

Cytonn Annual Markets Review - 2016

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Executive Summary

- **Global Markets Review:** Global economic growth is expected to remain moderate in 2016 as Central Banks' accommodative policies support growth. China's economy remains stable, contributing 1.2% of the expected 3.1% global GDP growth, indicating increased dependence on emerging markets to shore up global growth;
- **Regional Markets Review:** Sub-Saharan Africa region continued to register slow growth with IMF forecasting the region's economic growth to drop to its lowest level in over 2 decades to 1.4% in 2016 from 3.5% in 2015;
- **Kenya Macro Economic Review:** The Kenyan economy is expected to grow at between 5.7% - 6.0%, on account of a stable macro-economic environment, despite decreasing private sector credit growth;
- **Fixed Income:** Yields on government securities were relatively stable during the year given improved liquidity position in the money market and the government being ahead of its domestic borrowing programme;
- **Equities:** The market performed poorly during the year with NASI, NSE 20 and NSE 25 losing 8.5%, 21.1% and 15.8%, respectively. 2016 saw the enactment of the Banking Act (Amendment) 2015 that placed regulations on banks' loan and deposit pricing framework;
- **Private Equity:** Sub-Saharan Africa remained very attractive for global capital in 2016, as witnessed by increased flow of private equity funds into the region;
- **Real Estate:** During the year, real estate continued with its good performance recording high returns across all themes with rental yields of averagely 10.0% in retail, 9.4% in commercial office, 6.0% in residential and 5.8% in industrial. The sector had total average returns 25.8% (yield 7.8% + capital appreciation 18.0%).

Company Updates

- Including this final report, the annual markets review, we produced 52 reports in 2016. The Cytonn Report continues to be a fair, rigorous, objective and analytical report solely focused on informing the investor. We look forward to another successful year of analyzing the markets in 2017, and our first report for 2017 will be on our market outlook for 2017. Don't miss it and Happy New Year!
- 2016 has been a successful year at Cytonn, registering tremendous growth across all business lines. [Read our Managing Partner & Chief Executive Officer's yearly recap sent to staff](#)
- To invest in any of our current or upcoming real estate projects, please visit [Cytonn Real Estate](#). We continue to see very strong interest in our products:

- The Alma, which is now 55.0% sold and has delivered an annualized return of 55.0% p.a. for investors who bought off-plan. [See The Alma](#). We will be having site visits to showcase this iconic development every two weeks, right after the wealth management trainings. If interested in attending the site visit, email clientservices@cytonn.com
- Amara Ridge is currently 100.0% sold. See [Amara Ridge](#)
- We have 12 investment-ready projects, offering attractive development returns and buyer's targeted returns of around 25.0% p.a. See further details here: [Summary of investment-ready projects](#)
- We continue to beef up the team with the [ongoing hires](#): [Careers at Cytonn](#)

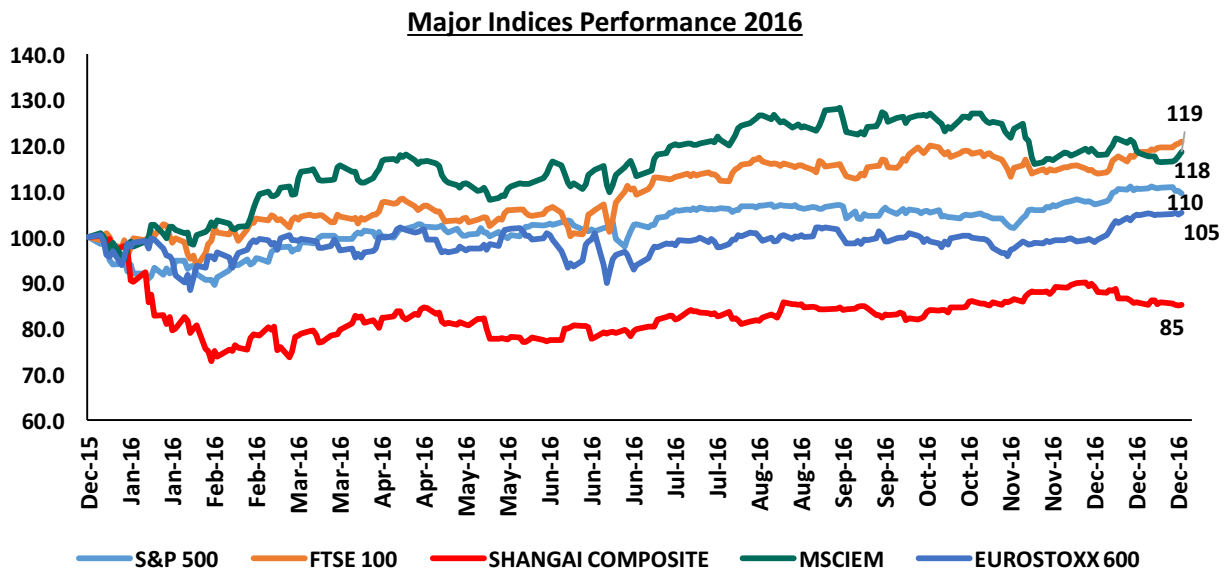
A: Global Markets Review

The year 2016 was characterized by uneven global economic growth, with the US and China economies proving resilient with expected growth of 2.2% and 6.9%, respectively in the year while the United Kingdom and the Eurozone recorded reduced economic growth at 1.6% and 2.1% for the year, respectively. The sluggish start of the year coupled with the Brexit led to increased uncertainty facing the global growth leading to the International Monetary Fund (IMF) reducing the world projected growth in their October issue by 0.1% to 3.1% from an earlier projection of 3.2% at the start of the year. Economic growth was largely supported by accommodative Central Banks policies in the advanced economies. Growth in emerging markets, in particular the South-East Asian regions, is proving resilient owing to recent stability in commodity prices, leading to the region contributing 1.8% to overall 3.1% global GDP growth, a higher contribution than advanced economies contribution of 1.6%.

In terms of trade, the World Trade Organization (WTO) downgraded their outlook for world trade growth in 2016 to 1.7% from 2.8% in April, citing a slowdown in China and falling import levels in the United States. This is the first time in 15 years that international commerce is seen to lag GDP growth of the world economy, having grown 1.5x faster than GDP over the 35-year period from 1981 to 2016, and 2.0x faster since globalization picked up in the 1990s. There is increased anti-globalization campaign aimed at preserving the various local economies but from the past it is clear that open markets are good in helping both developed and developing countries attain maximum productivity leading to high GDP growth and increased job creation and hence economic prosperity.

Global equity markets registered mixed performance, with investor sentiment mixed throughout the year on the back of a slowdown in China and Central Banks' policy divergence as the Fed raised rates and the European Central Bank extended its quantitative easing program. The S&P 500 index performed better than other global indices, rising 9.9%, followed by the MSCI emerging markets index that rose 8.1%. The Shanghai Composite was the worst performer having declined by 12.3%. The strong performance of the US stock was driven by the positive economic growth better than expectations, recording an annualized growth rate of 3.5% for period ending September 2016 while Shanghai composite loss was attributed to negative investor

sentiment due to rising levels of debt towards the end of the year.



United States

The Federal Reserve raised interest rates by 25bps during their December, 2016 meeting to between 0.50% - 0.75%, from 0.25% - 0.50% previously, being the most significant monetary policy announcement during 2016, the second rate hike after ten years. This decision was supported by (i) stable economic growth, (ii) a strengthening labor market, and (iii) rising inflation. Economic growth in the US has been solid, with Q3'2016 annualized GDP coming in at 3.5% driven by an increase in personal consumption, following the 1.4% growth in Q2'2016 and 0.9% growth in Q1'2016. Consumer spending has been the major driver of US growth this year, supported by a strong labor market that saw the unemployment rate fall to 4.6% in November from 5.0% in January, currently within the full-employment rate of 5.0% following an average monthly increase in jobs by 190,000 during the year.

The stock market performance improved on account of (i) an improvement in corporate earnings that rose 4.3% in Q3'2016 from Q3'2015, and (ii) the conclusion of US elections whereby the Republican candidate Donald J. Trump won, and he is expected to implement pro-growth policies during his term. The S&P 500 has gained 11% since the start of the year. In terms of valuations, the Cyclically Adjusted Price/Earnings (CAPE) ratio is currently near historical highs at 27.8x, far above the historical average of 16.7x, indicating an overvaluation of the market.

Eurozone

The Eurozone has performed marginally well in 2016, with the pace of growth maintaining momentum over the course of the year, as economic growth in Q3'2016 came in at 1.6%, similar to growth in the first half of the year. Manufacturing activity in the Eurozone remains strong, measured by the Purchasing Managers Index, which averaged at 53.2 in 2016 compared to 48.0 in 2015, indicating expansion of the manufacturing sector. The region however suffered the

biggest significant geo-political event during the year in the form of Brexit, whereby the United Kingdom (UK) voted to leave the Eurozone, and this is expected to (i) cause a decline in intra-regional trade, (ii) lead to uncertainty over jobs in the UK, and (iii) result in a decline in consumer spending. This is expected to adversely affect the United Kingdom and the Eurozone region as well.

The European Central Bank (ECB) met in December and maintained the base lending rate at 0.0%, and the rates on the marginal lending facility and deposit facility at 0.25% and -0.4%, respectively. In addition, the ECB announced an extension of their monetary policy easing program to December 2017 from March 2017, however, with a reduction in the amount of purchases to EUR 60 bn a month from earlier EUR 80 bn per month, amounting to an additional EUR 480 bn in asset purchases. The monetary easing has had a positive effect on the region's economic growth.

