Cytonn Business and Market Outlook - 2017

9th January, 2017

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I. Introduction to Cytonn

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

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

77	Over Kshs. 77 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

We collect funds from our clients

We invest them in high growth opportunities

We deliver the best possible returns

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Our Business

Where We Operate

Our Business Lines

Investments	Real Estate	Diaspora	Technology	Co-operative
Alternative investment manager focused on private equity and real estate	We develop institutional grade real estate projects for investors	We connect East Africans in the diaspora to attractive investment opportunities in the region	We deliver world-class financial technology solutions	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
Cash Management Solutions	●	●	
Regular Investment Plan • Education Investment Plan • Regular Investment Solution • Co-op Premier Investment Plan • Land Investment Plan	●	●	●
Real Estate Development • Real Estate Developments • Sharpland	●	●	●

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

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

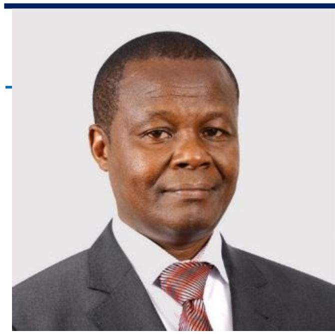
Antti-Jussi Ahveninen, MSc

Non-Executive Director

Nasser J. Olwero, MPhil

For bios, visit www.cytonn.com

Board of Directors, continued…



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

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.

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II. Global and Regional Markets Outlook

Global Market Summary

India and China have the highest expected 2016 GDP growth rates of major economies at 7.6% and 6.7%, respectively

World GDP Growth Rates

	Region	2013a	2014a	2015a	2016e	2017f
1.	India	6.6%	7.2%	7.6%	**7.6%**	7.6%
2.	China	7.8%	7.3%	6.9%	**6.7%**	6.4%
3.	United States	1.7%	2.4%	2.6%	**3.5%**	2.2%
4.	Middle East, North Africa	2.4%	2.7%	2.3%	**3.4%**	3.4%
5.	United Kingdom	1.9%	3.1%	2.2%	**1.8%**	1.1%
6.	Euro Area	(0.3%)	1.1%	2.0%	**1.6%**	1.5%
7.	Sub-Saharan Africa	5.2%	5.1%	3.4%	**1.4%**	3.0%
8.	Japan	1.4%	0.0%	0.5%	**0.5%**	0.6%
9.	South Africa (SA)	2.3%	1.6%	1.3%	**0.1%**	0.8%
10.	Brazil	3.0%	0.1%	(3.8%)	**(3.3%)**	0.5%
	Global Growth Rate	**2.9%**	**3.4%**	**3.2%**	**3.1%**	**3.4%**

Source – International Monetary Fund (IMF)

Factors That Will Affect Global Markets in 2017

2017 set to be a year of political risks and rising anti-trade movements that threaten global growth

Political Uncertainty Looms

- The US president elect is set to take office later in January
- Two major members of the European Union (EU), France and Germany, will hold general elections in 2017 with key discussions surrounding security concerns and level of immigrants
- A widening prosperity gap in developed economies has led to the emergence of populist movements, which are expected possibly sway elections towards movements that promise radical changes

Global Trade Slowdown

- The growth in world trade is expected to decline driven by a slowdown in trade liberalization and the recent rise in protectionist policies from the developed markets
- The anti-trade populism movement that emerged in the recently concluded US elections threatens to disrupt established trade alliances
- Instead of protectionism, trade reforms that lower barriers should be pursued, which will improve global growth

Stability in Oil Prices

- The World Bank raised its 2017 forecast for crude oil prices to USD 55.0 per barrel, from USD 53.0 per barrel in October 2016, as members of the Organization of the Petroleum Exporting Countries (OPEC) reached an agreement to cut down on oil production by 1.2 mn barrels per day from January 2017
- The capping of production will put a lid on oil supply, coupled with an improvement in demand from emerging markets should see relative stability in oil prices during the year

Global Market Outlook

The US economy is expected to remain strong in 2017 while China grows at a steady pace, supported by positive structural reforms, while the Eurozone is expected to grow by 1.4% in 2017

United States

- The US Fed raised the Federal Funds Rate by 25 bps to a bound of 0.50% - 0.75% in December, amid improved economic growth, a strengthening labour market and increasing inflation
- The Fed plans 3 interest rate hikes in 2017, a more aggressive rate hike cycle than previously expected
- According to the US Fed, GDP growth is expected to rise to 2.1% in 2017, from the estimated 1.9% previously, though the economy faces risk of the strengthening putting a strain on the competitiveness of all US exports and rendering them more expensive

Euro-Zone

- The IMF revised its growth forecast downwards for the Eurozone to 1.4% in 2017, from 1.6% earlier, following Brexit
- To spur growth and look to mitigate any negative political repercussions on the economies of the Eurozone, the European Central Bank (ECB) extended the quantitative easing program to December 2017 from March
- The current negative investment rates are expected to persist in 2017 and are expected to impact growth and investment

China

- China's robust economic growth continues into 2017, as the country grew at a steady 6.7% in the first three quarters of 2016 from 6.9% in 2015
- However, the country's use of monetary and fiscal stimulus due to declining growth over the years led to the total debt to GDP rising to 250.0% with local government debt contributing only 41.0% of GDP
- The continued implementation of positive structural reforms, as well as a focus towards an economy driven by market forces, rather than political intervention, remains a bright spot for China

Regional Market Outlook

The Sub Saharan Africa Region is expected to grow by 3.0% in 2017 according to the International Monetary Fund, compared to an expectation of a 4.9% growth excluding Nigeria and South Africa

- Sub Saharan Africa is expected to register the slowest growth in 2016 estimated at 1.4% according to International Monetary Fund (IMF)
- This has been brought about by a slowdown in some of the largest economies in the region like Nigeria and Angola that rely on commodities, which are set to experience slower growth, given the low oil and commodity prices that prevailed in 2016
- Following the OPEC meeting in December 2016 and their decision to cut oil production by 1.2 mn barrels/day, we expect the global oil prices to recover in 2017 and hence growth prospects should be better for these economies
- However, the International Monetary Fund (IMF) projected that SSA region will grow by 3.0% in 2017, which is higher than their 2016 projection of 1.4%, compared to a growth of 4.9% in 2017 from 3.9% in 2016, excluding Nigeria and South Africa
- This highlights the drag that the major commodity driven countries will have on overall growth for this region

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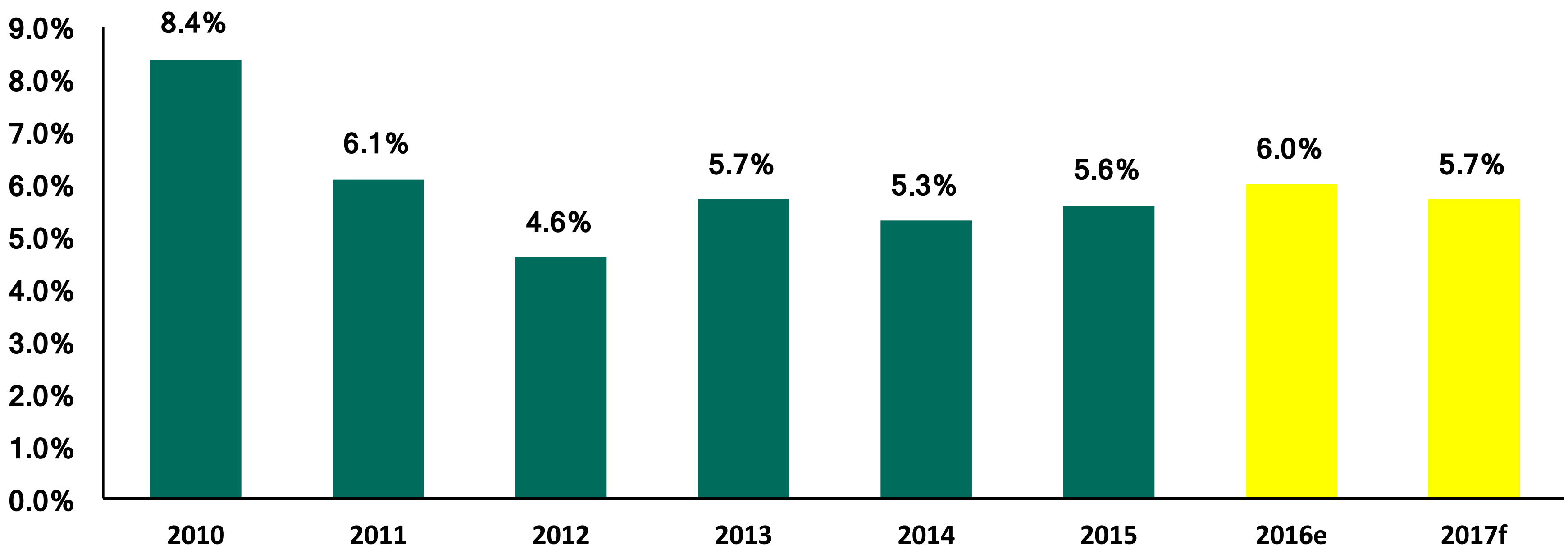
III. Kenya Macroeconomic Outlook

Economic Growth - GDP

2017 GDP is expected to grow by 5.7% underpinned by high infrastructural spending

GDP Growth (%)



