Cytonn INVESTMENTS

Cytonn Weekly #6/2017

Cytonn Weekly

Executive Summary

Fixed Income: During the week, T-bills were oversubscribed for the second week running, with overall subscription coming in at 174.5%, compared to 167.4% recorded the previous week. The Energy Regulatory Commission (ERC) has increased the forex levy on power bills in the month of February by 52.4%, to Kshs 1.3 from Kshs 0.8 per Kilowatt hour in January,

Equities: During the week, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 1.0%, 3.1% and 2.0%, respectively, taking their YTD performances to (5.9%), (7.4%) and (7.6%), respectively. Banks are required to implement a forward looking approach to estimate credit losses once the adoption of the IFRS 9 standard replaces the current International Accounting Standards (IAS) 39,

Private Equity: The Carlyle Group, the fifth largest private equity group by committed capital over the last five-years, acquired a majority stake in CMC Networks (CMC) based in South Africa, which is Africa?s largest managed connectivity provider, for over Kshs 10.4 bn (USD 100 mn). In addition, Washington-based Carlyle Group and San Francisco-based TPG, are among a group of institutional investors vying to acquire Kenyan coffee chain Java House in a transaction estimated to be worth Kshs 10.4 bn (USD 100 mn),

Real Estate: Kenya?s retail sector expanded by 13% between 2015 & 2016 hitting the Kshs 1.8 tn mark, whereas Pacific International Lines (PIL) and China?s Guangzhou Yansha Development Zone sign a trade pact with Kenya Shipping Agency,

Company Updates

- Our Investment Analyst, John Ndua, discussed East African Portland Cement?s search for USD 433.5 million to repay debt and upgrade their existing factory. Watch John Ndua on CNBC here
- Our Investment Analyst, Caleb Mugendi, discussed Kenya?s adoption of the International Finance Reporting Standard 9 that requires banks to implement a forward looking approach to estimate credit losses. Watch Caleb Mugendi on CNBC here
- Cytonn Real Estate, the real estate development affiliate of Cytonn Investments, held its Grand Valentines Activation, which showcased real estate products to both current and potential clients, and offered discounts for units purchased during the activation. See Event Note
- We continue to see very strong interest in our Private Wealth Management training, which is at no cost, and is held bi-weekly, but is open only to pre-screened participants. To register for the training kindly use this link: See training
- Cytonn Private Wealth held a wealth management trained on the real estate market in Kenya, the investments opportunities available in real estate, and the various ways investors can access the attractive returns in the asset class. See Event Note
- 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
- For recent news about the company, see our news section here
- 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
  - The Ridge Phase One is currently 20% sold. See The Ridge
  - Taraji Heights is currently 10% sold. See Taraji Heights
  - 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.comif 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

During the week, T-bills were oversubscribed for the second week running, with overall subscription coming in at 174.5%, compared to 167.4% recorded the previous week. Subscription rates for the 91, 182 and 364-day papers came in at 44.0%, 298.6% and 137.4% compared to 93.4%, 255.6% and 128.6% the previous week, respectively. The 91-day paper continues to witness undersubscription as investors express preference for the 182 and 364-day papers, which continue to offer investors higher returns on a risk-adjusted basis as compared to the 91-day paper. Given the possible upward pressures on interest rates, we maintain our recommendation for investors to be biased towards short-term fixed income instruments. Yields on the 91, 182 and 364-day T-bills remained relatively unchanged during the week, closing at 8.7%, 10.5% and 10.9%, from 8.7%, 10.6% and 10.9%, respectively, the previous week. The Central Bank has remained disciplined in maintaining rates and we have seen the market respond to this with the current acceptance rate at 34.3%, 258.4% and 100.1% for the 91-day, 182-day and 364-day papers, respectively.