The stock markets in the Eurozone have been on a downward trend, with EuroStoxx 600 declining by 4.9%, while the FTSE 100 lost 5.6%, owing to the anticipated slowdown in economic growth in the United Kingdom following Brexit.

China

The Chinese economy experienced a consistent growth rate of 6.7% during all 3 quarters of 2016, putting the economy on track to attain 6.5% - 7.0% economic growth target for 2016. This was supported by an increase in private consumption and a pickup in the industrial sector that posted the strongest growth in profits at 14.5% in Q3'2016, boosted by a recovery in commodity prices and increased investment in infrastructure. According to IMF China is projected to contribute 1.2% towards the 3.1% global GDP growth in 2016, being the single largest individual contributor to global GDP growth, ahead of India and the US at 0.6% points and 0.5% points, respectively. Economic performance in 2016 was supported by (i) increased government infrastructure spending, (ii) accommodative monetary policy, and (iii) an increase in consumer spending. The continued implementation of structural reforms should help China overcome risks that include weak global demand for exports, falling investment in the manufacturing sector and a slowdown in credit growth.

B: Regional Markets Review

Sub-Saharan Africa (SSA) continued to register slow GDP growth with IMF forecasting economic growth to drop to its lowest level in over 2 decades to 1.4% in 2016 from 3.5% in 2015. This decline is mainly attributed to; (i) declining oil prices which has affected key commodity exporting economies, such as Nigeria, (ii) terrorism and humanitarian crimes, and (iii) critical drought particularly in Lesotho, Malawi and Zambia. These factors as well as global flight to safety following unfavorable macroeconomic environment in this region have contributed to the slowdown in inflows from foreign direct investments into the region. The above factors have also highlighted the need for economic diversity given (i) homogeneous economies such as Nigeria, Angola and South Africa are expected to collectively register negative growth of 1.3% according to the IMF while (ii) heterogeneous economies such as Kenya, Ethiopia and Ivory Coast are expected to be resilient and deliver over 6.0% on average.

Given the dismal growth prospects, Sub-Saharan Africa is expected to record slower growth, which is projected at 1.4%, compared to the world growth, which is expected to come in at 3.1%.

Sub-Saharan African currencies lost against all the major global currencies during the year as a result of (i) strengthening of the dollar globally, (ii) increased outflow from the commodity dependent markets, and (iii) foreign investors shifting their investment portfolios to cheaper and less risky markets. The Nigerian Naira was the worst hit currency during the year shedding 58.1% against the dollar as the country continued to experience recessionary economic environment and reduced investor confidence. This led the Central Bank of Nigeria (CBN) to devalue the Naira during the year to mitigate the effects of the recession and retain investor confidence.

On the political front, the region registered varying stances during the year with Ghana and Zambia ushering new political regimes in peaceful elections, which are expected to support a bounce back of the local markets moving forward. However, challenges remain in countries like Gambia, which is experiencing political instability after disputed presidential elections, and Burundi, which is still in political crisis.

Sub-Saharan African stock markets have significantly underperformed, with negative returns across the board as illustrated below.

<i>Values in USD</i>			
Country	31-Dec-15	30-Dec-16	YTD Change
Zimbabwe	114.9	145.6	26.8%
South Africa	3273.4	3722.6	13.7%
Tanzania	1.1	1.0	(8.0%)
Kenya	1.4	1.3	(8.5%)
BVRM	0.5	0.5	(9.6%)
Malawi	21.8	18.4	(15.8%)
Zambia	521.3	421.2	(19.2%)
Uganda	0.5	0.4	(21.9%)
Ghana	523.6	387.5	(26.0%)
Nigeria	143.7	85.0	(40.8%)

The region has undergone increased infrastructural spending, and consequently development, during the year in a move targeted to spur economic growth. According to the African Infrastructural Development Index (AIDI) 2016 by African Development Bank (AfDB), Mali, Kenya and Mauritius experienced the highest level of infrastructural development supported by ICT growth while Burundi, Djibouti and Lesotho had the least levels of infrastructural development. The heightened infrastructural development comes in place despite the erosion in the regional currencies as most of the spending is dollar denominated but the region is bound to have significant benefits from the developmental spending currently underway.

C: Kenya Macro Economic Review

According to IMF, the Kenyan economy was projected to grow by 6.0% in 2016, up from 5.6% in 2015, underpinned by (i) low oil prices, given Kenya is a net importer of oil, (ii) stable agricultural performance as result of stable weather conditions, (iii) supportive monetary policy, (iv) ongoing infrastructure projects being undertaken by the government, and (v) recovery of tourism sector. So far, the economy has done well having grown by 5.9% in Q1, 6.2% In Q2 and 5.7% in Q3: we still expect the overall 2016 growth to come between 5.7% and 6.0% a bit stronger than the 2015 growth of 5.6%. In the third quarter, GDP growth came in at 5.7%, down from 6.2% in the second quarter, attributed to slow growth in Agriculture (3.9%), Manufacturing (1.9%), Construction (9.3%), Electricity and Water (7.0%) and Financial Services (6.1%). We expect GDP growth to remain stable going forward on account of:

- i. Stable macroeconomic environment despite both local and global challenges,
- ii. Consistent agricultural performance and
- iii. The recovery of the tourism sector, which grew 13.8% y/y during the third quarter of 2016, with tourist arrivals into the country increasing significantly by 25.8% y/y over the same period

However, some of the key challenges facing the economy include:

- i. Relatively lower earnings expected from the banking sector following the signing of the Banking Amendment Act 2015, which is expected to suppress earnings especially in the fourth quarter of the year, and may stifle revenue collection by the Kenya Revenue Authority,
- ii. Diminishing Private Sector Credit Growth, further weakened by the signing of the Banking Amendment Act 2015, which slowed for the 15th consecutive month in October to close at 4.6%, the slowest pace since June 2008, a key variable that influenced National Treasury into revising GDP growth forecast for 2016 downwards to 6.0% from 6.5%, previously,
- iii. Increased cases of corruption and mismanagement of public funds which continue to persist,
- iv. The upcoming Kenya general elections, scheduled to be held in August 2017, have also brought about some measure of uncertainty in the market, with investors wary of the post-election violence experienced in the previous election, and concerns if the economy will witness significant withdrawal of funds. The persistent wrangles between the ruling coalition and the opposition, which have recently heightened, coupled with periodic threats for mass protests do not augur well for the stability of and confidence in the Kenyan economy.

The Kenyan budget continues to grow with the 2016/2017 coming in at Kshs 2.3 tn from 2.0 tn in the last financial year. The budget shall be funded by tax collection (Kshs 1.5 tn), domestic borrowing (Kshs 236.1 bn), and foreign borrowing (Kshs 462.3 bn), with the balance of Kshs 101.6 bn being topped up by grants and aid. This budget was based on a GDP growth assumption of 6.5% for the year 2016; the projected growth of around 6.0% might lead to a shortfall in the budget. The treasury further released the 2016 Budget Review and Outlook Paper (BROP), the 4th under the current administration, in a bid to amend the existing budget.

The BROP'16 reviewed crucial elements of the budget leading to some key variances on the FY2016/2017 projections. Key changes highlighted on the paper include;

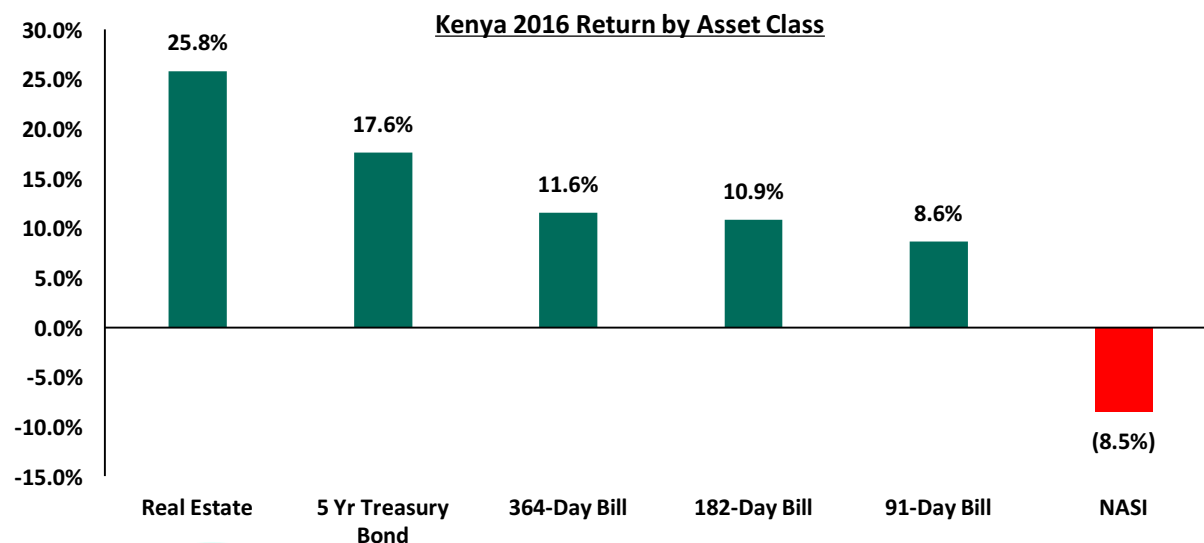
- Total expenditure set to decline by 8.9% attributable to a 26.5% reduction in development expenditure while recurrent expenditure is expected to increase slightly by 1.3%;
- Total revenue set to be revised downwards by 2.9% to Kshs 1.46 tn from Kshs 1.50 tn, accounting for 20.1% of GDP compared to 20.7% previously;
- Foreign borrowing expected to go down significantly by 37.8% to Kshs 287.6 bn from Kshs 462.3 bn; and
- Domestic borrowing set to increase by 24.8% to Kshs 294.6 bn from Kshs 236.1 bn following the signing of the Banking Amendment Act 2015, which has driven down interest rates, and hence created an avenue for government to acquire cheap funds from the local market.

