Cytonn INVESTMENTS

# Cytonn Weekly #50

## Cytonn Weekly

# Executive Summary

**Fixed Income:** During the week, T-bills were undersubscribed, for the first time in 17-weeks, with overall subscription coming in at 72.7%, compared to 106.4% recorded the previous week as investors focused on the 2-year bond on auction, which was oversubscribed with a subscription rate of 118.5%. The US Fed raised the Federal Funds Rate by 25 bps to a bound of 0.50% - 0.75%, while data from the Central Bank of Kenya (CBK) indicated that Kenya?s domestic debt level rose by 5.6% in the 4-months since the start of the current fiscal year;

**Equities:** During the week, the Kenyan equities market was on a downward trend, with NASI, NSE 20 and NSE 25 losing by 1.1%, 1.7% and 0.9%, respectively. The Insurance Regulatory Authority (IRA) released Q3?2016 numbers for the insurance industry, with the industry recording growth in core earnings of 32.3% to Kshs 9.3 bn from Kshs 7.0 bn in Q3?2015;

**Private Equity:** Overseas Private Investment Corporation (OPIC), the development finance arm of the United States government, approved an investment of USD 200.0 mn in Apis Growth Fund II and Helios Credit Partner, and as well committed a USD 200.0 mn investment in the LeapFrog Investments Fund;

**Real Estate:** Shelter Afrique, a housing development finance institution, has launched a competition dubbed ?5,000 For 5,000 Homes? in a bid to boost affordable housing in Africa.

# Company Updates

- In order to have a more focused initiative to address affordable housing for Nairobi?s rapid urbanization, Cytonn Real Estate has started and staffed an Affordable Housing Development Unit. The unit will bring together various initiatives such as (i) alternative building technology, (ii) build to rent development model, and (iii) efficient designing, all aimed at developing a product that addresses mass housing.
- Caleb Mugendi, our Investment Analyst, discussed the growth in earnings in the insurance sector and penalties by Central Bank of Kenya (CBK) on commercial banks.See Caleb on CNBC
- Cytonn Diaspora requests applications from qualified firms interested in selling products and services to Kenyans in the Diaspora. If you are interested in applying to be a Cytonn Diaspora partner, please find the RFP at Diaspora Partner Applications
- The first Cytonn Diaspora bus tour took place on 17th December 2016 in Nairobi, with our current and potential investors joining the bus tour. The tour took our diaspora clients and potential clients to our real estate development sites, which started from our office at The Chancery to Amara Ridge in Karen, to The Ridge site in Ridgeways, and ended at Ruaka, where The Alma and Taraji Heights are located.
- 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:
  - The Alma, which is now 53.0% sold and has delivered an annualized return of up to 55.0% p.a.

for investors who bought off-plan. See The Alma. We will be having site visits to showcase this iconic development every 2-weeks. If interested in attending the site visit, email clientservices@cytonn.com

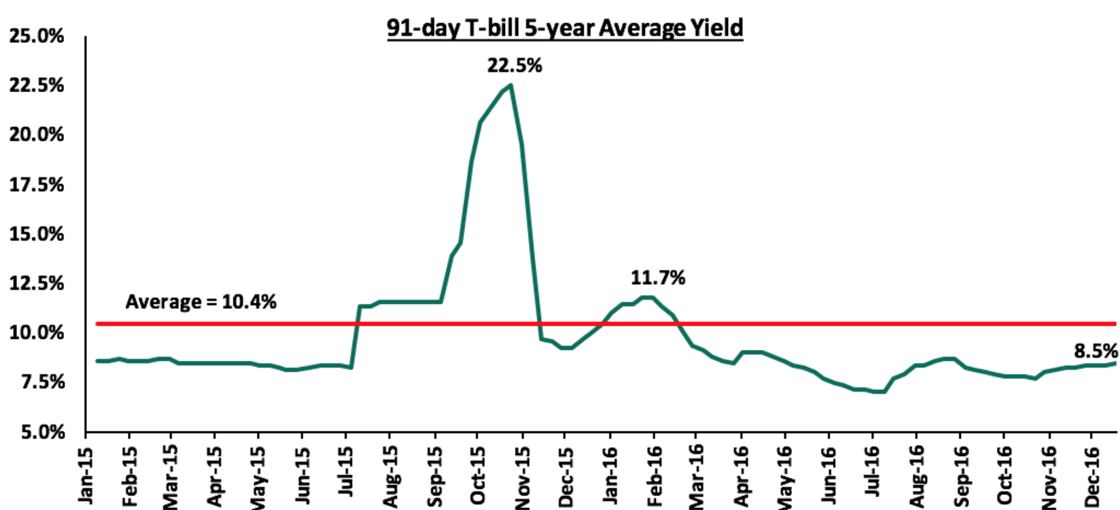
- Amara Ridge is currently 100.0% sold. See Amara Ridge

- We have 12 investment-ready projects, offering attractive development returns and buyer's targeted returns of around 25.0% p.a. See further details here: Summary of investment-ready projects
- We continue to beef up the team with several ongoing hires: **Careers at Cytonn**.

