



# Effects of Interest Rate Cap on Available Investment Opportunities

## Wealth Management Training



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## **I: Introduction to Cytonn Investments**

# What We Stand For



## Our Mission

We deliver innovative & differentiated financial solutions that speak to our clients' needs



## Our Vision

To be Africa's leading investment manager by consistently exceeding clients' expectations



## Our Values

### People

Passionate and self-driven people who thrive in a team context

### Excellence

Delivering the best at all times

### Client Focus

Putting clients' interest first at all times

### Entrepreneurship

Using innovation and creativity to deliver differentiated financial solutions

### Accountability

We take both corporate and personal responsibility for our actions

### Integrity

Doing the right things

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# Overview of The Firm

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**Strategy is  
straightforward –  
just pick a general  
direction and  
implement like hell**

— Jack Welch

# About Us

Cytonn Investments is an alternative investment manager with presence in East Africa, Finland and the US. We provide investors with exposure to the high growth East Africa region. Our investors include global and local institutional investors, individual high net-worth investors and the diaspora. We also service retail investors through our Cytonn Co-operative

## FACT FILE

**74**

Over Kshs. 73 billion under mandate

**3**

Three offices across 2 continents

**150**

Over 150 staff members

**12**

12 investment ready projects

## A unique franchise differentiated by:

### Independence & Investor Focus

Focused on serving the interest of clients, which is best done on an independent platform to minimize conflicts of interest

### Alternative Investments

Specialized focus on alternative assets - Real Estate, Private Equity, and Structured Solutions

### Strong Alignment

Every staff member is an owner in the firm. When clients do well, the firm does well; and when the firm does well, staff do well

### Committed Partners

Strong global and local partnerships in financing, land and development affiliate



# Why We Exist

Africa presents an attractive investment opportunity for investors seeking attractive and long-term returns. Despite the alternative markets in Africa having high and stable returns, only a few institutional players serve the market. Cytonn is focused on delivering higher returns in the alternative markets, while providing the best client service and always protecting our clients' interests.

## WE SERVE FOUR MAIN CLIENTS SEGMENTS:

- Retail segment 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

## WE INVEST OUR CLIENT FUNDS IN:

- Real Estate
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions



# Our Business

## Where We Operate



## Our Business Lines

### Investments

Alternative investment manager focused on private equity and real estate

### Real Estate

We develop institutional grade real estate projects for investors

### Diaspora

We connect East Africans in the diaspora to attractive investment opportunities in the region

### Technology

We deliver world-class financial technology solutions

### Co-operative

Provides access to attractive alternative investment opportunities for members

# Our Solutions

To unearth the attractive opportunity that exists in alternative markets in Africa, we offer differentiated investment solutions in four main areas:

## HIGH YIELD SOLUTIONS

Our expertise in the alternative markets enables us to offer investors high yielding investments. Our robust credit analysis coupled with our quick dealing capabilities, our extensive research coverage and our innovative structuring helps to ensure consistent and above market returns to investors.

## REAL ESTATE INVESTMENT SOLUTIONS

Our comprehensive real estate capabilities enable us to find, evaluate, structure and deliver world-class real estate investment products to our investors in the East African region. Our capabilities include fundraising, market research and acquisition, concept design, project management and agency and facility management.

## PRIVATE REGULAR INVESTMENT SOLUTIONS









Attractive returns in the alternative segments have typically been accessible to institutional and high net-worth investors. Our regular investment solutions provide access to the alternative investments to members of the Cytonn Co-operative.

## PRIVATE EQUITY

We seek to unearth value by identifying potential companies and growing them through capital provision, partnering with management to drive strategy and institutionalizing their processes. Our areas of focus are Financial Services, Education, Renewable Energy and Technology Sectors.

# Our Products

We serve three main types of clients namely, high net-worth individuals, institutions and retail, each with diverse needs. Below are the suitability criteria for the various products.

	INSTITUTIONAL CLIENTS	HIGH NET WORTH INDIVIDUALS (HNWI)	RETAIL CLIENTS
<b>Cash Management Solutions</b>			
<b>Regular Investment Plan</b> <ul style="list-style-type: none"><li>• Education Investment Plan</li><li>• Regular Investment Solution</li><li>• Co-op Premier Investment Plan</li><li>• Land Investment Plan</li></ul>			
<b>Real Estate Development</b> <ul style="list-style-type: none"><li>• Real Estate Developments</li><li>• Sharpland</li></ul>			

# Our People



If you could get all the people in an organization rowing the same direction, you could dominate any industry, in any market, against any competition, at any time.