The revision though good due to a decrease in expenditure might negatively impact growth because all the reduction is on development expenditure, with recurrent expenditure slightly increasing. The continued reliance on foreign borrowing remains a concern as it opens the country to increased effects of the global economy, while domestic debt continues to crowd out private sector credit growth; both exposure to global shocks and crowding out of the private sector are bad for the economy.

The Kenya shilling remained resilient, depreciating slightly by 0.1% against the USD, having appreciated by 1.2% against the dollar during the first half of the year. This was mainly influenced by (i) the high levels of foreign exchange reserves averaged USD 7.5 bn, equivalent to 4.9 months (ii) improved diaspora remittances, with cumulative 12 months' inflows to June 2016 increasing by 11.0% to USD 1.7 bn from USD 1.5 bn in the year to June 2015. However, towards the end of the year, the shilling depreciated driven by global dollar strength driven by the Fed raising rates. We have seen the Central bank support the shilling leading to a decline in forex reserves to USD 7.0 bn, from USD 7.8 bn in October, which has led to the decline in the months of import cover below the 1-year average of 4.9 months, to 4.6 months, down from 5.2 months at the start of October.

Inflation rate has remained relatively stable over the year with the annual average at 6.3%. Inflation hit a low of 5.0% in May, following a steady decline since the start of the year from the 7.8% recorded in January, owing to low food and fuel prices in the first quarter of the year. For the last seven months, inflation has been on an upward trend picking at 6.7% in November and closed the year at 6.4% in December. Interesting to note is that the low-income segment of Nairobi had seen the largest impact throughout the first half of 2016 with fuel price rises adversely affecting kerosene users and basic food item price rises worsening the situation. Going forward, we expect upward inflationary pressure to be felt but be contained within the government target annual range of 2.5% - 7.5%. The key risks to high inflation include (i) the possible upward pressure from the food component of the CPI basket (ii) increasing oil prices following the Organization of Petroleum Producing Countries' (OPEC's) decision to reduce crude oil production by 1.2 mn barrels/day, and (iii) the low base effect for 2016

The graph below shows the summary of returns by asset class in 2016 (Real Estate, Bonds, Treasury Bills and Equities market). The best performing asset in 2016 was real estate and the worst performing was equities. Clearly, investors who did not have diversified and balanced portfolios, with exposures to real estate and fixed income registered under-performance in 2016.



Source: Cytonn Investments

The table below summarizes the seven macro-economic indicators that we track, the expectations at the beginning of the year, the actual 2016 experience and the impact of the same on investor sentiment:

Macro-Economic Factor	Expectations Jan 2016	2016 Experience	Effect
Exchange Rate	Shilling to depreciate against major currencies	<ul style="list-style-type: none"> Shilling is flat against the dollar having depreciated by 0.1% since the turn of the year 	Neutral
Interest Rates	Upward pressure on interest rates as a result of increased government borrowing	<ul style="list-style-type: none"> CBR decreased 100 bps to 10.5% and later on in the year 50 bps to 10.0% 91 Day T-Bill hitting a low of 7.1% 	Positive
Inflation	To remain within single digit levels, but above CBK's upper bound of 7.5%	<ul style="list-style-type: none"> Inflation has been maintained within the CBK target of 2.5% to 7.5% during the course of the year During the course of the year, inflation has averaged 6.3% 	Positive
GDP	5.5% - 6.0% growth in 2016	<ul style="list-style-type: none"> 5.9% growth in Q1'2016 6.2% growth in Q2'2016 5.7% growth in Q3'2016 National Treasury revised GDP growth forecast downwards from 6.5% to 6.0% primarily due to slowing private sector credit growth We project 2016 GDP growth to come in at between 5.7% - 6.0% 	Neutral

<p>Corporate Earnings</p>	<p>Stock market was trading at a PE of 12.8x compared to a historical average of 13.8x. We projected corporate earnings growth rate of 10.0%</p>	<ul style="list-style-type: none"> • Several companies released positive H1'2016 results, mainly composed of the banking sector, with weighted average growth in core EPS of 15.8%, above expectation of 12.5% • Banks released positive Q3'2016 results, with weighted average growth in core EPS of 15.1%, above expectation of 12.5%. Two companies issued a profit warning • We expect corporate earnings to come in at 12.5% despite the Banking Act (Amendment) 2015 coming into effect and cutting down on bank's profitability 	<p>Positive</p>
<p>Investor Sentiment</p>	<p>Yields on the 5-year and 10-year Eurobonds stood at 7.7% and 8.9% respectively, with flows out of Kenya following the rate hike having been priced into the market indicating no large foreign investor inflows expected</p>	<ul style="list-style-type: none"> • Investor sentiment has been good as evidenced by the decline in yields for the 5-year and 10-year Eurobonds by 4.6% and 7.8% respectively • The US Fed hiked interest rates leading to investors demanding higher premiums from emerging market investments, to compensate for the relative risk • Britain pulled out of the European Union (EU), in a move that threatened to see investors shift their focus away from frontier markets, given the global uncertainty 	<p>Positive</p>
<p>Security</p>	<p>Expected to improve on account of Government initiatives to eradicate extremism</p>	<ul style="list-style-type: none"> • The security has remained sound leading to all threatening agency affirming Kenya's Sovereign rating • Moody's affirmed Kenya's B1 rating • S&P raised the rating from negative to stable and • Fitch affirms the default rating at B+ 	<p>Neutral</p>

