Cytonn Q3?2016 Quartely Markets Review

Cytonn Weekly

Executive Summary

- Global Markets Review: Global economic growth is expected to remain sluggish in 2016, as Central Banks? accommodative policies struggle to spur growth and deal with the economic shocks like Brexit;
- Regional Markets Review: Stability in commodity prices, coupled with increased capital inflows will steer growth in 2016 through to 2017;
- Kenya Macroeconomic Review: Kenya?s economy grew by 6.2% in Q2?2016, an increase from the 5.9% recorded in Q1?2016. Kenya?s inflation increased slightly in Q3?2016 to 6.3% in September 2016 from 5.8% in June 2016. The Kenya shilling has depreciated by 0.2% against the US dollar closing at Kshs 101.3, compared to Kshs 101.1 as at the end of June 2016;
- Fixed Income: During the quarter, yields on the 91 and 182-day T-bills were on an upward trend, rising 80 bps each to 7.9% and 10.6%, respectively, while the yields on the 364-day declined 50 bps to 10.6%. The Kenyan Parliament passed the Banking (Amendment) Act 2015 bill that sought to cap interest rates charged on loans and increase the rates paid on deposits;
- Equities: During Q3?2016, the Kenyan equities market was on a downward trend, with NASI, NSE 25 and NSE 20 declining by 3.5%, 9.9% and 5.7%, respectively. For the companies that released their H1?2016 results, the performance was relatively better than what was recorded in H1?2015, with the listed banks? H1?2016 results posting a 15.8% core EPS growth compared to 4.7% in H1?2015;
- Private Equity: Energy, Technology, Financial, Telecommunication and FMCG sectors continued to witness increased private equity activity in Africa during the quarter driven by high demand due to the continent?s expanding middle class;
- Real Estate: The real estate sector experienced various efforts to reduce development costs among them tax incentives for low-cost housing developers and caps on environmental fees. There were some fund-raising efforts through the capital markets through DREiT. Developers are increasingly exploring innovative purchase options for the end-user to increase uptake for housing units.

Company Updates

- Our development affiliate, Cytonn Real Estate, this week closed a joint venture agreement for a 100 acres land in Ruiru valued at Kshs 1.5 billion. The land will be used for a comprehensive master-plan development, currently in concept development and will be in the market in 6 months. Commenting at the signing of the deal, Elizabeth N. Nkukuu, CFA, Cytonn?s Chief Investment Officer and Head of Cytonn Real Estate said, ?this confirms that we continue to be the preferred joint venture solutions provider for land owners looking for trusted development and financing partners. Majority of the developments will go towards providing mid-income housing.

This brings our total mid-income housing units in the pipeline to over 6,000 thousand units.?

- Last week we launched another real estate product, The Ridge, a comprehensive, luxurious lifestyle mixed-use development in Ridgeways, right on the Northern bypass. The Ridge experienced strong demand with over 20% of units sold on the launch day. For more information, The Ridge Fly-Through & The Ridge Event Note. To purchase The Ridge, contact your financial advisor or email us: clientservices@cytonn.com
- 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 50.0% sold and has delivered an annualized return of 55.0% 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 25.0% p.a. See further details here: Summary of investment ready projects
- Our Senior Investment Analyst, Duncan Lumwamu, was on CNBC discussing the dominance of Kenyan Banks in Tanzania?s mortgage market and the maize importation stalemate. See link: Duncan Lumwamu on CNBC
- Our Investment Manager, Maurice Oduor, discussed creating wealth and how to diversify investments on Money Matters, Saturday Nation. See link : Maurice on Wealth Creation
- We continue to beef up the team with several ongoing hires: Careers at Cytonn.

A. Global Markets Review

Introduction

The year 2016 has so far been characterized by a number of headwinds facing the global economy including (i) the slow growth in the developed markets which has come in at 1.8% p.a in the first half of the year compared to 1.9% last year, (ii) low commodity prices negatively affecting commodity exporters in emerging market, and (iii) weak global trade. The sluggish start of the year brought about similar downward global economic growth revisions by the World Bank and IMF in July to 2.4% and 3.1% from earlier projections of 2.9% and 3.2%, respectively at the start of the year. In addition, the World Trade Organization (WTO) has downgraded their outlook forecast for world trade growth in 2016 to 1.7% from 2.8% in April, citing a slowdown in China and falling import levels in the United States. This is the first time in 15 years that international commerce is seen to lag GDP growth of the world economy, having grown 1.5x faster than GDP in the long term, and 2.0x as fast since globalization picked up in the 1990s.

In terms of the four key economic regions:

i. US: The US Fed kept the Federal Funds rate constant in the 0.25% - 0.5% band. This is despite noting that economic conditions as well as the labor market, had improved, with the total number of jobs created increasing by 150,000 in August, and the unemployment rate remaining at a low of 4.9%, which is considered as full employment in the US economy. The main concern that the Fed had was the status of the other world economies, which are weaker, and their possible impact on the US economy
ii. Europe: The region has slowed this quarter growing at 0.3%, following ?Brexit?. Despite an aggressive quantitative easing programme of Euro 80.0 bn per month, which is aimed at stimulating the economy and increasing GDP growth, the region still suffers from low growth and low inflation
iii. Asia: Concerns remain over economic growth in Asia, especially given the slowdown in China, and its wide-reaching effects on emerging markets, which depend on China as a key export destination for their raw materials
iv. Emerging Markets: The regions are expected to grow at 3.5%, compared to 3.4% in 2015, with the

commodity importers expected to do much better than commodity exporters. Concerns in this economic block remain the impact that global economic trends will have on these economies.

