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Cytonn Investments Management Plc

Kenya Corporate Analysis **September 2017**

Rating class	Rating scale	Rating	Rating outlook	Expiry date
Long term	National	BB(KE)		
Short term	National	B(KE)	Stable	September 2018
Commercial paper	National	B(KE)		

Financial data:

(USD'm comparative)

	31/12/15	31/12/16
KES/USD (avg.)	98.2	101.5
KES/USD (close)	103.3	103.0
Total assets	64.5	114.9
Total debt	23.7	54.3
Total capital	36.3	51.8
Cash & equiv.	0.2	0.6
Sales	1.9	5.3
EBITDA	0.2	(2.5)
NPAT	6.9	1.1
Op. cash flow	6.1	3.9
Market cap.	n.a	
Market share	n.a	

Related methodologies/research:

Global Master Criteria for Rating Corporate Entities, updated Feb 2017
Global Criteria for Rating Property Funds, updated Feb 2017
Global Master Criteria for Rating Funds and Asset Managers, updated Mar 2017

Rating history:

Cytonn Investments Management Plc ("Cytonn" or "the group")
Initial/Last Rating (Sep 2017)
Long term: BB(KE)
Short term: B(KE)
Commercial paper: B(KE)
Rating outlook: Stable

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Summary rating rationale

- Founded in 2014, Cytonn is a Kenyan investment manager that offers a range of alternative products to retail and institutional investors, supported by an extensive distribution model and over 300 skilled professionals.
- While Cytonn has a comprehensive strategy outlining the rapid growth of assets under management, its main exposure is to the development and sale of residential and mixed-use properties, with plans to increase the project pipeline from KES82.7bn at 1H FY17 (FY16: KES46.7bn) to c.KES112.2bn by 3Q FY18. Accordingly, the ratings take account of the risks of identifying, funding and executing such developments, and Cytonn's ability to effectively recycle capital while consistently generating targeted returns for investors.
- The ratings are constrained by the short track record, albeit GCR notes the rigour of the governance structures, comprehensive risk protocols and the quality of management. While Cytonn's research, support structures and client profile are deemed sound, its broader investment philosophy and strategic execution remain unproven, as its offerings are still at nascent stages and none of the developments have been completed.
- Some comfort is taken from the partnership with global private equity firm Taaleri Plc, and relationships being developed with strong financial institutions. While the associated funding is moderate given the aggressive growth forecasts, this is indicative of Cytonn's ability to secure support from major institutional investors/funders.
- The real estate model is built on extensive due diligence, research and market knowledge, which allows management to unlock value from partnerships with landowners. Leveraging its agency force, Cytonn plans to pre-sell 10-15% of a project off-plan and a large proportion of the remainder during construction to mitigate capital risk.
- Revenues mostly result from sales and management fees, and as such, growth is contingent on timely and successful project execution (which could be curtailed by regulatory, construction and socio-political factors) as well as strong project uptake, while margin and free cash flow variability could be exacerbated by market volatility. This could restrict planned project returns, which range from 20-30%.
- Each project is housed in a separate special purpose vehicle ("SPV"), which is set up as a limited liability partnership and funded using equity, mezzanine finance and bank debt at 20:20:60 split. Cash Management Solutions ("CMS"), the group's funding vehicle, invests in the developments *via* one-year rolling investments (that have historically yielded a return of 21% p.a.), providing the advantages of a revolving bank facility.
- Plans to issue three-year project notes backed by cash flows from four developments will add funding flexibility, in view of the rapid deal pipeline traction projected. The mezzanine and external debt ratios per project align with most developers, but a strong Issuer rating depends on (amongst other factors) there being ample unencumbered assets/investments that can be readily sold at prices close to net book/open market value. Liquidity is also function of the ability to sustain strong pre-sales and capital inflows from Cytonn's portfolio of investment products, given the high implied capital charge of using bank overdraft facilities to bridge funding gaps.
- Cytonn reports conservative LTVs and earnings based gearing at company level, but the developments significantly elevate group LTV metrics, while driving a weak/volatile debt service and earnings based gearing trajectory, which is only likely to stabilise with the medium-term diversification of the asset profile. Although Cytonn could comfortably guarantee the yield on the project notes, guaranteeing the principal effectively negates the ring-fencing of the SPVs, compromising the company's credit protection metrics.
- While sound regional growth and a burgeoning middle class represent strong latent demand for quality residential property, this is sensitive to adverse socio-economic changes that constrain per capita income and lending activity (*inter alia*).

Factors that could trigger rating action may include

Positive change: Timely completion of large developments, while maintaining credit risk metrics within guidance, demonstrating the ability to manage a rapidly expanding project pipeline without curtailing free cash flows.
Negative change: Delays in the execution of key projects and/or the manifestation of unmitigated regulatory, construction or market risks. An overly aggressive project rollout could also curtail liquidity and ultimate debt service, placing pressure on the ratings.

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Background and business profile

Cytonn was founded in September 2014 by a team that wished to form an independent platform that is purely focused on the interests of targeted investors. A highly-publicised legal engagement followed the exit of the team from Britam Asset Managers ("BAM"), although GCR has been advised that all cases against Cytonn's partners have been withdrawn or stopped by way of judicial review. Accordingly, no legal risks are expected from this legacy relationship.

Beginning on a clean slate, the team set Cytonn with the objective to provide a comprehensive range of alternative investment products targeted at both retail and institutional investors. Its differentiation is investment in alternative investments, a client-focused/oriented approach, strong alignment for all staff throughout the firm, and the use of strategic partnerships to ensure sustainable growth. The myriad products offer clients returns that outperform conventional investment vehicles. The group invests in East Africa, and draws clients from regional markets, the broader Kenyan diaspora, as well as corporates in Europe and North America, leveraging an extensive agency force and offices in Nairobi, Finland and the United States. Appendix A (per page 12 of this report) outlines Cytonn's operating structures, which fall under five units (namely technology, diaspora, real estate, asset management, as well as media and advertising), while table 1 summarises the product profile, which is tailored to cater to a diverse client base.

Table 1: Group market focus

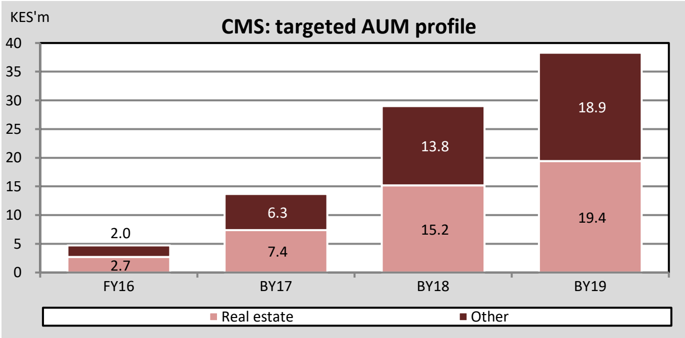
Segments
- Retail, through Cytonn Co-operative membership
- High Net-worth Individuals through Cytonn Private Wealth
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional clients

Investment focus
- Real Estate
- Private Equity: sectors:- financial services, education & HR, IT, hospitality, real estate
- Fixed Income Structured Solutions
- Equities Structured Solutions

Products	Institutional clients	High net worth individuals	Retail clients
Private equity investments	•	•	
High yield solutions Cash Management Solutions Fixed income notes	•	•	
Regular investment solutions Education investment Regular investment solution Co-op premier investment Land investment	•	•	•
Real estate ("RE") solutions RE investments RE-backed fixed income notes Rent stabilised investment units	•	•	•

Although Cytonn has clearly delineated a strategy outlining the rapid growth of assets under management ("AUM"), its main exposure is to the development and sale of residential and mixed-use properties. The group has leveraged a strong internal knowledge base with respect to the regional property market, a well-developed research function, and the incorporation of real estate development expertise by partnering with highly skilled players in this space. Against this backdrop, management secured support from Taaleri Africa Fund (an offshoot of Finnish private equity firm Taaleri Plc[1]), to finance Amara Ridge and Situ Village, two of its first real estate projects. Cytonn plans to increase the project deal pipeline from KES82.7bn at 1H FY17 to over KES112bn by 3Q FY18. This will represent value vested in 28 projects, from 10 effective August 2017 (1H FY17: eight developments). Other key objectives include:

- reaching critical mass by 1H FY18, which will enhance the firm spread to c.5%. This will largely be achieved by launching 18 new property developments (Appendix C), with a mean project size of KES3.5bn (c.USD34m);
- increasing the total AUM to c.KES38bn by FY19, whose composition will be split between real estate and other investment options;
- expanding collection targets for the distribution team to KES24bn, from c.KES3.2bn at 1H FY17;
- increasing earnings from KES200m to c.KES1.2bn; and
- optimising the capital structure by enhancing internal efficiencies to generate firm spread of c.7% p.a.



None of the group's developments have been completed, with the first to be finalised in 4Q FY17. Accordingly, the ratings take account of the risks of identifying, funding and executing such developments, as well as Cytonn's ability to effectively recycle capital while generating targeted returns for investors. Table 2 provides a summary of the first seven projects that the group put out to market. This gives insight into the niche market and nodal positioning, scale and capital commitment required to ensure the uptake of the projects in a highly competitive environment.