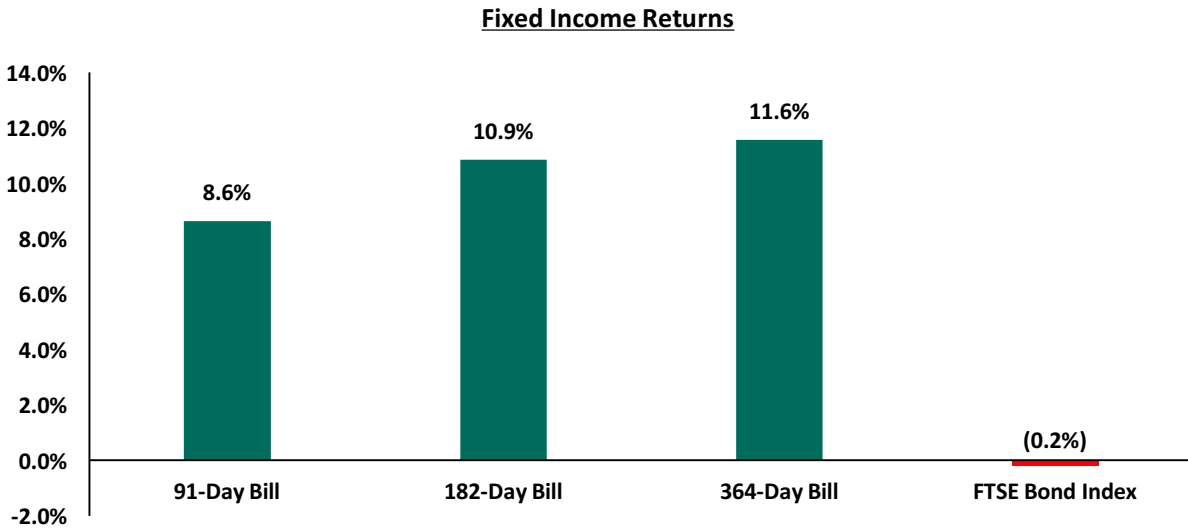
Source: Cytonn Investments

D: Fixed Income Review

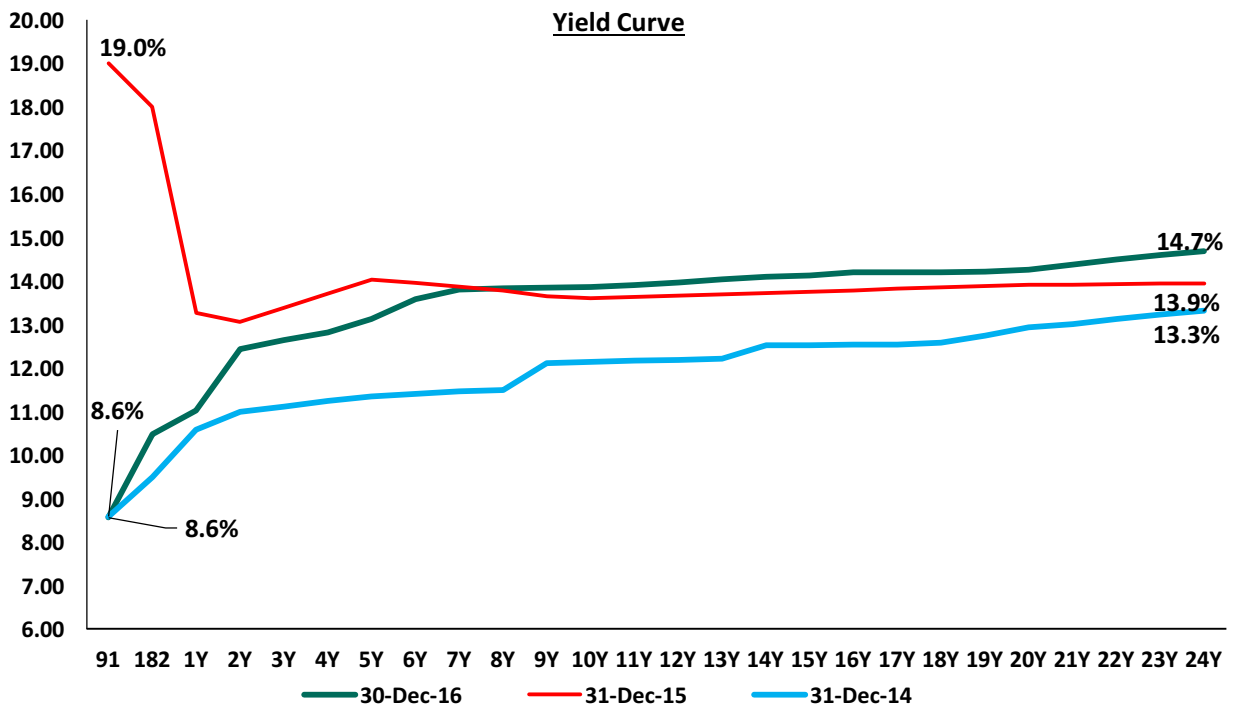
During the first half of the year, yields on T-bills were on a downward trend with the 91, 182 and 364-day papers declining by 330 bps, 130 bps, and 170 bps, respectively, to 7.1%, 9.8% and 11.1% from 10.4%, 11.1% and 12.8% in December 2015, respectively. The decline in yields was as a result of high liquidity in the money markets, especially in the second quarter, highlighted by the interbank rate declining to 2.2% in early June, from 7.5% at the beginning of the year. Yields on government securities have remained low since and appear to have bottomed out, mainly attributed to (i) high preference to risk free government securities especially after the capping of the lending rates also as indicated by the reduced lending to the private sector, and (ii) reduced pressure from the government borrowing program as they are currently ahead of the pro-rated domestic borrowing target of Kshs 119.2 bn, having borrowed Kshs 172.2 bn, which is 144.4% of the pro-rated target. It is important to note that the government is in the process of revising its domestic borrowing target upwards to Kshs 294.6 bn from Kshs. 229.6 bn, which if passed by Parliament, will take the pro-rated borrowing target to Kshs 153.0 bn, meaning that the government will still be ahead of the borrowing target.

Despite the stable interest rate environment, there was increased activity in the secondary bonds market as local institutional investors opted out of the equities market, causing bond turnover at the NSE to rise by 39.4% to Kshs 428.3 bn in 2016 from Kshs 307.2 bn in 2015. Based on the yield curve movement and the FTSE Bond Index, the average bond portfolios have made a capital loss of 0.2% over the year.

The graph below shows the returns of various fixed income securities:

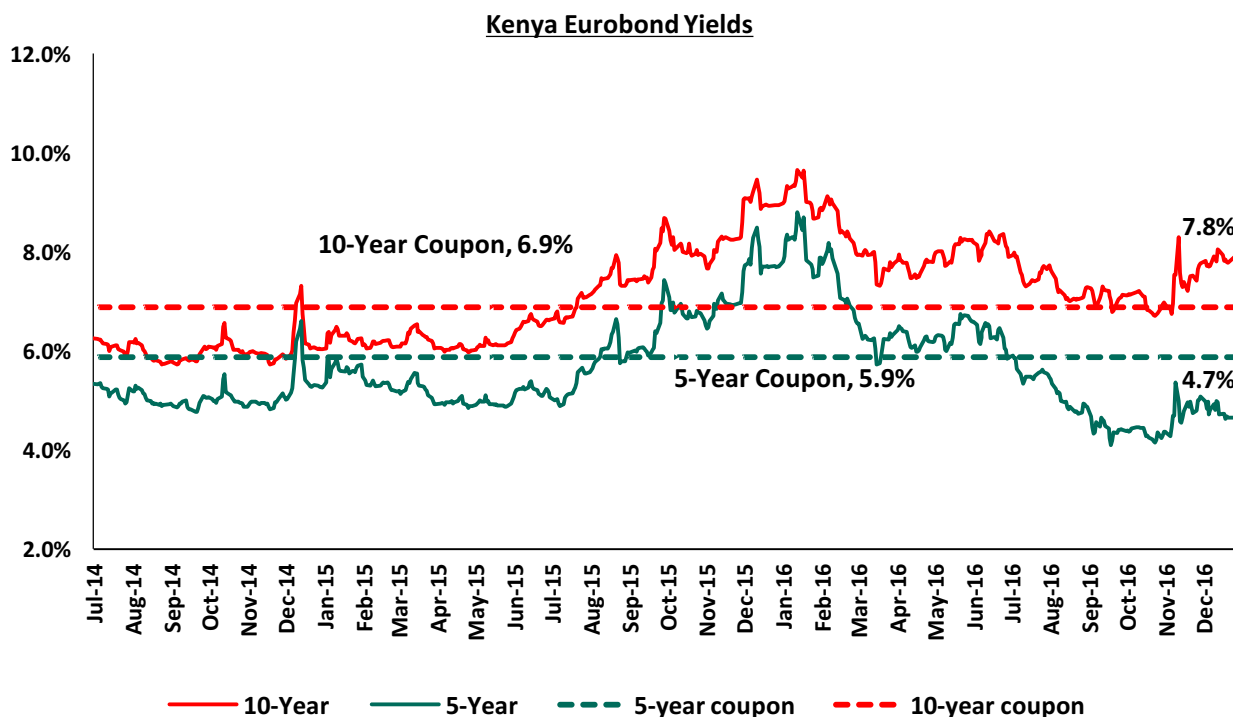


The graph below shows the evolution of the yield curve during the year, from an inverted yield curve to a normal yield curve given reduced pressure on government borrowing.



During the first half of the year, the money markets were characterized by (i) high liquidity, which was skewed towards the larger banks as a result of flight to safety following the closure of Chase Bank, and (ii) Central Bank of Kenya (CBK) actively participating in the money market through reverse repos in a bid to support small banks, by ensuring liquidity distribution in the interbank market. This was evidenced by (a) the decline in average interbank rate from 8.7% in H1'2015 to 4.4% in H1'2016, and (b) the oversubscription in government securities.

Yields on the 5-year and 10-year Eurobonds that were issued in 2014, started the year at 7.7% and 8.9% respectively, hitting their peaks in mid-January, following allegations on the mismanagement of the Eurobond funds, coupled with political instability following the disagreement between the government and opposition over the reconstitution of the electoral body - IEBC, which culminated in the commissioners leaving office. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.1% points and 1.9% points, respectively, for the 5-year and 10-year bond on account of improving macroeconomic conditions and improved investment outlook of Kenya as a good investment destination.



The Kenyan fixed income market remains positive with the Government being ahead of its domestic borrowing for this fiscal year having borrowed Kshs 172.2 bn for the current fiscal year against a target of Kshs 119.2 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 229.6 bn budgeted for the full financial year). It is important to note, however, that the government is in the process of revising its domestic borrowing target upwards to Kshs 294.6 bn, which will take the pro-rated borrowing target to Kshs 153.0 bn, and the government will still be ahead of the borrowing target. Interest rates, which had reversed trends due to the enactment of The Banking Act (Amendment), 2015, appear to have bottomed out in July and we expect them to persist at the current levels, having risen slightly

over the last few months. It is due to this that we think it is prudent for investors to be biased towards short-term fixed income instruments given the prevailing interest rates environment.