United States

US economic growth advanced 1.4% in the second quarter, higher than the previously estimated 1.1% for Q2?2016. The upward revision was due to higher exports and higher consumption.

The US Federal Reserve left the Federal Funds rate unchanged at its meeting in September 2016 despite earlier expectations that it could raise the rates from the current band of 0.25% to 0.5%. The Fed noted that the case for an increase in interest rates had strengthened in recent months, but decided to wait for further evidence of continued progress towards its objectives. While most indicators point to a pickup in economic activity, including an improving labour market with rising job gains, strong household spending, and improvements in the housing sector; low levels of business fixed investments and persistently low inflation continue to necessitate caution.

The stock market performance improved on account of the extended accommodative policy by the Fed, with the S&P 500 having gained 6.2% since the start of the year, despite corporate earnings falling by 4.3% y/y, marking the 5th consecutive decline in quarterly earnings. In terms of valuations, the Cyclically Adjusted Price/Earnings (CAPE) ratio is currently near historical highs at 26.8x, far above the historical average of 16.7x, indicating an overvaluation of the market.

We expect the US market to remain volatile with possibilities of a decline in equities market from the current levels owing to the upcoming presidential elections in November and the possibility of a rate hike by the Fed in December.

Eurozone

The Eurozone experienced a slowed economic growth at 0.3% in Q2?2016 down from the 0.5% growth experienced in Q1?2016. This was mainly attributed to the poor performance of major economies such as France and Italy which realized almost flat GDP growth. Manufacturing activity in the Eurozone remains strong, measured by the Purchasing Managers Index, which was at 52.6 in Q3?2016, similar to the 52.6 recorded at the end of Q2?2016. The market expectation for Eurozone Q3?2016 GDP growth stands at 0.4% for the quarter, and a y/y projection of 1.7%, which is pegged on improved consumer spending.

The European Central Bank (ECB) met in September and maintained the base lending rate at 0.0%, and the rates on the marginal lending facility and deposit facility at 0.25% and -0.4%, respectively. However, the ECB reaffirmed its plans to run quantitative easing to March 2017 or beyond if needed, calling on Eurozone governments to step up their structural reforms and fiscal policies in order to collectively achieve their goals. The inflation rate remains low at 0.2%, which is quite low compared to the ECB target of 2%.

The Euro Stoxx 300 has been on a downward trend, losing 12.2% YTD due to the uncertainty surrounding ?Brexit?, the inability of Eurozone to stimulate inflation back to the target of 2.0%, and the announcement of no additional stimulus which has further rattled the markets.

We expect the ECB to continue their QE programme, and possibly even extend the programme beyond March 2017 in case the uncertainty following the Brexit dents the Eurozone recovery and the low inflationary environment persists.

China

The Chinese economy experienced a growth rate of 6.7% in Q2?2016 which was unchanged from Q1?2016 and against an estimate of 6.6%. This could be attributed to the stimulus measures put in place by the Government and the Peoples Bank of China to add more liquidity to the economy and spur bank lending.

China still managed to contribute 1.2% towards global growth until H1?2016, being the single largest individual contributor to global GDP growth. The first half performance in 2016 was supported by increased government infrastructure spending, accommodative monetary policy, and an increase in consumer spending. The continued implementation of structural reforms should help China overcome risks that include weak export demand, falling manufacturing investment and a slowdown in credit growth.

China experienced increased level of imports in the month of August, rising 1.5% for the first time in two years? time while exports declined by 2.8%. This was mainly as a result of sluggish world demand on China?s exports. The Shanghai Composite Index, however, remains one of the worst performing indices having lost 18.3% year to date.

China?s economy is showing fresh signs of strength, from increased business confidence to an expansionary factory gauge reading, according to the earliest private indicators for September. We expect to see the Chinese economy growing within the government targets of 6.5% - 7% for the rest of the year amidst the shift to a service-based economy from manufacturing and export based.

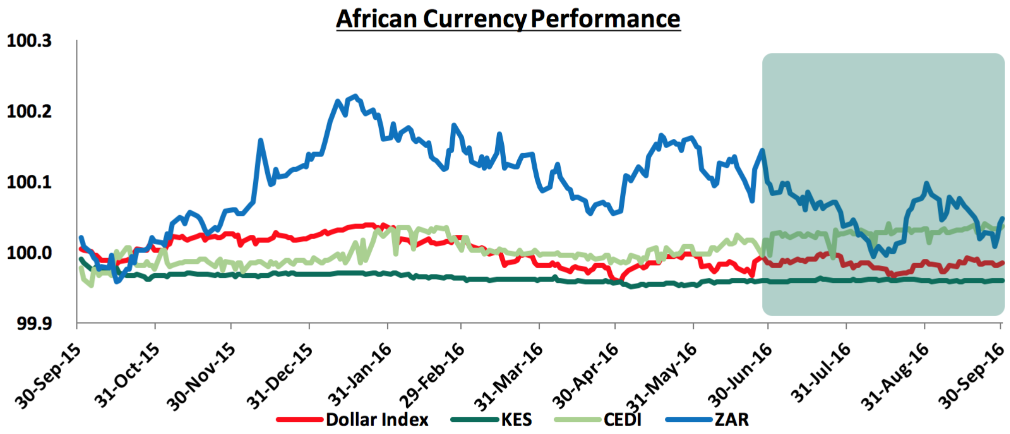
B. Regional Markets Review

The Sub-Saharan Africa region registered mixed performance in the 9 months to September 2016. The Commodity dependent economies have registered a contraction in GDP, while few countries continued on an upward growth trajectory. Nigeria and South Africa, which cumulatively account for 50% of Sub-Saharan Africa?s output, registered sluggish growth; Nigeria GDP contracted by 2.1% in H1?2016 while South Africa posted a 0.6% growth in Q2?2016, up from a 0.1% contraction in Q1?2016.

