Cytonn Monthly – May 2017

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Executive Summary

Fixed Income and Macro Economic Review: In May, yields on the 91-day paper decreased to 8.5% from 8.8% at the end of April, while the 364-day paper remained unchanged at 10.9% driven by high subscription rates as the markets remained relatively liquid. The 182-day paper was floated back into the auction market after an 8-week absence and in the month the yield on the paper declined to 10.4% compared to 10.5% offered in March. Kenya's inflation rate for the month of May increased slightly to 11.7%, from 11.5% recorded in April, driven by an increase in food prices;

Equities: During the month of May, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 11.3%, 9.0% and 11.7%, respectively, taking their YTD performance to 11.3%, 8.0% and 11.2%, for NASI, NSE 20 and NSE 25, respectively. The President of Kenya signed the Movable Property Security Rights Bill 2017 into law, which seeks to facilitate use of movable assets as collateral for credit facilities. The Central Bank (CBK) shortlisted potential investors in Chase Bank as part of its process to bring the lender into full operation, having been under the management of KCB Group and the Kenya Deposit Insurance Corporation (KDIC) as the official receiver;

Private Equity: During the month of May, buyouts and fundraising activities in the Sub-Saharan Africa private equity space continued to gather pace, evidenced by (i) travel giant, Thomas Cook India Group, buying out Private Safaris, and (ii) the announcement of the final close of Africa Rivers fund (ARF) at USD 50.0 mn by XSML, a fund manager active in Central and East Africa;

Real Estate: The real estate sector experienced significant investment in the industrial sector due to a growing demand of quality warehouses. In the residential sector, local and international developers continued to take opportunity of the wide housing deficit for affordable housing. The hospitality sector also received a positive boost with various hotels opening business as well as serviced-apartments gaining traction;

Cytonn INVESTMENTS

Company Updates

- Cytonn Real Estate (CRE) shall be launching one of its projects, RiverRun Estates, a Kshs 10.0 bn master-planned community project on 100 acres in Ruiru, on the 17th of June and attached is the link to the invitation. See here
- On Friday, 2nd June 2017, Cytonn Investment Co-operative Society Limited (Cytonn Co-op) held its Annual General Meeting (AGM). The Cytonn Co-op enables its members to grow wealth by creating a disciplined investment culture, coupled with the ability to access high returns. See Event Note
- Our Investments Analyst, John Ndua, discussed the economic value of the Standard Gauge Railway (SGR) on KBC Channel 1. Watch John on KBC here
- Our Investments Analyst, John Ndua, discussed the SGR launch by President Uhuru Kenyatta on Citizen TV. Watch John Ndua on Citizen here
- We continue to showcase real estate developments by our real estate development affiliate, Cytonn Real Estate, through weekly site visits. Here are progress videos and pictures on The Alma and Amara. The site visits target both investors looking to invest in real estate directly, and also those interested in high yield investment products to familiarize themselves with how we support the high yield returns. If interested in attending the site visits, kindly register here
- We continue to see very strong interest in our Private Wealth Management training, which is at no cost, and is held bi-weekly, but is open only to pre-screened participants. The training can also be offered to institutions that would like their employees to be trained on Private Wealth Management. To get further details contact our Client Services team at clientservice@cytonn.com

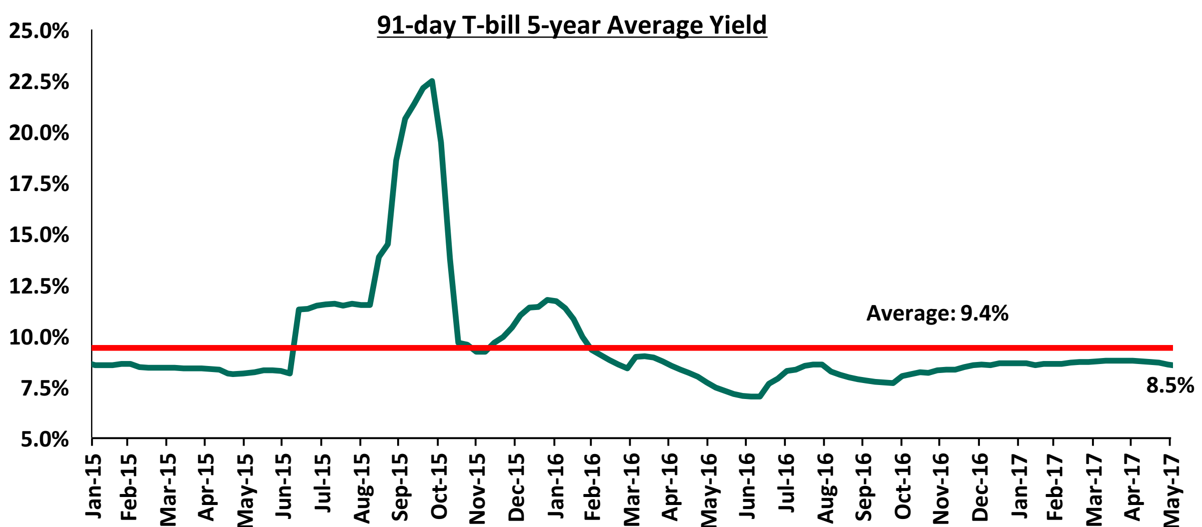
- For recent news about the company, see our news section here
- We have 13 investment-ready projects, offering attractive development and buyer targeted returns of around 25.0% p.a. See further details here: Summary of investment-ready projects
- To invest in any of our current or upcoming real estate projects, please visit Cytonn Real Estate
    - The Alma, which is over 55.0% sold, has delivered an annualized return of 55.0% p.a. for investors who bought off-plan. See The Alma
    - Amara Ridge is currently 100.0% sold and has delivered 33.0% p.a. returns to investors. See Amara Ridge
    - The Ridge Phase One is currently 31.0% sold. See The Ridge
    - Taraji Heights is currently 10.0% sold. See Taraji Heights
- Our integrated lifestyle development in Ruaka, Alma, is over 55.0% sold, and we are currently looking for 3-10 acres in Kikuyu, Lower Kabete, Upper Kabete, Loresho or Mountain View for our next development. We are also looking for 7-10 acres of land in Karen, Garden Estate and Langáta for development of villas. Contact us at rdo@cytonn.com if you have any land for sale or joint ventures in the above areas.
- We continue to beef up the team with the ongoing hires: Careers at Cytonn

Fixed Income and Macro Economic Review

The T-bills subscription rates remained high and increased in May to 168.9% from 131.8% in April due to the high liquidity in the market. The subscription rates for the 91 and 364-day papers during the month came in at 230.8% and 128.3%, from 125.1% and 138.6% the previous month, respectively. The yield on the 91-day paper decreased to 8.5% from 8.8% in April, whereas that of the 364-day paper remained unchanged at 10.9%. The 182-day paper was floated back into the auction market after an 8-week absence, with the yield on the paper declining to 10.4%, from 10.5% in March, while subscription rate for the paper came in at 184.8% from 403.0% in March.