— **Patrick Lencioni**



We are focused on one agenda:  
**THE CLIENT**

# Board of Directors

To ensure that we remain focused on the clients' interests, we have put in place proper governance structures. We have a board of directors consisting of 10 members from diverse backgrounds, each bringing in unique skill-sets to the firm



**Non-Executive Director**  
Chairman

**Prof. Daniel Mugendi Njiru, PhD**



**Non-Executive Director**

**Madhav N. Bhalla, LLB**



**Non-Executive Director**

**Antti-Jussi Ahveninen, MSc**



**Non-Executive Director**

**Nasser J. Olwero, MPhil**

For bios, visit [www.cytonn.com](http://www.cytonn.com)





**Non-Executive Director**

**James M. Maina, MA**



**Non-Executive Director**

**Michael Bristow, MSc**



**Non-Executive Director**

**Rose Kimotho, M.B.S.**



**Executive Director**

Managing Partner

**Edwin H. Dande, CPA, MBA**



**Executive Director**

Senior Partner

**Elizabeth N. Nkukuu, CFA, MBA**



**Executive Director**

Partner

**Patricia N. Wanjama, CPS (K), MBA**

For bios, visit [www.cytonn.com](http://www.cytonn.com)

# Governance



If you have leadership without governance you risk tyranny, fraud and personal fiefdoms. If you have governance without leadership you risk atrophy, bureaucracy and indifference.

— Mark Goyder

## INVESTMENTS & STRATEGY COMMITTEE

The committee oversees and provides strategic investment direction, including the implementation and monitoring process.

The committee consists of five directors with three non-executive directors namely: James Maina (Chairman), Antti-Jussi Ahveninen, Madhav Bhalla, Edwin Dande and Elizabeth Nkukuu.

## AUDIT RISK & COMPLIANCE COMMITTEE

The committee establishes and oversees risk and compliance, including the implementation and monitoring process.

The committee consists of four directors with two non-executive directors namely: Madhav Bhalla (Chairman), Nasser Olwero, Edwin Dande and Patricia Wanjama.

## GOVERNANCE, HUMAN RESOURCES & COMPENSATION COMMITTEE

The committee establishes, oversees and implements governance structure, human resource policies and firm wide compensations.

The committee consists of four directors with three non-executive directors namely: Antti-Jussi Ahveninen (Chairman), Prof. Daniel Mugendi, Michael Bristow and Edwin Dande.

