Cytonn INVESTMENTS

Cytonn Monthly ? January 2017

Cytonn Weekly

Executive Summary

Fixed Income and Macro Economic Review: Yields on T-bills were relatively unchanged during the month, closing at 8.7%, 10.5% and 10.9%, from 8.6%, 10.5% and 11.0% for the 91, 182 and 364-day papers, respectively, at the end of December. Kenya?s inflation rate for the month of January increased to 7.0%, from 6.4% recorded in December, driven by an increase in food and transport prices;

Equities: During the month, the equities market was on a downward trend with NASI, NSE 25 and NSE 20 losing 8.3%, 12.3% and 11.1%, respectively. The performance was driven by poor performance of banking sector stocks, with Barclays, Equity Group and KCB Group losing 20.3%, 19.2% and 19.1%, respectively. The Central Bank of Kenya (CBK) issued a directive to commercial banks requiring them to provide comprehensive reports on their revised business models by April 2017;

Private Equity: The month of January was characterized by an increase in PE activity, with a number of fundraising activities by private equity firms, acquisitions and buy outs of firms by PE firms, especially in Kenya;

Real Estate: Increased development activity witnessed in the real estate sector across all themes, buoyed by favorable legal policies and high demand for residential real estate

Company Updates

- On Tuesday, Cytonn Investments announced a partnership with Superior Homes, a leading real estate developer, that will see Cytonn purchase a 25.0% stake in the company, with the option to purchase a further stake. Commenting on the acquisition, Edwin H. Dande, our CEO said, ?Superior Homes has a strong track record given their landmark 160 acre Greenpark development. This partnership is crucial to accelerating our goal of reaching Kshs. 100 billion of real estate under development. Our model is very simple, we acquire capital at a total cost of about 20% per annum, we deploy to real estate that delivers about 25% per annum, giving us a gross margin of 5% per annum; once we achieve Kshs. 100 billon of real estate under development, we?d deliver a gross margin of Kshs. 5 billion per year before expenses.? See Press Release
- In a bid to showcase our varied real estate products, Cytonn Investments will be hosting a Grand Valentine?s Activation at the Liaison House Car Park, State House Avenue, on Saturday 11th Click here to subscribe
- Our Investments Analyst, Caleb Mugendi, discussed market movements in the Kenyan market, including the move by Nairobi Securities Exchange (NSE) listed companies to enhance efficiency and boost returns by selling non-core assets. See Caleb Mugendi on CNBC here
- Our Investments Manager, Maurice Oduor, discussed the profit warning issued by CIC Group, citing a rise in claims and a significant drop in valuation of its shares portfolio at the Nairobi

Securities Exchange. See Maurice Oduor on CNBC here

- Our Investments Analyst, John Ndua, discussed the Kenya Monetary Policy Committee?s decision to maintain the Central Bank Rate (CBR) at 10.0%, citing moderate inflationary pressures and continued uncertainty in the global macroeconomic environment. See John Ndua on CNBC
- We continue to see very strong interest in our Private Wealth Management training, which is at no cost, and held bi-weekly by Cytonn Private Wealth, but is open only to pre-screened participants. To register for the training kindly use this link: See training
- For recent news about the company, see our news section here
- In a bid to continue showcasing the real estate developments by our real estate development affiliate, Cytonn Real Estate, we shall be organizing site visits every two weeks right after the Cytonn Private Wealth Management Trainings. If interested in attending the site visits, kindly email clientservices@cytonn.com
- 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
- 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 55.0% sold and has delivered an annualized return of 55.0% p.a. for investors who bought off-plan. See The Alma.
  - Amara Ridge is currently 100.0% sold. See Amara Ridge
  - Following the completion of sales for Amara Ridge, we are currently looking for land in Karen for our next development. Contact us at res@cytonn.com if you have any land for sale or joint ventures in Karen
- We continue to beef up the team with the ongoing hires: Careers at Cytonn

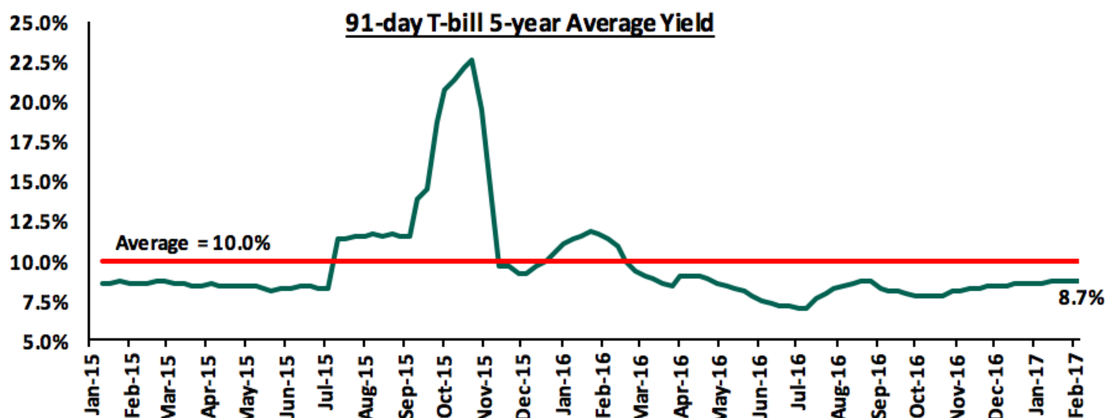
Fixed Income and Macro Economic Review

The month of January was characterized by low Treasury bill subscriptions, with overall subscription decreasing to 68.5% from 105.0% in December on account of tight liquidity in the money market. Despite the low subscription rates during the month, the government remained disciplined by rejecting expensive money from the market as can be seen by the decline in the monthly average acceptance rate, which came in at 78.0% of the total bids received compared to 84.0% in December. Yields on T-bills were relatively unchanged during the month of January, closing at 8.7%, 10.5% and 10.9%, from 8.6%, 10.5% and 11.0% for the 91, 182 and 364-day papers, respectively, at the end of December. We noted that during the month, investor preference shifted more towards the shorter-term paper, with the 91-day T-bill receiving higher subscriptions, averaging 95.3%, as compared to 69.5% and 44.9% for the 182 and 364-day papers, respectively.