# Fixed Income

During the week, T-bills were undersubscribed, with overall subscription coming in at 72.7%, compared to 106.4% recorded the previous week. The decrease in subscription levels for Treasury bills can be attributed to investors directing their bidding towards the 2-year Treasury bond on offer, which received subscriptions of 118.5%. Subscription rates on the 91, 182 and 364-day paper came in at 64.7%, 124.1% and 26.6%, from 54.4%, 125.8% and 121.8%, respectively, the previous week. The 182-day paper continues to offer investors the best returns on a risk-adjusted basis, reflected in its oversubscription. Yields on the 91-day and 182-day T-bills increased by 10 bps each to 8.5% and 10.6% from 8.4% and 10.5% recorded the previous week, respectively, while the 364-day remained unchanged at 11.1%.

The 91-day T-bill is currently trading below its 5-year average of 10.4%. The lower yield on the 91-day paper is mainly attributed to the expected low interest rates environment following (i) the operationalization of the Banking Act (Amendment) 2015, which has led to more liquidity in the money market given reduced lending to the private sector, and (ii) reduced pressure from the government borrowing program as they are currently ahead of the pro-rated domestic borrowing target of Kshs 110.4 bn, having borrowed Kshs 155.8 bn, which is 41.1% above the pro-rated target. It is important to note that the government is in the process of revising its domestic borrowing target upwards to Kshs 294.6 bn from Kshs. 229.6 bn, which if passed by Parliament will take the pro-rated borrowing target to Kshs 141.6 bn, meaning that the government will still be ahead of the borrowing target. Key to note is that the interest rates have bottomed out and we expect them to persist at the current levels, despite having risen slightly this week.




Last week, the Treasury issued a 2-year bond to raise Kshs 30.0 bn for budgetary support. Yield on the bond came in at 12.5%, in line with our recommended bidding range of between 12.3% - 13.0% as indicated in our Cytonn Weekly #49. The bond was oversubscribed at a performance rate of 118.5%, with the market weighted average rate coming in at 13.1%, a much higher rate than the then 12.3% prevailing in the secondary market for a 2-year bond, with investors seeking 80 bps premium over current yields, but government only accepting a 20 bps premium. As expected, given

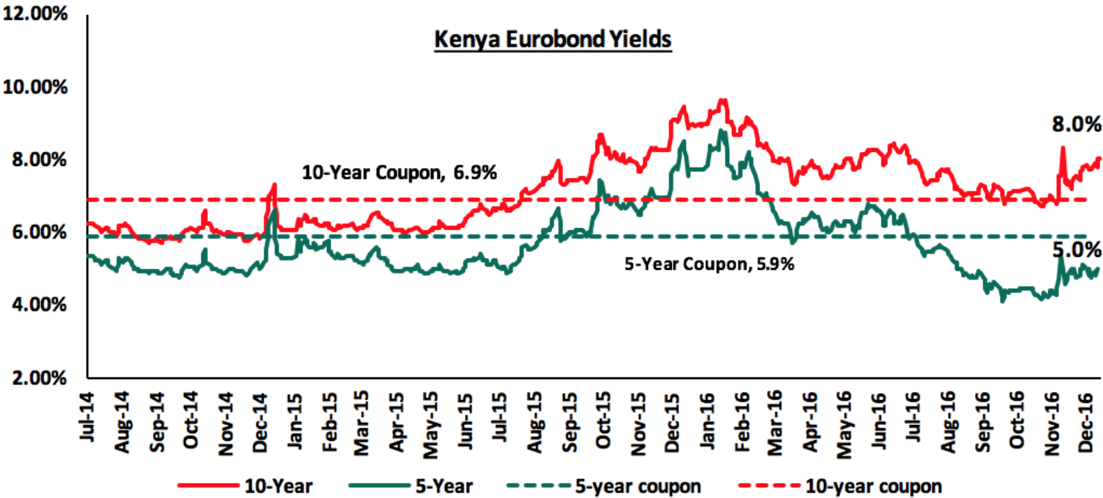
that interest rates have remained fairly stable on account of reduced pressure on government borrowing for the fiscal year 2016/17, it is clear from this auction that the government is no longer willing to accept bids that are significantly above market and hence unrealistic, having only accepted Kshs 10.5 bn out of the Kshs 35.5 bn of bids received. The government has previously displayed inconsistency by accepting higher yields in treasury securities auctions while forcing banks to reduce interest rates, as witnessed in the 15-year infrastructure bond auction where the government accepted a yield of 13.2% on a tax-free infrastructure bond, which equated to a 15.5% yield on an equivalent taxable bond, adjusting for the 15.0% tax rate, for a tenor of 11.25 years, as noted in our Cytonn Weekly #42. This led to further crowding out of the private sector and reduction in credit growth to the private sector as illustrated in our Cytonn Weekly #47, whereby September 2016 growth came in at 5.3% year-on-year, down from highs of 20.5% in a similar period in 2015.

The CBK weekly report revealed that the interbank rate decreased by 90 bps to 5.2%, from 6.1% registered the previous week, despite a liquidity reduction of Kshs 3.1 bn that was driven by tax payments of Kshs 22.3 bn and reverse repo maturities of Kshs 15.3 bn. As highlighted in our **Cytonn Weekly #28**, the interbank rate is often determined by the liquidity distributions within the banking sector as opposed to the net liquidity position in the interbank market.