Table 2: Project schedule, 1H FY17	Amara Ridge	The Alma	Situ Village	The Ridge	Taraji Heights	RiverRun Estates	Newtown
Land (ha)	5.0	4.7	29.4	9.9	2.8	100	1,000
% complete	80.0	13.0	20.0	n.a	n.a	n.a	n.a
Built Area (sqm)	5,100	34,590	26,274	97,294	31,360	184,420	xx
Units (no.)	10 Villas	464 (1, 2,3-bed apartments)	50 Villas; 10 cottages	726 (1, 2,3-bed apartments)	248 (1, 2,3-bed apartments)	1,321 (town houses, cottages; apartments)	Mixed use (residential, commercial)
Committed capital (KES'bn)	0.8	3.4	5.3	10.8	2.6	14.4	22.0
--Drawn (KES'bn)	0.5	1.2	1.7	1.0	0.2	1.5	3.4
LTV (%)	52.0	31.0	34.0	38.0	40.0	44.0	42.0
Project IRR (%)	25.0	30.0	28.0	26.0	23.0	24.0	20.0
Investor IRR (%)	22.0	24.0	27.0	22.0	22.0	22.0	20.0
Construction period (weeks)	72	130	120	206	103	360	480
Commencement	3Q FY15	2Q FY16	3Q FY16	2Q FY17	2Q FY17	3Q FY17	3Q FY18
Completion	1Q FY17	4Q FY18	3Q FY19	3Q FY21	1Q FY19	2Q FY24	2Q FY21*
Sales status (%)	100.0	60.0	20.0	20.0*	20.0	20.0	5.0*

*Relates to phase I of the respective projects.

According to Cytonn, the cash conversion cycle per project is approximately two to three years. The aggressive project rollout signifies a marked amplification of spread derived

[1] Nasdaq Helsinki-listed Taaleri Plc has three business lines: Wealth Management, Financing and Energy (AUM, FY16: EUR4.8bn. Market cap: 24/08/17: EUR299.7m). Taaleri has two African funds, one of which invests in real estate in selected territories.

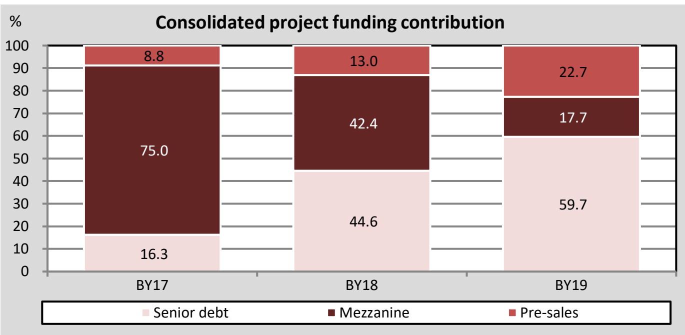
from managing its clients' assets (with the two-percentage point increase in the targeted firm spread equating to c.KES770m, assuming AUM of KES38.3bn by FY19). This, however, also implies material execution risk for the group, which has to absorb any losses arising from market, construction and regulatory risk or internal inefficiencies.

The pace of growth and the focus on real estate heightens the capital intensity of Cytonn's strategic objectives. In this regard, management set up CMS as a funding vehicle. As a key client-facing partner for the group, CMS raises funding from high net worth individuals in Kenya. A pre-agreed profit sharing arrangement guarantees a set return for investors, while Cytonn retains any residual. As outlined below, Cytonn Diaspora and Cytonn Co-op also serve similar functions, while a large distribution network of agents targets local high net worth investors. CMS has so far provided funding for land acquisition and initial portions of the construction phase on Cytonn's first developments. At the beginning of FY17, it accounted for 98% of the funds derived from investment products, with Cytonn project notes and Co-op making up the balance.

Table 3: Group investment cycle

Funding sources	Investments	Exit
Distribution (high net worth investors) Global & local investors (*via* Investments) International investors (Cytonn Diaspora) Retail (Cytonn Co-op)	Real estate (through CRE) Other: financial services, education, technology, hospitality	Individuals (Cytonn Agency) Institutional investors Investment vehicles LLPs, REITs, income funds

The issue of up to KES10bn in Cytonn project notes backed by cash flows from The Alma, Situ Village, The Ridge and Taraji Heights (per Appendix D) is expected to see the split between structured products and CMS change to 37:63 by FY17. This, however, only represents the portion of funding derived from investment products. With respect to overall funding for the real estate developments, the percentage of mezzanine finance in use is expected to taper in the medium term, as Cytonn develops a more efficient funding structure. A cheaper funding profile will also come from establishing a track record (in terms of delivering promised returns to investors, sustaining the planned AUM growth trajectory and achieving traction with its base of investment products). This (all things being equal) would see stronger market uptake of Cytonn's debt issues and more competitive pricing of its bank facilities.



According to management, a KES1.5bn facility is close to being finalised with a major domestic financial institution. This will be priced at 14.5% p.a. (against a 20% p.a. yield Cytonn will guarantee investors that take up the three-year project notes). Together with the partnership with TT Africa Fund and facilities that have been provided by other prominent financial institutions, this indicates Cytonn's ability to establish relationships with strong counterparties, which is positively considered.

Cytonn's partners have invested mostly *via* mezzanine finance vehicles, as this is the most tax-efficient point of entry (as opposed to coming in as pure equity partners). GCR recognises the equity-like features of such capital, although the guaranteed yield and the finite investment tenor sees the hybrid instruments treated as debt. That said, the ratings recognise the liquidity uplift provided by mezzanine finance investors 'recycling' their investments into future note issues or projects and the option to accrue interest on certain products.

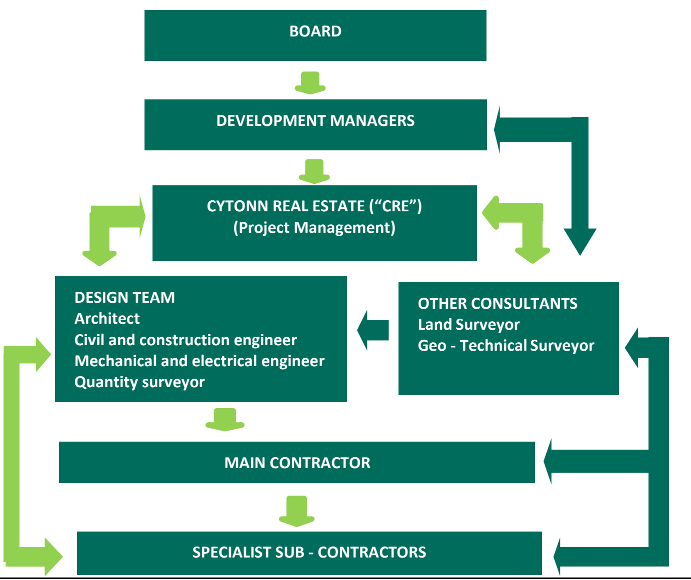
As distribution is key to the model, Cytonn maintains a large tied agency force, currently sitting at 150 people. Agents come off retainer after a year, but the group has been able to achieve a high retention rate to date, which is expected to average at least 80% in the medium term. The sustained growth of the agency force is critical to the achievement of the aggressive targets with respect to bringing in client assets, maintaining strong AUM growth, robust pre-sales and stabilising the real estate financing model. The balance between retaining the independent financial advisors and securing a stable tied agency force is expected to ensure that at least 70% of the required distribution targets will be achieved (target: 80%), with the balance of capital required to come from external debt funding sources. As such, strong execution by the distribution team will play a major role in ensuring the timely financing and rollout of the new (higher value) real estate projects projected. Fundraising from the CMS route and real estate pre-sales is expected to consistently fall short of requirements to finance the ramp up in projects over the next two years, and this is expected to continue until FY19, when the first of the large-scale projects begin to release capital.

Corporate structure

At the group's inception, funds were initially raised from internal resources by the partners, after which a round of private placements materially bolstered equity ahead of the first development. In March 2017, shareholders passed a special resolution to convert Cytonn into a public company in line with *sec* 70 of the Companies Act (2015), as its shareholder base had grown to exceed 50 counterparties. Although it is not listed, the change in designation now allows for the free transfer of Cytonn's shares.

The group is structured such that the various disciplines are housed in limited liability partnerships or limited liability corporations ("LLPs" or "LLCs"), which allows for a joint representation of the interests of all counterparties. Cytonn typically serves as the principal partner, providing critical intellectual capital to ensure effective asset selection, and managing the operations of a number of underlying partnerships. The developments are ring-fenced in discrete SPVs, each with its own layers of governance. This ensures that the interests of all counterparties (including the landowners) are equally represented, allows for input from an advisory function, and enables timely and effective decision-making by the technical boards. In addition to reducing contagion risk across projects, this has also been designed to simplify joint arrangements between Cytonn and other parties.

Special purpose vehicle governance structure



GCR takes cognisance of the depth of the group's board, with directors drawn from diverse sectors. The managing partner is supported by two executive partners, heads of finance, investment, regional markets, project management and distribution, as well as support functions (being legal, brand & business administration, technology, and human resources) led by professionals with proven experience both locally and in the region. As this analysis does not comprehensively cover the intricacies of strong corporate governance, GCR always recommends an independent assessment to fully test the rigour and veracity of a group's compliance structures.

Table 4: Group corporate governance checklist

Description	Findings
Directors - Executive	3 partners: the managing partner is supported by the chief investment officer and head of legal.
- Non-executive	9 (of which 6 are independent).
Frequency of meetings	Quarterly, and *ad hoc* as necessary. Individual SPVs' board of representatives also meet quarterly, and the SPVs' boards receive monthly reports from CRE.
Separation of the chairman	The chairman is separate from the executive.
Board committees	4 – Audit & Risk; Technology & Innovation; Human Resources, Governance & Compensation; Investment and Strategy
Internal control/ compliance	Yes- reports to the Audit & Risk committee.
External auditors	Grant Thornton Certified Public Accountants (Kenya). Unqualified group audits were provided for both operating years. All the SPVs' accounts are audited, in line with external auditors' requirements.

At the group level, management investment committee meetings are held weekly to vet potential projects, which are either passed, sent back for further review or rejected, based on strict internal hurdle rates and considerations. All the technical teams are represented at these meetings, which allows for the early identification and correction of any internal redundancies and bottlenecks. The committee is also used as a multi-disciplinary task force and to refine potentially viable, but poorly presented opportunities.

Most of Cytonn's capital and that of CMS' clients remains vested in development assets, and it is the proceeds from these sales that will provide most of the cash flows for ongoing investments in real estate projects and to pay clients promised returns. As such, the group is exposed to numerous risks inherent to real estate and those unique to developing markets. Real estate developments are innately exposed to, *inter alia*; regulatory risk (such as zoning, licencing and other approvals), construction risk (including delays, building and weather-related risk, as well as market risk (including demand for and pricing of developments).