During the week, T-bills were oversubscribed, with overall subscription coming in at 167.4%, compared to 76.6% recorded the previous week, with the subscription rate on the 91-day T-bill decreasing to 93.4%, from 146.0% the previous week, whereas those on the 182 and 364-day papers increased to 255.6% and 128.6%, from 84.6% and 22.3%, respectively, the previous week. The oversubscription during the week sees a 5-week run in which T-bills were undersubscribed come to an end, and can be attributed to investors who were turned down last week in the cancelled bond auction and are now looking for investment opportunities in the T-bill market. Despite the rise experienced in subscription levels during the week, yields on the 91, 182 and 364-day T-bills remained relatively flat, coming in at 8.7%, 10.6% and 10.9% from 8.7%, 10.5% and 10.9%, respectively, the previous week. The 182-day paper continues to offer the highest return on a risk-adjusted basis, as evidenced by the higher subscription levels on the paper during the week.

The 91-day T-bill is currently trading below its 5-year average of 10.0%. 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 (Amendment) Act 2015, which has led to investors channeling

funds more actively towards government securities, and (ii) reduced pressure from the government borrowing program as they are currently ahead of the pro-rated domestic borrowing target of Kshs 141.3 bn, having borrowed Kshs 157.0 bn, which is 111.1% of the pro-rated target.



During the month, the Kenyan government re-opened a bond, FXD 2/2007/15 with an effective time to maturity of 5.4 years, seeking to raise Kshs 30.0 bn for budgetary support. The auction was however cancelled, an indication that either (i) investors bid at yields that the CBK considered unrealistically above market, or (ii) subscription rates for the bond were low as a result of the tight liquidity that has characterized the money market since the beginning of the year. This was the second time since the beginning of the year that we saw CBK cancel an auction, following the auction for a 364-day T-bill that was cancelled at the beginning of the year.

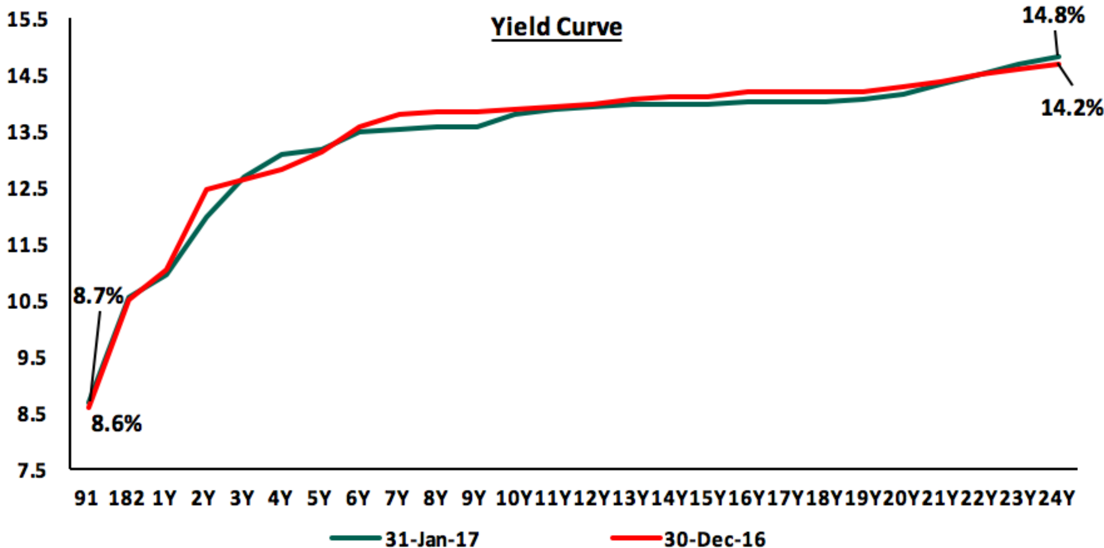
During the month, the money market witnessed increased liquidity, which saw the interbank rate decline to 7.4%, from 8.2% at the end of December. The market experienced a net liquidity injection of Kshs 53.8 bn during the month, from Kshs 50.1 bn in December, as a result of reduced T-bill primary issues and Transfer from Banks ? Taxes, which came in at Kshs 32.3 bn and Kshs 86.0 bn, from Kshs 56.4 bn and Kshs 117.7 bn, respectively, last month. 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. Key to note is that during the month, T-bill rediscounts stood at Kshs 4.9 bn, an indication that there were some players in the interbank market that experienced liquidity challenges, given that the T-bill rediscounting rate is usually calculated at 3.0% above the prevailing interest rate.

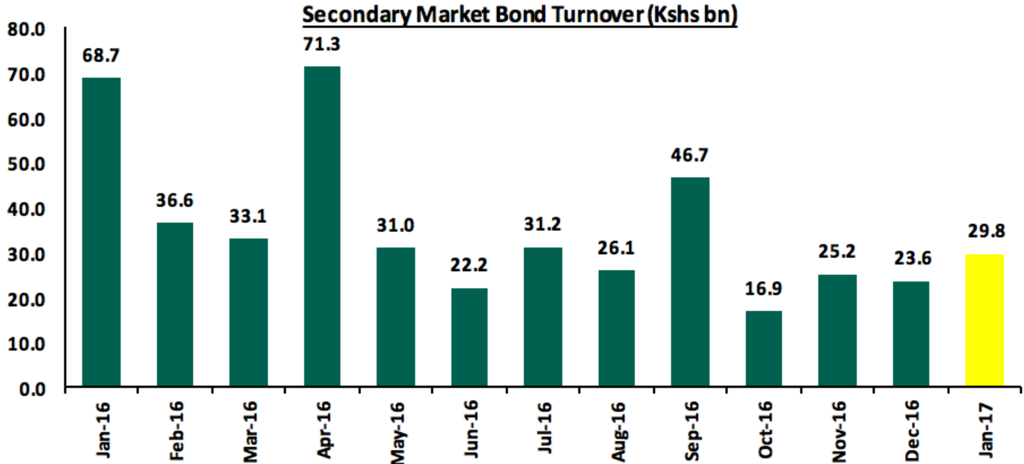
Below is a summary of the money market activity during the month:

all values in Kshs bn, unless stated otherwise			
Jan Monthly Liquidity Position ? Kenya			
Liquidity Injection		Liquidity Reduction	
Term Auction Deposit Maturities	0.0	T-bond sales	0.0
Government Payments	99.1	Transfer from Banks - Taxes	86.0
T-bond Redemptions	0.0	T-bill (Primary issues)	32.3
T-bill Redemption	66.5	Term Auction Deposit	0.0
T-bond Interest	6.2	Reverse Repo Maturities	57.6
T-bill Re-discounts	4.9	Repos	3.8
Reverse Repo Purchases	58.2	OMO Tap Sales	1.4
Repos Maturities	0.0		
Total Liquidity Injection	234.9	Total Liquidity Withdrawal	181.1
		Net Liquidity Injection	53.8

