Presentation to Chase Bank (Kenya) Limited

2017 Economic Outlook

8th September, 2016

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I: Overview of the Firm

160 Members, 1 Agenda – The Client

Introduction - Layout of the Business

Cytonn Investments runs its business across Africa, North America and Europe

Investments	Real Estate	Diaspora	Technology	Cooperative
Alternative investment manager, focused on private equity and real estate	Development arm focused on developing institutional grade real estate projects for investment	Our platform to connect East Africans in the diaspora to attractive investment opportunities in the region	Our technology affiliate, focused on delivering world-class web & platforms to automate all business lines	Investment society providing retail investors access to attractive alternative investment opportunities

Introduction to Cytonn Investments

Cytonn Investments is an independent investments management company

- Our mission is that ***"we work to deliver innovative & differentiated financial solutions that speak to our clients needs"***

- Cytonn Investments is differentiated in several respects:

  1. **Independence & Investor Focus:** Cytonn is solely focused on serving the interest of clients, which is best done on an independent investment management platform to minimize conflicts of interest

  2. **Alternative Investments:** Specialized focus on alternative assets - real estate, private equity, and structured products

  3. **Partnerships with Global Institutional Investors:** Such as Taaleri of Finland

  4. **Strong Alignment:** Every staff member participates in ownership. When clients do well, the firm does well; and when the firm does well, staff do well

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Cytonn's Corporate Structure – Kshs 73 bn Under Mandate

Cytonn Investments

Kenya

Cytonn Investments Ltd
- Independent investment management company, serving HNW & institutional clients

Cytonn Real Estate
- Development affiliate providing investment grade real estate development solutions

Private Equity
- Financial Services
- Education
- Technology

United States

Cytonn Diaspora
- Diaspora platform connecting investors in the diaspora with opportunities in the East African Region

Cytonn Investments LLC
- US advisory and investment management company

Board of Directors

The board is comprised of 10 members from diverse backgrounds, each bringing in unique skill-sets

Prof. Daniel Mugendi,
Chairman

Antti – Jussi Ahveninen,
Non-executive Director

Madhav Bhalla,
Non-executive Director

James Maina,
Non-executive Director

Nasser Olwero,
Non-executive Director

Rose Kimotho, M.B.S
Non-executive Director

Mike Bristow,
Non-executive Director

Edwin H. Dande,
Managing Partner & CEO

Elizabeth N. Nkukuu,
Partner & CIO

Patricia N. Wanjama,
Partner & Head of Legal

The Management Team

The team brings in diverse global and local experience in investments, real estate, finance and brand

Edwin H. Dande,
Managing Partner & CEO

Elizabeth N. Nkukuu,
Partner & CIO

Patricia N. Wanjama,
Partner & Head of Legal

Josephat Gichimu,
Finance Manager

Maurice Oduor,
Investment Manager

Johnson Denge,
Real Estate Services Manager

Frank Ndubi,
Quality Assurance Manager

Shiv Arora,
Head of Private Equity
Real Estate

The Management Team

The team brings in diverse global and local experience in investments, real estate, finance and brand

Robert M Mwebi,
Project Manager

Martin Gitonga
Project Manager

Peter Karenju,
Project Manager

Nyambura Kiarie,
Real Estate Agency Manager

Gaurang Chavda,
Head of Private Wealth Management

Winfred Ndung'u,
Brand & Business Admin Manager

Beverlyn Naliaka,
PR & Communication

Cytonn Investment Solutions

We offer differentiated investment solutions in four main areas

High Yield Solutions

- The Team's expertise and market knowledge enable us to offer investors higher yields than the market average
- Regular credit analysis, quick dealing capability and the large banking spread in the market allow the team to capitalize on investment opportunities

Real Estate Investment Solutions

- Our unique strategic partnerships with Cytonn Real Estate, our development affiliate, enables us to find, evaluate, structure and deliver world class real estate investment products for investors
- Our platform connects global capital seeking attractive return with institutional grade development opportunities in the East African region

Private Regular Investment Solutions

- We understand that investors have varying financial goals. Our highly customized and simple to understand investment products will enable you to achieve your investment objective
- We offer solutions to both local investors, and those in the diaspora interested in the investment opportunities back in Kenya and the region

