

**INVESTING THROUGH THE NAIROBI STOCK EXCHANGE**

**“Kenya as an Emerging Market”**

**Finance Seminar by the Strathmore University**

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August 2007**



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# What is the Stock Exchange?

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## Some definitions:-

- **A market in which shares of stock are bought and sold.**
- **The organized trading of securities through various exchanges and through the over-the-counter market.**
- **A "stock exchange" is a specific form of a stock market, a physical location where stocks and bonds are bought and sold, such as the Nairobi Stock Exchange, the JSE Ltd, NYSE Euronext Inc., or NASDAQ.**
- **The set of institutions that facilitate the exchange of stocks between buyers and sellers. A stock market can be an actual place, but with the growth of electronic transactions a large fraction of stock market transactions are no longer centrally located in a particular location.**

**With the absence of the processes of transformation, users would have essentially illiquid investment opportunities. In order to acquire liquidity, they would have to buy or sell entire firms.**

# The Role of the Stock Exchange?

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## The Role of the NSE:-

- **The Role of the NSE in the Kenyan Economy is best discerned by examining the mandate of the Exchange to all its Key Stakeholders.**
- **We have numerous Stakeholders but the key ones are the Issuers (listed companies), Investors, financial services regulators and the Government.**
- **NSE has a huge public profile and visibility which comes with a lot of negative publicity. We really are the first line regulator and where there are issues bigger than the NSE then the CMA must take up its mandate.**

<b>NSE Stakeholders</b>	<b>What we do for them</b>	<b>Mandate</b>
<b>Investors</b>	<b>Information</b> <b>Investment opportunities</b> <b>Security</b> <b>Wealth creation</b> <b>Transfer process</b> <b>Transparency</b> <b>Helpdesk</b> <b>Arbitration opportunity</b> <b>Confidence</b> <b>Education</b>	<b>To provide an open and effective transparent avenue for</b> <ul style="list-style-type: none"> <li>● <b>price discovery</b></li> <li>● <b>wealth creation and management</b></li> </ul>
<b>Issuers</b>	<b>Liquidity</b> <b>Source of low cost capital</b> <b>Self actualization</b> <b>Competition</b> <b>Competition</b> <b>Governance</b> <b>Tax savings</b> <b>Exit</b> <b>Succession</b> <b>Education</b>	<b>To provide opportunities for</b> <ul style="list-style-type: none"> <li>● <b>unlocking value</b></li> <li>● <b>enhancing profile</b></li> <li>● <b>raising governance standards</b></li> <li>● <b>maximize shareholders value</b></li> </ul>
<b>Media</b>	<b>Information</b> <b>News</b> <b>Clarification</b>	<b>To provide accurate, factual and timely financial information</b>

<b>NSE Stakeholders</b>	<b>What we do for them</b>	<b>Mandate</b>
<b>Regulators</b>	<b>Regulatory opportunity Information Market development Source of revenue</b>	<b>To provide first line market regulation</b>
<b>Government</b>	<b>Privatization/exit opportunity Barometer of economy Raise funds Execute policy FDI</b>	<b>To provide a platform for policy implementation, privatization and capital raising</b>
<b>Members and Market intermediaries</b>	<b>Business opportunities Transparency Efficiency Economies of scale</b>	<b>To provide robust capital market infrastructure for them to conduct their business</b>
<b>Competitors</b>	<b>Competition Other markets (globalization) Banks Real estate</b>	<b>To remain relevant to our competitors</b>
<b>Staff</b>	<b>Employment Career growth Self actualization Self esteem</b>	<b>To be the employer of choice in the financial service sector</b>

# Types of Users

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## Investors

- **The owner of a financial asset. An organization, corporation, individual, or other entity that acquires an ownership position in an investment, assuming risk of loss in exchange for anticipated returns.**
- **A person whose principal concern in the purchase of a security is the minimizing of risk, compared to the speculator who is prepared to accept calculated risk in the hope of making better-than-average profits, or the "gambler" who is prepared to take even greater risks.**