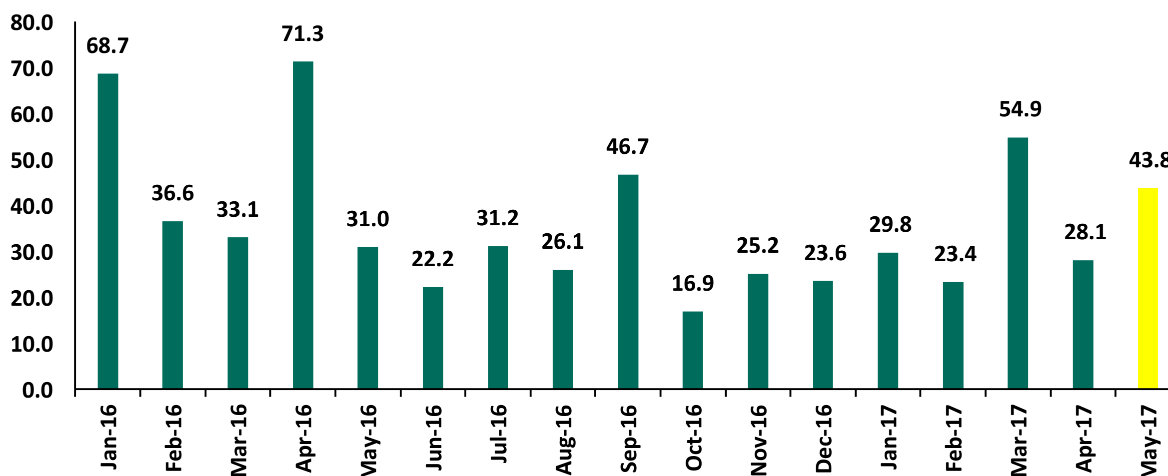
For this week, T-bills subscriptions remained high, increasing to 157.5%, compared to 141.9% recorded the previous week, with the subscription rates on the 91, 182 and 364-day papers coming in at 209.2%, 155.0% and 139.3% compared to 129.3%, 150.7% and 138.2% the previous week, respectively. The yield on the 91-day paper declined by 10 bps w/w to 8.5%, from 8.6% the previous week, whereas yields on the 182 and 364-day papers remained unchanged to close at 10.4% and 10.9%, respectively.

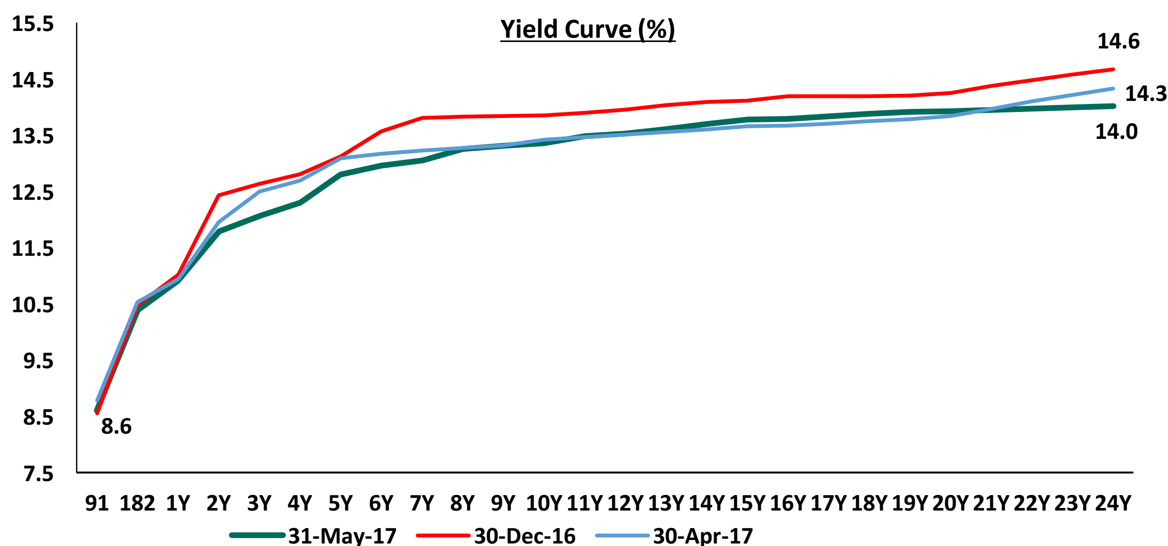
The 91-day T-bill is currently trading below its 5-year average of 9.4%. The lower yield on the 91-day paper is mainly attributed to the low interest rates environment we have been experiencing, given (i) the government is ahead of its domestic borrowing target for the current fiscal year, having borrowed Kshs 385.0 bn against a target of Kshs 271.9 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 294.6 bn budgeted for the full financial year), and (ii) the high liquidity in the money markets.



During the month of May, the Kenyan government re-opened two bonds (FXD 2/2010/10 and FXD 1/2009/15), with effective tenors of 3.4 and 7.4 years, and coupons of 9.3% and 12.5%, respectively, in a bid to raise Kshs 40.0 bn for budgetary support. The market average rates for the bids came in at 12.6% and 13.4% while the average yields of the accepted bids were 12.5% and 13.1% for the two bonds, respectively. Just like the previous bond auctions held this year, the government did not accept expensive bids, accepting Kshs 20.0 bn out of the Kshs 38.8 bn worth of bids received, translating to an acceptance rate of 51.5%. The government also opened the same bonds through a tap sale, collecting Kshs 15.9 bn, meaning the government managed to collect a total of Kshs 35.9 bn from the bond issues, representing 89.8% of the Kshs 40.0 bn it had initially intended to collect.

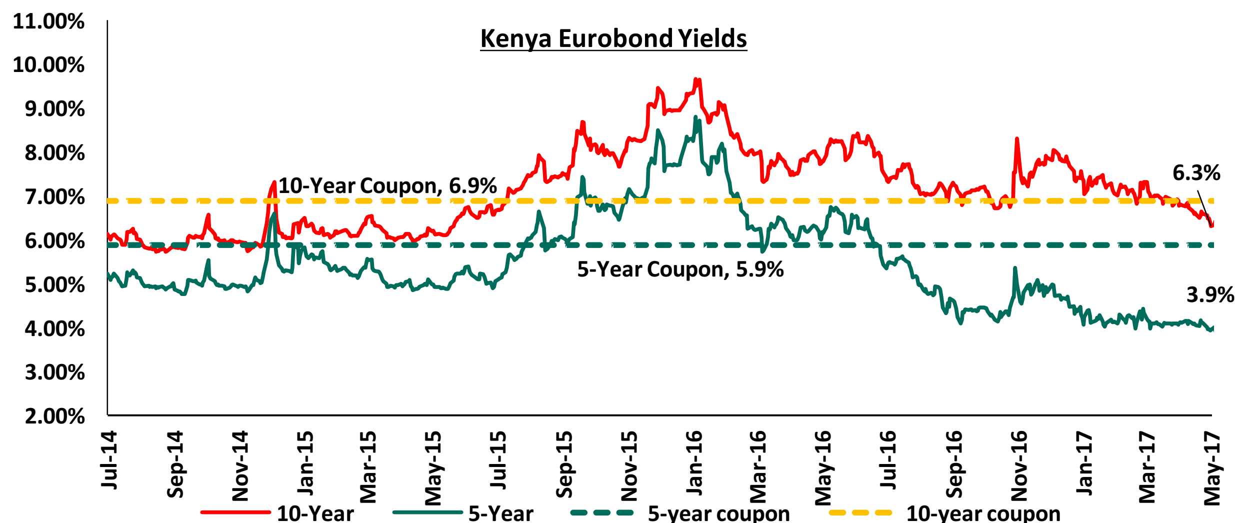
As can be seen in the graphs below, the secondary bonds market recorded increased activity, with turnover rising by 55.9% to Kshs 43.8 bn in the month of May, from Kshs 28.1 bn recorded in April. The yields on government securities have declined since the beginning of the year and during the month of May as highlighted in the yield curve below. The performance for the secondary bonds stood at 1.7% in May, as per the NSE FTSE Bond Index.