Below is a summary of the money market activity during the week:

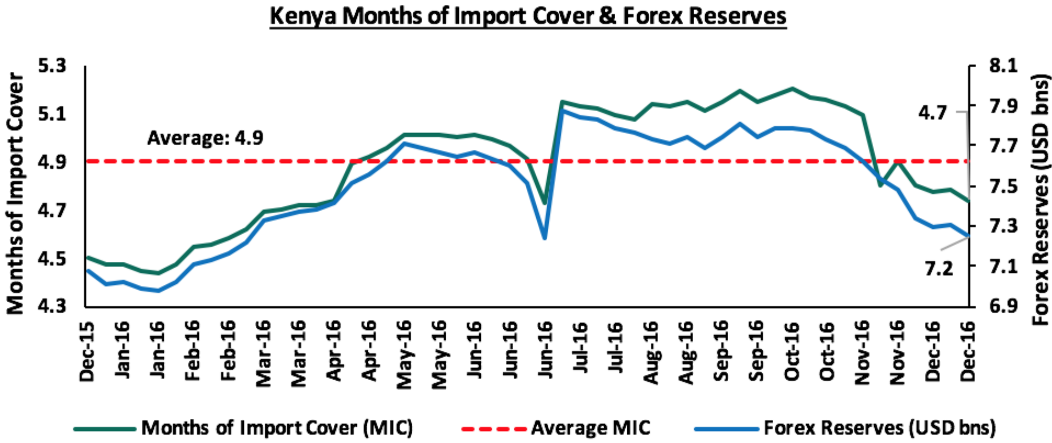
| *all values in Kshs bn, unless stated otherwise* | | | |
|---|---|---|---|
| **Weekly Liquidity Position ? Kenya** | | | |
| **Liquidity Injection** | | **Liquidity Reduction** | |
| Term Auction Deposit Maturities | 0.0 | T-bond sales | 0.0 |
| Government Payments | 19.7 | Transfer from Banks - Taxes | 22.3 |
| T-bond Redemptions | 0.0 | T-bill (Primary issues) | 14.4 |
| T-bill Redemption | 14.6 | Term Auction Deposit | 0.0 |
| T-bond Interest | 1.9 | Reverse Repo Maturities | 15.3 |
| Reverse Repo Purchases | 12.7 | Repos | 0.0 |
| Repos Maturities | 0.0 | T-Bills/T-Bonds Tap Sale | 0.0 |
| **Total Liquidity Injection** | **48.9** | **Total Liquidity Withdrawal** | **52.0** |
| | | **Net Liquidity Injection** | **(3.1)** |

According to Bloomberg, yields on the 5-year and 10-year Eurobonds increased week on week by 24 bps and 31 bps to 5.0% and 8.0% from 4.7% and 7.7%, respectively, the previous week. The increase in yield is attributed to the Fed hiking interest rates by 25 bps during the week, and investors demanding an equivalent premium in emerging market debt, to cater for the risk. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 3.8% and 1.6%, respectively, for the 5-year and 10-year bond due to improving macroeconomic conditions. This is an indication that Kenya remains an attractive investment destination.




The Kenya Shilling remained relatively stable and resilient this week, losing by 0.2% against the dollar to close the week at Kshs 102.2, from Kshs 102.0 the previous week. The shilling remained

stable despite (i) the 25 bps hike in the Federal Funds Rate, which saw the dollar reach a 14-year high globally, and (ii) rising dollar demand from local importers as the year comes to a close. On a YTD basis, the shilling is flat having gained 0.1% against the dollar. In recent weeks, we have seen the forex reserves reduce to USD 7.2 bn from USD 7.8 bn in October, which has led to the decline in the months of import cover below the 1-year average of 4.9 months, and is currently at 4.7 months, down from 4.8 months recorded previous week. Just 2-months ago, on 6th October 2016, there was 5.2 months of import cover. As stated in our Cytonn Weekly #45, this is worrying as the rate of decrease in the reserve could be an indication that the CBK is using a lot of reserves to support the shilling, and may continue to do so in the near-term given the global strengthening of the dollar.




The US Federal Reserve?s Open Market Committee (FOMC) met during the week, on Wednesday 14th December, 2016 to agree on a path for the US monetary policy. In line with our expectations of a 25 bps increase in our Cytonn Weekly #49, the Fed decided to increase rates to between 0.50% - 0.75%, from 0.25% - 0.50% previously. The decision by the Fed to hike rates was based on:

- **Economic Growth** ? US economic growth has improved, with the GDP having grown by 0.8%, 1.4% and 3.2% in Q1?2016, Q2?2016 and Q3?2016, the highest growth levels experienced in the last 2-years,
- **Employment** - The US employment rate has improved over the last 12 months, with unemployment currently at 4.6% as compared to 5.0% in a similar period last year, indicating a strengthening labor market, and
- **Inflation** - Inflation has been increasing, having hit a 2-year high of 1.6% as at October 2016, and is now just 40 bps shy of the 2.0% target.

In addition to raising rates by 25 bps during this meeting, the Fed is expected to accelerate its rate-hiking pace now that the economy is expected to do even better come 2017.This is likely to lead to global strengthening of the US dollar, hence resulting in; (i) weakening of other currencies including the Kenya Shilling, which is likely to come under pressure especially in the short to medium term, (ii) higher debt obligations for countries with US dollar denominated debt as their debt service and debt repayments will cost more with the strengthening dollar, and (iii) a reduction in prices of commodities, especially gold. With the CBK expected to step in to protect the shilling, we expect to see a reduction in our foreign exchange reserves with the months of import cover moving further below the 1-year average of 4.9 months.