**The objective is to acquire a financial asset to maximize your investment (through medium or long term capital appreciation or regular income) whilst at the same time minimizing your risk.**



## Speculator

- **Speculators buy, hold, and sell stocks, commodities, futures, currencies, collectibles, real estate, or any valuable thing to profit from fluctuations in its price as opposed to buying it for use or for income - dividends, rent etc. Speculation is one of three market roles in western financial markets, distinct from hedging and arbitrage**

**The objective is to invest one's money and assume the risk of price change in the hope of accurately predicting the direction prices will move.**



## Dealer

- **Any investor who makes frequent purchases or sales for her own account, typically for short-term profits.**
- **Professional dealers, also known as competitive or floor traders, are individuals who buy and sell securities for their own accounts. They don't pay commissions, so they can profit on small differences in price, but they must abide by the rules established by the exchange on which they trade. The term dealer also describes people who execute trades at asset management firms.**

**The objective is to gain from short-term price changes rather than long-term capital appreciation.**

# Products traded at the NSE: Shares and Bonds

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- What is a Share/What is a Bond

- **A share is a unit of ownership.**

A bond is a promise or a covenant;  
It may also be considered an IOU



## Share Trading

- The NSE member firms (Stockbrokers) take buy and sell orders from clients;
- The client can obtain a list of member firms from the NSE Marketing Desk, the NSE website or the NSE Annual report;
- Typically, shares are bought in lots of 100 or Ksh. 3000 whichever is lower;
- The Client is required to pay for them within 5 days of the deal being concluded;
- The client should soon after receive a statement as proof of their shareholding.



## Bond Trading

All listed bond transactions should go through the exchange.  
This is important for the following reasons:

- To protect the buyer or seller from fraud;
- To facilitate efficient price discovery.

Bond Settlement is on a **T+3** Basis  
(the buyer completes payment)



## Benefits of Trading in Listed Securities

- **Income**
  - Dividends from shares.
  - Fixed coupon payment from treasury and corporate bonds.
- **Capital Gains are tax exempt.**
- **Collateral**
- **Affordability**
- **Operating Convenience**
- **Liquidity**
- **Hedge against Inflation**

# The Stockbroker

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## Functions of a Stockbroker

- Acts as an intermediary between the Stock Exchange and the investor;
- Provides advice, guidance and assistance in making investment decisions;
- Going through a stockbroker, also entitles the client to seek legal recourse through the stock exchange in case of a dispute.

It is therefore essential for the client to choose the right stock broker for their individual needs and investment philosophy



## Functions of a Stockbroker

In much the same way as you choose a good lawyer, doctor, estate agent, or other professional. Seek advice, solicit opinions, ask for references, and then make up your own mind according to what kind of investor you plan to be.

A seasoned stockbroker with a good track record can become a powerful partner in the pursuit of wealth, but it's important to remember that any investment decisions you make will ultimately be your own.

# The Role of the Agent

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## The Agent

Any person appointed by the Stockbroker to operate as its agent. The Agent is like the outsourced Sales Department of the Stockbroker.

The Stockbroker uses the agent as an outreach device for purposes of servicing the market, particularly in cases where the Stockbroker is not able to set up offices/branches in all areas having demand for their services.

The Investors' cost of using Agent is zero, since the commissions are shared between the agent and the stockbroker.

The Agent does not handle the monies of the client. The client pays any cash directly to the Stockbroker or writes a cheque in the name of the Stockbroker.

# The Role of the Central Depository and Settlement Corporation (CDSC)

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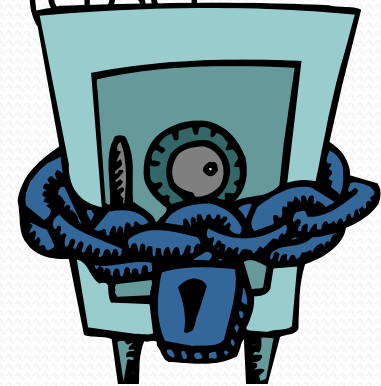


What is a Central Depository System ?

