Cytonn 2019 Markets Outlook

Private Equity Outlook

Summary of 2018 Private Equity Activity

The year 2018 saw a slight slowdown in private equity (PE) activity across Sub-Saharan Africa, with the total value of reported African private equity deals in H1'2018 being USD 0.9 bn, a 10.0% drop from USD 1.0 bn reported in H1'2017. In regards to fund raising, the total value of African PE fundraising in H1'2018 was USD 2.1 bn. This is an improvement compared to the total value fundraising in H1'2017, which was reported at USD 2.0 bn. The slowdown was attributed to macroeconomic headwinds that hit two of Africa's most developed PE markets, South Africa and Nigeria, coupled with a slump in oil prices, which negatively affected private investments. The table below highlights fundraising activity by sector in Africa;

2018 Private Equity Fundraising Activity by Sector

Sector	Funding Raised (Kshs bns)	Entities Funded
Fintech	27.0	10
Financial Services	2.8	3
Education	4.9	2
Real Estate	None Disclosed	
Hospitality	None Disclosed	
Total	34.7	15

2019 Outlook

Despite the slowdown in 2018, we view the long-term growth trajectory for private equity as *POSITIVE*, supported by the following key factors;

i. Economic Growth: According to the World Bank, GDP growth in Sub-Saharan Africa rebounded to 2.4% in 2017, after slowing sharply to 1.3% in 2016. Growth in the region is projected to continue to rise to 2.7% in 2018 and an average of 3.4% in 2019-20, on the back of firming commodity prices and gradually strengthening domestic demand. According to IMF analysis, private investment increases when GDP growth is high; a 1%-point increase in GDP growth rates leads to a 0.21% points increase in the private investment rate. We expect this positive correlation to hold, and as a result private equity activity is set to improve,

ii. Political Stability: According to IMF data, reforms that strengthen the judiciary and regulatory environment are crucial for promoting private investment during periods of strong economic growth. Democratic elections have passed in multiple African countries, including Angola, which saw its first transfer of power to the opposition party since peacetime in 2002. This should provide investors in those countries with much greater confidence than in previous years, and,

iii. Economic Recovery in West Africa: Improvements in commodity prices combined with the regions expected economic recovery will drive further investment in West Africa. Private equity investors and other state players, such as China, will also benefit from a potential uptick in public sector spending on important infrastructure works, and we may see greater appetite for Private Public Partnerships (PPPs) and general private capital in government-led projects.

We expect private equity activity to be largely focused in the following sectors we cover;

Key Private Equity Sectors

Sector	Driving Factors	Outlook
Fintech	· Africa's low penetration rates for traditional banking services at 25 % according to the Global Findex database · Higher mobile penetration at 44% according to the GSMA 2017 Report · Fintech lending, in particular continues to draw most interest from investors. The untapped potential in credit and credit related industries in Africa is highlighted by the significant difference in credit extension activity in Africa compared to other world regions. Fintech lending addresses this by providing access to credit via convenient and already established channels	Positive
Financial Services	· The increasing demand for credit, · The growing financial services inclusion in the region through alternative banking channels, · Increased innovation and new product development within the financial services sector, and · Need for consolidation in the sector, which has already picked up pace	Positive
Education	· Demand for quality education and a more comprehensive curriculum, · The entry of international brands over the past years such as the Nova Academies, GEMS Cambridge, JSE listed ADvTech Limited and Bridge Schools Despite this, the market still seems opportunistic, and the regulation landscape is still very uncertain in Kenya.	Neural

The table below summarizes the various factors that affect private equity activity in the country. With three indicators being *POSITIVE*, and two at *NEUTRAL*, the general outlook for the private equity environment in 2019 is *POSITIVE*.

Private Equity Indicators

Factor	2019 Outlook	Effect
Economic Growth	5.8% growth projected in 2019, lower than the expected growth rate of 6.0% in 2018, but higher than the 5-year historical average of 5.4%	Positive
Foreign Direct Investments	FDI into the country steadily decreased at a CAGR of 27.3% from 2012 USD 1.4 bn to USD 0.4 bn in 2016. Kenya however saw FDI increase by 71.0% in 2017, to USD 0.7 bn. This is a reflection of the degree of foreign interest in the Kenyan business environment. We expect this growth to continue albeit at a slower pace given concerns of slowing global growth.	Neutral

During the Week

In the financial services sector, private Equity firms AfricInvest, which is based in Tunisia, and Catalyst Principal Partners, based in Kenya, acquired 24.2% stake in Prime Bank Kenya. The acquisition was valued at Kshs 5.1 bn, with the capital injection targeted to carry out strategic plans including expanding locally and into the region. The investment has been carried out through a special purpose vehicle, AfricInvest Azure, formed jointly by AfricInvest and Catalyst, on terms which have not been disclosed. As at Prime Bank's last reporting in Q3'2018, the bank had a book value of Kshs 21.2 bn. As such, the transaction is being carried out at a price-to-book value (P/Bv) of 1.0x, which is a 23.6% discount to the market's current trading valuation of 1.3x P/Bv for listed Kenyan banks. For more details on the transaction, please see our Prime Bank Acquisition Note. The transaction marks the first bank acquisition in 2019.

