Brexit Impact, & Cytonn Weekly Report #25

Cytonn Weekly

Executive Summary

- **Fixed Income:** Yields on T-bills continued to decline with the 91, 182 and 364-day dropping to 7.1%, 9.3% and 10.7%, respectively;
- **Equities:** During the week, the equities market was on a downward trend with NASI, NSE 20 and NSE 25 losing 3.7%, 2.1%, and 3.3%, respectively, with the YTD performance closing at -2.6%, -8.3%, and -4.4%, respectively. Insurance Regulatory Authority released Q1?2016 numbers on the insurance industry showing total insurance premiums registered a year-on-year growth of 9.6%. Communications Authority of Kenya has released the Q3?2015/16 sector statistics report, showing a marginal growth in mobile subscriptions;
- **Private Equity:** Energy continues to witness increased private equity activity in the Sub-Saharan African region as Denham Capital and GreenWish Partners collaborate to develop, build and finance a portfolio of 600 megawatts of renewable energy assets across Sub-Saharan Africa by 2020 as part of their USD 1bn project pipeline; South African private equity firm Ethos exits its investment in industrial products Brandcorp to Bidvest Group;
- **Real Estate:** Fusion Capital limited issued the country's first Development Real Estate Investment Trust (D-REIT), to the public at an IPO of Kshs 23 per unit. The offer closes on July 15th, and we shall have our analysis of the offering in the July 10th weekly;
- **Focus of the Week:** The United Kingdom held a referendum to determine if they should remain or leave the EU. With the outcome being an exit, we examine the implication of this in both global and local markets.

Company Updates

- To enhance client experience, last week we launched a Client Relationship and Investment Management System (CRIMS), where all the clients? transactions can be viewed and done online. To learn how to log into our online account, contact clients services at clientservices@cytonn.com
- Cytonn Investment Co-operative membership recruitment drive is still on. For more information please see the link: Cytonn Cooperative. The cooperative allows the ordinary investor to access above average market returns that have hitherto been accessible only to our private wealth investors. To join, please contact us at coop@cytonn.com or download the forms from the website on this link: Application for membership in cytonn investment co-operative.
- Last week we released our Cytonn Kenya Banking Sector Q1?2016 Report. Cytonn Q1 2016 Banking Report: The sector is in transition under a capable CBK governorship and we believe the transition will lead to a stronger, more stable and disciplined banking sector, which is good for the economy
- Cytonn Real Estate is currently carrying out a research on the retail market in Kenya. A section of the report includes giving insight into consumer spending habits and hence the demand for retail

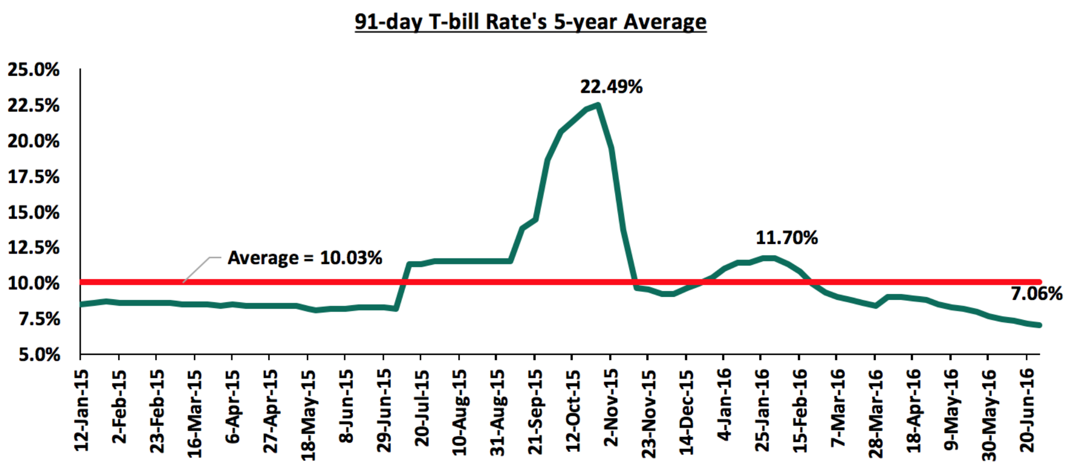
space in the country. To aid us in this, we are seeking opinion and shopping patterns from the general public. Kindly assist us by filling out a 5-minute questionnaire accessible by clicking on this link: Questionnaire. We shall have random cash prizes for 5 participants

- To invest in any of our current or upcoming real estate projects, please visit Cytonn Real Estate. We continue to see very strong interest in our products, particularly The Alma , which is now 50% sold and has delivered an annualized return for 55% p.a. for investors who bought off plan. We have 12 investment ready projects, offering attractive development returns and buyer's returns of a minimum of 25% p.a. See further details here: Summary of investment ready projects.
- We continue to beef up the team with other ongoing hires: Careers at Cytonn

Fixed Income

During the week, T-bills were oversubscribed with a performance rate of 122.0%, down from 136.2% recorded last week. Subscriptions for the 91-day and 182-day were at 133.2% and 179.1%, respectively, compared to 190.9% and 143.9% the previous week. However, the 364-day was still undersubscribed with a performance rate of 57.5%, compared to 92.0% the previous week. As highlighted in our Cytonn Weekly report #24, the gross under subscription of the 364-day paper is attributable to investors preferring short-term papers in anticipation of rate increment in the short to medium-term as the government indicated that they will be increasing the domestic borrowing target by Kshs. 25.8 bn to Kshs 245.0 bn, from the last financial year of Kshs. 219.2 bn. Yields, however, continued declining, coming in at 7.1% and 9.3% from 7.2% and 9.6% for the 91-day and 182-day, respectively. However, the 364-day yield remained flat at the 10.7% recorded last week, showing signs of interest rates bottoming out. We attribute the high performance of the government securities to flight to quality, as investors remain cautious following the fall of two banks and volatility in the stock market.