- **A CDS is for securities what a bank is for cash**

## Clearing, Settlement and Depository System (CDSC)

In its simplest definition  
CDS is for securities, what a bank is for cash  
For example: Company X issues shares to Party A and Party B



With no CDS, if A decides to  
sell to B:

A manual registration process  
where A delivers shares to B  
via a broker in exchange for  
payment.

With a CDS environment (share  
certificates in the custody of the  
CDS); if A decides to sell to B:

A book entry debit to A's account and  
a credit to B's account.  
Simultaneously, B will pay A.

# The Process of Investing through the Stock Exchange

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## Cost of Buying a Share

- **Stockbroker Commission 1.78% for amounts upto Kshs. 100,000. Above Kshs. 100,000, the Stockbroker Commission is negotiable and subject to a maximum of 1.5%.**
  - **CMA Levy 0.12%;**
  - **NSE Levy 0.12%;**
  - **CDSC Levy 0.06%;**
  - **NSE Levy 0.14%;**
  - **NSE Investor Compensation Fund 0.01%;**
  - **CMA Investor Compensation Fund 0.01%.**



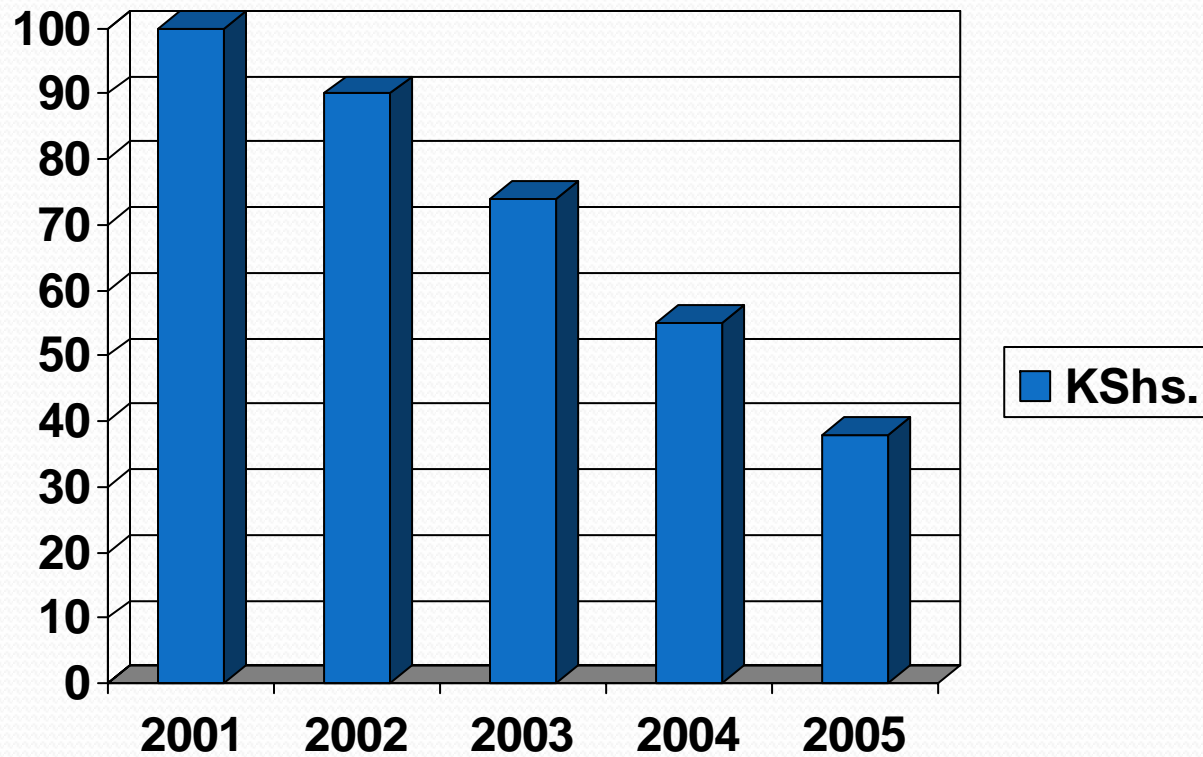
# The Process of Investing in the Stock Exchange

1. Choose a Stockbroker;
2. Open a CDS Account with your Stockbroker;
3. Place your order with the Stockbroker;
4. Pay using a cheque or cash;
5. Keep informed – read on the economy, announcements made by the companies that you have invested in and their competitors.