Private Equity

- Cytonn seeks to unearth value by identifying potential companies and growing them through capital provision and partnering with their management to drive strategy
- We primarily invest in the Financial Services, Education and Technology sectors

Cytonn Real Estate's Unrivalled & Unique Capabilities

Cytonn has all the necessary capabilities to deliver the very best real estate investment product

Fundraising

- The global market exposure combined with local experience networks have it easier to raise funds
- Our investors comprise of global and local institutions, local high-net-worth investors and Kenyans in the diaspora
- An experienced and passionate team to collect and manage funds, bringing about diverse investment portfolios with good returns

Market Research & Site Acquisition

- Research team is an essential part of any investment, helping identify the highest and best use and concept for the different land deals received and taken up by the company
- Cytonn has one of the best research teams in the region who carry out intensive market research for internal use and uses the data to release the data for guidance of external customers as well
- Our Site Acquisition team uses the market research to find the best sites for development given the opportunity in the economy

Concept Design

- Cytonn has unique concept designs that arise from partnerships with global institutions in countries like Dubai giving superior quality products to the market
- The internal concept team in collaboration with the project management function work tirelessly to deliver the products of the firm

Project Management

- The project management function is a vital part of real estate whose role is to ensure projects are delivered in the best quality, within scope and the most efficient resource use
- Cytonn boasts of a large PM team with diverse experience in the various aspects of project management to deliver world class real estate products

Sales and Marketing

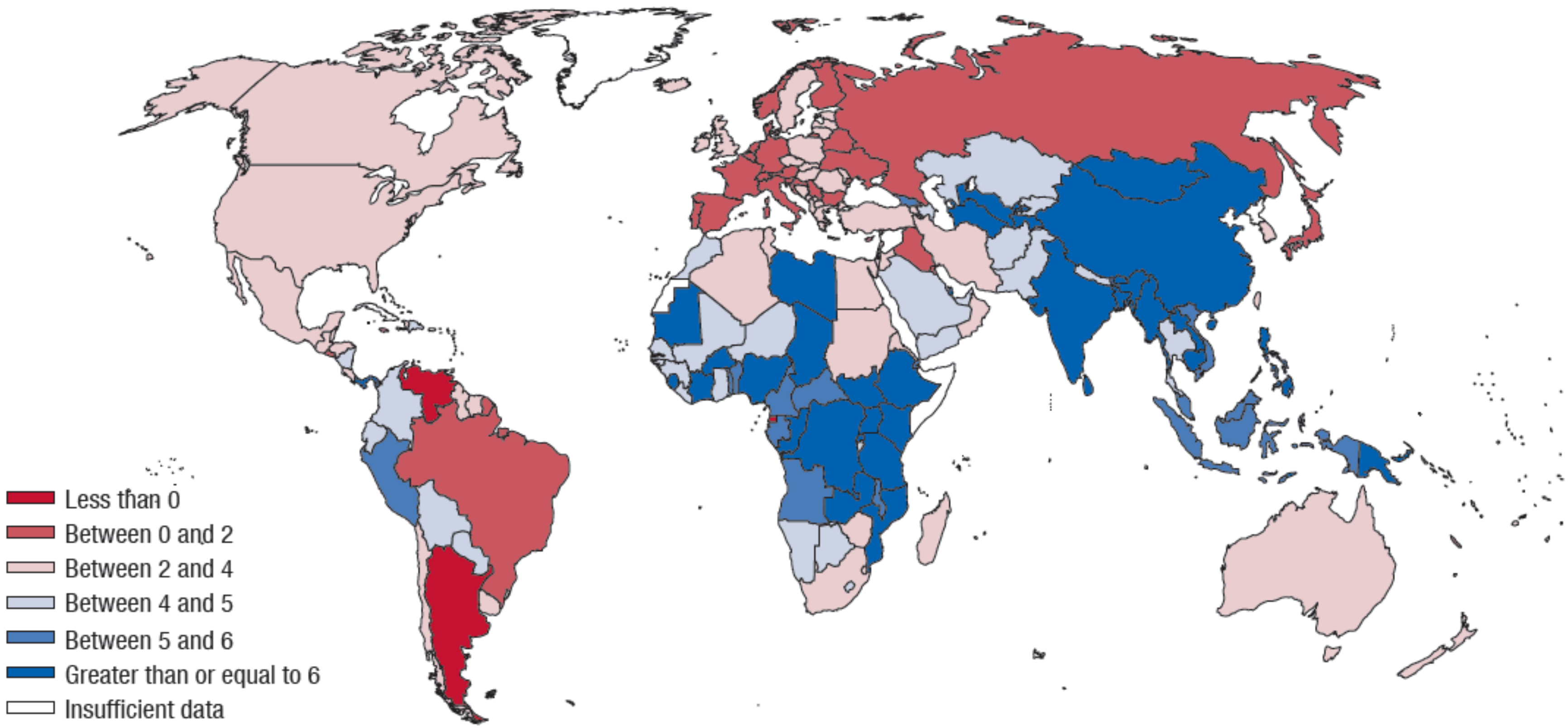
- The marketing and brand team have enabled the brand reach great heights and visibility locally and globally by employing their experience, passion and innovation
- The firm has one of the best distribution teams that ensure our products reach far and wide. Their experience is backed by success stories of making sales of up to 45% even before start of construction developments