According to Bloomberg, the yield on the 5 and 10-year Eurobonds with 2.1 and 7.1-years to maturity declined by 20 and 60 bps to 3.9% and 6.3%, from 4.1% and 6.9% in April, respectively. Since the mid-

January 2016 peak, yields on the Kenya Eurobonds have declined by 4.9% points and 3.3% points, for the 5 and 10-year Eurobonds, respectively, due to the stable macroeconomic conditions and declining tenors as the maturity dates draw nearer. The declining Eurobond yields and Standard & Poor's (S&P) having maintained Kenya's foreign and local currency sovereign credit ratings for the short and long term at "B+/B", respectively, are an indication that Kenya remains a stable and hence attractive investment destination.



The Kenya Shilling depreciated by 0.2% to the USD during the month to close at Kshs 103.4, from Kshs 103.2 in April. The weakening of the shilling during the month was primarily driven by dollar demand from oil and retail importers. On a year to date basis, the shilling has depreciated against the dollar by 0.9%. In the coming months, given the high forex reserve level, currently at USD 8.2 bn (equivalent to 5.4 months of import cover), and the IMF having maintained Kenya's precautionary credit facility at USD 1.5 bn (equivalent to 1.0 more month of import cover) that Kenya can draw on in case of any balance of payment emergencies, we believe that the shilling should remain stable.

The inflation rate for the month of May increased by 20 bps to 11.7%, from 11.5% in April, below our projection of 12.3% - 12.5%, due to better than expected effects of the long rains season, with the food component of the CPI basket registering reduced growth and the prices of vegetables declining. The slight rise was driven by (i) an increase in food prices, which rose 1.3% m/m from 3.6% in April, and (ii) an increase in housing, water, electricity, gas and other fuels, which rose 0.1% m/m from 0.6% in April.

Below is a table with the notable changes during the month;

Key Changes in the Consumer Price Index (CPI) during the month of May			
Broad Commodity Group	**Price change m/m**	**Price change y/y**	**Reason**
Food & Non-Alcoholic Beverages	1.3%	21.5%	Increase in the prices of sugar, milk, and maize grain, attributed to the prevailing drought, despite a decline in prices of vegetables
Housing, Water, Electricity, Gas and other Fuels	0.1%	2.9%	Increased cost of kerosene, cooking gas and charcoal

Going forward, we expect inflationary pressures to stabilize at current levels given (i) the food component of the CPI basket is expected to decline slightly, with depressed rainfall witnessed in the long rains season between March and May, which has served to ease the drought situation, and (ii) rising US oil production, which has suppressed the global recovery of oil prices following OPECs decision to extend the deal to cut down on oil production. We expect inflationary pressures to ease in the second half of 2017, and average 10.5% over the course of the year, which is above the upper bound of the government target range of 2.5% - 7.5%. It is important to note that the inflationary pressure is more supply driven and not a monetary

policy issue (where the government reduces rates to spur growth that leads to inflation) as the government has managed to maintain interest rates low and the Central Bank Rate (CBR) is still at 10.0%.

The Monetary Policy Committee (MPC) met during the month, on Monday 29th May, to review the prevailing macroeconomic conditions and give direction on the Central Bank Rate (CBR). The MPC maintained the CBR at 10.0%, which was in line with our expectations as per our MPC Note. The Committee noted that the decision was on the back of a relatively stable macroeconomic environment, with expectations of (i) a stable foreign exchange market: due to a narrowing current account deficit, the high foreign reserves and precautionary measures taken with the IMF, and (ii) a resilient banking sector; with the average commercial banks liquidity ratio and capital adequacy ratio at 44.4% and 18.8%, respectively, as at April 2017. The main pressure is on inflation and the committee noted that inflation is expected to remain above the government target range of 2.5% - 7.5% due to the food supply constraints.

During the month, the government launched the first phase of the Standard Gauge Railway (SGR), ahead of the expected completion date of December 2017, which is estimated to have cost Kshs 327.0 bn, and runs from Mombasa to Nairobi, stretching 472.0 km. China's Exim Bank provided 90.0% of the funding, through loans, with the balance being funded by the government. The project is expected to enhance faster and efficient means of transport, while the government has estimated that the project will add 1.5% points to Kenya's GDP growth. The SGR project will boost the economy through (i) reducing the costs of transporting goods and hence commodity prices are expected to decline, rendering them more affordable, (ii) the mushrooming of trading centres and hubs around the SGR, leading to job creation and employment, (iii) reducing the wear and tear on roads, saving a lot of taxpayers money in road rehabilitation, which would otherwise be deployed in more productive areas of the economy, and (iv) improving the ease of doing business in Kenya, which will impact positively on investor sentiment and attract foreign investment into the country. We expect continued heavy government spending on infrastructure to continue as the government seeks to achieve its vision 2030, with increased developments in the country and the realization of key infrastructural projects that will see an efficient transport system in place, improve the standards of living and spur economic growth, with the only caution being the high debt levels that the country is getting into.

Conclusions: Rates in the fixed income market have remained stable supported by,

i. ***The government is ahead of its domestic borrowing target for the current fiscal year, having borrowed Kshs 385.0 bn against a target of Kshs 271.9 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 294.6 bn budgeted for the full financial year), and***
ii. ***The government may also be looking at concessionary loans to finance the expenditure rather than borrowing from the foreign market.***

Some of the factors putting upward pressure on interest rates are:

i. ***The government is catching up on its spending target, with total expenditure for the third quarter of the 2016/17 fiscal year coming in at Kshs 1.49 tn, which represents 97.7% of the pro-rated target of Kshs 1.53 tn, while development expenditure for the third quarter of the 2016/17 fiscal year had an absorption rate of 109.5% against 96.2% for recurrent expenditure,***
ii. ***The government has only borrowed Kshs 205.8 bn of the budgeted foreign borrowing, representing 44.5% of its foreign borrowing target of Kshs 462.3 bn, and***
iii. ***The Kenya Revenue Authority (KRA) is expected to miss its overall revenue collection target of Kshs 1.5 tn for the current fiscal year, having collected Kshs 989.9 bn, representing 64.7% of the overall target, over the first 10 months of the fiscal year.***