The inflation rate has been increasing gradually since June 2016, after hitting a low of 5.0% in May 2016, and is currently at 6.7% as at November. Interesting to note is that the low income segment of Nairobi has seen the largest impact throughout the last half of 2016 with fuel price rises adversely affecting kerosene users and basic food item price rises worsening the situation. We project the annual inflation rate for the month of December to range between 6.2% - 6.5% compared to 6.7% in the month of November. This is because despite (i) an increase in diesel and kerosene prices as highlighted in the December 2016 Energy Regulatory Commission (ERC) report, (ii) an expected

trickle-down effect on the cost of energy, transport and food, and (iii) increased consumer spending given that the festive season has just begun, the high base effect of last year should cure for cyclicality and therefore there are no major threats to high inflation in the country as yet. However, following the Organization of Petroleum Producing Countries? (OPEC?s) decision to reduce crude oil production by 1.2 mn barrels/day starting January 2017, we are likely to see a rise in inflation as local fuel prices follow the upward trend of global crude oil prices. Key to note is that crude oil prices have already begun to rise, having hit USD 57.0 per barrel up from USD 46.0 per barrel in November, and up from lows of USD 25.0 per barrel experienced earlier in the year. The increase in oil prices is likely to impact the currency negatively, as well as the current account position to worsen given the increased spending on oil importation in 2017.

Data from the CBK has revealed that Kenya?s domestic debt level increased to Kshs 1.9 tn in October 2016, an increase of 5.6% from the Kshs 1.8 tn recorded in July 2016. This increase was driven by borrowing through Treasury bonds, which increased by 9.8% to Kshs 1.3 tn in October, up from Kshs 1.1 tn as recorded at the beginning of the fiscal year, and T-bills contribution increased by 5.4% to Kshs 620.0 bn in October from Kshs 588.0 bn in July 2016. This resulted in an increase in the country?s total debt level despite the Treasury having paid off its Kshs 44.2 bn overdraft facility from the CBK, bringing the debt to GDP ratio up to 50.3%. As indicated in our topical on Kenyan Debt Sustainability, there are still risks associated with the changing funding patterns that could see the debt levels continue to rise well above the 50.0% IMF recommendation. We maintain our view that Kenya currently lies within the safer bounds in terms of debt levels, however, it is imperative that we be cautious on borrowing if we are to maintain long-term economic stability.

***The Government is ahead of its domestic borrowing for this fiscal year having borrowed Kshs 155.8 bn for the current fiscal year against a target of Kshs 110.4 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 229.6 bn budgeted for the full financial year). It is important to note, however, that the government is in the process of revising its domestic borrowing target upwards to Kshs 294.6 bn, which will take the pro-rated borrowing target to Kshs 141.6 bn, and the government will still be ahead of the borrowing target. Interest rates, which had reversed trends due to the enactment of The Banking Act (Amendment), 2015, appear to have bottomed out and we expect them to persist at the current levels. It is due to this that we think it is prudent for investors to be biased towards short-term fixed income instruments given the prevailing interest rates environment.***