The 91-day T-bill is currently trading below its 5-year average of 10.0%, having witnessed a downward trend in the last two months. However, despite the reduction in the Central Bank Rate by 100 bps to 10.5%, we expect the rates to bottom out at the current levels as we close out on the current fiscal year.

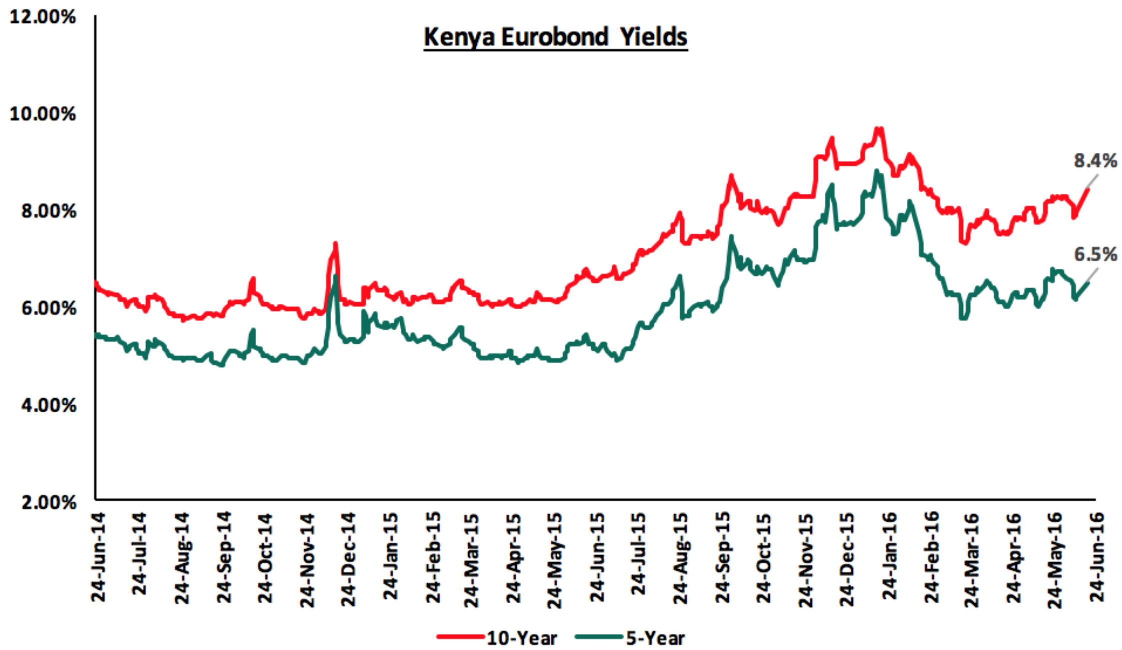


The Central Bank weekly report revealed that the interbank rate increased by 134 bps to 3.9%, from 2.6% the previous week, due to a liquidity reduction of Kshs 34.5 bn in the money market. This was due to (i) government security issuances of Kshs. 46.1 bn, and (ii) quarterly tax payments by banks of Kshs. 49.7 bn.

all values in Kshs bn, unless stated otherwise			
Weekly Liquidity Position ? Kenya			
Liquidity Injection		**Liquidity Reduction**	

Term Auction Deposit Maturities	10.0	T-bond sales	30.6
Government Payments	33.0	Transfer from Banks - Taxes	49.7
T-bond Redemptions	8.0	T-bill (Primary issues)	15.5
T-bill Redemptions	6.6	Term Auction Deposit	0.0
T-bond Interest	0.0	Reverse Repo Maturities	10.9
Reverse Repo Purchases	14.6		
Total Liquidity Injection	**72.2**	**Total Liquidity Withdrawal**	**106.7**
		Net Liquidity Injection	**(34.5)**

According to Bloomberg, yields on the 5-year and 10-year Eurobonds issued in 2014 have declined by 215 bps and 118 bps from 8.8% and 9.6%, respectively, since their peak in mid-January 2016 on account of improving macroeconomic conditions. Week-on-week, the 5-year and 10-year rates were relatively unchanged ending the week at 6.7% and 8.4% from 6.5% and 8.4%, respectively. The rate increases seems to have reduced following the slowdown in the anti IEBC protest in the last two weeks as the political class seem to have reached a consensus on how to reconstitute the electoral body.