East African markets also present myriad risks related to inadequate infrastructure, including roads, railways and ports, as well as insufficient and often unreliable power supply. In addition, regional economies report large current account deficits as a function of import reliance for consumer goods, which is further exacerbated by the large capital imports associated with the rampant public and private sector development that is occurring. These deficits drive volatile and often high inflation, as well as currency fluctuations, in turn impacting interest rates (and therefore credit extension and affordability). Apart from inflating project costs and eroding real returns, these factors affect planning accuracy, thereby increasing capital risk. The internalisation of strong level of technical expertise and construction capability allows for better management of deadlines, costs and regulatory risks, and is thus positively viewed. Cytonn uses external consultants for innovation and specialised skills, with all work put out to tender to ensure transparency as well as active market participation. It will also likely partner with external contractors on larger developments, with these developers possibly providing both technical and financial resources.

Table 5: Project origination process

Gate 0: Site Evaluation and acquisition Site acquisition, extensive legal checks and other due diligence on the property and finalising deal with land owner	**Gate 1: Business case** Determine viability of the project including costs, constraints and market research	**Gate 2: Pre-development** Obtain statutory approvals, source required funds, and award contracts
Gate 4: Exit Project is brought to an orderly close and exited through the most viable option		**Gate 3: Development** Construction phase, which should end with issuing the practical completion certificate

The governance and operating structures have also been designed so as to accurately allocate and measure resources assigned to each project, which are treated as individual equity investments with targeted returns and investment hurdles. The process of identifying and securing viable projects, from due diligence to actual ground-breaking (outlined in table 5) requires extensive research, real-time feedback and co-ordination across all technical teams, as well as strict management oversight and timely response. For example, five projects signed onto the deal pipeline in FY16 came from a process of reviewing more than 1,800 land parcels. Regardless of having passed all the other hurdles, construction does not begin until 10-15% of a planned development is sold off-plan, with plans to sell off a fair amount of the remaining units prior to completion. If actual uptake is weak, a project can be scrapped before ground-breaking, with the partnerships with landowners and other parties dissolved to mitigate further capital risk.

Projects are structured to mitigate material cost variability, albeit Cytonn generally has to factor in the risk of increases in material costs. As such, plans include contingency reserves to cater for minor cost variations, as well as insurance and guarantees to cover failure to deliver within schedule or per pre-agreed specifications (including latent defects on completed projects, which will still fall to CRE's account up to a year post completion). Large projects will be rolled out in phases, further reducing exposure. Regulatory risks are addressed through a strong focus on compliance, with various policies and procedures in place to this end. According to Cytonn, constant engagement with the relevant professional bodies is part of the key deliverables of the legal team. CRE and its professional staff are registered with the respective regulators, and the company also a member of the Kenya Property Developers Association and other industry bodies. These strategies and mitigants aside, the group remains inherently exposed to the abovementioned factors, with risks further exacerbated by the current concentration to a few projects.

Management assessment

Due to its high requirements with respect to human capital, Cytonn has a team of over 300 professionals, supported by interns and the aforementioned advisers/agents. Cytonn's long term vision entails planned residential communities and mixed-use developments across East Africa, although projects underway are currently focused on certain nodes in Nairobi. The longer tail pipeline includes projects in certain rapidly expanding nodes in cities such as Kigali and Kampala in its opportunity pipeline. GCR has carried out an assessment of management quality based on its fund criteria, reviewing the corporate profile, risk framework, performance (against mandate and internal benchmarks), as well as financial sustainability (*inter alia*).

Table 6: Management quality considerations	
Corporate profile	**Ownership & governance:** With respect to Cytonn (the group), partners are able to freely transfer shares and can therefore trade out of the partnership without materially impacting its sustainability. Its subsidiaries are incorporated as LLPs/LLCs, which reduces certain corporate governance considerations. That said, strong boards have been constituted while board charters are in progress for the SPVs, showing stronger governance rigour than is typical of fund administrators/start up entities. **Human resources/staffing:** Evidence of appropriate segregation of functions. Note is also taken of the proven track record of the managing partners and associated professionals. Retention is bolstered by the partnership structure. **Client/market profile:** Cytonn targets both individual and institutional investors, with investment horizons of at least one year. Asset/liability mismatches are expected to increase as large-scale entities are taken on, especially if Cytonn's CMS products do not perform in line with expectations. Some comfort is taken from the strong distribution network, which is expected to drive strong AUM growth, RE pre-sales and continued retention of client assets in the medium term.
Portfolio management and performance	**Investment philosophy & strategy:** The group targets strong yields from alternative investments (including real estate as well as quote and private securities), presenting a high-risk mandate compared to funds targeting capital preservation. **Performance and financial stability:** Cytonn has a largely unproven performance profile, given that none of its RE developments have yet to reach completion, and that its broader investment offerings are at nascent stages. The stability of the business is contingent upon partnership commitment, which has not yet been compromised or fully tested, given Cytonn's short history. The significant exposure to Greenfields real estate projects considerably increases performance risk, as Cytonn guarantees returns on its offerings, the partnerships are vulnerable to material capital erosion if the residual income is weak/erratic, or if projects are loss-making. There is also potential contagion risk that could arise from weak delivery on initial projects, which could affect future market participation in/ta up of Cytonn's investment offerings. CMS is targeting an aggressive AUM profile off a low base; with the intention to replicate management's success at BAM in this regard. Management has shown a strong product development profile to date, albeit the sustainability of this strategy remains to be tested.

Table 6: Management quality considerations (contd.)	
Portfolio management cont.	**Management practices:** Cytonn's investment management processes are based on strong precepts, including fundamental economic research (as evidenced by published observed evidence and due diligence related to ongoing projects), analysis and external consultations, upon which house views on market pricing, demand and macro-trends are based. Quantitative models and subjective analysis are used to determine working project optimisation decisions. Assets are chosen to suit the credit/diversification and duration requirements of the portfolio, subject to market considerations. **Research and support structures:** Support functions are in-house, and are maintained on the back of a extensive ERP system (SAP Bus 1). Systems are fully automated; Nasser Olwero (Director of Information Science at World Wildlife Fund) heads the Technology & Innovation committee. The IT team has 30 developers, and has built the group's system and software requirements on the back of internal engagement and industry best practice.
Risk management	**Compliance:** Risk oversight structures are clearly delineated. Systems are structured to mitigate breaches/and to flag any in real time. Breaches are communicated to the management committee immediately (a feature of the system), albeit the speediness of interventions is unclear. Reconciliation controls are in place, albeit the rigour of the asset/liability matching function have not been assessed. The Investment Policy Statement outlines the investment limits, as well as daily, weekly and monthly reconciliations for all the funds. The Cytonn Relationship & Investment Management System ("CRIMS") has automated the firm and increases operational efficiency and security. **Concentration risk:** In terms of ownership, this is considered to be moderate-high, albeit the participation by way of partnerships has risen beyond the 50 level. Investor retention is managed *via* close relationships with clients, matching investor appetites and profiles to the market exposures, and following internal liquidity, divestiture and investment uptake limits. That said, these parameters are quite broad, which elevates performance risk. Asset quality and concentration risk are also impacted by significant exposure to a single asset class, albeit note is taken of free cash flows already being derived from the initial projects. Cytonn is also growing its private and quoted private equity exposures. Overall delivery is strongly contingent upon timely completion and continued success of the distribution model. **Market risk:** Although note has been taken of the rigour of the research function, exposure to high-yield products increases market risk, especially since there are no capital preservation offerings to ameliorate this risk. Quoted equity exposures currently include strong counters (such as KCB), albeit this the weighted credit risk may be impacted by future asset selection and the planned increase in exposure to unquoted securities. Banking counterparty exposure is intermediate, with highly-rated counterparties expected to give futher comfort. The improved debt maturity profile expected to result from project note issuance and greater access to bank facilities does bring better matching of project vs. funding/liability maturity.

GCR notes that Cytonn's CMS in particular, does not fall under the jurisdiction of collective investment scheme or other regulatory requirements that are in place to govern fund administration in Kenya, including (but not limited to) registration with the Capital Markets Authority ("CMA"). A number of Cytonn's products (such as the Co-op and Diaspora offerings) do not fall under the ambit of the Central Bank, Sacco Societies Regulatory Authority, as the underlying entities are not deposit-taking institutions and are not required to register with the Retirement Benefit Authority, as they do not directly engage policyholders.

According to management, Cytonn operates under *reg* 21 of the Capital Markets Act, which does allow for private offerings. The group is also in discussions with CMA on licencing and finding the right regulatory structure within which the Authority can have effective oversight of its offerings, as the current framework does not cover them.

Operating environment

Kenya's economy grew at an estimated 5.8% in 2016, on the back of strong public fixed capital formation, services, agricultural productivity and resilient consumer demand, amongst others. Although growth fell behind the state's aspirational targets, the economy does reflect underlying momentum from public investment in fixed capital and renewed foreign investor interest. A number of key construction tenders have either been awarded, or have advanced materially in their planning. These projects aside, Kenya has decades of infrastructural backlogs to address, with power and transportation deficiencies in particular, continuing to limit substantive economic devolution and industrial development.

While inflation moderated to a low of 5% in May 2016, it breached the Central Bank of Kenya's ("CBK") upper limit in February 2017, rising to 11.5% in April 2017, then futher to 11.7% YoY in May 2017. The food and non-alcoholic beverages basket, which accounts for around a third of the CPI weighting, drove the upward trend, with the cost of staples such as maize and potatoes increasing at more than 20%, due to the drought affecting most of the country and the region. This follows on steep food price inflation trends since 2015, implying that disposable income, mainly in the lower income brackets, has been massively eroded. Although pressures cooled notably from June 2017 as food prices moderated, retail performance as well as manufacturing productivity for the year are expected to be materially lower than initially forecast.