- Commodity Prices
  As highlighted in our H1?2016 Markets Review, global commodity prices continued to plunge in 2016 and are expected to stabilize in 2017. In Q3?2016, the global commodity prices rebounded and are expected to remain stable in Q4?2016, which will consequently stabilize the commodity-dependent economies of Sub-Saharan Africa; Nigeria, Ghana and other oil and metal exporting nations. However, the commodity-dependent economies? recovery will be achieved in the medium term, as internal imbalances settle in, particularly the dents on their current accounts.

- Post Brexit Effects
  The impact of Brexit on Sub Saharan Africa markets was overstated, as the markets quickly recovered from the global trough, which can be attributed to the increased global investor focus on frontier markets, particularly Sub Saharan Africa where economic growth is ranked among the highest globally leading to continued growth in net capital inflows.

- Currency Performance
  Sub-Saharan African currencies held stable against all the major global currencies as a result of (i) a stable dollar performance globally, and (ii) low oil prices, which are beneficial for net oil importer countries. Below is a chart showing the performance of select African currencies against the dollar performance, as indicated by the dollar index:



- African Eurobonds
  Yields on African Eurobonds have continued to decline, highlighting the improved investor sentiment and perception on account of improving macro-economic conditions and a relatively improving political landscape. Ghana successfully raised USD 750.0 mn through its 5th Eurobond at a yield of 9.3%, with a weighted average tenor of 5 years, recording more than 5.0x subscription level, indicating the high appetite for Frontier markets securities. Below is a graph depicting the Eurobond performance of select African sovereign bonds:

- Equity Market Performance:
  Sub-Saharan stock market performance has remained subdued in 2016 with negative returns across the board as illustrated below. This can be attributable to (i) weak economic performance brought about by low commodity prices, and (ii) reduced foreign investor interest in holding African equities as investors remain risk averse.

Summary of African Equities Market Performance (USD)			
Country	31-Dec-15	30-Sep-16	YTD Change
South Africa	3,273.4	3,787.6	15.7%
Tanzania	1.1	1.1	5.2%
BRVM	0.5	0.5	(4.0%)
Kenya	1.4	1.4	(4.8%)
Uganda	0.5	0.5	(12.9%)
Rwanda	0.2	0.2	(11.7%)
Zambia	521.3	434.7	(16.6%)
Ghana	523.6	464.0	(11.4%)
Malawi	21.8	19.1	(12.7%)
Nigeria	143.7	87.9	(38.8%)

We still maintain our view that infrastructural spending, stable commodity prices, and political stability will be the key drivers for Africa?s growth.

C. Kenya Macroeconomic Review

Kenya?s GDP grew by an impressive 6.2% in Q2?2016, up 30 bps from the 5.9% recorded in Q2?2015. This growth is attributed to a stable macroeconomic environment as exemplified by;

- H1?2016 average annual inflation at 6.2%, within the CBK band of 2.5% -7.5%, 2015
- a narrowing current account deficit currently at 6.5% of GDP from 7.3% of GDP in H1?2015, and
- an 8.4% growth in exports accompanied by an 8.3% decline in imports resulting in an improved export-import ratio to 29.4% from 26.0% in 2015, supported further by improved export prices and the decline in oil prices,

The sectors that supported the growth include Agriculture (5.5%), Transportation and Storage (8.8%), Real Estate (8.7%) and Wholesale & Retail trade (6.1%). Tourism has continued to recover in 2016, recording a growth of 15.3%.

Key sectors that contributed to this growth are as follows:

Sectoral Contribution and Growth- 2015 and 2016				
Sector	Q2'2015 Contribution	Q2'2016 Contribution	Q2'2015 growth	Q2'2016 growth
Agriculture, forestry and fishing	23.2%	23.1%	4.0%	5.5%
Taxes on products	11.6%	11.5%	5.8%	5.1%
Manufacturing	10.7%	10.4%	5.1%	3.2%
Real Estate	8.5%	8.6%	10.2%	8.7%
Wholesale and retail trade	8.3%	7.4%	5.2%	6.1%
Education	6.8%	6.6%	4.5%	4.1%
Transport & Storage	6.4%	6.5%	6.8%	8.8%
Financial &insurance activities	5.9%	6.0%	7.7%	7.5%
Construction	5.1%	5.2%	11.2%	8.2%
Public Administration	4.7%	4.7%	6.3%	6.7%
Information and Communication	3.0%	3.0%	7.0%	8.6%
Others	5.8%	6.9%	n/a	n/a
Overall Growth	100.0%	100.0%	5.9%	6.2%

We expect Kenya?s GDP to come in at 5.8% underpinned by high government expenditure on infrastructure, an improvement in the performance of the private sector and a recovery in the tourism industry.

During the quarter, the Kenya shilling weakened by 0.2% against the dollar closing at Kshs 101.3, compared to Kshs 101.1 as at the end of June 2016. On a year to date basis, the Kenya Shilling has appreciated by 1.0% against the dollar. The stability of the Kenya shilling can be attributed to (i) large forex reserves with 5.2 months of import cover, (ii) current low oil prices which have eased up the country?s current account deficit by lowering the oil import bill, and (iii) increased diaspora remittances which rose by 14.8% in June 2016 to USD 156.0 mn from USD 136.0 mn in the same period last year.