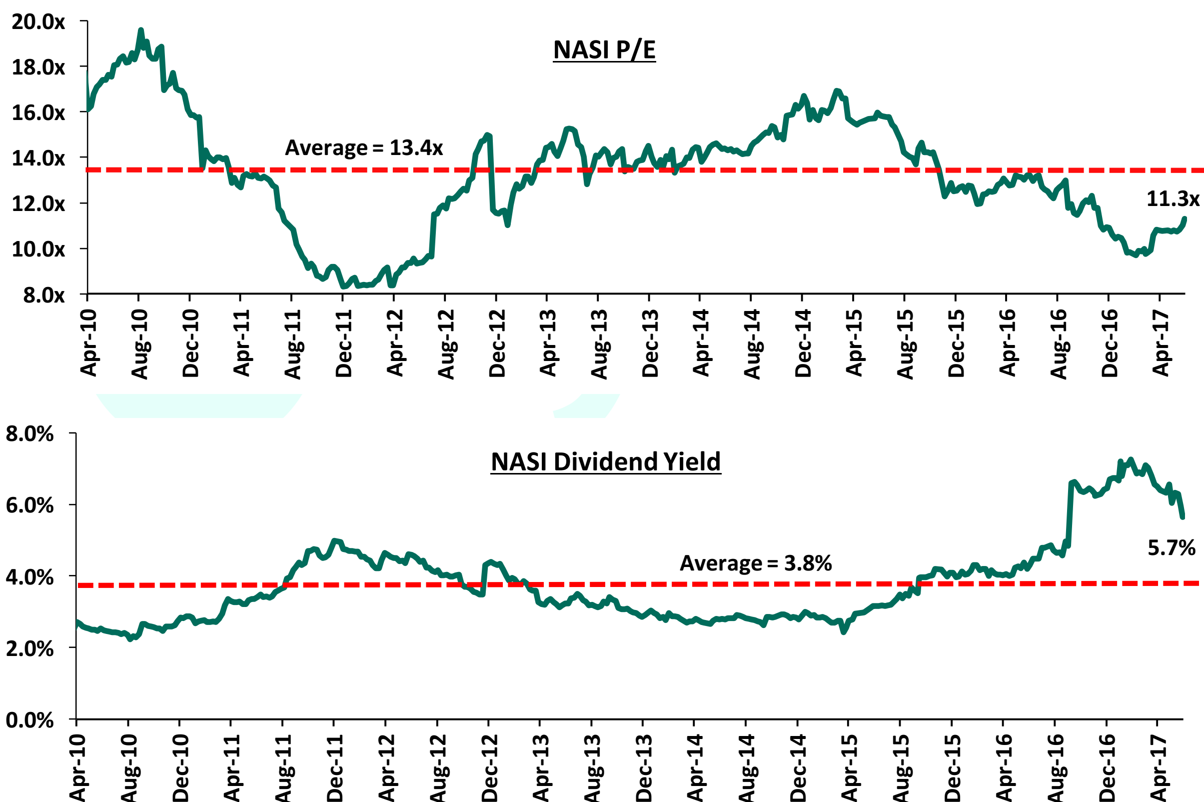
Overall, the possible budget deficit and the high inflationary environment that we are currently in, create uncertainty in the interest rate environment. It is due to this that we think it is prudent for investors to be biased towards short-term fixed income instruments to reduce duration risk.

Equities

During the month of May, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 11.3%, 9.0% and 11.7%, respectively, taking their YTD performance to 11.3%, 8.0% and 11.2%, for NASI, NSE 20 and NSE 25, respectively. The equities market performance during the month was driven by gains in large caps led by KCB Group, Co-op Bank and Safaricom, which gained 26.2%, 18.6% and 15.6%, respectively. Since the February 2015 peak, the market has lost 16.4% and 37.4% for NASI and NSE 20, respectively.

Equities turnover increased by 23.9% during the month to USD 136.8 mn from USD 110.4 mn in April 2017, taking the YTD turnover to USD 596.0 mn. Foreign investors were net sellers for this month with net outflows of USD 16.6 mn, compared to net inflows of USD 7.2 mn witnessed in April 2017. YTD, foreign investors are net buyers with net inflows of USD 7.9 mn.

The market is currently trading at a price to earnings (PE) ratio of 11.3x, versus a historical average of 13.4x, with a dividend yield of 5.7% versus a historical average of 3.8%. The current 11.3x valuation is 16.4% above the most recent trough valuation of 9.7x experienced in the first week of February of 2017, and 35.9% above the previous trough valuation of 8.3x experienced in December of 2011. The charts below indicate the historical P/E and dividend yields of the market.



Barclays Plc, in its move to focus on its two core markets of Britain and the United States, has further reduced its stake in its South African operations (Barclays Africa Plc). Barclays has sold a stake of 33.7% in Barclays Africa to institutional investors at South African Rand R37.7bn (Kshs 302.4 bn). This transaction is at a price-to-book (P/B) valuation of 1.1x, which is an 8.6% discount to market, as Barclays South Africa is currently trading at a P/B of 1.2x. Barclays Africa, which is listed on the Johannesburg stock exchange and is present in 10 countries in Africa, has declined in value in recent months, against the backdrop of the political crisis in South Africa. The significance of this transaction to Barclays Africa is enhanced decision-making capacity in line with their strategy of becoming a leading standalone financial services group in Africa, as Barclays Plc will hold only a minority stake of 23.4%. In the recent past, Barclays Bank Kenya has asserted that the exit by Barclays Plc would have no impact on the Kenyan business as all decisions regarding Barclays Bank Kenya are made at the Barclays Africa level and not Barclays Plc, thus assuring customers that the business will continue with operations in the country.

As indicated in our Cytonn Weekly #19/2017, the month of May saw the President of Kenya sign the Movable Property Security Rights Bill 2017 into law, which seeks to facilitate use of movable assets as collateral for credit facilities. This new law will allow borrowers to use the same asset to access credit from different lenders through formation of a centralized electronic registry for mobile assets that financial institutions can use to verify the security offered. Implementation of this law will (i) enhance the ability to access credit using movable assets, and (ii) provide an opportunity for banks to create a niche, especially in the SME and private household loans segment. This is a move aimed at widening the bracket of those able to access debt from commercial lenders. However, in our view, this law might not increase loans disbursement under the current interest rates regime since (i) its implementation may be delayed as the government has to make regulations prescribing to issues such as the minimum value of assets to be listed and how their existence shall be ascertained, and (ii) it shall still be based on the credit ability of the borrowers since we are yet to have well-established markets to sell the collateral upon default.

The Central Bank of Kenya (CBK) shortlisted potential investors in Chase Bank out of the 12 that expressed interest including 3 local banks, 4 foreign financial institutions and 5 other financial institutions and consortia. The interest in Chase Bank by both local and foreign financial services sector players is an indication that the Kenyan banking sector remains attractive as it offers access to high returns with the return on equity being among the highest in the world, with listed banks having recorded return on equity of 19.9% in FY'2016. For CBK and KDIC, this is a historic development that sets a benchmark as it is the first time that a Kenyan bank under receivership has been reopened as highlighted in our Cytonn Weekly #18/2017.

Vodacom Group announced its plan to acquire 34.9% ownership of Safaricom in a share swap deal with Vodafone Kenya. As highlighted in our Cytonn Weekly #20/2017, Vodafone Kenya, which has a 39.9% stake in Safaricom, will cede 34.9% of its shareholding in return for a 5.0% stake in Vodacom Group for an estimated Kshs 266.6 bn, increasing its stake in Vodacom Group from 65.0% to 70.0%. The proposed transaction is at valuation of price-to-earnings of 15.7x, which is a 7.6% discount to market, as Safaricom is currently trading at a P/E of 16.9x and EV/EBITDA of 16.3x. Vodafone Kenya will continue to hold a 5.0% interest in Safaricom following the transfer. The transaction is aimed at simplifying Vodafone Kenya's operations in Africa, as it has been focusing on reorganizing its portfolio of global assets, through refocusing on fewer regions and stabilizing its emerging markets businesses. We, however, do not expect a significant change in Safaricom's strategy, given (i) the current Safaricom directors also sit on Vodacom Group's board, and (ii) Vodafone Kenya will maintain a 5.0% stake in Safaricom hence maintaining a seat on the board. The proposed transaction is subject to regulatory and shareholder approval.

