



Cytonn Q3'2017 Markets Review

Cytonn Weekly

Executive Summary

Global Markets Review: Most global economies are expected to register improved economic growth in the third quarter of 2017, with China, the US and the Eurozone expected to grow at 6.5%, 2.3% and 1.3% annually, respectively. Monetary policy in the US and the EU remained stable with the US Fed maintaining the Federal Funds Rate at a bound of 1.00% - 1.25% in their September meeting, while the European Central Bank (ECB) maintained the base lending rate at 0.0%. Going forward, market consensus is for the US Fed to proceed towards normalization with a rate increase in December, and the ECB to proceed with monetary stimulus, which involves attempts such as lowering of interest rates in a bid to stimulate the economy by increasing money supply;

Sub-Saharan Africa and Regional Review: During Q3'2017, the International Monetary Fund (IMF) released the World Economic Outlook Update for July 2017, raising Sub-Saharan Africa's growth expectation in 2017 to 2.7%, from 2.6% previously, primarily due to an upgrade on South Africa's growth prospects, informed by an increase in mining output and improved rainfall in the country. According to estimates compiled by Focus Economics, Sub Saharan Africa GDP grew by 2.4% annually in Q2'2017, an acceleration from 2.0% growth recorded in Q1'2017. Regional currencies registered mixed performance in Q3'2017, with majority of the currencies gaining against the dollar. Yields on African Eurobonds have declined, shedding 1.2% points YTD on average in Q3'2017, highlighting improved investor sentiment owing to improving macro-economic conditions and a relatively stable political landscape;

Kenya Macro Economic Review: Kenya's economy registered a growth of 5.0% in Q2'2017 as compared to 4.7% recorded in Q1'2017, and 6.3% in Q2'2016 mainly due to subdued growth in the agriculture sector at 1.4% from 5.5% recorded in Q2'2016, and a slowdown in the growth of the financial intermediation sector, which expanded by 4.3%, down from 7.5% recorded in Q2'2016;

Fixed Income: During the third quarter of 2017, T-bills auction recorded an undersubscription, with the subscription level coming in at 86.2% from 140.3% in the Q2'2017. Yields on T-bills remained relatively stable, closing the quarter at 8.1%, 10.3%, and 11.0%, from 8.3%, 10.3%, and 10.9% for the 91, 182, and 364-day papers, respectively, at the end of June 2017;

Equities: During the quarter, the Kenyan equities market was on an upward trend, with NASI, NSE 25 and NSE 20 gaining 6.1%, 4.9% and 4.0%, respectively, as a result of gains in large cap stocks. Top gainers for the quarter were DTB, Standard Chartered, Safaricom and KCB Group, which gained 15.6%, 11.1%, 8.8% and 8.6%, respectively. Since the peak in February 2015, NASI and NSE 20 are down 8.6% and 31.8%, respectively. During the quarter, listed banks and insurance companies released H1'2017 results, recording a decline in their core earnings per share;

Private Equity: Financial Services, Technology, Energy and FMCG sectors witnessed high levels of private equity activity during Q3'2017 as evidenced by increased deal activity by global investors including Abraaj Group, IFC, Fairfax Africa, and Actis, among others;

Real Estate: In Q3'2017, the real estate sector recorded a decline in performance, due to the wait and see approach adopted by risk averse investors during the electioneering period. The commercial office sector recording quarter on quarter declines of 1.9% points in occupancy rates, 0.1% points in rental yields, and 0.4% points in asking prices. The retail sector recorded 7.9% decline in average occupancy levels year to date, resulting in a decline in rental yields from 10.0% to 9.8%. The residential sector recorded a 3.2% year on year decline on total return across all the unit typologies. On average, the rental yields were 9.8% and 9.1% in Q3' 2017, compared to 10.2% and 9.2% in H1'2017, for the retail and commercial office sector, respectively.

Company Updates

- In an effort to enhance corporate governance, transparency, and accountability, we subjected the firm to a rigorous review by Global Credit Rating agency (GCR), and received an initial rating of DOUBLE B (BB), with a STABLE Cytonn is one of the very few firms in the market that subject themselves to a credit rating by an independent agency. Getting the firm rated is part of the many initiatives we are undertaking to achieve the highest levels of corporate governance, including the ongoing efforts to list the firm and the recent board appointments.
 - Read more on the GCR rating [here](#)
 - See the full report on Cytonn's Rating [here](#).
 - Our Investments Manager, Maurice Oduor, also discussed Cytonn Investments' credit rating. Watch Maurice on CNBC [here](#)
- Cytonn Real Estate, the development affiliate of Cytonn Investments, was in Kampala to release the Kampala Real Estate Investment Opportunity Report, a comprehensive market research on residential, commercial and retail themes in Kampala and its environs. See the Report [here](#). After the release of the report they hosted a Kampala Investors' Dinner in order to expose investors to a diversified portfolio of investment grade real estate products in Kenya and also to discuss the potential investment opportunity in Uganda. See [Event Note](#)
- Our Senior Manager, Regional Markets, Johnson Denge, discussed Kampala's real estate sector, following the release of Kampala Real Estate Investment Opportunity report by Cytonn Real Estate. Watch Johnson on CNBC [here](#)
- Our CEO & Managing Partner Edwin H. Dande trained British American Tobacco - Kenya (BAT-K) staff on "Maintaining a comfortable lifestyle into retirement", during BAT-K Staff Annual General Meeting. See [Event Note](#)
- Cytonn Real Estate, the development affiliate of Cytonn Investments, launched a Kshs 20.0 bn iconic mixed-use development named "Cytonn Towers." The 35 floor triplex towers will be located in Kilimani and its construction is expected to commence in Q4'2018. See [Event Note](#) and watch the video showcasing the development [here](#)
- Cytonn Investments held their quarterly Pension Trustees Training at Sarova Panafric Hotel to educate Trustees on the importance of having alternative investments in their portfolio. The event is aimed at being a quarterly event to be carried out in the various regions and we shall share the timetable for the various trustees to plan. See [Event Note](#)
- We continue to showcase our real estate developments by our real estate development affiliate, Cytonn Real Estate, through weekly site visits. Watch progress videos and pictures on [The Alma](#), [Amara](#), [The Ridge](#) and [Taraji Heights](#). The site visits target both investors looking to invest in real estate directly and those interested in high yield investment products to familiarize themselves with how we support our high yield returns. To deliver high yield returns, our cost of capital is priced off the loan markets where all-in pricing ranges from 16.0% to 21.0% and our yield on real estate developments ranges from 23.0% to 25.0%, hence our top-line gross spread is about 6%. If interested in attending the site visits, kindly register [here](#)
- We continue to see very strong interest in our Private Wealth Management training (largely covering financial planning), which is at no cost, and is held bi-weekly, but is open only to pre-screened participants. We also continue to see institutions and investment groups interested in

the trainings for their teams, if interested in the training for your employees or investment group please get in touch with us through our Client Services team at clientservices@cytonn.com. To view the wealth management training topics click [here](#)

- For recent news about the company, see our news section [here](#)
- We have 10 investment-ready projects, offering attractive development and buyer targeted returns of around 23.0% to 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](#)
 - The Alma, which is over 55.0% sold, 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 and has delivered over 20.0% p.a. returns to investors. [See Amara Ridge](#)
 - Situ Village is currently 15.0% sold. [See Situ Village](#)
 - The Ridge (Phase 1) is currently 31.0% sold. [See The Ridge](#)
 - Taraji Heights is currently 10.0% sold. [See Taraji Heights](#)
 - RiverRun Estates (Phase 1) is currently 8.7% sold after the recent launch. [See RiverRun Estates](#)
- We continue to beef up the team with ongoing hires: [Careers at Cytonn](#)

A. Global Markets Review

Introduction

The global economy has been on a recovery path, and according to the Organization for Economic Co-operation and Development (OECD), they still project a 3.5% GDP growth driven by recovery in the developed markets. They however, see room for growth from the emerging markets. The key catalyst for growth has been the supportive monetary policy, however, going forward there is need for more structural support through fiscal policies. The labor market has been recovering but the next phase is to focus on the growth of wages to increase consumption power. On the various regions economic growth in the third quarter of 2017, is projected to be 6.5%, 2.3% and 1.3% annually for China, the US and the Eurozone, respectively. The commodities markets experienced relative stability in Q3'2017, with Brent Crude prices averaging USD 51.0 per barrel during the quarter.

A summary of the key happenings in Q3'2017 per region follows below:

United States:

The US Fed maintained the Federal Funds Rate at a range of 1.00% - 1.25% in September, in line with our expectations, following the last 25 bps hike in June. The decision to maintain rates at this current level was influenced by a slight increase of 0.2% in core inflation items excluding food and utilities. This was positive news after three consecutive quarters of declining core inflation. The effects of Hurricanes Harvey and Irma are yet to be reflected in Q3'2017 data, however expectations are of a temporary pick-up in inflation as a result of USD 150.0 bn in damages and consequent reconstruction expenditures. The unemployment rate remained stable at 4.3%, while private sector jobs increased by 439,689; an increase of 1.2% from the same period a year earlier. There is possibility of a rate hike in December since the unemployment rate has remained low, growth is picking up (the PMI for September 2017 came in at 53.0 compared to 52.8 in August 2017) and inflation is stable.

The stock market has been on an upward trend with the S&P 500 advancing by 4.0% during the quarter and 16.2% on a YTD basis. The increase was driven primarily by gains in technology, energy and financials stocks due to high growth in revenues by companies with international operations as the US Dollar weakened against major currencies. US valuations are still higher than their long term historical average with the Shiller Cyclically Adjusted P/E multiple of 30.7x, which is higher than the

historical mean of 16.7x. US 10 Year Treasury yields remained relatively stable at 2.3%. The US Dollar also lost ground as the Dollar index retreated 9.4% YTD, losing 3.2% during the quarter.

The US economy remains strong with IMF maintaining the 2.1% growth forecast with the main risk to growth being politics. Political risk remains high, with the Trump administration and congressional Republicans dealt another disappointment in their attempt to repeal Obamacare.

Going forward, we expect continued US Dollar stability driven by expectations of a rate hike at the Fed meeting in December and continued strength in the Euro and Yen.

Eurozone:

The Eurozone is on the path to recovery, with a positive outlook in 2017, as the region expanded by 0.6% in Q2'2017 compared to 0.5% in a similar period last year, with growth driven by Germany, Spain and France. The labor market recovery also continued, with the unemployment rate dropping to 7.7% in August 2017 from 10.6% in August 2016.

The European Central Bank (ECB) maintained the base lending rate at 0.0%, and the rates on the marginal lending facility and deposit facility at 0.25% and (0.40%), respectively. The current negative deposit rates are expected to persist in 2017 and impact growth positively by spurring consumption. Moreover, inflation increased to 1.5% in August 2017, up from 1.4% in August 2016, justifying the ECB's decision to continue its quantitative easing program, with the decision on whether to take a gradual approach to reduction in bond purchases likely to happen in the bank's October meeting. Under the QE program, the ECB currently injects EUR 60.0 bn into European bond markets monthly.

The stock markets were on a positive trend with The Stoxx 600 index returning 4.3% for the quarter and the YTD return is at 6.0%, driven primarily by solid corporate earnings growth and margin expansion due to higher Eurozone and international growth. Going forward, the EU market outlook is stable, driven by strong macro-economic fundamentals, loose monetary policy, robust corporate earnings growth and a pick-up in manufacturing with the Eurozone's Flash PMI rising to a 79-month high of 58.2 in September 2017, from 57.4 in August 2017.