The Monetary Policy Committee (?MPC?) met during the quarter and lowered the CBR for the second time in 2016 by 50 bps to 10.0% on account of (i) the persistent slowdown in private sector credit growth which stood at 15.5% against the CBK target of 18.3% and, (ii) the fairly stable core inflation that declined from 6.4% in July to 6.3% in September 2016 indicating that inflationary pressures remain at bay. The move was contrary to our expectation that MPC would retain the CBR at 10.5%. See MPC Note. We view that lowering the CBR was a signal by the Central Bank that the economy still requires an accommodative policy for growth and was intended to spur credit uptake following the signing into law of the Banking Amendment Act 2015 that pegs all commercial banks loans at a 4.0% cap on this rate.

The inflation rate increased during the quarter to 6.3% in the month of September, from 5.8% in June 2015, in line with our September projection of 6.3% - 6.5%. The trend in inflation rate during the quarter has been driven largely by (i) an increase in food and non-alcoholic beverage prices, and (ii) an increase in pump prices of diesel and petrol. Inflation rose slightly to 6.34% in September from 6.3% in August driven by a 0.6% increase in food prices, despite consumers benefiting from a decline in oil prices for the month of September that reduced the transport index inflation gauge by 0.3%. Going forward, we expect inflation to remain within the CBK target range of 2.5% to 7.5% in Q4?2016.

Macroeconomic Indicators Table

The table below summarizes the various macroeconomic factors, the expectation at the beginning of

2016, the actual 2016 experience so far and the impact of the same, and our expectations going forward:

Summary of Macro Economic Indicators - 2016				
Macro-Economic Indicators	2016 Expectation	2016 Experience	Going Forward	Outlook
GDP	GDP growth of 5.5%-6.0%	5.9% growth in Q1?2016. IMF, WB and Treasury expect GDP to come in at 6.0%	We expect GDP growth for 2016 to come in at 5.8% driven by government spending on infrastructure and the recovery of the tourism sector	Positive
Interest Rates	Upward pressure on rates	The CBK reduced the CBR by 50 bps to 10.0%. KRA met their target of Kshs 1.2 tn. Government has borrowed Kshs 97.7 bn ahead of its pro-rated target of Kshs 61.8 bn	The interest rate environment is expected to remain relatively stable following the enactment of the Banking Act Amendment, 2015 and the renewed effort by the CBK to improve private sector credit growth	Neutral
Inflation	To remain within single digit levels, but above CBK?s upper bound of 7.5%	Inflation declined from the high of 8.0% in December through January to August at 6.3%	We expect Inflation rate to remain below the CBK?s upper limit of 7.5%	Neutral
Exchange Rate	Shilling to depreciate against major currencies	The shilling has appreciated 1.0% against the dollar YTD. Forex reserves hit a high of 5.2 months of import cover during H1?2016	The shilling expected to remain stable in the short to medium term supported by (i) foreign exchange reserves equivalent to 5.2 months of import cover, and (ii) increased dollar inflows from tourism and remittances. We are however likely to see upward pressure in the short term driven by volatility in the stock market	Neutral
Corporate Earnings	To remain subdued due to the high interest environment, depreciating shilling and inflationary pressures	Several companies have released positive H1?2016 results, mainly banking sector (listed) with weighted average growth in core EPS of 15.8%, above expectation of 12.5%	We expect corporate earnings to be better than 2015, exhibiting growth in profits owing to better macroeconomic conditions. We expect strong corporate earnings supported by favorable macroeconomic conditions	Positive

Investor Sentiments	Flows out of Kenya from the rate hike have been priced into the market, and neutral stance on corporate earnings means no large foreign investor inflows	Investor sentiment has been high with foreign investors being net buyers throughout the year with inflows of USD 56.8 mn	We are neutral on investor sentiment given the uncertainty brought about by the interest rate caps which might lead to repatriation of foreign funds from the market	Neutral
Security	To improve given government initiatives to eradicate extremism	Kenya has received an upgrade in credit rating by Moody?s as a positive indicator that the environment is safe to carry out business operations	Security is expected to be tight given the number of international events being held in the country and the government?s initiative to eradicate extremism. However, uncertainty still exists given that 2017 is an election year and recent attacks at the Coast	Neutral

Of the seven macroeconomic indicators that we follow, all have remained as they were at mid-year 2016. However, from January 2016, Interest rates and Exchange rates outlook have improved from negative to neutral, while corporate earnings have turned positive from neutral. Only Security has worsened from positive to neutral. We maintain our expectation that the operating environment will remain conducive to support stronger economic growth in 2016 compared to 2015.

D. Fixed Income

During Q3?2016, yields on 91-day and 182-day T-bills were on an upward trend with the 91 and 182-day T-bills increasing by 80 bps each, to 7.9% and 10.6%, respectively from 7.1% and 9.8%, respectively in June 2016. On contrary, yields on the 364-day T-bill were on a downward trend declining by 50bps to 10.6 % from 11.1% in June 2016.