In yet another announcement, Tier I Bank, Commercial Bank of Africa (CBA), has issued a Kshs 1.4 bn cash offer to Jamii Bora Bank shareholders, to acquire a 100.0% stake. If successful, and without further capital injection, the acquisition would be done at a 0.4x P/Bv multiple, lower than the recent local bank acquisitions average of 1.6x P/Bv. This was analyzed in detail in our CBA Acquisition Note. These transactions are in line with our expectation of consolidation in the Kenya banking sector following the enactment of the Banking (Amendment) Act, 2015 and the fact that Kenya is overbanked, as highlighted in our Q3'2018 Banking Sector Report.

In the education sector, Dubai based GEMS Education, an international education company owned by a consortium of institutional investors, including Varkey Group and American private equity firm Blackstone Group, is set to acquire 100% stake of Hillcrest International Schools from its current owners, Fanisi Capital and businessman Anthony Wahome, for Kshs 2.6 bn. The transaction details are as below;

i. Fanisi owns 55.0% stake in the school, while Mr. Wahome owns 45.0%,
ii. The amounts paid in consideration for the combined stake is Kshs 2.6 bn,
iii. Fanisi Capital and Mr Wahome acquired 100% of Hillcrest from Barclays Bank of Kenya, the family of Kenneth Matiba and other creditors in 2011, for a total of Kshs 1.8 bn. The exiting parties stand to realize a profit of Kshs 0.8 bn on the seven-year investment at an IRR of 5.4%.

Hillcrest International Schools is a group of schools that offers the British curriculum, International General Certificate of Secondary Education (IGCSE) and caters for children aged 18-months to young adults aged 18-years. GEMS offers global advisory and educational management and is the largest operator of kindergarten-to-grade-12 schools in the world. The buyout of Hillcrest will help the Dubai chain of schools to expand in the Kenyan market, adding to its Nairobi-based GEMS Cambridge International School. The investment is evidence of increasing investor interest in Kenya's education sector. Other investors who have invested in the education sector include:

1. Advtech Group, a private education provider, listed in the Johannesburg stock exchange, which opened a school under its Crawford Schools brand in Tatu City on 4th September 2018, offering pre-primary education focusing on the THRASS (Teaching, Handwriting, Reading and Spelling Skills) curriculum,
2. Nova Pioneer, a South African educator, has set up a primary school and a high school in Tatu city offering the 8-4-4 curriculum,
3. Centum Limited, an investment firm, in partnership with Sabis Education Network, has set up the Sabis International School in Runda,
4. Cytonn Investments, through its education affiliate Cytonn Education Services, will provide education at all levels. From Early Childhood Development Education (ECDE) to tertiary education, beginning with a technical college-branded Cytonn College of Innovation and Entrepreneurship,
5. Advtech Group, Schole (Mauritius) Limited, a London based education provider, and Caerus

Capital, a leading international education consultancy group jointly acquired Makini Schools at an estimated value of ZAR 184.2 mn (Kshs 1.7 bn).

The investments are an indication of investors' interest in the education sector in Sub-Saharan Africa, which is motivated by:

i. Increasing demand for quality and affordable education, according to The Business of Education in Africa report by Caerus Capital, the Gross Enrollment Ratio (GER) has doubled over the last ten years, from 4.5% in 2006 to 8.5% in 2016,
ii. Support such as ease of approvals, offered to investors in the education sector by governments looking to meet Sustainable Development Goals (SDGs) targets of universal access to education.

Despite the recent slowdown in growth, we maintain a POSITIVE outlook on private equity investments in Africa as evidenced by the increasing investor interest, which is attributed to; (i) Economic growth, which is projected to improve in Africa's most developed PE markets, (ii) the attractive valuations in Sub Saharan Africa's private markets compared to its public markets, and, (iii) the attractive valuations in Sub Saharan Africa's markets compared to global markets. Going forward, the increasing investor interest, stable macro-economic and political environment will continue to boost deal flow into African markets.