Eurozone economic prospects remain strong due to the expectations of a unified Franco-German alliance following the re-election of Angela Merkel as German Chancellor for a 4th consecutive term. There will be expectations of progression of major fiscal initiatives like the establishment of a common EU fiscal stability mechanism. Renewed cooperation between France and Germany is expected to minimize the impact on growth caused by the United Kingdom's EU exit following last year's referendum. The outlook for the UK also improved as Teresa May's government took a more appealing tone with the European Commission with regards to post Brexit separation talks, promising stronger protection for EU citizens living in the UK.

China:

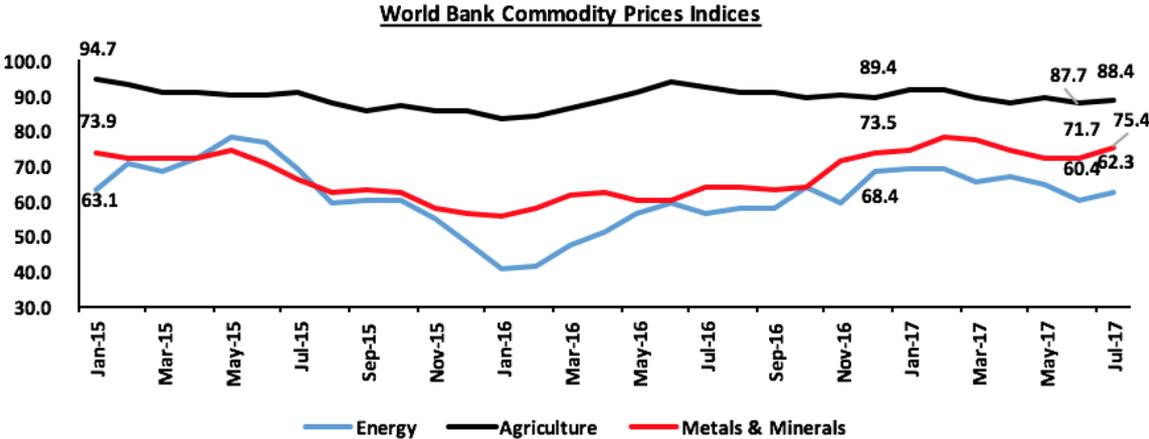
The Chinese economy grew by 6.8% in the third quarter of 2017, driven by (i) a pick-up in the pace of industrial production, (ii) an increase in private consumption, and (iii) increased investment in infrastructure. The Chinese Government expects the economy to slow down to 6.5% in 2017, from 6.7% in 2016, due to reforms expected to be carried out during the year, with the aim of dealing with the country's huge debt build-up, which is currently at 256% of GDP and is forecasted to grow to 300% of GDP by 2022. Some of the reforms that the Chinese government is implementing include (i) refinancing government debt with cheaper debt, which will ease the cost of servicing the debt, (ii) introduction of debt-to-equity swaps in a bid to trim China's corporate debt loads, and (iii) a slow down on accumulation of new debt. Standard & Poor's downgraded China's sovereign credit rating to A+ in August from AA-, citing that the period of strong credit growth had increased financial and economic risks and reduced financial stability.

The Shanghai Composite advanced 4.9% in Q3'2017, as liquidity concerns eased because the People's Bank of China injected USD 16.0 bn into the economy through open market operations. The increase in the Shanghai Composite also continues to be driven by MSCI's potential inclusion of 222 large cap Chinese A shares in the MSCI World Index. Inflows to Mainland Chinese equities are estimated at USD 500.0 bn in 2018 as a result of the inclusion, with China's equity markets being the world's second largest after the US, at a market cap of USD 7.0 tn compared to the US' USD 25.0 tn.

Going forward, we expect that the continued implementation of structural reforms will help China overcome risks that include weak global demand for exports, falling investments in the manufacturing sector and a slowdown in credit growth. Additionally, infrastructure investments aimed at rebuilding ports, roads and rail networks are expected to further enhance China's blueprint in the global market. China's importance to the global economy remains significant, with the country accounting for 15.0% of global GDP and 25.0% of global GDP growth in 2016.

Commodity Prices:

Global commodity prices have collectively experienced gains in the Q3'2017 period, aligning to the expectations of a recovery, with energy, agriculture and metals & minerals having gained 3.1%, 0.8%, and 14.5% respectively in the quarter, according to the World Bank Commodity Prices Index. The gains were driven by a re-bounce in Chinese GDP growth for Q3'2017, which came in at 6.8%, as producers anticipated increased volumes. However, energy and agriculture have lost 8.9% and 1.1% on a YTD basis, respectively, while metals & minerals gained by 2.5% YTD. Oil prices averaged at USD 51.0 per barrel during the quarter, and declined by 9.3% YTD to USD 47.7 per barrel at the end of the quarter from USD 52.6 per barrel in December 2016, owing to oversupply from the US shale oil market and African countries such as Nigeria and Libya which were exempted from the OPEC agreement to cut prices. The YTD decline in commodity prices is set to take a toll on economic growth of commodity-driven economies while oil importing countries such as Kenya are likely to benefit from this, with lower local fuel prices and improvements in their current account balances. Below is a chart showing the performance of select commodity prices, with (8.9%), 2.5% and (1.1%) for energy, metals & minerals, and agriculture performance, YTD, respectively.



B. Sub-Saharan Africa and Regional Review

During Q3'2017, the International Monetary Fund (IMF) released the World Economic Outlook Update for July 2017, raising Sub-Saharan Africa's growth expectation in 2017 to 2.7%, from 2.6% previously, primarily due to an upgrade on South Africa's growth prospects attributed to (i) better than expected rainfall, and hence increased agricultural output, and (ii) increased mining activity, brought about by a rebound in commodity prices. The upgraded outlook on Sub-Saharan Africa's growth prospects is expected to improve investor sentiment and encourage investment in the region.

Currency Performance

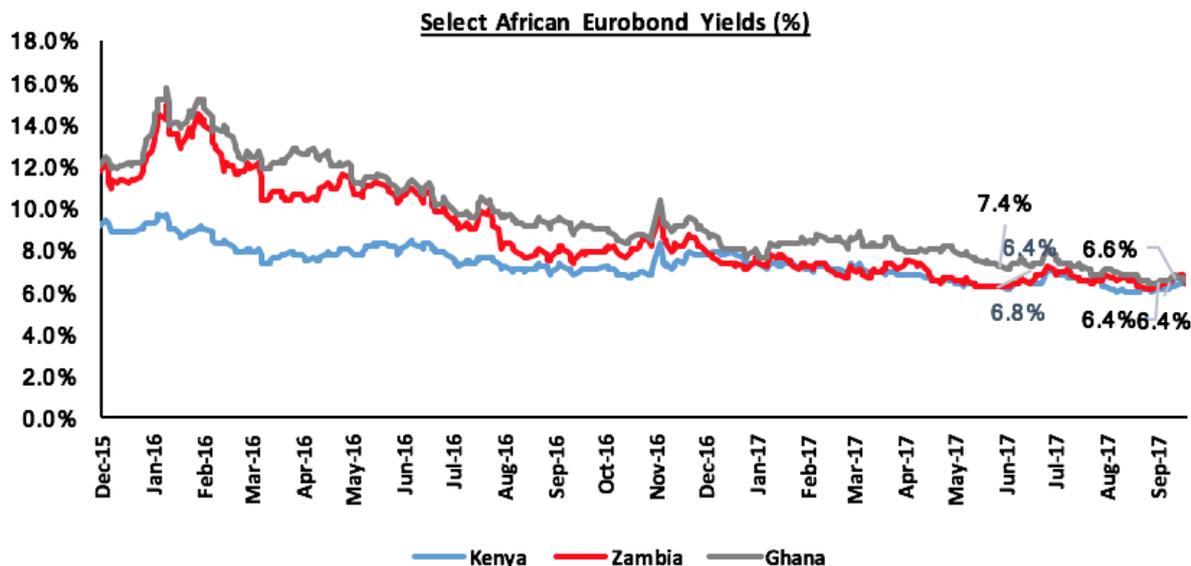
Regional currencies registered mixed performance in Q3'2017, with majority of the currencies gaining against the dollar. In the East African region, the Ugandan Shilling and Tanzanian Shilling depreciated by 0.2% and 0.5%, respectively, against the dollar driven by increased food imports during the drought period and increased oil imports as importers took advantage of the lower global oil prices that were expected to rise. Despite the increasing political uncertainty being witnessed in Kenya due to the prolonged election period as a result of the nullification of the 8th August 2017 elections, the Kenyan currency strengthened by 0.5% in the Q3'2017 period. The strengthening of the shilling during the Q3'2017 period was primarily driven by dollar inflows from investors abroad into the local debt and equity markets, amid attractive market valuations and a relatively stable business environment, brought about by a non-violent election. Below is a table showing the performance of select African currencies, ranked by q/q.

Select Sub Saharan Africa Currency Performance vs USD							
Currency	Sep-16	Dec-16	Jun-17	Sep-17	Last 12 Months Change(%)	YTD Change (%)	Q'Q Change(%)
Mauritius Rupee	35.5	36.0	34.5	34.0	4.4%	5.9%	1.5%
Kenyan Shilling	101.3	102.5	103.7	103.2	(1.9%)	(0.7%)	0.5%
Botswana Pula	10.5	10.7	10.3	10.2	2.7%	4.8%	0.4%
Malawian Kwacha	721.1	727.5	725.4	726.2	(0.7%)	0.2%	(0.1%)
Ugandan Shilling	3,390.0	3,596.5	3595.9	3,603.0	(5.9%)	(0.2%)	(0.2%)
Ghanaian Cedi	4.0	4.2	4.4	4.4	(9.9%)	(3.9%)	(0.2%)
Tanzanian Shilling	2,182.0	2,181.0	2226.7	2,238.6	(2.5%)	(2.6%)	(0.5%)
South African Rand	13.7	13.7	13.1	13.5	1.7%	1.8%	(3.2%)
Zambian Kwacha	10,050.0	9,938.0	9145.0	9,688.0	3.7%	2.6%	(5.6%)
Nigerian Naira	315.0	315.3	322.3	355.0	(11.3%)	(11.2%)	(9.2%)

A negative change in the currency indicates a depreciation in the currency against the dollar while a positive change indicates a gain in the currency against the dollar

African Eurobonds

Yields on African Eurobonds have continued to decline, shedding 0.4% points on average in Q3'2017 from Q2'2017, highlighting the improved investor sentiment owing to improving macro-economic conditions and a relatively stable political landscape. Zambia and Ghana yields declined marginally q/q to end the quarter at 6.4% and 6.6% from 6.8% and 7.4% respectively, while the Kenyan Eurobond yield remained stable at 6.4% over the same period. During Q3'2017, Nigeria indicated that it would issue a USD 2.5 bn Eurobond by mid-November to fund the 2017 budget. This comes on the back of a successful raise of USD 1.0 bn through its third Eurobond at a yield of 7.9%, with a tenor of 15-years, recording more than 7.0x subscription level, which was done in H1'2017. This indicates the high appetite for frontier market government securities, which are offering attractive returns compared to developed economies. Governments needs to be careful on taking too much foreign currency denominated debt as they leave the country vulnerable to exogenous shocks. Below is a graph depicting the Eurobond performance of select African sovereign bonds:



Equities Market Performance:

Majority of the SSA stock markets recorded positive returns during Q3'2017 attributed to renewed investor interest following attractive valuations. In the East African region Kenya and Uganda stock markets were up 7.1% and 2.4%, respectively, while Tanzania DSE declined by 3.5% as the mining stocks declined following the government's implementation of an export ban on gold and copper.