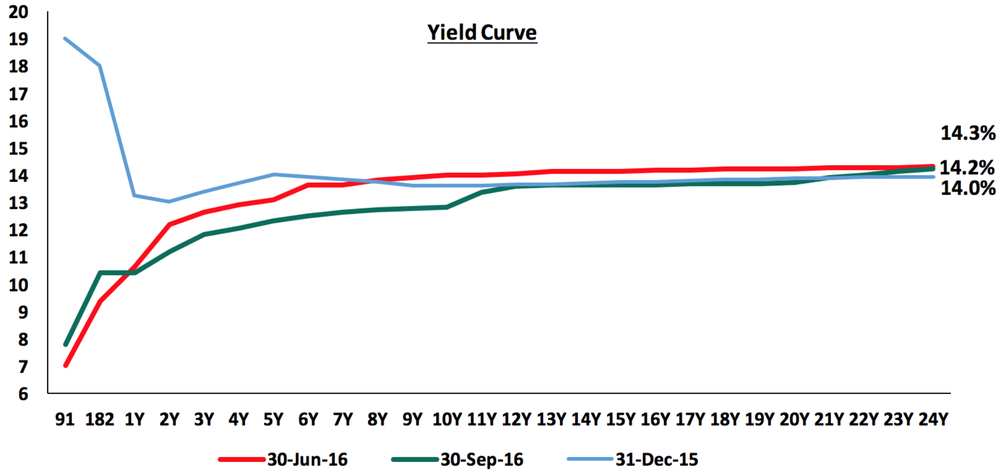
During the week, T-bills were oversubscribed with overall subscription decreasing to 129.5% compared to 169.3% recorded the previous week. Subscription rates, however, decreased across all tenors with the 91-day, 182-day, and 364-day with subscriptions of 118.1%, 144.6%, and 122.1%, respectively, declining from 158.6%, 167.8%, and 177.9%, respectively, the previous week. Yields declined across all tenors with the 91, 182 and 364-day papers decreasing to 7.8%, 10.4% and 10.4% from 7.9%, 10.6%, and 10.6%, respectively, the previous week.

The Treasury released the ?Securities Issuance Calendar? for quarter 1 of the 2016/2017 fiscal year. This is a new initiative that is aimed at increasing transparency in bond issuance by the government thus improved secondary market bond activities. September bond issuance marked the end of fiscal year Q1?2016 of the bond issuance calendar and the Treasury is yet to issue the same program for fiscal year Q2 of 2016/2017 fiscal year. Below is the summary of the primary auction for the quarter that ended September 2016;

Summary of the Primary Bond Auction ? Q3?2016								
Issue date	Security	Security Code	Offer Amount (bns)	Amount accepted (bns)	Performance rates	Average accepted amount	Secondary market yield	Variance
25-Jul-16	5-Year Bond	FXD2/2016/5	30	24.4	136.30%	14.10%	13.60%	0.50 %
25-Jul-16	20-Year Bond (re-open)	FXD1/2008/20		9.1		14.80%	14.80%	0.03 %
29-Aug-16	10-Year Bond	FXD1/2016/10	25	26.3	105.20%	15.00%	14.60%	0.40 %

26-Sep-16	5-Year Bond	FXD3/2016/5	25	23.1	225.80%	13.10%	13.00%	0.10 %
26-Sep-16	20-Year Bond	FXD1/2016/20		12.3		14.60%	14.70%	-0.06 %

The graph below shows the evolution of the yield curve during the year. As can be seen, the yield curve seems to have normalized with a downward shift in the short term and upward shift in the longer term, while the longer-end has increased.



There was reduced activity in the secondary bond market, with bond turnover falling by 46.0% to Kshs 81.2 bn from Kshs 150.3 bn in Q2?2016 and Kshs 106.6 bn in Q1?2016. The FTSE Index registered a positive return for the period. Below is the bond performance of the FTSE Bond Index for bond portfolios;

FTSE Bond Index Performance ? Q3?2016			
Index	30-Jun-16	30-Sep-16	% Change
FTSE Bond Price Index (1-3 years)	96.41	97.08	0.97%
FTSE Bond Price Index (7-10 years)	95.80	95.58	(0.22%)
FTSE Bond Price Index (>10 years)	79.74	79.19	(0.55%)
FTSE Bond Price Index (Consolidated)	88.72	89.11	0.39%

During the quarter, money markets were characterized by relatively high liquidity on account of government payments and Treasury bill redemptions. This can be evidenced by (i) the decline in the average interbank rate from 8.7% in H1?2016 to 6.5% in Q3?2016, and (ii) the oversubscription of government securities. The graph below shows the interbank rate evolution during the year. The average reverse repo rates during the quarter stood at 10.4% and indication that some banks are still locked from the interbank market and hence have to rely on Central bank for liquidity.

The quarter saw two legislations affecting the Financial Services sector passed. The Parliament passed The Banking Act (Amendment) Bill, 2015, which sought to put a cap on interest rates, which was eventually signed into law by the President on 24th August 2016. We are of the view that banks will prefer lending to the government as opposed to SMEs and other perceived high-risk borrowers since the rates remain higher on a risk-adjusted basis. In addition, Parliament passed a bill that requires Treasury to be consulted by CBK before a bank is placed under receivership. We expect this increased level of controlled regulation to limit CBK?s ability to act swiftly in containing risks in the event of a financial sector crisis. We are yet to see how this works since the central Bank is supposed to be independent.