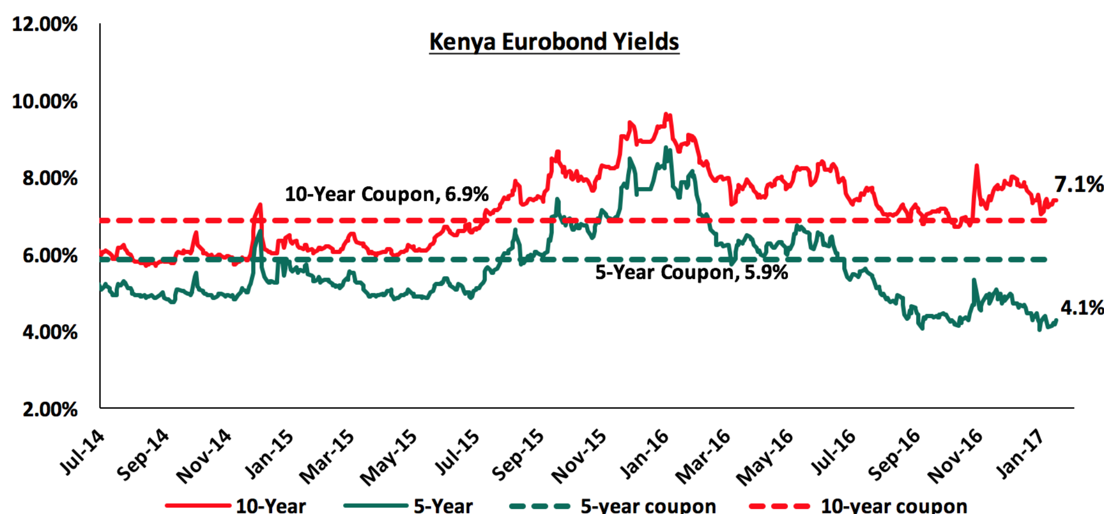
The market remained relatively liquid during the week as can be seen by the huge treasury bills subscriptions amounting to Kshs 27.9 bn. The high liquidity was as a result of an increase in government payments and T-bill redemptions, which came in at Kshs 59.7 bn and Kshs 23.7 bn, from Kshs 35.7 bn and Kshs 12.8 bn, respectively, the previous week. The high liquidity led to an increase in deposits placement by commercial banks with the Central Bank, which amounted to Kshs 40.2 bn in the week. The increased liquidity in the market from government payments saw the average interbank rate decline by 40 bps to 6.8% from 7.2% recorded the previous week, while the volumes transacted increased to Kshs 16.5 bn from Kshs 15.8 bn transacted the previous week. 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	59.7	Transfer from Banks - Taxes	15.5
T-bond Redemptions	0.0	T-bill (Primary issues)	23.8
T-bill Redemption	23.7	Term Auction Deposit	40.2
T-Bills Rediscounts	0.0	Reverse Repo Maturities	9.5
Reverse Repo Purchases	8.8	Repos	13.8

Repos Maturities	12.6	T-Bills/T-Bonds Tap Sale	0.0
Total Liquidity Injection	**104.8**	**Total Liquidity Withdrawal**	**102.8**
		Net Liquidity Injection	**2.0**

According to Bloomberg, the yield on the 10-year Eurobond decreased by 20 bps w/w to 7.1% from 7.3% the previous week whereas that of the 5-year Eurobond increased by 10 bps w/w to 4.1%, from 4.0%, the previous week. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.7% points and 2.5% points, 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 appreciated this week, gaining marginally by 13 bps against the dollar to close the week at Kshs 103.6, from Kshs 103.8 the previous week, on account of low dollar demand and dollar inflows from non-governmental organizations. On a year to date basis, the shilling has depreciated against the dollar by 1.1%. In recent months, we have seen the forex reserves reduce to USD 6.9 bn (equivalent to 4.6 months of import cover), from USD 7.8 bn in October 2016 (equivalent to 5.2 months of import cover). The level of forex reserves has now stabilised, an indication of the confidence of the Central Bank with the current levels of the shilling. The Kenya Shilling trades freely, but the Central Bank occasionally intervenes in the market to reduce the rate of the currency volatility.

For the month of February, the government is seeking to issue a new 12-year amortized Infrastructure Bond (IFB 1/2017/12) with an effective tenor of 8.8 years, in a bid to raise Kshs 30.0 bn for partial support of infrastructural projects in the roads, energy and water sectors. Given that investors will participate up until 21st February 2017, we shall provide the bidding recommendation for this bond issue in our next report.

Inflationary pressures are expected to increase in the first half of 2017 due to (i) the ongoing drought that is affecting food supply and has led to an increase in electricity tariffs, (ii) the increase in oil prices in the international market, and (iii) the strengthening of the dollar. This week, the Energy Regulatory Commission (ERC) increased the forex levy on power bills in the month of February by 52.4% to Kshs 1.3, from Kshs 0.8 per Kilowatt hour in January, as they pass on the effects of the strengthening dollar to the consumers. In our view the inflation figures will be high in the first half of 2017, touching a high of 8.1%, which is above the CBK target, but should normalise towards the end of the year and lie within the upper bound of the 2.5% - 7.5% target.