Below is a summary of the performance of key exchanges:

Equities Market Performance (Dollarized)							
Country	Sep-16	Dec-16	Last 3 Months	Sep-17	Last 12 Months	YTD Change(%)	Q'Q Change(%)
Malawi	19.1	18.3	21.7	27.4	43.7%	49.5%	25.9%
Ghana	446.0	395.6	443.1	518.9	16.3%	31.2%	17.1%
Kenya	1.4	1.3	1.5	1.6	17.2%	21.6%	7.1%
Rwanda	0.2	0.2	0.1	0.2	(2.0%)	0.6%	4.9%
South Africa	3,783.0	3,688.1	3,950.1	4,068.9	7.6%	10.3%	3.0%
Uganda	0.5	0.4	0.5	0.5	5.4%	16.7%	2.4%
Zambia	429.9	421.7	520.5	513.4	19.4%	21.8%	(1.3%)
Tanzania	1.1	1.0	1.0	0.9	(17.6%)	(7.1%)	(3.5%)
Nigeria	90.0	85.3	102.0	98.4	9.4%	15.3%	(3.5%)
BRVM	0.5	0.5	0.4	0.4	(15.6%)	(12.7%)	(8.7%)

The African region remains attractive supported by the high demand for basic needs and continued infrastructure development. Key risks remain reliance on commodity prices and political tension in some countries. Stock markets valuations remain attractive for long-term investors.

C. Kenya Macroeconomic Review

The Kenyan economy remains strong but this year we have seen a decline in growth compared to last year. KNBS released the Q2'2017 GDP data, which indicated that the economy expanded by 5.0% compared to 4.7% recorded in Q1'2017, and 6.3% growth recorded in Q2'2016. This slowdown from 6.3% in a similar period last year was due to (i) subdued growth in the agriculture sector at 1.4% as compared to a growth of 5.5% recorded in a similar period last year due to the effects of the 2016/17 drought, and (ii) a slowdown in the growth of the financial intermediation sector, which expanded by 4.3%, down from 7.5% recorded in Q2'2016, as the private sector credit growth continues to slow down, hitting 2.1% as at May 2017 and deteriorating further to 1.6% in August. Some of the key sectors that supported growth are tourism and transport that grew by 13.4% and 8.2%, respectively. The prolonged political uncertainty following the nullification of the presidential elections held in August is expected to take a toll on the economy and therefore we expect the economy to record

lower growth compared to last year due to a slowdown in agriculture and financial intermediation, and we have seen the World Bank, the Kenya National Treasury and IMF revise downwards their projections for this year to 5.5%, 5.5% and 5.3%, from 6.0%, 5.7% and 5.7%, previously, respectively. We project that the economy will grow by between 4.7% - 5.2% in 2017. We shall release our Kenya Q2'2017 GDP Growth and Outlook in the course of the week giving a detailed analysis and outlook.

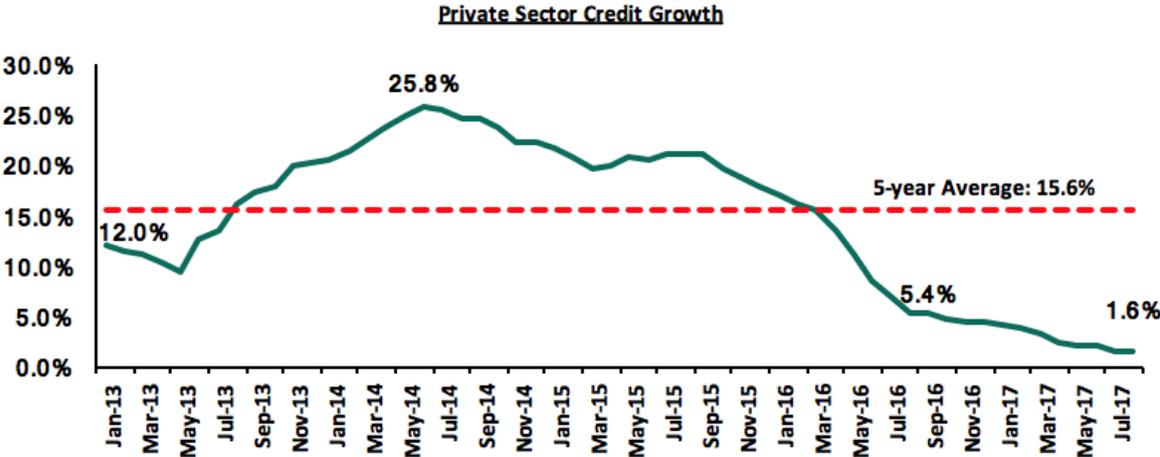
The Kenya National Treasury raised the Kenya Revenue Authority's (KRA's) collection target for the fiscal year 2018/19 by 15.0% to Kshs 1.7 tn from the Kshs 1.5 tn target set for the current fiscal year, in a bid to reduce the fiscal deficit further to a projected 5.4% of GDP (6.3% in FY 2017/18, reduced from 8.9% in FY 2016/17). This comes after a report by Standard & Poor (S&P) viewed Kenya's biggest economic risk as its rising public debt level, which hit 54.4% of GDP in Q1'2017, which is above the IMF's recommended threshold of 50.0% for frontier markets. The FY 2017/18 Budget Policy Statement highlighted measures that will improve collections, the main ones being (i) promotion of local industries, and (ii) encouraging FDI re-investments. Despite the measures put in place, it will be difficult for KRA to meet its new set targets since the operating environment in 2017 is more challenging due to (i) low corporate earnings with the listed banking sector - a big tax contributor - recording a 13.8% decline in core earnings in H1'2017 as compared to a growth of 15.5% in a similar period last year, (ii) Increased lay-offs that will affect the collections of PAYE, and (iii) uncertainty in the political environment that is expected to lead to foreign investors taking a wait-and-see approach in weeks leading up to the re-run of the presidential poll in October. These factors may take a toll on the amount of tax collected by the KRA in this fiscal year.

The Kenya Shilling gained against the US Dollar by 0.5% in Q3'2017 to close at Kshs 103.2 from Kshs 103.7 at the end of H1'2017, mainly driven by (i) speculative investors selling dollars they had bought in the run up to the elections and buying back the shilling, and (ii) dollar inflows from foreign investors to the local equity and debt markets. This week, the Kenyan Shilling remained stable against the dollar to close at Kshs 103.2 from Kshs 103.3 the previous week. In our view, the shilling should remain relatively stable to the dollar in the short term, supported by (i) the weakening of the USD in the global markets, (ii) increased diaspora remittances that grew by 5.3% to USD 1.0 bn in 7 months to July 2017 from USD 987.2 bn in 7 months to July 2016, and (iii) the CBK's activity as they have sufficient forex reserves, currently at USD 7.5 bn (equivalent to 5.0 months of import cover). However, we have seen forex reserves decline significantly from USD 8.3 bn at the peak in April this year, but not to an alarming level, as import cover currently stands at 5.0 months.

The inflation rate has been on a downward trend in Q3'2017 declining to 7.1% in September from 9.2% in June 2017 bringing the average for the year to 9.0% compared to 6.3% in a similar period in 2016. The decline in inflation during the quarter was driven by (i) a drop in food prices, which dropped by 4.3% during the quarter, due to better than expected effects of the long rains season, and (ii) a 0.9% decline in fuel prices following the reduction of diesel and petrol pump prices. We expect inflationary pressures to ease in the last quarter of 2017 driven by the stable food and fuel prices.

The Monetary Policy Committee (MPC) met twice in Q3'2017, and in all the meetings the MPC maintained the CBR at 10.0% as a result of (i) a relatively stable foreign exchange market, despite the current account deficit widening to 6.4% of GDP in July, from 6.2% in May, (ii) a resilient banking sector, with the average commercial banks liquidity ratio and capital adequacy ratio remaining well above the statutory limits, despite the gross NPL ratio rising to 10.7% in August, from 9.9% in June, and (iii) expectations that inflation and the current account deficit will decline supported by lower food & fuel prices and expected favorable weather conditions, which will improve food production and reduce reliance on imports, respectively. Going forward, we expect the MPC to maintain the policy rate but also to take note of the impact of the interest rate cap on private sector credit growth and economic growth in setting the direction of the monetary policy. However, we note that private sector credit growth improved slightly to 1.6% in August, from 1.4% in July, but

still remained below the 5-year average of 15.6%. We believe that this change of trend since the start of a downward slope in August 2015 will be a key driver in future monetary policy decisions. The graph below shows the trend in private sector credit growth since 2013, hitting a low of 1.4% in July 2017:



Macroeconomic Indicators Table

The table below summarizes the various macroeconomic indicators, the expectation at the beginning of 2017, the actual YTD 2017 experience, and the impact of the same, and our expectations going forward:

Summary of Macro Economic Indicators						
No.	Indicators	2017 Expectations	YTD Experience	Going Forward	Outlook - Beginning of the year	Current Outlook
1.	GDP	GDP growth of 5.4% - 5.7%	GDP growth for Q2'2017 came in at 5.0% following a 4.7% growth in Q1'2017. It is highly unlikely that there will be significant recovery in Q3 and Q4	We expect GDP growth for 2017 to come in at between 4.7% - 5.2%, a decline from 5.8% experienced in 2016 but still close to the 10-year average of 5.3%	Neutral	Neutral
2.	Interest Rates	A stable outlook on interest rates in 2017 with the CBR maintained at 10.0%	The CBK has maintained the CBR at 10.0% in all the two meetings held during the quarter	The interest rate environment is expected to remain relatively stable and we expect the MPC to maintain the CBR at 10.0% throughout this year	Neutral	Neutral

3.	Inflation	Expected to average 7.2%, within the 2.5%-7.5% government target	Inflation decreased to 7.1% in September from 9.2% in June 2017 mainly due to a drop in food and fuel prices	We expect inflationary pressures to ease in the last quarter of 2017, but average 8.7% over the course of the year, which is above the upper bound of the government target range of 2.5% - 7.5%	Neutral	Neutral
4.	Exchange Rate	Shilling to depreciate against major currencies	The shilling has appreciated by 0.7% against the dollar YTD on account of increased dollar inflows from investors in the equity and debt markets, and sale of dollar holdings by speculators after the elections	We expect the currency to remain relatively stable against the dollar supported by the CBK, which has sufficient reserves of USD 7.5 bn (equivalent to 5.0 months of import cover) to support the shilling in the short term. The key risk remain elections	Negative	Neutral
5.	Corporate Earnings	Corporate earnings growth of 8.0% in 2017 due to lower earnings for commercial banks attributed to the cap on interest rates	Several companies have released H1'2017 results, mainly banking sector (listed) with weighted average decline in core EPS of 13.8% from a growth of 15.5% in H1'2016	We still expect corporate earnings to be worse than 2016, weighed down by the Financial Services sector, owing to slower private sector credit growth at 1.6% as at August and the effects of the cap on interest rates. We still expect average Earnings growth of 8.0% in 2017, mainly supported by listed non-financial companies such as Safaricom Ltd	Neutral	Neutral
6.	Investor Sentiments	Foreign investors to demand higher premiums due to political risks posed by elections and economic risk due to the planned rate hikes by the US Fed	Investor sentiment has been positive, with foreign investors entering the market in search of attractive valuations, amid a relatively peaceful election period	Political and economic risks on frontier markets still remains with the upcoming presidential poll, uncertainty still prevails in the political scene. However, we expect long term investors to enter the market seeking to take advantage of the attractive valuations	Neutral	Neutral

