Cytonn Monthly – October 2016

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Executive Summary

Fixed Income: Yields on government securities were relatively unchanged during the month closing at 8.0%, 10.3% and 10.6%, from 7.9%, 10.3% and 10.6% for the 91, 182 and 364-day papers, respectively, at the end of September. Kenya's inflation rate for the month of October increased slightly to 6.5%, from 6.3% recorded in September. The World Bank released Kenya's Economic Update, sighting economic growth to come at 5.9% in 2016, unchanged from an earlier forecast of 5.9%;

Equities: The Kenyan equities market registered mixed trends during the month, with NASI and NSE 25 rising by 0.2% and 0.3%, respectively, while NSE 20 declined by 0.4%. Equity Group and Safaricom released their Q3'2016 and H1'2017 results, respectively, both recording growth in EPS. Equity Group grew by 17.7% to Kshs 4.0 per share from Kshs 3.4 per share in Q3'2015, and Safaricom registered EPS growth of 13.8% to Kshs 0.51 per share from Kshs 0.45 per share in H1'2016;

Private Equity: October was characterized by (i) heightened fundraising activity from Kenyan based private equity funds looking to close their second funds, and (ii) increased investment in healthcare across Africa;

Real Estate: During the month, Cytonn Investments released a hospitality market report for the country, which highlighted the attractive investment opportunity in serviced apartments. Turner & Townsend, a UK-based global construction and management firm opened an office in Nairobi.

Company Updates

- Shiv A. Arora, our Head of Alternative Investments, discussed Mumias Sugar posting an increase in their H1'2016 losses, and Kenya Power & Lighting Company (KPLC) registering a 1.4% drop in pre-tax profits due to high network expansion rates. **See Shiv on CNBC**
- Maurice Oduor, our Investments Manager discussed this week's market performance on KTN. **See Maurice on KTN**
- Elizabeth N. Nkukuu, CFA, our Senior Partner, Chief Investment Officer and Head of Cytonn Real Estate was a guest panelist at the African Summit on Entrepreneurship and Innovation (ASENTI), a forum that brings together SMEs, startups and different stakeholders from Africa for interaction and training on entrepreneurship and innovation. **See Event Note**
- Cytonn Investments hosted Independent Financial Advisers and Market Intermediaries at a breakfast on Wednesday to introduce them to the Cytonn Project Notes (CPN) and award the highest performing Independent Financial Advisers. **See Event Note**
- Cytonn Technologies, a technology solutions provider powered by Cytonn Investments showcased its work, innovative capabilities and pipeline projects. Cytonn technologies offers cutting edge solutions in web application development, user interface design, e-commerce solutions, network design, network management, integrated business solutions and general office IT support. **See Event Note**. Visit **Cytonn Technologies Website** for more information
- We continue to see very strong interest in our Private Wealth Management Training, which is at no cost, held bi-weekly and is open only to pre-screened individuals. Kindly visit **Cytonn Private Wealth Management Training** to register
- Cytonn Real Estate has launched an innovative payment plan for all it projects and currently for **The Alma**, its aspirational apartment community development in Ruaka. The "0% Down & 10-year Payment

Plan" is targeted at enhancing ownership and affordability for both prospective home owners and real estate investors who may not be able to afford the monthly payments over a 3-year construction period. The 0% Down & 10-Year Payment starts as low as Kshs 90,400 per month for 1-bedroom apartments. See table below for various plans:

(all values in Kenya Shilling unless stated otherwise)

The Alma 10-Year Payment Plan

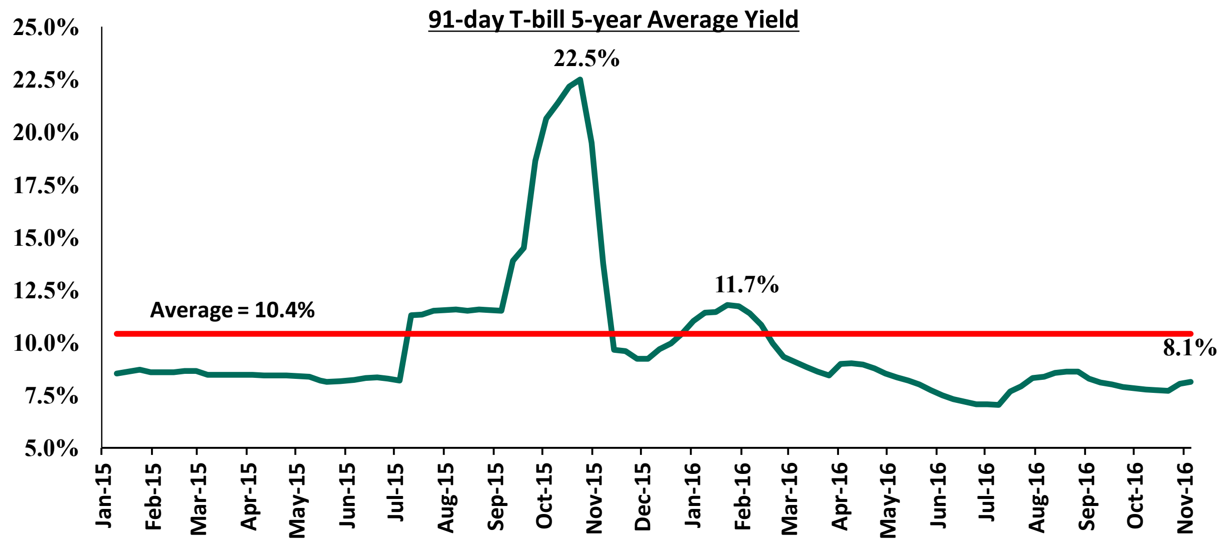
Unit Typology	Principal Amount	Payment Period (Months)	Monthly Installment Amount
1-Bedroom	5,018,160	120	90,400
2-Bedroom	7,700,000	120	138,700
3-Bedroom	11,300,000	120	203,600

- To invest in any of our current or upcoming real estate projects, please visit **Cytonn Real Estate**. We continue to see very strong interest in our products:
    - The Alma, which is now 55.0% sold and has delivered an annualized return of 55.0% p.a. for investors who bought off-plan. See **The Alma.** We will be having site visits to showcase this iconic development every two weeks, right after the wealth management trainings. If interested in attending the site visit, email clientservices@cytonn.com
    - Amara Ridge is currently 100.0% sold. See **Amara Ridge**
    - We have 12 investment-ready projects, offering attractive development returns and buyer's targeted returns of around 25.0% p.a. See further details here: **Summary of investment-ready projects**
- We continue to beef up the team with several ongoing hires: **Careers at Cytonn**.