Global view of economic growth determines regions of focus

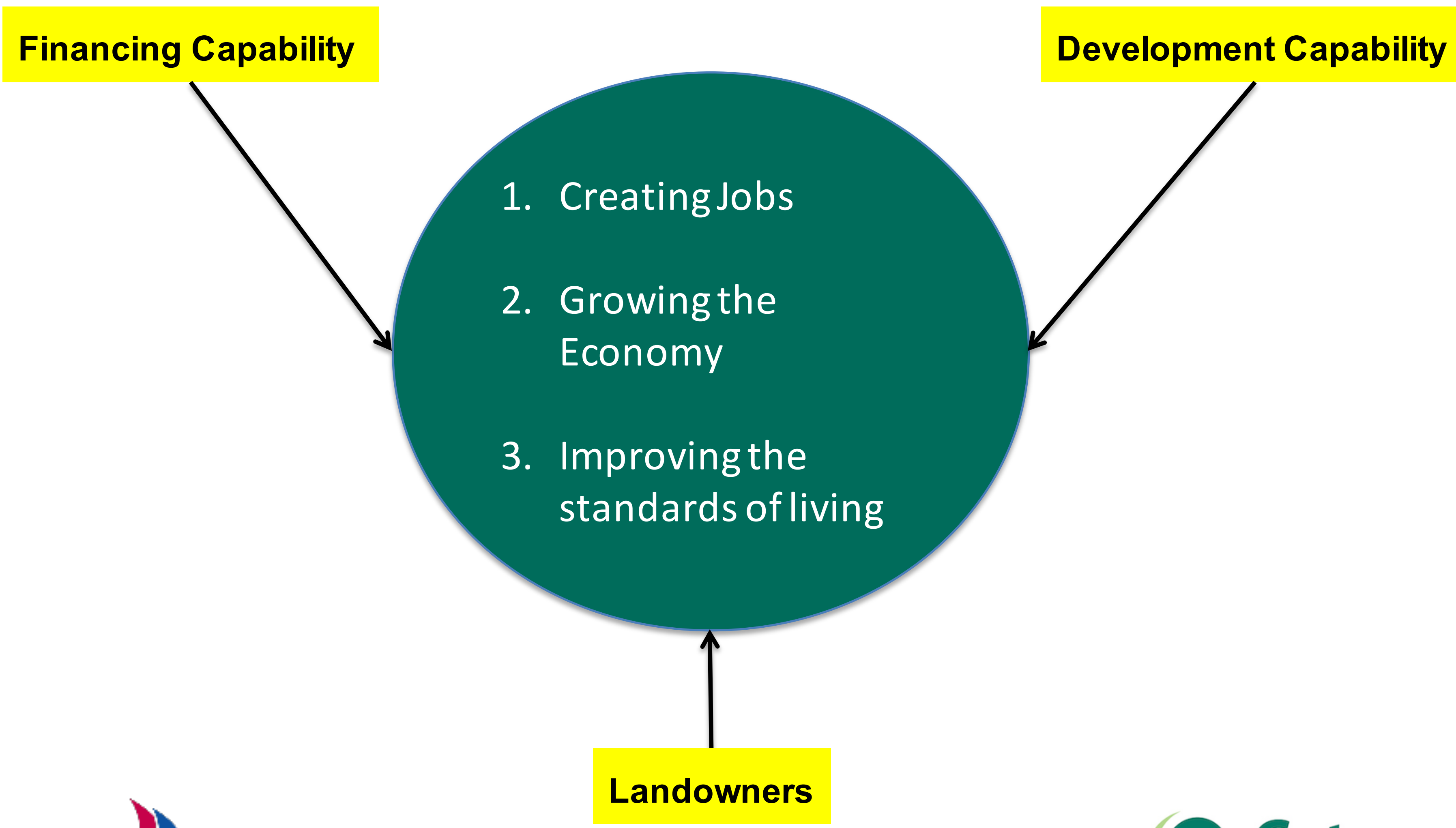
There is demand from global capital (light colors) looking for attractive returns (dark colors)