Government remains ahead of its domestic borrowing schedule by Kshs 159.2 bn, having borrowed Kshs 373.8 bn compared to a pro-rated borrowing target of Kshs. 214.6 bn. This is positive for government financing as the surplus can be used to plug in the deficit arising from foreign borrowing and tax collection as can be seen in the summary below:

(all values in Kshs mn, unless stated otherwise)					
2015/2016 Budget Financing					
Source of Financing	**2015/2016 FY Target**	**Pro-rated Target**	**Actual Collection**	**Variance**	**Possible Effect on Interest Rates**
Foreign Borrowing	401,691	393,322	296,650	(96,672)	Negative
Domestic Borrowing	219,200	214,633	373,828	159,194	Positive
KRA Collections*	1,254,867	1,228,724	1,237,422	8,698	Positive
Total Funding	**1,875,758**	**1,836,680**	**1,907,900**	**71,220**	Positive
****Pro-rated based on 8-months published data***					

(all values in Kshs bn, unless stated otherwise)
2015/2016 Budget Expenditure as at December 2015

Area of Expenditure	2015/2016 FY Target	Actuals	Variance	Possible Effect on Interest Rates
Recurrent	501.7	416.5	85.2	Positive
Development	332.2	204.4	127.8	Positive
Other	163.1	106.5	56.6	Positive
Total Expenditure	**997.0**	**727.4**	**269.6**	**Positive**
Source - The Treasury/CBK				

The Kenya Shilling remained stable during the week to close at 101.3 compared to the previous week, as a result of traders trading cautiously ahead of the uncertainty surrounding the Brexit vote. On a YTD basis, the shilling has appreciated against the dollar by 1.0% supported by (i) the high levels of foreign exchange reserves currently at USD 7.6 bn, equivalent to 5.0 months of import cover, and (ii) improved diaspora remittances, with cumulative 12 months? inflows to March 2016 increasing by 10.2% to USD 1.6 bn from USD 1.5 bn in March 2015.

According to published reports, the 2015/2016 supplementary budget of Kshs 14.7 bn was tabled in the Kenyan Parliament this week. The budget is split into: (i) Kshs 7.2 bn targeted at funding development expenditure, and (ii) Kshs 7.5 bn targeted at funding recurrent expenditure. The Ministry of Energy and Petroleum has received the largest share of the supplementary budget with an allocation of Kshs 7.3 bn. The Ministry of Agriculture was allocated Kshs 4.8 bn, which will go towards funding for irrigation projects. Ministry of Health got an allocation of Kshs 1.8 bn to support the rollout of the universal health care. Our view is that the move to rebalance the allocation is necessary in order to align funding to the crucial sectors of the economy. Of key to note is that this is the first time that the supplementary budget has been read after the following year?s budget and this could be a move to realign the budget to the actual spend.

We are projecting inflation for the month of May to remain within the range of 4.9% - 5.2%, driven by increases in food prices and low electricity tariffs, coupled with marginal increase in pump prices during the month and a much lower base from last year. We expect inflation to remain within the government target annual range of 2.5% - 7.5%, going forward to the end of the year.

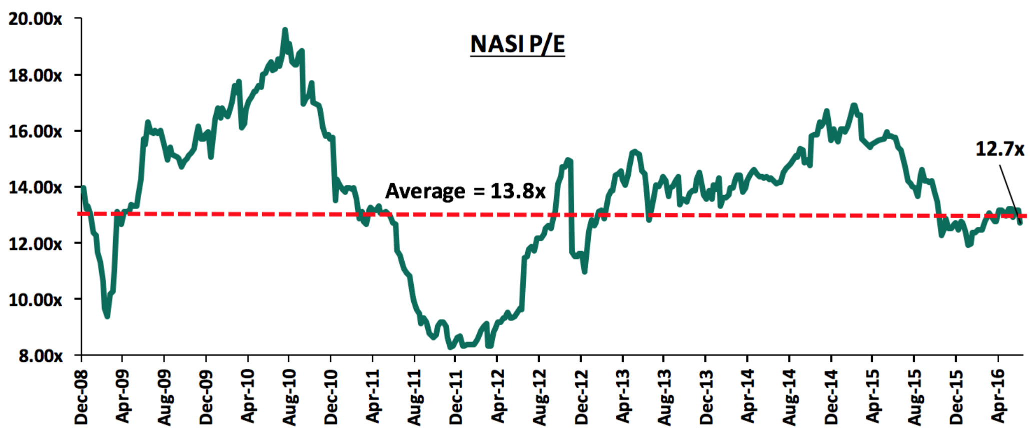
The government is ahead of its domestic borrowing schedule, having borrowed Kshs 373.8 bn for the current fiscal year compared to a target of Kshs 214.3 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 219.2 bn budgeted for the full financial year). With only one week left to the end of the current fiscal year, the government has surpassed its local borrowing target. The additional Kshs 159.2 bn above the target will go towards plugging the tax collection deficit by KRA. The government will look to shift their attention to achieving the foreign borrowing target and start front-loading for the next fiscal year. With interest rates still coming down, but showing signs of bottoming out at the current levels, we advise investors to lock in funds in short to medium term paper for tenors between six months and one year as the rates are attractive on a risk-adjusted basis.