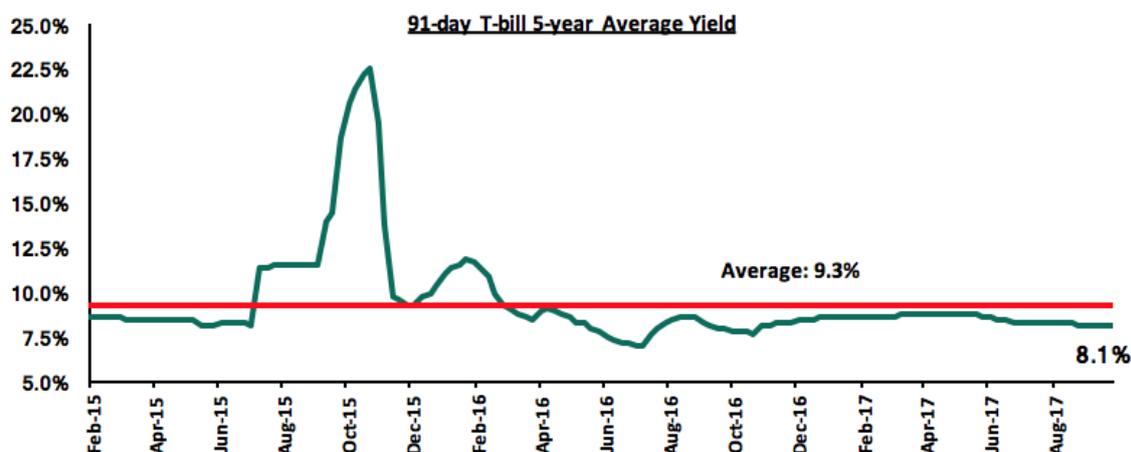
7.	Security	Expect the government to put initiatives in place to ensure improved security, however, the 2017 election remains a challenge	In January, the U.S. Department of State issued a travel warning regarding threats by Al-Shabaab on the Somalia border, coastal and north-eastern counties. In March, the U.K government issued a warning due to security concerns in parts of Laikipia County	Security situation is expected to improve as we head towards the re-run presidential elections. However, uncertainty still exists following the nullification of the presidential election results, with heightened political activity	Neutral	Negative
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Of the seven macroeconomic indicators that we follow, 1 has improved: exchange rate has turned neutral from negative, mainly because of (i) the weakening of the USD in the global markets, and (ii) increased diaspora remittances that grew by 5.3% to USD 1.0 bn in 7 months to July 2017 from USD 987.2 bn in 7 months to July 2016; and 1 has turned negative from positive: security - given the uncertainty that exists around the heightened political activity in the run up to the re-run of the presidential poll. The rest of the indicators remained unchanged at neutral. The net effect is neutral with a bias to negative because of the 7 indicators, 6 are neutral and one that is negative. Consequently, we can conclude that the operating environment for Q4'2017 will remain stable, same as it has been YTD, but economic growth in 2017 will decline from that recorded in 2016.

D. Fixed Income

During the third quarter of 2017, T-bills auction recorded an undersubscription, with the subscription level coming in at 86.2% from 140.3% in the Q2'2017. Overall subscriptions for the 91, 182, and 364-day papers in Q3'2017 came in at 83.9%, 101.5% and 71.6%, respectively. Yields on T-bills remained relatively stable in Q3'2017, closing at 8.1%, 10.3%, and 11.0%, from 8.3%, 10.3%, and 10.9% for the 91, 182, and 364-day papers, respectively, at the end of Q2'2017. This week, T-bills were undersubscribed with overall subscription coming in at 53.1%, compared to 41.2% recorded the previous week. Subscription rate for the 91, 182, and 364-day papers came in at 100.6%, 52.6%, and 34.5% from 64.5%, 35.3%, 37.7%, the previous week, respectively. Yields on the 91, 182 and 364-day T-bills remained unchanged during the week at 8.1%, 10.3%, and 11.0%, respectively.

The 91-day T-bill is currently trading below its 5-year average of 9.3%. The lower yield on the 91-day paper is mainly attributed to the low interest rates environment we have been experiencing, and we expect this to continue in the short-term given: (i) the government is expected to meet its domestic borrowing target for the 2017/18 fiscal year, as capping of interest rates will make it easier for government to borrow from the domestic market, as institutions channel funds more actively towards government securities given the attractive risk return proposition on government securities relative to loans, and (ii) the government is expected to meet its foreign borrowing target in the 2017/18 fiscal year, with budget estimates projected to decline from Kshs 463.9 bn in FY 2016/17 to Kshs 277.3 bn, according to the 2017 Budget Review and Outlook Paper (BROP).



During Q3'2017, the Kenyan Government offered 5 Treasury bonds, distributed across the three months as indicated with details in the table below:

No.	Date	Bond Auctioned	Effective Tenor to Maturity (Years)	Coupon	Amount to be Raised (Kshs bn)	Actual Amount Raised (Kshs bn)	Average Accepted Yield	Subscription Rate	Acceptance Rate
1	28/07/2017	FXD 1/2017/10	10	Market determined	30.0	5.2	13.0%	71.3%	27.3%
2	03/08/2017	FXD 1/2017/5	5	Market determined	30.0	17.6	12.5%	88.9%	66.0%
		FXD 1/2017/10 (Re-open)	9.9	13.0%			13.1%		
	31/08/2017	FXD 1/2017/5 (Tap Sale)	5	12.5%	13.0	13.0	12.5%	100.0%	100.0%
3	21/09/2017	FXD 1/2017/2	2	Market determined	30.0	27.0	11.6%	147.7%	71.3%
		FXD 1/2017/10 (Re-open)	9.9	13.0%			13.1%		
	26/09/2017	FXD 1/2017/2 (Tap Sale)	2	11.6%	13.0	0.6	11.1%	13.1%	
FXD 1/2017/10 (Re-open, Tap Sale)		9.9	13.0%	13.1%					

*for the last tap sale on 29th September, the auction results did not include the value of bids received hence we are not able to calculate the subscription and acceptance rates

The acceptance rate on treasury bonds improved gradually in the third quarter of the year, closing at 71.3% for the September offer up from 27.3% in July, as the market adjusted to the efforts of the CBK to maintain the rates at low levels. We note that the FXD 1/2017/10 was re-opened twice in the quarter as the first auction recorded subscription of 71.3% with the market average rate for the bids coming in at 13.3%, 30 bps above the accepted rate of 13.0%. The average subscription rate for bonds issued in Q3'2017 came in at 102.0%, attributable to the high liquidity in the money market. We are of the view that investors should keep short due to the uncertainty in the interest rates environment.

The money market was liquid during Q3'2017, with a net liquidity injection at Kshs 79.8 bn. Despite this, the average interbank rate increased by 1.9% points to close at 7.2%, from 5.3% at the end of H1'2017 as liquidity continues to be skewed towards the bigger listed banks. The increase in injection was as a result of (i) government payments of Kshs 342.3 bn, (ii) T-bill redemptions of Kshs 264.3 bn, and (iii) reverse repo purchases of Kshs 105.2 bn as the CBK participated in Open Market

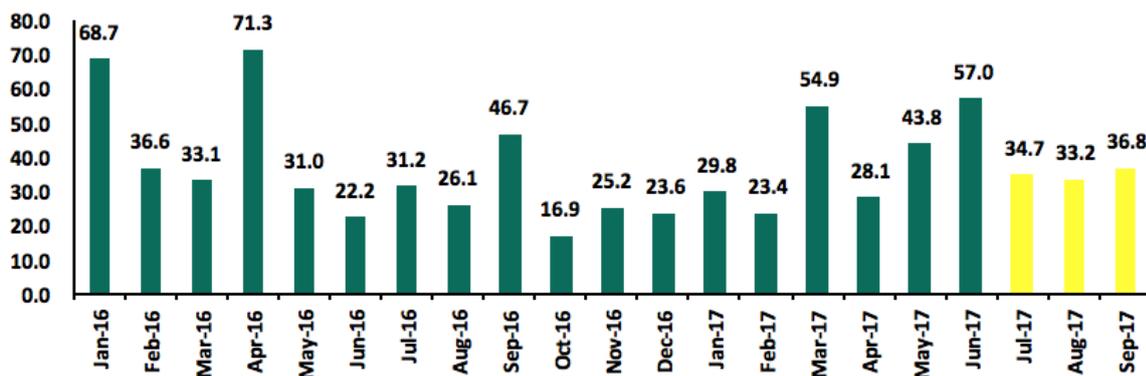
Operations (OMO) to boost liquidity.

Below is a summary of the money market activity in Q3'2017:

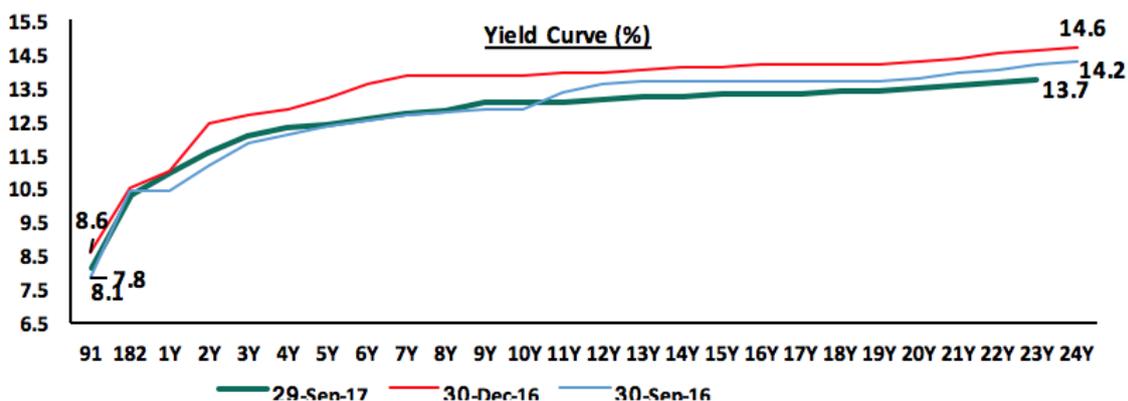
<i>all values in Kshs bn, unless stated otherwise</i>			
Quarterly Liquidity Position - Kenya			
Liquidity Injection		Liquidity Reduction	
Government Payments	342.3	T-bond sales	44.6
T-bond Redemptions	20.4	Transfer from Banks - Taxes	311.2
T-bill Redemption	264.3	T-bill (Primary issues)	233.8
T-bond Interest	27.6	Reverse Repo Maturities	71.6
T-bill Re-discounts	0.2	OMO Tap Sales	24.5
T-bond Re-discounts	0.5	Term Auction Deposits	90.3
Reverse Repo Purchases	105.2	Repos	56.5
Term Auction Deposit Maturities	90.3		
Repos Maturities	61.5		
Total Liquidity Injection	912.3	Total Liquidity Withdrawal	832.5
		Net Liquidity Injection	79.8

The secondary bonds market recorded reduced activity in Q3'2017, with turnover decreasing by 18.8% to Kshs 104.6 bn, from Kshs 128.9 bn recorded in Q2'2017; but increasing marginally by 0.7% from Kshs 103.9 bn recorded in Q3'2016

Secondary Market Bond Turnover (Kshs bn)



The performance of the FTSE bond index for the quarter was a 0.1% gain, bringing the YTD performance to 1.8%. Yields on government securities have been on a downward trend since the beginning of the year as highlighted in the yield curve below.



Rates in the fixed income market have remained stable, and we expect this to continue in the short-term. However, a budget deficit that is likely to result from depressed revenue collection creates uncertainty in the interest rates environment as any additional borrowing in the domestic market to plug in the deficit could lead to upward pressures on interest rates. Our view is that investors should

be biased towards short-to medium term fixed income instruments to reduce duration risk.