Figure 2.1. 2015 GDP Growth Forecasts and the Effects of a Plausible Downside Scenario

1. 2015 GDP Growth Forecasts[1]
(percent)



Cytonn's strategy brings three key pillars together



Deal pipeline overview – 85% to low and mid-income housing

Kshs 74 Billion Deal Pipeline

Low to mid-income Housing 85%

- Masterplanned Development
- Comprehensive Development
- Low to mid-income Modular Housing

Prime Residential and Mixed-use 15%

- High Density Integrated Mixed-use
- Gated Communities

Summary of Projects – Kshs 74 bn Deal Pipeline Details

- **Set 1:** Projects are in the market, construction phase and being sold
- **Set 2:** Projects are in design stage
- **Set 3:** Projects are in acquisition stage

	Projects	Concept	Project Size (Kshs mn)
	SET 1		
1	Athi Sharpland	Site & Service Scheme	644.7
2	Amara Ridge	Gated community	1,000.0
3	Taraji	Integrated lifestyle development	2,508.0
4	The Alma	Integrated lifestyle development	3,826.6
5	Situ Village	Gated masterplanned community	5,500.0
	Sub - Total		**13,479.3**
	SET 2		
6	The Annex	Integrated lifestyle development	522.9
7	Project Kitale	Masterplanned development	700.0
8	Rongai Sharpland II	Site & Service Scheme	937.4
9	Project Westlands	Serviced apartment concept	1,000.7
10	Project Ridgeways	High density mixed-use development	9,317.0
11	NewTown by Cytonn Real Estate	Low to mid income masterplanned city	22,500.0
	Sub - Total		**34,978.0**
	SET 3		
12	Project Mombasa	High density mixed-use development	3,750.0
13	Project Hurlingham	Mixed Used Office complex	7,000.0
14	Project Upper Hill	Mixed used office complex	15,000.0
	Sub - Total		**25,750.0**
	GRAND TOTAL		**74,207.3**

II. Macroeconomic Indicators

Macroeconomic Indicators

Various indicators point to a positive economic growth in 2017 with GDP, Government Borrowing, Revenue Collection and Monetary Policy having a positive outlook

Macro-Economic Indicators	Expectations at start of the year	2016 Experience	Outlook	2017 Economic Outlook
GDP	We expect GDP growth for 2016 to come in at 5.8% driven by government spending on infrastructure and the recovery of the tourism sector	5.9% growth in Q1'2016. IMF, WB and Treasury expect GDP to come in at c 6.0%	We expect GDP growth to be strong in 2017, driven by continued Government spending on infrastructure, the energy sector, the construction and real estate sector and the recovery of tourism	**Positive**
Government Borrowing	Government expected to borrow Kshs 229.0 bn from the local market and Kshs 459.4 bn from foreign markets	Government has borrowed Kshs 53.2 bn against a pro-rated target of Kshs 29.8 bn. The Government has postponed foreign borrowing to Q4'2016	We expect the Government to be ahead of its local borrowing target, but lag behind in its foreign borrowing target. However given the capping of Interest Rates we expect little pressure on government borrowing	**Positive**
Revenue Collection	KRA would miss their revenue collection target for 2015/2016 FY	The KRA met their collection target for the 2015/2016 FY having collected Kshs. 1.2 tn against a target of Kshs. 1.2 tn	We expect the government to meet on the revenue collections due to (i) the passing of the Tax Procedural Bill and reforms in the Kenya Revenue Authority to eradicate corruption (ii) Positive macro-economic environment which is expected to support corporate earnings growth	**Positive**
Monetary Policy/Interest Rates	Upward pressure on rates in 2016	(i) CBR decreased 100 bps to 10.5% (ii) 91 Day T-Bill hitting a low of 7.1%	We expect the Monetary Policy committee to be maintain the CBR while monitoring keenly inflation and currency movements given the interest rate cap imposed on banks	**Positive**