# Money Management

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10% Inflation destroys your Retirement Fund  
-and it does not take long!





Why does a share potentially protect an Investor from Inflation?

- ✓ Because the assets of the company will be rising in value every year - hopefully in line with inflation

- ✓ Because the earnings of the company will be rising in value every year - hopefully in line with inflation

Both the above factors should be reflected in a rising share price

However, if the company if the company allows its assets to deteriorate or does not grow its earnings - its share price will fall.

However, if all is well the investors will benefit from:

- ✓ Rising asset values
- ✓ Rising earnings



## Broad Classification of Equities:

### ↳ Blue Chip Stocks

High Grade investments in quality companies that have unbroken records of earnings and dividend growth.

### ↳ Growth Stock

A growth company is a company that is growing its sales, earnings and market share at a rate greater than the market and economy.

### ↳ Value Stock

It is a stock in which share price is at a substantial discount to its fair value

- ❖ Market over reacted to bad news
- ❖ General lack of understanding of business

### ↳ Income Stock

It is usually purchased for its high sustainable dividends yield



## Broad Classification of Equities:

### ↳ Cyclic Stock

Commodity and mining related stocks that are very much dependent on the cycle of the industry that they trade in:

- ❖ Mining Company
- ❖ Chemical Company
- ❖ Cement Company

### ↳ Interest Rate Sensitive Stock

- ❖ Company whose core earnings are dependent on interest rates
- ❖ Banks
- ❖ Highly geared companies
- ❖ Companies selling on credit



## Fixed Income Instruments

- Fixed Income Instruments have a longer life to maturity on issue than money market instruments.
- Fixed Income Instruments are usually offered for 12 months and longer:
  - ❖ Government Bonds 1-15 years (The government is the safest borrower as it has the full taxing authority of the state and is the only authority that can print money)
  - ❖ Corporate Bonds 1-7 years (Mabati Rolling Mills, PTA Bank, Athi River Mining, Faulu Kenya, East African Development Bank and Shelter Afrique)



## Fixed Income Instruments

### ↳ Advantages

- ❖ Offer a higher level of income than T-Bills
- ❖ Enables one to lock-in income over the medium term - the and plan ahead
- ❖ An active secondary market allows for exit and capital gains

