Cytonn Q1'2019 Markets Review

Private Equity

Financial Services Sector:

Deals in the Financial Services sector during the quarter include;

i. Sidian Bank, a Kenyan Tier 3 bank, received a USD 12.0 mn (Kshs 1.2 bn) Tier II capital injection from the Investment Fund for Developing Countries (IFU), a Danish Development Finance Institution (DFI). The funds are expected to boost the bank's regulatory capital ratios as it works towards achieving its strategic objective of becoming a Tier 2 bank by 2022, as the bank's total capital to total risk-weighted assets ratio was 14.0% as at Q3'2018 and 14.4% as at FY'2018, which is below the minimum statutory requirement of 14.5% for banks. With Sidian Bank having an equity position of Kshs 3.6 bn as at Q3'2018, the transaction was done at a price-to-book value (P/Bv) multiple of 1.6x, which is a 6.7% premium to the current listed banks trading multiple of 1.5x. For more information, see our Cytonn Weekly #10/2019, and,
ii. Private Equity firms AfricInvest, which is based in Tunisia, and Catalyst Principal Partners, based in Kenya, acquired a minority stake in Prime Bank Kenya. The stake acquired is 24.2% of Prime Bank Kenya, through a capital injection of Kshs 5.1 bn, with the capital targeted to carry out strategic plans including expanding locally and into the region. As at Prime Bank's last reporting in Q3'2018, the bank had a book value of Kshs 21.2 bn, and as such, the transaction was carried out at a price-to-book value (P/Bv) of 1.0x, which is a 33.3% discount to the market's current trading valuation of 1.5x P/Bv for listed Kenyan banks. This was the first bank acquisition in 2019, and 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. For more information, see our Prime Bank Kenya Acquisition Note.

We expect that investors will continue to show interest in the financial services sector, motivated by attractive valuations especially in the banking sub-sector, growth of financial inclusion and regulation that requires institutions to increase their capital requirements across the sector consequently providing an opportunity for mergers and acquisitions.

FinTech Sector:

Deals in the FinTech sector during the quarter include;

i. Kenya's second and third largest telecommunication companies, Airtel and Telkom, announced the signing of a binding agreement that will see the shareholders of the two companies merge their respective mobile, enterprise, and carrier services businesses in Kenya to operate under a joint venture company. We expect this merger to have the following effects on the Kenyan telecommunication space: (i) Subscriptions / Voice Market Share is expected to be split between two major players with the merged entity set to increase its share, (ii) The combined entity will command a market share of 29.6%, (iii) Airtel will make an entry into the fixed data services market, and (iv) Mobile Money is least likely to be affected given that neither of the two merging entities have a significant share in the market. The overall effect to the market is that we will now have a company that has scale to provide a credible market alternative to the currently dominant Safaricom. For more information, see our Cytonn Weekly #06/2019,

ii. Branch International, a mobile-based microfinance institution headquartered in California with operations in Kenya, Tanzania and Nigeria, raised Kshs 500.0 mn (USD 4.9 mn) in capital investment based on its third issued commercial paper in the Kenyan market. The Silicon Valley start-up, founded in 2015, processes loans ranging from Kshs 250 to Kshs 70,000 daily and applies machine learning to create an algorithmic approach to determine credit worthiness via customers' smartphones. The commercial paper was arranged by Barium Capital, a capital–raising advisory firm owned by Centum Investments. For more information, see our Cytonn Weekly #03/2019,
iii. OneFi, a Nigeria-based FinTech firm that provides mobile loans to clients, announced plans to buy out Amplified Payment System Limited (Amplify), a mobile payment solutions firm that provides platforms to connect banks based in Nigeria for an undisclosed amount. According to the announcement, OneFi will acquire Amplify’s intellectual property, staff and clientele, comprising of more than 1,000 merchants who transact on the platform. For more information, see our Cytonn Weekly #12/2019,
iv. Dutch impact investor Goodwell Investments made a USD 2.0 mn (Kshs 203.0 mn) investment in Nairobi-based consumer goods catalogue and delivery service Copia for an undisclosed stake. Copia, a Silicon Valley start-up launched in Kenya in 2013, uses technology and a network of more than 3,000 local agents to deliver goods and services to about 40,000 “underserved consumers” in rural Kenya. Copia enables households to access goods that would otherwise be difficult to obtain without travelling to a major city. For more information, see our Cytonn Weekly #04/2019.

The growing interest in FinTech sector, driven by Africa’s low penetration rates for traditional banking services at 25% according to the Global Findex database and high mobile penetration at 44% according to the Global System for Mobile Communications (GSMA) 2017 Report. We expect that investors will continue to show interest in the FinTech sector in Sub-Saharan Africa as more businesses seek to enhance efficiency and reduce costs by incorporating technology in their operations. Furthermore, the significant difference in credit extension activity in Africa compared to other regions gives FinTech lending firms a perfect opportunity to provide credit via convenient and already established channels.