The CBK loosened monetary policy during 2016, with the Central Bank Lending Rate ("CBR") falling to 10.0% in September 2016, from 11.5% in January 2016. Over the same period, T-bill rates fell from 11.36% to a low of 7.76% (October 2016), before rising steadily to 8.62% in January 2017. In August 2016, the Government of Kenya ("GoK") signed a bill to cap the interest rate that banks can charge customers at 4% above the CBR. This has effectively capped the current maximum interest rate at levels well below what was being charged previously, translating to large savings on several listed companies' existing loan agreements. However, with banks' margins expected to be squeezed by the recent developments, it remains unclear what impact this will have on banks' willingness to lend in the medium term. This rate cap change followed the collapse of three banks from August 2015 to March 2016, and accordingly, appetite for corporate bond issues is likely to stay low. There is still some demand for short term paper from private investors, albeit more appropriate for small to medium sized corporates with low debt requirements (up to KES500m).

Growth is expected to slow to c.5% in 2017, albeit with continued strong performances from construction and real estate. That said, GCR notes the moderately disruptive impact of the recent elections. As expected, planned public and private infrastructure projects slowed in the run up to August 2017, while business and investor activity are expected to be restrained into 2018.

Property market

During 2016, property market dynamics in Kenya became more challenging, akin to the economic climate. Both the number of transactions and prices for prime space have eased, particularly in the Nairobi CBD and surrounding satellite cities, mainly due to oversupply. The elections have also been partial constraining factor. Mombasa's real estate segment, on the other hand, has been adversely affected by the drop in the tourism industry over the few last years.

While residential property prices continue to show positive yearly growth, the pace has slowed dramatically. As strong demand for housing persists, however, most developers have focused on the middle to high-end property market (considered to yield more lucrative returns), thus excluding the vast majority of the population. Developers have also tended to lean more towards rentals than sales, with the high and upper middle segments becoming saturated. Given the high rates charged in these neighbourhoods, vacancies have started to rise. Nonetheless, large mixed-use projects remain popular, with the appeal of such properties being the quality of life offered by living, working and having all amenities in close proximity, in addition to the modern facilities and green spaces on offer. A factor impeding residential sales is the limited rate of mortgage approvals by banks. As the capping of interest rates has reduced the cost of borrowing for potential buyers, mortgages are now less attractive for financial institutions, whilst rising bad debts feed into tightening lending criteria. The softening of sales and rentals has also been impacted by lay-offs and closures of businesses.

The office sector is in a glut in a number of nodes, as most new developments were built for speculative purposes in view of the historical strong demand and became available simultaneously, amidst corporates and NGOs downscaling, and the departure of multinational firms, mainly in the oil industry. The relatively long lead time in securing tenants is also compounded by the high market saturation of very good quality buildings available. Furthermore, while there has been a trend of developers offering higher grade buildings in new decentralised office nodes away from the CBD (such as Westlands, Upper Hill and Parklands) where strong demand still exists, these too have showed lower occupancy rates, thus forcing down rentals.

In the retail space, several new malls have opened in the past two years, although 2016 saw a slow-down in the uptake of space, partly on account of financial challenges facing three major local retailers. Furthermore, certain malls are struggling to attract footfall, given financial pressures on consumers. Thus in a generally passive real estate market where sales are slowing, further construction may eventually trigger sizeable price depreciations in some nodes due to oversupply, especially if a recovering stock market draws demand from both institutional funders and high net worth individuals. GCR has reviewed pressures impacting regional markets, including general patterns observed with respect to development activity, pricing, institutional capital investment, rates, letting activity and regulatory changes (including the evolution in spatial planning, amongst other factors).

That said, note has been taken of Cytonn's strategic nodal positioning in seven key areas around the Nairobi CBD, as well as the positioning of projects in areas that show strong sustained medium to long term demand in the region. Per management, demand largely derives from a burgeoning middle-class, which is seeking to secure competitively priced developments. Cognisance is taken of backlog for housing of around two million units, albeit this has to be considered against the backdrop of increased development rollout, pressure on disposable income and evolving socio-political dynamics. The true efficacy of this strategy will have to be borne out/proven by strong uptake of properties within Cytonn's developments over the rating horizon, which will translate to strong free cash flow and liquidity through the cycle.

Financial performance

A financial synopsis of the group and company is appended to this report and brief comment follows hereafter. Due to the short track record and extensive changes expected in Cytonn's profile and performance, the analysis mainly focuses on the company and group projections to FY19.

Revenues have risen materially since Cytonn's inception, on the back of the launch of The Alma and Situ Village. At group level, turnover is underpinned by the sale of units, which is recognised as a percentage of completion, and only when a sale agreement has been signed. Out of the sales revenue, the SPVs pay project management fees upon the attainment of certain milestones, while Cytonn also receives structuring fees from the projects. Residual income comprises flows from the fund (CMS) and annual management fees (plus carry) for assets managed on behalf of institutional clients. Cytonn also recognises commission income from the SPVs (2% of sales), and pays 1% of sales to its agency force on retainer. At company level, Cytonn only reports income from services rendered, as well as the residual return (or loss) it earns as the principal partner responsible for the administration of the underlying LLPs and LLCs.

Gross profit is calculated on the basis of the proportion of costs associated with sales revenue achieved. FY16 saw the group report an operating loss before interest, depreciation and tax, mostly because of the increase in capabilities across the group, which saw staff costs quadruple to KES232m, absorbing c.43% of revenue. This has been considered against the relative underperformance against budget at the topline, due to some delay on certified revenue outcomes (a factor of lower than anticipated sales). As such, the effect of the ramp up in advertising costs due to the launch of a number of new projects, the managing partners' hurdle rate, as well as legal and professional fees, saw costs surpass revenue recognised for the year.

Table 7: Revenue and earnings composition (company)	KES'm			% contribution		
	BY17	BY18	BY19	BY17	BY18	BY19
Structuring fees	345	339	460	27.1	14.0	15.9
CMS residual income	85	278	183	6.7	11.4	6.3
Project management fees	325	472	463	25.5	19.4	16.0
Return from subsidiaries	517	1,336	1,781	40.6	55.1	61.7
Total revenue	**1,271**	**2,425**	**2,886**	**99.9**	**100.0**	**100.0**
Other	1.1	0.2	0.2	0.1	0.0	0.0
Total Income	**1,272**	**2,425**	**2,887**	**100.0**	**100.0**	**100.0**
EBITDA/margin	1,272	2,425	2,887	55.2	55.6	60.6
Net profit/margin	665	1,298	1,662	52.3	53.5	57.6

GCR has noted the material progress made by 1H FY17, where group revenue was nearly 2.5x the value recognised a year earlier. Employee costs were also closely aligned to expectations, absorbing c.34% of group revenue. Table 7 shows the revenue split planned for the medium term, showing how much the top line (and margin) performance will rely on sustaining project efficiencies with (the company position used as it illustrates the revenue split). GCR's analysis will not only focus on performance against the strong targets, but also on underlying outcomes such as the rate of pre-sales achieved, any project schedule delays and the impact thereof, inefficiencies, as well as Cytonn's ability to generate operating leverage from the timely launch (and management) of the new projects planned.

While the consolidated finance costs of Cytonn's external loans have been modest to date, the group net interest cover ratio has been erratic/weak. This is expected to improve as free cash flows from the real estate projects increase, which in turn is a factor of the timely roll out of developments planned for the short to medium term. The cost of funding projected for the group's projects is intermediate, at an estimated 18% flat rate for bank facilities, and a fixed 21% p.a. on the financing derived from CMS. Looking ahead, the planned project notes will pay partners an estimated 20% p.a. Year-on-year debt service metrics at group level are materially enhanced by the capitalisation of the finance charge and the accrual of interest (albeit the latter increases the point in time burden of refinancing on note maturity).

Company debt levels are modest and are expected to remain fairly low, as gearing will be limited mostly to participation on the SPVs' notes and financing for land purchases. Pricing risk will be moderated by the fixed rates on imminent facility drawdowns/note issues, although the group will still be exposed to rate variability in the medium term, depending on changes to monetary policy, market pricing factors and exposures arising from any cross-territorial/foreign currency loans.

Sizeable fair value gains have been recognised to date, and will continue to accrue from ongoing projects. Independent valuations are conducted for the projects each year, which does give some comfort with respect to the veracity of the financial position. Cytonn had to impair its exposure to Imperial Bank after the entity was placed under receivership (KES96m). The expense is flagged largely because it points to laxity in selecting counterparty exposures, with the group expected to employ much more stringent policies going forward. According to management, the investment team uses the CAMELS (capital adequacy, management experience, liquidity and sensitivity) framework and other analytical tools to enhance the rigour of asset selection for banking securities.

Overall, and after accounting for taxation, the company net profit margin is projected at an average of 55% over the three years to FY19. The group net profit margin is projected to average a lower 38% after accounting for the funding cost of the SPVs and higher effective taxation rate. Major considerations in respect of the ratings in this regard are margin and cash earnings resilience through the cycle, which will be dependent on timely and successful project execution. As this could be curtailed by regulatory, construction and socio-political constraints, weaker than anticipated project uptake and market volatility, GCR has considered stressed conditions, which could see project returns fall short of management's expectations of 20-30%. In comparison, the targeted spread of 5-7% p.a. allows for more headroom to absorb variability (after accounting for guaranteed returns earmarked for Cytonn's investors and partners). That said, even this is susceptible to variability on a year-on-year basis, as it depends on the progressive performance of the developments.