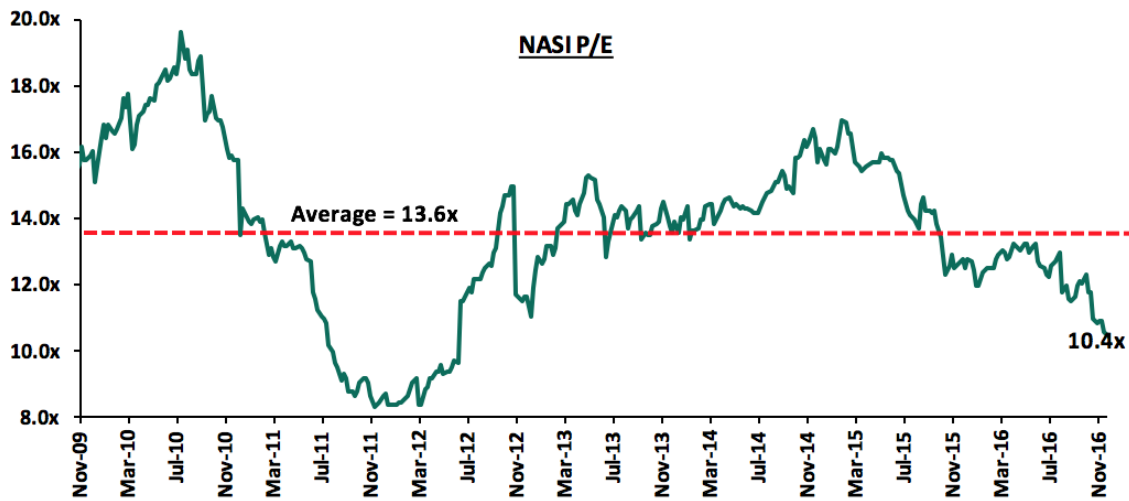
# Equities

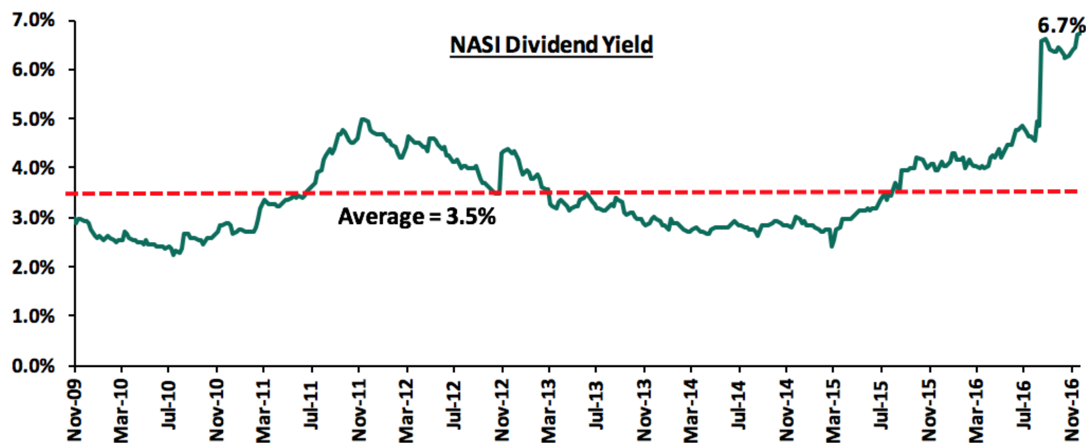
During the week, the Kenyan equities market was on a downward trend, with NASI, NSE 20 and NSE 25 losing by 1.1%, 1.7% and 0.9%, respectively, taking their YTD performances to (10.2%), (23.2%) and (17.4%), respectively. Performance was driven by losses in select large cap stocks, namely ARM, Barclays and Diamond Trust Bank, which lost 8.0%, 6.1% and 5.5%, respectively. Since the February 2015 peak, the market has lost 43.5% and 26.3% for NSE 20 and NASI, respectively.

Equities turnover declined by 14.8% to close the week at USD 15.3 mn, from USD 17.9 mn the previous week. Foreign investors turned net buyers with a net inflow of USD 2.0 mn, compared to a net outflow of USD 0.6 mn recorded the previous week, with foreign investor participation increasing to 76.6% from 71.1% recorded the previous week. Safaricom, Equity Group and EABL were the top movers jointly accounting for 69.6% of market activity. We maintain our expectation of stronger earnings in 2016 compared to 2015 supported by a favorable macroeconomic environment. However, the key risk lies within the banking sector, following the implementation of the Banking (Amendment) Act, 2015, which stipulates the loan and deposit pricing framework. With the banking sector still dependent on interest income, which as per results released in Q3?2016 was at 72.0% of total operating income, volatility in this revenue stream may depress earnings for banks, especially

during the fourth quarter.

The market is currently trading at a price to earnings ratio of 10.4x, versus a historical average of 13.6x, with a dividend yield of 6.7% versus a historical average of 3.5%. The charts below indicate the historical P/E and dividend yields of the market.




**Insurance Regulatory Authority (IRA) Q3?2016 Report**

IRA released Q3?2016 numbers for the insurance industry with the market recording growth in core earnings by 32.3% to Kshs 9.3 bn from Kshs 7.0 bn, as compared to a decline of 44.7% recorded in a similar period last year. Total gross insurance premiums registered a 6.5% y/y growth to Kshs 157.3 bn, from Kshs 147.7 bn in Q3?2015, compared to a 13.1% y/y growth registered a year earlier.

Key highlights of the performance to Q3?2016 from Q3?2015 include:

- Operating revenue grew by 15.9% to Kshs. 134.1 bn from Kshs 115.7 bn, driven by net premium income, which grew by 8.2% to 124.5 bn from Kshs 115.1 bn and a 1,521.3% increase in other income to Kshs 9.5 bn from Kshs 0.6 bn. Just as is the case with most African countries, with low insurance penetration rates, the non-life segment remained dominant contributing 66.1% (Kshs 104.0 bn) of total premiums while long-term insurance business contributed 33.9% (Kshs 53.3 bn),
- Operating expenses grew by 13.7% to Kshs 120.9 bn in Q3?2016 driven by (i) a 10.9% increase in claims incurred and benefits paid to Kshs 76.2 bn from Kshs 68.7 bn, and (ii) a 12.0% increase in commissions and management expenses to Kshs 42.2 bn from Kshs 37.7 bn. The faster growth in claims compared to premiums led to the loss ratio increasing to 64.5% from 62.9%. This coupled with the 12.0% increase in commissions and management expenses led to the combined ratio increasing to 102.6% from 99.1%. This clearly indicates that the core insurance business is currently loss making and insurance companies are now relying on other income streams to drive

profitability,

- Total industry profitability increased by 32.3% to Kshs 9.3 bn from Kshs 7.0 bn driven by a 250.8% growth in life business profitability to Kshs 4.3 bn from Kshs 1.2 bn in Q3?2015. Key to note is that despite the slower growth in gross insurance premiums, the industry profitability grew by a higher rate supported by a 1,521.3% increase in other income to Kshs 9.5 bn from Kshs 0.6 bn,
- Total assets held by the insurance sector increased by 7.4% to Kshs 494.8 bn from Kshs 460.6 bn in Q3?2015 driven by an 8.0% growth in investments to Kshs 406.6 bn from Kshs 376.3 bn,
- Shareholders? funds grew by 13.4% to Kshs 134.6 bn from Kshs 118.7 bn in Q3?2015, attributed to capital restructuring following the changes in regulatory capital requirements.