Kenya continues to be a great entrepreneurs? hub and next week the country shall be hosting the Africa Finance and Investment Forum (AFIF), an event organized by the European Market Research Centre (EMRC), which is focused on strengthening the private sector in Africa by boosting entrepreneurship and attracting investments into the continent, with the aim of creating vibrant

economies through the encouragement of entrepreneurship. A total of 300 participants are expected to attend the forum, comprising of financiers, market specialists, government representatives, investors and policy makers. Despite being an election year in Kenya, the country continues to experience stabilized macroeconomic conditions amidst global economic shocks, proving it to be a preferred investment destination for foreign investors.

Nigeria has issued a new 15-year Eurobond, which is the country?s third Eurobond since the last issues in 2011 and 2013, to raise USD 1.0 bn for budgetary support. The bond?s yield came in at 7.9%, below the initial expectation of 8.5%, and was oversubscribed by 780.0%, with investor bids amounting to USD 7.8 bn. This performance was better than expected with Nigeria being in a recession and its currency having lost 58.1% and 0.2% against the dollar in 2016 and 2017, respectively. The pricing for the 10-year Eurobond for Nigeria is 80 bps above the current yield that the 10-year Kenyan Eurobond is trading at, reflecting the more stable macroeconomic environment in Kenya. The slump in Nigeria?s economy was driven by falling oil prices in the global market and shortage of foreign exchange due to the weakened Naira. Currently, investors seem to have confidence the region is set for recovery and steady growth going forward, with the recovery of global oil prices, which is Nigeria?s major export contributing 10.5% to GDP. The Eurobond issuance by Nigeria highlights (i) the appetite for dollar denominated debt for those economies looking to finance their budget deficits through foreign borrowing, with Kenya as well mulling over a Eurobond issuance, and (ii) investors continuing to seek attractive returns in Africa. However, given the global dollar strength, such significant foreign borrowing by Nigeria, and any African country, will leave them exposed to shocks in the global economy and also make repayments expensive, further leading to currency depreciation.

As indicated in our Cytonn Annual Market Outlook for 2017, the global macroeconomic outlook is likely to be shaped by an anti-trade populism, with the growth in world trade expected to decline driven by a slowdown in trade liberalization and the recent rise in protectionist policies from the developed markets such as the United States. In line with this and already being witnessed towards the tail end of 2016, a report by the United Nations Conference on Trade and Development (UNCTAD) 2016 on Global Investments Trend Monitor, global Foreign Direct Investments (FDIs) were on a decline mainly driven by weak global economic growth, poor performance of the commodities market and a lacklustre increase in the volume of world trade. Key take outs from the report include:

- Global FDI inflows declined by 12.9% to USD 1.5 tn in 2016, from USD 1.8 tn in 2015 with flows into developing economies declining by 24.8% and developed economies declining by 10.4%,
- FDI inflows into the Eurozone declined by 29.0% due to instability in the region as investors opted for markets in North America, with the US recording an increase of 11.6%, supported by strong equity investment inflows on the back of strong prospects for growth, and,
- FDI inflows into the African continent recorded a decline of 5.9% to USD 54.0 bn from USD 51.0 bn, driven by low commodity prices in global markets. The biggest losers in Africa were (i) Angola, which recorded a decline of approximately 50.0%, and (ii) Mozambique, which recorded a decline of 11.0%. However, South Africa, Nigeria and Egypt recorded increased FDI activity, edging up by 38.0%, 29.0% and 8.7%, respectively.

UNCTAD noted that 2017 will be a rebound year for FDI across the globe as the global economic growth recovers to a growth rate of 3.4%, from 3.1% in 2016, as per the projections of International Monetary Fund (IMF). However, the slowdown in world trade is expected to remain a drag on FDI flows this year, as the recent rise in protectionist policies from developed markets threatens to disrupt established trade alliances, negatively impacting recovery of FDI flows to developing economies.

The Government is ahead of its domestic borrowing for this fiscal year having borrowed Kshs 160.8 bn for the current fiscal year against a target of Kshs 145.7 bn (assuming a pro-