Fixed Income

Treasury bill subscriptions remained high during the month of October, with overall subscriptions coming in at 112.6% compared to 135.6% in September. Yields on T-bills remained relatively unchanged from the month of September, closing the month at 8.0%, 10.3% and 10.6%, from 7.9%, 10.3% and 10.6% for the 91-day, 182-day and 364-day papers, respectively, at the end of September. During the week, T-bills were oversubscribed with overall subscription increasing to 145.2%, compared to 107.0% recorded the previous week. Subscription rates on the 91-day, 182-day and 364-day papers increased during the week coming in at 126.1%, 170.4% and 132.8% from 108.4%, 122.6% and 90.4% respectively. The 182-day paper continues to be the most preferred paper as it offers the highest return on a risk-adjusted basis. Yields on the 91-day, 182-day and 364-day T-bills were on an upward trend coming in at 8.1%, 10.4% and 10.7% from 8.0%, 10.3% and 10.6%, respectively, the previous week.

The 91-day T-bill is currently trading below its 5-year average of 10.4%. The downward trend on the 91-day paper is mainly attributed to the expected low interest rate environment following (i) the operationalization of the Banking Act Amendment 2015, which has led to more liquidity in the market, and (ii) reduced pressure from the government borrowing program as they are currently ahead of the pro-rated domestic borrowing target of Kshs 83.9 bn, having borrowed Kshs 116.1 bn, which is 138.4% of the pro-rated target. However, key to note is that as indicated in our **Cytonn Weekly #42**, the interest rates have bottomed out and we expect them to stabilize at the current levels.



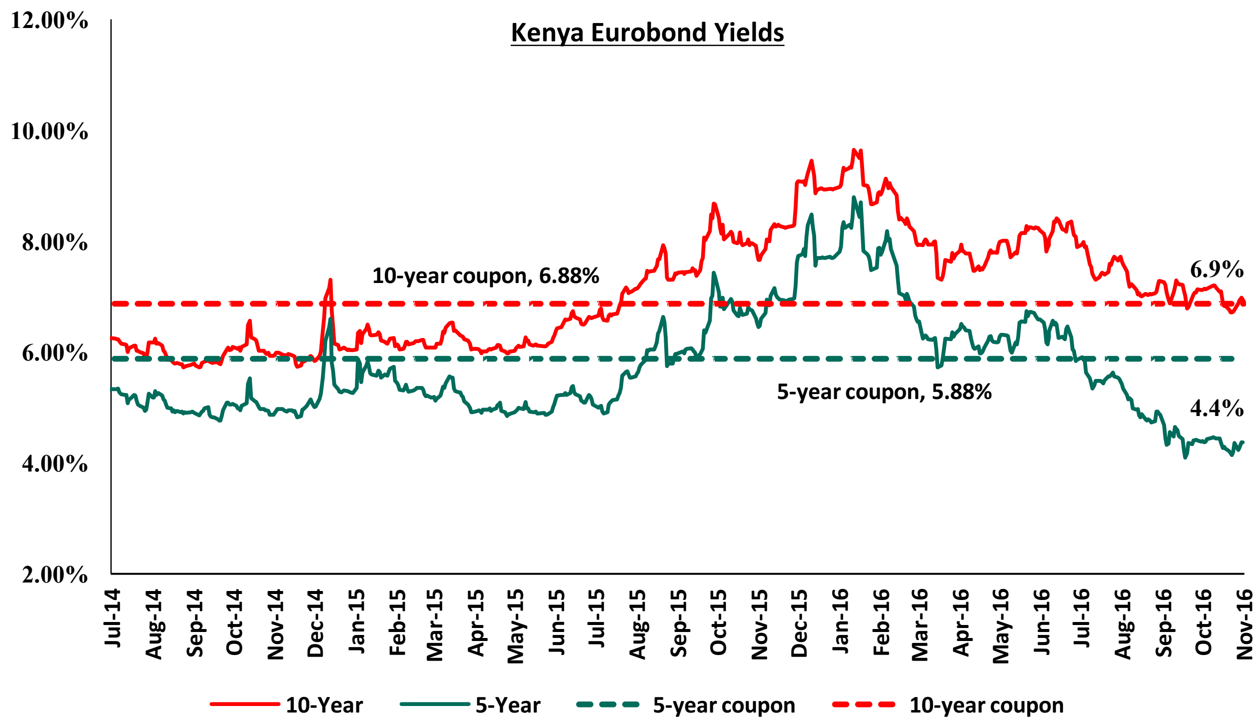
During the month, the money market witnessed increased liquidity, which saw the interbank rate normalize to 4.4%, from 6.2% at the end of September. The market experienced a net liquidity injection of Kshs 20.3 bn during the month attributed to government payments of Kshs 101.7 bn as well as increased Treasury Bills redemptions of Kshs 81.4 bn.

Below is a summary of the money market activity during the month:

all values in Kshs bn, unless stated otherwise

Monthly Liquidity Position – October 2016			
Liquidity Injection		**Liquidity Reduction**	
Term Auction Deposit Maturities	0.0	T-bond sales	30.6
Government Payments	101.7	Transfer from Banks - Taxes	77.1
T-bond Redemptions	11.0	T-bill (Primary issues)	77.9
T-bill Redemption	81.4	Term Auction Deposit	0.0
T-bond Interest	12.0	Reverse Repo Maturities	41.2
Reverse Repo Purchases	41.0	Repos	0.0
Repos Maturities	0.0		
Total Liquidity Injection	**247.1**	**Total Liquidity Withdrawal**	**226.8**
		Net Liquidity Injection	**20.3**

According to Bloomberg, yields on the 5-year and 10-year Eurobonds decreased by 0.1% and 0.2%, respectively, from 4.5% and 7.1% the previous month to 4.4% and 6.9%, respectively. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.4% and 2.7%, respectively, for the 5-year and 10-year Eurobonds, due to improving macroeconomic conditions. This is an indication that Kenya remains an attractive investment destination.