The government is ahead of its domestic borrowing target for this fiscal year, 2016/2017, having borrowed Kshs 97.7 bn against a target of Kshs 57.4 bn (assuming a pro-rated borrowing throughout the year of Kshs 229.6 bn budgeted for the full fiscal year). Interest rates are currently witnessing downward pressure owing to the enactment of The Banking Act Amendment, 2015. With Interest *rates coming down, we advise investors to lock in their funds in short to medium-term papers, tenors of between six months and one year, as the rates are higher on a risk-adjusted basis.*

E. Equities

During Q3?2016, the Kenyan equities market was on a downward trend, with NASI, NSE 25 and NSE 20 declining by 2.7%, 8.4% and 10.9%, respectively, driven by a decline in large cap stocks. Since the start of Q3?2016, 44 stocks have declined, 3 stocks remaining unchanged while 16 stocks have risen in price. Among the top 10 stocks by market cap, Safaricom was the only gainer in Q3?2016 on the back of the company issuing a special interim dividend of Kshs 0.68 per share, adding to the Kshs 0.76 annual dividend. Co-op Bank, Equity Group, KCB Group, DTB and Barclays declined by 25.3%, 20.1%, 17.0%, 15.8% and 15.1%, respectively, following the enactment of the Banking Act Amendment 2015 that capped the maximum rate that can be charged on loans by commercial banks to 4.0% above the Central Bank Rate.

During the week, the Kenyan Equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 2.0%, 2.1% and 2.4%, respectively. Safaricom was the top mover for the week, accounting for 42.7% of the market turnover. Since the February 2015 peak, the market has been down 41.0% and 23.0% for the NSE 20 and NASI, respectively.

Equity turnover in Q3?2016 decreased by 13.4% to USD 466.4 mn compared to USD 538.7 mn in Q3?2015. Foreign investors were net buyers with net inflows of USD 57.5 mn, a 274% increase from the net inflows of USD 15.4 mn recorded in Q2?2016. The sustained foreign investor inflows during the quarter can be attributed to improving investor sentiment following expectations of stronger earnings growth in 2016 compared to 2015.

The market is currently trading at a price to earnings ratio of 12.0x, a decline from the 12.8x at the beginning of the year vs. a historical average of 13.7x, with a dividend yield of 6.4%, vs. a historical average of 3.5%.

The charts below indicate the historical PE and dividend yields of the market.

During Q3?2016, banks and insurance companies released H1?2016 results, with banks recording improved performance whereas insurance companies recorded a decline in earnings.

Listed Banks H1?2016 results:

Kenyan listed banks released their H1?2016 results recording core earnings per share growth of 15.8%, up from a growth of 4.7% in H1?2015. In summary, the listed banks can be categorized into four main buckets:

- The strong growth banks: Banks with above 20% earnings per share growth. Standard Chartered, HF Group, I&M Holdings, and CFC Stanbic. It?s notable that these banks are more focused on corporate clientele. Standard Chartered has recovered from poor 2015 performance
- The stable growth banks: Banks with 10% and above in earnings per share growth. Co-op, Equity, KCB Group, and DTB Bank
- Anemic growth banks: Banks with below 10% earnings per share growth. Such as NIC Bank
- Negative growth banks: Barclays and National Bank

Key highlights from the results are:

- Deposit Growth: 8 of the 11 listed banks recorded an increase in deposit growth, with the exception of National Bank, KCB Group and CFC Bank that registered year on year declines
- Loan Growth: Deposit growth surpassed growth in loans, highlighting the slowdown in credit

uptake to the private sector. The weighted average for deposit growth was at 8.9%, while that for loan growth was at 7.3%
- Loan loss provisions: With increased supervision of banks, we witnessed a jump in loan loss provisions averaging 122.4% for the 11 listed banks, noting the increment in the level of credit risk across the whole sector
- Cost containment: Despite the tough operating environment, banks were able to contain costs recording an average cost to income ratio of 45.7%, compared to 48.0% for the same period last year
- Returns: Listed banks, with the exception of NBK, recorded positive double digits returns on average equity averaging 20.6% while return on average assets averaged 3.1%
- Valuation: With a sector valuation of 0.9x price to book and 5.2x price to earnings from 1.6x and 7.9x at the beginning of the year, respectively, we think that the sector has become fairly attractive for a long-term investor.

In summary, the banking sector is in transition to a more regulated, yet innovative environment. However, key issues such as the introduction of ICAAP framework, increased focus on sufficient provisioning, and increased level of ?controlled? regulation (Prudential Guidelines and Interest Rate Cap) will transition the industry into consolidation and innovations. Those that remain will be stronger banks in a more efficient and stable banking sector. For more information on the listed banks? H1?2016 performance, see our Cytonn H1?2016 Banking Sector Report.

Listed Insurance Companies H1?2016 results:

Listed Insurance Companies released their H1?2016 results recording core earnings per share decline of 7.4% from a decline of 4.7% recorded in H1?2015. In our view, the sector remains attractive with vast potential for growth especially in commercial lines such as oil, real estate and infrastructure. We expect increased regulation in the sector, as well as increased consolidation to reduce duplication of products by insurance companies with key focus on revenue diversification. Key highlights from the results are:

- Rising expense ratios: Listed insurers? expense ratios witnessed a considerable increase in half year to a 5 year high of 57.2% owing to higher operating expenses
- Declining Solvency ratios: Solvency ratios in insurers are declining steadily, currently at an average of 28.7%, from 29.1% in 2015, on the back of asset growth outpacing growth in equity
- Valuation: With a sector valuation of 1.1x price to book from 1.5x at the beginning of the year, and a historical average of 1.7x, we think that the sector has become fairly attractive for a long-term investor

For more information on the listed insurance companies H1?2016 performance, see our H1?2016 Insurance Report.