## TECHNOLOGY & INNOVATION COMMITTEE

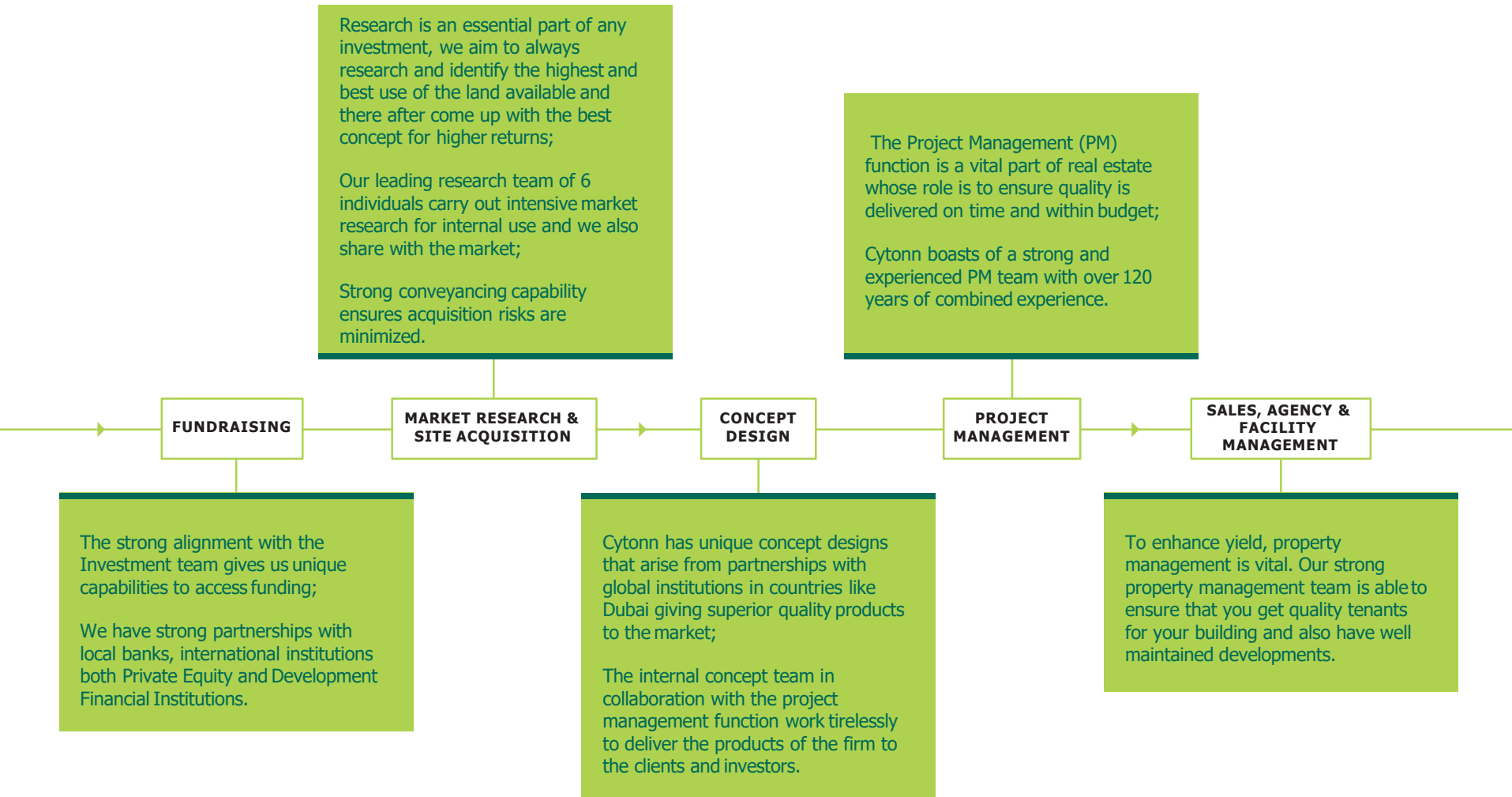
The committee establishes, oversees and implements technical expertise and innovative processes as a driver towards competitiveness.

The committee consists of three directors, with two non-executive directors namely: Nasser Olwero (Chairman), Michael Bristow and Patricia Wanjama.



# Cytonn Real Estate's Unique Capabilities

Cytonn has all the necessary capabilities to deliver the very best Real Estate for investors.



**AMARA RIDGE**



**SITU VILLAGE**



**THE ALMA**



**NEWTOWN**





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## **II. Introduction to Investments**

# Introduction to Investments

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Knowing what investments will do well under each scenario is important

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- **Investments:** This is the purchase of an Asset with the hope of generating some income in future or the asset appreciating hence being able to sell it at a profit
- The investment outlook of an economy is determined by :
  - Economic performance
  - Inflation trends
  - Interest rates
  - Exchange rates
  - Political stability

***Investments returns is largely determined by investors' views on all the above***

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### **III. Types of Investments Asset Classes**

# Types of Investments Asset Classes

There are two main broad classifications of investments based on the ease of accessibility

	<u>Description</u>	<u>Characteristics</u>
<b>Traditional Investments</b>	i. Equities	<ul style="list-style-type: none"><li>• Liquid</li><li>• Price visible on stock exchange</li></ul>
	ii. Fixed Income	<ul style="list-style-type: none"><li>• Liquid</li><li>• Highly sensitive to interest rates</li><li>• Returns made of both coupon and principal</li></ul>
<b>Alternative Investments</b>	i. Private Equity	<ul style="list-style-type: none"><li>• Illiquid</li><li>• Difficult to price</li><li>• Lack of availability of transaction data</li><li>• Relatively high returns compared to Equities</li></ul>
	ii. Real Estate backed investments	<ul style="list-style-type: none"><li>• Illiquid</li><li>• Provides inflation hedge (have their own value)</li><li>• Low correlation with traditional investments</li><li>• Lack of availability of transaction data</li><li>• Relatively high returns compared to Fixed Income</li></ul>

**Structured high yielding investments solutions sit between Traditional and Alternative Asset classes**

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## **IV. Kenya's Interest Rate Cap & Effects**