The Kenya Shilling depreciated against the dollar by 0.2% during the month, to close at 101.6, compared to 101.3 the previous month. This was mainly driven by dollar demand from oil importers and manufactures which outweighed the inflows from exporters, mostly from the horticultural industry. We expect the shilling to remain stable for the remainder of the year supported by the high levels of foreign exchange reserves equivalent to 5.1 months of import cover.

The inflation rate for the month of October increased by 20 bps to 6.5% from 6.3% in September; the increase is in line with our projection of 6.5% as highlighted in **Cytonn Weekly #42**. The increase was driven by increasing food prices and power bills due to the foreign exchange levy expense incurred by energy producers. Going forward, we expect inflationary pressure to be contained within the government target annual range of 2.5% - 7.5%, despite the possible upward pressure from the food component of the CPI basket. The food situation in the country has taken a hit following an audit report that indicated that over 754,000 bags of maize valued at Kshs 1.8 bn stored at the National Cereals and Produce Board (NCPB) depots is unfit for consumption, which we believe will impose some upward pressure on the inflation rate.

During the month, the Kenyan Government offered a 15-year infrastructure bond to raise Kshs 30.0 bn from the domestic market for partial funding of infrastructure projects in the following sectors: roads, energy and water. Yields for the bond came in at 13.2% with the government accepting Kshs 30.6 bn from the auction. As indicated in our **Cytonn Weekly #42**, government accepted expensive money, having accepted a yield of 13.2% on a tax-free infrastructure bond, which equates to a 15.5% yield on an equivalent taxable bond, for a tenor of 11.3 years, when adjusting for the 15.0% tax rate. After the successful offer, the government offered an extra Kshs 10.0 bn tap sale towards the end of the month of October which we think shall be fully taken up. We note the inconsistency between what Central Bank is forcing banks to do by reducing interest rates, and the higher yield that government is accepting in treasury securities auction. It is hard to see why a banking institution would lend to an individual at 14.0% as opposed to the government at 15.5%. This might lead to less credit to the private sector as the government is a safer investment.

World Bank released its 13th edition of Kenya's Economic Update with a focus on the economic performance in the current environment of changing global economic trends. World Bank projected Kenya's economy to grow at 5.9% in 2016 largely driven by investments in infrastructure. The World Bank expects that with a stable monetary policy aimed at controlling exchange rates and stable inflation, the country will experience increased private sector credit uptake and investments. This comes at a time when the International Monetary Fund (IMF) projected the growth in Sub-Saharan Africa (SSA) to decline to 1.4% in 2016 from 3.5% in 2015. However, the Eastern Africa region is vibrant and has been outdoing much of its counterparts in SSA, and hence is expected to withstand headwinds affecting other SSA economies. The report highlighted several downsides to the sustainability of this growth, which include: (i) security threats, (ii) rebalancing of the Chinese economy, (iii) subdued prices of coffee and tea, and (iv) the 2017 elections which if turns chaotic could slow down foreign direct and private investments. We maintain our projected GDP growth rate for Kenya at 6.0% for the year 2016.

The National Treasury released the 2016 Budget Review and Outlook Paper (BROP), the 4th under the current administration. The purpose of the paper is to review the performance of previous budget and to revise the current one based on the performance so far. The BROP 2016 has reviewed key elements of the budget with some key variances on the FY 2016/2017 projections as highlighted the table below:

all values in Kshs unless stated otherwise

BROP Review of the Budget with Key Variances on the FY 2016/17 Projections			
	Budget (bns)	**BROP'16 (bns)**	**% Change**
Total Revenue	1,500.5	1,456.3	(2.9%)
Total Revenue as % of GDP	*20.7%*	*20.1%*	(0.6%)
Expenditure:	2,275.6	2,074.1	(8.9%)
Expenditure as a % of GDP	*31.3%*	*28.6%*	(2.7%)
Recurrent	1,168.5	1,183.5	1.3%
Development	817.3	600.9	(26.5%)
Other	289.8	289.7	0.0%
Budget Deficit- excluding Grants	**(775.1)**	**(617.8)**	**(20.3%)**
Deficit as a % of GDP	***(9.7%)***	***(8.1%)***	***1.6%***
Grants	72.7	31.7	(56.4%)
Budget Deficit- including Grants	**(702.4)**	**(586.1)**	**(16.6%)**
Deficit as a % of GDP	*(9.7%)*	*(8.1%)*	1.6%
Net Foreign Financing	462.3	287.6	(37.8%)
Domestic borrowing	236.1	294.6	24.8%
Domestic borrowing as a % of GDP	*3.3%*	*4.1%*	0.8%
Public Debt to GDP (net of deposits)	*49.1%*	*47.4%*	(1.7%)
Nominal GDP	**7,259.0**	**7,259.0**	**0.0%**

The key highlights and our view on the same include:

- The total revenue has been revised downward by 2.9% from Kshs 1.50 tn from Kshs 1.45 tn accounting for 20.1% of GDP compared to previous 20.7%. Tax revenues estimates were revised downwards by 4.4% to Kshs 1.2 tn from Kshs 1.3 tn. In our view, government needs to find ways of widening the tax base to increase revenue collection, and is making headway with this through the i-Tax system,
- The total expenditure is set to decline by 8.9% to account for 28.6% of the GDP, from 31.3% previously, mainly driven by a 26.5% decline in development expenditure while the recurrent expenditure is set to increase marginally by 1.3%. This is a negative for the economy, with expenditure geared away from development activities, which will drive GDP growth, towards recurrent expenditures, which are showing no signs of efficiency. Key to note is that the reduction in development expenditure is also due to low absorption of 71.6% in the last fiscal year,