Below is a summary of the performance:

| Income Statement (Kshs. Bn) | Q3'2016 | Q3'2015 | Annual Change (%) |
|---|---|---|---|
| Gross Premium Income | 157.3 | 147.7 | 6.5% |
| Net Premium Income | 124.5 | 115.1 | 8.2% |
| Other Income | 9.5 | 0.6 | 1,521.3% |
| Operating Revenue | 134.1 | 115.7 | 15.9% |
| Claims incurred and benefits paid | 76.2 | 68.7 | 10.9% |
| Commissions and Management Expenses | 42.2 | 37.7 | 12.0% |
| Operating Expenses | 120.9 | 106.3 | 13.7% |
| Profit Before Tax (PBT) | 13.2 | 9.4 | 40.7% |
| Profit After Tax (PAT) | 9.3 | 7.0 | 32.3% |

| Balance Sheet (Kshs. Bn) | Q3'2016 | Q3'2015 | Annual Change (%) |
|---|---|---|---|
| Shareholders' Funds | 134.6 | 118.7 | 13.4% |
| Investments | 406.6 | 376.3 | 8.0% |
| Total Assets | 494.8 | 460.6 | 7.4% |
| Total Liabilities | 374.8 | 341.9 | 9.6% |

Competition continues to intensify in the insurance industry with the combined market share for listed companies (both life and non-life) declining to 29.1% from 30.4% in Q3?2015. With both increased competition and regulation in the industry, there is need for insurance companies to come up with innovative products so as to increase insurance uptake. In addition, as highlighted in our H1?2016 Insurance Sector Report, there is need for companies to increase market awareness to grow the low market penetration of 3.0% compared to countries such as South Africa, which is at 14.0%. Going forward, we expect the industry to make headway in this, especially supported by bancassurance partnerships from the banking sector as banks seek alternative revenue sources to maintain their profitability margins in their interest cap era. The ongoing infrastructural projects across the country including the LAPSSET project and oil and gas exploration are expected to create more demand for insurance products as project managers seek to transfer project risks, thus insurers will be required to adopt innovative approaches to coverage including partnerships to increase capacity and technical expertise.

According to the economic indicators report by Central Bank of Kenya (CBK) for October, banks? profitability declined for the 4$^{th}$ consecutive month from Kshs 15.6 bn in June to Kshs 9.3 bn in October, which was 14.7% lower than those posted in September of Kshs 10.9 bn. This decline in October could be attributed to the effect of interest rate capping, which reduced net interest earnings, since October was the first full month the banking sector operated under the interest capping law. Gross loans increased marginally by 2.2% to Kshs 2.3 tn from Kshs 2.2 tn in October 2015, with a month-on-month growth of 1.0% (22.8bn), while deposits registered a 6.1% growth to

Kshs 2.7 tn from Kshs 2.5 tn in October 2015. However, the quality of loans reduced with the non-performing loans increasing by 66.4% to Kshs 0.2 tn from Kshs 0.1 tn recorded in a similar period last year. We expect the level of provisioning to stabilize going forward as banks adopt more stringent risk assessment framework. Despite the declining trend in bank?s earnings and the fact that listed banks contribute approximately half of Nairobi Securities Exchange?s market capitalization, we still expect stronger earnings for the year as compared to 2015 supported by a more favorable macroeconomic environment.

The Treasury is once again proposing a rescue package for the Uchumi supermarket chain in this year?s supplementary budget estimates tabled in Parliament last week. The retailer survived a winding up suit mid this year, when suppliers moved to court seeking to force it to pay up on back-dated debt worth Kshs 3.6 bn. The government, which owns 14.7% stake in Uchumi and is the second largest shareholder after Jamii Bora bank with 14.9%, termed the bailout package as equity participation. The bailout comes after the company?s search for a high net-worth investor willing to inject up to Kshs 5.0 bn in exchange for a controlling stake failed, coupled with the failed sale of Ngong? Road Branch, Lang?ata Hyper store and a 20-acre plot in Kasarani, which received low offers and contested ownership of two of the parcels. Given that this is not the first time the retailer is being bailed out by the government, we feel that issues affecting Uchumi go beyond liquidity problems and are rather; (i) corporate governance related, and (ii) the moral hazard that arises from the expectation that the government will always bail them out. Efforts to remedy this have been made but as highlighted in Cytonn Weekly #33, Kenya?s recent track record with government involvement in the private sector is not inspiring, as can be evidenced by poor performance of state-owned companies in industries where other pure private sector competitors are thriving. We are still of the opinion that an outright sale of Uchumi, at whatever price that would clear a private transaction, would have been a better option rather than committing taxpayers? money into an initiative that could be resolved by the private markets. There were private players ready and willing to transact, the issue was pricing. Had the government firmly shut out any possibility of a taxpayer rescue, Uchumi would have had no option but to accept the best bid on the table. We believe the rescue continues to entrench the expectation that the government will always be there to bailout Uchumi whenever it is mismanaged to financial dire straits.