- We expect 2017 GDP growth to be between 5.4% - 5.7% supported by (i) continued expenditure on infrastructure, (ii) the recovery of the tourism sector, and (iii) the continued growth of the construction sector
- We however expect the growth to be slower than for 2016 given the expectation of slow growth in agriculture and Financial Intermediation given (i) the continued drought, which came after an El – Nino, and (ii) the interest rate caps, which will reduce banks margins

Source – Cytonn Research

Kenya – GDP Growth in a Diversified Economy

The contribution of five major sectors has reduced to 59.0% in September 2016 from 89.1% in the year 2000, indicating Kenya’s diversified economy

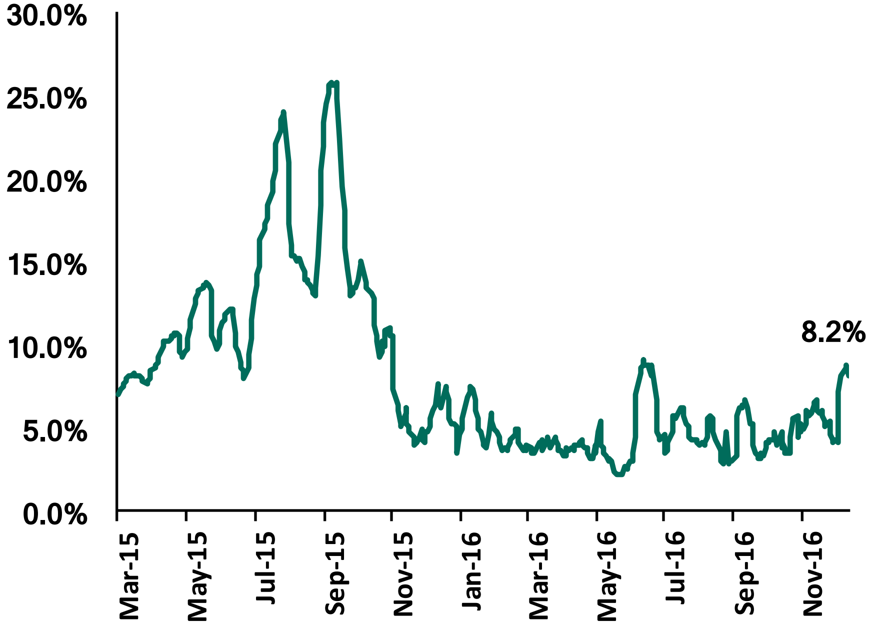
	2000	2010	Q3’2016
Agriculture	31.3%	23.7%	19.3%
Manufacturing	17.0%	11.5%	10.2%
Wholesale & Retail Trade	16.5%	7.1%	8.7%
Financial Services	13.8%	6.0%	6.3%
Real Estate & Construction	10.5%	12.6%	14.5%

Source – KNBS

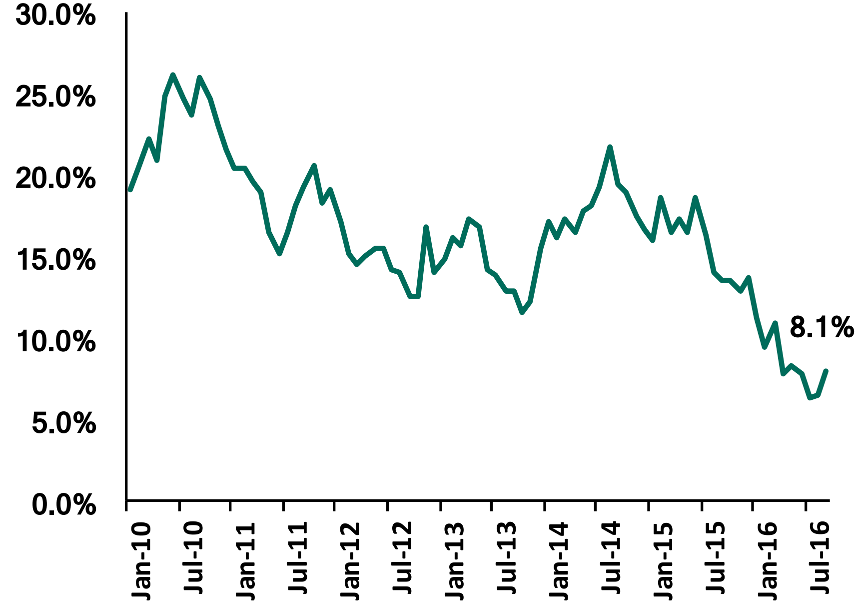
Market Liquidity and Money Supply

The mismatch in interbank rate and money supply is an indication of skewed liquidity, and we expect liquidity distribution to improve within the economy

Interbank Rates (%)



Money Supply Growth (M3) (y/y)



- Throughout the year the interbank has been low indicating high liquidity levels in the money market, however, this is in contrary to the broad money supply growth (m3), which indicates that it grew at its slowest rate since 2011
- This is an indicator that liquidity is skewed towards the fewer larger banks due to flight to safety from smaller banks following the collapse of Imperial Bank and Chase Bank
- We expect liquidity distribution in the money market to improve given CBK's efforts to distribute liquidity within the banking sector

Source – Central Bank of Kenya

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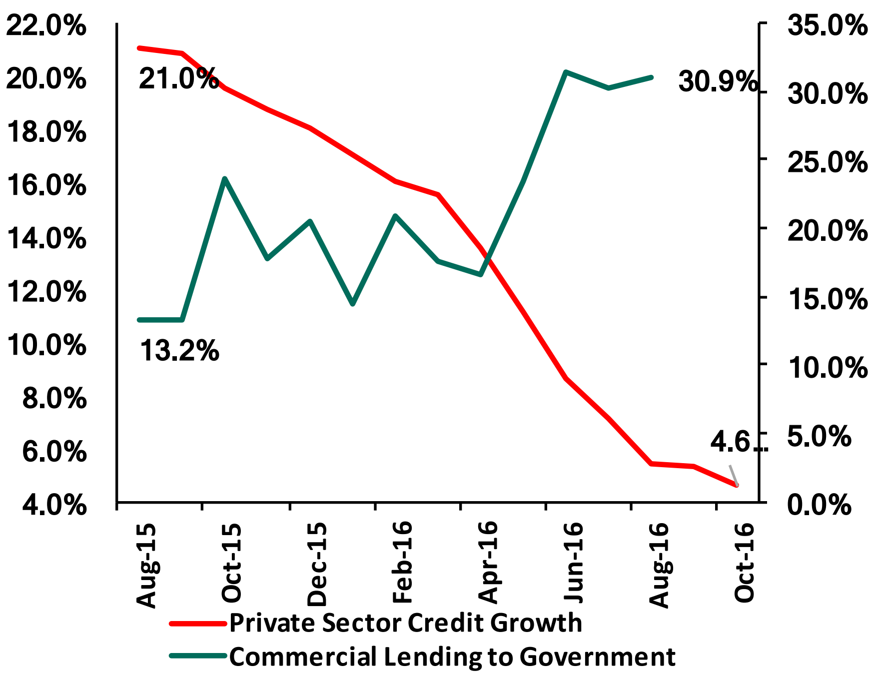
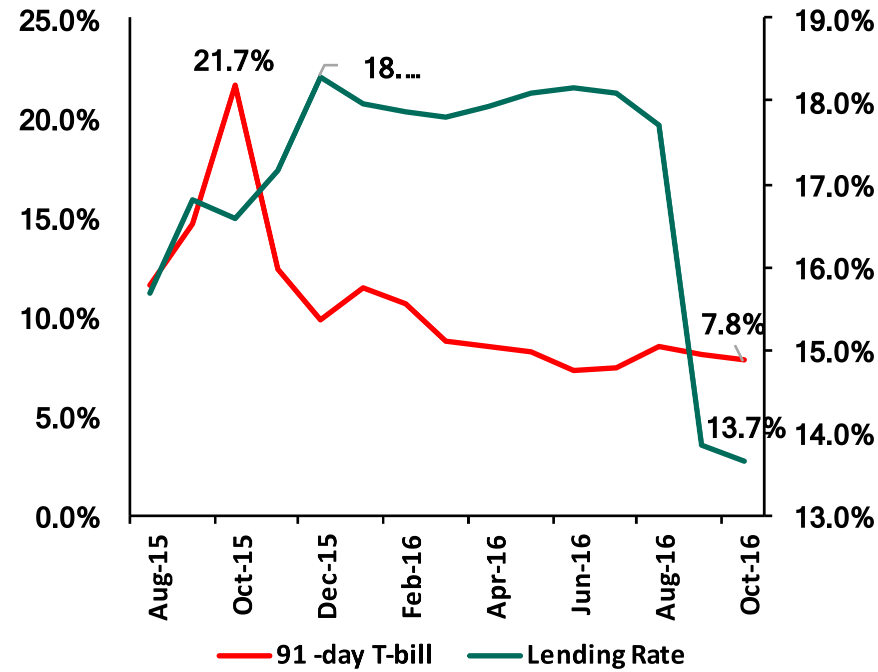
Private Sector Credit Growth

The private sector credit growth is expected to slowdown in 2017 as the interest rates cap takes root

