Cytonn INVESTMENTS

Kenya Mortgage Refinancing Company Update & Cytonn Weekly #17/2019

Private Equity

The International Finance Corporation (IFC), a member of the World Bank Group that offers investment, advisory and asset management services to private firms in less developed countries, announced the consideration of a USD 9.0 mn (Kshs. 0.9 bn) debt investment in a greenfield hotel project located in the Kasisi area, a rural outskirt of Lusaka, Zambia. The project, which is sponsored by Union Gold Zambia, the largest hospitality provider in Zambia, is a 249-room greenfield resort hotel with a multipurpose venue that will have a capacity of up to 2,500 persons. The upscale resort hotel will cost USD 29.6 mn (Kshs. 3.0 bn) and is expected to be completed by early 2021. The development that will be located within Bonanza Estate, a residence with an 18-hole golf course will be operated by Protea Hotel by Mariott, a hospitality firm owned by Union Gold Zambia, and that has 7-accommodation establishment across Africa. Apart from provision of financing, IFC is also expected to play a critical role in setting up of the development's governance structure as well as provide industry expertise and advice. The investment by IFC is expected to promote the development of Zambia's tourism sector through creation of employment and growth opportunities and the introduction of the concept of combining a hotel and multipurpose venues which is expected to foster competition and consequently better services offering within the market. The last decade has seen many global operators opening quality hotels in key markets in Sub-Saharan Africa like South Africa, Mauritius and Kenya with the supply of new hotels attributed to high occupancy rates. We expect the hospitality sector in Sub-Saharan Africa to continue performing well driven by;

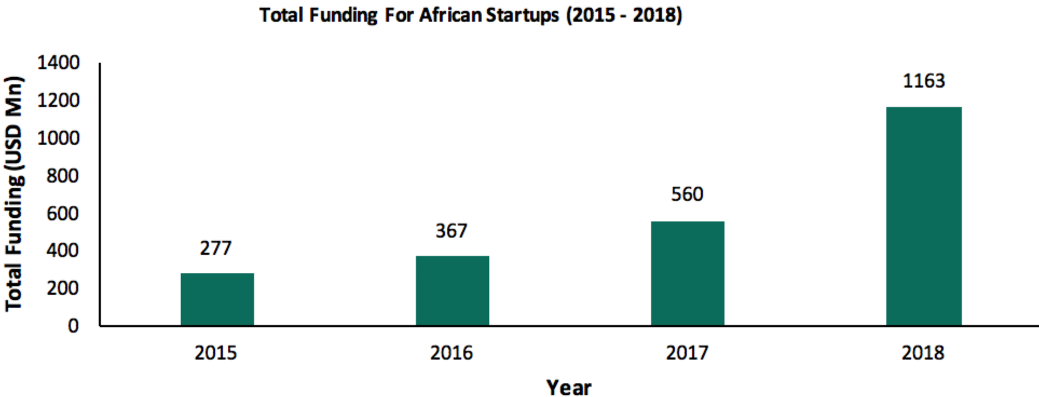
?. A growing population and expected strong economic growth where GDP is expected to grow by 2.7% in 2018, and 3.4% in 2019, from 2.6% in 2017,
i. Growth in both international and domestic travelers to the market,
ii. An expected improvement in hotel standards as there is a shortage of quality hotels in Africa and as the middle class grows, there is higher demand for quality hotels, and,
iii. Increase in intra-African travel as the continent experiences better connectivity, access to low-cost airlines, and more countries embracing visa-free travel within Sub-Saharan Africa.

In Kenya, we expect further growth in the hospitality sector as a result of (i) restoration of political calm following the reconciliation of the Country's two top political leaders last year, (ii) improved hotel standards as hotels rebrand while some embark on refurbishment and expansion, and (iii) improved flight operations and systems such as direct flights from the USA to Kenya, which commenced in October, 2018.

Nimai Capital, a Dubai-based financial institution that supports financial inclusion in South Asia and Africa, announced the launch of a USD 150.0 mn (Kshs 15.2 bn) Nimai Emerging Financial Services Fund (NESF) in partnership with Victoria Commercial Bank (VCB), a mid-sized Kenyan financial institution that serves premier corporate clientele. The fund aims to invest in financial services in African and South Asian countries such as Ghana, Tanzania, Kenya, Bangladesh, Sri Lanka, Nepal and India, and will be regulated by the Cayman Islands Monetary Authority. The partnership will