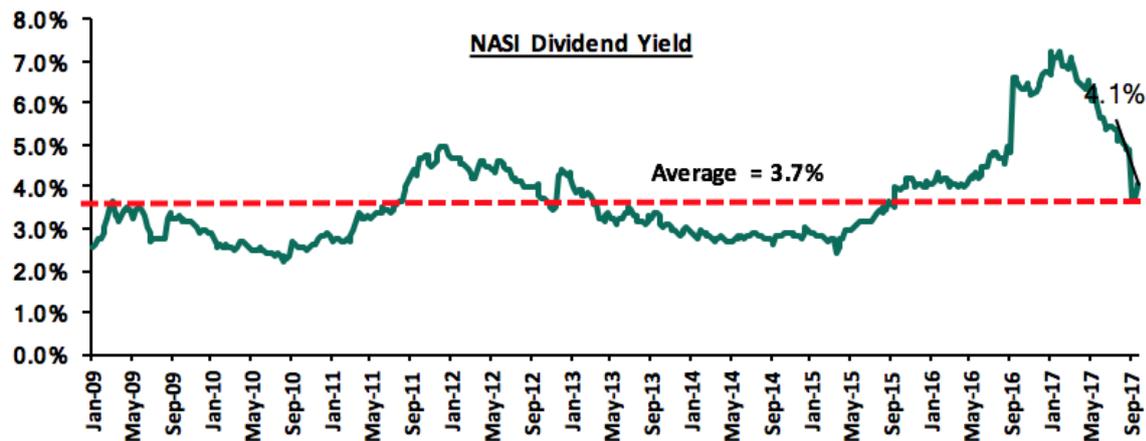
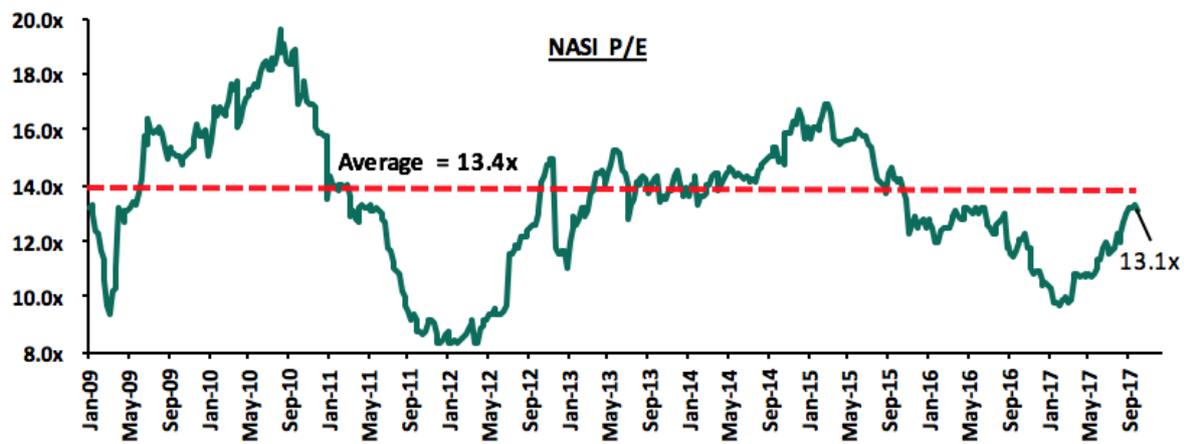
E. Equities

During Q3'2017, the Kenyan equities market was on an upward trend, with NASI, NSE 25 and NSE 20 gaining by 6.1%, 4.9% and 4.0%, respectively, as a result of gains in prices of large cap stocks. Top gainers for the quarter were DTB, Standard Chartered, Safaricom and KCB Group, which were up by 15.6%, 11.1%, 8.8% and 8.6%, respectively. Since the peak in February 2015, NASI and NSE 20 are down 8.6% and 31.8%, respectively.

During the week, the Kenyan Equities market was on a downward trend with NASI, NSE 25 and NSE 20 losing 2.2%, 1.6% and 0.3%, respectively, taking their YTD performance to 21.7%, 21.0% and 17.7% for NASI, NSE 25 and NSE 20, respectively. This week's performance is attributed to losses by large cap stocks such as KCB Group and Safaricom, which lost 4.7% and 3.9%, respectively, as investors took profit following the rally in the stock market.

Equity turnover during Q3'2017 rose by 10.8% to USD 516.8 mn from USD 466.4 mn in Q3'2016. Foreign investors were net sellers with net outflow of USD 106.3 mn compared to net inflows of USD 57.5 mn recorded in Q3'2016. The foreign investor outflows during Q3'2017 can be attributed to a subdued investor sentiment, as a result of political uncertainty during the election period, which saw investors take profit following a rally in the stock market. We expect the market to record subdued activity over the coming few weeks as market players remain cautious of the renewed political uncertainty in the country. Despite this, we are of the view that the market will remain supported by improved investor sentiment once the country takes to the polls for the presidential elections scheduled for October 26th.

The market is currently trading at a price to earnings ratio (P/E) of 13.1x, versus a historical average of 13.4x, and a dividend yield of 4.1%, compared to a historical average of 3.7%. Despite the valuation nearing the historical average, we believe there are pockets of value in the market, with the current P/E valuation being 22.6% below the most recent peak in February 2015. The current P/E valuation of 13.1x is 35.1% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 57.6% above the previous trough valuation of 8.3x experienced in December 2011. The charts below indicate the historical P/E and dividend yields of the market.



During the quarter, a number of Kenyan institutions received ratings from various global rating companies. These include (i) KCB Bank whose long-term and short-term national scale ratings of AA and A1+, respectively, were affirmed by Global Credit Ratings, with a stable outlook for the fourth straight year, (ii) Co-operative Bank and Equity Bank whose capacity to continue mobilizing deposits from the domestic and global institutional investors in a capped interest rate environment was rated as “strong” by Moody’s Investors Service, (iii) Jubilee Insurance Kenya’s national scale claims paying ability of AA-, affirmed by GCR, with a stable outlook, and (iv) Cytonn Investments Management Public Limited Company (Plc) was accorded a maiden national scale issuer ratings of BB (KE) in the long term, by GCR, with a stable outlook. As highlighted in our **Cytonn Weekly #27/2017**, ratings are essential for a well-functioning market as they facilitate best pricing and timing of public offerings, as companies with good ratings get public recognition thus can easily attract investors.

During the quarter, listed banks and insurance companies released H1’2017 results, recording a decline in their core earnings. Banks recorded an average decline in core earnings per share of 13.8% compared to 13.3% in H1’2016, weighed down by the enactment of the Banking Act (Amendment) 2015, which placed regulations on banks’ loan and deposit pricing framework, while the listed insurance recorded an average decline of 5.6% in core earnings per share, from an average gain of 69.4% in H1’2016.

Kenyan Listed Banks Results

Kenyan listed banks released their H1’2017 results, recording an average growth in core earnings per share of (13.8%) compared to 13.3% in H1’2016. Below is a summary of some of the metrics that we track:

Bank	Core EPS Growth	Deposit Growth	Loan Growth	Net Interest Margin	Loan to Deposit Ratio	Exposure to Government Securities	ROaA	ROaE
	H1'2017	H1'2017	H1'2017	H1'2017	H1'2017	H1'2017	H1'2017	H1'2017
KCB Group	(0.2%)	1.3%	16.7%	8.7%	84.3%	24.0%	3.2%	20.2%
DTB Kenya	(5.8%)	18.6%	7.2%	6.8%	74.7%	41.1%	2.3%	18.8%
Equity Group	(7.8%)	13.6%	-1.5%	9.7%	73.1%	37.2%	3.5%	22.0%
NIC Bank	(11.9%)	18.9%	4.1%	7.1%	87.7%	33.3%	2.3%	13.6%
Stanbic Holdings	(12.1%)	12.5%	8.0%	5.3%	75.1%	38.6%	1.9%	10.6%
Barclays Bank	(13.3%)	3.2%	6.8%	10.1%	86.8%	27.9%	2.8%	17.2%
I&M Holdings	(17.9%)	10.3%	9.1%	7.7%	89.5%	31.3%	3.0%	17.2%
Co-op Bank	(25.4%)	2.7%	14.2%	8.8%	88.4%	26.0%	3.2%	19.4%
Standard Chartered	(34.4%)	17.6%	(1.1%)	8.4%	50.4%	47.6%	2.7%	16.6%
National Bank	(42.2%)	3.4%	(12.0%)	6.9%	57.7%	38.1%	0.0%	0.3%
HF Group**	(74.0%)	(6.0%)	(1.3%)	5.7%	89.3%	9.2%	0.6%	4.1%
H1' 2017 Weighted Average*	(13.8%)	9.3%	7.0%	8.6%	77.9%	33.1%	3.0%	18.7%
H1' 2016 Weighted Average*	15.5%	8.5%	7.7%	9.0%	79.2%	29.6%	3.5%	22.3%

* The weighted average is based on Market Cap as at 31st August, 2017

**For Housing Finance, given their primary business of mortgage provision, we used the Loans to Loanable funds ratio. The Loan to Deposit ratio is at 141.3%

Key take outs from the Kenya Listed Banks performance include:

- The listed banks recorded a 13.8% decline in core EPS, compared to a growth of 15.5% in H1'2016. All the banks recorded negative growth, with KCB Group registering the least decline, a 0.2% decline, on the back of a 2.9% growth in Net Interest Income (NII),
- Deposits grew at 9.3% during the first half of the year, a faster rate than loans, which grew by 7.0%. The loan growth came in lower as private sector credit growth slowed to 2.1% in H1'2017, below the government's set target of 18.3%, with banks adopting a more prudent credit risk assessment framework to ensure quality loan books, which saw the loan to deposit ratio drop to 77.9% from 81.1% in H1'2016. This means that even as deposits were growing, banks were not lending,
- Following the Banking Act (Amendment) 2015, banks saw their net interest margins (NIM) drop in H1'2017, which declined to 8.6% from 9.0% in H1'2016,
- Exposure to government securities recorded an increase as indicated by investment in government Securities to deposit ratio, which increased to 33.1% from 29.6% in H1'2016 as banks allocated more funds towards the government, with government securities considered risk free, depriving the private sector of credit in the process,
- The increase in the gross non-performing loan (NPL) ratio to 11.5% from 10.1% in H1'2016 highlights increased risks around asset quality in the sector, with banks having taken a prudent approach with the adoption of IFRS 9, and,
- Listed banks recorded a decline on return on average equity to 18.7% from 22.3% in H1'2016, as the banks' profitability was affected by the capping of interest rates, which suppressed net interest income in the first half of the year.

For a comprehensive analysis on the Kenya Listed Banks performance, see our Cytonn H1'2017 Banking Sector Report.

Kenya Listed Insurance Company Results

The listed insurance firms released their H1'2017 results, recording an average decline of 5.6% in core earnings per share, from an average gain of 69.4% in H1'2016. Below is the summary of the

metrics tracked.