- Foreign borrowing is set to go down significantly by 37.8% to Kshs 287.6 bn from Kshs 462.3 bn as the domestic borrowing increases by 24.8% to Kshs 294.6 bn from Kshs 236.1 bn and this can be attributed to the interest rates cap which has driven the interest rates down offering the government cheap source of funds from the commercial banks. In as much as this will reduce our exposure to foreign currency obligations, large increases in domestic borrowing may lead to crowding-out of the private sector from accessing credit,
- Wages and salaries as a percentage of National Government Revenues are projected to rise by 1.1% to 30.8% from 29.7%. In the last fiscal year, the absorption rate for wages and salaries was less by Kshs 26.1 bn of the target,
- Budget deficit exclusive of grants is however set to decline by 20.3% to Kshs 617.8 bn from Kshs 775.1 bn accounting for 8.1% of the GDP from 9.7% previously. This is a positive for the economy and shows Kenya is pushing towards being compliant with IMF measures for the stand-by facility, to curb down the budget deficit to 6.0% in the medium-term.

Due to the reduced foreign borrowing, the public debt to GDP ratio is set to decline by 170 bps to 47.4% from 49.1% expressing external debt sustainability and low risk towards external debt distress.

Going forward the government is focused on enhancing efficiency and effectiveness as per the Medium-Term Fiscal Framework to strengthen resilience to risks present in the economy and support sustained growth. The strategies laid out include: (i) maintaining prudent fiscal standards in line with the medium-term debt targets, (ii) scaling up infrastructure investment in transport, irrigation and alternative sources of energy, (iii) strengthening capacity-building in public financial management, (iv) enhancing the governments cash management system to avoid undue pressure on payment flows, and (iv) effective management of natural resources including recently discovered oil.

The United States Federal Open Market Committee (FOMC) met on 2nd November to assess the economic state of the country and decide on what action to take on the Federal Funds Rate. As per our expectations, the committee decided to maintain the federal funds rate at 0.25% to 0.5% with eight members out of ten voting for maintaining. Despite the macro economic conditions having improved in recent past, the decision made was based on the need of further proof of continued progress towards its objectives of achieving maximum employment and a 2.0% inflation rate. The decision to maintain interest rates was not only influenced by U.S. factory and employment data which saw unemployment rate rise from 4.9% to 5.0%, but also the U.S. elections with the committee highlighting that it wouldn't risk to increase the volatility in the market, which has already been detected to be on the rise. Despite the accommodative policy there is a possibility of a rate hike in the next meeting scheduled for 13th and 14th December this year.

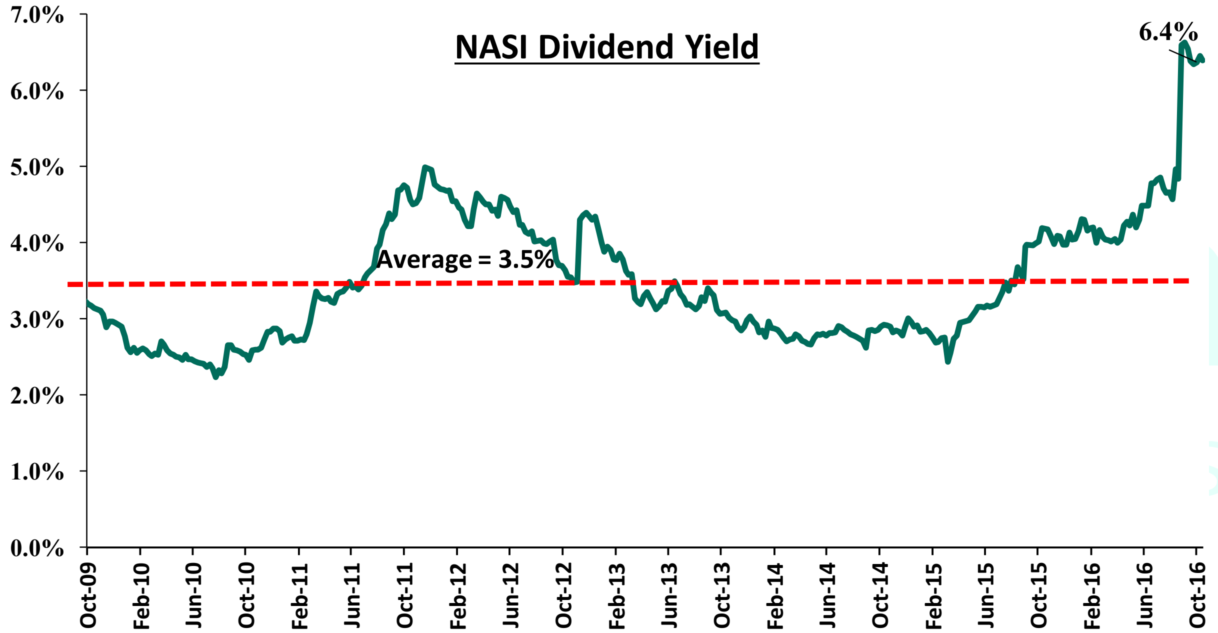
The Government is ahead of its domestic borrowing for this fiscal year having borrowed Kshs 116.1 bn for the current fiscal year against a target of Kshs 83.9 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 229.6 bn budgeted for the full financial year). Interest rates, which had reversed trends due to the enactment of The Banking Act Amendment, 2015, appear to have bottomed out and we expect them to persist at the current levels. It is due to this that we think it is prudent for investors to be biased towards medium-term papers.