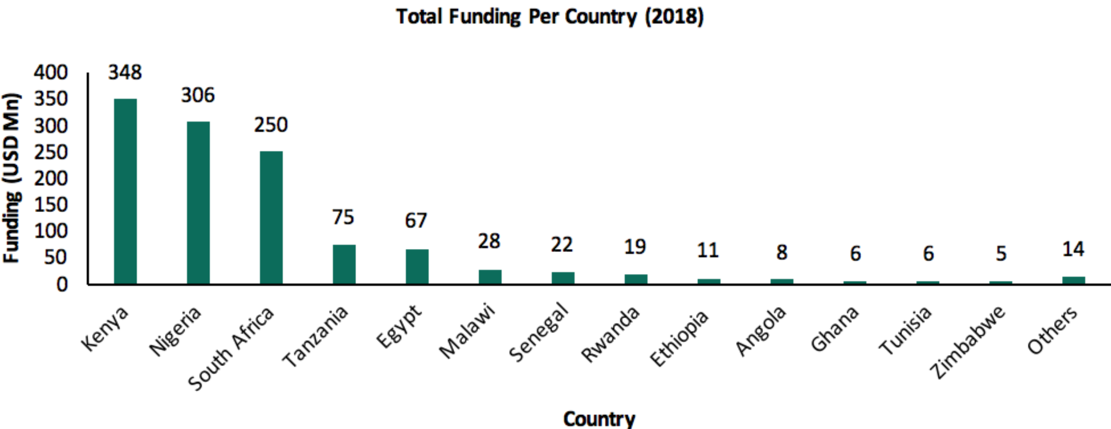
leverage on VCB's business experience and deep knowledge of the Kenyan financial services market, and Nimai's deep operational capability in both African and Asian markets, as well as their resources. According to the announcement, the fund managers plan to deploy up to USD 45.0 mn (Kshs 4.6 bn) in the Ghanaian financial services sector as the first investment. Apart from bolstering the working capital of investee companies, the fund will also focus on creating access to diaspora financial services, advisory, fintech integration and linkage to international markets. VCB has over the years established itself as an important financier of small and medium enterprises and we expect the institution to leverage on the new partnership to increase lending to this segment, as well as improve its Non-Funded Income (NFI) that grew by 19.4% to Kshs 428.4 mn in 2018 from Kshs 358.7 mn the previous year.

Partech Ventures, a global investment platform for tech and digital firms released a report on capital raising activity for African Tech Start-ups in 2018. According to the report, funding raised by a total of 146 African tech-startups grew by 108.0% to USD 1.2 bn in 2018 from USD 560.0 mn in 2017 driven by an increased number of series A & B startups attracting funding and increased appetite of global private equity investors to invest in African tech start-ups.



Source: Partech Ventures Report, 2018

The report also highlighted that Kenya, Nigeria and South Africa are still the most attractive destinations for PE investors with the 3 countries absorbing 78.0% of the total funding in 2018. Kenya was the leading country in fundraising activity for tech startups beating traditional rivals, South Africa and Nigeria, to attract USD 348.0 mn in 44 funding deals. Nigeria attracted USD 306 mn in 26 funding transactions while South Africa attracted USD 250.0 mn in funding over 37 deals.



Source: Partech Ventures Report, 2018

In terms of the sector break down, financial services remained the most attractive segment in the region for private equity investors, attracting 50.0% of the total funding. Fintech firms raised USD 379.0 mn (Kshs 38.5 bn) during the year, representing 33.0% of the total funding while off-grid tech and Insurtech firms attracted USD 194.0 mn (Kshs 19.7 bn) and USD 8.9 mn (Kshs 904.2 mn) during the year. Fundraising in business-to-business (B2B) and tech adoption also received significant

funding with the segment receiving USD 353.0 mn (Kshs 35.9 bn) across 55 deals that accounted to 30.4% of the total fundraising activity. The increased deal activity in 2018 highlights growing investor confidence in African tech start-ups with Kenya gaining ground on Nigeria and South Africa, the two most developed African PE markets, a trend we expect to continue in 2019 driven by;

?. High Returns - According to data collected by Crunchbase, since 2007, Fintech start-ups have raised an average of USD 41.0 mn (Kshs 4.2 bn) in Venture Capital and exited for an average value of USD 242.9 mn (Kshs 24.7 bn). This gives investors a better opportunity to invest in a sector that attracts a growing pool of new investors and in the end exit at a high price,
i. Attractive Realization Periods - Private equity firms typically focus on investing for a short lead-time, often between three to five years. Many Fintech companies start showing profits by year three hence giving a chance for investors to realize their gains in time, and,
ii. Cheaper Running Costs - They are cheaper to run since a FinTech company is not weighed down by the same burden of costly regulation that governs traditional businesses. This makes PE firms to manage their FinTech portfolio with easy flexibility.

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) 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. Going forward, the increasing investor interest, stable macro-economic and political environment will continue to boost deal flow into African markets.