# Kenya's Interest Rate Cap

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## The interest rate cap enacted into law stipulates a bank's lending and deposit pricing framework

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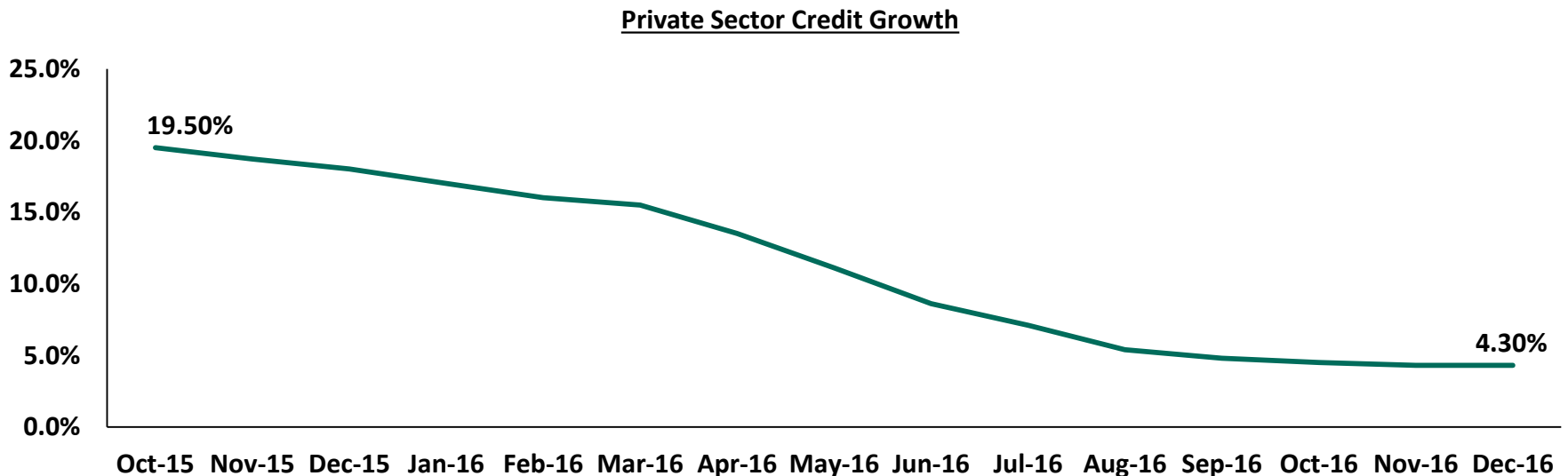
- In September 2016, the President assented into law a bill capping lending rates at 4.0% above the Central Bank Rate, currently at 10.0%, and the deposit rates at 70% of the CBR
- Bank deposits thus attract interest at a rate of 7.0%, and this applies to term deposits and saving accounts deposits
- The interest rate cap carried a lot of expectations among consumers, including;
  - **Access to cheaper sources of funds:** The capping of interest rates was expected to ease access to credit for retail consumers, and ease the burden of exorbitant interest payments on loans
  - **A decline in the cost of goods and services:** Owing to the now cheaper costs of accessing funds in the economy, consumers expected the cost of purchasing a number of goods and services to decline, as sellers would adjust their prices downwards on the cheaper financing costs they now have to settle
  - **Businesses were expected to register improved growth:** This is owing to the favourable economic environment and access to cheap financing, thus contributing more to the country's economic growth and resulting in a faster growing economy



# Effects of the Interest Rate Cap

Private sector credit growth stood at 4.3% in 2016, a decline from 20.6% in 2015

- Private sector credit growth has been declining throughout the year to close at an 8-year low of 4.3% in 2016, compared to 20.6% in 2015, not picking up even after the interest rate was capped. This is below the CBK's recommended 12-15% growth required to support economic growth and stable job creation
- After the capping of interest rates, banks have preferred to lend more to the public sector (local government and parastatals), which recorded a 10.9% growth in 2016



# Effects of the Interest Rate Cap

## Banks adopt cost rationalization measures in a bid to remain profitable in the interest rate cap era

- The interest rate cap has negatively affected the yield banks earn on their assets, and also the cost of their funds, thus narrowing their net interest margin. This will negatively affect the growth of their funded income going forward
- As such, banks are increasingly adopting cost rationalization measures such as laying off staff and closing branches to remain profitable during this interest rate cap era, with 10 banks having announced downsizing plans