Private Sector Credit vs Government Credit



Interest Rates



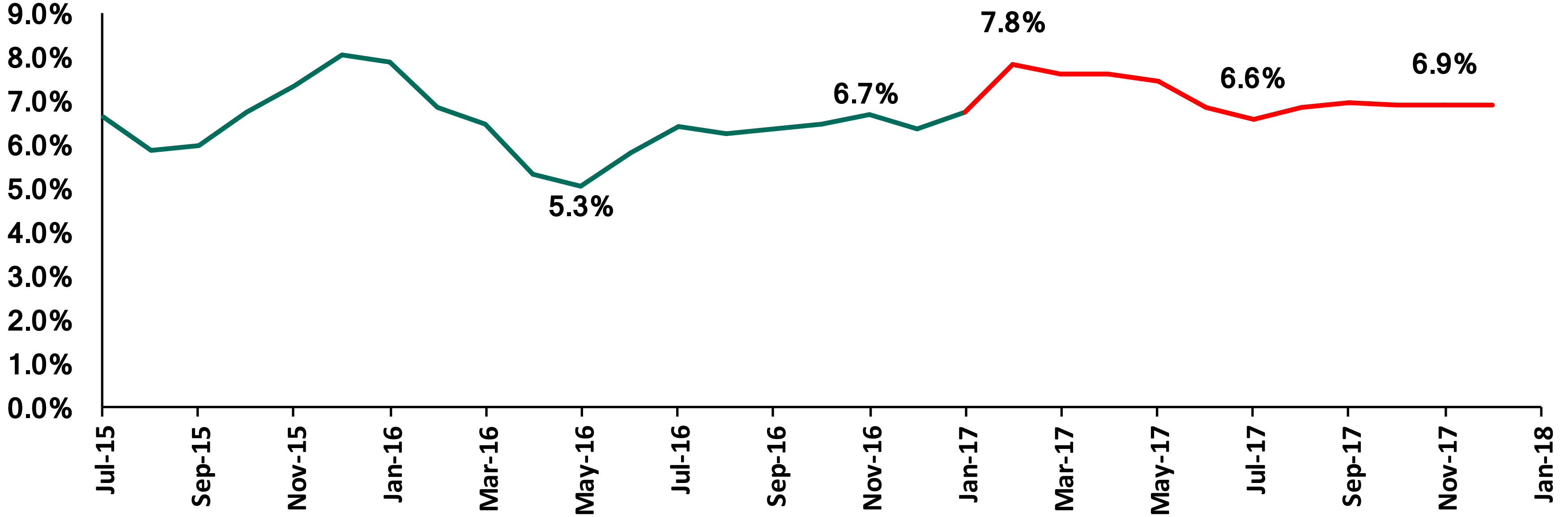
- The significant decline in private sector credit growth can be attributed to the increase in Non-Performing Loans which prompted banks to reassess their risk assessment framework, preferring to lend to the government as it is risk free
- Given the operationalization of the Banking (Amendment) Act, 2015, the new loan pricing framework will lock out most consumers and SMEs from accessing funds thus we expect further slowdown in private sector credit growth in 2017

Source – Central Bank of Kenya

Inflation Forecast

Kenya inflation rate is expected to average 7.2% in 2017, driven by food and fuel prices

Kenya's Inflation Rate Forecast 2016

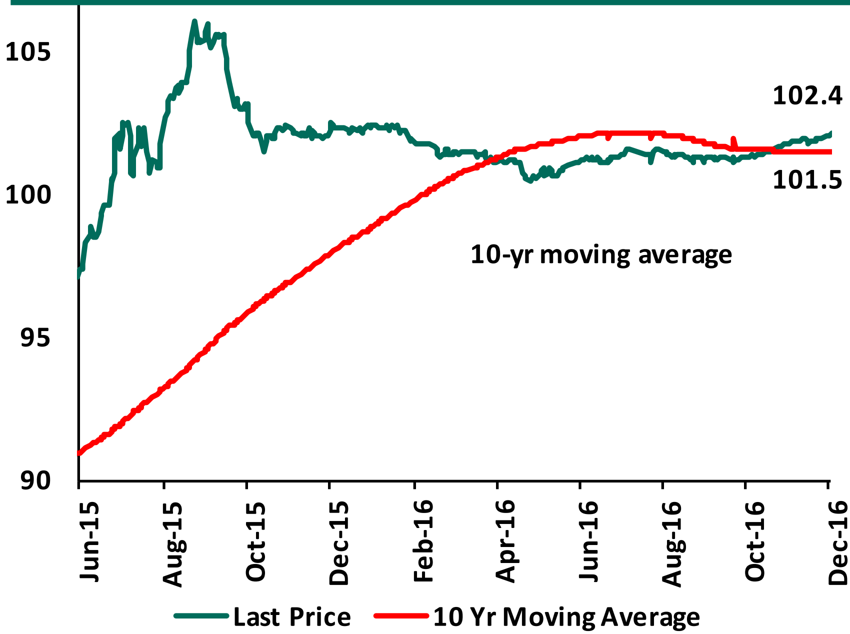


- Kenya's Inflation rate stood at 6.3% for the year 2016 down from 6.6% in 2015, despite rise in Food and Non-alcoholic beverages by 11.2% y/y
- Going forward, we expect inflationary pressure to persist in 2017 driven by; (i) drought which will persist until mid-2017 driving food prices up (the major CPI basket mover), and (ii) currency depreciation as the dollar strengthens globally with forex reserves dropping to USD 7.0 bn equivalent to 4.6 months of import cover as at December 2016
- The average inflation in the year 2017 is expected to however remain within the bound of 2.5% - 7.5% set by the CBK

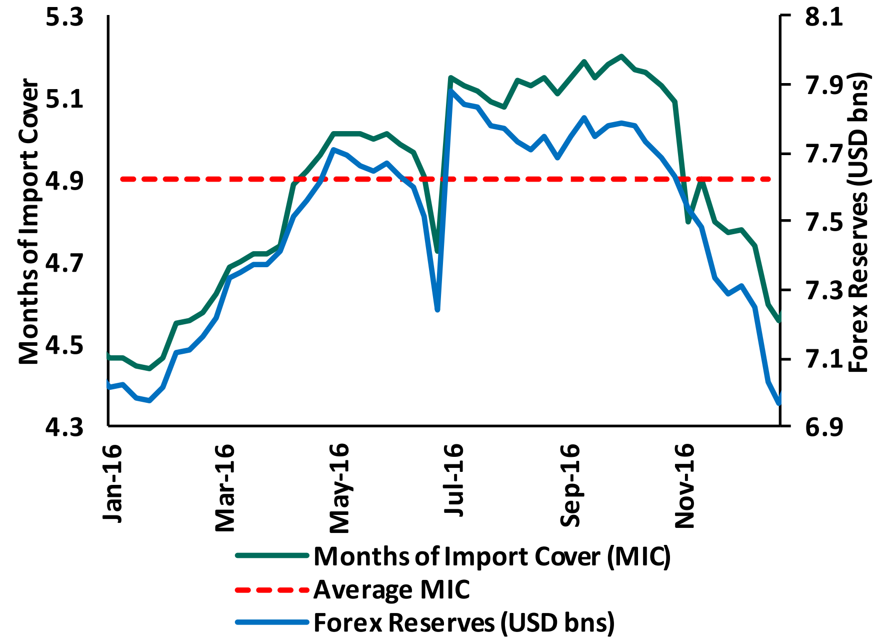
Exchange Rates

We expect the Shilling to depreciate against the dollar in 2017 as the dollar strengthens globally

Kshs. Vs USD



Kenya Months of Import Cover and Forex Reserves



- The Kenya Shilling depreciated slightly by 0.1% in 2016 owing to (i) global strengthening of the dollar owing to the Fed rate hike, (ii) Brexit which saw increased uncertainties in the global forex market prompting the CBK to use forex reserves to support the shilling. This was mainly in the second half of the year as in H1'2016 the shilling was up by 1.2% owing to an improving current account deficit and high forex reserves
- Going forward we expect the shilling to depreciate against the dollar driven by (i) continued global strengthening of the dollar as the Fed plans to increase their rate hiking cycle in 2017, and (ii) recovery of the global oil prices