Education Sector:

Deals in the Education sector during the quarter include;

i. GEMS Education announced its plan to acquire 100.0% stake of Hillcrest International Schools from its current owners, Fanisi Capital and businessman Anthony Wahome, for Kshs 2.6 bn. Currently, Fanisi owns 55.0% stake in the school, while Mr. Wahome owns 45.0% following an acquisition from Barclays Bank of Kenya, the family of Kenneth Matiba and other creditors in 2011, for a total of Kshs 1.8 bn. For more information, see our Cytonn Monthly – January 2019.
ii. The African Management Initiative (AMI), a Pan-African company focused on skills development and workplace learning announced the close of a USD 1.8 mn (Kshs 180.2 mn) Series A funding round aimed at promoting in-person as well as on-the-job training for staff in African countries. Investisseurs & Partenaires (I&P), a French impact investing group dedicated to Sub-Saharan Africa, invested USD 1.0 mn in the funding round. The firm aims to use the funds to enhance its innovative mobile-based learning platform and widen its market coverage in Africa. For more information, see our Cytonn Weekly #08/2019.

We expect that investors will continue to show interest in the Education sector in Sub-Saharan Africa mainly as a result of the (i) increasing demand for quality and affordable education, with the Gross Enrolment Ratio (GER) having doubled over 10-years to 8.5% in 2016, from 4.5% in 2006, according to a report, “The Business of Education in Africa” by Caerus Capital, and (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 tertiary education.

Hospitality Sector:

i. Inside Capital Partners, a Mauritian independent private equity manager announced a commitment to invest USD 7.5 mn (Kshs 756.1 mn) in Latitude Hotels Group, an African lifestyle hospitality Group based in Zambia, for an undisclosed stake. Latitude Group currently runs 3 hotels in Zambia, Malawi and Uganda. The hospitality group will use the funds to develop three additional hotels in Kenya, Ethiopia and Mauritius by 2021. The fund manager, who is currently proceeding with a second round of fundraising targeted to raise USD 60.0 mn (Kshs 6.0 bn), is expected to make further investments in the hospitality sector targeting entities with an underlying strong net asset value, above market occupancy levels and a strong development pipeline. For more information, see our Cytonn Weekly #08/2019.

We expect that investors will continue to show interest in the Hospitality sector in Sub-Saharan Africa mainly as a result of the (i) economic growth, which is projected to improve in Africa's most developed PE markets, (ii) attractive valuations in Sub-Saharan Africa's private markets compared to its public markets, and (iii) attractive valuations in Sub-Saharan Africa's markets compared to global markets.

Reports:

I. African Private Equity and Venture Capital Association (AVCA) released four reports during Q1'2019. The reports are;

i. The *2018 Annual African Private Equity (PE) Data Tracker*, which indicated that the total value of African PE fundraising increased by 12.5% to USD 2.7 bn (Kshs 272.2 bn) in 2018 from USD 2.4 bn (Kshs 241.9 bn) in 2017. This was an indication of a positive shift in investors' confidence in Africa's PE industry following declines in 2016 and 2017, after a peak in 2015, which saw a handful of large funds achieving final closes during the year. For more information, see our Cytonn Weekly #11/2019,
ii. The *2018 Annual Limited Partner (LP) Survey*, which was a study that analyses the plans, views, preferences, expectations and evolving attitudes of 60 Limited Partners (LPs) from Africa, Asia, Europe and North America regarding Private Equity (PE) in Africa. According to the report, LPs' appetite for African PE has remained steady, with 53.0% of LPs planning to increase their PE allocation on the continent over the next three-years and Nigeria being viewed by majority of LPs as the most attractive country for PE investment in Africa over the next three-years with a popularity index ranking of 58.0%, followed by Kenya (40.0%) and Egypt (31.0%). For more information, see our Cytonn Weekly #06/2019,
iii. The *2019 Profile of Africa's Institutional Investors,* which mapped the different pools of capital for African private equity and also provided an overview of the demographics of institutional investors with allocations to Africa. According to the report, majority of the institutions are European based with 36.0% having their head offices in Europe while North American based institutions came second at 32.0% of the total. For more information, see our Cytonn Weekly #06/2019,
iv. *The Private Credit Strategies in Africa Report* that provided an overview of some of the key opportunities and challenges facing the private credit industry in Africa. According to the report, a major driver of the increasing interest in private credit in Africa relates to the difficulties that small and medium-sized enterprises (SMEs) in Africa often face in accessing financing through traditional avenues, such as banks. For more information, see our Cytonn Monthly – February 2019.

II. The Competition Authority of Kenya (CAK) released their 2018 Annual Report, which highlighted the number of mergers that the Authority handled. The Authority handled 150 merger notifications in 2018, a 15.4% increase from 130 merger notifications handled in 2017. The merger notifications were mainly from the following sectors; manufacturing, real estate, distribution, investment, services, advertising and agriculture, which accounted for 51.2% of all the mergers that were notified to the Authority while other sectors accounted for the balance of 48.8%. Merger transactions involving international companies, mainly private equity funds, were 83 in 2018, accounting for 55.3% of the 150 merger notifications, while those involving local companies were 67 in 2018, accounting for 44.7% of the 150 merger notifications. For more information, see our Cytonn Weekly #07/2019.

Private equity investments in Africa remains robust as evidenced by the increasing investor interest, which is attributed to; (i) rapid urbanization, a resilient and adapting middle class and increased consumerism, (ii) the attractive valuations in Sub Saharan Africa's private markets compared to its 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 African markets.