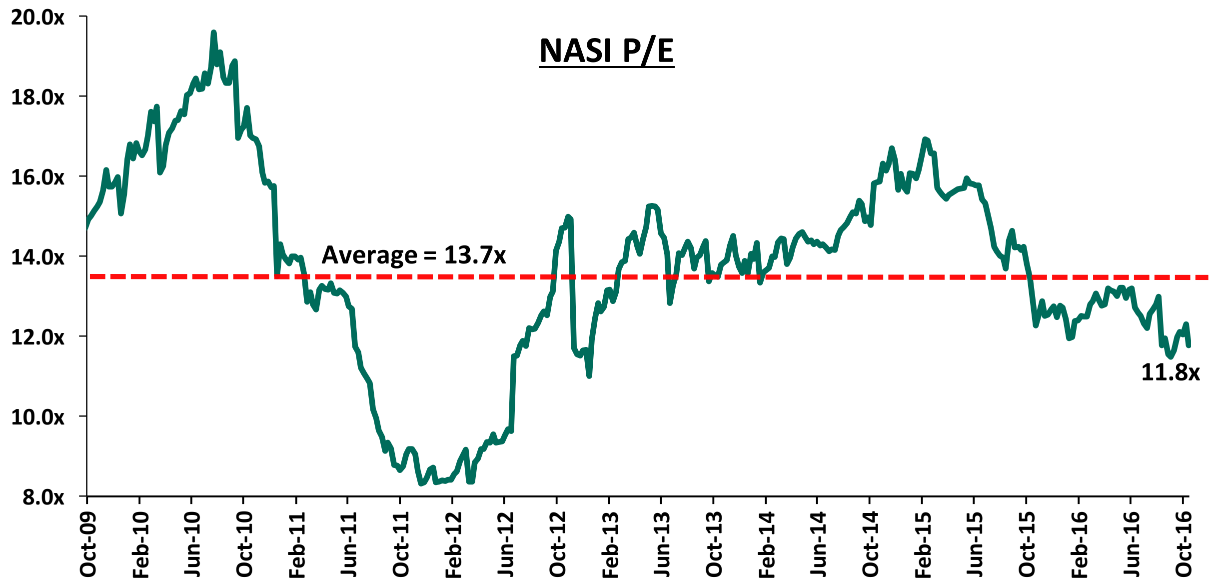
Equities

During the month of October, the equities market registered mixed trends with NASI and NSE 25 rising by 0.2% and 0.3%, respectively, while NSE 20 declined by 0.4%, taking their YTD performances to negative 20.7%, 13.4% and 5.9%, for the NSE 20, NSE 25, and NASI, respectively. The equities market performance for the month was driven by gains in large caps led by Bamburi, Diamond Trust Bank, BAT and Cooperative Bank that gained 5.2%, 5.2%, 2.4% and 2.4%, respectively while KCB Group, Standard Chartered Bank and Safaricom lost 3.9%, 1.8%, and 0.5%, respectively. This week, the trend reversed and the market was on an upward trend, with NASI, NSE 20 and NSE 25 rising 3.3%, 1.5% and 2.2%, respectively. The gains this week were on the back of gains by large cap stocks such as Safaricom, KCB Group and Barclays which gained 6.8%, 6.5% and 5.6%, respectively, despite a loss by BAT of 1.0%.

Equities turnover fell by 53.5% during the month of October to USD 77.4 mn translating to an average daily turnover of USD 3.9 mn, from USD 166.5 mn in September 2016, equivalent to an average daily turnover of USD 7.9 mn. Foreign investors were net sellers for this month with net outflows of USD 1.3 mn, compared to net inflows of USD 13.3 mn witnessed in September 2016. We maintain our expectation of stronger earnings in 2016 compared to 2015 supported by a favorable macroeconomic environment.

The market is currently trading at a price to earnings ratio of 11.8x, versus a historical average of 13.7x, with a dividend yield of 6.4% versus a historical average of 3.5%. The charts below indicate the historical PE and dividend yields of the market.





During the month, we saw a push by central banks in the region to improve regulation and stability in the financial services sector, which saw Twiga Bancorp Limited, a Tanzania government-owned bank, and Crane Bank, the 4th largest bank in Uganda, put under receivership by their respective central banks. Both regulators cited non-compliance to the capital requirements as the basis for their actions. Banks in Tanzania are required to hold total capital of 12.5% of the total risk weighted assets, which Twiga Bancorp failed to attain following heavy losses totaling TZS 18.0 bn (USD 8.3 mn) in the past one year. In the last banks' supervision report, Bank of Uganda reported that all banks had met the minimum core capital requirements of 8.0% of risk-weighted assets and off balance sheet items but Crane Bank was deemed to be under-capitalized and this could be attributed to a rise in operating expenses and impairment losses in loans that resulted in a loss of USHs 7.4 bn (USD 2.1 mn) in 2015. The move by central banks in East Africa to tighten their oversight role on the banking sector is highly commendable as it; (i) increases investor confidence in the sector, and (ii) will lead to a more stable and secure banking sector.

The Capital Markets Authority of Kenya is in the final stages of developing a Guidance Note on a new product, Global Depository Receipts and Notes, which will allow Kenyan companies to sell their shares in other countries without having to cross-list their shares, while international companies will also be able to sell their shares in Kenya. The regulations will also enable investors to:

1. Short sell (where investors can be able to sell borrowed shares in the hope of a future price drop that will allow them to buy back the same stocks at a profit), although this can only be carried out by regulated persons, and,
2. Cover securities lending and borrowing that allows an investor to raise an amount equivalent to the value of their shares at a fee without giving up ownership.

Depository receipts are tradable certificates issued in one country representing shareholding in a company listed in another and depository notes allow for corporate bonds to be traded under the same arrangement. This new product will be attractive to Kenyan companies which have been against cross listing due to the lengthy process involved and relative inactivity in other regional markets. The product is expected to lead to (i) increased overall market liquidity, owing to an increased investor base, (ii) increased flexibility of financing by increasing the volume of securities available for trading, and (iii) more transparent pricing of local stocks due to increased coverage by global analysts, which in turn will result to increased depth and efficiency of the capital markets.

Equity Group released Q3'2016 results:

Equity Group released their Q3'2016 results recording core earnings per share (EPS) growth of 17.7% to Kshs 4.0 per share from Kshs 3.4 per share in Q3'2015, in line with our projection of Kshs 4.0 per share. The growth in EPS was driven by a faster growth in operating revenue of 15.3% than operating expense growth of 13.3% in Q3'2016.