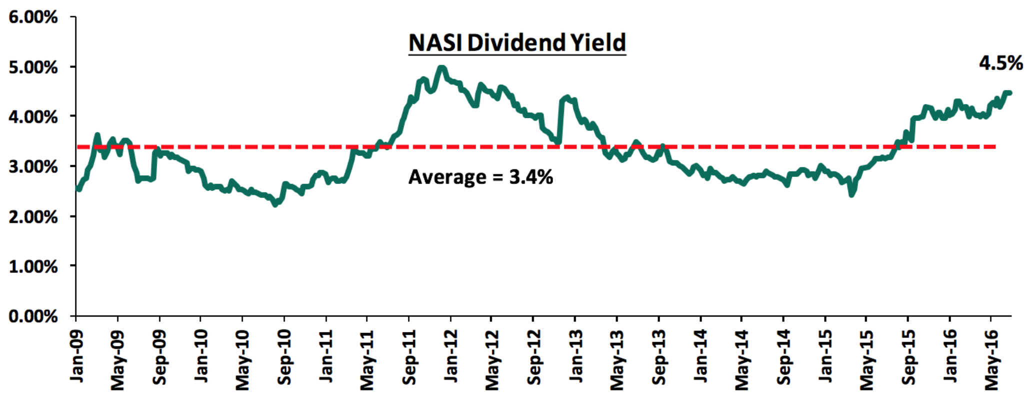
Equities

During the week, the equities market was on a downward trend with NASI, NSE 20 and NSE 25 losing 3.7%, 2.1%, and 3.3%, respectively, with the YTD performance coming in at -2.6%, -8.3%, and -4.4%, respectively, with the NSE 20 touching its 4 year low this week at 3,706.4 points. The downward trend was on the back of losses in large cap stocks led by Safaricom, EABL, and Equity, which lost 6.7%, 4.3%, and 3.8%, respectively. Since the February 2015 peak, the market has been down 32.6% and 20.0% for NSE 20 and NASI, respectively.

Equities turnover declined by 6.4% during the week to KES 3.8 bn from KES 4.1 bn last week, on the back of increased foreign investors? activity on a net selling position with net outflows of USD 333,000, compared to net inflows of USD 2.3 mn recorded the previous week. We expect earnings growth to improve in 2016 compared to 2015 supported by a favorable macroeconomic environment despite the negative start to the year. Given the low valuations, long-term investors should gradually be taking positions in the market.

The market is currently trading at a price to earnings ratio of 12.7x, versus a historical average of 13.8x, with a dividend yield of 4.5% versus a historical average of 3.4%. The charts below indicate the historical PE and dividend yields of the market.





During the week, the real estate market segment had improved activity with the Real Estate Investment Trust (I-REIT) turnover increasing by 53.9% to Kshs 6.3m from Kshs 4.1m the previous week on the back of strong local demand.

Insurance Regulatory Authority (IRA) Q1?2016 report

IRA released Q1?2016 numbers for the insurance industry showing total insurance premiums registered a year-on-year growth of 9.6% to Kshs 58.5 bn from Kshs 53.3 bn in Q1?2015.

Key highlights from the report were;

- Claims incurred increased by 12.0% to Kshs 13.9 bn from Kshs 12.4 bn in Q1?2015, outpacing written premium, which grew by 9.6% to Kshs 58.5 bn from Kshs 53.3 bn in Q1?2015. The higher growth in claims is a pointer to the squeezed underwriting margins for the insurance companies. Kenya?s insurance industry continues to be largely driven by non-life business with non-life premiums contributing 68.6% of total premiums compared to the global scenario where non-life premiums contribute 45.2%
- Total industry profitability declined by 46.7% to Kshs 1.8 bn from Kshs 3.3 bn in Q1?2015 driven by a 29.1% drop in profitability in the short term business
- Total assets held by the insurance sector increased by 10.1% to Kshs 498.5 bn from Kshs 452.8 bn in Q1?2015. The industry also held Kshs 398.8 bn in income generating investments, a growth of 7.9% from Kshs 369.7 bn
- The number of fraud cases increased by 60.0% to 43 from 26 in Q1?2015, however the value involved decreased by 311.8% to Kshs 63.0 mn from Kshs 260.0 mn which represents 0.45% of total claims. Below, please see a summary of the performance:

Balance Sheet	Q1 2016	Q1 2015	Annual Change (%)
Shareholders' Funds	130.1	117.9	10.4%
Total Assets	498.5	452.8	10.1%
Total Liabilities	368.4	335.0	10.0%
Investments	398.9	369.7	7.9%

Income Statement	Q1 2016	Q1 2015	Annual Change (%)
Gross Premium Income	58.5	53.3	9.6%
Net Premium Income	46.3	41.3	12.2%
Commissions and Management Expenses	13.0	11.5	13.0%
Profit Before Tax (EBT)	2.7	4.4	(39.4%)
Profit After Tax (PAT)	1.8	3.3	(46.7%)

Source: IRA

The Q1?2015 performance reinforces our views in our FY?2015 Insurance Report that there is a need; (i) to diversify and tailor-make products to cater for all income brackets, (ii) support the uptake of life insurance through market awareness to grow the low penetration of 3.0% compared to South Africa at 14.0%, and (iii) increase regulation in the industry to be line with the riskiness of the business and to reduce fraud in the industry.

