Kingdom Securities Limited

Fixed Income - Pre-Auction Note



March 2020 Primary Issue

Re-opened: FXD1/2018/20Yr (18.07Yrs)

Re-opened: FXD1/2018/25Yr (23.32Yrs)

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Dear Investor,

We issue our March 2020 Fixed Income Pre-auction note in an environment of uncertainty, faced by a pandemic of unknown end, investors have resorted to put their trust in the government papers.

- We project heavy subscription with a focus on the 20-year paper. Our projection factors current liquidity situation, coupled with the CBK's need of maintaining stability on the yields rates.
 - FXD1/2018/20 Conservative 13.25% 13.40% Aggressive 13.45% 13.60%
 - FXD1/2018/25 Conservative 13.45% 13.60% Aggressive 13.65% 13.80%
- The Kenyan economy is estimated to have grown by 5.6% in 2019. The economy is projected to grow at 6.0% in 2020 but already facing serious head winds including:
 - COVID 19 pandemic which can lead to disruption of supply chain channels.
 - Locust Infestation -2nd and 3rd phase which can have a heavy effect on agricultural production
 - Weather risk inadequate rainfall during the rainy season poses a huge risk to agriculture.
 - Government debt squeeze heavy competition for investment funds between the government and private sector
- The CBK has featured heavily in the OMO through 7 day repos moping liquidity on competitive bidding with the CBR (8.25%) acting as the ceiling.
- CBK MPC will be meeting on Monday march 23rd, 2020. We expect a 0-25 basis cut on the CBR. Liquidity remains high, inflation remains within government range of 5%±2.5%, private credit has seen a 5 month average of 6.9% as of December 2019, while banking environment remaining stable.
- The IMF staff visited the country and presented a positive sentiment on the progress of the country in terms of qualifying for the precautionary Standby Credit Facility. The mission, expected back in the country in April, is anticipated to ratify granting of the facility before the end of the fiscal year 2019/2020 after the government met most of the conditions including VAT on pump prices and repeal of the interest rate cap.
- Interest rates on short term papers saw a downward movement on high liquidity environment. The 364-day paper shed 48.7bps in the last two auctions with subscription standing at 404.2% in the last four sales.
- The market performance continues to favor activities in the bonds secondary market as investors escape bloodbath in the equities market.

Currency weakens...

Month-to-date, the shilling has shed 1.23% and 3.74% against the USD and the Euro respectively. It however gained marginally by 0.36% against the STG Pound.

This is credited to the following;

- Driven by the objective of improving the forex reserves and increasing months of import cover, the Central bank has embarked on buying dollars worth Kes 40Bn (USD 400Mn).
- Against the backdrop of corona virus, which has metamorphosed from a health crisis to an economic nightmare, global markets have faced volatilities and rocked with uncertainties. This has seen currencies shed off their value as the supply chains have been distorted.
- Informed by the aforementioned two reasons, we foresee the shilling oscillating in current 102.50-103.00 levels on the USD.

13-03-20	USD	Euro	GBP
W/W	0.13%	0.30%	2.16%
MTD	1.23%	3.74%	0.36%
M/M	1.99%	3.92%	1.03%
YTD	1.06%	1.32%	2.83%
Y/Y	2.32%	1.56%	1.10%

Table 1: International Currencies

Source: CBK, KSL



Figure 1: International Currencies

Source: CBK, KSL

Inflation Spikes...

February registered highest inflation in 10 months at 6.37%, a 59bps uptick from 5.78% in January 2020. However, it has well remained within the government range of 5.00%±2.5%, while standing 62bps higher compared to aggressive prediction of 5.75%.

The inflationary pressures was attributed to;

- The food and Non-alcoholic Drinks' Index edged up 2.61% caused by a spike in prices of tomatoes (29.59%), onions (7.28) and kales (3.15%).
- Housing, water, Electricity, Gas and Other Fuels' index registered an uptick of 0.47% from increase in house rents.

We forecast March inflation to stand at 4.07% - 4.38% based on decline food index, lower petroleum prices and low base levels.

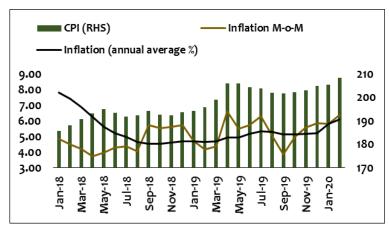


Figure 2: Inflation and CPI

Source: KNBS, KSL

T-bills Market...

- The week ended 13th March 2020 depicted a strong investor appetite on the T-bills market as investors opted out of the stock market.
- In the last auction, the performance rates stood at 201.78%, 92.46% and 460.38% on the 91, 182 and 3674-day papers respectively in comparison to 21.41%, 98.92% and 52.16% recorded in the previous auction.
- We advise investors to go long on the 182-day paper as it has high acceptance with lowest yield decline.