Despite the poor YTD equities market performance in Q3?2016, listed companies have delivered better results in 2016 compared to 2015. The better results can be attributed to improved macroeconomic conditions in 2016, with Q1?2016 GDP growth coming in at 5.9%, compared to a growth of 4.9% in Q1?2015.

Equities Recommendation Table

Below is our equities recommendation table. Key changes from last week?s recommendation include;

- CIC has moved from an ?Accumulate? recommendation, with an upside of 13.9% to a ?Lighten? recommendation with an upside of 2.5% following an 11.4% week on week price increase.

all prices in Kshs unless stated									
EQUITY RECOMMENDATION									
No.	Company	Price as at 30/06/16	Price as at 30/09/16	q/q Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**	Recommendation
1.	ARM	32.0	24.5	(23.4%)	(41.3%)	40.3	0.0%	64.5%	Buy
2.	Bamburi Cement	170.0	151.0	(11.2%)	(13.7%)	231.7	7.8%	61.2%	Buy
3.	KCB Group***	33.8	28.0	(17.2%)	(36.0%)	42.5	7.5%	59.3%	Buy
4.	Centum	44.0	39.5	(10.2%)	(15.1%)	56.7	2.4%	45.9%	Buy
5.	Kenya Re	19.5	19.8	1.5%	(5.7%)	26.9	3.6%	39.5%	Buy
6.	HF Group	20.3	16.0	(21.4%)	(28.3%)	19.8	9.2%	33.3%	Buy
7.	Co-op Bank	16.2	12.4	(23.8%)	(31.4%)	15.2	6.8%	29.9%	Buy
8.	DTBK***	165.0	139.0	(15.8%)	(25.7%)	173.2	1.8%	26.4%	Buy
9.	BAT (K)	835.0	820.0	(1.8%)	4.5%	970.8	6.2%	24.6%	Buy
10.	NIC	36.5	25.8	(29.5%)	(40.5%)	30.8	3.5%	23.1%	Buy
11.	Britam	14.2	11.0	(22.9%)	(15.8%)	13.2	2.4%	22.9%	Buy
12.	Barclays	9.6	8.2	(15.1%)	(40.1%)	9.2	9.7%	22.6%	Buy
13.	Equity Group	38.5	30.8	(20.1%)	(23.1%)	34.2	7.7%	18.9%	Accumulate
14.	I&M Holdings	110.0	88.0	(20.0%)	(12.0%)	101.1	3.9%	18.8%	Accumulate
15.	CfC Stanbic	80.0	71.5	(10.6%)	(13.3%)	75.5	7.9%	13.5%	Accumulate
16.	Jubilee Insurance	455.0	469.0	3.1%	(3.1%)	482.2	1.8%	4.6%	Lighten
17.	CIC Insurance	4.6	4.4	(4.3%)	(29.0%)	4.4	2.5%	2.5%	Lighten
18.	Standard Chartered***	195.0	180.0	(7.7%)	(7.7%)	169.9	6.6%	1.0%	Lighten
19.	Liberty	13.6	14.7	8.1%	(24.6%)	13.9	0.0%	(5.4%)	Sell
20.	Safaricom	17.8	20.0	12.1%	22.4%	16.6	3.6%	(13.1%)	Sell
21.	Sanlam Kenya	37.0	37.0	0.0%	(38.3%)	30.5	0.0%	(17.6%)	Sell
22.	NBK	9.6	6.7	(30.7%)	(57.8%)	2.7	0.0%	(59.4%)	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 with a bias to positive? for investors with short to medium term investments horizon and we have now turned ?positive? for investors with long-term investments horizon.

F. Private Equity

During the third quarter, African Capital Alliance (ACA) and Oasis Capital Ghana raised approximately USD 570.0 mn and USD 27.0 mn for their private equity funds, respectively, with a focus on attractive and diversified deals across their target sectors.

Deals focused on the financial services, energy and technology sectors as expounded below;

Financial Services Sector

The Financial services sector continued to attract capital in Q3?2016 supported by the need for financial services in the region. Some of the deals include:

1. International Finance Corporation (IFC) acquiring a 2.5% equity stake in ADvTECH valued at USD 13.0 mn, effectively valuing the company at USD 520.0 mn. This transaction resulted in an increase in IFC?S total holdings in ADvTECH to 4.1% after an earlier acquisition of 1.6%,
2. CDC Group, UK?s development finance institution, allocated USD 20.0 mn to EuroMena Fund III, a 9-year closed-end generalist private equity fund, and another USD 20.0 mn to Atlantic Coast Regional Fund II (ACRF II), a 10-year growth equity fund.

Financial services sector continues to attract private equity players driven by (i) improved regulatory frameworks, (ii) growth of the middle class population with increasing numbers seeking financial services, and (iii) innovation in the sector with integration of mobile technology.

Energy Sector

With an ever-growing demand for energy, both from commercial users and domestic consumers, there has been an increase in the number and value of investments into this sector with focus on renewable energy. Deals in the energy sector over the third quarter of the year include:

1. Helios Investment Partners (Helios) and The Vitol Group (Vitol), an energy and commodities company based in the U.S., bought a 49.0% controlling stake valued at USD 210.0 mn in Oando PLC (Oando), effectively valuing the company at USD 428.6 mn,
2. The Rockefeller Brothers Fund joined the investor consortium backing Lekela Power, the renewable energy joint venture between private equity firm Actis and developer Mainstream Renewable Energy, by committing to invest USD 10.0 mn.