Kenya Re has acquired an additional 4.4% stake in Zep-Re, a regional reinsurer. Kenya Re is the largest reinsurer in the country and was the largest shareholder in the company, previously holding a 15.4% stake in the company, bringing its total holding in Zep Re to 19.8%. The transaction valued at Kshs 1.3bn effectively values Zep Re at Kshs 28.4 bn, and reinforces Kenya Re?s strategy of expansion into the region, with Zep Re having presence in Cameroon, Zambia, Zimbabwe and Sudan. International Finance Corporation (IFC) has also disclosed its intentions to invest up to Kshs 2.0 bn in Zep Re, with the African Development Bank, already holding a 14.7% stake.

Quarterly Statistics ? Telecommunications Sector

The Communications Authority of Kenya (CAK) released industry data for the quarter ended March 2016, which indicated that Safaricom had a 3.1% q/q increase in subscriber numbers to 25.1 mn, resulting in an increase in market share to 65.6%, up from a 64.7% market share in the previous quarter.

Key highlights from the report were;

- Mobile penetration in the country increased by 1.5% to 89.2%, from 87.7%, in December 2015, driven by an increase of 3.5 million subscriptions leading to total mobile subscribers of 38.3 mn
- Safaricom recorded a 0.9% increase in total subscription market share to 65.6%, up from 64.7% in the year ended December 2015, while Airtel?s market share decreased to 17.5%, from 19.2% as of December 2015, after disconnecting over half a million sim cards in compliance with the new sim card regulations
- The minutes of use per subscriber per month in the industry increased by 4.7% to 93.2, from 89.0 in the previous quarter
- Internet subscription increased by 3.8% to 24.8 mn, translating to internet penetration of 87.2%. Mobile data market share changed slightly with Safaricom?s market share declining to 60.8%, from 63.0% in the previous quarter. Airtel and Equity?s Finserve gained a larger market share, with Airtel registering a 21.0% share, up from 18.0% and Equity registering a 6.8% share, up from 5.0%. Orange?s market share declined to 11.2%, from 14.0%
- The number of mobile money transfer subscriptions was 24.8 mn whereas the number of mobile money transfer active agents stood at 147,761, with Kshs 840.3 bn transferred among users during the period. Value of M-Pesa transactions stood at Kshs 764.7 bn, equivalent to 91% of total

amount transacted via mobile phone.

Nairobi Business Ventures (NBV), the proprietor for the shoe vendor K-Shoe, this week became the first firm in nearly 2 years to be listed on the GEMS segment of the Nairobi Securities Exchange after Home Afrika, Flame Tree, Atlas Development and Kurwitu Ventures. The GEMS segment provides options for SMEs to raise funding, especially long-term funding. NBV was listed by introduction and offered 23.6 million shares valued at Kshs 5.0 each, putting the valuation of the company at Kshs 118 mn and at a PE of 26.7. On the first day of trading, NBV?s shares were up 60.0% by the close of the market, with the price per share now at Kshs 8.0. The company has registered a CAGR of 31.9% in revenue over the last 4 years, with current EBIT margin of 20.6%. Over the last four years, the company has registered a CAGR of 74.2% with profit after tax of Kshs 4.4 mn in 2016. The company seeks to establish a leather footwear and accessories manufacturing plant in Kenya. Given the higher purchasing power driven by the growing middle class in Kenya, there is a significant market opportunity to tap into in the Kenya retail market but has to compete with imported brands that have taken root in the company.

The NIC Bank takeover bid of Imperial Bank was challenged in court and currently has been halted. NIC had gotten the go ahead with the purchase after the shareholders failed to raise the Kshs 10.0 bn to recapitalize the bank. All accounts with up to Kshs 1.0 mn had been paid off already and with NIC bank?s acquisition of the assets and liabilities, an additional Kshs 1.5 mn will be paid off to depositors. Once completed, 92.0% of Imperial?s former depositors who claimed their balances will have been paid in full. However, for accounts holding over Kshs 2.5 mn, the CBK?s expectation is that they would only have access to a maximum of 40% of the remaining verified deposits above Kshs 2.5 mn, which according to CBK translates to cumulative payout ratio for all verified deposits to an estimated 59%. CBK has not yet outlined how the remaining 41% of deposits will be paid out.

If this move takes place, NIC Bank will assume the majority of staff and branches of Imperial Bank. NIC Bank currently has 35 operational branches and through this arrangement, NIC will have the opportunity to acquire up to 26 additional branches resulting into 51 total branches in the Country. However, Imperial Bank shareholders have challenged this move by in court, temporarily stopping the transfer, in fear that this move may lead to liquidation of the bank. Despite this, the expectation is that the court ruling will be in CBK?s favour which will see NIC take up assets and liabilities of Imperial. NIC Bank is the second bank to be appointed to oversee the revival of a closed bank, after CBK appointed KCB Group to oversee the reopening of Chase Bank. Our view is that the move further supports the regulator?s resolve to strengthen and stabilize the Kenyan banking sector. As highlighted in our Q1?2016 Banking report, NIC has maintained a pole position in asset financing and is curving a niche in the segment of the market which used to be served by Imperial Bank. This move will see NIC further grow its business and market share in Kenya.