While cash generated by operations mirrored the EBITDA trend, the reported position has historically been distorted by material fair value adjustments related to the properties. This is expected to continue going forward, although GCR will focus on the underlying cash generative ability of the various projects and other investments. Working capital flows are also distorted by the timing of new projects and the various phases, with trading assets expected to be funded from advances and accruals. At the group level, sizeable inter-company movements intermittently reflect inflated, albeit transient working capital positions. The cost of these movements would only weigh on the funding profile if the cash conversion cycle slows due to project disruptions or delays, although the effect could also arise from materially elevated project costs. The group would be expected to sustain a comfortable debt serviceability ratio from free cash flows to support sound Issuer ratings. Erratic cash generation or protracted working capital pressures could lead to volatile discretionary cash flows and/or debt service metrics for the SPVs or the group, which could impact adherence to covenants and overall credit risk metrics.

Cytonn's property related cash flows are split between operating and investing cash flows, because assets being developed are meant for disposal to generate above-market returns on clients' funds under management. Cytonn's financing activities also comprise movements related to SPVs drawing on and settling CMS facilities, as well as cash flows related to land acquisitions, which for a typical property fund, would be represented as investing activities (being support to/from vendors or development partners). As such, the analysis has focused on the underlying factors driving the financing activities and how substantially the movements are likely to evolve going forward. An important consideration is also that financing will continue to be influenced by how successfully management can raise funding from pre-sales and CMS, as well as how quickly the cash cycle turns in order to reduce external debt to comfortable levels as the project pipeline gains traction.

Funding and liquidity profile

Table 8: Asset and funding profile (KES'm)	FY15	FY16	BY17	BY18	BY19
	Company				
Tangible equity	95	(277)	1,476	2,791	4,483
Total debt	91	576	403	752	1,209
Other liabilities	98	231	74	89	75
Company liabilities	**284**	**530**	**1,953**	**3,633**	**5,767**
Fixed assets	21	40	94	144	191
Subsidiaries/associates	41	10	260	450	735
Equities/other investments	87	339	953	1,884	3,080
Cash	6	19	582	1,064	1,711
Other assets	129	122	64	91	51
Company assets	**284**	**530**	**1,953**	**3,633**	**5,767**
	Group				
Tangible equity	3,746	5,331	6,858	17,243	20,424
Debt	2,456	5,644	12,476	15,116	25,985
--of which is senior debt	***1,492***	***2,137***	***9,189***	***11,134***	***19,139***
Other liabilities	466	859	635	1,107	1,934
Consolidated liabilities	**6,669**	**11,835**	**19,969**	**33,466**	**48,343**
Fixed assets	23	47	94	144	188
Investment properties	5,580	10,051	17,143	28,285	42,428
Subsidiaries/associates	761	1,125	1,213	2,334	3,560
Cash	21	64	886	1,671	709
Other assets	285	548	634	1,032	1,459
Consolidated assets	**6,669**	**11,835**	**19,969**	**33,466**	**48,343**

Table 8 outlines the differences between the company and consolidated position, emphasising the ring-fencing of the properties (and related debt exposure) to the development LLPs. The consolidated position also reflects the traction expected to be achieved with the non-property subsidiaries, investment in quoted securities (currently dominated by a holding of KCB shares) and private equity, as well as the accumulation of a fairly sizeable liquid asset portfolio from retained income. In comparison, the company position is dominated by investment of residual income accrued, which is projected to be vested in various securities as well as cash/gilt instruments.

Current and imminent real estate projects are to be funded by equity, mezzanine finance and debt at a 20:20:60 split. Plans to issue Cytonn project notes backed by cash flows from four developments will add funding flexibility in view of the deal pipeline projected. While the company position excludes the SPVs' obligations, Cytonn guarantees project note investors a yield of 20% p.a. CMS invests in the developments by way of one-year rolling investments (that have historically yielded a return of 21% p.a.), which provide an important source of funding and the advantages of a revolving facility. That said, high pre-sales are essential to ensure a comfortable funding profile for each project. They would also avoid unduly elevating the proportion of bank facilities drawn down at the high cost of funding that Cytonn has to contend with in the short to medium term. Equity derives from the partners, with note also taken of the landowners' contribution to capital.

Table 9: Gearing metrics (KES'm)	FY15	FY16	BY17	BY18	BY19
	Company				
Total debt: investments (%)	71.5	165.1	33.2	32.2	31.7
Net debt: investments (%)	66.9	159.7	n.a	n.a	n.a
Total debt: EBITDA (x)	2.8	neg	0.6	0.6	0.7
Net debt: EBITDA (x)	2.7	neg	n.a	n.a	n.a
Adj. total debt: EBITDA (%)*	--	--	0.8	0.8	1.0
Net interest cover (x)	88.9	203.4	251.7	88.9	203.4
	Group				
Gearing: external debt					
Total debt: properties (%)	34.7	24.6	53.6	39.4	45.1
Net debt: properties (%)	34.4	24.0	48.4	33.5	43.4
Total debt: investments (%)	30.6	22.1	50.1	36.4	41.6
Net debt: investments (%)	30.2	21.5	45.2	30.9	40.1
Total debt: EBITDA (x)	84.1	neg	12.7	8.1	13.6
Net debt: EBITDA (x)	104.0	neg	11.5	6.9	13.1
Gearing (mezzanine and external debt)					
Total debt: properties (%)	44.0	56.2	72.8	53.4	61.2
Net debt: properties (%)	43.6	55.5	67.6	47.5	59.6
Total debt: investments (%)	38.7	50.5	68.0	49.4	56.5
Net debt: investments (%)	38.4	49.9	63.1	43.9	55.0
Total debt: EBITDA (x)	166.6	neg	17.3	11.1	18.4
Net debt: EBITDA (x)	165.2	neg	16.1	9.8	17.9
Net interest cover (x)	n.a	neg	105.0	200.2	195.3

*Assumes an EBITDA of 40% of recurring revenue/income.

The mezzanine and external debt ratios per project align with most developers, but the elevated gearing metrics and the high proportion of capital exposed to development risk typically places pressure on the Issuer ratings until a track record of successful execution has been established, and until the Issuer has ample unencumbered investments that can be readily sold if so required. In this regard, note has been taken of Cytonn's ability to retain earnings, which will allow for the build-up of a liquidity buffer. The equity investments have also been considered, although disposal of these assets is likely to be restricted given that they may be linked to Cytonn's Regular Investment products.

The group's gearing metrics are aligned with those of "$BB_{(KE)}$" band-rated Issuers, with the high debt to EBITDA ratios especially indicative of the drag on earnings associated with the construction phase of the projects. This (and pressure on interest cover or debt service) could be significantly amplified by development bottlenecks or constrained uptake of the group's projects. In comparison, the company reflects a fairly strong credit risk profile, underpinned by the insulation of the balance sheet from the funding exposures of the projects. As such, Cytonn would be comfortably able to cover the return to the project note investors without materially impacting its credit risk profile. Should Cytonn guarantee any of the projects' debt, then the obligations of the SPVs would rank *parri passu* with those of the company. Even when it comes to the subordinated obligations, cross-guarantees transfer the risk of ultimately settling such obligations to the company, materially constraining its credit protection measures.

Due to the nature of its property exposure, a medium-term debt maturity profile comfortably aligns with Cytonn's investment horizon in this space. As such, the use of bank facilities and medium-term project notes does represent an improved asset/liability matching profile compared to CMS funding. However, it still represents an important source of capital, as banks would be cautious about fully funding such a large development exposure, Therefore, it will be important to sustain strong growth in CMS' AUM in order to ensure timely project rollout and completion.

Outlook and rating rationale

Although GCR notes Cytonn's comprehensive strategy, its main exposure is to the development and sale of residential and mixed-use properties, with plans to grow the property deal pipeline significantly through to FY19. Accordingly, the ratings take account of the risks of identifying, funding and successfully executing the project pipe-line, as well as management's ability to effectively recycle capital while consistently generating targeted returns for investors. This presents features similar to those of a REIT, although the group does benefit from retaining generated cash flows, investing broadly beyond the property space, as well as the capital and liquidity support from CMS.

The Issuer ratings are constrained by the short track record, albeit note is taken of the sound group governance structures, rigour of the risk protocols and the quality of management. The real estate model, especially is built on extensive due diligence, research and market knowledge, which allows management to unlock value from vacant land it secures through partnerships with the owners. That said, the broader investment offerings are still at nascent stages, and although some are already cash generative, none of the developments are yet complete.

Some comfort is taken from management's ability to secure partnership with global private equity firm Taaleri Plc and engagement with strong financial institutions. While associated funding is moderate given the strong growth trajectory planned, these relationships are an indication of Cytonn's ability to secure support from strong institutional investors and financial institutions.

Cytonn reports fairly low net LTVs at company level, which allows for it to comfortably guarantee the yield on the project notes. At group level, it presents high LTV ratios as well as a weak/volatile debt service and earnings based gearing trajectory, a trend which is only likely to stabilise with the diversification of the asset profile in the medium to long term. Guaranteeing the SPVs' principal would thus compromise the company's credit protection metrics, as it would effectively negate the ring-fencing of these obligations.

GCR has considered the medium to long term prospects of the region's property market, given the backdrop of a rapidly growing domestic economy and increased wealth levels. This notwithstanding, there are inherent risks associated with exposure to Greenfield real estate projects in emerging markets, including an ambivalent and/or evolving regulatory landscape, as well as high construction and market risks. Although the region provides exceptional growth prospects, it is exposed to additional risks including deficiencies in transportation infrastructure, erratic/costly power supply, the dependence of the economy on tourism and agriculture/horticulture, as well as the evolving socio-political environment. These factors amplify construction and market risks in particular, while having an effect on business and investor confidence in certain asset classes.

Plans to issue Cytonn project notes backed by cash flows from four developments will add funding flexibility in view of the rapid deal pipeline traction projected. While company debt excludes the SPVs' obligations, Cytonn does guarantee partners investing in the notes a return of 20% p.a. The mezzanine and external debt ratios per project align with most developers, but a strong Issuer rating is dependent on (amongst other factors) the group having ample unencumbered investments that can be readily sold at prices close to net book/open market value. This is currently constrained by the fact that the projects are still in progress, while the unencumbered equity portfolio is still relatively small. Liquidity is also function of the ability to sustain strong pre-sales and capital inflows from the sale of Cytonn's portfolio of investment products, given the high implied capital charge of using external revolving facilities to bridge funding gaps.