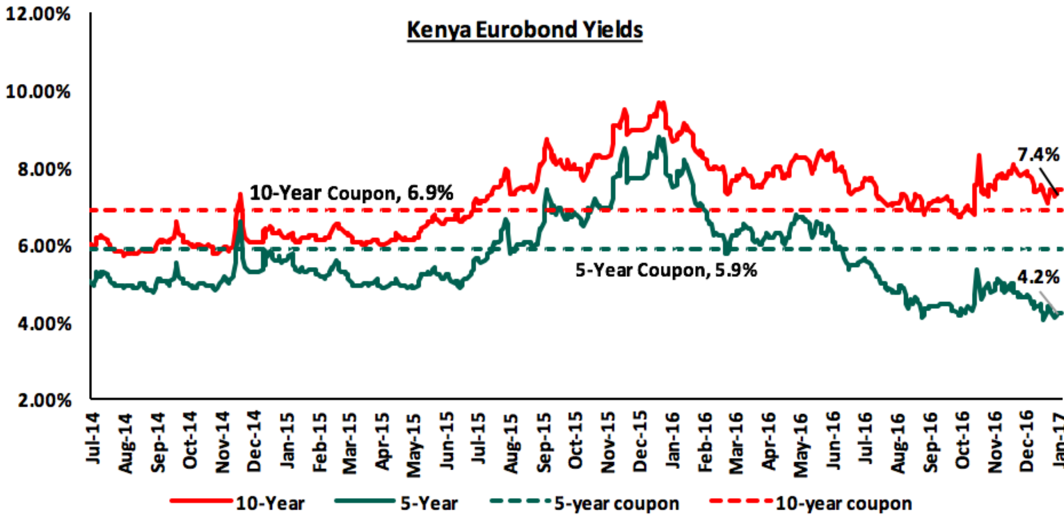
Secondary bonds market recorded improved activity, with turnover increasing by 26.3% to Kshs 29.8 bn in the month of January from Kshs 23.6 bn recorded in December, despite the yields on government securities remaining relatively flat during the month of January. However, bond

turnover has declined by 56.6% to Kshs 29.8 bn in January 2017 compared to Kshs 68.7 bn in January 2016, due to the tight liquidity environment. The performance for the secondary bonds stood at (0.4%), as per the NSE FTSE Bond Index. Below are graphs for the secondary bond market activity, in terms of both yield and turnover.





According to Bloomberg, yields on the 5-year and 10-year Eurobonds decreased by 50 bps and 40 bps, to 4.2% and 7.4% from 4.7% and 7.8% the previous month, respectively. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.6 percentage points and 2.2 percentage points, for the 5-year and 10-year Eurobonds, respectively, due to improving macroeconomic conditions. This is an indication that Kenya remains an attractive investment destination.



The Kenya Shilling depreciated against the US Dollar by 1.4%, during the month to close at Kshs 103.9 from Kshs 102.5 in December. The weakening of the shilling during the month was mainly driven by heightened dollar demand from oil importers in anticipation that the shilling would weaken further on account of (i) the global strengthening of the dollar following the US Fed rate hike in December, where it highlighted plans to accelerate its rate-hiking pace in 2017, and (ii) the expected recovery of global oil prices following OPEC?s decision to cut down on oil production this year. Despite this, the forex reserve level has maintained at 4.6 months of import cover since December 2016, with the Kenya shilling seen strengthening against the US Dollar this past week, gaining 0.1% w/w, supported by foreign investor inflows and dollar weakness in the global markets. In recent months, we have seen the forex reserves reduce to USD 6.9 bn (equivalent to 4.6 months of import cover), from a peak of USD 7.8 bn in October 2016 (equivalent to 5.2 months of import cover). However, it is important to note that if the reserve levels drop too low, the government can access the IMF credit facility, comprised of a USD 989.8 mn 24-month Stand-By Agreement (SBA) and USD 494.9 mn 24-month Stand-By Credit Facility (SCF), bringing the combined facility to USD 1.5 bn.

The inflation rate for the month of January increased by 60 bps to 7.0% from 6.4% in December, slightly above our projection of 6.5% - 6.7%. The rise was driven by (i) an increase in food prices, which rose 1.7% m/m, on account of the prevailing drought in the country, and (ii) transport prices, which rose 0.6% m/m, despite a notable decrease in the cost of diesel. Going forward, we expect upward inflationary pressures from (i) the food component of the CPI basket due to the persistent dry weather that is expected to carry on for the first half of the year, (ii) global recovery of oil prices spurring cost-push inflation, and (iii) the weakening shilling due to global strengthening of the dollar increasing the cost of imports. We expect upward inflationary pressures to persist in the first half of 2017, pushing the inflation rate above the upper bound of the government target range of 2.5% - 7.5%. However, this upward pressure will level off in the second half of the year as the drought eases, and we expect inflation to average within the government target range over the course of the year.

The Monetary Policy Committee (MPC) met on Monday 30th January 2017 to review the prevailing macroeconomic conditions and give direction on the Central Bank Rate (CBR). The MPC maintained the CBR at 10.0%, which was in line with our expectations as per our MPC Note. The Committee noted that the decision was on the back of a stable macroeconomic environment with (i) a robust economic growth of 5.7% in Q3?16, (ii) a stable foreign exchange market, supported by a narrowing current account deficit, from 6.8% in 2015 to an estimated 5.5% in 2016 and sufficient buffers from reserves and the precautionary IMF facility, and (iii) the banking sector recording notable growth in 2016, with the average commercial banks? liquidity ratio and capital adequacy ratio at 41.4% and 18.7%. Going forward, we expect the MPC to take key note of the impact of interest rate capping on the banking sector and the economy, given that (i) private sector credit growth is currently at an 8-year low, slowing to 4.3% in December 2016, and (ii) the banking sector will have released the FY?2016 results prior to the next MPC meeting. Further, pressure could weigh in on the MPC, on account of a weakening shilling and the expected widening of the current account deficit following the recovery of global oil prices and should the current drought persist, which may necessitate the importation of food items.