However, we think it would be helpful for the market to understand the process by which CBK picks the successor bank to resolve failing banks, it is not clear to the market the process through which KCB Group got the mandate to oversee Chase Bank and how NIC Bank has received the mandate to oversee Imperial Bank; transparency and predictability is essential to deepening our financial markets.

Below is our equities recommendation table. Key changes from our previous recommendation are;

- Barclays has moved from an ?Accumulate? recommendation, with an upside of 19.2% to a ?Buy? recommendation with an upside of 20.4% following a 1.5% week on week price decline
- Liberty Kenya has moved from a ?Hold? recommendation, with a downside of 9.2% to an ?Accumulate? recommendation with an upside of 16.2% following a 6.0% week on week price decline.

all prices in Kshs unless stated									
EQUITY RECOMMENDATION									
No.	**Company**	**Price as at 17/06/16**	**Price as at 24/06/16**	**w/w Change**	**YTD Change**	**Target Price***	**Dividend Yield**	**Upside/ (Downside)****	**Recommendation**
1.	KCB Group***	35.0	34.5	(1.4%)	(21.1%)	49.4	5.6%	48.8%	Buy
2.	Centum	47.8	44.5	(6.8%)	(4.3%)	57.2	2.1%	30.6%	Buy
3.	Kenya Re	21.0	21.0	0.0%	0.0%	26.7	3.5%	30.6%	Buy
4.	Barclays	10.0	9.9	(1.0%)	(27.6%)	10.9	9.7%	20.4%	Buy
5.	DTBK***	178.0	175.0	(1.7%)	(6.4%)	204.2	1.4%	18.1%	**Accumulate**
6.	Liberty	15.8	14.8	(6.0%)	(24.1%)	17.2	0.0%	16.2%	**Accumulate**
7.	HF Group	20.3	20.0	(1.2%)	(10.1%)	21.6	7.5%	15.5%	**Accumulate**
8.	Equity Group	40.0	38.5	(3.8%)	(3.8%)	42.1	5.4%	14.8%	**Accumulate**
9.	Jubilee Insurance	469.0	455.0	(3.0%)	(6.0%)	477.8	1.8%	6.8%	**Hold**
10.	Pan Africa	40.0	37.0	(7.5%)	(38.3%)	39.0	0.0%	5.4%	**Hold**
11.	I&M Holdings	108.0	108.0	0.0%	8.0%	109.5	3.5%	4.9%	Lighten
12.	Standard Chartered***	215.0	214.0	(0.5%)	9.7%	208.6	5.8%	3.3%	Lighten
13.	CfC Stanbic	83.0	81.5	(1.8%)	(1.2%)	83.6	0.0%	2.6%	Lighten
14.	CIC Insurance	4.6	4.7	2.2%	(24.2%)	4.7	1.9%	1.9%	Lighten
15.	NIC	36.8	36.5	(0.7%)	(15.6%)	35.7	2.7%	0.5%	Lighten
16.	Co-op Bank	17.0	16.8	(0.9%)	(6.7%)	16.0	4.3%	(0.4%)	Sell
17.	Safaricom	18.7	17.5	(6.7%)	7.1%	16.6	4.2%	(0.6%)	Sell
18.	Britam	15.0	14.7	(2.3%)	12.7%	14.1	1.9%	(1.8%)	Sell
19.	NBK	10.0	10.6	5.5%	(33.0%)	5.4	0.0%	(48.8%)	Sell
***Target Price as per Cytonn Analyst estimates**									
****Upside / (Downside) is adjusted for Dividend Yield**									
*****Indicates companies in which Cytonn holds shares in**									
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									

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.

Private Equity

Denham Capital, a global energy-focused private equity firm, and GreenWish Partners, a renewable energy investment company dedicated to sub-Saharan Africa, have partnered to develop, build and finance a portfolio of 600 megawatts (MW) of renewable energy assets across Sub-Saharan Africa by 2020, as part of their USD 1bn project pipeline.

Africa presents a large opportunity for the development of renewable energy projects and investments, driven by a growing population, rapid urbanization, and development of towns and cities, which require large amounts of electricity to power and drive growth. As per the International Energy Agency, Sub-Saharan Africa is among the most underserved power regions in the world:

1. 600 mn people in Sub-Saharan Africa do not have access to electricity,
2. The African electricity gap requires USD 40 bn of investments annually, and renewable assets such as wind, solar and geothermal will help to bridge the gap,
3. Average annual consumption of electricity per capita in Sub-Saharan Africa, excluding South Africa, is 162-kilowatt hours (kWh), which is equal to 2.3% of the global average of 7,000 kWh, and,
4. Under-provision of power and electricity cost the region between 2-4% of GDP on an annual basis.

Ethos, a South African private equity firm, has exited its investment in Brandcorp, the holding company of businesses involved in the distribution and reselling of industrial products in South Africa, including products such as hand tools, general hardware, welding equipment and power tools. Ethos has exited to Bidvest, an investment holding company listed on Johannesburg Stock Exchange (JSE), for an undisclosed amount. The deal illustrates the ease of exit for Africa private equity investors; Ethos has successfully exited 91 of its 104 investments across all its funds.