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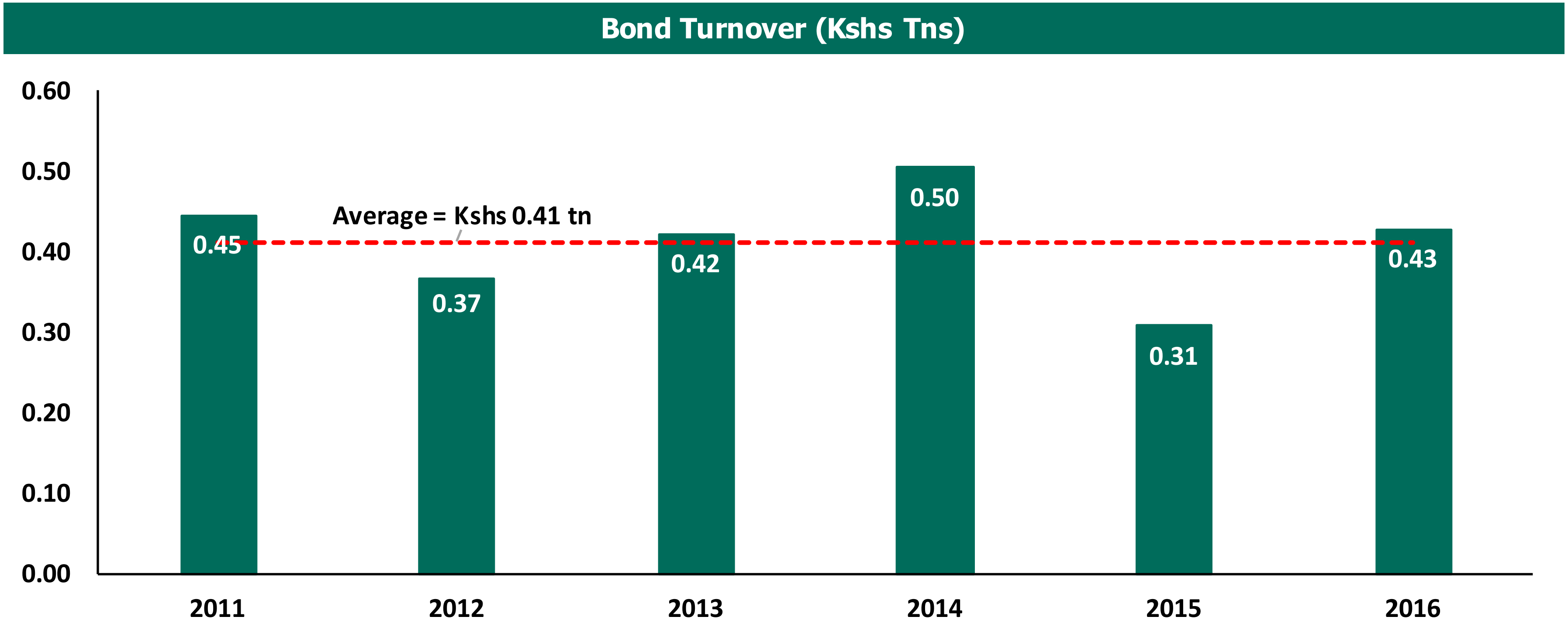
IV. Fixed Income Market Outlook

Secondary Bond Market Activity

We expect market activity and turnover to remain high in 2017 as commercial banks increase their exposure to government securities following the enactment of the Banking (Amendment) Act, 2015



- In 2016, secondary bond market turnover rose to Kshs 0.43 tn from Kshs 0.31 tn in 2015 despite interest rates remaining stable
- We expect activity and turnover to remain high in 2017 given commercial banks have increased their exposure to government securities as they shy away from lending to the private sector following the enactment of the Banking (Amendment) Act, 2015

Source- Central Bank of Kenya (CBK)

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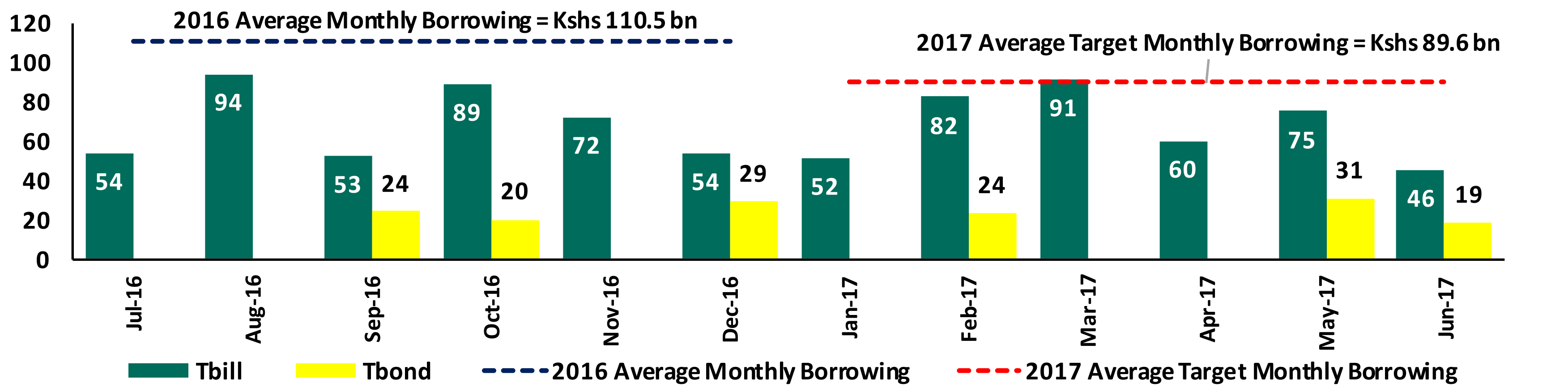
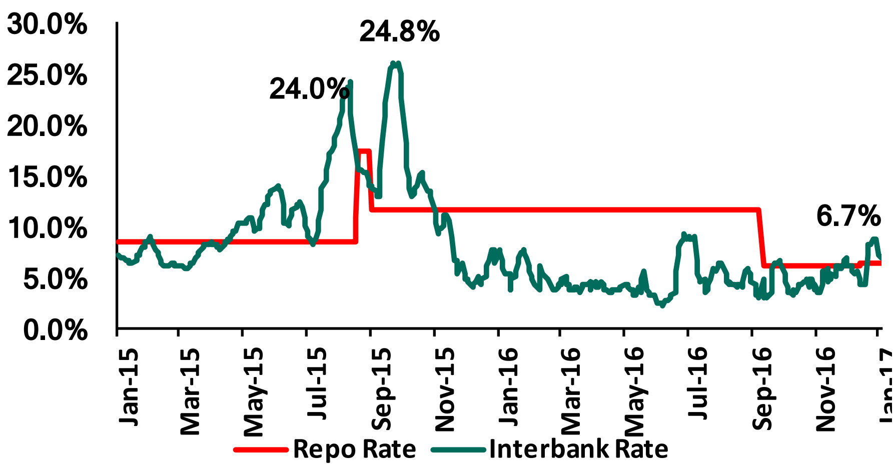
Market Liquidity and Government Borrowing

Liquidity set to remain high and mitigate any pressure exerted on interest rates due to increased domestic borrowing

Fiscal Year 2016/17 Government Domestic Borrowing Programme



Interbank & Repo Rates



- The huge maturities in February and March 2017 coupled with the expected increase in the domestic borrowing target and the foreign borrowings delays could result in an upward pressure on interest rates and lead to domestic borrowing being higher than the average monthly borrowing target of Kshs 89.6 bn
- However, we expect this to be mitigated by the improved liquidity position in the money market given the expected maturity levels

Source – Central Bank of Kenya

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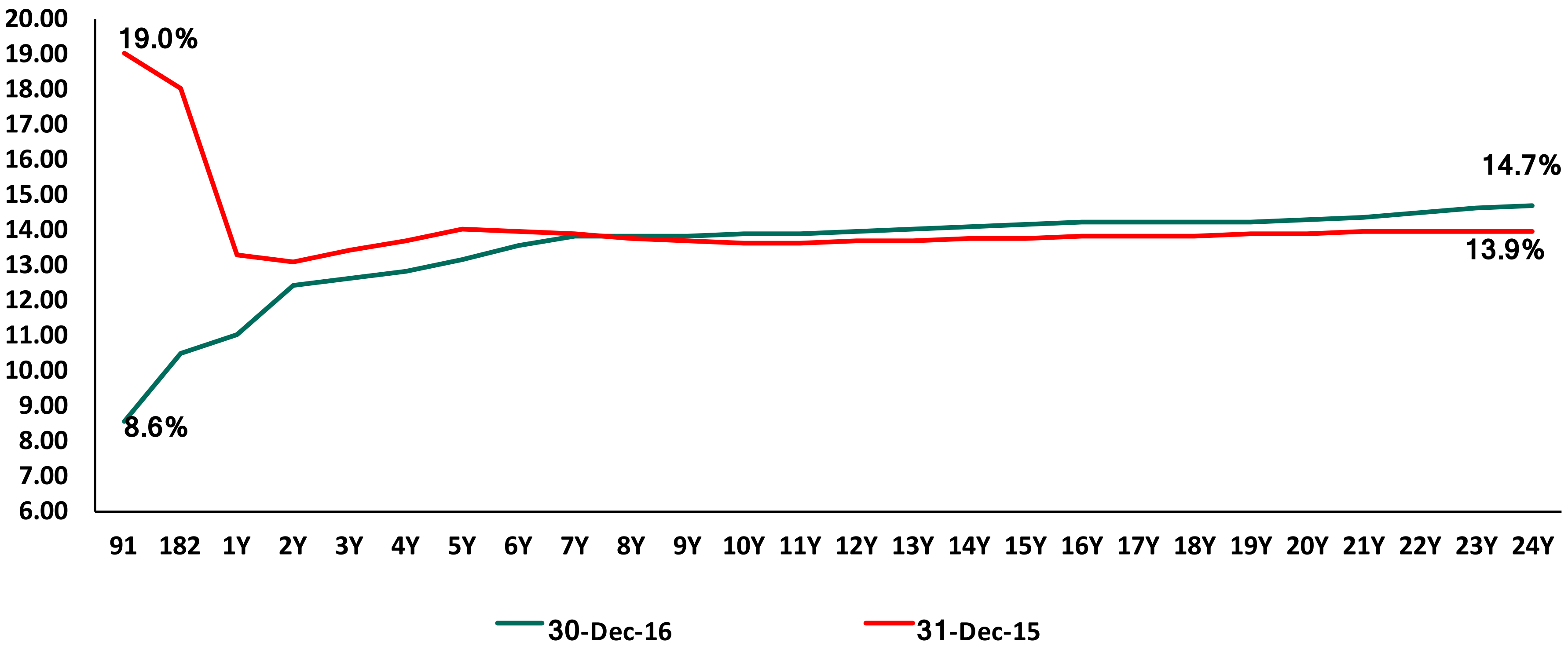
Yield Curve Developments