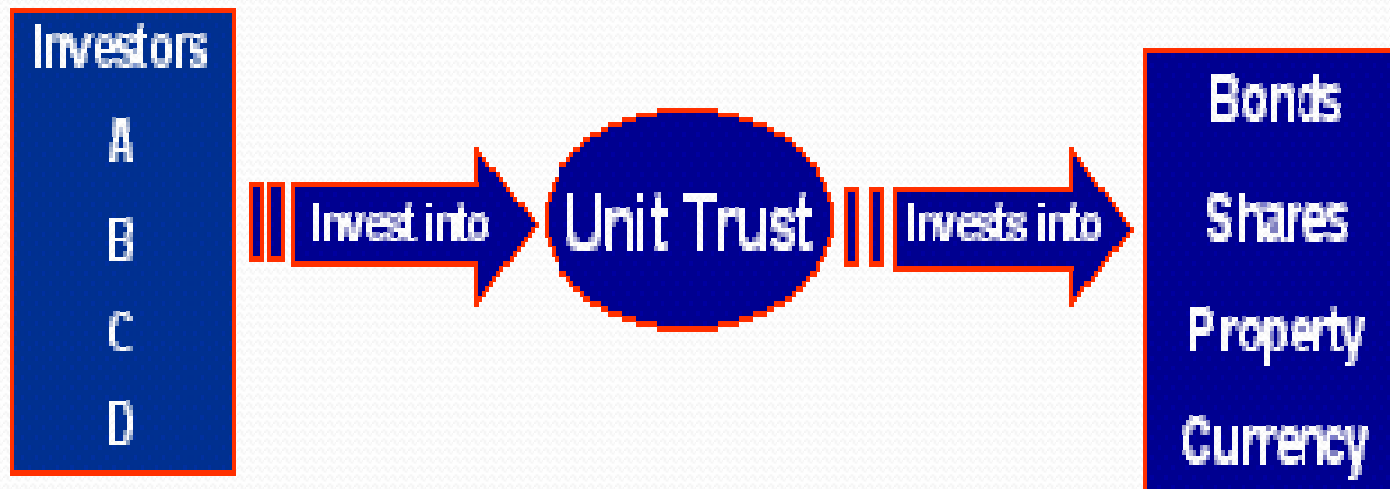
### ↳ Disadvantages

- ❖ Interest rate sensitive



## Unit Trusts

- A unit trust is a pooled investment vehicle where individuals pool their savings together and invest in shares, fixed income securities, money market instruments, property, basically almost all the investment vehicles discussed above
- Investors contributions are divided into units, the value of which will fluctuate depending on the value of the underlying investments.
- Unit trusts allow individuals to diversify (spread) their risk
- Units trusts allow for economies of scale.
- Administration of the trust vests with a Manager who accepts contributions from investors and invests on their behalf.



# Market Performance Overview

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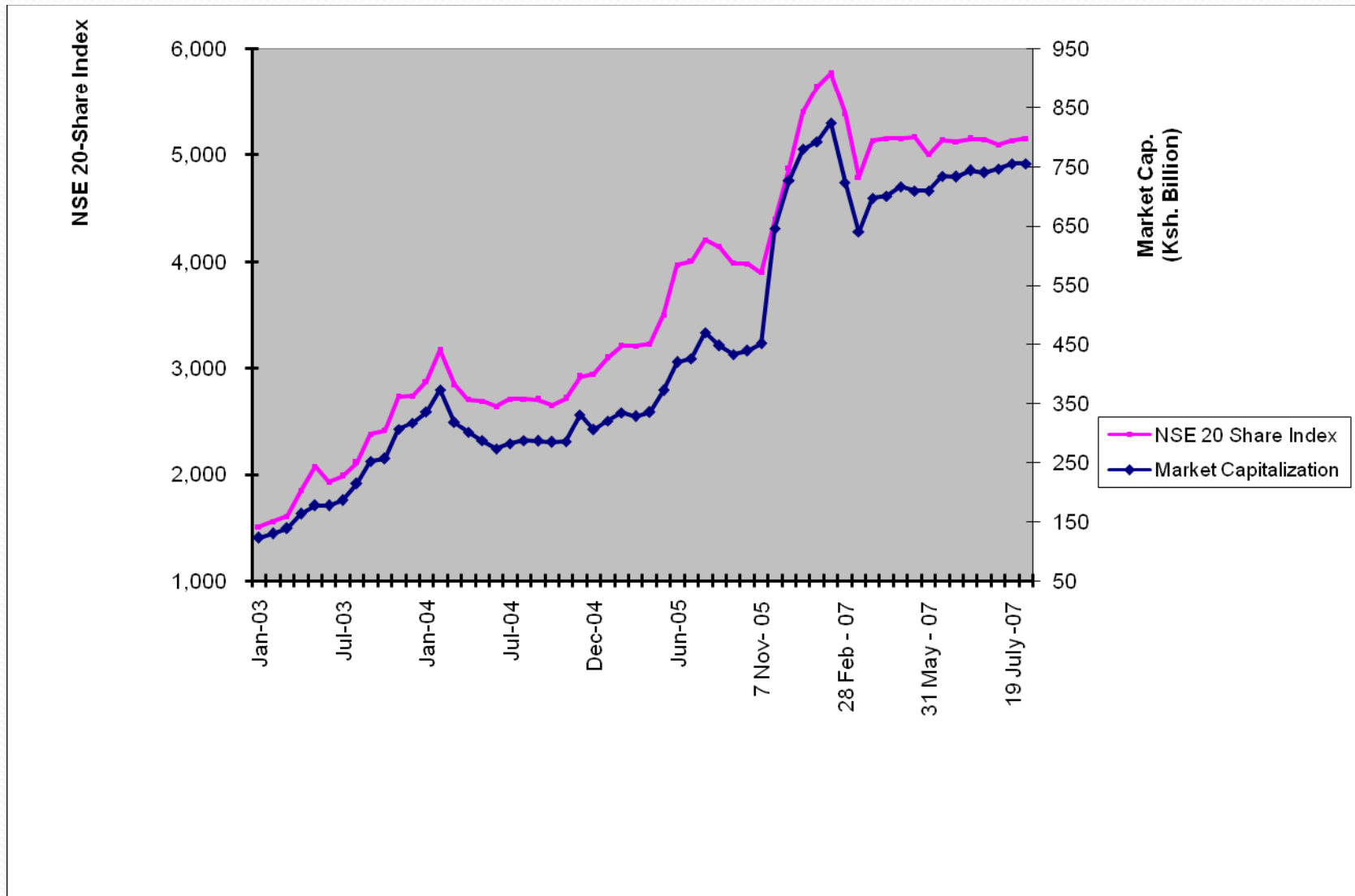


