GCR Kenyan Corporate Sector Risk Scores
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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Corporate Entities, May 2019

The GCR Kenyan Corporate Sector Risk Assessment

GCR utilises the sector risk score in conjunction with the country risk score, to determine the operating environment risk score for each individual sector within the Kenyan environment. The following sector risk scores are intended to provide users with an overview of the major factors that impact GCR's assessment of the relative risk of each sector in the local economy. The following list is not a comprehensive list of all sectors of the economy, but largely covers GCR's Kenyan corporate rating universe. Additional sector risk scores will be introduced as necessary.

GCR will periodically publish updated "Kenyan Corporate Sector Risk Scores", which will supersede previous publications. This supersedes GCR's September 2019, available at:

https://gcrratings.com/risk-scores/.

In the wake of the COVID-19crisis, GCR has lowered the sector risk scores for Hospitality and Discretionary Retail. For a full review of the expected impact of the pandemic on all Kenyan Corporate sectors risk scores, please see the research released on 19 March 2020. The research is available at:

http://gcrresearch.com/reports/house/industry-reports/

Kenyan Corporate Sector Risk Scores

Construction, Sector Risk Score 2.5

GCR considers the Kenyan construction sector to evidence high risk characteristics. This is attributed to the highly cyclical nature of the sector spend, which is fundamentally dependent on strong economic performance, meaningful government spending and political stability. While there are only a limited number of domestic construction companies that can undertake large infrastructure projects, there is significant competition at the lower end of the market. More significantly, international companies continue to dominate the large infrastructure projects due to experience and funding arrangements negotiated at the intergovernmental level. Counterbalancing these concerns somewhat is ongoing government support and potential growth of the industry that is implied by Kenya's long term infrastructure and housing development plans. Accordingly, cross-cyclical industry profitability is expected to remain ahead of that generally evidenced in the region.

Hospitality, Sector Risk Score 3.0

GCR considers the Kenyan hospitality sector to evidence moderately high risk characteristics. This is because of the highly discretionary nature of industry spend, being dependent on strong economic performance and consumer confidence in key source markets, which gives rise to above average cyclicality. In addition, the industry is susceptible to exogenous shocks ranging from terrorism, political instability and disease. Offsetting these concerns is the significant support provided to the industry by the Kenyan government, given the hospitality sector's ability to contribute to economic growth and job creation. As barriers to entry are fairly low, the potential for earnings has attracted a major increase in new hotels and venues in recent years, which has significantly increased competition in the industry. Nevertheless, GCR expects the continued promotion of the industry and infrastructure development by the Kenyan government to be supportive of industry growth and profitability.

In light of the COVID-19 pandemic, the almost complete shutdown of global and regional travel has severely impacted the hospitality sector, negating previous expectations of industry growth. Numerous conferences and events have been cancelled, and only the most essential business travel is being undertaken (where such travel is even possibility). This too may be halted as entry restrictions are placed on an increasing number of countries that trade with Kenya. Accordingly, hotel occupancy levels have fallen to unprecedented lows, resulting in the temporary closure of numerous hotels and substantial job losses. The impact will however, be felt more broadly than the hotel industry, as airlines, safari operators, tourist attractions and restaurants all suffer from the plunge in tourist volumes.

Manufacturing, Sector Risk Score 3

GCR's sector risk score for Kenyan manufacturing reflects the industry's above average cyclicality and high susceptibility to technology disruptions. The manufacture of consumer goods continues to face significant pressure from imported products, with many businesses having been forced to close in recent years. However, domestic manufacturing has been supported by agro-processing, which benefits from the close proximity to Kenya's large agricultural sector. While overall manufacturing has demonstrated sustained growth, there has been some volatility, driven by political considerations and consumer sentiment. Thus, growth was only marginally positive in 2017, due to the prolonged election period, but accelerated to 4.2% in 2018. Nevertheless, industry margins remain under some pressure due to the weaker consumer environment in Kenya and the problems experienced by some of the large retailers, which provide a key gateway to the market for many manufactured products. While the weak environment is likely to persist over the short term, GCR considers the long term trends for those industries that can insulate themselves from import substitution to be positive.