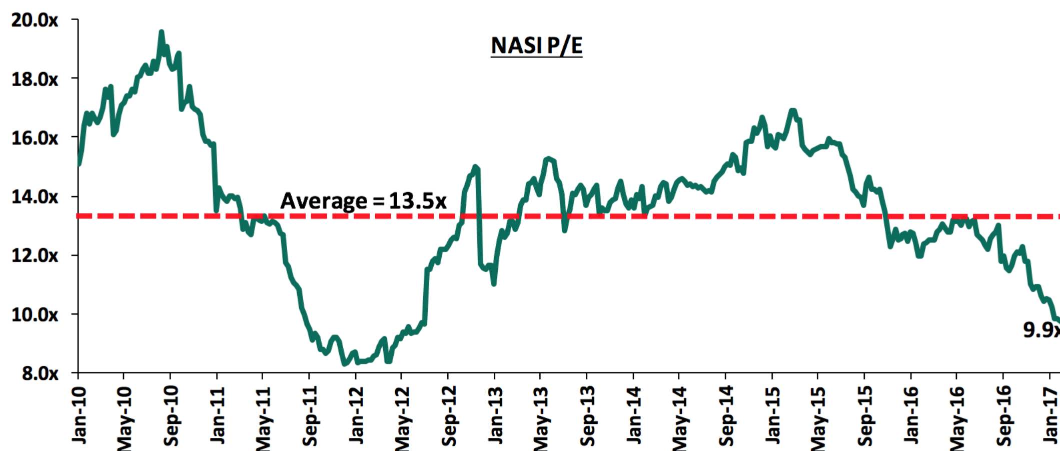
rated borrowing throughout the financial year of Kshs 229.6 bn budgeted for the full financial year). It is important to note, however, that the government is in the process of revising its domestic borrowing target upwards to Kshs 294.6 bn, which will take the pro-rated borrowing target to Kshs 187.0 bn, implying that the government will fall behind its borrowing target. 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%, it 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, and result in longer term papers no longer offering investors the best returns on a risk-adjusted basis. It is due to this that we think it is prudent for investors to be biased towards short-term fixed income instruments.

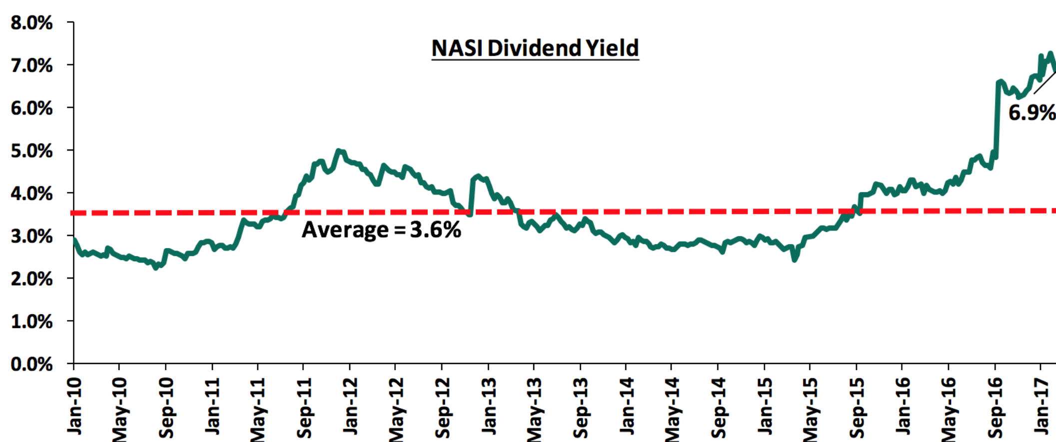
Equities

During the week, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 1.0%, 3.1% and 2.0%, respectively, taking their YTD performances to (5.9%), (7.4%) and (7.6%), respectively. The upward trend was as a result of gains in large cap stocks such as Barclays Bank, Co-operative Bank and Equity Bank, which rose by 10.8%, 10.1%, and 8.0%, respectively. Since the February 2015 peak, the market has lost 42.1% and 24.9% for NSE 20 and NASI, respectively.

Equities turnover increased by 34.0% to close the week at USD 40.4 mn, from USD 30.1 mn the previous week. Foreign investors were net buyers with net inflows of USD 2.7 mn, a rise of 161.9% compared to a net inflow of USD 1.0 mn recorded the previous week, with foreign investor participation decreasing to 61.8%, from 79.6% recorded the previous week. Safaricom was the top mover for the week, accounting for 39.4% of market activity. We expect the Kenyan equities market to be flat in 2017, driven by slower growth in corporate earnings, neutral investor sentiment on the coming general elections and the aggressive rate hike cycle in the US.

The market is currently trading at a price to earnings ratio of 9.9x, versus a historical average of 13.5x, with a dividend yield of 6.9% versus a historical average of 3.6%. The current 9.9x valuation is only 19.3% above the most recent trough valuation of 8.3x experienced in December of 2011. The charts below indicate the historical P/E and dividend yields of the market.