During the month, we had a number of earnings releases and detailed below are the ones for this past week:

National Bank of Kenya released Q1'2017 results

NBK released Q1'2017 results recording a decline in core earnings per share by 81.8% to Kshs 0.2 from Kshs 1.1 in Q1'2016, attributed to a 31.0% decline in operating income, despite a 21.3% decrease in operating expenses. Key highlights for the performance from Q1'2016 to Q1'2017 include:

- Total operating income declined by 31.0% to Kshs 2.1 bn from Kshs 3.0 bn in Q1'2016, against our estimate of a 10.1% decline to Kshs 2.7 bn. This was attributed to a 36.4% decline in Net Interest Income coupled with a 14.3% decline in Non-Funded Income,
- The 36.4% decrease in Net Interest Income (NII) was attributed to a 34.2% decline in interest income to Kshs 2.3 bn from Kshs 3.5 bn in Q1'2016 as a result of lower yield in line with the new regulation, outpacing a 30.3% decline in interest expense to Kshs 0.9 bn from 1.3 bn in Q1'2016. The Net Interest Margin improved to 7.5% from 6.8% in Q1'2016,
- Non-funded income (NFI) declined by 14.3% to Kshs 0.6 bn from Kshs 0.7 bn in Q1'2016, against our expectation of a 4.2% growth. The decrease in NFI was attributed to a 22.1% decline in other fees and commissions to Kshs 0.3 bn from Kshs 0.4 bn in Q1'2016 and a 49.8% decline in other

income to Kshs 0.1 bn from 0.2 bn in Q1'2016. The current revenue mix stands at 70:30 funded to non-funded income from 76:24 in Q1'2016,

- Total operating expenses decreased by 21.3% to Kshs 2.0 bn from Kshs 2.5 bn in Q1'2016 following an 81.2% decline in Loan Loss Provisions (LLP) to Kshs 0.1 bn from Kshs 0.7 bn in Q1'2016. Staff costs increased by 7.3% to Kshs 0.94 bn from Kshs 0.88 bn in Q1'2016. Without LLP, operating expenses grew slightly by 1.4% to Kshs 1.9 bn from Kshs 1.8 bn registered in Q1'2016,
- Cost to Income ratio worsened to 95.9% from 84.1% in Q1'2016. Without LLP, the CIR still deteriorated to 89.6% from 60.9% in Q1'2016,
- Profit after tax decreased by 82.2% to Kshs 0.06 bn from Kshs 0.33 bn in Q1'2016,
- The loan book contracted by 12.3% to Kshs 58.1 bn from Kshs 66.3 bn in Q1'2016, faster than our expectation of an 11.4% contraction to Kshs 58.8 bn,
- National Bank is currently not sufficiently capitalized with a core capital to risk weighted assets ratio at 11.1%, just 0.6% above the statutory requirement of 10.5%, with total capital to total risk weighted assets falling below statutory requirement of 14.5% by 2.9% to close the period at 11.6%. See our NBK Q1'2017 Earnings Note

HF Group released Q1'2017 results

HF Group released Q1'2017 results recording a decline in core earnings per share by 73.1% to Kshs 1.0 from Kshs 3.8 in Q1'2016, attributed to an 8.8% growth in total operating expenses far outpacing a 22.0% decline in operating revenue. Key highlights for the performance from Q1'2016 to Q1'2017 include:

- The 22.0% decline in operating income was attributed to declines in both Non-Funded Income (NFI) and Net Interest Income (NII) by 28.5% and 20.4%, respectively,
- Net interest income (NII) declined by 20.4% to Kshs 0.8 bn from Kshs 1.0 bn in Q1'2016, following a 19.6% decrease in interest income to Kshs 1.9 bn from Kshs 2.3 bn in Q1'2016 despite a 19.0% decline in interest expense to Kshs 1.1 bn from Kshs 1.3 bn in Q1'2016. The Net Interest Margin (NIM) thus declined to 5.7% from 6.2% in Q1'2016,
- Non-Funded Income (NFI) declined by 28.5% to Kshs 0.17 bn from Kshs 0.24 bn in Q1'2016. The decline in NFI was as a result of a 57.3% decrease in fees and commissions on loans to Kshs 0.01 bn, from Kshs 0.04 bn in Q1'2016, and a 27.5% decline in other income to Kshs 0.09 bn from Kshs 0.13 bn in Q1'2016, as a result of reduced property sales for the bank. The current revenue mix stands at 82:18 funded to non-funded income from 81:19 in Q1'2016,
- Total operating expenses grew by 8.8% to Kshs 0.8 bn from Kshs 0.7 bn in Q1'2016 attributable to a 46.6% increase in Loan Loss Provisions (LLPs) to Kshs 0.2 bn from Kshs 0.1 bn in Q1'2016. Without LLP, operating expenses remained relatively unchanged at Kshs 0.6 bn. Staff costs also increased by 7.3% to Kshs 0.27 bn from Kshs 0.25 bn in Q1'2016,
- Cost to Income ratio (CIR) deteriorated to 86.7% from 62.2% in Q1'2016. Without LLP, CIR worsened to 66.0% from 51.2% in Q1'2016,
- Profit before tax (PBT) declined by 72.5% to Kshs 0.1 bn from Kshs 0.5 bn in Q1'2016, with profit after tax (PAT) declining by 73.1% to Kshs 0.08 bn from Kshs 0.33 bn in Q1'2016,
- Housing Finance Group is currently sufficiently capitalized with the core capital to risk weighted assets ratio at 15.7%, 5.2% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 2.8% to close the period at 17.3%. See our HF Group Q1'2017 Earnings Note

Family Bank released Q1'2017 results

Family Bank Group released Q1'2017 earnings posting a 149.2% decline in profit before tax (PBT) to a loss of Kshs 0.3 bn, from a profit of Kshs 0.5 bn in Q1'2016. This is attributable to a 34.2% decline in total operating revenue to Kshs 1.5 bn from Kshs 2.3 bn in Q1'2016, which the 0.4% decline in total operating expenses to Kshs 1.78 bn from Kshs 1.80 bn in Q1'2016 could not offset. Key highlights for the performance

from Q1’2016 to Q1’2017 include:

- The 34.2% decline in operating income is attributed to a decline of 37.4% and 27.0% in net interest income (NII) and non-funded income (NFI), respectively,
- Net interest income (NII) declined by 37.4% to Kshs 1.0 bn from Kshs 1.6 bn in Q1’2016 on account of a 43.7% decline in interest income to Kshs 1.7bn from Kshs 3.0 bn in Q1’2016 despite a 51.0% decline interest expense to Kshs 0.7 bn from Kshs 1.4 bn in Q1’2016,
- Non-Funded Income declined by 27.0% to Kshs 0.5 bn from Kshs 0.7 bn. The decline in NFI was on account of a 61.2% decline in fees and commissions on loans to Kshs 0.1 bn from Kshs 0.2 bn in Q1’2016, despite a 1.6% increase in other fees and commissions to Kshs 0.4 bn from Kshs 0.3 bn in Q1’2016. The current revenue mix stands at 66:34, Funded to Non-Funded Income from 69:31 in Q1’2016,
- Total operating expenses declined by 0.4% to Kshs 1.79 bn from Kshs 1.80 bn on account of a 26.9% decline in staff costs to Kshs 0.5 bn from Kshs 0.7 bn in Q1’2016 bn despite a 206.5% increase in Loan Loss Provision (LLP) to Kshs 0.2 bn from Kshs 0.1 bn in Q1’2016,
- The Cost to Income ratio (CIR) increased to 117.0% from 77.3% in Q1'2016. Without LLP, the CIR rose to 100.8% from 73% in Q1'2016. The Gross NPLs increased significantly by 92.1% to Kshs. 8.3 bn from Kshs 4.3 bn in Q1'2016,
- Profit after tax decreased by 175.2% to Kshs (0.3) bn from Kshs 0.3 bn in Q1’2016,
- Total Assets declined by 22.4% to Kshs 66.8 bn from Kshs 86.0 bn attributed to a decline of 20.5% in net loans to Kshs 46.6 bn from Kshs 58.7 bn in Q1'2016,
- Total Liabilities declined by 26.3% to Kshs 54.3 bn from Kshs 73.6 bn in Q1’2016 attributed to a decline in customer deposits by 32.4% to Kshs 44.5 bn from Kshs 65.8 bn in Q1’2016. The loan book also recorded a decline of 20.5% to Kshs 46.6 bn from Kshs 58.7 bn. This led to an increase in the loan to deposit ratio that jumped to 104.9% from 89.1%, a 15.7% spike, quite higher than the preferential range of 80%-90%,
- Family Bank Group is currently sufficiently capitalized with the core capital to risk weighted assets ratio at 17.3%, 6.8% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 6.4% to close the period at 20.9%.