Listed Insurance Companies H1'2017 Earnings and Growth Metrics							
Insurance Company	Core EPS Growth	Net Premium growth	Claims Growth	Loss Ratio	Expense Ratio	ROaA	ROaE
	H1'2017	H1'2017	H1'2017	H1'2017	H1'2017	H1'2017	H1'2017
Jubilee Insurance	23.2%	22.0%	38.7%	101.8%	37.3%	4.3%	18.0%
Liberty	18.9%	(2.2%)	9.0%	83.4%	79.6%	1.2%	6.3%
Kenya Re	3.7%	7.1%	1.6%	51.0%	41.0%	8.5%	13.6%
CIC	(3.5%)	16.9%	27.2%	65.0%	57.2%	0.3%	1.2%
Britam	(44.1%)	8.8%	84.8%	54.7%	70.0%	2.0%	8.9%
Sanlam*	N/A	11.7%	5.0%	83.9%	51.1%	0.3%	2.4%
H1'2017 Weighted Average	(5.6%)	12.8%	42.8%	72.7%	54.3%	3.3%	10.9%
H1'2016 Weighted Average	69.4%	5.1%	0.8%	66.5%	55.5%	3.0%	9.0%
* Sanlam's EPS cannot be calculated since it registered a loss in 2016							
* The weighted average is based on Market Cap as at 31st August, 2017							

Jubilee Holdings and Liberty Holdings recorded impressive growth, but the overall performance was weighed down by Britam Holdings, which was the worst hit due to change in valuation methodology on the long-term insurance claims; the change in the methodology used to account for long-term insurance liabilities to the Gross Premium Valuation from the Net Premium Valuation as per the IRA requirements, had a one-off effect of reducing the claims in H1'2016, due to the decline in Long-Term Insurance Liabilities by Kshs 2.2 bn in the period brought about by the change, and hence the normalization in net insurance benefits and claims in H1'2017. The sector experienced marginal improvement in operational efficiency with the expense ratio declining to 54.3% from 55.5% in H1'2016 despite the loss ratio rising to 72.7% from 66.5% indicating increased claims in the industry. This resulted to the industry average combined ratio increasing to 127.0% from 122.0% in H1'2016. On average, the insurance sector has delivered a Return on Average Equity of 10.9%, an improvement from 9.0% in H1'2016.

In an effort to keep our rankings of companies on the Cytonn Corporate Governance Ranking (Cytonn CGR) Report up-to-date, we continually update the rankings whenever there are changes on any of the 24 metrics that we track, and how this affects the company ranking. This week, Stanbic Holdings appointed Ms. Rose Bosibori Osoro as an independent non-executive director. Stanbic's gender diversity score improved slightly to 25.0% from 18.0% but still maintains a score of 0.5. Its overall score declined to 56.3% from 58.3% due to increase in the board size to an even number 12 from an odd number 11. Stanbic therefore declined its ranking to position 41 from position 39.

Below is our Equities Universe of Coverage:

all prices in Kshs unless stated otherwise								
No.	Company	Price as at 30/06/17	Price as at 29/09/17	q/q Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**
1.	NIC***	33.5	38.5	14.9%	48.1%	58.2	3.2%	54.3%
2.	KCB Group***	37.8	41.0	8.6%	42.6%	57.1	4.7%	43.9%
3.	HF Group***	10.5	10.5	0.0%	(25.4%)	14.2	2.0%	37.9%
4.	Barclays	10.0	10.1	1.5%	19.1%	12.5	9.6%	33.3%
5.	DTBK	160.0	185.0	15.6%	56.8%	234.1	1.4%	27.9%
6.	I&M Holdings	103.0	130.0	26.2%	44.4%	149.6	2.4%	17.5%
7.	Equity Group	37.8	38.8	2.6%	29.2%	40.5	5.1%	9.6%
8.	Co-op Bank	17.0	17.1	0.6%	29.2%	17.5	5.4%	8.1%
9.	Kenya Re	20.8	20.0	(3.6%)	(11.1%)	20.5	3.5%	6.0%

10.	Stanbic Holdings	71.0	79.0	11.3%	12.1%	79.1	5.2%	5.3%
11.	Jubilee Insurance	440.0	475.0	8.0%	(3.1%)	490.5	1.8%	5.1%
12.	Liberty	11.4	13.0	14.0%	(1.5%)	13.0	0.0%	(0.2%)
13.	StanChart	208.0	231.0	11.1%	22.2%	199.8	4.3%	(9.2%)
14.	Britam	12.7	15.0	18.6%	50.0%	13.2	1.8%	(10.2%)
15.	Safaricom	22.8	24.8	8.8%	29.2%	19.8	4.7%	(15.4%)
16.	Sanlam Kenya	28.8	28.0	(2.6%)	1.8%	21.1	1.0%	(23.8%)
17.	CIC Group	4.1	5.4	30.5%	40.8%	3.7	1.8%	(28.9%)
18.	NBK	8.9	9.9	10.7%	36.8%	5.2	0.0%	(47.4%)
<i>*Target Price as per Cytonn Analyst estimates</i>								
<i>**Upside / (Downside) is adjusted for Dividend Yield</i>								
<i>***Banks in which Cytonn and/or its affiliates holds a stake</i>								
<i>For full disclosure, Cytonn and/or its affiliates holds a significant stake in KCB Group and NIC Bank, ranking as the 5th largest local institutional investor and the 9th largest shareholder, respectively</i>								

F. Private Equity

During Q3'2017, we witnessed increased private equity activity, with transactions being witnessed across all major sectors such as financial services, education, FMCG and technology, combined with active fundraising activities.

Financial Services

Deals in the financial services sector during the quarter include:

1. Private Equity firm AfricInvest, through its fund Africinvest Fund III, is set to acquire a 14.3% equity stake in Britam Holdings Ltd (Britam) through the subscription for new shares. The transaction, which is subject to approval from both regulators and shareholders of Britam, will see Africinvest III inject Kshs 5.7 bn for an allocation of 360.9 mn new ordinary shares at a subscription price of Kshs 15.9 per share, a 6.0% premium to the current market price of Kshs 15.0 per share. For more information, see our note: **Africinvest III invests in Britam**.

We expect that Investors will continue to show interest in the financial service sector, motivated by lower valuations, coupled with increased capital requirements across the sector.

In the Technology Sector

Deals in the technology sector during the quarter include:

1. BSP Fund LLC, a Canadian venture capital firm acquired 100.0% stake in iHub Limited, a Kenyan company that runs an innovation incubation laboratory for tech entrepreneurs for an undisclosed amount. iHub was previously owned by Mr Erik Hersman and Mr Josiah Mugambi, who owned 49.95% stake each while Ms Juliana Rotich and David Kobia each owned 0.05%. For more information, see our **Cytonn Weekly #38/2017**.
2. International Finance Corporation (IFC), the private sector arm of World Bank Group is set to acquire an undisclosed stake in a Kenyan based mobile technology firm, Africa's Talking, for USD 6 mn (Kshs 620.4 mn). Africa's Talking provides a cloud-based platform to businesses and developers allowing them to integrate messaging, voice and video communication services into their applications. For more information, see our **Cytonn Weekly #37/2017**.

The technology sector in Sub-Saharan Africa continues to attract investors whose interest in technology-driven companies is catalyzed by the rising need for tech products as more businesses seek to enhance efficiency and reduce costs.

In the FMCG Sector:

Deals in the FMCG sector during the quarter include:

1. The Abraaj Group, a Dubai-based private equity firm is set to acquire a 100% stake in Kenya's Java House Group (Java) after it emerged the top bidder among a group of institutional investors

including Actis, headquartered in London, Washington-based Carlyle Group and San Francisco-based TPG, who were all looking to acquire the food chain. The transaction, whose value is undisclosed, but is estimated at Kshs 13.0 bn, will see Washington-based Emerging Capital Partners (ECP) give up their 90.0% stake in the business and the food chain's founder Kevin Ashley his 10.0% stake. For more information, see our **Cytonn Weekly #27/2017**.

2. South African based firm, Coca-Cola Beverages Africa Proprietary Limited (CCBA), which is Africa's largest Coca-Cola bottler, acquired Kisumu based Equator Bottlers, an authorized Coca-Cola Bottler, for an undisclosed amount. For more information, see our **Cytonn Weekly #27/2017**.
3. Kansai Plascon Africa Limited, a subsidiary of Japanese paint maker Kansai Paint Co. Ltd, completed the acquisition of a 90.0% stake in Kenyan paint and coating manufacturer, Sadolin Group. The transaction was valued at USD 100.0 mn hence valuing the company at USD 111.1 mn (Kshs 14.5 bn). The remaining 10.0% stake is held by undisclosed local investors. For more information, see our **Cytonn Weekly #34/2017**.

This continued investment in the FMCG sector in Sub- Sahara Africa is driven by (i) increase in disposable income spent on consumables, such as beverages and processed food products, (ii) infrastructural developments, such as improved road and transport networks, (iii) ease of access to FMCG products, and (iv) growth in the retail sector.

Other Key PE Highlights:

1. French oil giant Total has acquired 100% stake of Maersk Oil, the oil and gas unit of Danish shipping giant A.P. Moller Maersk, for USD 7.5 bn. The transaction is structured in that (i) Maersk will receive USD 5.0 bn worth of Total shares, and (ii) Total will acquire USD 2.5 bn of Maersk Oil's debt. The acquisition effectively transfers Kenya's Maersk Oil assets to Total which gives Total a stake in the Kenyan oil reserves in, South Lokichar, Turkana, estimated at 750 mn barrels. For more information, see our **Cytonn Monthly-August 2017**
2. Fairfax Africa, an investment holding company of Canadian life insurer Fairfax Financial has completed the acquisition of a 42.4% stake of Atlas Mara valued at USD 159.0 mn effectively valuing the company at USD 375.0 mn. Atlas Mara Limited is a private equity firm based in the British Virgin Islands that invests in Sub-Sahara African financial services firms. The acquisition is part of Atlas Mara's strategy to raise USD 200 mn in order to increase its stake in Union Bank of Nigeria and expand its operations. For more information, see our **Cytonn Weekly #37/2017**.
3. The Competition Authority of Kenya (CAK) has approved the acquisition of 56.2% stake in Kenya's hospitality chain, Avenue Group, by Dubai-based private equity (PE) firm Abraaj Group at an undisclosed value. Other deals approved by CAK include acquisition of a controlling stake in the Kenyan unit of global insurance broker Aon, by a South African private equity firm Capital Works through its newly created investment vehicle Extologix Proprietary, and acquisition of full control of Mombasa-based Associated Vehicle Assemblers (AVA) by Simba Corp, by buying out 50% stake held by Marshalls East Africa at an undisclosed value. For more information, see our **Cytonn Weekly #37/2017**

Fundraising:

During Q3'2017, we witnessed the below fundraising activity;

1. Shortlist, a Kenyan-based employment tech start-up, has received Kshs 103.0 mn seed funding in both equity, for an undisclosed stake, and debt from US-based private equity firm University Ventures, Indian angel investor Samir Shah of Sattva Capital, Kenya-based seed fund Zephyr Acorn, global impact investor FARM Ventures, and US-based investor Bodley Group. The tech start-up offers talent sourcing, screening and shortlisting services to corporates and has offices in Nairobi, Mumbai and India. For more information, see our **Cytonn Weekly #38/2017**.
2. Kenya's Twiga Foods Ltd, a mobile based business to business food supply platform successfully raised USD 12.8 mn (Kshs 1.3 bn) during their Series A funding. The investment which is made up

of USD 6.3 mn in equity, USD 4.0 mn in debt and USD 2.8 mn in grant funding from United States Agency for International Development (USAID), will go toward expansion of the business by enabling it to increase the number of vendors, diversify its product portfolio, and introduce advanced supplier services. For more information, see our **Cytonn Weekly #31/2017**.

3. Three Danish Pension Funds; Pension Danmark, PKA and Medical Doctors' Pension Fund, together with A.P. Moller Holding, a holding company of Danish Based shipping company, A.P. Moller-Maersk, have set up a fund that will invest in infrastructure development in Africa, focused in the transport and energy sector. The fund has received USD 550.0 mn in commitments from the partners and targets to achieve a total of USD 1.0 bn in commitments in the next 12-months. For more information, see our **Cytonn Weekly #32/2017**.

The successful fundraising activity by Private Equity firms indicates a positive outlook by investors in the Sub-Saharan Africa private equity space, motivated by the continued growth in the sector and an increasing number of successful exits, with a 9.1% increase in the number of successful exits recorded in 2016.