Key highlights for the performance from Q3'2015 to Q3'2016 include:

- Operating revenue grew by 15.3% to Kshs 48.9 bn in Q3'2016 from Kshs 42.4 bn in Q3'2015 driven by a 26.3% growth in net interest income, despite a 1.4% decline in non-funded income,
- The 26.3% growth in net interest income was supported by a 26.0% growth in interest income to Kshs. 39.8 bn, from Kshs. 31.6 bn in Q3'2015, outpacing a 24.6% rise in interest expense to Kshs. 7.5 bn from Kshs. 6.0 bn in Q3'2015. Net interest margin increased to 11.0% from 10.2%,
- Non-funded income recorded a decline of 1.4% to Kshs 16.6 bn from Kshs 16.8 bn in Q3'2015 driven by a 27.5% decline in fees and commissions on loans to Kshs 2.9 bn from Kshs 4.1 bn in Q3'2015. The current revenue mix stands at 66:34 funded to non-funded income. The decline in non-funded income raises questions about the positioning of Equity Bank as a fee driven transaction bank with growth coming from interest income and not fee income,
- Operating expenses grew by 15.3% to Kshs 27.4 bn in Q3'2016 from Kshs 24.2 bn in Q3'2015 driven by a 95.3% increase in loan loss provision to Kshs 3.3 bn from Kshs 1.7 bn in Q3'2015. The slower growth in expenses resulted in a decline in cost to income ratio to 56.0% from 57.0% in Q3'2015,
- The faster growth in operating income than operating expenses led to an increase in reported PAT y/y by 17.7% to Kshs 15.1 bn from Kshs 12.8 bn in Q3'2015, compared to our expectations of a 17.4% rise,
- Loan and advances grew by 3.0% to Kshs 271.4 bn from Kshs 263.4 bn, while customer deposits grew by 4.8% to Kshs 331.3 bn from Kshs 316.1 bn. This led to a decline in the loan to deposit ratio to 81.9% from 83.3% previously,
- Excluding regional businesses, deposits grew by 22.0% to Kshs. 271.3 bn from 222.4 bn highlighting the impact of the local alternative channels of distribution and deposit mobilization such as mobile banking and agency banking.

Key to note is that Equity Group earnings for Q3'2016 were majorly from core business with net interest income growing by 26.3% as compared to non-interest income decline of 1.4%. Through their digital platform, Equity Bank disburses 84.0% of the total number of loans issued by the bank. Going forward we expect (i) innovation and execution through their alternative channels like agency and digital, which have witnessed significant growth and currently attributed to 84.9% of total transactions, and (ii) further exploration of their regional business that are not under the Interest Rate Cap, to drive growth.

For a more comprehensive analysis, see **Equity Group Holdings Q3'2016 Earnings Note**.

Safaricom Limited released H1'2017 results

Safaricom released H1'2017 results recording core EPS growth of 13.8% to Kshs 0.51 per share from Kshs 0.45 per share in H1'2016, driven by a core EBITDA growth of 22.2% to Kshs 47.5 bn from Kshs 38.8 bn in H1'2016

Key highlights are:

- Operating revenue increased 14.9% y/y to Kshs 102.0 bn from Kshs 88.8 bn, outpacing the increase in operating expenses that rose by 10.9% to Kshs 54.6 bn from Kshs 49.2 bn in H1'2016,

- Voice revenue grew by 1.1% y/y to Kshs 45.7 bn from Kshs 45.2 bn, while messaging revenue grew 8.1% y/y to Kshs 8.6 bn from Kshs 8.0 bn. Despite a 6.0% y/y growth in the number of total customers to 26.6 mn from 25.1 mn in H1'2016, voice monthly average revenue per user (ARPU), declined 5.6% to Kshs 294 from Kshs 311.4, indicating that the traditional revenue streams of voice are not benefitting as much from the increasing customer base,
- M-Pesa revenue rose 33.7% to Kshs 25.9 bn from Kshs 19.4 bn in H1'2016. This was supported by the growth in M-Pesa customers by 12.2% to 24.8 mn, and an increase in activity as measured by active users in the last 30 days by 12.2% to 17.6 mn customers from 15.7 mn in H1'2016,
- Mobile data revenue grew by 46.3% y/y to Kshs 13.4 bn from Kshs 9.2 bn driven by a 44% y/y increase in mobile data usage per customer to 231 MBs. This led to a 21% increase in the mobile data Average Revenue Per User (ARPU) to Kshs 144,
- Operating profit increased 22.2% y/y to Kshs 47.5 bn from Kshs 38.8 bn owing to cost optimization across operations, leading to an EBITDA margin expansion to 46.5% from 43.8% in H1'2016,
- Profit after tax increased by 32.4% to Kshs 23.9 bn from Kshs 18.1 bn boosted by a one-off provision write back amounting to Kshs 3.4 bn from a dispute settled in favor of the company.

Safaricom plans to continue improving its service offering through (i) investing in their network to enhance capacity, coverage and quality, (ii) increasing network coverage and capacity to ensure excellent performance, and (iii) investing in a call center to improve customer care experience.

For more details of Safaricom FY'2016 results, see **Safaricom Limited H1'2017 Earnings Note**.

During the month, we had a number of other earnings releases, namely:

- **KenGen released H1'2016 results**: Core EPS declined by 41.4% y/y to Kshs 3.1 from Kshs 5.2 in H1'2015. Operating revenue increased by 24.3% y/y to Kshs 36.4 bn from Kshs 29.3 bn in H1'2015 supported by rising electricity sales, outpacing growth in operating expenses of 5.9% y/y to Kshs 8.9 bn form Kshs 8.4 bn in H1'2015. The decline in earnings is mainly attributed to a tax charge of Kshs 4.5 bn for the year, compared to a tax credit in H1'2015, when the company benefited from investment allowances of Kshs 2.8 bn, following the completion of the Olkaria 280 MW plant. See more details on the results in our **Cytonn Weekly #42**
- **Kenya Airways released H1'2016 results**: Loss per share declined by 40% y/y to Kshs 3.2 from Kshs 8.0 attributed to reduced fleet ownership costs which declined by 35.3% y/y to Kshs 8.5 bn from Kshs 13.1 bn, following the lease of 2 of its Boeing aircrafts to Middle Eastern airline Oman air and 1 to Turkish airlines. See more details on the results in our **Cytonn Weekly #43**
- **KPLC released FY'2016 results:** Earnings per share grew by 1.7% to Kshs 3.9 bn from Kshs 3.8 bn in FY'2015. This growth is mainly attributed to a decline in fuel cost by 50.8% y/y to Kshs 12.7 bn from Kshs 25.8 bn owing to increased usage of geothermal and hydro sources during the year