The yield curve has since normalized from its inverted state experienced in December 2015

Yield Curve



- The yield curve during the year transitioned from an inverted yield curve (owing to the high interest rate environment and desire of investors to keep short) to a normal yield curve given reduced pressure on government borrowing

Source – Central Bank of Kenya

Fixed Income Market Outlook

Of the 7 indicators we track , 5 are neutral (monetary policy, Government borrowing, inflation, investor sentiment and security) and 2 are negative (revenue collection and currency). It is due to this that we think it is prudent for investors to be biased towards short-term papers

Macro-Economic Indicators	2016 Experience	2017 Outlook	Current View
Government Borrowing	• The Government is ahead of its domestic borrowing target having borrowed Kshs 172.2 bn against a pro-rated target of 119.2 bn. This translates to Kshs 103.6 bn per month. It has however not borrowed from the foreign markets having a target of Kshs 459.4 bn • Government in the process of revising the domestic and foreign borrowing targets to Kshs 294.6 bn and Kshs 287.6 bn	• Going forward, the monthly target of Kshs 76.8 bn is achievable supported by the operationalization of the interest rates cap which has seen commercial banks prefer to lend to the central government • Given that the KRA is likely to miss out on revenue collection, domestic borrowing is not sufficient to cover amount to be borrowed from foreign market	Neutral
Revenue Collection	• The Kenya Revenue Authority collected Kshs 289.0 bn, 18.4% lower than the prorated target of Kshs 342.5 bn. Despite the collection being below target, KRA has collected 12.1% more compared to a similar period last year	• Given the expectation of subdued corporate earnings in 2017, KRA is likely to miss out on their target of revenue collection and given that they have not yet managed to tax the informal sector	Negative
Monetary Policy	• CBR decreased 100 bps to 10.5% and later on in the year 50 bps to 10.0%	• The CBR is expected to be maintained as the CBK monitors the inflation and exchange rate expectation	Neutral
Inflation	• Inflation has been maintained within the CBK target of 2.5% to 7.5% during the course of the year • During the course of the year, inflation has averaged 6.3%	• Going forward, we expect inflationary pressure to persist in 2017 driven by; (i) drought which will persist until mid-2017 driving food prices up (the major CPI basket mover) and, (ii) currency depreciation as the dollar strengthens with forex reserves dropping to 4.6 months of import cover in December 2016	Neutral

Fixed Income Market Outlook, continued…

Of the 7 indicators we track , 5 are neutral (monetary policy, Government borrowing, inflation, investor sentiment and security) and 2 are negative (revenue collection and currency). It is due to this that we think it is prudent for investors to be biased towards short-term papers

Macro-Economic Indicators	2016 Experience	2017 Outlook	Current View
Exchange Rate	• Shilling is flat against the dollar having depreciated by 0.1% since the turn of the year	• We expect the shilling to depreciate against the dollar driven by (i) continued global strengthening of the dollar as the Fed plans to increase their rate hiking cycle in 2017, and (ii) recovery of the global oil prices	**Negative**
Investor Sentiments	• Investor sentiment has been good as evidenced by the decline in yields for the 5-year and 10-year Eurobonds by 4.6% and 7.8% respectively • The US Fed hiked interest rates leading to investors demanding higher premiums from emerging market investments, to compensate for the relative risk • Britain pulled out of the European Union (EU), in a move that threatened to see investors shift their focus away from frontier markets, given the global uncertainty • Moody's affirmed Kenya's B1 rating • S&P raised the rating from negative to stable and Fitch affirms the default rating at B+	• Given (i) global uncertainties due to political/ economic risks as major economies vote and, (ii) expectations of an increased rate hike cycle by the Fed we expect foreign investors to be weary and demand higher premiums from riskier frontier markets. However, we expect long term investors to enter the market seeking to take advantage of the current low valuations	**Neutral**
Security	• The security has remained sound leading to all the rating agencies affirming Kenya's Sovereign rating	• Given that 2017 is an election year, political tensions have started to rise and security might deteriorate as seen in previous elections	**Neutral**

Fixed Income Market Outlook

We think investors should be biased towards short-term fixed income instruments as interest rates have bottomed out and we expect them to persist at the current levels

- We expect initial upward pressure on interest rates in 2017, as the government might have to plug in the deficit that is likely to arise from revenue collection and foreign borrowing, from the domestic market

- However, liquidity and liquidity distribution in the money market are expected to improve owing to high maturity amounts and efforts to improve liquidity distribution by the Central Bank of Kenya (CBK), thus the possibility that this might mitigate the upward pressure on interest rates

Interest rates appear to have bottomed out and we expect them to persist at the current levels, having risen slightly over the last few months. However, there is uncertainty in the interest rate environment as the government might have to borrow more domestically to plug in the deficit that may arise from revenue collection and foreign borrowing. It is due to these reasons that we think it is prudent for investors to be biased towards short-term fixed income instruments

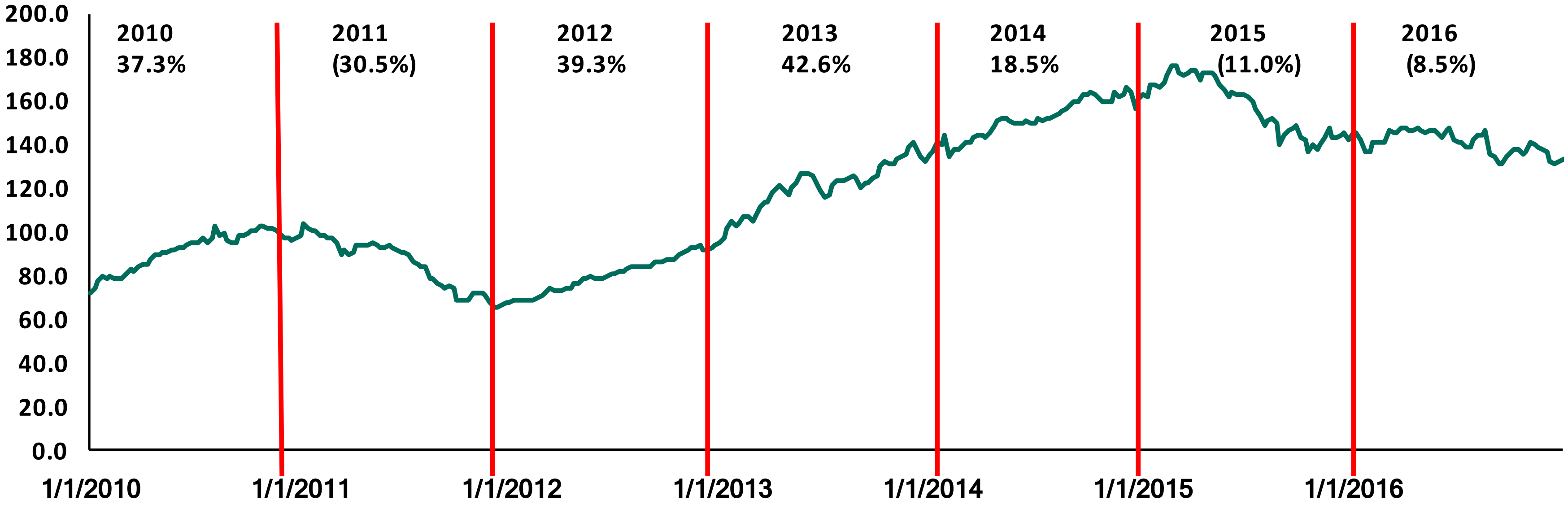
V. Kenya Equities Market Outlook

Kenya Equities 2016 Performance

NASI declined by 8.5% during the year compared to a 11.0% decline recorded in 2015

- During the year 2016, the Kenya equities market registered negative performance with NASI, NSE 20 and NSE 25 losing 8.5%, 21.1% and 15.8%, respectively, as a result of declines in large cap stocks. Equity turnover declined by 31.6% to USD 1,448.7 mn from USD 2,119.5 mn in 2015

NASI Yearly Returns



- In the year 2016, foreign investors turned net buyers recording net inflows of USD 88.8 mn compared to net outflows of USD 12.3 mn in 2015. The sustained foreign investor net inflows can be attributed to foreign investors preferring Kenya to other frontier markets such as Nigeria, which experienced net foreign outflows