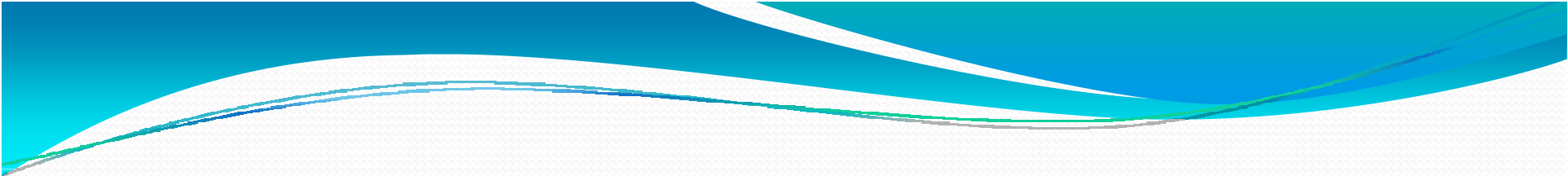
**EQUITY MARKET PERFORMANCE : NSE 20 Share Index  
& Mkt. Cap.  
(31 Dec. 2002 – 23 July 2007)**

<b>Mkt. indicator</b>	<b>31 Dec. 2002</b>	<b>23 July 2007</b>	<b>% Change</b>
<b>NSE 20 Share Index</b>	<b>1,362.85</b>	<b>5,154.42</b>	<b>278.21</b>
<b>Mkt Cap. (Kshs. Billions)</b>	<b>112.05</b>	<b>760.24</b>	<b>578.08</b>

# EQUITY MARKET PERFORMANCE : NSE 20 Share Index & Mkt. Cap.

Jan. 2003 to 23 July 2007



- 
- **In the first quarter of 2007, the market underwent a correction. As of June 22 2007, the NSE 20 Share index is down 9.24% since the end of 2006 (a record-breaking year in all respects).**
  - **This can be attributed to a variety of factors:-**
  - **The January effect and the first quarter seasonality of reduced trading activity, which is caused by investors selling liquid assets to cover the obligations of the new-year;**
  - **Speculators taking profits and exiting the market;**
  - **Value investors sitting on the sidelines, waiting to pick up equities at more reasonable valuations;**
  - **2006 IPOs brought in a slew of new investors who have never experienced a correction and due to lack of proper education some could be panic selling.**

**End**

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