Real Estate

During the week, Fusion Capital opened the sale of its Development Real Estate Investment Trust, (D-REIT), which has been dubbed Fusion Real Estate Development (**?FRED?**) ? Commercial, to the public at an IPO price of Kshs. 23.0 per unit. Key points to note from the issuance are:

1. Fusion Capital, the promoter of the REIT, aims to raise Kshs. 2.3 bn through the sale of 100.0 mn units closing on July 15th 2016, and will be listed on the Nairobi Securities Exchange on July 28th 2016,
2. Units in the REIT are targeted to professional investors, with a minimum application size of Kshs. 5.0 mn, equivalent to 218,000 units,
3. The trust will be a close-ended fund and existing unit holders will have the right to approve the additional issuance of units for further funding of the REIT?S activities,
4. The Kshs. 2.3 bn of money raised will be used to develop a mixed use development comprising of residential, office and retail project in Meru, Kenya, a project known as Greenwood City,
5. The base case construction period for the development is at 24 months, with a post-development period of 12 months for the REIT to earn rental income,
6. As per estimates from Fusion, the project will deliver Kshs 1.2 bn of profit, and a project IRR of 20.3%.

The introduction of laws regulating REITs in 2012 has seen firms show interest in the newly introduced instruments as an alternative to bank loans and internally generated money when financing projects. Last year, Stanlib investment launched the first I-REIT in the market raising Kshs 3.6 billion through an income REIT that is currently listed on the Nairobi Securities Exchange. We shall be performing a detailed analysis on FRED, to provide our Recommendation on the offering for our investors, as well as the tax considerations behind developing through a REIT in our Cytonn Weekly, to be released on 10th July 2016.

In a move to boost the levels of mortgages in the Kenya market, Treasury has allowed the National Social Security Fund (NSSF) to finance mortgage loans by removing restrictions imposed by Section 38 (1) (c) of the NSSF Act. This will allow the public pensions fund manager to channel mortgage financing to members through banks, non-banking financial institutions and insurance companies. This move by Treasury, may be seen as positive however given the rates shall be commercial, it may not have any significant impact on the Kenyan economy, as majority will still be priced out of a loan. At an average loan size of Kshs 7.5 million, few Kenyans can afford homes financed by commercial funding.

Brexit Impact on Global and Local Markets

This week, we saw a historic referendum vote take place in the United Kingdom (UK) on whether the UK should remain as part of the European Union (EU). The result of the vote was 52% voted for leaving the EU against 48% who voted for remaining in the EU. In this research note, we shall (i) first explain the structure of the EU, (ii) the UK referendum question leading up to a vote, and (iii) the implications of the vote to leave EU on global and local markets.

The European Union (EU) is a politico-economic union of 28 European states. The EU operates through a system of supranational institutions and intergovernmental-negotiated decisions by the member states. The EU has developed an internal single market through a standardized system of laws that apply in all member states. Within the Schengen Area, passport controls have been abolished to allow free movement of citizens of member states. EU policies aim to: (i) ensure the free movement of people, goods, services, and capital, (ii) enact legislation in justice and home affairs, and (iii) maintain common policies on trade, agriculture, fisheries, and regional development. The Eurozone, officially called the Euro Area, is a monetary union of 19 of the 28 European Union (EU) member states, which have adopted the euro as their common currency and sole legal tender. The other nine states like the UK that continue to use their own currencies are not members of the Euro zone.

While being a member of the EU certainly came with several benefits, especially with regards to trade, there were some drawbacks. For example, lax immigration laws between EU members and excessive regulations on businesses. This has led to widespread debate within the United Kingdom about whether or not to remain in the EU, commonly known as the Brexit, a short form of ?Br?itain ?Exit?ing the EU. The UK Independence Party (UKIP), led by Nigel Farage and London mayor Boris Johnson, were the main proponents of Brexit, in addition to MPs within the Prime minister David Cameron?s own conservative party.

The main reasons highlighted by the proponents of the Brexit were:

- The EU threatens the UK?s sovereignty. A series of EU treaties over the past couple of decades have shifted increasing amounts of power from the individual member states to the central EU bureaucracy in Brussels, especially with regards to competition policy, agriculture, and copyright and patent law,
- While wielding a lot of power, The EU bureacrats in Brussels were perceived to be insular to popular pressures
- Excessive EU regulations hinder operations/growth of British businesses,
- The EU allows for too many immigrants to enter the UK, which has increased competition for jobs, led to lower wages for the lower-middle class and has caused an increased security issue,
- The UK would not have to make the mandatory annual contribution to the central EU budget worth about GBP 9.0 bn.

On the other hand, those who opposed the Brexit outlined the following reasons that UK should remain in the EU:

- About 3.0 mn British jobs are directly linked to the UK being a member of the EU?s single market,
- 44% of the UK?s exports go to EU countries. Leaving the EU would mean that the UK does not receive trade benefits such as favorable tax rates when trading with EU countries, thus posing a disadvantage to several businesses,
- Since joining the EU, the ratio of UK?s per capita GDP to that of Germany and France has greatly improved,
- EU countries have banded together in defense against international threats such as Islamic State (IS), the UK would be disadvantaged in this sense if they were to leave the EU.