The MPC further adopted to completely do away with the Kenya Bankers Reference Rate (KBRR) as the base lending rate, following the new law which stipulates the loan pricing framework. The KBRR, which was introduced to provide a transparent credit pricing framework, had already lost credibility as a pricing metric as highlighted in our Cytonn Monthly ? January 2016, owing to (i) the MPC decision in January 2016 to maintain the KBRR constant despite its computation suggesting a rise to 10.8% from 9.8%, so as to protect consumers from higher borrowing costs as banks would have re-priced their loans upwards, (ii) the MPC indicated that they will be re-working the formula for calculating KBRR but have never released the new formula, and (iii) The KBRR as a tool on its own failed to regulate loan pricing and CBK had to establish additional enforcement mechanisms such as

monthly publication of loan rates by commercial banks.

The Central Bank of Kenya (CBK) released its quarterly economic review for the first quarter of the fiscal year 2016/17. The report reviewed the key macroeconomic indicators, with the data indicating stabilized macroeconomic conditions despite the uneven money market liquidity distribution and rising government borrowing. The government projects the external debt and domestic debt to account for 24.1% and 26.7% of GDP, respectively, by the end of the current fiscal year. As highlighted in our Cytonn Weekly #2/2017, the government has initiated plans to raise USD 1.1 bn through syndicated loans as part of the budget financing for this fiscal year, and to assist the government in boosting its foreign reserves, and in the process, bring stability to the shilling. The debt sustainability update in March 2016 indicated that Kenya faces low risk to external debt distress as we also highlighted in our Cytonn Weekly #49. However, going forward, there are risks associated with the changing funding patterns that could see the debt levels continue to rise, and are already above the 50.0% threshold set by International Monetary Fund (IMF) for frontier markets, currently at 54.9% of GDP as per the Annual Public Debt Management Report for the year ended June 2016. Given the expected Fed rate hikes during the year, the expected widening of the current account deficit due to recovery of oil prices and the increased perception of risk as we head into the election, we expect the shilling to come under pressure and hence raising more dollar denominated debt will only serve to strain the country?s debt servicing capacity.

The United States Federal Open Market Committee (FOMC) met on 1st February, 2017 to assess the current state of the US economy and shed light on a possible rate hike. The decision to maintain the Federal Funds Rate at 0.50% - 0.75%, despite the heightened uncertainty brought about by the impact of the Trump administration on the economy was based on (i) inflation which rose 1.6% y/y, and (ii) a strengthening labor market adding 246,000 new jobs in January, from 151,000 in December, with the economy operating at full employment of a 4.7% unemployment rate. Given that the new administration is keen on an expansionary program with a key focus on job creation, despite the US economy already at full employment, key focus will be placed on economic trends in the US. It is expected that the Fed may hike interest rates come March, should the Trump administration economic plan become clearer and the job market continues to experience growth.

The Government is ahead of its domestic borrowing for this fiscal year having borrowed Kshs 157.0 bn for the current fiscal year against a target of Kshs 141.3 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 181.3 bn, implying that the government will fall behind its borrowing target, especially in a tight money market liquidity condition that we have been experiencing recently. The government has only borrowed Kshs 45.8 bn from the foreign market, representing 9.9% of its foreign borrowing target of Kshs 462.3 bn, and given Kenya Revenue Authority (KRA) has already missed its first half of 2016/17 fiscal year revenue collection target by 10.6%, is expected to miss its overall revenue collection target of Kshs 1.5 tn for the current fiscal year. This creates uncertainty in the interest rate environment as the government might have to plug in the deficit by borrowing from the domestic market, a move that may exert upward pressure on interest rates. It is due to this that we think it is prudent for investors to be biased towards short-term fixed income instruments.