Cytonn Investments Management Limited: Company financials

(Kenyan shillings in millions except as noted)

Income Statement Year ended: 31 December	2015	2016	B2017	B2018	B2019
Sales income	144.3	119.9	1,271.2	2,424.5	2,886.2
Management fees and other income	0.0	4.0	1.2	0.2	0.2
Total income	***144.3***	***123.9***	***1,272.4***	***2,424.7***	***2,886.4***
EBITDA	*40.1*	*(137.0)*	*702.8*	*1,348.6*	*1,748.9*
Depreciation and amortisation	(6.5)	(12.2)	(18.1)	(26.7)	(37.2)
Operating income	**33.6**	**(149.1)**	**684.7**	**1,321.9**	**1,711.7**
Net finance charges	(4.8)	(61.4)	(7.7)	(6.5)	(6.8)
Property revaluations	2.3	(184.1)	0.0	0.0	0.0
Abnormal/exceptional items	0.0	0.0	0.0	0.0	0.0
NPBT	**31.1**	**(394.7)**	**677.0**	**1,315.4**	**1,704.9**
Taxation charge	(14.0)	(20.9)	(12.2)	(17.7)	(43.1)
NPAT	**17.1**	**(415.6)**	**664.8**	**1,297.7**	**1,661.8**
Cash Flow Statement					
Cash generated by operations	**42.5**	**(324.0)**	**n.a**	**n.a**	**n.a**
Utilised to increase working capital	(46.2)	141.7	n.a	n.a	n.a
Net interest paid	(4.8)	(61.4)	n.a	n.a	n.a
Taxation paid	1.1	(23.5)	n.a	n.a	n.a
Cash flow from operations	**(7.5)**	**(267.3)**	**n.a**	**n.a**	**n.a**
Maintenance capex*	(6.5)	(12.2)	n.a	n.a	n.a
Discretionary cash flow from operations	**(14.0)**	**(279.5)**	n.a	n.a	n.a
Dividends	0.0	0.0	n.a	n.a	n.a
Retained cash flow	**(14.0)**	**(279.5)**	**n.a**	**n.a**	**n.a**
Net expansionary capex	(21.3)	(19.1)	n.a	n.a	n.a
Investments and other	(127.7)	(221.4)	n.a	n.a	n.a
Proceeds on sale of assets/investments	0.0	4.1	n.a	n.a	n.a
Shareholders interest: cash movement	77.7	42.6	n.a	n.a	n.a
Cash movement: (increase)/decrease	(5.9)	(12.8)	n.a	n.a	n.a
Borrowings: increase/(decrease)	91.3	486.1	n.a	n.a	n.a
Net increase/(decrease) in debt	**85.4**	**473.3**	**n.a**	**n.a**	**n.a**
Balance Sheet					
Ordinary shareholders' interest	94.8	(277.1)	1,476.1	2,791.4	4,483.0
Outside shareholders' interest	0.0	0.0	0.0	0.0	0.0
Total shareholders' interest	**94.8**	**(277.1)**	**1,476.1**	**2,791.4**	**4,483.0**
Short term debt	1.0	1.2	0.0	0.0	0.0
Long term debt	90.3	575.0	403.1	752.0	1,209.2
Total interest-bearing debt	**91.3**	**576.3**	**403.1**	**752.0**	**1,209.2**
Preference shares	0.0	0.0	0.0	0.0	0.0
Other liabilities	98.1	231.0	73.5	89.4	74.9
Total liabilities	**284.2**	**530.2**	**1,952.7**	**3,632.8**	**5,767.1**
Fixed assets	21.3	40.3	93.9	143.9	190.6
Investment properties	0.0	0.0	0.0	0.0	0.0
Investments in subsidiaries and associates	41.2	10.4	260.3	449.8	734.7
Equities, accrued earnings from investments	86.6	338.7	953.1	1,884.2	3,080.0
Cash and cash equivalents	5.9	18.7	581.8	1,064.3	1,710.5
Other assets	129.2	122.2	63.6	90.6	51.3
Total assets	**284.2**	**530.2**	**1,952.7**	**3,632.8**	**5,767.1**
Ratios					
Efficiency/Profitability:					
Growth in assets under management (%)	1.4	4.7	13.7	28.9	38.3
Annuity income growth (%)	n.a	(14.1)	927.3	90.6	19.0
EBITDA : revenues (%)	27.8	neg	55.2	55.6	60.6
Operating profit margin (%)	23.3	neg	53.8	54.5	59.3
Return on equity (%)	36.1	neg	110.9	60.8	45.7
Return on capital employed (%)	28.9	neg	62.9	48.8	37.1
Properties for sale : total investments (%)	n. a	n. a	n. a	n. a	n. a
Expenses: annuity income (%)	78.4	231.3	44.8	44.4	39.4
Expenses: avg. total investments (%)	88.5	116.3	72.9	60.7	37.0
Coverage:					
Operating income : gross interest (x)	6.0	neg	88.9	203.4	251.7
Operating income: net interest (x)	6.9	neg	88.9	203.4	251.7
Activity and liquidity:					
Days receivable outstanding (days)	204.4	382.8	26.7	11.6	9.0
Current ratio (:1)	1.4	0.6	8.8	12.9	23.5
Cash & cash equivalents: debt (x)	0.1	0.0	1.4	1.4	1.4
Marketable securities: debt (x)°	0.6	0.4	1.4	1.5	1.5
Capitalisation/liquidity:					
Total debt : equity (%)	96.3	neg	27.3	26.9	27.0
Net debt : equity (%)	90.1	neg	n.a	n.a	n.a
Total debt : EBITDA (%)	284.4	neg	57.4	55.8	69.1
Net debt : EBITDA (%)	266.1	neg	n.a	n.a	n.a
Total debt : total investments (%)	71.5	165.1	33.2	32.2	31.7
Net debt : total investments (%)	66.9	159.7	n.a	n.a	n.a
Equity: total assets (%)	32.1	108.7	20.6	20.7	21.0
Discretionary cash flow: net debt (%)	neg	neg	n.a	n.a	n.a

*Depreciation used as a proxy.

°Assumes a 40% haircut on the value realisable from the investments.

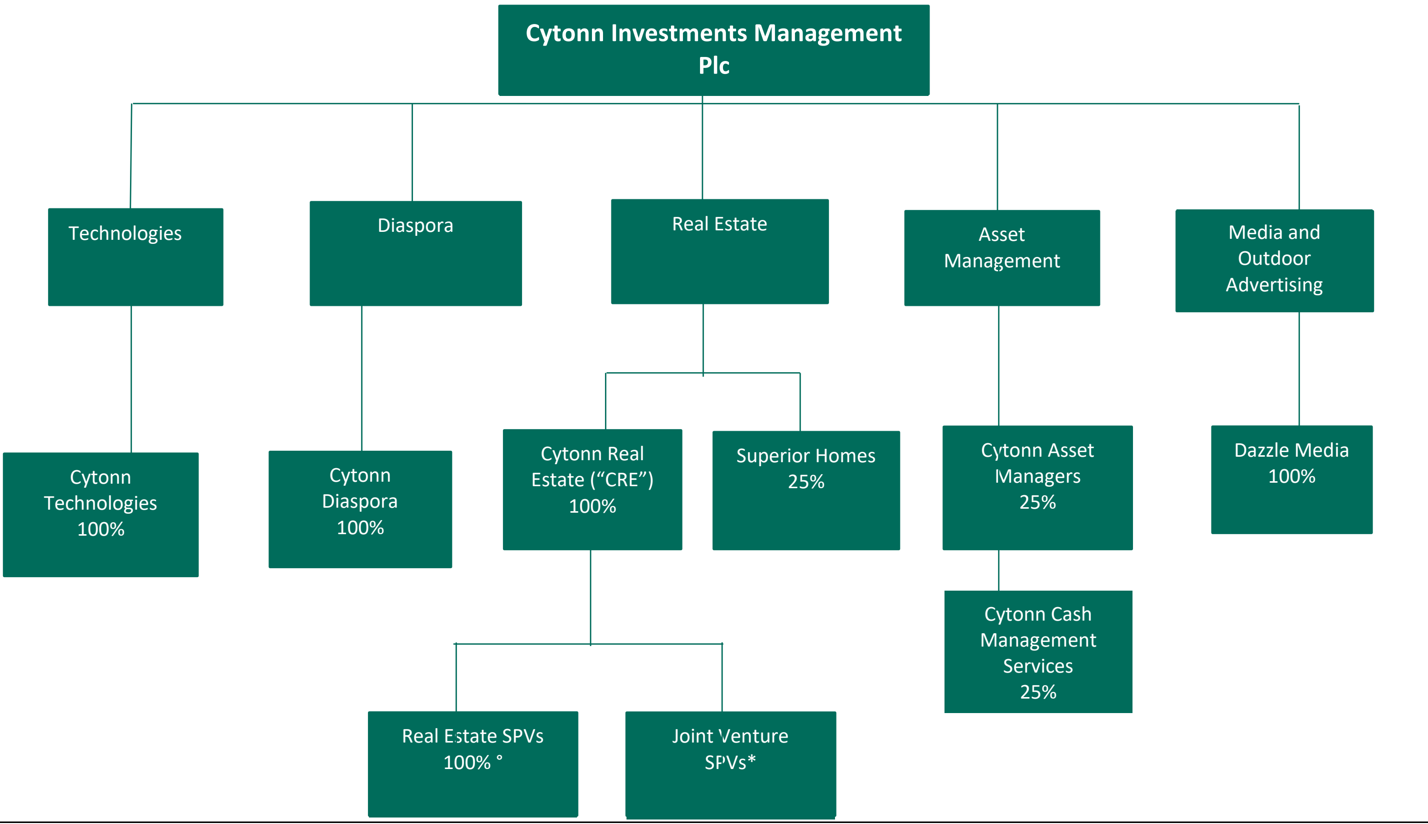
Cytonn Investments Management Limited: Group financials