The energy sector has continued to attract large private equity investment, with a key example being the partnership by Denham Capital and GreenWish Partners to develop, build and finance a portfolio of 600 MW of renewable energy assets across Sub-Saharan Africa worth USD 1.0 bn.

Technology Sectors

Deals in the technology and e-commerce sector over the third quarter of the year include:

1. CDC, a UK development finance institution, injected USD 55.5 mn in Africa Internet Group (AIG), a parent group of Jumia, Easy Taxi, Hellofood, Jovago, Lamudi and Kamyu,
2. GreenHouse Capital, a Nigerian venture capital fund managed by Venture Garden Group, plans to invest USD 10.0 mn into technology start-ups over the next two years. GreenHouse Capital has already invested over USD 3.0 mn out of the USD 5.0 mn in their first tranche, in high-growth African technology start-ups.

Telecommunication Sector

Deals in the telecommunication sector over the third quarter of the year include:

1. Emerging Africa Infrastructure Fund (?EAIF?), a donor-backed private infrastructure development group, loaned USD 20.0 mn to Helios Towers Africa (?HTA?), as part of a syndicated loan worth USD 105.0 mn, to finance the purchase of approximately 950 telecommunications towers in the Democratic Republic of Congo (DRC),
2. Development Partners International (DPI) invested USD 100.0 mn through its ADP II Fund in Atlantic Business International (ABI). The investment will be used to increase capital in ABI?s subsidiaries as well as fund IT investments.

FMCG Sector

In the FMCG, International Finance Corporation (IFC), committed to lend up to USD 4.5 mn to Tropical Heat Limited, a spices and snacks maker in Kenya, in order to assist the company to finance their expansion plans, which include the construction of a new factory on an eight-acre piece of land in Limuru.

The FMCG sector is expected to continue witnessing increased activity from both local and global players given the rising middle class.

Private equity investment activity in Africa has continued to improve, as evidenced by the increase in the number of deals and deal volumes into the region, with funds continuing to prefer financial services, energy, healthcare, education, and IT sectors although infrastructure, real estate, and natural resources are gaining ground. We remain bullish on PE as an asset class in Sub-Saharan Africa given (i) the abundance of global capital looking for investment opportunities in Africa, (ii) attractive valuations in the private sector, and (iii) better economic growth projections compared to global markets.

G. Real Estate

During Q3?2016, there were a couple of activities that happened in the real estate sector.

1. Fund-raising activities

There is continued interest by real estate firms to access capital through the capital markets and in Q3?2016 we saw;

i. Fusion Capital sought to list a DREIT. However, the firm failed to list the DREIT in the market as it recorded a 37.9% subscription rate raising Kshs 873.8 mn out of the targeted Kshs 2.3 bn from only 4 investors, thus did not meet the set threshold. Fusion Capital will, therefore, have to raise additional capital through a private placement to fund a mixed-use development in Meru,
ii. Green Park Estate Developer, Superior Homes announced plans to list in the Growth Enterprise Market Segment (GEMS) of the NSE,
iii. Stima Sacco announced plans to issue a corporate bond aiming to raise Kshs 5.0 bn to diversify into the mortgage business for periods of 10-15 years at a fixed rate and on a reducing balance.

The track-record for real estate issuances has not been good this far due to unfavourable market sentiments, lack of sufficient product knowledge and clarity on exit strategies and returns as highlighted in our Cytonn Weekly Report #32. Developers will need to address these issues for successful offerings.

2. Development Incentives

The Finance Bill 2016 proposal tabled in Parliament was in September signed into law. Effective 1 Jan 2017, developers will pay 15.0% in income taxes for constructing at least 400 low-cost residential units annually. While this will help curb the current high housing deficit especially in the low-income segment, there?s need for clarity regarding the value or definition of a ?low cost? house and in which year of income the 15% tax becomes applicable considering that the life cycle of selling residential units would be spread over a number of years.

3. Innovative end user Financing

In a bid to increase uptake of property, developers have increased focus on financing options available for the end-buyers of property.

i. For Stima Sacco, should the bond be successful, it shall be used to give borrowers (who have to be members of the Sacco) funding to buy houses and repay over 10-15 years. The borrowers shall 20% deposit, with the Sacco financing the rest of their mortgage costs based on their contribution to the Sacco,
ii. Commercial Bank of Africa (CBA) also announced a partnership with Bamburi Cement to finance mortgage borrowers in the lower middle-income class for houses whose prices range between Kshs 0.5 mn to Kshs 4.5 mn,
iii. On the same note mortgage holders are set for a Kshs 3,750 additional relief on their monthly earnings. The amended Finance Act 2016 provides for tax exclusion on the interest portion of mortgage repayments up to Kshs 25,000 up from the previous Kshs 12,500. The relief applies to all loans taken to buy or refurbish properties from banks, Saccos and insurance companies. This relief is however only applicable for single residential dwellings where the owner lives.

These initiatives by real estate stakeholders are likely to increase the mortgage uptake and provide ease of exit to developers as well as increase home ownership in Kenya. The recent capping of interest rates can only increase the chances of success for this initiative but it is good to note that most people still cannot afford to service a mortgage even at this levels since most of the prices of the houses are well above their reach.

The real estate sector remains resilient in terms of growth recording an 8.7% growth in Q2?2016 compared to 6.7% in Q1?2016, according to recently released data by the KNBS. The outlook for the real estate sector remains positive driven by (i) incentives for mass development, (ii) the rising middle class with higher disposable incomes and propensity to spend, (iii) increased investment in infrastructure, (iv) use of alternative building technology to lower costs, and v) innovative end-user financing.

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