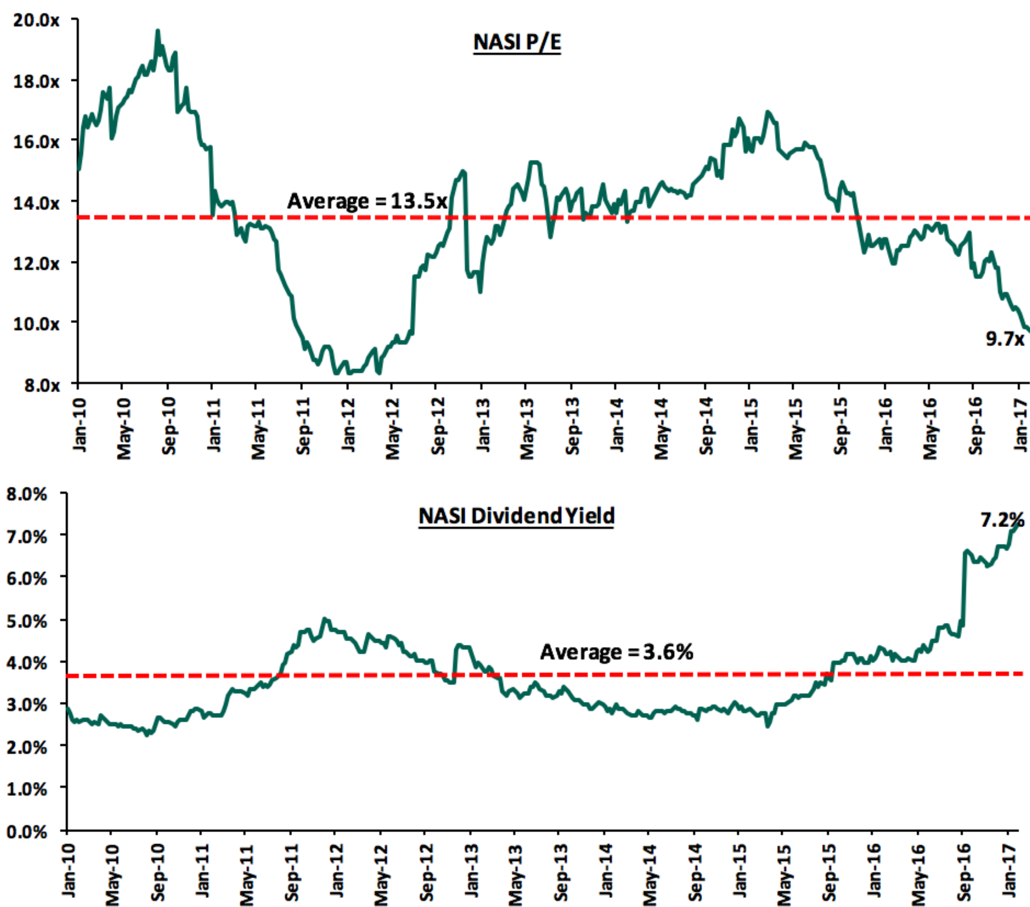
Equities

During the month of January, the equities market was on a downward trend with NASI, NSE 25 and NSE 20 losing 8.3%, 12.3% and 11.1%, respectively, taking their YTD performances to (8.3%), (12.3%) and (11.1%), respectively. The equities market performance during the month was driven by losses in large caps led by Barclays, Equity Group and KCB Group, which lost 20.3%, 19.2% and 19.1%, respectively. This can be attributed to (i) uncertainty surrounding the upcoming August

general elections as investors take a wait-and-see approach, and (ii) the decline in the price of banking stocks due to anticipated low earnings due to low interest income as a result of the Banking (Amendment) Act, 2015, which stipulates the loan and deposit pricing frameworks for banks. Since the February 2015 peak, the market has lost 49.2% and 31.1% for the NSE 20 and NASI, respectively.

Equities turnover increased by 30.2% during the month to USD 116.0 mn from USD 89.1 mn in December 2016. Foreign investors were net buyers for this month with net inflows rising 194.3% to USD 15.6 mn, compared to net inflows of USD 5.3 mn witnessed in December 2016.

The market is currently trading at a price to earnings (PE) ratio of 9.7x, versus a historical average of 13.5x, with a dividend yield of 7.2% versus a historical average of 3.6%. The charts below indicate the historical PE and dividend yields of the market.



During the month, the Central Bank of Kenya (CBK) issued a directive to commercial banks requiring them to provide comprehensive reports on their revised business models by April 2017. The CBK had earlier issued a circular to all commercial banks in November 2016, requiring them to hold capital consistent with their risk profile and business strategy under the Internal Capital Adequacy Assessment Process (ICAAP) document, starting April this year. Institutions are to design the ICAAP to cater for their own individual needs and circumstances with the capital held by each bank consistent to its risk profile and business strategy, as opposed to the past where all banks regardless of size and risk profile held similar capital requirements. In addition, the new guidelines will also give the CBK a say in the amount of capital held by banks with regional operations and corporate governance will be included as a key metric in assessing the capital adequacy of a bank. This development comes at a time when the banking sector has witnessed 3 banks, Imperial Bank, Dubai Bank and Chase Bank, placed under receivership due to mismanagement brought about by poor corporate governance. As highlighted in our Cytonn weekly #49, the move to introduce risk-based supervision by the CBK is likely to see some of the commercial banks in the industry raise more funds to cover their risk exposure and may lead to increased mergers and acquisitions in the

industry. This will result in improved investor confidence in the country?s financial services sector, leading to a more stable sector.

Uchumi supermarket released their FY?2016 results, recording a 17.1% improvement in loss per share to Kshs 7.8 from a Kshs 9.4 loss in 2015, attributed to a 31.7% decline in operating expenses to Kshs 3.3 bn, a 55.5% reduction in provisions and write offs to Kshs 0.5 bn, and a Kshs 0.1 bn gain on loss of control of subsidiaries.

Key points to note include:

- Operating revenue declined by 50.4% to Kshs 6.4 bn from Kshs 13.0 bn, while gross profit declined by 54.3% to Kshs 0.9 bn from Kshs 2.1 bn, attributed to closure of its non-performing branches in Kenya, Uganda and Tanzania, as well as supply chain problems it experienced during the period;
- Operating expenses declined by 31.7% to Kshs 3.3 bn from Kshs 4.8 bn, attributed to cost management tools that were adopted by management, as its turnaround strategy takes form;
- This led to an improvement in the operating loss to Kshs 2.0 bn from a loss of Kshs 2.2 bn recorded in the previous year;
- Provisions and write offs declined by 55.5% to Kshs 0.5 bn from Kshs 1.0 bn in 2015, leading to an improvement in earnings before interest, tax, depreciation, and amortization (EBITDA) to a loss of Kshs 2.3 bn from a loss of Kshs 3.2 bn recorded in 2015;
- Finance costs increased by 22.4% to Kshs 0.4 bn from Kshs 0.3 bn, and Loss before tax improved by 24.0% to Kshs 2.7 bn, from Kshs 3.5 bn recorded last year;
- The retailer closed its regional subsidiaries in Uganda and Tanzania where it was operating 6 and 5 branches, respectively and closed 2 branches in Kenya. It has also been seeking to offload some of its fixed assets in order to generate cash to pay off suppliers and stabilize its operations
- The Board of Directors did not recommend the payment of a final dividend

After delaying announcing its results twice, the retailer received a disclaimer of opinion on the group financial statements, with the auditor citing lack of audit evidence on foreign subsidiaries up to the date of loss of control and lack of evidence on Property and Equipment opening balances. The Board and management continue to focus on its turnaround strategy that includes (i) adoption of a franchising model, (ii) working capital funding through shareholder loans, and (iii) re-negotiation of supplier contracts. We maintain our view that Uchumi?s success going forward will be hinged on its ability to (i) implement its turnaround strategy, and (ii) pay off its suppliers to avoid winding up the company.

During the month, EABL released their H1?2017 results, recording a flat core EPS growth of 1.8% to Kshs 7.1 from Kshs 7.0 in H1?2016. This was a result of (i) a 12.0% decline in operating expenses to Kshs 7.3 bn, attributed to an 18.5% decline in selling costs, which outpaced a 6.3% decline in operating revenue, and (ii) forex gains of Kshs 0.6 bn, compared to forex losses of Kshs 0.5 bn reported last year. See Cytonn Weekly #4/2017 for details on EABL results.