E: Equities

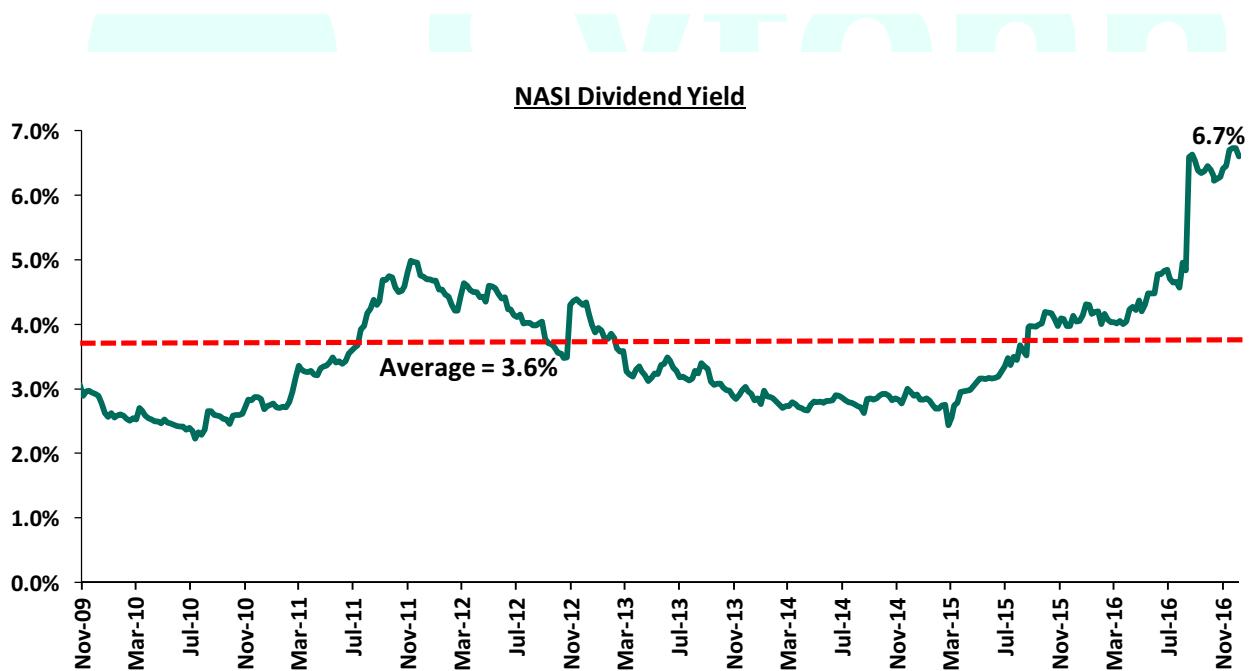
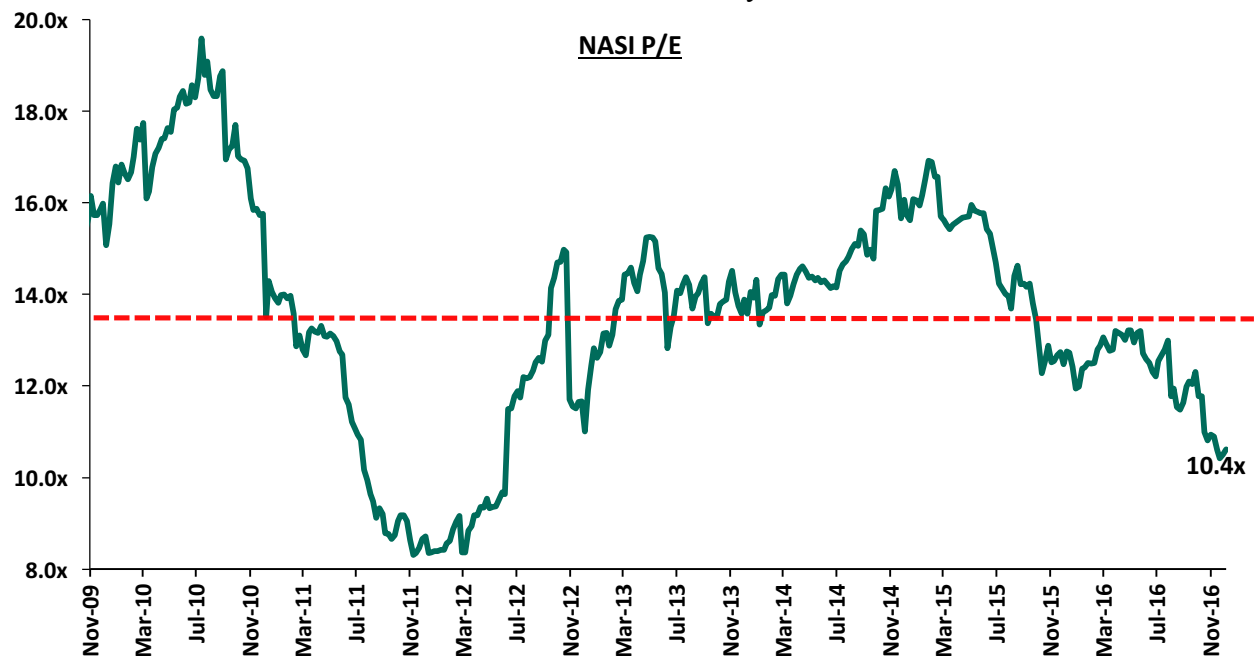
During the year, the Kenya equities market performed poorly with NASI, NSE 20 and NSE 25 losing 8.5%, 21.1% and 15.8%, respectively, as a result of declines in large cap stocks. Since the February 2015 peak, the market has lost 42.1% and 24.9% for NSE 20 and NASI, respectively. The top five losers for the year were Uchumi, Kapchorua Tea, National Bank, Sanlam and Home Afrika declining 63.9%, 60.0%, 54.3%, 54.2%, and 53.8%, respectively. National Bank's decline was as a result of consistent poor performance by the bank and the dismissal of top management owing to mismanagement at the bank, while Sanlam declined as a result of the poor earnings released by the insurer. Key to note, Sanlam has issued a profit warning for FY'2016 results, being the 3rd consecutive profit warning from the company in the last 3 years.

The top five gainers for the year were KenolKobil, Kenya Airways, Safaricom, BAT and Kenya Power and Lighting Company, advancing 55.2%, 19.4%, 17.5%, 15.8% and 9.1%, respectively. KenolKobil rose on the back of the company recording an impressive 84.6% gain in core EPS for FY'2015 results, while Kenya Airways was supported by positive boardroom changes that saw investor confidence in the management of the airline improve.

The top movers for the year were Safaricom and Equity group with a turnover of Kshs 43.4 bn and Kshs. 25.8 bn, respectively.

The market is currently trading at a price to earnings ratio of 10.4x, compared to 12.7x at the beginning of the year and a historical average of 13.6x. The market dividend yield has increased to 6.7% from 4.1% as at January and a historical average of 3.6%.

The charts below indicate the historical P/E and dividend yields of the market.



During the year, banks released their results with the Q3'2016 indicating an increase in earnings growth of 15.1%, compared to 9.7% in Q3'2015. The growth currently witnessed in the sector is as a result of conducive business environment that has been characterized by a relatively stable interest rate environment. The post operationalization of Banking Act (amendment) 2015 environment is expected to be tough for banks since the Net Interest Income is expected to come

under pressure given the loan and deposit pricing framework that is currently in use which is set at 4.0% above the CBR and 70.0% of CBR for Loans and deposit, respectively. However, we expect banks to find a way to protect their margins with tactics such as increased fee levies, constraining accounts that are eligible for interest in favor of transaction accounts, reduced lending in favor of government securities among other margin protection tactics. Kindly see our detailed analysis of the banking sector Q3'2016 performance in our banking report. [Cytonn Q3'2016 Banking Report](#)

Listed insurance companies also released their half-year results, registering mixed performance. While Kenya-Re, Jubilee and CIC Insurance registered a y/y growth in earnings of 4.1%, 4.9% and 48.2%, respectively, the positive results were countered by declines of 15.4%, 41.9% and 148.6% by Liberty, Britam and Sanlam, respectively. The declines were mainly as a result of (i) the fair value losses on investments given the poor performance of the equities market, (ii) fraud in a number of insurance class policies, and (iii) stiff competition within the sector that results in price undercutting. For more information on insurance sector performance, please see our detailed analysis of the sector H1'2016 performance in our insurance report. [Cytonn H1'2016 Insurance Report](#)

Other results of keynote were Safaricom and East African Breweries Limited:

- Safaricom announced a 19.8% increase in profit to a record Kshs 38.1 bn. Core earnings per share grew by 18.8% driven by a 19.8% growth in total revenue that outpaced a 14.0% increase in operating expenses. The increase in earnings was mainly attributed to a 27.2% increase in revenue from its mobile money transfer service, MPESA, and a 42.7% increase in total data revenue.
- EABL registered a 7% growth in profits to Kshs 10.3 bn from Kshs 9.6 bn. This is mainly attributed to increased sales of its Senator keg and dry spirits, which grew 112% and 22%, respectively. The Senator keg brand registered the sharp increase due to reduced levies, which led to a reduction in its sales price.

This year, 4 listed companies gave profit warnings to investors compared 16 companies in 2015. Companies are required to issue profit warnings if they project a more than 25% decline in profits year over year. They are namely NSE, Sasini, Sameer and Sanlam: (i) NSE attributed its losses to reduced commissions as a result of slowdown in trading activities at the Nairobi Securities Exchange, (ii) Sasini attributed the drop to a significant one-off net gain it obtained relating to a disposal of land in its last financial year, and (iii) Sameer attributed its drop to a one-off charge in respect of plant and machinery costs related to the closure of its Yana tyre factory, citing stiff competition from cheaper imports, (iv) Sanlam has anticipated a decrease in profits in light of its expensive growth strategy, lower income from property sales and a decrease in the fair value of its government and equity securities. Fewer companies issued profit warnings mainly due to a more favourable macro-economic environment that was conducive for corporate earnings growth.

Listings and significant capital raisings during the year included:

- I. Deacons, a popular local clothes retailer, listed on NSE by way of introduction. It floated 123.6 mn shares at Kshs 15.0 on the Alternative Investment Market Segment (AIMS), stopping its trading on the Over the Counter (OTC) market. The purpose of the listing on the bourse was offer its shareholders (i) liquidity, (ii) exit options, and (iii) price discovery which was not sufficient in the OTC platform,
- II. Nairobi Business Ventures, a local shoe and leather accessories retail chain, also listed by way of introduction. It floated 23.6 mn shares at Kshs 5.0 per share, on the Growth Enterprise Market Segment (GEMS). This comes after the company raised Kshs 28.0 mn from investors in a private placement. The funds raised were to be used to support its expansion and the building of a factory to manufacture its own leather and footwear accessories,
- III. CDC Group invested USD 140.0 mn in ARM Cement Limited. This is to enable the company to boost its production capacity and potentially expand its current operations to other neighboring countries,
- IV. Kengen raised Kshs 25.5 bn from a rights issue, a 92.0% subscription out of its targeted Kshs 28.8 bn, which will be used to retire debt obligations and improve their capital structure.

2016 saw enactment of a number of legislations and other developments that affected the equities market and investor sentiment, namely:

- i. **The Banking Act (Amendment) 2015:** The Act put in place restrictions on the rates banks offer on loans and deposits. The amendment put (i) a cap on lending rates at 4.0% above the Central Bank Rate (CBR) and (ii) a floor on the deposit rates at 70% of the CBR.
- ii. **Oversight of Collective Investment Scheme (CIS) funds:** The Capital Markets Authority now requires CIS's to disclose their distribution of fixed deposits across Tier 1, 2 and 3 banks, in a bid to protect investor funds. This follows the collapse of 3 local banks.
- iii. **Insurance Amendment Act of 2016:** This seeks to implement a risk based capital adequacy system, with insurers covering high risk businesses being forced to raise capital levels.
- iv. **Amendment of the Kenya Deposit Insurance Corporation Act (KDIC):** Treasury wishes to amend the Kenya Deposit Insurance Corporation Act, to be involved before a bank is placed under receivership was approved by parliament
- v. **Internal Capital Adequacy Assessment Process (ICAAP) -** All banks and mortgage finance institutions are required to formulate their own ICAAP that ensures that overall internal capital levels that are adequate and consistent with their strategies, business plans, risk profiles and operating environments

In 2016, Kenya's operating environment was conducive for business operation. NASI has however declined by 8.5% owing to the reduced level of activities at the Nairobi Securities Exchange as foreign investors shy away from the local market. Market valuation currently stands at 10.4x PE compared to 12.7x PE at the beginning of the year, indicating cheaper valuations. Earnings growth is much stronger and the operating environment conducive for

business to operate. We remain neutral on equities but with a positive bias in the near term, but are positive in the long term.

