%	10.9%
0ver 5 years	18%	13%	0%	17%	3%	10.0%
Unspecified	0%	21%	0%	2%	14%	7.4%

Key Takeaway: *Most households took less than 2 years to settle down in the satellite towns after purchase of land. This indicates that land acquisition in these towns was not necessarily for speculative purposes.*

III. Motivation to acquire land in the area

	O.Rongai	Utawala	Ruai	Ruiru	Kikuyu	Average %
To acquire a residence &settle down	**68%**	**54%**	**64%**	**66%**	**51%**	**60.8%**
Accessibility to place of work	**7%**	**8%**	**14%**	**13%**	**6%**	**9.6%**
Serenity	7%	4%	0%	2%	6%	3.8%
Security	0%	13%	7%	0%	6%	5.1%
Affordability	7%	0%	0%	4%	3%	2.9%
Inheritance	4%	0%	0%	0%	6%	1.9%
Move away from the city	7%	0%	0%	0%	0%	1.4%
Investment	0%	0%	7%	0%	3%	2.0%
Appreciation of land value	0%	0%	7%	0%	0%	1.4%
Unresponsive	0%	21%	0%	15%	20%	11.1%

Key Takeaway: *Most of the households moved into these satellite towns mainly to acquire or own a home and raise a family while others were motivated by the need to settle down from the hustle and bezel of Nairobi City*

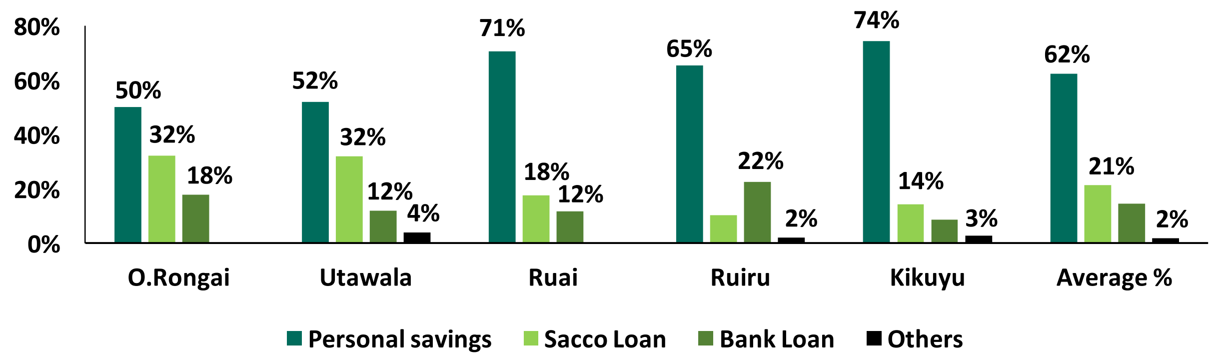
At an approximated average annual housing deficit of 200,000 units, Nairobi is an attractive market for residential developments. However, owing to the relatively high land prices in the area, most of the developments are mainly vertical apartment buildings. High land prices have pushed developers and investors into the city's satellite towns where prices are relatively lower and ranging widely from as low as Ksh 3 million per acre in Ongata Rongai to as a high as over Ksh 50 million per acre in Kiambu. Our research indicated that the target market for land in satellite towns are mainly individuals within the middle income class. It also indicated that households in this segment are mainly motivated to settle by the desire to own a home.

Our real estate research team conducted further research on select Nairobi satellite towns with a key aim of identifying the settlement characteristics of households in these areas. The research mainly focused on 5 key points:

- **Time taken between land acquisition and settlement:** This helped in identifying movement patterns into the satellite towns as well test the likelihood of hindrances to settling,
- **Payment plan for land acquisition:** This helped in identifying the most favourable payment plans for residents,
- **Mode of financing for land acquisition and construction:** This enabled us gauge the income class of residents in the respective towns as well as better clarify reasons behind time scales taken to settle down,
- **Infrastructural challenges:** This helped identify the main challenges within these towns as well as point out the key areas that the real estate industry should focus when developing property in these towns

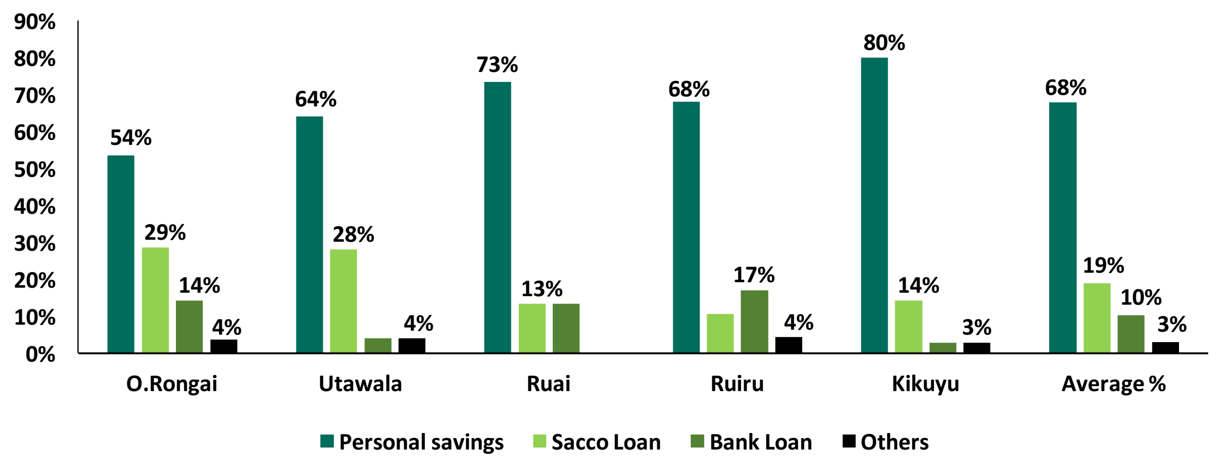
The key findings were as summarised below:

IV. Mode of Financing for Land Acquisition



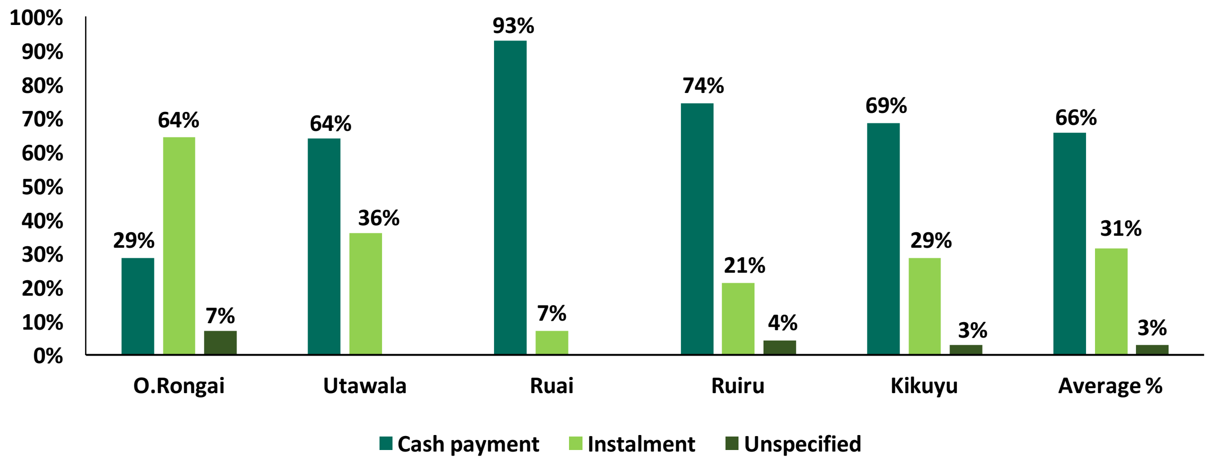
Key Takeout: *Most households used personal savings to finance land acquisition. A few households complimented their personal savings with either bank or Sacco loans. Savings groups (chamas) made this possible as households reported to have bought land in groups and later subdivided it amongst themselves.*

V. Mode of Financing for House Construction



Key Takeout: *Most families used personal savings for construction of houses as well. Savings groups (chamas) also played a big role in this area, indicating their importance in the growth of the real estate sector.*

VI. Land Acquisition Payment Plans



Key Takeout: *Most households bought land on cash terms. Households in these areas most likely fall within the lower middle income class and are beneficiaries of well-structured payment plans for land acquisition.*

VII. Key challenges faced in the area

	O.Rongai	Utawala	Ruai	Ruiru	Kikuyu	Average %
Poor roads	**32%**	**29%**	**24%**	**41%**	**43%**	**34.1%**
Lack of sewerage connection	**20%**	**31%**	**52%**	**21%**	**22%**	**29.3%**
Water connection	**30%**	**24%**	**20%**	**12%**	**9%**	**18.8%**
Insecurity	0%	2%	4%	14%	17%	7.5%
Power outages	5%	6%	0%	5%	4%	4.1%
Poor drainage system	0%	2%	0%	4%	2%	1.6%
Lack of garbage collection services	8%	0%	0%	0%	0%	1.6%
Poor network coverage	4%	0%	0%	0%	0%	0.8%
Lack of schools/hospitals	0%	0%	0%	1%	2%	0.6%
Long title processing period	0%	2%	0%	0%	0%	0.4%
No enforced residential planning	0%	2%	0%	0%	0%	0.4%
High commuting expenses	0%	2%	0%	0%	0%	0.4%
Unavailability of street lighting	0%	0%	0%	1%	0%	0.2%

Key Takeout: *Some of the key challenges raised by the residents included infrastructural developments e.g. roads, sewerage and water in that order. Infrastructure issues can mainly be attributed to the rapid urbanizations surpassing infrastructure and there has been general inadequacy of planning policies in the Nairobi's satellite towns. Households in these areas depend on septic tanks for sewerage disposal, even in Ruai, where the Nairobi Sewerage Treatment Plant is situated. Realtors* *setting up developments in these areas should give more attention to roads as well drilling boreholes so as help improve the living standards of households. It however remains a challenge to the local authorities to provide for these facilities through proper physical planning.*

Conclusion

Land acquisition in Nairobi's satellite towns is mainly driven by the desire to own a home and settle down. Owing to the large number of middle income earners currently relocating to such areas, industry players in real estate should strive to provide products that speak to the specific needs of clients in every category. Provision of key infrastructural amenities such as good roads, water, sewer reticulation and power should form a key component of the property on sale. In addition, well thought-out and structured payment plans should be put in place to enable clients across all income brackets acquire land and develop within the shortest time period.

In reference to our Cytonn Sharp-land projects in Ongata Rongai and Athi River for instance, infrastructural services are being addressed through the provision of electricity, construction of roads for easy access as well as provision of adequate and reliable water sourced from boreholes. In addition, we have gone the extra mile to structure payment plans that fit every income class, where clients purchase property on monthly instalments ranging from as little as Ksh 25,000 with an option for a zero deposit agreement. The Ongata Rongai property sits on a 60acre piece of land, 100m off the Ongata Rongai - Kitengela road, 3Km from Tuala Township and is currently selling at early-bird offer price of Ksh 850,000 per 1/8acre plot. For enquiries and more information, you can reach by texting the word "sharp" to 22102, calling us on 0709 101 000 or emailing us on sales@cytonn.com