Source- Bloomberg

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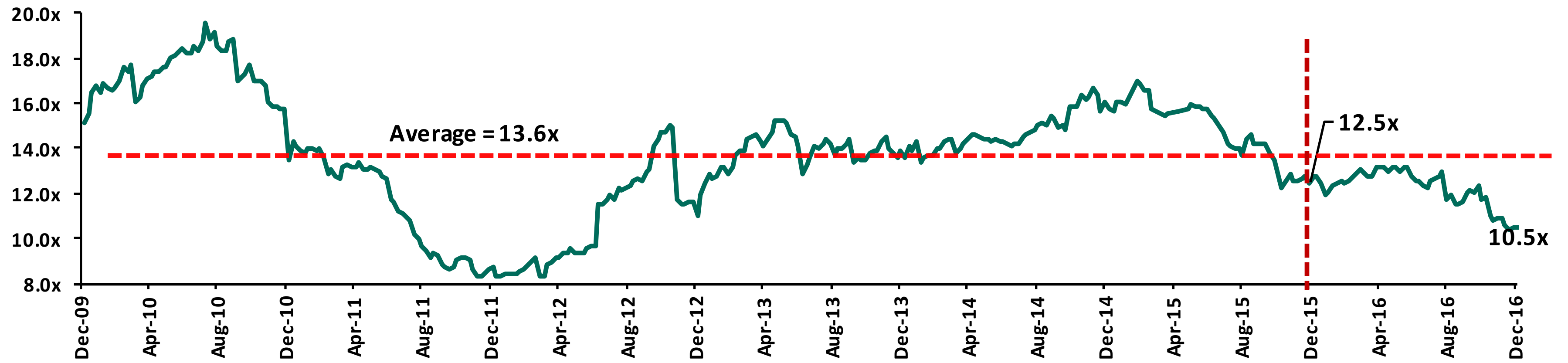
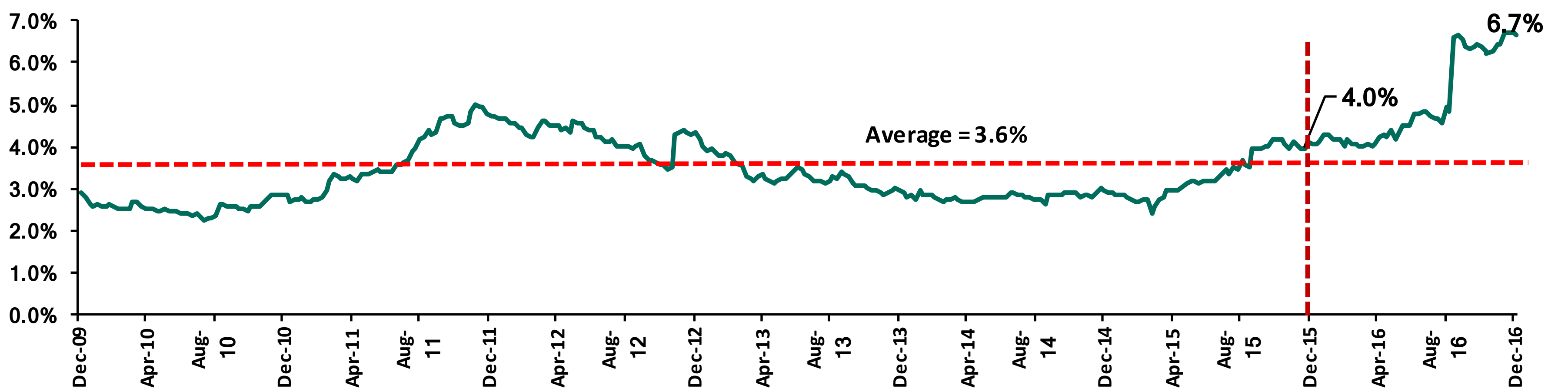
NASI Price to Earnings and Dividend Yield

NASI is trading at a lower P/E than historical average, with a dividend yield higher than the historical average

NSE All Share Index P/E



NSE All Share Index Dividend Yield

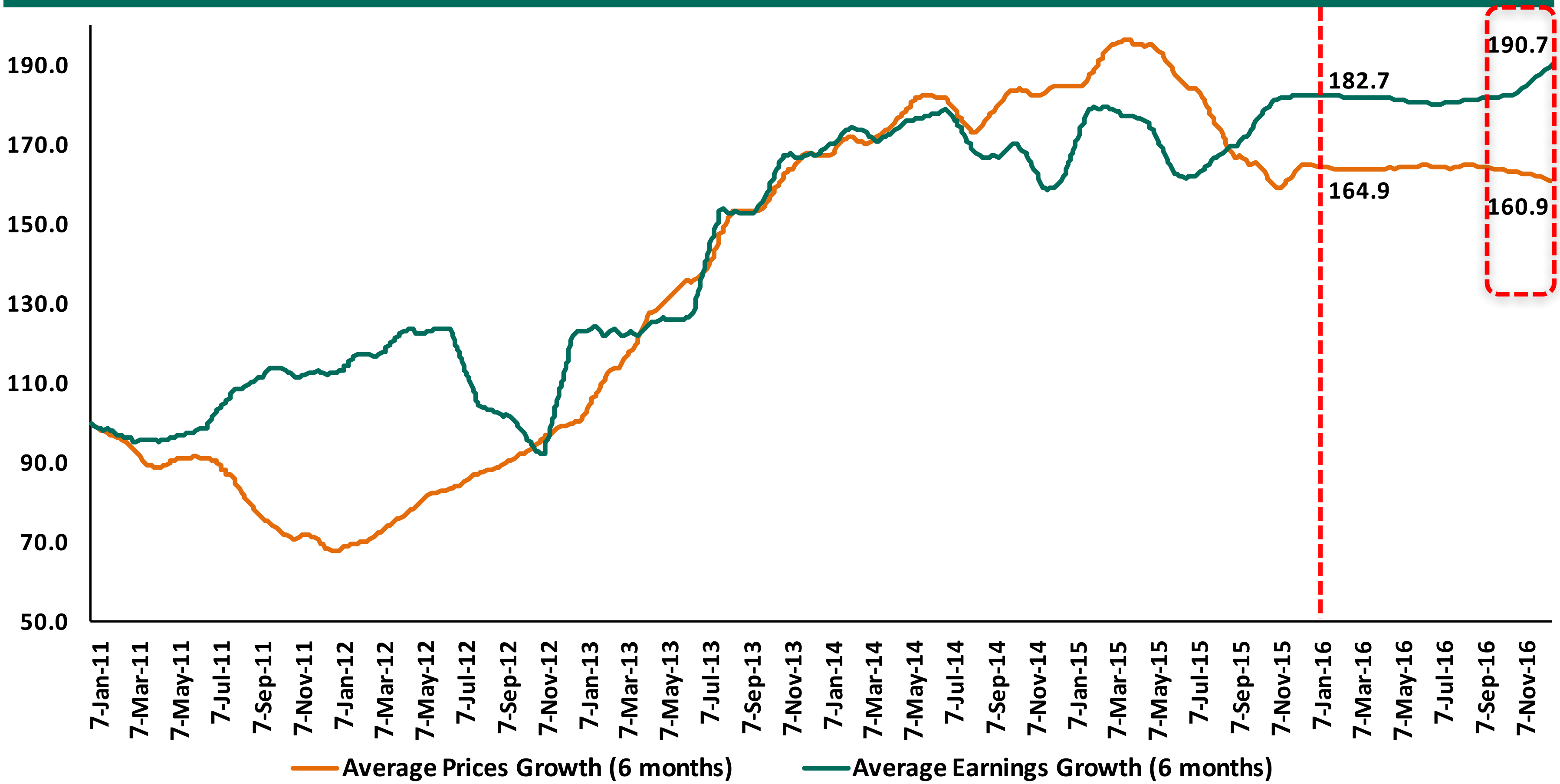


Source- Bloomberg

Prices vs Earnings Growth – Market Not Driven by Fundamentals

We expect an uptick in equity prices as earnings growth has not been matched by increasing prices. Despite the 4.4% increase in 6-month average earnings, average prices fell 2.4% in 2016

Price vs Earnings Growth



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Factors That Will Affect the Equities Market in 2016

In 2017, we expect non-financial companies to register higher core earnings growth than financials

1. **Corporate Earnings**: On average, we expect earnings growth for the year 2017 to come in at an average of 8.0%, lower than our 2016 expectation of 12.5%. The lower earnings growth is attributed to expectation of depressed earnings for commercial banks due to the implementation of the Banking (Amendment) Act, 2015, which placed regulations on banks' loan and deposit pricing framework, thereby reducing the net interest margin for banks. Non-financials are expected to perform better since they are less affected by the interest rate environment. Additionally, key risks still remain with regards to the 2017 general elections, which might affect Kenya's business operating environment and thus corporate earnings growth

2. **Capital Markets Investor Sentiments:** We expect the equities market to register a decline in net foreign inflows in 2017 as investors exit stocks listed on the Nairobi bourse due to (i) expected lower earnings from commercial banks, (ii) uncertainties over political and social risks as Kenya undertakes general elections, and (iii) expectations of a more aggressive rate hike cycle by the Fed that will make the US market more attractive. Despite this, we still expect Kenya to attract flows from long-term investors in preference to other frontier markets

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Factors That Will Affect the Equities Market in 2016, continued …

Increased regulation is expected to boost investor confidence in the equities market

3. **Interest Rates:** We expect the Monetary Policy Committee (MPC) to maintain the Central Bank Rate (CBR) relatively at the current 10.0% as the Central Bank monitors Kenya's inflation rate and exchange rate expectation. The inflation rate is expected to continue rising steadily due to rising food and oil prices, while the currency is expected to depreciate further on account of continued strengthening of the dollar
4. **Diversification of Capital Markets and New Listings:** We do not expect any major listing on the Nairobi Securities Exchange in 2017. However, we expect increased products offerings with (i) the expected launch of trading of derivatives that was delayed in 2016, and (ii) possible setting up of a commodities exchange. The Central Depository & Settlement Corporation (CDSC) is also set to launch a new trading platform in April 2017 that will allow a settlement cycle of 1 day (T+1). Additionally, the CDSC is looking to add listed equities from other African countries, starting with Nigeria. This is expected to (i) increase liquidity in the market, (ii) make pricing of bonds and equities easier as it improves price discovery mechanisms in the securities exchange, and (iii) improve depth of the capital market
5. **Regulation:** We expect corporate governance practices on issuers of securities to the public to be enhanced after the implementation of the Code of Corporate Governance and the Stewardship Code for Institutional Investors. This is expected to increase investor confidence in the equities market