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Macroeconomic Indicators

We are neutral on Inflation, Exchange Rate, Investor Sentiment and Security; but closely monitoring their developments as the year unfolds

Macro-Economic Indicators	Expectations at start of the year	2016 Experience	Going Forward	2017 Economic Outlook
Inflation	To remain within single digit levels, but above CBK's upper bound of 7.5%	Inflation declined from the high of 8.0% in December through January to August at 6.3%	We expect Inflation rate to remain below the CBK's upper limit of 7.5%	**Positive**
Exchange Rate	Shilling to depreciate against major currencies	The shilling has appreciated 0.9% against the dollar YTD. Forex reserves hit a high of 5.2 months import cover during H1'2016	The shilling to remain stable in the short to medium term supported by (i) foreign exchange reserves equivalent to 5.1 months of import cover, and (ii) increased dollar inflows from tourism and remittances. We are however likely to see upward pressure in the short term driven by volatility in the stock market	**Neutral**
Investor Sentiments	Flows out of Kenya from the rate hike have been priced into the market, and neutral stance on corporate earnings means no large foreign investor inflows	Investor sentiment has been high as evidenced by the decline in yields for the 5-year and 10-year Eurobonds by 4.0% and 2.6% respectively	We are neutral on investor sentiment given the uncertainty brought about by the interest rate caps which might lead to repatriation of foreign funds from the market and the possibility of a Fed rate hike which will make emerging and frontier markets less attractive on a risk adjusted basis	**Neutral**
Security	Expected to improve given Government initiatives to eradicate extremism	Kenya has received an upgrade in credit rating by Moody's as a positive indicator that the environment is safe to carry out business operations	Security is expected to be tight given the number of international events being held in the country, the electioneering season and the government's initiative to improve security	**Neutral**

III. Impact of the Banking Act (Amendment) Bill

Impact of the Banking Act (Amendment) Bill

The private sector is expected to be crowded out as banks will prefer loaning to the government

Several countries around the world, 76 to be exact, have put in place interest rate caps for various reasons but ended up with more problems to solve and eventually scrapped them off. We are of the view that capping interest rates might solve the high interest rate spreads in the banking sector, but what we expect going forward will be challenges such as:

- **Crowding out of the Private Sector** - Locking out of SMEs and other perceived "high risk" borrowers from accessing credit, as banks will prefer to loan to the Government. This will effectively lead to lower standards of living in the economy as the lower access to credit leads to a decline in both consumption and investment expenditure, reducing aggregate demand in the economy,
- **Pressure on smaller banks** - small banks who effectively have been shut out from the interbank market and now have to mobilize funds at higher rates effectively straining their operations and eventually we may end up witnessing consolidations and acquisitions,
- **Non-interest bearing accounts** - Banks are likely to introduce bank accounts with zero interest features to bypass the minimum interest payable For example, Co-operative Bank affirmed compliance with the 14.5% maximum rate on bank loans, but was silent on the minimum rate on deposits,

Impact of the Banking Act (Amendment) Bill

Shadow banking systems might emerge as clients priced out of the market seek credit

- **Opaque pricing** - Pricing will be opaque as the Bill is based on an unreasonable premise that the highest extra risk premium in the Kenya market is 4.0%,
- **Dollarization of the economy** - Banks may resort to cheaper dollar funding, which will lead to a dollarization of the Kenyan economy, eroding all gains made so far in stabilizing the Kenyan Shilling,
- **Shylocks and shadow banking** - The emergence of strong shadow banking systems, which may result into inefficiencies in terms of transmitting the effects of monetary policy decision into the economy, and
- **Retrenchments** - Risk of job losses as banks cut jobs to maintain their cost base due to the lower margins