Out-of-court talks between Kenya Airways and its pilots in a dispute over the leasing of aircraft and crew for the national carrier?s subsidiary, Jambojet, have stalled. The Kenya Airline Pilots Association (Kalpa) sued Kenya Airways to stop it from entering into a wet lease (wet leases involve the hiring of both aircraft and crew to operate flights) agreement with DAC Aviation East Africa, which it feels will render the national carrier?s pilots redundant. This comes just a week after the 24-hour strike by technical workers who cited poor pay, lack of promotions and unfavorable shift patterns as the reasons for downing their tools. As highlighted in Cytonn Weekly #49, the recent boardroom change in the company has had a positive impact, especially in resolving personnel conflicts and we expect the airline to make tangible gains in its turnaround strategy ?Operation Pride?, which focuses on (i) closing the profitability gap, (ii) improving the business model, and (iii) optimizing on capital.

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

- HF Group moved to a ?Buy? recommendation with an upside of 24.2% from an ?Accumulate? recommendation with an upside of 16.2%, following a 7.0% w/w price decline
- I&M Holdings moved to a ?Sell? recommendation with a downside of 0.6% from a ?Lighten? recommendation with an upside of 4.7%, following a 5.6% price increase
- Liberty Kenya Holdings moved to a ?Sell? recommendation with a downside of 2.1% from a ?Lighten? recommendation with an upside of 3.3%, following a 5.6% price increase

| all prices in Kshs unless stated | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| EQUITY RECOMMENDATION | | | | | | | | | |
| No. | Company | Price as at 9/11/16 | Price as at 16/11/16 | w/w Change | YTD Change | Target Price* | Dividend Yield | Upside/ (Downside)** | Recommendation |
| 1. | ARM | 25.0 | 23.0 | (8.0%) | (44.9%) | 37.0 | 0.0% | 60.9% | Buy |
| 2. | Bamburi | 156.0 | 155.0 | (0.6%) | (11.4%) | 231.7 | 7.8% | 57.3% | Buy |
| 3. | KCB Group*** | 28.3 | 28.3 | 0.0% | (35.4%) | 39.6 | 7.5% | 47.7% | Buy |
| 4. | Britam | 10.2 | 10.1 | (1.0%) | (22.3%) | 13.2 | 2.4% | 33.1% | Buy |
| 5. | Stanbic Holdings | 70.0 | 69.5 | (0.7%) | (15.8%) | 84.7 | 7.9% | 29.8% | Buy |
| 6. | Kenya Re | 21.8 | 21.8 | 0.0% | 3.6% | 26.9 | 3.6% | 27.3% | Buy |
| 7. | HF Group | 12.9 | 12.0 | (7.0%) | (46.1%) | 13.8 | 9.2% | 24.2% | Buy |
| 8. | BAT (K) | 840.0 | 840.0 | 0.0% | 7.0% | 970.8 | 6.2% | 21.8% | Buy |
| 9. | NIC | 26.8 | 26.5 | (0.9%) | (38.7%) | 30.8 | 3.5% | 19.7% | Accumulate |
| 10. | CIC Insurance | 4.0 | 4.0 | 0.0% | (35.5%) | 4.4 | 2.5% | 12.5% | Accumulate |
| 11. | Equity Group | 30.0 | 30.0 | 0.0% | (25.0%) | 31.3 | 7.7% | 12.0% | Accumulate |
| 12. | Sanlam Kenya | 29.3 | 27.8 | (5.1%) | (53.8%) | 30.5 | 0.0% | 9.9% | Hold |
| 13. | Co-op Bank | 13.4 | 13.5 | 1.1% | (25.0%) | 13.6 | 6.8% | 7.5% | Hold |
| 14. | Jubilee | 485.0 | 487.0 | 0.4% | 0.6% | 482.2 | 1.8% | 0.8% | Lighten |
| 15. | I&M Holdings | 90.0 | 95.0 | 5.6% | (5.0%) | 90.7 | 3.9% | (0.6%) | Sell |
| 16. | DTBK*** | 127.0 | 120.0 | (5.5%) | (35.8%) | 116.8 | 1.8% | (0.9%) | Sell |
| 17. | Barclays | 9.1 | 8.5 | (6.1%) | (37.5%) | 7.6 | 9.7% | (0.9%) | Sell |
| 18. | Liberty | 13.5 | 14.2 | 5.6% | (27.2%) | 13.9 | 0.0% | (2.1%) | Sell |
| 19. | Safaricom | 19.0 | 18.8 | (1.3%) | 15.0% | 16.6 | 3.6% | (7.8%) | Sell |
| 20. | StanChart*** | 189.0 | 185.0 | (2.1%) | (5.1%) | 157.7 | 6.6% | (8.2%) | Sell |
| 21. | NBK | 7.6 | 6.9 | (9.9%) | (56.5%) | 3.8 | 0.0% | (44.5%) | 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 are ?positive? for investors with long-term investments horizon.***

# Private Equity

Overseas Private Investment Corporation (OPIC), the development finance arm of the United States government, injected USD 200.0 mn, divided equally, in Apis Growth Fund II and Helios Credit Partner. Apis Growth Fund will use the USD 100.0 mn to implement its strategy, which aims to invest in financial inclusion methods by developing internet facilities and through technological innovations in Sub-Saharan Africa. Helios Credit Partner will develop a loan offering solution for companies based in Sub-Saharan Africa. The sector has shown immense potential and opportunity, as only 20.0% of companies in Sub-Saharan Africa have access to credit lines or bank loans. This investment initiative by OPIC will directly contribute to the expansion of financial inclusion in the region by indirectly impacting key sectors such as energy, finance, transport, logistics, and telecommunications.