Private equity investments in the Sub-Sahara African Region remains robust as evidenced by the increased deal flow in a number of sectors that support growth. The increasing investor interest in private equity investment in sub-Sahara Africa is attributed to (i) rapid urbanization, a resilient and adapting middle class and increased consumerism, (ii) the attractive valuations in the private markets compared to the public markets, (iii) the attractive valuations in Sub Saharan Africa's markets compared to global markets, and (iv) better economic projections in Sub Sahara Africa compared to global markets. We remain bullish on PE as an asset class in Sub-Sahara Africa. Going forward, the increasing investor interest and stable macro-economic environment will continue to boost deal flow into the market.

G. Real Estate

The real estate sector has witnessed a reduction in transaction volumes in the market partly due to the political uncertainty brought about by the extended electioneering period and oversupply in the market segments, especially in the commercial office segment. Other factors include the continued credit constraint in the market and the financial challenges of the key retailer in the market, Nakumatt, which was the key anchor tenant in many prime malls.

The most notable events in Q3'2017, across all themes, include:

Residential

There was a decline in residential sector activity mainly attributed to the wait and see approach adopted by risk averse investors during the electioneering period and reduced credit supply by banks as a result of the enactment of the Banking Amendment Act 2015. During Q3'2017, the following activities were recorded;

1. Kenya National Bureau of Statistics (KNBS) released its annual Leading Economic Indicators Report, which showed a 16.3% decline in value of building approvals between January and May 2017 to Kshs 105.7 bn from Kshs 126.3 bn in the same period in 2016. The residential building approvals declined by 28.2% from Kshs 74.2 bn to Kshs 58.1 bn, while commercial building approvals recording a decline of 9.3% from Kshs 52.0 bn to Kshs 47.6 bn in the same period. For more information, see our **Cytonn Weekly #32/2017**
2. Hass Consult released their Q2'2017 House Price Index showing a 3.1% q/q drop in sale prices, and a 2.0% q/q drop in rental prices. Detached houses recorded the biggest q/q price drop at 4.0%, while apartments recorded a 1.4% q/q price drop during Q2'2017. For more information, see **Cytonn Monthly - July 2017**
3. Kenya Bankers' Association also released their Housing Price Index for Q2'2017 highlighting a

slower growth in property prices at 1.0% compared to a 1.1% increase in Q1'2017. Apartments registered the highest rise at 1.0% compared to prices of bungalows and Maisonettes at 0.3% and 0.4%, respectively, indicating higher demand for more affordable units given the lower cost of construction per unit on the developers' side and therefore relatively lower prices for sale. For more information, see **Cytonn Monthly - July 2017**

4. Cytonn released the Nairobi Metropolitan Area Residential Report 2017 indicating that average prices increased by 3.8% in 2017 compared to a 7.4% increase in 2016 while rental yields remained fairly stable averaging at 5.6% in 2017 compared to the 2016 average of 5.2%. This indicates sustained demand for rental housing whereas demand for sale houses declined.

The performance of the residential sector in 2017 according to Cytonn Investments is as summarized below:

<i>(all values in Kshs unless stated otherwise)</i>							
Year on Year Change in Price Appreciation and Rental Yield							
Unit Typologies	Average Price Appreciation 2017	Average Rental Yield 2017	Total Returns 2017	Average Price Appreciation 2016	Average Rental Yield 2016	Total Returns 2016	Y/Y Change in Total Return
Detached	4.2%	5.2%	9.4%	6.5%	5.2%	11.7%	(2.3) %
Apartments	3.5%	6.0%	9.5%	8.3%	5.2%	13.5%	(4.0) %
Average	3.8%	5.6%	9.4%	7.4%	5.2%	12.6%	(3.2) %
<p><i>Prices in 2017 appreciated albeit at a lower rate of 3.8%, which is 3.7% lower than the same in 2016 due to a slow-down in demand attributed to investor anxiety over the 2017 elections. Rental yields remained stable at 5.5% compared to 5.2% yield in 2016 indicating sustained demand for rental housing.</i></p>							

Source: Cytonn Research

For the full report including the sub-market analysis, see the **Nairobi Residential Research Report**.

On the mortgages front, the Central Bank of Kenya released their Annual Bank Supervision Report 2016, which indicated that there was a 1.5% drop in the uptake of home loans from 24,453 mortgages in 2015 to 24,085 in 2016. In addition, the value of non-performing mortgages increased from Kshs 11.7 bn in 2015 to Kshs 22.0 bn in 2016. The decline in uptake of mortgages was attributed to tighter credit rating standards adopted by banks following the interest rate cap, thus locking out potential borrowers. Mortgage growth has been slow in Kenya and we attribute this to low incomes and high property prices with the average mortgage loan size increasing to Kshs 9.1 mn in 2016 from Kshs 8.3 mn in 2015. Cytonn Investments, in September 2017, released a mortgage and rental affordability report indicating that given the median household income of Kshs 325,000, mortgages are unaffordable with an average index of 65 across Nairobi sub-markets, where an index of 100 and above shows affordability. On the other hand, rents are affordable in most sub-markets in Nairobi with an average index of 124. For the methodology and detailed mortgage and rental affordability indices, refer to the full report here: **Nairobi Metropolitan Mortgage and Rental Affordability Report 2017**

In our view, the decline in performance in the residential sector is only temporary, and is expected to recover in the near-term and increase in the medium-term, supported by high demand due to (i) the huge housing deficit, estimated at 2.0 mn units, (ii) rapid urbanization at 4.4% p.a. compared to a global average of 2.0%, (iii) government incentives such as the 50% tax cut for developers who supply 100 affordable units annually, and (iv) the CBK governor announcing the plans to push for the repeal of the Interest Rate Cap so as to reverse the negative effect it has had on private sector credit growth. Investors have still indicated a positive outlook through plans to develop housing including;

1. Cytonn Real Estate launched a mixed-use development dubbed *Cytonn Towers*, in Kilimani, that will include residential apartments in addition to the hotel, serviced apartments and office space,
2. Superior Homes announced plans to commence development of a gated community on 337-acres

in Athi River that it is set to acquire from East Africa Portland Cement. The firm is currently selling Phase 5 of their 'Green Park' Master-planned development started in 2005,

- Acorn Holdings Limited, a partnership between local real estate developer Acorn Group and Helios, a London based private equity fund, announced plans to begin construction of 3,800 hostel units in Nairobi at a total cost of Kshs 7.4 bn. The development is targeting the student population which has grown by a CAGR of 18.0% in the last 5 years to 564,500 in 2016 from 251,200 in 2012, according to Economic Survey 2017 For more information, see our [Cytonn Weekly #34/2017](#)

Going forward, we expect slow performance given the postponement of the 2017 elections and the political unrest in various parts of the country. However, should we hold peaceful elections, we expect the market to recover and transactional volumes to increase in Q1'2018.

Commercial Office

In the third quarter of 2017, the commercial office sector softened further with occupancy levels, rental yields and prices declining by 1.9% points, 0.1% points and 1.4%, respectively, q/q. This is attributable to the slowdown in economic activities as a result of the general election as well as increased supply in some submarkets constraining performance as shown below:

Summary of Commercial Office Returns in Nairobi Over Time							
Year	FY 2016	Q1 2017	H1 2017	Q3 2017	Δ Q1 (2017)	Δ H1 (2017)	Δ Q3 (2017)
Occupancy (%)	88%	86%	86%	84%	(1.8%)	(0.4%)	(1.9%)
Asking Rents (Kshs/Sqft)	103	102	100	101	(0.6%)	(2.3%)	1.0%
Average Prices (Kshs/Sqft)	13,003	13,211	13,103	13,055	1.6%	(0.8%)	(0.4%)
Average Rental Yields (%)	9.40%	9.0%	9.2%	9.1%	(4.8%)	2.8%	(0.1%)
<i>Commercial office market softened slightly in the third quarter of the year with occupancy rates, yields and asking prices declining by 1.9% points, 0.1% points and 0.4% , respectively attributable to the slowdown in economic activities as a result of the elections</i>							

Source: Cytonn Research

In submarket analysis, in Q3'2017 as in the first half, Gigiri and Karen were the best performing nodes with average rental yields of 12.9% and 10.4%, respectively, mainly attributable to low supply in these markets, prime locations as well as high quality office space which attract clientele maintaining the occupancy level at above the 85% mark and enabling developers to charge prime rents. Nodes with increased office space such as Upper hill had lower returns with average rental yields of 8.5% and occupancy levels of 78.9% as shown below;

Summary of Commercial Office Performance by Nodes Q3 2017				
Location	Price Per Sqft "Kshs"	Rent Per Sqft "Kshs"	Occupancy %	Rental Yields %
Gigiri	14,000	135	70.0%	12.9%
Karen	14,583	120	87.4%	10.4%
Parklands	12,417	99	77.3%	9.7%
Kilimani	13,353	103	85.6%	9.4%
Westlands	13,125	108	91.7%	9.3%
UpperHill	13,737	106	78.9%	8.5%
Msa Road	11,643	78	78.3%	8.3%
Nairobi CBD	12,750	86	91.4%	8.3%
Thika Road	11,500	78	81.1%	8.1%
Grand Total	13,055	101	84.1%	9.1%
<i>Karen and Gigiri are is the best performing nodes due to superior locations enabling it to charge prime rents, they also have relatively lower supply of office space and of high quality thus boosting its occupancy levels which average at 87.4%. Thika Rd, Mombasa Road and the CBD had the lowest yields mainly due to poor locations and low quality office space hence attracting lower rental charges. Upperhill witnessed a decline in rental yields from 9.0% in FY 2016 to 8.5% in the third quarter of 2017 mainly attributed to increased supply thus reduced occupancy levels and returns</i>				

Source: Cytonn Research

Despite the softening of the market, developers are still bullish on the office market evidenced by the following activities in the quarter aimed at increasing office space supply in Nairobi:

1. World Bank's plans to fund construction of a USD 30 mn office complex at an undisclosed location that will house various parastatals such as Kenya National Highways Authority (KenHA), Kenya Urban Roads Authority (KURA), Kenya Rural Roads Authority (KERRA), the Engineers Board of Kenya, the National Construction Authority and the National Transport and Safety Authority. The complex, developed by Chinese firm, AVIC, will include 350,000 square feet of office space, a 500-seater auditorium and a service building,
2. Kasarani Investments Holdings Ltd, a subsidiary of Garden City developer Actis, announcing plans to start construction of a business park comprising of 600,000 square feet of office space, a hospital, hotel and a residential village adjacent to the Garden City Mall along Thika Road, in November 2017.

Given that the market has an oversupply of 3.2mn square feet of office space from the Cytonn analysis and the political environment is still heated, we expect the slowdown in the performance of the office market to persist to the end of the year with developers reducing development activity except in specific pockets of value such as in Grade A offices, in sub markets like Karen and Gigiri, which still have a low supply and have attractive returns with yields of on average 12.9% and 10.4%, respectively, serviced and furnished offices, which are gaining trend with occupancies averaging 66.1%, and yields averaging 13.4% and in Mixed Use Development that are likely to have higher uptakes as a result of the live work play environment

Retail sector

In Q3'2017, the retail sector softened as well with average occupancy levels declining by 1.7% points q/q from 83.1% in H1 2017 to 81.4% in Q'3 2017, the rents declined by 0.5% points q/q as well resulting in a 0.4%-point decline in rental yields from 10.2% in H'1 2017 to 9.8% in Q'3 2017.