The question of the referendum for the UK to leave the EU was first brought up in September 2015. Bloomberg?s Brexit tracker showed the opinion polls since that period and indicated that the polls had been split and are constantly fluctuating, showing no side as a clear winner. The polls as at June 22nd, 2016 indicated that 46.2% prefer remaining in the EU, 44.3% would prefer leaving and 9.6% were undecided. This uncertainty made risk-averse investors wary of the UK and EU countries, resulting into depreciation of the GBP and the Euro since the announcement of the referendum in late 2015. The referendum question reached a climax on June 24th when the British went to vote to determine whether they will remain or exit the Euro. The results showed that majority of UK citizens, 52% voted for Britain leaving EU against 48% who voted for remaining in EU.

The implications of the Brexit on the global economy include;

1. **UK and EU**: For the UK, this means renegotiating trade agreements with the EU. Scotland supports the EU and may want to secede in order to remain part of the EU. And for the remaining EU members, there is increased uncertainly as nationalistic sentiments in other EU countries may gather steam and seek their own exit referendums
2. **US:** Federal Reserve is likely to adopt a wait-and-see stance in its attempt to increase rates, as Brexit referendum was one of the reason cited as to why the Fed chose to leave rates unchanged in its June meeting. Going forward the decision by the Fed will largely depend on how this will affect both the stability of European and global economies. Politically, the Brexit victory, which

was propelled largely by nationalistic sentiments and anti-immigrant rhetoric in the UK, may embolden the Donald Trump?s ?make America great again? theme, which has gained momentum due to similar nationalistic and anti-immigration sentiments in the US

3. **China:** The Chinese economy is one of the losers of the Brexit as EU is one of China?s biggest trading partners, accounting for 16% of the China?s total export in 2015 with 2.6% destined to the UK. A downward revision of growth prospects of these two economies will directly affect external demand for China?s products
4. **Asia**: While Asian markets trade linkage with UK fall below 2%, we are likely to see impacts on Asian markets coming from the performance of Euro Area as direct trade accounts for between 10%- 15% of the total exports. If the Brexit leads to rounds of referendum in other EU member state, which will further weakens the growth prospects for EU, the Asian markets are likely to feel the impacts
5. **Sub-Saharan Africa (SSA)**: Growth prospects in SSA will remain muted mainly due to weaker commodity price environment and also renewed risk as a result of volatility that may come from the Brexit. The impact of financial market developments is likely to be felt much more immediately. Rising risk aversion will be particularly negative for the SSA region, which has already seen trend deterioration in creditworthiness, with Brexit potentially exacerbating current financing difficulties.

Having considered the effects of Brexit on the global markets, we now look at the potential impact of Brexit on Kenya. There are a number of areas to consider, most importantly trade and renegotiation of contracts for trade.

1. Kenya exports tea, coffee, and flowers to UK, equal to 27% of fresh produce in UK, 56% of black tea in UK. Any renegotiations of the deals because of Brexit will lead to export delays, and loss of revenue. This is made even worse as it may lead to the current account deficit widening, as well as less inflows of foreign exchange
2. Kenya is likely to face capital flight as investors seek safe havens like US treasuries and gold which may exert pressure on the Kenya Shilling in the short term
3. Kenya in 2015 exported 1.3bn euros worth of products to the EU. A downward revision of growth prospects for the EU economies will result into lower external demand for Kenyan products, which may negatively affect the current account position
4. There is another potential impact in terms of tourism. UK is the largest exporter of tourists to Kenya, benefitting our local economy in terms of foreign exchange earnings, visa revenues, domestic spending, and the direct and indirect jobs created through the upkeep of the hospitality sector. UK's vote to leave the EU has caused a significant depreciation in the Sterling Pound, which will make it more expensive for UK tourists to travel to Kenya, having a negative impact on our tourist arrivals and GDP growth, at a time when the tourism sector is struggling to recover.

The table below shows the trade between Kenya and UK, EU and Europe:

Kenya Trade Partners (2015)				
Region	**Exports** (Kshs bns)	**Imports** (Kshs bns)	**% of total exports**	**% of total imports**
UK	40.7	43.0	7.0%	2.7%
EU	125.9	232.7	21.7%	14.8%
Europe	134.5	295.6	23.1%	18.7%

Source; Economic Survey 2016

In conclusion, EU is a classical example of an integration that had noble intentions at the beginning but in the long term, member nations are unwilling to sacrifice their sovereignty for the success of the bloc. Neither party is willing to make concrete sacrifices for the success of the entire bloc. Regionally, Tanzania is opposed to full East Africa Community (EAC) integration to protect its fledgling agricultural and manufacturing industries from

Kenyan competition should full integration be realized. On the ground, Tanzanians are worried that full EAC integration will lead to a loss of ?Tanzanian ?jobs to skilled, more educated Kenyans, the same mood that was in the UK; Eastern European immigrants are taking jobs and claiming benefits belonging to UK citizens.