Cytonn INVESTMENTS

Other releases in the month include:

- NIC Bank released Q1’2017 results, recording a 3.9% decline in core earnings per share to Kshs 1.5 from Kshs 1.6 in Q1’2016, due to a 9.7% decline in total operating income but was cautioned by a 13.6% decline in total operating expenses. See Cytonn Weekly #18/2017 for details on NIC Bank results.
- Stanbic Bank released Q1’2017 results, recording a 9.3% decline in core earnings per share to Kshs 6.3 from Kshs 7.0 in Q1’2016, attributed to a 9.9% decline in total operating income, which outpaced a 4.7% decline in total operating expenses. See Cytonn Weekly #18/2017 for details on Stanbic Bank results.
- ARM Cement released their FY’2016 results, recording a 3.1% decline in loss per share to Kshs 3.2 from Kshs 3.3 in FY’2015. This was driven by a 13.2% decline in revenue to Kshs 12.8 bn from Kshs 14.7 bn and a 102.6% increase in interest expenses to Kshs 2.8 bn. See Cytonn Weekly #18/2017 for details on ARM Cement results.
- KCB Group released Q1'2017 results posting a 1.9% decline in core earnings per share (EPS) to Kshs 1.48 from Kshs 1.51 after adjusting for the scrip shares. The decline in EPS is attributed to a 5.0% growth in operating expenses to Kshs 9.3 bn from Kshs 8.9 bn registered in Q1’2016, which outpaced a 2.7% growth in operating income to Kshs 15.9 bn from Kshs 15.5 bn registered in Q1’2016. See Cytonn Weekly #19/2017 for details on KCB Group results.
- Safaricom released FY’2017 results, recording a 27.4% growth in core earnings per share to Kshs 1.2 from Kshs 1.0 in FY’2016, driven by a 14.8% growth in service revenue to Kshs 204.1 bn from Kshs 177.8 bn in FY’2016. See Cytonn Weekly #19/2017 for details on Safaricom results.
- Co-op Bank released Q1'2017 results posting a 6.1% decline in core earnings per share (EPS) to Kshs 0.66 from Kshs 0.7 in Q1'2016 attributed to a 1.8% decline in operating revenue to Kshs 10.1

bn from Kshs 10.3 bn registered in Q1'2016. The revenue decline was far outpaced by a 6.5% growth in operating expenses to Kshs 5.6 bn from Kshs 5.2 bn registered in Q1'2016. See Cytonn Weekly #20/2017 for details on Co-op Bank results.

- DTB released their Q1'2017 earnings posting an 8.8% increase in core earnings per share (EPS) to Kshs 6.3 from Kshs 5.8 in Q1'2016, driven by a 0.1% decrease in operating expenses and a 2.3% increase in operating revenue. See Cytonn Weekly #20/2017 for details on DTB results.
- I&M Bank released Q1'2017 earnings posting a 16.9% decline in PBT to Kshs. 2.1 bn from Kshs 2.5 bn in Q1'2016. This was driven by a 35.9% increase in operating expenses to Kshs 1.9 bn from Kshs 1.4 bn in Q1'2016 outpacing an increase of 2.1% in operating income to Kshs 4.0 bn from Kshs 3.9 bn in Q1'2016.

Of the 11 listed banks that have released their Q1'2017 results, only DTB has recorded an increase in core earnings per share, with the average decline in core earnings across the listed banking sector at 8.7%. This is a significant decrease compared to the average growth of 14.6% registered for Q1'2016. The sector has, however, experienced faster deposit growth and all banks showed efforts to protect their Net Interest Margins given that this was the quarter when the full effect of the law capping interest rate was in effect. Key to note is that most of the banks, namely DTB, NIC, Co-op, Equity, StanChart, HF Group and NBK have increased their exposure to government securities. This could be attributed to the change in loan and deposits pricing framework brought about by the interest rate caps that has made most lenders increase exposure to the risk-free government as opposed to other risky borrowers. The interest rate cap was meant to improve lending to the consumer, but so far the cap has curtailed lending as evidenced by the declining private sector credit growth at 4.0% as at March 2017, which is an 8-year low.

The listed banking sector stocks Q1'2017 earnings and growth metrics is as summarised in the table below.

Listed Banks Q1'2017 Earnings and Growth Metrics

Bank	Core EPS Growth		Deposit Growth		Loan Growth		Net Interest Margin		Loan to Deposit Ratio		Exposure to Government Securities	
	Q1'2017	Q1'2016	Q1'2017	Q1'2016	Q1'2017	Q1'2016	Q1'2017	Q1'2016	Q1'2017	Q1'2016	Q1'2017	Q1'2016
DTB	**8.8%**	9.5%	22.1%	26.1%	4.8%	24.1%	7.4%	7.4%	74.9%	87.3%	39.1%	30.1%
KCB	**(3.2%)**	6.1%	7.9%	6.6%	14.3%	16.5%	8.6%	8.4%	86.6%	81.7%	23.2%	24.8%
NIC Bank	**(3.9%)**	(0.3%)	6.8%	14.8%	3.9%	6.1%	7.9%	8.1%	98.7%	101.5%	26.4%	23.2%
Equity	**(5.6%)**	19.8%	16.1%	8.1%	(4.8%)	22.4%	10.3%	11.0%	75.4%	91.9%	32.5%	20.8%
Co-op	**(6.0%)**	7.7%	6.9%	11.9%	15.0%	16.1%	8.8%	9.5%	87.9%	81.7%	23.0%	17.2%
Stanbic	**(9.3%)**	3.0%	20.0%	3.2%	11.4%	14.7%	6.4%	5.9%	88.4%	95.2%	22.4%	52.6%
I&M Bank	**(16.9%)**	10.3%	14.3%	15.7%	8.8%	11.3%	8.0%	7.8%	86.2%	96.1%	34.7%	29.9%
BBK	**(19.8%)**	2.6%	7.6%	8.3%	10.7%	21.7%	10.2%	10.4%	92.8%	90.2%	24.2%	27.2%
StanChart	**(20.5%)**	42.7%	11.1%	12.9%	6.5%	(3.7%)	9.8%	9.7%	57.0%	59.5%	47.2%	37.5%
HF Group	**(73.1%)**	47.6%	(6.4%)	23.6%	2.2%	12.1%	5.7%	6.2%	142.7%	130.8%	11.1%	10.2%
NBK	**(82.2%)**	(38.4%)	(6.7%)	16.6%	(12.3%)	(5.3%)	7.5%	6.8%	62.7%	66.7%	38.2%	28.8%
Weighted Average*	**(8.7%)**	**13.9%**	**11.9%**	**10.8%**	**7.0%**	**15.8%**	**9.1%**	**9.3%**	**81.9%**	**86.0%**	**30.4%**	**26.5%**