The European Investment Bank (EIB) approved Kshs 27.0 bn of new lending towards Small and Medium Enterprises (SMEs) in the East African region, an increase from the Kshs 10.0 bn the EIB disbursed last year. This will be disbursed through a Kshs 21.2 bn credit line with Equity Group, I&M Holdings and Bank of Africa. Kenya?s small business sector contributes approximately 33.8% to Kenya?s GDP according to the Kenya National Bureau of Statistics Report on Micro, Small and Medium Enterprises. The recent capping of interest rates has further reduced the already slow growth in private sector credit growth, which was at 4.6% in October 2016 from a high of 21.0% in August 2015, thus limiting SME access to funding. As highlighted in our Cytonn Weekly # 2/2017, entrepreneurs, especially in the agricultural sector, will be able to access loans, thus providing an injection of much-needed funding into the SME sector. This engagement is recognition of the role of lending as an efficient way for small business to access finance, and an important channel to

stimulate the economy.

During the month, NASI emerged the second worst performing index globally after Venezuela?s Stock Market Index, having dropped 8.3% in January. The decline was attributed to (i) uncertainty surrounding the upcoming August general elections as investors take a wait-and-see approach, and (ii) the decline in the price of banking stocks due to anticipated low earnings from lower interest income as a result of the Banking (Amendment) Act, 2015, which stipulates the loan and deposit pricing frameworks for banks. As highlighted in our Cytonn Weekly #3/2017, we expect the prices to remain flat given the prospects for the macroeconomic environment for 2017 being less positive compared to 2016.

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

I. Jubilee Insurance moved to a ?Hold? recommendation, with an Upside of 7.3% from a ?Lighten? recommendation with an Upside of 0.2%, following a 6.7% w/w price decline
II. DTB moved to an ?Accumulate? recommendation, with an Upside of 11.0% from a ?Hold? recommendation with an Upside of 8.0%, following a 3.6% w/w price decline

all prices in Kshs unless stated									
EQUITY RECOMMENDATION									
No.	Company	Price as at 30/12/16	Price as at 31/01/17	m/m Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**	Recommend ation
1.	KCB ***	28.8	23.3	(19.1%)	(19.1%)	39.6	7.5%	77.8%	Buy
2.	Sanlam	27.5	18.0	(34.5%)	(34.5%)	30.5	0.0%	69.4%	Buy
3.	Bamburi	160.0	150.0	(6.3%)	(6.3%)	231.7	7.8%	62.3%	Buy
4.	ARM	25.5	19.7	(22.7%)	(22.7%)	31.2	0.0%	58.4%	Buy
5.	NIC	26.0	20.8	(20.2%)	(20.2%)	30.8	3.5%	51.9%	Buy
6.	Britam	10.0	9.6	(4.5%)	(4.5%)	13.5	2.9%	44.2%	Buy
7.	Stanbic	70.5	65.0	(7.8%)	(7.8%)	84.7	7.9%	38.2%	Buy
8.	Equity	30.0	24.3	(19.2%)	(19.2%)	31.3	7.7%	36.8%	Buy
9.	Kenya Re	22.5	20.5	(8.9%)	(8.9%)	26.9	3.6%	34.8%	Buy
10.	HF Group	14.0	11.1	(20.7%)	(20.7%)	13.8	9.2%	33.5%	Buy
11.	Co-op Bank	13.2	11.5	(12.9%)	(12.9%)	13.6	6.8%	25.1%	Buy
12.	I&M	90.0	79.0	(12.2%)	(12.2%)	90.7	3.9%	18.7%	Accumulate
13.	Barclays	9.1	7.3	(20.3%)	(20.3%)	7.6	9.7%	14.5%	Accumulate
14.	BAT (K)	909.0	897.0	(1.3%)	(1.3%)	970.8	6.2%	14.4%	Accumulate
15.	DTBK***	118.0	107.0	(9.3%)	(9.3%)	116.8	1.8%	11.0%	Accumulate
16.	Liberty	13.2	12.6	(4.6%)	(4.6%)	13.9	0.0%	10.8%	Accumulate
17.	Jubilee	490.0	457.0	(6.7%)	(6.7%)	482.2	1.8%	7.3%	Hold
18.	StanChart***	189.0	165.0	(12.7%)	(12.7%)	157.7	6.6%	2.2%	Lighten
19.	Safaricom	19.2	18.5	(3.4%)	(3.4%)	16.6	3.6%	(6.6%)	Sell
20.	NBK	7.2	7.0	(3.5%)	(3.5%)	3.8	0.0%	(45.3%)	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

During the month of January, there were a number of fundraising activities by private equity firms in Africa, and acquisitions of a number of companies, especially in Kenya.

On Acquisitions:

- Cytonn Investments (?Cytonn?) purchased a 25% stake in Superior Homes (Kenya) Limited (?SHK?), a real estate developer valued at Kshs. 4 bn. The purchase of 25% of the shares was from the current owners, the Henderson Family, making Cytonn?s stake, over a series of option transactions, worth Kshs. 1 bn. The deal is complementary and compelling with Cytonn getting a partner that has a strong track record in master-planned developments and construction capabilities, while Superior Homes gets a partner that has a strong track record in structuring

real estate investment products. The strategic acquisition will enable Cytonn to complement its development affiliates, diversify its real estate development portfolio, and accelerate its goal of reaching Kshs. 100 billion in real estate under development