LeapFrog Investments Ltd plans to raise USD 800.0 mn for its latest fund as it seeks stakes in African banks, insurance brokers and payment companies to tap into rising demand among low-income consumers for intermediary products in the financial services industry. In supporting this fund and the growth in Africa, OPIC has approved an investment of as much as USD 200.0 mn in the fund. This private equity investment is underpinned by: (i) greater scope for investments among companies that target Africa?s emerging consumers because they are more than four times the size of the continent?s middle class, (ii) new regulations requiring insurance companies in Kenya to hold more cash that will create buyout opportunities, (iii) attractive markets in Africa which can be attributed to the continent?s largest population in Nigeria and more sophisticated consumers in Ghana, and (iv) the fact that the financial industry is also overbanked, with 41 lenders serving 44 mn people, creating opportunities for mergers and takeovers because of new interest-rate caps that are squeezing profit margins, and requiring larger players to enter into the market and capitalize banks.

The International Finance Corporation (IFC) and FMO, the Dutch development bank, have invested

USD 15.1 mn in Mobisol GmbH, a Berlin-based solar energy company, to deliver pay-as-you-go solar energy services to off-grid communities in East Africa. This will involve the customers paying off the installations over 3-years using mobile money transfers which will offer sustainability of the project even in rural areas. The funds will enable Mobisol to accelerate its growth in existing markets in Rwanda and Tanzania where they have already installed more than 67,000 systems and will aid its expansion into Kenya. This investment emphasizes the commitment to bridging the infrastructure gap and to mitigating climate change by delivering reliable, clean and affordable alternatives to fossil fuels, support sustainable energy solutions and steady access to energy for low-income households.

***Private equity investment activity in Africa has continued to improve, as evidenced by the increase in the number of fundraises and deal volumes in the region. Preference is still skewed towards financial services, energy, and technology sectors although infrastructure and Fast Moving Consumer Goods (FMCG) industries have now gained traction. 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) strong economic growth projections, compared to global markets.***

# Real Estate

Over the week, Finland-based private equity firm Taaleri, through its Africa Fund, indicated an interest in increasing its investment in Kenya?s first Development Real Estate Investment Trust (D-REIT), the FRED-Commercial, which was issued by Fusion Capital on 20$^{th}$ June 2016. The D-REIT issue was aimed at raising financing for a Kshs 3.7 bn Greenwood City project in Meru. The FRED-Commercial however achieved an undersubscription of 37.9%, raising Kshs 873.8 mn, below the 50.0% threshold required by the Capital Markets Authority (CMA) to list on the Nairobi Stock Exchange (NSE). The private equity firm remains optimistic about the potential of Kenya's Real Estate Investment Trust (REIT) market as it looks to deepen its investment in East Africa. They remain optimistic that the factors leading to the undersubscription can be curbed as in other continents, for example, UK?s first REIT was introduced in the 1990s and faced undersubscription but later in 2000, the market absorbed it having appreciated its value as an investment asset class.

Shelter Afrique, a housing development finance institution, has launched a competition dubbed ?5,000 For 5,000 Homes,? which involves a design competition for eco-friendly and affordable housing concepts. The competition is expected to boost affordable housing in Africa and see the winners take home Kshs 10 mn. The competition aims to lead to the development of 5,000 dwelling units at a cost of not more than Kshs 500,000 per unit from the successful participant?s design. The objective of the competition is to:

- Stimulating innovative thinking on designs for sustainable and eco - friendly homes that can be produced at a capital cost of not more than Kshs 500,000, and,
- Spurring a discussion on bringing out affordable housing concepts for the rising urban population.

Shelter Afrique and its partners will support the financing for the development and completion of 5,000 units with the winning entry in agreed locations across Africa. Proposed designs will be characterized with the following key specifications;

- One-bedroom dwelling unit with a plinth area of approximately 45 square meters, inclusive of a kitchen, bedroom, toilet and living area with an adequate lighting;
- Adequate head room and floor to ceiling heights with possible options for natural ventilation;
- Use of eco- friendly and light weight sustainable materials to achieve low construction cost, and;
- An easy to replicate design;

The competition is open to all the players in the housing sector including teams of designers, artists,

architects and engineers among others. This move by Shelter Afrique, is consistent with the Kenyan government strategy to encourage development of low cost housing by offering various incentives such as The Finance Bill, 2016, which offers a 15.0% corporate tax relief to developers who put up at least 400 low-cost residential houses p.a. and the proposed removal of NEMA and NCA Levies. In our view, with the continued support of government and the finance institutions to developers, we remain optimistic that the housing deficit of 250,000 dwelling units, which majorly lies in the low-income sector will be addressed. However, given the high land prices, we don?t see how a housing unit in urban areas like Nairobi, which have the most need for affordable units, can be developed at a cost of just Kshs. 500,000 given the high cost of land.

***The market outlook points to increased housing supply as both the government and finance institutions support housing projects with increased focus on low-cost housing using various incentives. In addition, we expect increased fundraising initiatives through capital markets as developers seek financing through issuance of debt instruments and REITs majorly targeting foreign investors due to the capital-intensive nature of the real estate sector.***

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