Kenyan banks are likely to face increased pressure with the introduction of the International Financial Reporting Standards (IFRS) 9, which requires banks to increase their loan loss provisioning. The new standard, which is expected to come into effect on 1st January 2018, stipulates that banks should implement a forward looking approach to estimate credit losses, compared to the current International Accounting Standards (IAS) 39 standards that only requires banks to provide for loans after they have become non-performing. According to Deloitte?s Fifth Global IFRS Banking Survey, the new approach will result in banks? loan loss provisions increasing up to 50% across all loan asset classes. We are of the opinion that the new rules will lead to a more stable and safe banking sector, however the increased provisioning will put pressure on capital ratios and may lead to capital raisings.

Cost rationalization measures in the banking sector, such as laying off staff and closing branches, continues with KCB Group?s Rwandan subsidiary this week also indicating that they intend to lay off 28 staff. This makes 10 banks that have announced downsizing plans since the implementation of the interest rate cap.

Kenya Banking Sector Restructuring			
No.	Bank	Staff Retrenchment	Branches Closed
1.	Sidian Bank	108	-
2.	Equity Group	400	-
3.	Eco bank	-	9
4.	Family Bank	Unspecified	-
5.	First Community	106	-
6.	Bank of Africa	-	12
7.	National Bank	Unspecified	-
8.	NIC	32	-
9.	Standard Chartered	300	-

10.	KCB Group (Rwanda)	28	-

Six members of the Kenya Bankers Association (KBA) have received approval from the CBK to implement the Real Time Interbank Switch System on their banking platforms. The system will facilitate the real time transfer of cash from one bank account to another and will enable mobile phone users to send and receive money without relying on mobile money transfer services such as M-pesa, Airtel Money and Orange Money as intermediaries. Additionally, the new system will also improve upon the current Real Time Gross Settlement System (RTGS) that takes four or more hours to reflect transfers in the recipient?s account and only operates between 8 am and 3 pm; since it takes 45 seconds for payments to reflect and operates for 24-hours. The system will be run by KBA?s Integrated Payments Service Limited (IPSL), which is tasked with (i) providing guidance on processing fees, (ii) monitoring the connectivity between the banks, (iii) adding new bank branches to the system, and (iv) sorting out any disputes that may arise between the customers and the banks. Using this channel, money transfer is set to be cheaper, for example, users sending Kshs 2,700 will pay Kshs 20 compared to mobile operator Safaricom?s Mpesa, which charges Kshs 55 for a similar transaction. Additionally, transfers below Kshs 500 will not pay any transaction fees. We are of the view that this could help increase bank?s competiveness in the money transfer market, which has in the recent past been dominated by the mobile phone operators. The total value of mobile money transactions registered a 13.0% increase to Kshs 1.1 tn from 957.1 bn in Q3?2016 from Q2?2016. This will help to increase banks? non-funded income going forward, especially with the interest rate cap whose effects will fully come into effect this financial year. The move will also increase financial inclusion within the country as more people will have access to more banking services on mobile and online platforms.

Cement manufacturer East Africa Portland Cement (EAPC) has approached the government to acquire part of its 14,000 acres of land as it seeks to raise Kshs 45.0 bn of capital to be used in (i) repaying its outstanding debt, (ii) upgrading its current facilities, and (iii) building new plants. The land had been carried at Kshs 8.4 bn in its June 2016 audited accounts, valuing the land at Kshs 0.6 mn per acre, which is a conservative view according to the management. Majority of the land has been used for extraction of raw materials, and hence the low price per acre, compared to comparables in the area of Kshs 3.0 mn per acre. The firm also has plans to undertake a rights issue to obtain the remaining part of the Kshs 45.0 bn capital not raised from the land sale. Government holdings in EAPC amount to 52.3%, compared to other listed companies with government holdings such as Kenya Airways and Mumias, where government has a stake of 29.8% and 20.0%, respectively. Both Kenya Airways and Mumias faced challenges with raising adequate capital for their turnaround strategies, and this may also be the case for EAPC. Kenya Airways had a rights issue in 2012, seeking to raise Kshs 20.7 bn, however managed to raise Kshs 14.5 bn, representing a 70% total subscription performance rate. Mumias on the other hand had to delay its rights issue that was scheduled for 2016, due to fears of a low subscription rate. The company had initially planned to raise between Kshs 3.0 and 4.0 bn. Mumias later received a bailout of Kshs 1.0 bn from the government. The company also has plans to lay off two thirds of their staff in a restructuring exercise to increase profitability. We are of the view that for EAPC, this land sale could be the lifeline the company needs to steer it back into profitability. However, all these companies where the government holds significant stakes, such as EAPC, Mumias, Kenya Airways, Uchumi and National Bank need to be fully privatised to inject private sector discipline and remove the moral hazard of always dipping into tax payers? pockets whenever they run into financial troubles due to mismanagement.