F: Private Equity

Despite the slowdown in economic growth in sub Saharan Africa, the region remains attractive due to; (i) growing population, (ii) increased disposable income as the middle class continues to grow, and (iii) improved ease of doing business. This saw private equity as an asset class benefit from increased activity. The activity is supported by (i) increased flow of global private equity funds into the region, (ii) increased ease of exit, and (iii) the growing entrepreneurial population, which provides a backbone for the asset class to thrive.

The emergence of global private equity players showcased the opportunity in the region. We witnessed various private equity transactions in different fronts, which include:

On the financial services sector front:

Entry:

As highlighted in our banking report, the Banking sector has continued to see a lot mergers and acquisition activity and of note is that most of the purchases are valued to prices well above the banking stocks trading metrics.

- Bank M completed the purchase of a 51% stake in Oriental Commercial Bank in Kenya, in a transaction valued at Kshs 1.3 bn, translating into a Price to Book Value (P/B) of 1.4x
- SBM Holdings Ltd. of Mauritius is set to acquire the entire share capital of Kenya's Fidelity Commercial Bank for Kshs 1.3 bn and will additionally inject Kshs 1.5 bn as growth capital into the bank. The transaction was valued at P/B of 1.6x
- Equator Capital Partners, a US based private equity fund, invested Kshs 600.0 mn through its ShoreCap II Fund into Jamii Bora Bank, for an equity stake of 15%, translating to a P/B of 1.3x

There were increased fundraising activity aimed at investments into the financial services sector;

- LeapFrog Investments Ltd plans to raise USD 800.0 mn for its latest fund as it seeks stakes in African banks, insurance brokers and payment companies to tap into rising demand among low-income consumers for intermediary products in the financial services industry
- Fairfax Africa Holdings Corporation, an investment holding company for Canadian insurer Fairfax Financial Holdings Ltd, sought to raise USD 1 bn for investing in public and private equity securities and debt instruments of African businesses or other businesses with customers, suppliers or business primarily conducted in, or dependent on, Africa
- International Finance Corporation (IFC) is set to commit USD 10.0 mn to Maris Capital's planned USD 70.0 mn investment vehicle, Africa Logistic Properties (ALP)

- Sanlam, a South African financial services group, and its short-term insurance subsidiary Santam, set to increase their stake in Saham Finances by a further 16.6% to 46.6%, from 30.0% held currently, subject to regulatory approvals

Exit

- PROPARCO, a French Development Agency and DEG – the German Investment & Development Company exited their combined 10.7% equity stake (4.43% and 6.25%, respectively) in I&M Holdings to CDC Group Plc bringing the total CDC holding in I&M to 10.7%
- South African government pension fund Public Investment Corporation (PIC) increased its shareholding in Barclays Africa Group from 6.0% after being the largest buyer in a conglomerate of companies that purchased the 12.2% stake offloaded by Barclays Plc in Barclays Africa Group

The financial services sector has also seen an increase in private equity transactions the Kenyan market since it remains the most attractive to private equity investors. This has been driven by (i) a rapidly growing and entrepreneurial population and demand for credit in Kenya, (ii) growing financial services inclusion in the region, (iii) increased innovations around financial tools with the financial sector, and (iv) increasing ease of exit in the financial services sector

Energy Sector Front:

Entry:

- The International Finance Corporation (IFC) and FMO, the Dutch development bank, invested USD 15.1 mn in Mobisol GmbH, a Berlin-based solar energy company, to deliver pay-as-you-go solar energy services to off-grid communities in East Africa.
- Helios Investment Partners (Helios) and The Vitol Group (Vitol), an energy and commodities company based in the U.S., bought a 49% controlling stake valued at USD 210mn in Oando PLC (Oando), effectively valuing the company at USD 428.6 mn
- Akiira Geothermal secured funding to drive its power generation expansion plans as it seeks to supply an additional 140 MW to the National grid through a power purchase agreement with Kenya Power

Exit:

- Actis exited from Umeme, a Ugandan electricity distribution company, by offloading 232.3 million shares equivalent to 14.3% of the issued ordinary shares to the Uganda Social Security fund, who have already bought 122 mn shares, and other institutional investors

The energy sector continues to attract investor through acquisitions and fundraising activities.

The energy market remains bullish with improvement in infrastructure and incentives offered in the generation of renewable energy offered by the company regulators.

On the technology sector front:

Entry:

- CDC, a UK development finance institution, injected USD 55.5 mn in Africa Internet Group (AIG), a parent group of Jumia, Easy Taxi, Hellofood, Jovago, Lamudi and Kamyu.
- Cactus Capital announced investments of an undisclosed amount into seed and growth stage African technology ventures, Flutterwave and E-Factor
- Japan's Toyota Tusho, owned by one of the world's leading auto-mobile makers, Toyota Group, bought a 9.5% stake in Kenyan-based tech firm Seven Seas Technology for Kshs 306.0 mn, valuing the tech firm at Kshs 3.2 bn
- OkHi, a Kenyan tech raised Kshs 77.0 mn from local and foreign investors led by Garage Capital, a venture capital fund based in Silicon Valley
- Fuzu, a Kenyan based online jobs search website, received an investment commitment of Kshs 186.0 mn from 3 investors, namely: Finnfund, Barona Technologies and Polkuni
- France Telecom closed the sale of its entire 70.0% stake in Telecom Kenya to Helios and the Kenyan Government. Helios, a UK private equity firm via Jamhuri Holdings acquired 60.0% stake while the Kenyan government acquired a further 10.0% stake, increasing its overall stake to 40.0%

The technology sector has shown potential for growth in the sub-Saharan Africa, this is evident by the investment by global firms such as CDC and Japan's Toyota Tusho. Kenya still exhibits potential in this sector with two of the major deals worth Kshs 492.0 mn, this can be attributed to a young and dynamic Kenyan population, entrepreneurial business offering services and a supportive regulatory framework

Other Deals Include:

Entry:

- Fanisi Capital is seeking to raise at least Kshs 4.0 bn from local investors as part of a Kshs 10.0 bn fund meant for regional investments in healthcare, agri-business, retail and education sectors.
- Pan African Housing Fund (PAHF), a private equity fund dedicated to residential real estate development in East and Southern Africa and managed by Phatisa, committed USD 5.1 mn of equity investment to develop a middle-income residential property in Zambia on a joint venture basis.
- LeapFrog Investments acquired an undisclosed majority stake in Goodlife Pharmacy at USD 22.0 mn from Catalyst Principal Partners.
- Abraaj's Growth Markets Healthcare Fund, which is currently fundraising, landed a USD 25 million commitment from the African Development Bank for African healthcare investments

- International Finance Corporation (IFC) acquired a 2.5% equity stake in ADvTECH valued at USD 13.0 mn, effectively valuing the company at USD 520.0 mn. This transaction resulted in an increase in IFC'S total holdings in ADvTECH to 4.1% after an earlier acquisition of 1.6%
- Catalyst Principal Partners, a private equity fund that specializes in emerging and mid-sized companies invested part of its USD 125 mn Fund I into Orbit Chemicals.
- Weetabix Food Company acquired a 50.1% controlling stake in Weetabix East Africa from Kenyan businessman Ahsan Manji, the founder of House of Manji.
- Old Mutual Investments Group (OMIG) and Nigeria's Sovereign Investment Authority (NSIA) agreed to set up two funds to invest in real estate and agriculture in Nigeria. This would be done through jointly raising USD 500.0 million fund to invest in real estate and another USD 200.0 million to invest in agricultural projects.
- Emerging Africa Infrastructure Fund ("EAIF"), loaned USD 20.0 mn to Helios Towers Africa ("HTA"), as part of syndicated loan worth USD 105.0 mn, to finance the purchase of approximately 950 telecommunications towers in the Democratic Republic of Congo (DRC)

Private equity investment activity in Africa has continued to improve, as evidenced by the increase in the number of deals and deal volumes into the region, with funds continuing to prefer financial services, energy, real estate, healthcare, education, and IT sectors although infrastructure, Fast Moving Consumer Goods (FMCG) industries and natural resources are gaining ground. The PE market in the year 2016 remained bullish given (i) the abundance of global capital looking for investment opportunities in Africa, (ii) attractive valuations in the private sector, and (iii) better economic growth projections compared to global markets.

G: Real Estate Market Review

The real estate sector continues to perform extremely well across all sectors supported by the (i) the accumulated housing deficit from previous years, (ii) continued investment in infrastructure, (iii) growing businesses in both SMEs and entry of global brands into the country, and (iv) the growing middle class. The land and house prices gained during the year and below is the sectorial performance:

I. Residential Sector

In 2016, we witnessed increased investment in residential real estate, with developers aiming to curb the huge housing deficit, which is approximated at 2 million units and growing at 200,000 units annually. Major residential developments launched this year include Alma, a Ksh 3 bn project by Cytonn Real Estate in Ruaka, Gem Juja, a Ksh 400 mn project by Urithi in Juja, Express Kenya with a Ksh 2 bn housing project in Industrial Area and the Ksh 300 bn Private Urban Renewal Project in Ngara and Pangani led by the Nairobi County government.