Equities Outlook: Review of Key Market Drivers

We remain "Neutral" on equities outlook in the short-term, but "Positive" in the long-term

Equities Market Indicators	Outlook 2017	Current View
Macro-economic Environment	• We expect 2017 GDP growth to be between 5.4% - 5.7% supported by (i) Government continued expenditure on infrastructure, (ii) the recovery of the tourism sector and (iii) the continued growth of the construction sector. • Interest rates are expected to remain at the current levels as the CBK monitors inflation and exchange rates, which are expected to remain within government bound and depreciate, respectively	**Neutral with a bias to Positive**
Corporate Earnings Growth and Valuations	• We expect corporate earnings growth of 8.0% in 2017 due to lower earnings for financial companies attributed to the implementation of the Banking Act (Amendment) ,2015. • Assumption of corporate earnings growth rate of approximately 8.0% gives a forward P/E of 9.6x, relatively cheaper than historical average of 13.6x	**Neutral with a bias to Positive**
Investor Sentiment and Security	• We expect 2017 to register reduced net foreign inflows due to uncertainties regarding political and social risks as Kenya undertakes general elections, and expectations of a more aggressive rate hike cycle by the Fed. However, we expect long term investors to enter the market looking to take advantage of the current low valuations. • We expect security to be maintained in the country supported by government initiatives towards improving internal security	**Neutral**

We maintain a "NEUTRAL" recommendation on equities for investors with short-term investment horizon since, despite the lower earnings growth prospects for this year, the market decline so far has made valuations attractive. The low valuation provides an attractive entry point for long term investors and thus we are positive for investors with a long term investment horizon.

VI. Private Equity Outlook

Private Equity Outlook

High return potential across all sectors and improving ease of doing business expected to drive Private Equity investment in 2017

- The year 2016 saw an increase in private equity deals in the Sub-Saharan Africa Region, with the first three quarters of 2016 registering 140 deals
- 33 of these deals with a disclosed value totaling Kshs 48.0 bn, an average of Kshs 1.5 bn per deal, came from East Africa, and 14 of them with a disclosed value of Kshs 30.6 bn came from Kenya
- In 2017, we expect a continuation of this trend, especially in Kenya, which remains an attractive destination for investors, a factor which is mainly because of:
  - (i) improvement in ease of doing business
  - (ii) high return potential across all sectors
  - (iii) a well-diversified economy
  - (iv) consolidation in sectors such as financial services, creating an avenue for increased private equity activity
  - (v) exits of deals adding confidence for PE investors on the depth of liquidity in the Kenyan market
- We expect investors to remain focused on the following key sectors:
  - (i) Financial services
  - (ii) Renewable energy
  - (iii) Education
  - (iv) Information and Communication Technology

Financial Services Sector

There exists high growth opportunities in the Financial Services sector driven by consolidation in the banking industry and innovations

- Of key focus in 2017 for the financial services sector will be the consolidation in the banking sector, which has already begun, with 3 deals recorded in 2016, namely :
  - (i) SBM Holdings, a Mauritian Bank, which is set to acquire 100.0% stake in Fidelity Commercial Bank
  - (ii) Bank M, a Tanzanian bank, acquiring 51.0% of Oriental Commercial Bank
  - (iii) I&M Holdings' 100% acquisition of Giro Commercial Bank
- With the enactment of the Banking (Amendment) Act 2015 that sought to cap interest rates charged on loans, banks will have to be innovative to find their niche in the market and remain competitive
- Weaker banks will have to merge or be acquired so as to remain competitive and shore up their capital base, creating an avenue for PE investors to invest in the sector
- The focus on financial services sector is driven by:
  - (i) the increasing demand for credit,
  - (ii) the growing financial services inclusion in the region through alternative banking channels
  - (iii) increased innovation and new product development within the financial services sector
  - (iv) the growing middle class supporting an inherent increase in consumption expenditure, and an increase in the percentage of the population that will require financial services

Renewable Energy Sector

Investor friendly regulations is a key driver to Private Equity investment in the renewable energy sector

- Kenya's renewable energy sector will continue to attract private equity investments with growth being driven by:
  - (i) increase in demand with the peak demand in 2015 being 1,512 MW, and growing at 7% annually, mainly attributed to growth in industrialization and increased connectivity of the rural areas
  - (ii) investor friendly regulations put in place by the industry regulators including
    - ✓ tax exemption and import duty on material used for renewable energy plant development
    - ✓ the Feed-in-Tariff that offer investors guarantee of return on their investments
  - (iii) high potential for wind, solar and geothermal energy generation in the country as indicated in the table below:

Energy Potential Sites in Kenya		
Source	**Potential Areas**	**Projects Connected to Grid**
Solar	Marsabit, Turkana, Malindi, Magadi, Meru, Garissa	Strathmore Power Plant (600kW)
Wind	Marsabit, Turkana, Ngong, Isiolo, Samburu, Wajir, Kilifi	Lake Turkana Wind Project (310MW), Kinangop(60MW), Kipeto(100MW)
Geothermal	Olkaria, Menengai, Suswa, Longonot , Lake Baringo, Eburru	Olkaria I, II, and , IV (430MW)

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Renewable Energy Sector, continued…

We expect long term investments targeting Kenya's Vision 2030 flagship projects

- We also expect long term investments targeting the Vision 2030 flagship projects which are expected to further drive energy demand, as indicated in the table below:

Kenya Vision 2030 Flagship Projects Energy Demands						
		Energy Demand(MW)				
Projects	**Completion Date**	**2015**	**2020**	**2025**	**2030**	**2035**
Konza Techno City	2017		104	334	603	832
Special Economic Zones	2019		41	170	317	482
LAPSSET oil pipeline and port	2025			325	650	975
LAPSSET refineries/industries	2025				346	745
Rapid transit system Nairobi	2030				105	315
Electrified railways						
• Mombasa-Nairobi	2030				153	456
• Nairobi-Kampala	2035					97
Total			**145**	**829**	**2,174**	**3,901**

Education Sector

We expect an increase in PE deals targeting private Primary and Secondary level education

- We expect an increase in deal volume in the education sector with a focus on Private Primary and Secondary level education
- The key drivers of investment in the sector will be:
  (i) demand for quality education and a more comprehensive curriculum
  (ii) the entry of international brands over the past years such as the Nova Academies
  (iii) a shift of demand from government funded education towards private education providers driven by the frequent disruptions in public schools
- Informed by demand for education and the ability to afford the education provided, PE investors in the education sector can focus on the following counties to provide either, Early Childhood Development (ECD), Primary or Secondary level education, as highlighted in the table

Education Sector, continued…

5 counties provide investment opportunities in all 3 levels of education

	Education Sector Investment Opportunities			
	County	ECD Level	Primary Level	Secondary Level
1.	West Pokot County	√		
2.	Turkana County	√		
3.	Samburu County	√		
4.	Isiolo County	√		
5.	Kilifi County	√		
6.	Nairobi City County	√		
7.	Kwale County	√		
8.	Nyandarua County		√	
9.	Trans-Nzoia County		√	
10.	Lamu County	√	√	
11.	Nyamira County	√	√	
12.	Busia County	√	√	
13.	Vihiga County		√	√
14.	Embu County		√	√
15.	Tharaka County		√	√
16.	Kiambu County		√	√
17.	Kisumu County		√	√
18.	Machakos County		√	√
19	Muranga County		√	√
20.	Nakuru County		√	√
21.	Elgeyo Marakwet County	√	√	√
22.	Kirinyaga County	√	√	√
23.	Taita Taveta County	√	√	√
24.	Laikipia County	√	√	√
25	Nyeri County	√	√	√

*- √- *Shows an investment opportunity in the level of education*

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Information and Communication Technology

The Government, health, agricultural and financial services sectors are likely to benefit from investment in ICT

- Kenya continues to register growth in ICT, driven by a young and innovative Kenyan generation
- Interest in the ICT sector has continued to grow and diversify to subsectors such as Agritech and Fintech
- The sector will remain attractive to investors as it is supported by:
    - (i) support for innovation by the government
    - (ii) increased exposure of Kenya's tech products to the global market and foreign investors
    - (iii) relative ease of entry into the sector
- Sectors likely to benefit from investment in technology innovations are:
    - (i) health sector, with an aim to increase efficiency and improve service delivery
    - (ii) the government, in a bid to increase transparency and reduce corruption in government dealings
    - (iii) the agricultural sector with a focus on providing information to farmers and easier sourcing of market for farm produce
    - (iv) financial services sector, as financial service providers strive to be innovative in their products thus improving customer reach and satisfaction, and also reducing operational costs

Private Equity Outlook

We expect increased consolidation in the financial services sector, and an increase in deals and deal volume across all sectors

- Our outlook for private equity remains positive
- We expect an increase in the number of deals and deal volume in education, technology and long term investments in the renewable energy sector
- For the financial services sector, we expect increased consolidation in the industry and more PE investors to take advantage of the cheaper market valuations

We remain bullish on PE as an asset class given:(i) the abundance of global capital looking for opportunities in Africa, (ii) the attractive valuations in private markets compared to public markets, and (iii) better economic growth in Sub Saharan Africa as compared to global markets.