**** The weighted average is based on Market Cap as at 2nd June, 2017***

Below is our Equities Universe of Coverage:

all prices in Kshs unless stated otherwise

Our Equity Universe

No.	Company	Price as at 28/04/17	Price as at 31/05/17	m/m Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**
1.	Liberty	10.2	10.5	3.4%	(20.5%)	13.0	0.0%	23.6%
2.	KCB Group***	31.5	39.8	26.2%	38.3%	41.9	6.3%	11.7%
3.	Jubilee Insurance	460.0	453.0	(1.5%)	(7.6%)	490.5	1.8%	10.1%

No.	Company							
4.	Kenya Re	18.1	20.5	13.3%	(8.9%)	20.5	4.4%	4.4%
5.	Britam	9.8	11.9	20.9%	18.5%	11.9	2.3%	2.7%
6.	CIC Group	3.4	3.8	11.9%	(1.3%)	3.7	3.2%	2.1%
7.	Barclays	8.2	9.0	9.1%	5.5%	8.2	10.0%	1.6%
8.	Standard Chartered	194.0	202.0	4.1%	6.9%	191.7	6.7%	1.6%
9.	I&M Holdings	91.0	92.5	1.6%	2.8%	88.0	4.0%	(0.9%)
10.	HF Group	10.1	9.8	(3.0%)	(30.0%)	9.2	4.7%	(1.3%)
11.	Co-op Bank	14.0	16.6	18.6%	25.8%	14.6	5.7%	(6.3%)
12.	Safaricom	19.3	22.3	15.6%	16.2%	19.8	4.7%	(6.4%)
13.	Stanbic Holdings	62.5	70.5	12.8%	0.0%	60.2	8.1%	(6.6%)
14.	NBK	6.3	6.7	5.6%	(7.6%)	6.2	0.0%	(6.8%)
15.	NIC	26.8	30.8	15.0%	18.3%	26.4	3.0%	(11.1%)
16.	Equity Group	33.0	38.0	15.2%	26.7%	30.9	5.1%	(13.6%)
17.	DTBK	125.0	140.0	12.0%	18.6%	114.6	2.2%	(15.9%)
18.	Sanlam Kenya	25.0	26.8	7.0%	(2.7%)	21.1	0.0%	(21.3%)

**Target Price as per Cytonn Analyst estimates*

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

****For full disclosure, Cytonn and/or its affiliates holds a significant stake in KCB Group, ranking as the 14th largest shareholder*

We remain "neutral with a bias to positive" for investors with short to medium-term investments horizon and are "positive" for investors with long-term investment horizon.

Private Equity

During the month of May, there was heightened private equity activity, with most of the transactions skewed towards acquisition across all major investment sectors with a few fundraising activities.

On Partnerships, Buyouts and Acquisitions

- GBfoods S.A., a leading multinational food company headquartered in Barcelona, formed a joint venture with Helios Investment Partners, an Africa-focused private equity investment firm, to create one of Africa's largest Fast-Moving Consumer Goods (FMCG) businesses, GBfoods Africa Holdco B.V. For more information, see our Cytonn Weekly #18/2017,
- Ethos, a South African Private Equity firm, through Ethos Fund VI, acquired an undisclosed majority stake in Little Green Beverages (LGB), in partnership with Nedbank Private Equity and the company's management. This was the ninth transaction for the USD 623.0 mn Ethos fund VI. For more information, see our Cytonn Weekly #18/2017,
- Private equity fund, Catalyst Principal Partners, acquired Jambo Biscuits, makers of flagship brand Britannia, under a newly established firm, Britannia Foods Ltd. This is the first investment by Catalyst, with its second fund Catalyst Fund II, which hit its first close earlier this year, at USD 103.0 mn (Kshs 10.6 bn) and is eyeing a final close of USD 175.0 mn (Kshs 18.1 bn) by the end of the year. For more information, see our Cytonn Weekly #19/2017,
- Travel giant, Thomas Cook India Group, a travel company listed on the Bombay Stock Exchange, bought out Nairobi-based safari operator, Private Safaris. Private Safaris is part of Kuoni's Destination Management Specialists (DMS), which is one of Kuoni Group's core activities. For more information, see our Cytonn Weekly #19/2017,
- Vumela Enterprise Development Fund, a fund managed by FNB Business Banking and Edge Growth, acquired a stake in Nova Pioneer, an independent school network in South Africa offering pre-school through secondary education for students from ages 3 through 19. The investment is a USD 1.1 mn (Kshs 115.9 mn) debt investment into Nova Pioneer. For more information, see our Cytonn Weekly #19/2017,
- Edmond de Rothschild Group, through Moringa, a Paris based impact investment fund, acquired an undisclosed stake valued at USD 3.0 mn in Asante Capital EPZ, a Kenyan Agro-forestry

company. This is the second investment from the USD 84.0 mn fund that closed in late 2015. For more information, see our Cytonn Weekly #20/2017,

- Craft Silicon, a multinational software development company providing customized software solutions for the financial sector, has acquired an undisclosed minority stake in restaurant listing portal EatOut, valued at Kshs 51.5 mn. This is their second major investment in a Kenyan technology company as it also backed Safaricom in founding Little Limited, the taxi hailing app. For more information, see our Cytonn Weekly #21/2017,
- Four investors: Google, Convergence Partners (Pan-African ICT-focused private equity firm), the International Finance Corporation (IFC), and Mitsui & Co, committed to invest USD 100.0 mn in CSquared, a Google broadband infrastructure company. CSquared will establish its headquarters in Kenya, with its main focus being building a wholesale metro fibre optic network to enable internet access in Africa. For more information, see our Cytonn Weekly #20/2017,

On the fundraising front:

XSML, a fund manager active in Central and East Africa, announced its final close of the Africa Rivers fund (ARF) at USD 50.0 mn. This is XSML's second fund after the USD 19.0 mn, Central Africa SME Fund (CASF) and brings a total of USD 69.0 mn under XSML's management. XSML undertook its first investment in Uganda through KARE Distribution (KARE), a company that deals in the distribution and wholesale of essential consumer goods such as locally produced cooking oil, water and detergent. For more information, see our Cytonn Weekly #21/2017,

On the Private Equity Report Release:

The number of exits achieved by private equity firms in Africa continues to grow as recorded by a report dubbed "How Private Equity Investors Create Value". According to the report, prepared by EY and African Private Equity and Venture Capital Association, 48 exits were achieved in 2016, a 9.1% increase from the 44 exits achieved in 2015. The exits were achieved by 31 PE firms, compared to 30 firms in the prior year. For more information, see our Cytonn Weekly #19/2017,

Private equity investments in Africa remain robust as evidenced by the increased deals and deal volumes in the region's key note sectors; Tourism, FMCGs, Education and Information Communication Technology (ICT). The increasing investor interest is attributed to (i) rapid urbanization, a resilient and adapting middle class and increased consumerism, (ii) the attractive valuations in private markets compared to global markets, and (iii) better economic projections in Sub Sahara Africa compared to global markets. Going forward, the increasing investor interest and stable macro-economic environment will continue to boost deal flow into African markets. We thus remain bullish on PE as an asset class in Sub-Sahara Africa.