In terms of performance, in completed houses, Karen and Runda were the best performing sub-markets in the high-end sector with returns of 17.4% and 11.5%, respectively. Apartments in the upper-middle income market have recorded slower uptake and price appreciation in areas such as Kilimani and Kileleshwa due to a possible oversupply of units. However, in satellite towns such

as Ruaka and Kikuyu, residential units have continued to record high returns due to the increasing demand from the growing middle class and improving infrastructure in these areas.

The summary for the top 5 areas according to the income level is as follows;

(i) High End Market-Top 5 Areas

Location	Average Uptake	Average Occupancy %	Average Rental Yield	Average Price Appreciation	Total Return
Karen	91.5%	4.8%	7.9%	9.5%	17.4%
Runda	100.0%	5.3%	6.0%	5.5%	11.5%
Loresho	93.7%	1.4%	2.7%	7.5%	10.2%
Roselyn	86.6%	8.0%	3.7%	6.3%	10.1%
Kitisuru	61.9%	5.0%	2.0%	4.3%	6.4%

Karen and Runda are the best performing markets with 17.4% and 11.5% returns, respectively. Property in Karen has high demand due to its upmarket state, proximity to major shopping hubs and improved access via the Southern Bypass, Langáta Road and Ngong'Road which is still undergoing expansion

(ii) Upper Middle Income Market-Top 5 Areas

Location	Average Uptake	Average Occupancy %	Average Rental Yield	Average Price Appreciation	Total Return
Ridgeways	98%	90%	5.4%	12.7%	18.1%
Kilimani	79%	66%	3.9%	9.9%	13.8%
Riverside	53%	93%	4.2%	8.2%	12.4%
Spring Valley	75%	82%	3.6%	8.5%	12.1%
Lavington	98%	83%	4.6%	7.3%	11.9%
Westlands	89%	73%	5.3%	6.4%	11.6%
Kileleshwa	88%	52%	6.0%	4.7%	10.7%

Ridgeways and Kilimani were the best markets in the Upper Middle Income Segment with total returns of 18.1% and 13.8% per annum on average. Ridgeways boasts of a prime location with accessibility via the Northern Bypass and Kiambu Road and proximity to the UN while Kilimani area attracts the middle class due to its proximity to main commercial hubs

(iii) Lower Middle Income Market-Top 5 Areas

Location	Average Uptake	Average Occupancy %	Average Rental Yield	Average Price Appreciation	Total Return
Ruaka	93%	95%	5.0%	13.4%	18.4%
Kikuyu	66%	73%	6.1%	11.2%	17.3%
Imara Daima	87%	91%	5.2%	11.2%	16.4%
Dagoretti	88%	91%	5.7%	9.8%	15.6%
Donholm	85%	89%	5.8%	9.6%	15.4%

Ruaka and Kikuyu were the best performing markets in the lower middle income segment with total returns of up to 18% and 17.3% per annum. This is due to infrastructural development in both areas and the growing middle income population

In the regional markets, Kisumu residential market is slowly picking up with most developments having been completed in the last 5 years. Two Bedroom apartments in high-end areas have the highest rental yields among residential units of 6.5% as compared to those in low-end areas with

yields of 4.8% and three bedroom units of 5.0%. This is because they have higher rents, due to the exclusive locations, better amenities and security provided in high-end areas. They also have higher demand than three bedrooms in high-end areas, as they are relatively cheaper. The summary for Kisumu market is as follows;

Kisumu Residential Market Summary

Location	Type	Plinth Area	Monthly Rent	Average Price	Price Appreciation	Rental Yield	Total Return
Kisumu-Low End	2-Bed	76	30,600	5.9m	6.9%	4.8%	11.7%
Kisumu-High End	2-Bed	84	42,000	7.9m	6.6%	6.5%	13.1%
Kisumu-Low End	3-Bed	108	40,000	7.1m	5.8%	5.3%	11.1%
Kisumu-High End	3-Bed	120	62,500	13.5m	6.1%	5.6%	11.7%

Developments in Kisumu recorded average returns ranging from 11% to 13% with 2 bed units in the high end market having the highest returns due to high demand

In the Coastal region, residential units have recorded slow uptake in the last 5 years. This can be attributed to the fact that most investors target short to medium-stay visitors to rent their units. However, due to insecurity and terrorist attacks in the period between 2011 and 2015, apartments recorded low occupancies and thus low returns. Some developments have lowered their prices so as to boost uptake. The summary for Mombasa market is as follows;

Mombasa Residential Market Summary

Location	Type	Plinth Area	Monthly Rent	Average Price	Price Appreciation	Rental Yield	Total Return
Mombasa-Mid End	2-Bed	114	68,000	13.6m	5.0%	6.0%	11.0%
Mombasa-High End	2-Bed	204	150,000	33.0m	(13.0%)	5.0%	(8.0%)
Mombasa-Mid End	3-Bed	166	76,000	15.5m	8.0%	5.0%	13.0%
Mombasa-High End	3-Bed	278	180,000	53.8m	1.0%	6.0%	7.0%

Developments in Mombasa recorded low returns due to price reduction to boost uptake, mostly in the high end market

II. Commercial Sector

In 2016, Commercial Real Estate as expected continued on its upward trend though a slowdown was witnessed in some themes such as commercial office. Retail and Industrial themes continued picking up with most construction activity being witnessed in the industrial theme amid a slight slowdown on retail construction over fears of oversupply. A summary of performance of the various commercial real estate themes is given below:

Offices

The Commercial Office Market in Nairobi in 2016 stagnated recording a slight increase in returns with the yields increasing by a meagre 0.1% points from 9.3% in 2015 to 9.4% this year. The performance was constrained by the tough economic environment that has caused some businesses especially in the financial services sector to downsize and multinationals such as Coca Cola, Standard Chartered and Tullow Oil to reduce their operations in the country. Despite

these challenges, the market recorded a slight improvement performance with rents increasing by 6% from Kshs 97 to Kshs 103 per square foot, prices also increased though marginally by 2 % from Kshs 12,800 to Kshs 13,000 per square foot translating to a slight increase in yield of 1.1% over the same period. Occupancy levels declined albeit marginally by 1% points from 89% but remained high averaging at 88%, though this is a 3% points decline from the five-year high of 91% witnessed in 2011. This is attributable mainly to the tough economic environment and increased supply of office space, which has grown with a five year CAGR of 16% from 1.7 mn square feet in 2011 to 3.6 mn in 2016 in Nairobi alone.

Summary of Commercial Office Returns in Nairobi Over Time							
Year	2011	2013	2015	2016	Δ (2013)	Δ (2015)	Δ (2016)
Occupancy (%)	91	90	89	88	(1%)	(1%)	(1%)
Completions (Sqft)	1.7 mn	2.4 mn	5.4 mn	3.6 mn	50%	125%	(33%)
Asking Rents (Kshs/Sqft)	78	95	97	103	22%	2%	6%
Average Prices (Kshs/Sqft)	10,557	12,433	12,776	13,003	18%	3%	2%
Average Rental Yields (%)	9.8%	10.0%	9.3%	9.40%	2.0%	-7.0%	1.1%

Occupancy levels remain high at 88% indicating that demand for office space is still high

In terms of submarket analysis in Nairobi, Gigiri, Parklands and Karen were the best performers in 2016 due to superior locations allowing them to charge premium rents for the same. These locations recorded on average rental yields of 12.9%, 10.4% and 10.3% respectively. Mombasa Road was the worst performing submarket with rental yields of on average 8.9%. Mainly due to poor location as a result of traffic congestions and its zoning for industrial use. Its performance has however improved from 2015 earnings by 0.6% points, attributable to opening of quality spaces in the area such as in the Next Gen Mall which opened in November.

Summary of Commercial Office Performance in Nairobi by Nodes				
Area	Price Per Sqft "Kshs"	Rental Yields %	Rent Per Sqft "Kshs"	Occupancy %
Gigiri	14,000	12.9%	150	90%
Thika Road	13,771	11.3%	104	80%
Parklands	12,500	10.4%	109	80%
Karen	15,063	10.3%	125	88%
Kilimani	13,676	9.5%	107	93%
Westlands	13,216	9.5%	104	92%
Upperhill	14,747	9.3%	113	90%
Nairobi CBD	11,750	9.0%	92	93%
Mombasa Road	11,098	8.9%	83	86%
Average	13,313	10.1%	110	88%

Gigiri is the best performing submarket due to prime location and high quality office space and are hence able to charge a premium above market

For the key markets in the country, the summary of the performance is as below:

Summary of Office Returns in Kenya				
Area	Average Rent Per Sqft Kshs	Average Price Per Sqft Kshs	Yield %	Occupancy %
Nairobi	110	13,313	10.1%	88.0%

Kisumu	102	13,000	9.40%	91.0%
Mombasa	98	12,833	9.20%	85.0%
Average	103	13,049	9.6%	88.0%
<i>Nairobi is the best performing market with high yields of up to 10.1%, this is attributable to the high demand for office given that it is the capital and hence the hub of businesses in the country</i>				

Retail

In 2016, Retail market continued with its upward trend and high returns recording average rental yields of 10.0% and an average annual occupancy of 89.3%. The rent charged averaged at Kshs 187 in Nairobi. In terms of submarkets, Karen Westlands and Kilimani were the best performing markets due to prime locations near high-end population and companies and ease of access to these areas. The three areas recorded average rental yields of 12.5%, 12.3% and 10.6%, respectively. The worst performing submarkets were Eastlands and Mombasa Road which recorded average rental yields of 7.5% and 8.2% respectively.