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VI. Real Estate Outlook

Real Estate Outlook - Drivers

Growing middle class, large housing deficit and high returns expected to drive real estate investments in 2017

- In 2016, real estate delivered high returns of on average 25.8% across all themes, with the best performing themes being retail and offices with average high yields of 10.0% and 9.4% respectively. In 2017 we expect the sector to continue with its good performance across all themes compared to traditional asset classes. The key drivers of real estate in 2017 will be:
  - ✓ **Demographic Trends** – Such as the growing middle class, rapid urbanization, rapid population growth and the youth bulge (21 to 35 years) will drive real estate development in 2017. This is as developers work towards satisfying their housing, entertainment and consumption needs thus boosting developments in the residential and retail themes
  - ✓ **Large housing deficit** - According to the National Housing Corporation (NHC), there is an effective housing deficit of over 200,000 units per annum to cater for the low to middle income market with Nairobi and its metro accounting for over 50.0% of this deficit hence we will witness increased development activity in a bid to tap into this market and reduce the deficit
  - ✓ **High returns** - Real estate has consistently outperformed other asset classes in the last 5 years, generating returns of over 25.0% p.a., compared to an average of 10.0% p.a. in the traditional asset classes. In 2016, real estate delivered returns of 25.8%, against -8.5% in equities and an average of 14.7% for the 10-year government bond. This significantly higher returns will thus lead to increased investments in the real estate sector

Real Estate Outlook - Drivers

Growth of businesses, increased infrastructural development and improved operating and legal environment expected to drive real estate investments in 2017

- **Growing businesses and entry of global brands locally –** In 2016, a number of global brands including Wrigley's entered the Kenyan market with Volkswagen announcing plans to put up shop in Kenya in 2017. These together with the growing small and medium businesses will lead to increased demand for office, industrial as well as residential real estate themes to house the offices, products and employment respectively
- **Continued improvement in infrastructure** - Infrastructural development has led to opening up of new areas for development e.g. along the Northern Bypass, Eastern and upcoming Western Bypass. The LAPPSET Corridor, SGR, expansion of airports and seaports are all opening up Kenya to real estate development and will lead to increased development along the hubs in towns such as Ruaka, Kikuyu and Athi River. Projects in the pipeline include the Standard Gauge Railway (SGR) which is expected to be operational by December of 2017
- **Better operating and legal environment** – in 2017, will have a better legal and operational environment for real estate investments as several policies enacted in 2016 come into action. They include:

  i) The 50.0% reduction in tax for developers constructing more than 400 units p.a.

  ii)the banking amendment act capping interest rates at 14.0%

  iii) the proposal to remove NEMA and NCA

  iv) digitisation of land records and increased transparency in the lands ministry as well issuing of title deeds
- The above if implemented will boost real estate development by reducing construction costs and fastening transaction process in the development process

Real Estate Outlook – Drivers, continued…

Devolution, Domestic and MICE Tourism and increased financing are also expected to drive investments in real estate in 2017

- **Domestic and MICE tourism** – Increased domestic tourism as well as the growing Meetings Incentives Conferences and Exhibitions (MICE) driven by improved security, growing businesses as well as county governments will greatly boost the hospitality industry in 2017
- **Devolution** – Devolution is boosting real estate development as it is placing onus on the County governments to improve the real estate landscape, which has led to reduced bureaucracy and investment in infrastructure as well as creating demand for real estate themes especially residential units, office space and retail to cater for population moving to the county headquarters. Nevertheless, the upcoming general election in 2017 may see a slowdown in selected markets especially areas previously affected by political tensions in the past. For instance, parts of Rift Valley, Nyanza region and the Coastal regions
- **Increased financing** – from both local and international players to real estate will boost investments in the real estate sector in 2017

Real Estate Outlook - Constraints

High land and construction costs, difficulty in fundraising, increased supply and competition as well as political tension will constrain real estate investments

- **High land and construction costs-** This will continue to be a challenge in the new year as land in Nairobi and other main town centres across the country is increasingly becoming expensive. Developers are likely to concentrate in areas in the outskirts of Nairobi where land is more affordable. While an acre of land in Donholm would cost Kshs 60 Mn and that in Mlolongo would cost Kshs 40 Mn, a similar parcel in Juja would cost between Kshs 10-Ksh 15 Mn. Construction costs will nevertheless remain high as developers have to incur infrastructural costs to make their developments viable in satellite towns

- **Difficulty in fundraising for developments** - Being a capital-intensive sector, developers will need to adopt innovative ways to finance developments. Following the poor performance of REITs in the last year, they are likely to shy away from the capital markets. In addition, banks are less likely to advance loans to small and medium sized companies with the low interest rates capped at 14.0%, preferring to lend to the government mainly due to their risk profile

- **Increased supply and competition-** Increased supply in some sectors such as the upper mid-end residential sector will result in competition and thus lower returns for investors. The office sector is likely to experience high competition with the increasing office space supply in Nairobi's key nodes such as Upperhill and Westlands. This is expected to lead to lower occupancy and thus lower yields for investors

- **Political tension-** As we enter the election year, we expect investors to shy away from long-term investments as the 'wait and see phenomena' set in. We therefore expect prices and rents to stagnate during the first half of the year, then pick up once the state has stabilised. Some investors may however choose to lock positions during this period through purchase of property at low prices then exit after the election period at higher prices

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Real Estate Outlook – Thematic Performance Review and Outlook

Outlook positive in residential due to high demand, neutral in commercial office as a result of increasing supply in the theme

Theme	2016 Performance	2017 Outlook	Effect
Residential	• Performance has remained stable with rental yields averaging at 5%-6% • Developments in the lower-mid end recorded the highest price appreciation due to high demand • Developments in the upper-mid end recorded lower price appreciation due to increased supply in these areas • Ruaka, Ridgeways and Kikuyu were the best performing markets with 18.4%, 18.1% and 17.3% total returns, respectively • Kisumu market is picking up with average returns ranging from11% to 13.0% • Mombasa market has recorded low to negative returns especially in the high-end segment as developers reduce prices so as to boost uptake	• Stagnation of prices during the first half of the year, then increase after the election period • Demand for housing will remain high but highly concentrated in the lower income segment • Increased investment in satellite towns due to affordability and availability of land for development	**Positive**
Commercial Office	• The Sector performed well with high occupancy rates of on average 88.0%, high yields at 9.4% and prices of Kshs 13,000 per square foot • There was increased development with notable developments being launched including Montave in Upperhill by Hass Consult and Abcon international Limited • Approximately 3.6 mn square foot of office space was added to the market	• The high returns in the sector expected to be sustained though we are likely to witness a slowdown in construction as a result of the high supply and subsequently lower occupancy rates in some submarkets especially in Mombasa Road and Upperhill • Development in the sector will be construed to grade A offices which are in short supply and renovation of existing buildings	**Neutral**

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Real Estate Outlook – Thematic Performance Review and Outlook

Outlook positive in retail, industrial and hospitality themes supported by expectations of strong performance in 2017 negative outlook for listed real estate due to negative investor sentiments and lack of institutional support

Theme	2016 Performance	2017 Outlook	Effect
Retail	• The sector earned high returns driven by high demand • On average rental yields were 10.1% and occupancy levels of 89.3% • 2016 saw opening of the Hub and entry of global chains such as Choppies of Botswana • As of 2016 Nairobi had more than 5.5 mn square feet of retail space creating fears of oversupply	• High returns to be sustained by demand and demographics • More international developers expected to enter the market seeking to cash in on the middle-class population and changing lifestyles • A slowdown in the development in Nairobi and increased development in the counties	**Positive**
Industrial	• High returns with rents of Kshs 35 per square foot rental yield of 5.8%, and an occupancy of 85% • The sector witnessed increased development both in warehouses and serviced industrial plots • Leather city phase one and infinity industrial park were launched	• We expect to witness increased development activity in the sector with better quality warehouses being constructed and hence higher rents and rental yields	**Positive**
Hospitality	• Increased arrivals witnessed in the country as a result of global conferences and improved security hence attracting tourists • Serviced apartments enjoyed high occupancy rates of on average 90% and high returns, with TRevPAR of USD 127 against USD 98 for hotels	• Increased domestic tourism expected as well as increased MICE tourism boosting revenues in the sector • Rates expected to remain largely the same in 2017 • Increased developments in the sector especially of three and four star hotels	**Positive**
Listed Real Estate	• Listed real estate performed poorly with the only listed REIT shedding 50% of its value in 2016 • The only other listing FRED – Commercial, a D REIT from fusion capital failed to meet the minimum requirement to list	• Low performance of listed real estate expected to persist as there are no measures to increase public awareness and boost the returns of the underlying assets • No public listings expected as investor sentiments towards REITS remain largely negative	**Negative**

Real Estate Outlook – Thematic Performance Review and Outlook

Positive outlook for real estate in 2017 driven by high returns, huge housing deficit and increased infrastructural development

- Our outlook for real estate remains positive in 2017, driven by the high returns being earned in the sector, the huge housing deficit, increased financing and infrastructural developments in the country and largely in Nairobi Metropolitan Area
- Investors will however have to be cautious in the investment ensuring that proper research and due diligence is done before investing and matching the right products to the right market to boost uptake and ensure they earn the high returns in the sector

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Thank You!

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