- Japanese multinational Toyota Tsusho, the global trading arm of Toyota Group acquired full control of Kenyan motor vehicle dealers, DT Dobie and CICA Motors, after buying all the shares from their parent company, CFAO Group. Toyota acquired a 97.8% stake in CFAO in December 2012 for USD 2.3 bn (Kshs 243.7bn), at a valuation of 18.9x P/E, and last month bought the remaining 2.2% for USD 54 mn (Kshs 5.4bn) at a valuation of 23.6x P/E, which represents a discount of 44.5% to the market average of 34.1x P/E. For more information, see our Cytonn Weekly #2/2017,
- Nakumatt Holdings Ltd, Kenya?s biggest retail chain by sales and network presence, landed a strategic investor to inject Kshs 7.7 bn for a 25.0% stake, valuing the business at Kshs 30.8 bn, at a 0.9x EV-to-sales valuation, which is a 50% premium to the average Emerging Markets retail stores multiple of 0.6x. This injection will enable the company, which has been facing a number of challenges including increasing debt levels in the last five-years from Kshs 4.7 bn in 2012 to Kshs 18.0 bn in 2016, to reduce its debt burden. The company also improved its corporate governance by naming three professionals to its management team; Mr. Andrew Dixon, Mr. Manoj Warrier and Mr. James Gakumo to spearhead Marketing, Information Technology and Risk Management, respectively. For more information on this deal, see our Cytonn Weekly #3/2017,
- Dubai based Abraaj Group, a private equity firm with a focus on emerging markets, expressed renewed interest to buy into the remaining 50.1% Barclays? International stake in Barclays Africa Group. In a plan to cut its holdings in Barclays Africa Group to 20.0%, Barclays International sold 103.6 mn shares for about USD 80.0 mn (12.2%) to a group of new and existing investors with 1.2% of this, about 1.24 mn shares, taken up by Public Investment Corporation. Barclays Africa Group is also selling or closing its other non-core operations to strengthen its balance sheet and improve overall efficiency. Abraaj, which manages about USD 10.0 bn in assets globally, may bid for up to 35.0% of Barclays Africa, which is valued at about USD 2.6 bn at market price. For details on this story, see our Cytonn Weekly #2/2017

On the fundraising front:

- The European Union (EU), the International Fund for Agricultural Development (IFAD), and the National Social Security Fund (NSSF) Uganda have jointly launched the Yield Uganda Investment Fund whose objective is to provide long-term Capital to agribusiness entrepreneurs. An initial USD 12.9 mn has been availed together with an additional USD 13.9 mn set to be raised by the fund manager to bring the total fund size to USD 26.8 mn. The fund is one of its kind where the EU is blending private equity and grants. The Yield Uganda Investment Fund is being arranged by Deloitte Uganda and Pearl Capital Partners Uganda (PCP, Uganda). PCP Uganda will be the fund manager and will issue capital investments ranging from USD 0.3 mn to USD 2.2 mn. For more information, see our Cytonn Weekly #4/2017.
- The Africa Finance Corporation issued its maiden Sukuk, an Islamic bond structured to generate returns to investors without infringing Islamic law. The 3-yr bond raised USD 150 mn from USD 230 mn in bids, beating its initial target of USD 100 mn and will mature on January 24th, 2020. AFC launched this fund to (i) further diversify their funding sources, (ii) build new relationships with key investors in international markets, and (iii) diversify their portfolio of projects to continue delivering real impact across the continent.

Private equity investment activity in Africa has continued to improve, as evidenced by the increase in the number of fundraising and acquisitions in the region. 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

In 2016, real estate emerged as the best performing asset class delivering returns of on average 25.8% against an average of (8.5%) for equities, (0.2%) on the NSE FTSE bond, and 11.6% for the 364-day bill. This, supported by the continued bear run of the Nairobi Stock Exchange (NSE), has made real estate a haven for investors looking for stable and attractive returns, and we have hence witnessed increased activity in the sector in January 2017 across all themes as covered below:

Commercial Sector

i. Commercial Office ? Increased demand for high quality office spaces, easily accessible and with adequate space has led to developers moving away from the CBD to the emerging business nodes such as Upperhill and Westlands. In response to the above, developers are also developing high quality office space and adopting Green Technology. In January, the main activities that shaped the commercial office theme include:
   - Ecobank moving its offices from Ecobank Towers in the CBD to Fortis Office Park in Westlands and KenInvest setting up a one stop center and moving its headquarters from Railways in the CBD to Upperhill in UAP ? Old Mutual towers. The relocation of corporates from CBD will see the performance of the commercial office sector in the CBD worsen. For instance, in 2016, the CBD recorded an average decline in rental yield of 3.2%, against an average increase in yields of 2.9% witnessed in the market. The CBD will thus have to be reinvented as a commercial office zone through improvement of infrastructure, and provision of specialized small offices or it will be relegated to playing mainly a retail function.
   - In January, the commercial office sector saw additional space in Grade A office buildings and adoption of energy friendly buildings as PDM unveiled a Class-A green building in Mililani ? Vienna Court. This is a trend that has been adopted globally and will most likely pick up in Nairobi. Grade A offices are in short supply in Nairobi accounting for less than 10% of the total office supply, and with entry of international brands such as Volkswagen, the demand for this space is likely to rise. Grade A offices are the best performing office class with rental yields of 10.4% and occupancy of 85.9% on average against 9.4% and 90.7% for grade B and 8.5% and 89.1% for grade C, respectively;
   - Nairobi was ranked the 10th most dynamic city by JLL in their latest City Momentum Index (CMI). The index analyses both macro and micro economic factors using 42 variables including GDP, population, commercial real estate construction and technology. Nairobi was boosted by low costs, rapid consumer market expansion and increased Foreign Direct Investment (FDI). See Report

ii. Retail - Retail space supply in Nairobi has grown at a CAGR of 16.9% over the last 6 years. This supply has led to an increase in competition in the sector hence forcing developers and realtors to differentiate their products in a bid to attract clients and increase footfall in malls. This was evidenced this month as the Two Rivers developers hired a German realtor to run the entity due for opening in February 2017. Despite the increased supply, the retail theme continues to offer attractive returns with rental yields and occupancy averaging at 10.0% and 89.3% in Nairobi, respectively

Residential

Fueled by the huge housing deficit of over 200,000 houses per annum, the residential theme continues to attract investments. Key activities in this theme in January 2017 include:

- The Industrial and Commercial Development Corporation (ICDC) announced that it will finance up to 80.0% of the purchase price for Oceania, its new development in Kizingo, Mombasa Island. The development consists of 3-bedroom apartments selling at prices of Kshs 18.5 mn to Kshs 19.0 mn per unit. The move is likely to boost uptake of the units as a result of the provision of financing.