Real Estate

The performance and activities in the various real estate sectors for the past month were as below:

Commercial

i. During the month, the retail sector showed serious constraints following the closure of various retail stores in the country; Tuskys shut down its operations in one of its CBD stores, Tuskys Beba Beba, following a recent closure of its Sheikh Karume Branch, while Nakumatt Supermarkets announced plans to close its poorly performing branches in Kenya and Uganda as well as cut off non-profitable retail products. We attribute the poor performance of retailers to the worsening economy which has led to (i) low sales volumes, and (ii) financial constraints attributable to the small-scale retailers' rush to expand in a bid to increase presence in the region,
ii. In the office sector, Nairobi remains the most preferred commercial hub in Sub-Saharan Africa, attracting both local and international investors. This month, security services firm, Security Group Africa (SGA) opened a new head office in Nairobi, Tulip House, along Mombasa road, in a bid to

improve communication and support for its country offices in East Africa. Also, Kasarani Investment Holdings, a subsidiary of Actis, invited public views on its plan to put up a Kshs 2.7 bn business complex in Ruaraka, dubbed Garden City Business Park. The project shall consist of 2 office blocks, as well as 2 hotels,

iii. In the industrial sector, Kenya has witnessed increased investment driven by (i) demand for high-quality warehousing space as growing local and international companies need to improve their distribution and supply chain operations, (ii) demand from shippers who require facilities for temporary storage of cargo before distribution or onward transit, (iii) demand for warehouse space by landlocked neighbouring countries that rely on Kenyan ports, and (iv) the rise of e-commerce, which has created demand for storage space for distribution centres. On this note, during the month, Africa Logistics Properties (ALP) broke ground on their 50,000 square meters, Grade-A logistics and distribution warehousing complex on 22.0 acres in Tatu City. ALP also intends to put up another warehouse on 49.0 acres at Tilisi, Kiambu. The firm intends to provide modern logistics services to retail, light industrial, fast-moving consumer goods as well as service the growing e-commerce segment.

We expect continued investment in high-end industrial facilities to continue leading on the commercial front as more international shops set up shop in Kenya.

<u>Residential</u>

During the month,

i. The Kenya Banker's Association (KBA) released their Housing Price index, the Q1'2017 KBA-HPI, which indicated that the housing market grew at a much slower rate in Q1'2017, recording a marginal price growth of 1.1% compared to 1.6% growth recorded in Q4'2016. The slow growth is attributed to decline in effective demand, which is attributed to (i) reduced financing in the market due to structural challenges in the banking sector, which have seen private sector credit growth decline to a low of 4.0% in March 2017, from a high of 21.0% in August 2015, and (ii) slower uptake from buyers and investors as they adopt a wait and see approach over the upcoming elections,

ii. Global Property firm, Knight Frank, also released the Prime Global Cities Index Q'1 2017 Report which tracks the price movement of luxury residential property across 41 cities in the world. The prices of luxury homes in Nairobi declined by 2.7% between March 2016 and March 2017 and 0.2% between September 2016 and March 2017.The prices however recorded a 0.9% increase in Q'1 2017. The 2016 performance was attributed to exit of diplomats and downsizing of international companies hence decreasing demand for luxury houses. The recovery of prices in Q'1 2017 can be associated to high risk investors locking money in real estate to hedge against elections risk and gain from the expected price appreciation after elections when the industry ricochets.

The following table shows the performance of residential sector over the last three years.

Residential units price change between 2015 to 2017			
Year	**12-month % change (March – March)**	**6-month % change (September – March)**	**3-month % change (January – March)**
2017	(2.7%)	(0.2%)	0.9%
2016	3.3%	2.2%	1.5%
2015	(0.5%)	0.3%	(1.0%)

This indicates a dip in the residential market performance between 2016 and 2017, which can be attributed to poor economic performance that led to downsizing of international companies hence decrease in demand for luxury houses

Source: Prime Global Cities Index Report by Knight Frank

Other highlights in the residential sector included:

i. Cytonn Real Estate launched The Ridge, a 10-acre luxurious mixed-use development comprising of 1, 2 and 3 bedroom apartments, serviced-apartments and over 2000 square meters of commercial space. The project is located approximately 300 meters away from the junction of Kiambu Road and the Northern Bypass, and about 5 minutes away from Windsor Golf Club and Two Rivers mall,
ii. Uriithi Housing Cooperative's announcement of a Kshs 1.5 bn residential project in Murang'a dubbed as Panorama Gardens,
iii. Lancet Kenya unveiled plans to build 190 houses that will comprise of two, three and four-bedroom maisonette and apartments in Mavoko, Machakos County,
iv. Ahcof Investments announced plans to construct a 10-floor residential complex in Lavington at a cost of Kshs 522.0 mn. The project will have 160 2-bedroom units on a 1-acre plot along Mbaazi Avenue.

We expect increased investment in the residential sector in a bid to address the huge demand for housing in the low-income spectrum.

Hospitality

The sector continues to receive a lot of interest supported by both leisure and business travel. Below are some of the key highlights in the sector in the month of May;

i. Pinnacle Towers, a 70-storey mixed-use development was launched in Upperhill. The Kshs 20.6 bn joint venture project will feature a 5-star Hilton Hotel, luxury apartments, office space, a mall and an entertainment centre on a 2-acre plot,
ii. Britam Holdings Limited broke ground on construction of Kshs 3.3 bn serviced apartments in Kilimani. The 11-floor development will comprise of 117 2-bedroom and 46 1-bedroom units on a 1.6-acre plot along Nyangumi Road, Kilimani area in Nairobi,
iii. Lazizi Premiere, Kenya's first airport hotel with 144-rooms on 1.5 acres was opened at the Jomo Kenyatta International Airport (JKIA),
iv. The 140-room Park-Inn Hotel by Radisson was officially opened at Westlands. The 11-floor tablet shaped hotel will be managed by the Carlson Rezidor Hotel Group.

In our view, the hospitality sector will continue to grow supported by (i) increased bleisure travel into the country, and (ii) aggressive marketing by the Kenyan government.

Land

The land sector continues to receive continued investments, especially in the satellite towns such as Thika, Ruiru and Murang'a, whose prices continue to soar due to improved infrastructure. In addition, people seek to move away from the congested CBD especially for residential purposes. We continue to see site and service schemes from major cooperative societies in Kenya.

i. Fusion Capital, in collaboration with Thika Royal Palms, unveiled Royal Palms which is a proposed gated community comprising of 70 eighth-acre plots. The plots on 10 acres of land will be sold at a competitive price of Kshs 2.3 mn each, compared to the market average of Kshs 2.6 mn

ii. Uriithi Housing handed over a 1,200-land project in Malindi to its members who bought the land as a joint investment initiative. The location of the project is ideal for tourist facilities.

With continued infrastructural development, nationwide, increase in land value is inevitable and thus land will continue to be a preferred investment. Investors should stay on the lookout for the next regions to receive infrastructural revamping

Statutory Actions

i. In a bid to improve on revenue collection from property owners, county governments continue to waive land rates fees, with the latest counties to do so being Kiambu, Kilifi, Mombasa, Meru and Kericho. Residential and commercial properties recorded the largest debt to the authorities, of Kshs 136.0 bn,
ii. The Kenya Revenue Authority announced plans to intensify compliance in the real estate sector especially collection of rental income tax by obtaining basic information on tax defaulters from third parties, including Kenya Power, Kenya Bankers Association, the Ministry of Land and county governments.