Centum Investments, the country?s largest publicly traded investment company, has acquired a 20-acre piece of land to develop a school, as part of its long term strategy to build 20 education centres across Africa. The firm has partnered with Sabis, a Beirut school management company, who will supply the school?s proprietary ICT driven curriculum and textbooks, and Investbridge Capital, a Dubai based corporate advisory and asset management firm. Centum owns 40% of the venture while

Investbridge and Sabis will own 40% and 20%, respectively. The land is estimated to have been acquired at Kshs 1.2 bn and the school, which will accept learners from Kindergarten straight through to High school, will cost Kshs 535.0 mn to construct, bringing the total cost to Kshs 1.7 bn. This move by Centum will help diversify its revenue streams from its portfolio that has invested primarily in the manufacturing, banking and real estate sectors.

Insurance policy holders will now receive a maximum pay-out of Kshs 250,000, up from Kshs 100,000 as compensation for a claim against a collapsed insurance provider. This was announced by the Policyholder Compensation Fund (PCF), which was established in 2004 following the collapse of several insurance companies, which exposed policyholders to losses from uncollected insurance claims. Firms which have collapsed include (i) Kenya National Assurance Company, which collapsed in 1996 due to theft of assets and mismanagement by senior employees, (ii) United Insurance Company, which collapsed in 2005 due to heavy claims from covered Public Service Vehicles (PSVs), (iii) BlueShield Insurance Company that collapsed in 2011 also due to a large number of claims from PSVs, and (iv) Lakestar Insurance, which was shut down in 2002 due to mismanagement of funds. Currently, policyholders and insurance firms contribute 0.25% of premiums payable on every insurance policy issued by an authorized insurance company. In our opinion, this could help increase confidence in the sector, primarily for small scale investors who use insurance products for saving and investment purposes.

This week, Kenya Airways ended its 18-month performance based contract with global strategic consulting firm, McKinsey and Company. McKinsey, one of the world?s top management consultants, was hired to assist in the implementation of ?Operation Pride?, the airlines turnaround strategy which is focused on key areas such as cost reduction, revenue management and price reviews among others, with the aim of bringing the national carrier back to profitability after 4 consecutive loss making years. The airline indicated that going forward, the turnaround initiatives will be handled in-house and McKinsey will only be hired on-a-need basis, depending on availability of resources. The contract drew criticism from the public due to its high cost, with McKinsey being paid Kshs 2.3 bn in the 10-months up to November 2016, at an average cost of Kshs 43.0 mn per week. We view this as a good move by Kenya Airways in terms of owning its turnaround strategy and cost reduction to return the airline back to profitability.

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

- We have put Sanlam under review following the retraction of their profit warning
- Barclays moved to a ?sell? recommendation, with an upside of 3.4% from an ?accumulate? recommendation with an upside of 14.5%, following a 10.8% w/w price increase
- Jubilee moved to a ?lighten? recommendation, with an upside of 2.3% from a ?hold? recommendation with an upside of 7.3%, following a 5.0% w/w price increase
- Standard Chartered moved to a ?sell? recommendation, with an upside of (3.3%) from a ?lighten? recommendation with an upside of 2.2%, following a 2.9% w/w price increase

all prices in Kshs unless stated									
EQUITY RECOMMENDATION									
No.	**Company**	**Price as at 3/02/17**	**Price as at 10/02/17**	**w/w change**	**YTD change**	**Target Price***	**Dividend Yield**	**Upside/ (Downside)****	**Recommendation**
1.	Bamburi Cement	148.0	148.0	0.0%	(7.5%)	231.7	7.8%	64.4%	Buy
2.	KCB Group***	24.3	25.5	5.2%	(11.3%)	39.6	7.5%	62.8%	Buy
3.	ARM	19.4	19.4	0.0%	(23.9%)	31.2	0.0%	60.8%	Buy
4.	NIC	21.0	21.3	1.2%	(18.3%)	30.8	3.5%	48.4%	Buy
5.	HF Group	10.8	10.7	(1.4%)	(23.9%)	13.8	9.2%	38.8%	Buy