Property, Sector Risk Score 4

GCR considers the Kenyan property sector to evidence moderate risk characteristics, underpinned by below average cyclicality and the presence of fixed assets that generate stable annuity income. Notwithstanding GCR's expectations of sound economic growth in Kenya and some of the inherent advantages described above, the property market has evidenced tentative signs of a slowdown which has resulted from oversupply of retail, office and upper-end residential space, coupled with the constrained supply of credit to the private sector. This has been reflected in the declining growth rates in both property prices and rental escalations in recent years, as well as pressure on vacancies. This comes after years of rapid growth, which was supported by an influx of multinational corporates using Kenya as the gateway into the broader East African market, a growing middle class and expatriate population. GCR expects the sound economic growth to support sound baseline demand and profit margins in the property sector over the rating horizon.

Property development, Sector Risk Score 1.5

The property development industry is highly cyclical, typified by numerous new projects during times of economic expansion, but the potential for sharp reductions in demand due to even small changes in the economic environment. While high industry regulation materialises in the need to obtain project approvals from various regulatory entities, barriers to entry are low for players with sufficient capital. Kenyan developers carry much more funding risk due to the reticence from the banking industry to take on construction-related risk. This also impacts demand side dynamics, with the take up of residential projects in the low to middle income brackets curtailed by a limited mortgage market. GCR has considered that developers partially counteract some of these weaknesses by building on internal expertise to garner annuity income from development and other fees, rigorously crafted agreements with development contractors, securing funding from international investors and development agencies, and by entering into joint arrangements with landowners. Nonetheless, overall earnings stability remains predicated to regular unit uptake and timely completion of projects, with the pace of the former mostly reliant on a sustained improvement in broader per capita wealth levels. Taking cognisance of the substantial development activity that has occurred in Kenya over the past few years, GCR considers the current environment to present substantial risks as vacancies have been rising and rental rates are stagnant. This view may ease as projects under construction are fully sold/tenanted, but it is considered unlikely in the current weaker economic environment.

Discretionary Retail, Sector Risk Score 2.75

Discretionary retail depicts above average cyclicality, as volumes are more susceptible to variability through the cycle, while the ability to pass through costs is considerably diminished during periods of declining demand or heightened competitive pressure. All retailers benefit from low regulatory oversight and limited environmental considerations, albeit that the low barriers to entry have resulted in a highly fragmented market, including many small players in the informal sector. That said, the potential to achieve effective supply chain management, relative cost flexibility and moderately low levels of disruption enables the industry to reflect some stability and to achieve cross-cycle profitability. Looking ahead, GCR expects consumer confidence to continue improving from the low levels evidenced during the post-election period of 2017, albeit that sustained broad economic growth is necessary to support

Previously GCR had expected a marginal improvement in consumer confidence to support a base level of discretionary spend in the economy. However, the curfew, combined with a general avoidance of public spaces, will worsen an already weak retail environment. Thus, discretionary retailers selling items such as fashion clothing, electronics, luggage and other high-end items will definitely see volumes decline as consumers refrain from going to shopping centres. Some rebound in sales may happen once the crisis subsides, but it is unlikely to make up for the lost sales volumes that can be expected during the current period. Automotive retail is a subset that is also expected to suffer, as consumers and businesses delay large purchases due to the current uncertainty

Non-Discretionary Retail, Sector Risk Score 3.5

GCR is of the view that non-discretionary retailers continue to present below average cyclicality and relatively sound cash flows, on the back of largely non-discretionary, high repeat business volumes. While relatively low barriers to entry, limited regulatory oversight and low environmental risks increase the potential for competitive pressures to curtail margins. Such pressures have been evidenced over the past 24 months with the failure of large grocery retailers in Kenya. Nevertheless, there remains a strong pent-up demand for access to consumer products from all segments of the Kenyan population and a number of new entrants have expanded to take up the positions vacated by the previous retailers. Accordingly, GCR expects the market for non-discretionary retailers to remain firm, notwithstanding the current headwinds the industry faces from the weaker consumer environment.

Security, Sector Risk Score 3.5

Private security depicts below average cyclicality, as the rise of terrorist and other threats in recent years has increasingly made private security an important consideration for business premises and wealthy private homes. Low barriers to entry have resulted in a highly fragmented market, including many small or unregistered players, but this may change going forward as the Kenyan government has established a body to oversee regulation in the industry. Improved enforcement of minimum job protection and service standards should support the large players in the industry who already comply, as industry margins have increasingly been squeezed by the myriad of non-compliant players in the industry, which have been able to undercut pricing. Larger players also have access to high-tech security solutions that provide relative cost flexibility and margin resilience. Looking ahead, GCR expects demand for private security to remain steady, on the back of persistent risks related to crime and terrorism, as well as the need to secure the growing number of infrastructure projects.

Figure 1: GCR Kenya Corporate Sector Risk Ranking