Summary of Retail Sector Performance by Nodes in Nairobi			
Location	Rent / SQFT 'Kshs'	Occupancy (%)	Yield (%)
Karen	216.7	96.3%	12.5%
Westlands	231.4	92.0%	12.3%
Kilimani	209.3	86.0%	10.6%
Kiambu Road	187.3	90.0%	10.1%
Thika Road	187.1	89.3%	10.0%
Ngong' Road	170.1	93.3%	9.7%
Satellite Towns	175.0	88.3%	9.3%
Mombasa Road	157.6	83.3%	8.2%
Eastland	148.2	85.0%	7.5%
Average	186.9	89.3%	10.0%
<i>Karen is the best performing submarket, with a yield rate of 12.5% and an occupancy of 96.0%. This is attributable to the premium for class charged on their rents and lower competition from small scale retailers present in low end areas</i>			

For the whole country, Mt Kenya and Nairobi were the best performers earning rental yields of 10.1% and 10.0% respectively. Mt Kenya's performance is attributed to Mt. Kenya as a tourist hub and high purchasing power mainly from the local community and presence of military personnel in the region, while for Nairobi the key factor pushing its momentum is improved infrastructure and high middle class population. Eldoret was the worst performing market with an average rental yield of 6.6%, which can be attributed to competition from small scale retailers in the region.

Summary of Retail Market Performance in Kenya By Regions			
Location	Rent / SQFT (Kshs)	Occupancy (%)	Yield (%)
Mt. Kenya	151.5	90.0%	10.1%
Nairobi	192.3	89.3%	10.0%
Kisumu	170.2	75.0%	9.4%
Mombasa	154.7	76.7%	7.2%
Eldoret	105.6	83.3%	6.6%
Average	154.9	82.9%	8.7%
<i>Mt. Kenya is the best performing market with high yields of on average 10.1% attributable to high purchasing power in the regions mainly from the local community, tourists and military personnel in Nanyuki</i>			

Industrial

In 2016, the industrial theme continued with its upward trend recording average yields of 5.8% on average, rent of Kshs 35 per square foot, sales price of Kshs 6,313 per square foot and a high uptake of 85%. In submarket analysis, Industrial Area was the best performing market with average rental yields of 7.2% and a high occupancy of 90%. This can be attributed to the high demand for warehousing space in the area due to presence of many manufacturing companies in the area. Baba Dogo and Ruiru also performed well with rental yields of 7.0% and 6.2% respectively. Baba Dogo due to proximity to Thika Road making it easy to access both the CBD and Central Kenya and Ruiru due to lower prices due to cheaper land prices. Athi River is the worst performing submarket with rental yields of 4.2% attributable to traffic congestions along Mombasa Road

Summary of Industrial Market Performance in Nairobi by Nodes								
Area	Unit Height (Metres)	Occupancy (%)	Unit Plinth Sqft	Rent per sqft Kshs	Price per Sqft Kshs	Price Appreciation (%)	Rental Yield (%)	Uptake %
Industrial Area	10	90%	7,144	43	7,522	6.8%	7.2%	68%
Baba Dogo	10	88%	9,206	40	6,175	5.1%	7.0%	70%
Ruiru	8	89%	6,917	35	6,000	9.1%	6.2%	66%
Syokimau	7	92%	9,822	36	5,882	2.7%	5.7%	98%
Mombasa Road	9	82%	7,769	30	7,568	13.9%	4.8%	50%
Athi River	8	71%	7,916	23	4,735	6.9%	4.2%	44%
Grand Total	9	85%	8,129	35	6,313	7.4%	5.8%	66%
<i>Industrial Area was the best performing market with average rental yields of 7.2% and a high occupancy of 90%. This can be attributed to the high demand for warehousing space in the area due to presence many manufacturing companies in the area</i>								

During the year, the main transactions in the commercial real estate sector included:

1. The Launch of Kshs 5.56 bn Montave Towers a Mixed-Use Development (MUD) of office, retail, and hotel space by a consortium of developers including Hass Consult and Abacus International Limited
2. The International Finance Corporation announced that it will invest in Kshs 1 bn equity in Africa Logistics Property (ALP) which intends to develop first grade warehousing in industrial parks that is Tatu City and Tilisi in Kiambu County
3. Ground breaking for Kshs 12.5 bn Infinity Industrial Park
4. Ground breaking for Kenya's first a construction supermarket in Nairobi expected to cost Kshs 10 bn
5. Launching of the Phase I of the Leather Industrial Park in Kinanie Athi River

III. Hospitality Sector

The year 2016 was a good year for the Hospitality sector in Kenya as evidenced by the 13.9% increase in tourist arrivals at Jomo Kenyatta International Airport (JKIA) and Moi International Airport between April and May 2016. In addition, the country hosted major global conferences, which resulted in full occupancies with hotels in Nairobi being the main beneficiaries. The main factors boosting the sector include i) Improved security and lifting of travel advisories ii)

Increased budgetary allocation to boost tourism iii) Hosting of major global conferences and; iv) Improved facilities as seen through the increased number of hotels attaining 5-star rating.

The attractiveness of the sector especially for business tourism over the past few years can be evidenced by increased investment in the sector characterized by the launching/unveiling of a number of hotels in the year including i) The English Point Marina in Mombasa ii) Tune Inn in Westlands and; iii) The launch of Montave in Upperhill

For the serviced apartments segment, we also had new entrants with the notable ones being i) The 11-storey Soho Apartments in Kilimani by a Chinese developer worth Ksh 1.8bn earlier on in April and; ii) Opening of Serviced apartments in Riverside, Nairobi under the Best Western brand in December

In terms of performance, serviced apartments (specifically in Nairobi) outperformed the hotels countrywide despite the high hotel rates. This can be attributed to the high occupancy levels for serviced apartments averaging at 90% all year round compared to hotels' average of 33% countrywide. The resultant is the serviced apartments having a Total RevPAR of USD 127.00 against Hotels' Total RevPAR of USD 98.00

Summary of the Hospitality Industry Performance			
Type	ADR (USD)	Total RevPAR (USD)	Occupancy Rate
Hotel	212	98	33.0%
Serviced Apartments	141	127	90.0%
Average for the Hospitality Sector	177	113	62.0%

Some of the challenges faced by hotels is the recovery from insecurity challenges that have caused a decline in occupancy and revenues while increasing costs specifically in marketing and enhancing security. On the other hand, serviced apartments especially within Nairobi are thriving, recording high occupancy levels and high returns due to the high numbers of business travellers.

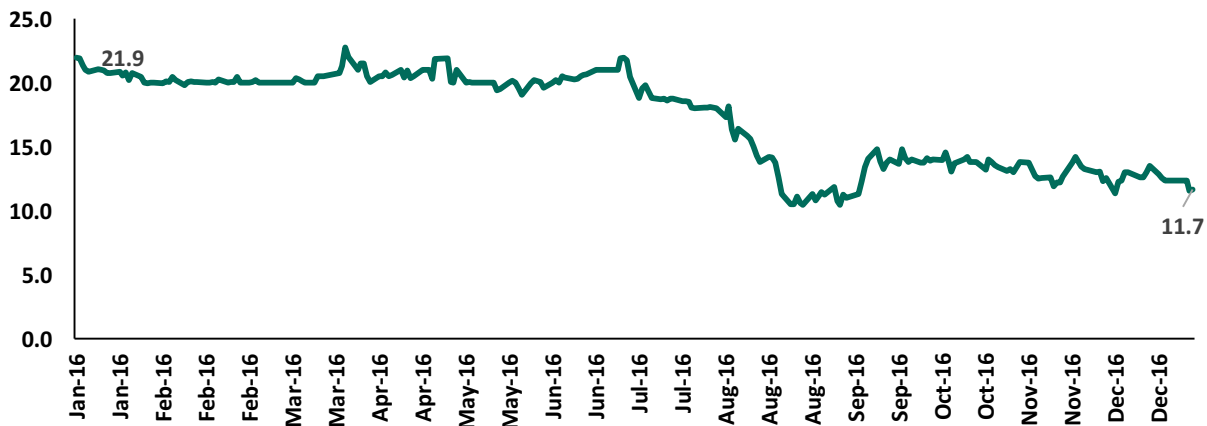
The opportunity in this sector thus lies in serviced apartments in Nairobi, 3 & 5-star rated hotels in Maasai Mara as well as 4 Star rated hotels in Nairobi offer the best investment opportunity. In order to address the likelihood of an oversupply, investors should differentiate their product offering especially in customer service to realize high occupancy levels.

IV. Listed Real Estate – REIT

During the year, the listed real estate market performed poorly with the only listed I-REIT in Kenya, Fahari I – REIT shedding 45% of its value, currently trading at Kshs 11 down from Kshs 20 at the time of the listing. This is a 50% decline from its price at the beginning of the year of Kshs 22. Fusion Capital also attempted to list a D-REIT FRED – Commercial, but it was undersubscribed raising only 37.8% from four investors out of the minimum requisite of 50% from at least seven investors and hence failed to list. The poor performance of listed real estate

can be attributed (i) poor returns from the underlying assets (ii) opacity of the exact returns from the underlying assets, (iii) inadequate investor knowledge and lack of institutional support for REITS, and (iv) the negative sentiment currently engulfing the sector given the poor performance of Fahari and failure of FRED.

Fahari REIT Performance 2016



We remain cautiously optimistic on the performance of the Real estate sector. The increased focus by institutional developers in the sectors poses as significant growth in the sector but competition is expected to be stiff as clients and investors demand for quality developments. The returns remain attractive and is expected to hold.

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