6.	Stanbic Holdings	66.0	65.0	(1.5%)	(7.8%)	84.7	7.9%	38.2%	**Buy**
7.	Kenya Re	20.8	20.0	(3.6%)	(11.1%)	26.9	3.6%	38.1%	**Buy**
8.	Britam	10.0	10.0	0.0%	0.0%	13.5	2.9%	37.9%	**Buy**
9.	I&M Holdings	78.0	74.5	(4.5%)	(17.2%)	90.7	3.9%	25.6%	**Buy**
10.	Equity Group	25.0	27.0	8.0%	(10.0%)	31.3	7.7%	23.6%	**Buy**
11.	Co-op Bank	11.4	12.5	10.1%	(5.3%)	13.6	6.8%	15.6%	**Accumulate**
12.	Liberty	13.0	12.2	(6.2%)	(8.0%)	13.9	0.0%	14.4%	**Accumulate**
13.	BAT (K)	915.0	906.0	(1.0%)	(0.3%)	970.8	6.2%	13.4%	**Accumulate**
14.	DTBK***	106.0	107.0	0.9%	(9.3%)	116.8	1.8%	11.0%	**Accumulate**
15.	Jubilee	457.0	480.0	5.0%	(2.0%)	482.2	1.8%	2.3%	Lighten
16.	Stanchart***	170.0	175.0	2.9%	(7.4%)	157.7	6.6%	(3.3%)	Sell
17.	Barclays	7.9	8.8	10.8%	(3.8%)	7.6	9.7%	(3.4%)	Sell
18.	Safaricom	18.7	18.5	(0.8%)	(3.4%)	16.6	3.6%	(6.6%)	Sell
19.	NBK	6.6	6.3	(4.5%)	(12.5%)	3.8	0.0%	(39.7%)	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

The Carlyle Group, a global private equity fund, has acquired through its Sub-Saharan Africa Fund, a majority stake in Johannesburg-based CMC Networks (CMC), Africa?s largest managed connectivity provider, for over USD 100 mn. Established in 2012, the Carlyle Sub-Saharan Africa Fund, with USD 698 mn of committed capital, has invested over USD 300 mn to date across a variety of industries, this being the seventh investment by Carlyle?s dedicated Sub-Saharan Africa fund. This partnership aligns with CMC Network?s goal to have an extensive geographic footprint. Currently, CMC has the largest managed connectivity network in Africa, with a comprehensive office footprint spanning 70 countries in Africa and the Middle East, serving over 50 global telecommunications carriers. The investment is opportune and will allow CMC to rapidly pursue new markets, products and avenues for growth, including new partnerships and acquisitions in the African market where CMC estimates that demand for high quality bandwidth is growing by 30% p.a.; the high growth rate can be seen in CMC?s good performance given that it has quadrupled its revenue in the last five-years.

In the Kenyan private equity market, two American private equity funds, Washington-based Carlyle Group and San Francisco-based TPG, are among a group of institutional investors vying to acquire Kenyan coffee chain Java House in a transaction estimated to be worth USD 100 mn. Java is currently owned 90% by Washington-based Emerging Capital Partners (ECP), which bought the stake in 2012 from the coffee chain?s founders, Kevin Ashley and John Wagner; a deal which was attributed to the growth prospects of the coffee house chain. The terms of the deal were not disclosed. Java has been experiencing continuous growth in its operations since its launch in 1999, namely;

- The restaurant has since expanded to three countries, nine cities, with 56 outlets and 2,000 employees throughout Nairobi and other Kenyan towns, Uganda and Rwanda, with the Kigali branch being the most recent. The growth has been rapid in the recent years with an increase in their operations by 43 outlets in 5-years,
- In addition to the casual dining restaurant brand, the company has also launched Planet Yogurt, the first self-serve frozen yoghurt brand in Africa, and a Nairobi-based pizzeria called 360 Degrees.

Java plans to expand across the continent in the next 5-years to open outlets in 5 more African countries namely in the cities of Kigali, Accra, Dar es Salaam, Lagos and Lusaka. The growth plan also involves opening additional branches of the sister brands, Planet Yoghurt and 360 Degrees Pizza. This growth is underpinned by the rise in consumer spending brought about by rising

disposable household incomes, fast economic growth, and a growing young population. The fast food industry is experiencing rapid growth, evidenced by global and local fast food chains that have signalled plans for aggressive expansion in 2017 to build on their entry into major towns around the country this year. Chicken Inn, Java House and American chains Hardee?s, Burger King and Kentucky Fried Chicken (KFC) are among the fast food chains that have unveiled plans to open new branches. Growth in this industry is attributed to increase in gross national disposable income.

Kenyan digital currency payments platform BitPesa has closed a USD 2.5 mn funding round. The round was led by US-based Draper Associates, an early stage venture-capital firm that encourages entrepreneurs to transform industries with new technologies, and Greycroft Partners alongside existing investors. This brings BitPesa?s total amount of funding raised to date to nearly USD 6 mn. BitPesa is a Pan-African, bitcoin platform redefining how businesses make payments to and from sub-Saharan Africa and currently operates in Tanzania, Uganda, Nigeria, the UK, the DRC and Senegal. The funding will facilitate BitPesa?s expansion of its services further across West and Southern Africa, as well as in the UK and Europe, as it seeks to become the largest licensed payment company in the UK, Europe and Africa that offers real-time settlement at wholesale FX rates to frontier and emerging markets.