Summary of Retail Market Performance in Nairobi Over Time					
Item	FY 2016	H1 2017	Q3 2017	Δ H1 2017	Δ Q3 2017
Asking Rents (Kshs/Sqft)	170	190	189	11.8%	(0.5%)
Occupancy (%)	89.3%	83.1%	81.4%	(6.2%)	(1.7%)
Average Rental Yields	10.0%	10.2%	9.8%	0.2%	(0.4%)
<i>Retail sector softened in 2017 with average rental yields declining by 0.4% points as a result of a decline in occupancy levels and rents by 1.7% points and 0.5% points attributable to increased supply in some submarkets and a tough economic environment lowering retailers returns hence a reduction in expansion measures by retailers</i>					

Source: Cytonn Research

In submarket analysis, prime suburbs such as Westlands, Karen and Kiambu and Limuru Road continued with the good performance recording average occupancy levels of more than 90% and attractive yields of more than 11.0%. Increased supply in some nodes such as Thika Road and Eastlands constrained their performance with the malls recording relatively low average occupancy levels of 75.3% and 61.8% leading to low rental yields of 8.4% and 6.3%, respectively.

(all values in Kshs unless stated otherwise)

Summary of Retail Sector Performance in Nairobi				
Location	Rent	Rent + other Income	Occupancy	Yield (%)
Westlands	235	258	91.0%	13.7%
Karen	231	254	98.0%	13.0%
Kiambu and Limuru Road	216	238	81.6%	11.2%

Kilimani and Lavington	181	199	87.0%	10.3%
Ngong Rd	179	197	88.8%	9.8%
Mombasa Road	188	207	68.8%	8.8%
Thika Road	191	210	75.3%	8.4%
Satellite Towns	130	143	82.5%	7.7%
Eastlands	153	169	61.8%	6.3%
Average	189	208	81.4%	9.8%
<p><i>Prime suburbs such as Westlands and Karen recorded attractive returns with average rental yields of 13.7% and 13.0%, respectively due to high quality offering of retail space and tenants and high demand from retailers due to the stronger financial muscle of the neighbourhoods</i></p> <p><i>Malls in Eastlands and Thika Rd recorded lower returns with average rental yields of 8.4% and 6.3% as a result of increased supply and low demand from retailers due to the weaker financial muscle of the neighbourhoods. The Malls recorded average occupancy levels of less than 80%</i></p>				

Source: Cytonn Research

The sector has been showing a mixed performance with some outlets showing resilience despite the tough economic times, while others like Nakumatt continue to shut branches.

The major highlights during the quarter were:

1. Naivas opened its recent store as the anchor tenant for Ciata Mall, along Kiambu Road, occupying 35,000 sqft of space
2. Nakumatt shut down its NextGen and TRM stores due to a cash crunch resulting from supplier debts while Naivas and Carrefour showed interest for the TRM space previously occupied by Nakumatt, which goes ahead to show that the retail sector is still strong given that some outlets are still on an expansion strategy while foreign retailers continue to set up shop in the sector. The formal retail industry penetration is approximately 30% showing immense opportunity for growth.

We expect a positive growth of the sector with the poorly performing outlets like Uchumi and Nakumatt who were previously considered as the country's retail giants being replaced by newer entrants and foreign stores. The sector will continue to grow supported by i) a rapidly growing population at 2.6% p.a and increase middle class with appetite for lifestyle shopping experience, ii) increased disposable income as a result of growing GDP at on average 5.1% p.a over the last five years and hence higher level of disposable income, iii) enhanced infrastructure, and (ii) foreign investment into the sector through foreign players.

Hospitality

In Q3'2017, the hospitality sector bucked the poor performance witnessed in the other real estate themes recording an upward trend as a result of increased demand for hotel facilities from both leisure and business travelers. This is affirmed by the Kenya National Bureau of Statistics (KNBS) data, which indicated that between January and May 2017, the number of international visitor arrivals increased by 10.9% at Jomo Kenyatta International Airport to 320,588 from 288,905 in the same period in 2016 and by 8.5% at Mombasa's Moi International Airport to 38,397 from 35,388. It was also noted that among the 874,385 international visitors in Kenya in 2016, about 69,000 were Chinese nationals and the number was expected to raise in 2017. For more information, see our [Cytonn Weekly #33/2017](#)

This growth is attributable to;

1. Aggressive marketing, which has helped restore confidence among key international markets such as Europe, USA and the new emerging markets in Africa and Asia as well as the domestic market,
2. Increase of direct flights between Kenya and China which has increased the number of Chinese tourists flying into Kenya, and,
3. Wildebeest migration which occurs between July and October attracts tourists into the country.

The sector remains unfazed by the electioneering period, where players in the industry continue to cash in on leisure and business travel creating a high demand for accommodation. However, despite the upward trend in the hospitality sector in the country, the chairman of Western Kenya Hospitality Leaders Association, noted that hoteliers in the Western part of Kenya made losses during the August elections period due to political uncertainty. We however expect a return to normalcy after the conclusion of the re-election.

On developments, Kenyan hotel group, Sarova Hotels, Resorts and Game Lodges, in July, unveiled a Kshs 1.3 billion new hotel in Nakuru County. The Sarova Group of hotels took over the management of Woodlands Hotel and Spa in March after signing a management agreement with the hotel's management. The 147-room Sarova Woodlands Hotel, targets the hospitality performance in the area that recorded a high ADR of USD 218 and a TRevPAR of 81 despite a relatively low average annual occupancy of 29.0% in 2016, which is set to be boosted by both local and international leisure and business travelers in Nakuru.

Construction activities in the industry have also been on the rise with traditional hotels trying to reclaim their position amidst the stiff competition. Nairobi Serena Hotel has embarked on expansion and refurbishment of existing facilities, while Ole Sereni Hotel in Nairobi is constructing a new facility adjacent to its Mombasa Road branch. In addition, Crowne Plaza in Upper Hill has opened a mixed-use annex adjacent to the Hotel with Hilton expanding to Upper Hill in Pinnacle Towers building by 2020. The increased construction and expansion activities are driven by the need for hotel brands to remain unique and relevant in the market amidst competition from global brands such as Sheraton, Ramada, Marriott, and Movenpick which have entered the market in the last few years.

Land Sector

The land sector recorded a decline in levels of activity, as the investors and developers adopt a wait and see approach due to the uncertainty posed by the political pressure. The most notable activities are:

1. The Johannesburg Stock Exchange listed ADvTECH Ltd, an education, training and placement company based in South Africa, announced the purchase of a land parcel in Tatu City. The parcel will be used to set up a THRASS education system Crawford schools brand, in line with the company's expansion strategy to various countries in Africa. For more information, see **Cytonn Weekly #34/2017**
2. The Lands Ministry announced the launch of the live digital lands registry services, at the Nairobi Registry. The services targeted for online registration include registration of lease, transfer of land, transfer of lease, charge or discharge and subdivision. The process is expected to improve accountability and efficiency in the ministry, and thus making the process less constraining for citizens and real estate developers especially due to the fact that ineffective land administration processes weigh heavily financially on both parties.

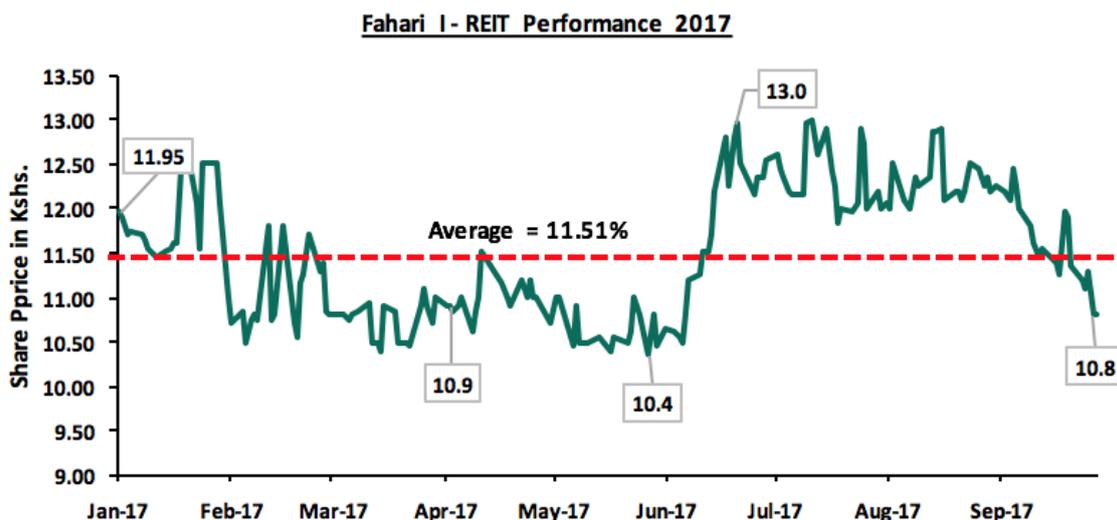
Prices remained relatively stable with capital appreciation in 2017 at average of 19.4%.

Listed Real Estate

In the listed real estate sub sector, in the quarter, Stanlib Fahari I-REIT released their H1'2017 earnings, registering a 220.8% growth in earnings per unit to Kshs 0.43 per unit from Kshs 0.13 per unit in H1'2016 attributed to a significant reduction in fund-management costs and increased rental income. The positive returns may in the long run spur investments in the sector though there remain concerns as approximately 60% of the revenues are going to professional fees, a clear indicator that the whole arrangement is primarily in the interest of the commercial interests around the REIT rather than the investor hence translating to low returns to the investor of 5.9% dividend yield from our analysis, compared to government securities such as T-bills yields which are currently at 8.1%,

10.3%, and 11.0% for the 91, 182, and 364-day papers, respectively, and market average yields for retail space in Nairobi at 9.8% while that of office space is 9.1% on average. In our view, there is need to align its interests with those of the investors, to improve the Fahari I-REIT performance. For more insight on the Stanlib-Fahari I-REIT, see the [earnings note](#).

The Fahari I-REIT's share price declined by 14.3% q/q and 9.6% year to date to close at Kshs 10.80 per unit this week, which is a 48.0% decline from Kshs 20.75 at the time of the listing in November 2015. The prices for the instrument have remained low averaging at Kshs. 11.5 in 2017 largely due to (i) opacity of the exact returns from the underlying assets, (ii) poor dividend yield of 5.9%, and (iii) the negative sentiment following the poor performance of Fusion D-REIT, which was undersubscribed in 2016.



Source: Bloomberg

To boost the listed real estate sector, the Capital Markets Authority (CMA), in July, backed the exemption of Real Estate Investment Trusts (REITs) from Value Added Tax (VAT), which accrues to both rent and professional services, in addition to exemption from stamp duty and capital gains tax. The regulator hopes that this incentive will spur interest in the product that opens up the property market for retail investors. Currently the Stanlib Fahari i-REIT is the only REIT in the market.

On the other hand, Britam Asset Managers has been licensed by the Capital Markets Authority (CMA) to operate as a (Real Estate Investment Trusts) REITs Manager. This move by Britam is to diversify their investment portfolio traded at Nairobi Securities Exchange (NSE) and offer investors an opportunity to invest in real estate as a viable investment option.

We remain cautiously optimistic on the performance of real estate driven by the (i) high annual returns of above 20%, with 2016 returns at 25.8%, (ii) positive demographics such as high population growth at 2.6% p.a. against a Sub Saharan average of 2.3%, (iv) rapid urbanization at 4.3% p.a., versus a global average of 2.0%, (v) an expanding middle class, and iv) improvement in infrastructure opening up new areas for development. The sector is however likely to record subdued activities given the re- election scheduled for 26th October 2017 and the political unrest in various parts of the country. However, should we hold peaceful elections, we expect the market to recover and transactional volumes to increase in 2018.