Below is our equities recommendation table. Key changes for the month include:

- NIC moved from a "Buy" recommendation with an upside of 23.1%, to an "Accumulate" recommendation with an upside of 15.5% following a 6.8% m/m price increase
- I&M Holdings moved from an "Accumulate" with an upside of 18.8%, to a "Hold" recommendation with an upside of 8.1% following a 10.2% m/m increase in price
- Standard Chartered moved from a "Lighten" with an upside of 1.0%, to a "Sell" recommendation with a downside of 4.4% following a 6.1% m/m price increase

all prices in Kshs unless stated										
EQUITY RECOMMENDATION										
No.	Company	Price as at 30/09/16	Price as at 31/10/16	m/m Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside) **	Recommendation
1.	KCB Group***	28.0	27.3	(2.7%)	(37.7%)	42.5	7.5%	63.5%	Buy
2.	Bamburi	151.0	159.0	5.3%	(9.1%)	231.7	7.8%	53.5%	Buy
3.	ARM	24.5	25.5	4.1%	(45.2%)	37.0	0.0%	45.1%	Buy
4.	Centum	39.5	39.5	0.0%	(5.4%)	56.7	2.4%	45.9%	Buy
5.	HF Group	16.0	14.9	(6.6%)	(29.0%)	19.8	9.2%	42.1%	Buy
6.	Kenya Re	19.8	20.8	4.8%	(6.7%)	26.9	3.6%	33.2%	Buy
7.	Britam	11.0	10.3	(6.4%)	(43.1%)	13.2	2.4%	31.2%	Buy
8.	DTBK***	139.0	138.0	(0.7%)	(26.2%)	173.2	1.8%	27.3%	Buy
9.	Co-op Bank	12.4	12.7	2.8%	(2.3%)	15.2	6.8%	26.5%	Buy
10.	Barclays	8.2	8.1	(0.6%)	(40.4%)	9.2	9.7%	23.3%	Buy
11.	BAT (K)	820.0	840.0	2.4%	7.0%	970.8	6.2%	21.8%	Buy
12.	Equity Group	30.8	30.8	0.0%	(23.1%)	34.2	7.7%	18.9%	Accumulate
13.	NIC	25.8	27.5	6.8%	(36.4%)	30.8	3.5%	15.5%	Accumulate
14.	Stanbic	71.5	72.5	1.4%	(12.1%)	75.5	7.9%	12.0%	Accumulate
15.	CIC Insurance	4.4	4.1	(6.8%)	(33.9%)	4.4	2.5%	9.8%	Hold
16.	I&M Holdings	88.0	97.0	10.2%	(3.0%)	101.1	3.9%	8.1%	Hold
17.	Jubilee	469.0	471.0	0.4%	(2.7%)	482.2	1.8%	4.2%	Lighten
18.	Liberty	14.7	14.0	(5.1%)	(28.2%)	13.9	0.0%	(0.4%)	Sell
19.	Sanlam Kenya	37.0	31.5	(14.9%)	(47.5%)	30.5	0.0%	(3.2%)	Sell
20.	StanChart***	180.0	191.0	6.1%	(2.1%)	169.9	6.6%	(4.4%)	Sell
21.	Safaricom	20.0	19.9	(0.5%)	22.1%	16.6	3.6%	(12.7%)	Sell
22.	NBK	6.7	6.7	0.0%	(57.8%)	2.7	0.0%	(59.4%)	Sell

**Target Price as per Cytonn Analyst estimates*

***Upside / (Downside) is adjusted for Dividend Yield*

****Indicates companies in which Cytonn holds shares in*

Accumulate – Buying should be restrained and timed to happen when there are momentary dips in stock prices.

Lighten – Investor to consider selling, timed to happen when there are price rallies

We remain "neutral with a bias to positive" for investors with short to medium-term investments horizon and we have now turned "positive" for investors with long-term investments horizon.

<u>Private Equity</u>

During the month of October, there were a number of announcements by private equity funds aimed at raising additional capital for their new funds due to exhaustion of capital in their first fund. There was also increased investment in the health sector across Africa.

On the fundraising front:

- Catalyst Principal Partners is seeking to raise USD 197.0 mn to invest in consumer driven sectors across the Sub-Saharan Africa region. The International Finance Corporation (IFC) has pledged to contribute USD 14.8 mn as part of this. The fund will focus on investing in different sectors including consumer goods, manufacturing, financial services and healthcare which have exhibited tremendous growth potential. This second raise comes after Catalyst Fund I, which raised USD 125 mn, and made a number of investments including Jamii Bora Bank (Kenya), Goodlife Pharmacy (formerly Mimosa, in Kenya) and Chai Bora (Tanzania),
- Fanisi Capital is seeking to raise at least Kshs 4.0 bn from local investors as part of a Kshs 10.0 bn fund meant for regional investments in healthcare, agri-business, retail and education sectors. This is

Fanisi's second round of capital raising, with the firm having raised Kshs 5.0 bn in the first fund whose proceeds were invested in companies such as Haltons Pharmacy, Kijenge Animal Products in Arusha, ProDev/Minimex Group in Rwanda, Ad Life, Hillcrest Schools and European Foods Africa Ltd. The fund is now targeting local institutional investors and as it has already attracted interest from the IFC, which plans to invest up to Kshs 750.0 mn in the new fund. The fund will have an investment mandate across Kenya, Tanzania, Uganda and Rwanda,

- The Islamic Corporation for the Development of the Private Sector (ICD – PS) - a multilateral organization and member of the Islamic Development Bank (IDB) Group - and the Deposit and Consignments Fund (DCF) - a Gabon-based fund partnered to start an SME-focused private equity fund, concentrating on Central Africa region and Gabon in West Africa. ICD has a mandate to support and promote private sector growth to strengthen its relations with the Central African region and Gabon, and contribute largely to the development of Islamic financing for SME's in the region.