Kenya Banking Sector Restructuring			
No.	Bank	Staff Retrenchment	Branches Closed
1.	Sidian Bank	108	-
2.	Equity Group	400	-
3.	Ecobank	-	9
4.	Family Bank	Unspecified	-
5.	First Community	106	-
6.	Bank of Africa	-	12
7.	National Bank	Unspecified	-
8.	NIC	32	-
9.	Standard Chartered	300	-
10.	KCB Group	500	-

# Effects of the Interest Rate Cap continued...

With the enactment of the Interest rate cap into law, banking sector counters registered a decline in prices, and currently the sector is undervalued with our 4 buys in our recommendation

- The interest rate cap has made the attractiveness of investment opportunities in the listed segment such as listed equities attractive to the retail investor
- Bank deposits, that offer a return of 7.0%, is lower than the return on treasury bills at 8.0%
- However, the decline in banking sector stocks offer an attractive entry point, with 4 banks in our coverage having buy recommendations

*all prices in Kshs unless stated*

No.	Company	Price as at 10/02/17	Price as at 17/02/17	EQUITY RECOMMENDATION		Target Price*	Dividend Yield	Upside/ (Downside)*	Recommendation
				w/w Change	YTD Change				
1.	KCB Group***	25.5	24.5	(3.9%)	(14.8%)	39.6	7.5%	69.1%	Buy
2.	HF Group	10.7	10.8	0.9%	(23.2%)	13.8	9.2%	37.6%	Buy
3.	Stanbic Holdings	65.0	65.5	0.8%	(7.1%)	84.7	7.9%	37.2%	Buy
4.	Equity Group	27.0	27.3	0.9%	(9.2%)	31.3	7.7%	22.6%	Buy
5.	Co-op Bank	12.5	12.1	(3.6%)	(8.7%)	13.6	6.8%	19.7%	Accumulate
6.	I&M Holdings	74.5	79.5	6.7%	(11.7%)	90.7	3.9%	18.0%	Accumulate
7.	NIC	21.3	27.0	27.1%	3.8%	30.8	3.5%	17.6%	Accumulate
8.	DTBK***	107.0	107.0	0.0%	(9.3%)	116.8	1.8%	11.0%	Accumulate

\*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

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## **IV. How Investors can benefit?**

# Taking advantage of the Interest Rate Cap

Investors and consumers can use the low interest rate environment to take up higher yielding assets to invest

- Owing to the capped interest rates, consumers who take up loans currently have an upper limit of 14% interest payments on the loans that they borrow. This is advantageous to business owners and investors, who can now access funds more cheaply than before
- Investors who prefer fixed rates of return e.g. from investing in bank deposits now have a lower yield on their investments, and can shift their investments into higher yielding asset classes like real estate and structured products in order to boost returns
- However, banks have also adopted more stringent risk assessment policies, thus actually qualifying for new credit has become a bit more difficult than before, since banks have to price their customers into the capped upper limit risk profile
- The upside to this is that other microfinance institutions and SACCOs also have reduced their lending rates in order to remain competitive in the lending space. Consumers can thus approach these alternative lending institutions as well to get loans

# Cytonn Project Note Return

With Sacco borrowings, the client gets a 15% return by the end of year 3

**CYTONN PROJECT NOTES RETURN WITH SACCO LOAN**

Period	Interest Received	Interest Paid	Return	%
Year 1	170,000	120,000	50,000	5.0%
Year 2	170,000	120,000	50,000	5.0%
Year 3	170,000	120,000	50,000	5.0%
<b>Total</b>	<b>510,000</b>	<b>360,000</b>	<b>150,000</b>	<b>15.0%</b>

**CYTONN PROJECT NOTES RETURN WITH BANK LOAN**

Period	Interest Received	Interest Paid	Return	%
Year 1	170,000	140,000	30,000	3.0%
Year 2	170,000	140,000	30,000	3.0%
Year 3	170,000	140,000	30,000	3.0%
<b>Total</b>	<b>510,000</b>	<b>420,000</b>	<b>90,000</b>	<b>9.0%</b>

- If a client borrows 1.0 mn Kshs at a rate of 12.0% p.a., they will realize an annual yield of 5.0% when they invest in the Cytonn's project note, which has a 20% annual rate of return
- This is just one example of taking advantage of the cheaper costs of debt and investing in an attractive product with higher comparable returns

# Q&A