The intent of the Bill was not to attack banks profitability but to protect the consumer from exploitation through unreasonable interest rates. We are concerned that those whom this Bill was intended to protect may end up being the biggest losers, with non-interest earning accounts and reduced access to mainstream bank loans such as bank unsecured loans whose pricing has to be way above 14.5%. We will monitor how the implementation unfolds, but so far banks have already eliminated some unsecured loans, emergency loans and motor vehicle loans

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Impact of the Banking Act (Amendment) Bill

The government is expected to benefit as banks will defer from loaning to riskier clients

Summary of Winners and Losers from the Banking Act (Amendment) Bill	
The Winners	**The Losers**
• Banks that lend primarily to the prime individual and corporate commercial segments because they have the most clients that can fit within the 4.0% risk premium. For example, Standard Chartered Bank	• Banks that lend primarily to the SME and sub prime segment because majority of their clients can't fit into the 4.0% risk premium. For example, Equity Group, KCB Group and Co-operative Bank
• Prime individual clients, because they will be highly sort after by the main stream banks since they will be seeking to bank prime clients, with assets to provide collateral	• Sub-prime clients because they will experience even most constrained access to conventional credit and will have to seek alternative & more expensive credit
• Corporate commercial segments because they will be highly sort after	• The SME sector since access to credit will be limited
• The government as banks will prefer to place money in Treasury instruments that are considered risk free	• The Kenyan economy, which is very reliant on SME sector. If there is less access to credit, the economy will register slow growth unless it adjusts very quickly by moving a lot of SME funding to the informal financing market
• Alternative finance and credit players that are outside the ambit of the amended Banking Act, 2015, since they can still price credit based on market dynamics	• Small depositors are likely to be pushed to no interest accounts
• Banks with multinational links as they can mobilize cheaper dollar funding from their parent company	• Government since banks will record low earnings, reducing their taxable income