(Kenyan shillings in millions except as noted)

Income Statement Year ended: 31 December	2015	2016	1H 2017[ᵻ]
Sales income	185.7	531.5	638.8
Management fees and other income	0.0	4.0	84.3
Total income	***185.7***	***535.5***	***723.1***
EBITDA	*18.4*	*(255.1)*	*47.7*
Depreciation and amortisation	(7.2)	(14.7)	(9.8)
Operating income	**11.2**	**(269.9)**	**37.9**
Net finance charges	19.1	(32.9)	(92.2)
Property revaluations	664.0	439.6	382.5
Abnormal/Exceptional items	0.0	0.0	0.0
NPBT	**694.3**	**136.9**	**328.2**
Taxation charge	(14.0)	(20.9)	(46.9)
NPAT	**680.3**	**116.1**	**281.3**
Cash Flow Statement			
Cash generated by operations	**680.1**	**270.2**	**420.4**
Utilised to increase working capital	(96.5)	179.4	57.5
Net interest paid	19.1	(32.9)	(92.2)
Taxation paid	1.1	(23.5)	(46.9)
Cash flow from operations	**603.8**	**393.2**	**338.8**
Maintenance capex*	(7.2)	(14.7)	(9.8)
Discretionary cash flow from operations	**596.6**	**378.4**	**329.0**
Dividends	0.0	0.0	0.0
Retained cash flow	**596.6**	**378.4**	**329.0**
Net expansionary capex	(22.8)	(24.7)	(34.8)
Investments and other	(2,568.8)	(891.4)	(2,115.5)
Proceeds on sale of assets/investments	0.0	4.1	0.0
Shareholders interest: cash movements	77.7	43.7	(20.8)
Cash movement: (increase)/decrease	(20.7)	(43.0)	(35.6)
Borrowings: increase/(decrease)	1,938.1	533.0	1,877.7
Net increase/(decrease) in debt	**1,917.4**	**490.0**	**1,842.1**
Balance Sheet			
Ordinary shareholders' interest	516.5	360.1	1,156.3
Outside shareholders' interest[ª]	3,229.8	4,971.2	3,373.7
Total shareholders' interest	**3,746.3**	**5,331.3**	**4,530.0**
Short term debt	445.9	333.7	0.0
Long term debt	2,010.4	5,310.7	8,974.6
Total interest-bearing debt	**2,456.3**	**5,644.4**	**8,974.6**
Preference shares	0.0	0.0	0.0
Other liabilities	466.4	859.1	1,216.5
Total liabilities	**6,669.1**	**11,834.7**	**14,721.1**
Fixed assets	22.8	47.5	92.9
Investment properties	5,580.2	10,050.8	11,660.2
Investments in subsidiaries and associates	760.7	1,125.1	1,922.4
Cash and cash equivalent	20.7	63.7	76.4
Other assets	284.6	547.6	969.2
Total assets	**6,669.1**	**11,834.7**	**14,721.1**
Ratios			
Cash flow:			
Operating cash flow : total debt (%)	24.6	7.0	7.6
Discretionary cash flow : net debt (%)	24.5	6.8	7.4
Profitability:			
Turnover growth (%)	n.a	188.4	35.0
Gross sales margin (%)	89.8	39.0	44.7
EBITDA : revenues (%)	9.9	neg	6.6
Operating profit margin (%)	6.0	neg	5.2
Return on equity (%)	169.9	neg	44.6
Properties for sale : total investments (%)	88.0	89.9	85.8
Coverage:			
Operating income : gross interest (x)	1.5	neg	0.4
Operating income: net interest (x)	n.a	neg	0.4
Activity and liquidity:			
Days receivable outstanding (days)	94.5	122.7	131.2
Current ratio (:1)	0.4	0.6	0.9
Marketable securities : debt (x)°	0.1	0.1	0.0
Capitalisation:			
Total debt : equity (%)	65.6	105.9	198.1
Net debt : equity (%)	65.0	104.7	196.4
Total debt : EBITDA (%)	16,657.6	neg	18,814.7
Net debt : EBITDA (%)	16,517.4	neg	18,654.5
Loan to value			
Total debt : investment properties (%)	44.0	56.2	77.0
Net debt : investment properties (%)	43.6	55.5	76.3
Total debt : total investments (%)	38.7	50.5	66.1
Net debt : total investments (%)	38.4	49.9	65.5

ᵻUnaudited interim results. Due to differences in disclosure on certain line items/assumptions, these results are not directly comparable with the full year position.
*Depreciation used as a proxy. °Assumes a 40% haircut on the value realisable from the investments.
ªReflects the positions/interests of other partners apart from the principal.

Appendix A: Group organogram at 30 June 2017



° The real estate/project SPVs are wholly-owned by Cytonn. CRE is entitled to 50% of the governance rights in its capacity as the projects' managing partner. It also earns a development management fee for successful delivery of any projects executed. Projects at 30 June 2017 included:

- Taraji Heights- Cytonn Investment Partners Ten, LLP
- The Alma- Cytonn Integrated Project, LLP
- The Ridge- Cytonn Investment Partners Eleven, LLP
- Situ Village- Ololua Estates, LLP
- Cytonn Towers/Kilimani- Cytonn Investment Partners Seventeen, LLP
- Applewood- Cytonn Investment Partners Eighteen, LLP

* The joint venture SPVs between Cytonn and various landowners are at an equity split of 50:50. Cytonn has also ceded 25% governance rights in the following SPVs to CRE:

- Amara Ridge- Cytonn Investment Partners Three, LLP
- Riverrun Estates- Cytonn Investment Partners Five, LLP
- Newtown- Mystic Plains LLP
- Westlands- Cytonn Investment Partners Nine, LLP

Appendix B: Real estate deal pipeline (KES82.2bn at 31 March 2017)

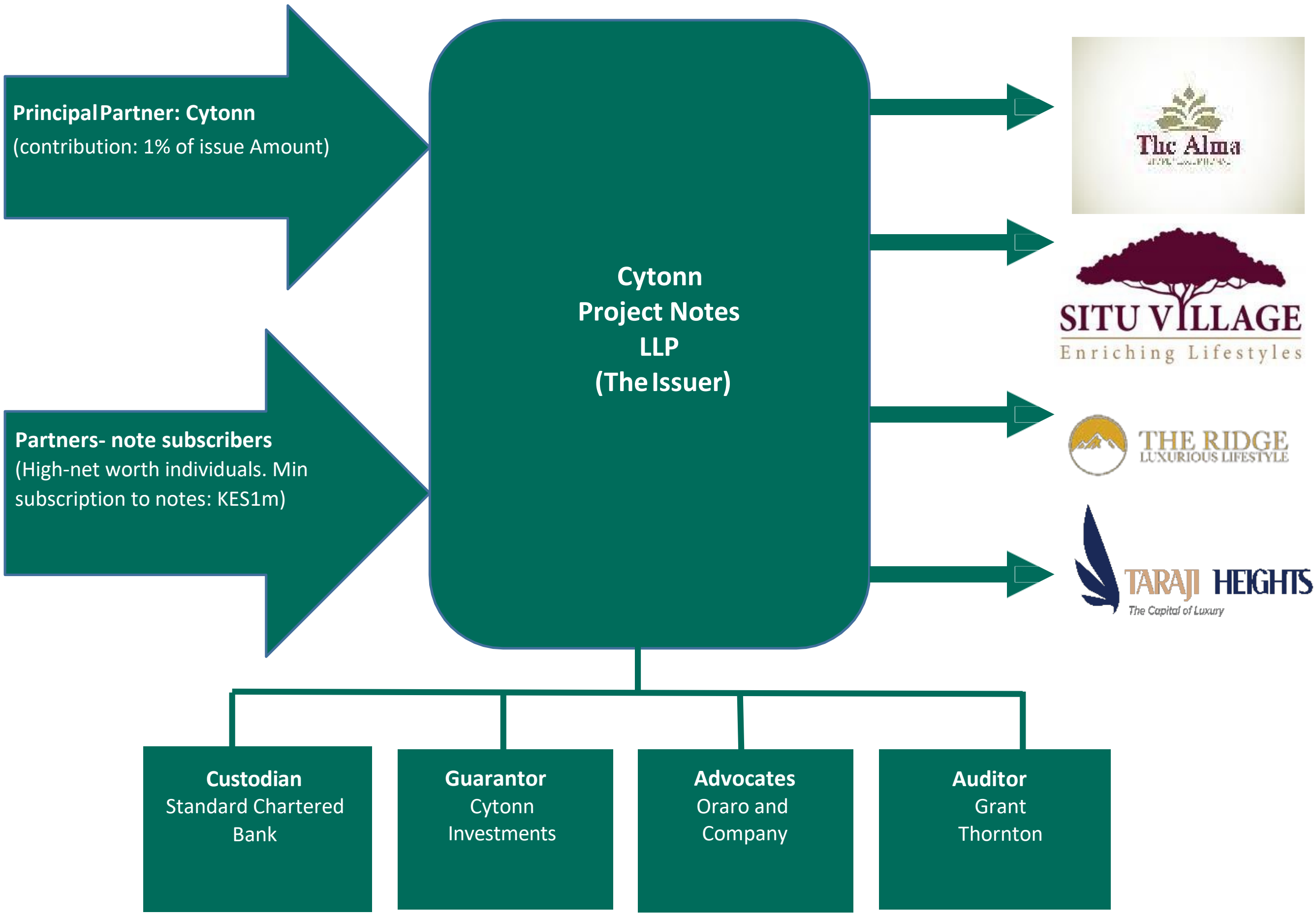
Name	Concept	Development Return (%)	Start date	Investment
	Launched projects			
Amara Ridge	10 exclusive villas, each sitting on a half-acre, with a lifestyle clubhouse to complement the development	25	May-15	Debt, Mezzanine, Off-plan Villa
The Alma	Integrated lifestyle development featuring 453 units of 1, 2 & 3-bedroom apartments. Mixed use with a retail, commercial and lifestyle facility	25-30	May-16	Debt, Mezzanine, Off-plan Residential Unit
New Town	Master-planned city in Athi River – mixed use, encompassing low-medium density clusters, high density residential, an office precinct, educational centre and trade centre	25-30	Nov-17	Equity, Debt, Mezzanine
Taraji Heights	Integrated lifestyle development with 250 units of 2 and 3-bedroom apartments, as well as lifestyle facilities	25-30	Apr-17	Equity, Debt, Mezzanine, Off-plan Residential Unit
The Ridge	High density mixed-use development in Ridgeways in Nairobi, comprising of 800 units of residential – mixed use, including commercial, retail and lifestyle features	25-30	Jun-17	Equity, Debt, Mezzanine, Off-plan Residential Unit
Situ Village	Master-planned gated community, with 50 exclusive villas, each sitting on a half-acre, retail, commercial facility and a clubhouse and lifestyle facility featuring exclusive cottages	35	Jun-17	Debt, Mezzanine, Off-plan Villa
	Projects at design phase			
Project Westlands	Serviced low-density apartment development	25-30	Aug-17	Equity, Debt, Mezzanine
RiverRun Estates	High density, mixed use development, comprised of 1,200 residential units, commercial, retail and lifestyle	25-30	Sep-17	Equity, Debt, Mezzanine
	Projects at deal origination			
Project Kilimani	High density mixed-use development in Kilimani, comprising of 1, 2 and 3-bedroom apartments, office, retail, hospitality and an executive club	25-30	Mar-18	Equity, Debt, Mezzanine
Project New Kitisuru	15 exclusive villas, on a 5-acre parcel, with a lifestyle clubhouse to complement the development	25-30	Dec-17	Equity, Debt, Mezzanine
Project Karen	20 exclusive villas, each sitting on a half-acre, with a lifestyle clubhouse to complement the development	25-30	Oct-17	Equity, Debt, Mezzanine