On the healthcare investment front:

- Catalyst Principal Partners acquired a controlling stake in Zenufa Laboratories of Tanzania for an undisclosed amount. The company offers affordable, quality medication manufactured to the highest international best practice standards with a wide range of over-the-counter (OTC) and prescription medicines for the Tanzanian market, with leading brands including Zenadol, Zenkof, Zn-vital and Dr. Cold. This has presented the company as an attractive investment for Catalyst Principal Partners in the healthcare sector in Tanzania, which has previously been dominated by imports,
- The African Development Bank (AFDB) committed to invest USD 20 mn equity in the Rx Healthcare fund. The fund is targeting a final capitalization of USD 200 mn and investments will first be made in the North African Region in Egypt, Tunisia and Morocco while the second set of investments will be made in both East and Western Africa.

In other happenings across the private equity space in Kenya, Kuramo Capital, the investors of TransCentury Limited (TCL), confirmed the current CEO Mr. Ng'ang'a Njiinu and put in place a number of minority protection clauses, including:

1. Veto powers on a range of decisions such as sale of assets, issuance of new shares, compensation and hiring and removal of its CEO and CFO,
2. Appointment of 3 out of 9 directors,
3. Influence and backing on board decisions including payment of dividends and compensation of managers earning above Kshs 632,000 per month, and,
4. Approval of certain transactions and documentation such as: business plans, loans to directors exceeding Kshs 1.0 mn, initiation and settlement of lawsuits with a value exceeding 5.0% of the company's total assets, issue of further shares or quasi-equity instruments, purchase or disposal of assets exceeding 10.0% of TCL's total assets and other related party transactions.

We view this as a positive step for TransCentury as it seeks to fund its projects through partnership with aligned partners who will not only fund but also assist in restructuring and consolidation of its business.

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

Real Estate

The month of October saw the release of the Hospitality Report dubbed "Sailing Through the Storm" by Cytonn Investments, which was in our **Cytonn Weekly #41**. The report showed that Kenya's hospitality sector has recorded increased investment as seen through the establishment of hotel and serviced apartment developments, which are prominent in Nairobi. Hotel bed supply has been increasing at a 3.0% CAGR over the last 5-years, while the supply of serviced apartments in Nairobi alone has grown at a CAGR of 23.6% over the last 5 years. However, the performance of the hospitality sector in Kenya has been on the decline with occupancy levels, international arrivals and Total Revenue per Available Room declining by CAGRS of 7.8%, 10.3% and 5.8%, respectively, over the last 5-years. The decline is largely attributed to security concerns, which in turn led to issuance of negative travel advisories, thus lowering demand for accommodation and other hotel-related services. The best opportunities for hotel establishments are in Maasai Mara for 3 & 5-star rated hotels, with Nairobi being the best performer for 4-star hotels. In line with this, The Royal Orchid hotel chain owners revealed that they have completed construction of a five-star hotel facility called Mara Azure near Kenya's Maasai Mara National Park set to open within the next two months, which in our view is not too realistic given the work needed to start ne and run a hotel. The facility will target the safari tourism product, with a focus on tourists who come to view the great wildebeest migration. Overall, the best investment opportunity lies in serviced apartments which record occupancy levels of 85.0% in Nairobi.

Hass Consult released their quarterly property price indices for Q3'2016. The indices indicated a growth of 1.2% and 7.0% for the residential property and land prices, respectively, in comparison to a similar period last year. The index indicated that the growth of house prices was higher in suburbs that in satellite towns with growth rates of 1.2% and 0.9%, respectively, for Q3'2016. Land prices grew by 7.0% for satellite towns compared to 1.4% growth among the Nairobi Suburbs. This is attributed to the fact that investor preference is skewed towards buying developed property in the suburbs with the intention of renting in the short-term and selling in the long-term, while land in satellite towns attracts investors who wish to benefit from the high land capital appreciation in the long-term driven majorly by (i) the ongoing infrastructural development, which has opened up new areas for development, and (ii) rapid urbanization and the growth of the middle class, which has created demand for affordable housing. In our view, land prices will continue to increase in areas experiencing infrastructural development such as the Western By-pass and the expansion of Machakos Junction – Rironi highway which has already been commissioned. The areas that are likely to experience an increase in land prices include Kikuyu, Rironi, Gachie, Ndenderu and Ruaka due to their proximity to the proposed Western By-Pass.

The continued improvement of transport network by the government such as the Standard Gauge Railway, super-highways and by-passes will continue to play a major role in ensuring sustained growth of the real estate industry: Phase 2A of the Standard Gauge Railway was launched during the month; it is expected to run from Nairobi to Naivasha. The SGR will offer several economic benefits including (i) opening-up of economic zones, (ii) faster transportation across the country, (iii) provision of employment opportunities, and (iv) revenue generation locally. The development of the railway is expected to have a positive impact on the real estate sector in Kenya mostly in the development of industrial property.

During the month, the key activities in the industry were: -

a) Turner & Townsend which is a UK-based global construction and management firm opened an office in Nairobi. The opening of the East Africa's regional headquarters in Nairobi is a move in line with their expansion plan after a 34-year existence in Southern and Western Africa. The firms focus will be the state's infrastructural projects in line with Kenya's Vision 2030 such as the Standard Gauge Railway and the LAPSSET project. The presence of several competent contractors in the region will bring about (i) increased competition, (ii) creation of jobs, (iii) skill transfer, and (iv) the introduction of international best practices to the region,

b) Chandaria Industries announced their plans to set up a Kshs 5.0 bn tissue paper manufacturing factory within their 29-acre leased parcel which is part of the Tatu Industrial Park in a bid to double its production capacity. The firm hopes to complete the construction in the next 4-years resulting in creation of over 1,000 job opportunities.