With a mortgage to GDP rate of just 2.4% in Kenya, and only 22,000 mortgages issued in Kenya, developers have had to develop creative financing solutions such as discounted off plan sales and instalment buying to attract sales, while buyers turn to alternative financing such as SACCO?s,

- Heri Homes, a local developer, unveiled 450-houses to be developed in the Nairobi Metropolitan Area, including Dagoretti and Waithaka;
- Last week, Kenya Bankers Housing Price Index for Q4?2016 was released. According to the index, house prices increased by 1.5%, a 0.7% percentage points decline from its Q3?2016 increase of 2.2%. This is attributable to reduced demand for houses especially those to be bought on mortgage after the enactment of the Banking (Amendment) Act 2015, forcing banks to be more stringent on the lending criteria hence locking many people from accessing loans, including mortgages. The index has however increased by 14.9% from its 2013 base. Key to note is that apartments constituted 60.0% of the transactions compared to 20.0% for maisonettes and 17.0% for bungalows. Apartments also had the highest increases in prices, indicating that demand in the residential sector is still largely in the low to the middle-income population group.

Hospitality

Improved security and aggressive marketing by the government through the Kenya Tourism Board (KTB) resulted in an increase in the number of tourists coming to the country which increased by 14.3% from 636,346 between January and October 2015 to 727,802 for a similar period in 2016. For 2017, we expect that domestic and Meeting Incentives Conferences and Exhibitions (MICE) tourism will boost the real estate sector. In January, key activities in the hospitality sector included:

- A report by United Nations World Tourism Organization (UNWTO), showed that there was an 8.0% growth in the number of tourists visiting Africa, reaching 58 mn in the year 2016 as a result of lifting of advisories over the Ebola Pandemic in West Africa and insecurity in East Africa;
- Nairobi was ranked as the 3rd best travel destination in the world by a British magazine ? Rough Guides;
- Radisson Blu announced that it will open four more hotels in Kenya, including Park Inn due to be opened in March 2017.

The above will not only boost the positive image of Nairobi and the country but will also lead to an increase in tourist numbers in the country, and hence boost the hospitality sector for the rest of the year.

Land

Land has always been a sensitive issue in Kenya, and this coupled with the opacity surrounding land registry and title issuance, has led to court cases that have sometimes dragged on thus affecting development. In January, key activities on this real estate theme included:

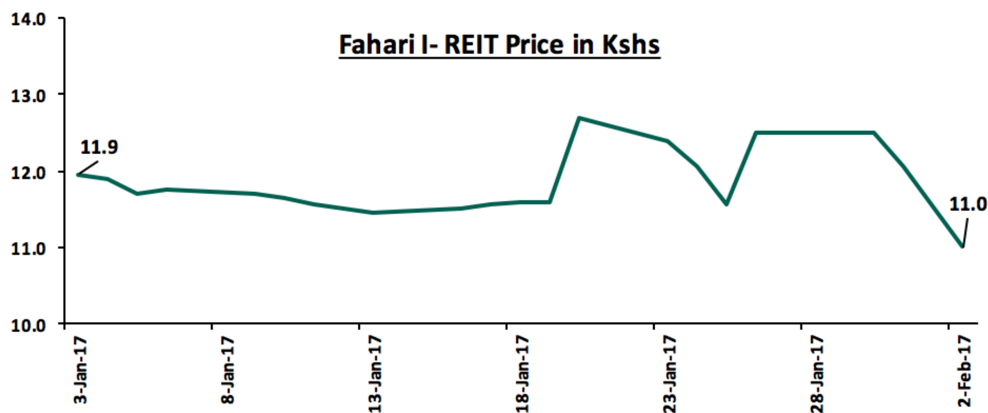
- There was opacity surrounding the issuance of title deeds at the coast as well as legal battles on land ownership, case in point being the 20-acre land parcel in Kasarani believed to belong to Uchumi Supermarkets. This often hinders transfer of land and hence limits the land?s development capabilities. The government thus needs to lay down proper structures to facilitate proper documentation in the lands ministry and supply title deeds to enable individuals transfer land and hence facilitate real estate development;
- Hass Consult released the Q4?2016 Land Index. According to the index, land prices in Nairobi rose by a meagre 0.8% from Q3?2016 to Q4?2016 and 5.1% from 2015 to 2016. Satellite Towns performed better than the Nairobi Suburbs, with land prices increasing by 2.3% q/q and 21.8% y/y. The best performing satellite towns were Juja and Ruiru with increases of 50.9% and 42.5%, respectively, attributed to improved infrastructure in the areas and the best performing suburbs were Donholm and Muthaiga. The slow growth in the land prices is attributable to slow growth in credit as banks tightened credit supply following the enactment of the Banking (Amendment) Act,

2015;

- Rendeavour, the group behind Tatu City, expanded the master plan by buying an additional 2,500-acres of land adjacent to the master plan. Initially on 2,500-acres, the new master plan will now be 5,000-acres. In our opinion the move was driven by the high uptake of the residential and industrial precincts currently, at 72.0% and 61.0% sales, respectively. This indicates the high demand in the market for real estate products targeting the middle-income earners especially residential units and plots, as well as the gap in the supply of quality industrial premises. Key manufacturing companies that have relocated to the area include BIDCO and Chandaria Group.

Listed Real Estate

The decline witnessed in listed real estate stock prices in 2016 persisted with the Fahari I - REIT losing 7.9 % to Kshs 11.0 per share in January from Kshs 11.95 per share at the beginning of the year.



Legal, Infrastructural and Financing Aspects of Real Estate:

- On the legal front, implementation of the removal of NCA and NEMA fees for development is set to begin. This will reduce costs associated with development by 0.15%, and also lead to an increase in development activity of both real estate and infrastructural development affected by the law.
- On the infrastructural front, smart traffic lights are set to be installed on busy highways. They are expected to ease movement and traffic and hence spur real estate activity on major highways such as Mombasa Road.
- The Japanese government will fund the second phase of the Ngong Road expansion from Kenya National Library to Prestige Plaza. We also expect to witness an increase in real estate activity and returns on the stretch above as well as areas accessed by Ngong Road.

Favorable legal policies, improvement of infrastructure as well as financing and high demand will continue to spur real estate development in 2017, with a slight slowdown expected in Q3?2017 over the elections. Our outlook for real estate remains positive.

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