Private equity investment activity in Africa has continued to improve, as evidenced by the increase in the number of deals and deal volumes in the region. Preference this week has been skewed towards the telecom and fast-food industries. Some of the major firms that have been on the spotlight include Carlyle Group, TPG Capital, Helios Partners and Emerging Capital Partners (ECP). 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

During the week, Procter & Gamble (P&G) released results of a survey on Kenya?s retail sector, which indicated a 13.0% expansion of the retail sector in 2016 compared to 2015. Expenditure in the sector amounted to Kshs 1.8 tn (USD 17.6 bn) in 2016 across different channels as follows;

- 30% from supermarkets,
- 67% from traditional retail,
- 3% from special channels such as e-commerce.

Traditional retail outlets continue to dominate the fast-moving consumer goods (FMCG) sector, even though supermarkets and other formal retail outlets are increasing their market share. This can be evidenced by the 18% increase in supermarkets expenditure in 2016, which resulted into a 30% market share for supermarkets, measured by expenditure, as per the P&G report. This could be supported by the fact that consumers perceive branded products to be of superior quality. This rapid expansion of the formal retail sector is driven by;

- Bulk shopping instead of shopping for individual items when the need arises,
- Increase in middle class spending characterized by rising consumerism,
- Increased supply of malls & shopping complexes countrywide that occupy more than 470,000 sqm, and,
- Penetration of supermarkets into residential areas whose population densify by day.

On the other hand, e-commerce and m-commerce has the least market share with the main obstacles being operational and logistical challenges. Nonetheless, mobile payments made to shops grew by 300% in the past 2-years making it the fastest growing sector in retail. From a developer?s perspective, the opportunity lies in the provision of retail space in areas with high population

growth, coupled with propensity to spend particularly in the mid and high income suburbs. Provision of modern warehousing could also answer to the operation and logistic challenges faced by e-commerce.

In other news, Singapore?s Pacific International Lines (PIL) and China?s Guangzhou Yansha Development Zone signed a trade pact with Kenya Shipping Agency. The partnership seeks to increase the firms? investments in Kenya by building more rail and road connections in East and Southern Africa. The network is expected to cover Kenya, Uganda, Rwanda, Burundi, South Sudan, Zambia and Malawi.

PIL, a leading carrier, has operations in over 100 countries including China & the Eastern Africa region, and accounts for 1.7% of the global shipping market share. Further, the two target the Kenya?s Special Economic Zones (SEZ) being developed by the government. There are several incentives under the SEZ Act 2015, such as:

- SEZ enterprises, developers and operators will be subjected to reduced corporate rates of 10% for the first 10-years of operation and 15% for the next 10-years,
- Dividends received by licensed SEZ enterprises, developers and operators are exempt of tax,
- Withholding tax on professional services and interest (other than dividends) by a SEZ enterprise, developer and operator to non-residents to apply at 10%, and,
- The supply of taxable goods to special economic zones enterprises, developers and operators licensed under the SEZA are exempt from VAT.

Infrastructure growth boosts real estate growth and the entire economy as evidenced by projects such as the LAPSSET project, Thika Superhighway and the read developments and bypasses, to name just a few. We have witnessed escalation of land prices in satellite towns resulting from improved transportation as tabulated below:

Capital Appreciation in select Towns		
Satellite town	**Infrastructure**	**Average Capital appreciation per annum**
Ruaka	Northern Bypass	31.1%
Kikuyu	Southern Bypass	27.9%
Utawala	Eastern Bypass	27.3%
Kamulu- Ruai	Eastern Bypass	24.5%
Ruiru	Eastern & Northern Bypass	25.3%
Average		**27.2%**
By Cytonn Investments: Jan 2017		

Following the recent formation of Nairobi Metropolitan Area Transport Authority (NAMATA), traffic congestion within the metropolis shall no longer be the order of the day if the plan is implemented. NAMATA will oversee the implementation of Kenya?s first Mass Rapid Transit System (MRT) through Bus Rapid Transit (BRT) system and the commuter railway. Easier access to the CBD and other places of work is a major factor considered by Nairobi residents. This means that suburbs whose land prices have stagnated owing to inaccessibility shall be revamped and begin to experience capital appreciation once again.

We expect increased development activity and investments into real estate as an asset class supported by the improvement of infrastructure to support the city?s expansion and the high returns being earned in the sector.

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