Appendix C: Deal origination schedule, 31 July 2017*

Name/designation		Project value (KES'm)	Weighting (%)	Cumulative value (KES'm)	Acquisition
1	Amara Ridge	807	0.59	807	Jun 16
2	Taraji Heights	2,797	2.05	3,604	Jul 16
3	The Alma	3,757	2.75	7,360	Aug 16
4	Situ Village	5,272	3.87	12,632	Sep 16
5	The Ridge	11,013	8.08	23,646	Oct 16
6	NewTown	22,354	16.39	46,000	Nov 16
7	Westlands	728	0.53	46,728	Dec 16
8	Ruiru	10,000	7.33	56,728	Jan 17
9	**New Kitisuru**	**1,063**	**0.78**	**57,791**	**May 17**
10	Karen - 5 acres Windy Ridge	950	0.70	58,741	Jun 17
11	Karen - 10 acres Miotoni	2,039	1.50	60,780	Jul 17
12	Karen 6.5 Acres Mudodo Lane	912	0.67	61,691	Aug 17
13	New Kitisuru 2	1,063	0.78	62,755	Jul 17
14	Kilimani	15,479	11.35	78,233	Sep 17
15	Lower Kabete 1	1,569	1.15	79,802	Jul 17
16	Kikuyu	2,894	2.12	82,696	Jul 17
17	Garden Estate/Redhill	1,000	0.73	83,696	Oct 17
18	Loresho	1,063	0.78	84,759	Nov 17
19	**Mt View**	**4,620**	**3.39**	**89,379**	**Dec 17**
20	Karen End	3,448	2.53	92,828	Jan 18
21	Loresho	1,000	0.73	93,828	Feb 18
22	Loresho	1,000	0.73	94,828	Mar 18
23	Loresho	1,000	0.73	95,828	Apr 18
24	Loresho	1,000	0.73	96,828	May 18
25	**Commercial (Ruiru)**	**10,000**	**7.33**	**106,828**	**Jun 18**
26	Amara Kampala	801	0.59	107,629	Jul 18
27	Alma Kampala	3,757	2.75	111,386	Aug 18
28	**Amara Kigali**	**801**	0.59	**112,187**	**Sep 18**
29	Scheduled for FY19	5,609	4.11	117,796	Jan 19
30	Scheduled for FY19	5,890	4.32	123,686	Apr 19
31	Scheduled for FY19	6,184	4.54	129,871	Jul 19
32	Scheduled for FY19	6,494	4.76	136,364	Oct 19

*These represent deals at the level of engagement with the landowners. Once the land partnership is finalised, the project moves to the design phase. Projects can still be jettisoned at this stage, if the land due diligence process does not pass. All projects that are moved onto the pipeline have been approved by the board management committee, a deposit has been received, or a land agreement is close to being finalised.

Appendix D: Cytonn project notes profile/counterparties



GLOSSARY OF TERMS/ACRONYMS USED IN THIS IN THIS DOCUMENT AS PER GCR'S CORPORATE GLOSSARY

Bad Debt	A bad debt is an amount owed by a debtor that is unlikely to be paid due, for example, to a company going into liquidation. There are various technical definitions of what constitutes a bad debt, depending on accounting conventions, regulatory treatment, and the individual entity's own provisioning and write-off policies.
Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Bankruptcy	Court proceedings at which an individual or a company is declared unable to pay its creditors. The liabilities of a bankrupt company typically exceed its assets.
Capital Expenditure	Expenditure on long-term assets such as plant, equipment or land, which will form the productive assets of a company.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Commercial Paper	Commercial paper is a negotiable instrument with a maturity of less than one year.
Consumer Price Index	CPI is an index of inflation. It is calculated by collecting and comparing the prices of a set basket of goods and services bought by a typical consumer at regular intervals over time.
Corporate Governance	Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed, and is used to ensure the effectiveness, accountability and transparency of an entity to its stakeholders.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit Rating Agency	An entity that provides credit rating services.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Debt Ratio	A ratio that measures a company's debt relative to its equity. Calculated by dividing long term debt by shareholders' equity. GCR typically uses a tangible equity as the denominator, after stripping out goodwill and other intangible assets.
Default	Failure to meet the payment obligation of either interest or principal on a debt or bond. Technically, a borrower does not default, the initiative comes from the lender who declares that the borrower is in default.
Diversification	Spreading risk by constructing a portfolio that contains different investments, whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Dividend	The portion of a company's after-tax earnings that is distributed to shareholders.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding.
Gearing	With regard to corporate analysis, gearing (or leverage) refers to the extent to which a company is funded by debt and can be calculated by dividing its debt by shareholders' funds or by EBITDA.
Gross Profit	Gross profit is the difference between company revenues or sales and the cost of sales, before accounting for administrative and financing costs.
Haircut	The percentage by which the market value of a security used as collateral for a loan is reduced. The size of the haircut reflects the expected ease of selling the security and the likely reduction necessary to realised value relative to the fair value.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Joint Venture	A project or other business activity in which two persons or companies partner together to conduct the project.
Liquidation	Liquidation is the process by which a company is wound up and its assets distributed. It can be either compulsory or voluntary. It can also refer to the selling of securities or the closing out of a long or short market position.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Loan To Value	Principal balance of a loan divided by the value of the property that it funds. LTVs can be computed as the loan balance to most recent property market value, or relative to the original property market value.
Long-Term Rating	A long term rating reflects an issuer's ability to meet its financial obligations over the following three to five year period, including interest payments and debt redemptions. This encompasses an evaluation of the organisation's current financial position, as well as how the position may change in the future with regard to meeting longer term financial obligations.
Mandate	Authorisation or instruction to proceed with an undertaking or to take a course of action. A borrower, for example, might instruct the lead manager of a bond issue to proceed on the terms agreed.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market Risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Net Profit	Trading/operating profits after deducting the expenses detailed in the profit and loss account such as interest, tax, depreciation, auditors' fees and directors' fees.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Private Placement	The sale of securities to a small number of institutional investors such as large banks, insurance companies and pension funds. Such issuances do not require a formal prospectus and are often not listed on an exchange.
Rating Outlook	A Rating outlook indicates the potential direction of a rated entity's rating over the medium term, typically one to two years. An outlook may be defined as: 'Stable' (nothing to suggest that the rating will change), 'Positive' (the rating symbol may be raised), 'Negative' (the rating symbol may be lowered) or 'Evolving' (the rating symbol may be raised or lowered).
Ring-fencing	Ring-fencing occurs when certain of a company's assets, liabilities or profits are financially separated for regulatory reasons, to isolate risk related to specific assets and/or liabilities, or to protect assets and/or income streams from risks (inter alia).
Short-Term Rating	A short-term rating is an opinion of an issuer's ability to meet all financial obligations over the upcoming 12 month period, including interest payments and debt redemptions.
Special Purpose Vehicle	An entity that is created to fulfil specific objectives. An SPV is normally bankruptcy/insolvency remote and created to isolate financial risk.
Tenor	The time from the value date until the expiry date of an instrument, typically a loan or option.

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

Cytonn Investments Management Limited participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit ratings have been disclosed to Cytonn Investments Management Limited with no contestation of the ratings.

The information received from Cytonn Investments Management Limited and other reliable third parties to accord the credit rating(s) included:

- the 2016 audited annual financial statements and audited financial statements for the 15 months to 31 December 2015;
- summary of the June 2017 management accounts;
- internal and/or external management reports;
- Cytonn Project Notes LLP SPV cash flow models;
- full year company and consolidated budgets spanning 2017-19;
- property portfolio and project pipeline data;
- term sheets in respect of specific facilities;
- corporate governance and enterprise risk framework; and
- debt facilities as at 30 June 2017.

The ratings above were solicited by, or on behalf of, Cytonn Investments Management Limited, and therefore, GCR has been compensated for the provision of the ratings.