Auction Results	2-Mar-2020	9-Mar-2020	16-Mar-2020
91-day			
Weighted Average Rate	7.32%	7.31%	7.31%
Performance Rate	58.43%	21.41%	201.78%
Acceptance rate	99.92%	88.53%	27.21%
182-day			
Weighted Average Rate	8.24%	8.19%	8.10%
Performance Rate	36.31%	98.92%	92.46%
Acceptance rate	73.28%	19.93%	27.25%
364-day			
Weighted Average Rate	9.50%	9.31%	9.10%
Performance Rate	489.29%	360.77%	460.38%
Acceptance rate	20.66%	52.16%	38.71%

Table 2: T-Bills Rate Auction

Source: CBK, KSL

Higher Redemptions within the month...

- Total redemptions within the next three-month stands at c.Kes 325.56Bn. The total T-bills payments for the month of March stands at c.Kes 257.55Bn and Kes 68.01Bn on T-bonds.
- Informed by the current liquid market, we are bullish that the treasury will raise enough money to meet this payment obligation as well as meet the budgetary support.

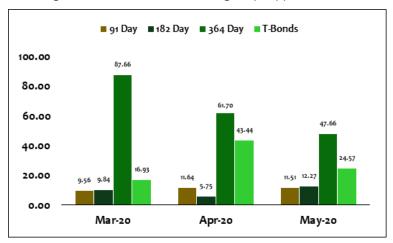


Figure 3: T-Bill and T-Bonds Redemption

Source: CBK, KSL

Evolution of the Yield Curve...

- The market has seen improved activities in the secondary bonds market with a focus on the short end of the curve. The 2 year and 5 year key rates shifted downward by 16.2bps and 14.8bps respectively with the mid to long end shifting upwards.
- Since the beginning of March, the market has traded KES 34.46Bn in value, a 92.7% increase compared to KES 17.89Bn over the same period in February as number of deals improved by 114.7%.
- We forecast short end activity to remain high with a further marginal downward shift credited to investors seeking refuge away from the equities markets as they await clarity on the COVID-19 developments.

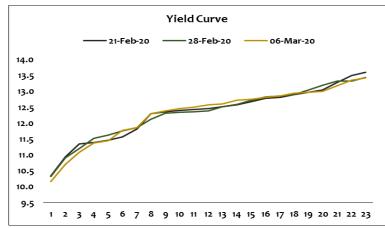


Figure 4: NSE Weekly Yield Curve Source: NSE, KSL

06/03/2020	03-01-20	06-03-20	15-03-19	YTD ∆	Υ/Υ Δ
2-year	10.446	10.1683	10.3615	-2.66%	1.9%
5-year	11.487	11.3768	11.1880	-1.0%	-1.7%
10-year	12.104	12.3891	12.2000	2.4%	-1.5%
15-year	12.521	12.7237	12.3420	1.6%	-3.0%
20-year	12.913	12.975	12.8377	0.5%	-1.1%
24-year	13.025	13.4217	13.0250	3.1%	-3.0%

Table 3: Key Yield Rates Movements

Source: NSE, KSL

Eurobond...

Eurobond Yields drastically shifted up with the 10-year bond at 6.935%, a 219.2bps upward shift m-t-d and 228.3bps on y-t-d. The value of the international bond continues to be affected by the global COVID-19 pandemic and international petroleum fights.

In the end, we anticipate the yields on the ten-year paper to shift downwards to the long-term range of 4.5%.

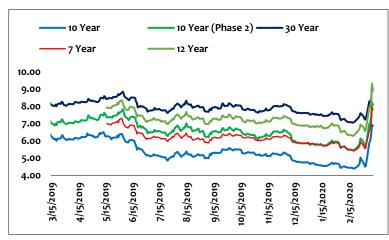


Figure 5: Eurobond Yield

Source: Bloomberg, KSL

Papers on issue...

The treasury has reopened two papers whose objective is to raise Kes 50Bn for budgetary support.

See below our bidding guidance. We project heavy subscription with a focus on the 20-year paper. Our projection factors current liquidity situation, coupled with the CBK's need of maintaining stability on the yields rates.

Issue	FXD1/2018/20	FXD1/2018/25
Tenor	18.07Yrs	23.32Yrs
Coupon	13.2%	13.4%
Closing Date	17-03-2020	17-03-2020
Taxation	10%	10%
Auction Date	18-03-2020	18-03-2020
Conservative	13.25% - 13.40%	13.45% - 13.60%
Aggressive	13.45% - 13.60%	13.65% - 13.80%

Table 3: NSE Weekly Yield Curve

Source: NSE, KSL

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