IV. General Banking Environment

Transition continues, to a more regulated, yet innovative environment

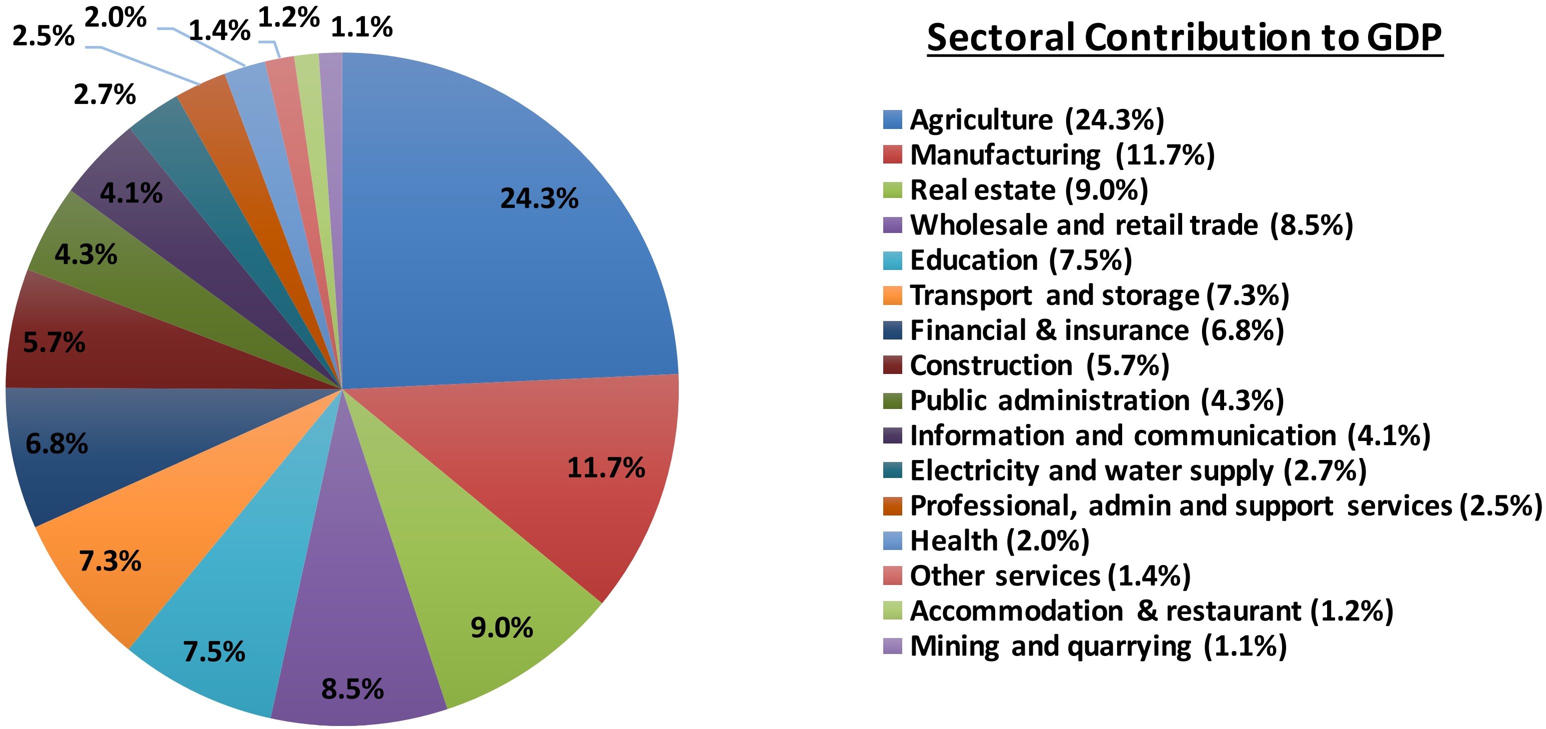
Transition Area	Summary	Effect on Banking Sector
Increased Regulation	• **Interest Rate Cap:** The Banking Act (Amendment) Bill, 2015 has been enacted into Law setting caps on lending and deposit rates across the industry • **Amendment of the Kenya Deposit Insurance Corporation Act (KDIC):** Treasury's wishes to amend the Kenya Deposit Insurance Corporation Act, to be involved before a bank is placed under receivership was approved by parliament • **Provisioning:** Banking industry has recorded an increased level of loan loss provisioning, with an average growth of 122.4% in H1'2016	• Banks have been obligated to comply with the new regulation. However, we have seen banks focusing on repricing loans with no mention of deposits. We are likely to see compressed NIMs going forward • Higher capital levels will create a stable banking system, forcing further consolidation going forward. Introduction of Internal Capital Adequacy Assessment Process (ICAAP) will also provide framework for capital assessment based on risk appetite for banks • The increased level of provisioning will improve the level of asset quality across the sector , creating a safer and attractive banking industry, providing more confidence to both the clients and investors
Sector Realignment	• **Strategic Initiatives** - Banks have continued to diversify their businesses by focusing on non-bank services; I&M Holdings has acquired Burbidge Capital, as it seeks to grow its business into transaction advisory. I&M Holdings is also in the process of acquiring Giro bank to further strengthen its niche market • **Innovative Banking** – In order to continue recording strong revenue growth, banks will have to innovate with possibilities of focus on transaction based banking, which could be targeted towards meeting specific customer needs and hence protecting their NIMs	• Interest rate capping has divided the industry into two: Winners and Losers. Winners will be banks focused on prime clientele and corporates that fit within both the loan and deposit pricing threshold • We are likely to see enhanced consolidation, where smaller, high-risk banks will be priced out of the deposit mobilization space, with larger banks likely to acquire the smaller ones • Banks will have to come up with innovative products, with possibilities of focus on transaction based banking, which could be targeted towards specific niches and clients

The sector is undergoing transition. However, key issues such as increased capital requirements coupled with introduction of ICAAP framework, increased focus on sufficient provisioning, and increased level of "controlled" regulation (Prudential Guidelines and Interest Rate Cap) will transition the industry into consolidation and innovations. Those that remain will be stronger banks in a more efficient and stable banking sector.

V. Economic Sector Analysis

Economic Sector Analysis

Agriculture is the largest contributor to GDP at 24.3% of the overall economy



- Nearly half of the country's land is agricultural; at 48.5%; though it is expected to decline gradually as more land is sourced for development purposes given the rising construction and real estate sectors in the country
- 2017's economic growth is expected to come in strong, at 6.1% as per the IMF, underpinned by (i) high government expenditure on infrastructure, (ii) the energy sector growth (iii) Real Estate and construction and (iv) the recovery of tourism

Source – KNBS, IMF

VI. Global Factors Affecting Banking

Global Factors Affecting Banking

Global slowdown in growth is expected to have a negative effect on emerging markets' economies

- The first half of 2016 was characterized by sluggish global growth, and as per World Bank's Global Economic Prospect in June, they revised the 2016 global growth projections downwards to 2.4%, from 2.9% earlier projected in January 2016. The downward revision was brought about by (i) the slow growth in the developed markets, (ii) low commodity prices affecting emerging markets, (iii) weak global trade, and (iv) diminishing capital flows.

In terms of the four key economic regions, the following factors might have an impact on the Banking Sector

US Markets

- The US Fed increased rates by 25 bps, to a band of 0.25% - 0.50%, from 0.0% - 0.25% and it is expected that they will increase the Fed Funds rate further in the in their September meeting
- The possibility of a shift to a faster rate hiking cycle by the US Fed will attract investors to the US markets and pull out of emerging and frontier markets due to their risk profile

Eurozone

- Despite an aggressive quantitative easing programme of Euro 80.0 bn per month, aimed at stimulating the economy and increasing GDP growth, the region still suffers from low growth and deflation
- Risks remain over the negative sentiment from Britain leaving the EU ("Brexit"), increasing economic and political uncertainty. This is negative for the banking sector as the global turmoil affect investors' risk appetite thus pulling out of emerging and frontier markets

Asian Markets

- Concerns remain over economic growth in Asia, especially given the slowdown of growth in China, and it's wide reaching effects on emerging markets, which depend on China as a key export destination. However, Kenya does not depend strongly on China for exports hence this might have some minimal effect on the economy

Source – Cytonn Research

VII. Impact of 2017 Elections

Impact of 2017 Elections on Economic Outlook

Threat of insecurity & slowing economic growth expected to impact the 2017 outlook negatively

During election periods, tensions run high and investors tend to be weary of investments due to the uncertainty surrounding such an environment. Moving into an election period we expect the following impact on the economic outlook

1. Threat of insecurity

- Election years in Africa in recent times have been faced with fighting communities with differing opinions. Post-election violence in 2007/2008 still haunts the country hence some level of insecurity is feared
- Investors are likely to practice the wait-and-see approach as they remain uncertain of the post election period after the results have been announced

2 Threat of slowing economic growth

- In the past, we have seen the economy slow or remain stagnant in terms of growth in 3 out of 5 of the election years, only expanding in the last election year, 2013
- Slowing economic growth negates the economic outlook for 2017 as investors may pull out their funds to invest in faster growing economies in the region

3. Low Investor confidence

- We expect investors to be cautious of investments during this period as they wait to see the outcome of the elections

We however believe that despite the threats posed by the election season, global players are keeping watch and we believe it is of the best interest of the country that peace prevails, hence our positive outlook on 2017 economic growth

VIII. Conclusion

Conclusion

Kenya’s economic outlook for 2017 is positive, supported by a strong macroeconomic outlook

2017’s economic outlook remains positive underpinned by a strong macroeconomic environment outlook. However headwinds present themselves in terms of tightened regulations, global turbulence and the uncertainty surrounding the elections. Despite this we expect 2017 to be a strong year economically

IX. Opportunities for Chase Bank in 2017

Opportunities for Chase Bank in 2017

Opportunity	Summary
Diversification of Clientele	• Chase Bank being predominantly an SME bank can diversify their clientele base and target corporate clients who are less risky. This is mainly informed by the fact that the interest rate cap will effectively put all clients in the same risk band of 4% above the base rate and with SME having a higher risk profile, diversifying into corporate banking will lower their risk significantly. Effectively, this will be positive for their loan book as the levels of default for corporate clients is less than that of SME clients
Diversification of Revenue from Net Interest Income	• Chase Bank has an opportunity to diversify their revenue from Net Interest Income to Non-Funded Income by putting more focus on transactional based banking, custodial business and other alternative operations such as brokerage and bancassurance. This will offer them a much more stable income source than relying on core banking operations which is bound to experience some turbulence especially given the interest rate caps
Diversification of Investments	• Given that interest rates have been capped, Chase Bank can diversify their investments away from loans into Treasury instruments and asset backed structured products which can be targeted towards high net worth individuals. Treasury instruments offers a risk free form of investment while asset backed structured products offer access to high yielding opportunities in the alternative investment space

Q&A