Cytonn Weekly #45

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Executive Summary

Fixed Income: Yields on the 91 and 364-day T-bills were on an upward trend, coming in at 8.2% and 10.7% this week up from 8.1% and 10.6% the previous week, respectively, while yields on the 182-day T-bill remained unchanged at 10.3%;

Equities: The Kenyan equities market registered mixed performance during the week, with NASI and NSE 25 declining by 1.1% and 0.6%, respectively, while NSE 20 gained by 0.4%. KCB Group released Q3'2016 results recording a growth in core EPS of 16.1% y/y to Kshs 5.2 from Kshs 4.4, while East Africa Portland Cement released FY'2016 results, recording a decline in core EPS of 31.1% y/y to Kshs 54.8 from Kshs 79.5;

Private Equity: Real estate continues to attract private equity funding with an interest towards logistics and warehousing developments. On exits, Actis plans to exit Umeme Holdings, the Ugandan power distributor, who are halfway through their 20-year deal with the Ugandan Government to distribute electricity;

Real Estate: House prices increased in Q3'2016 by 2.2% from Q2'2016, with apartments accounting for more than half of the market transactions. Private contractors set to take part in construction and maintenance of roads under Public Private Partnerships with the Kenyan Government;

Company Updates

- Cytonn Cash Management Solution (Cytonn CMS), an independent investment company advised by Cytonn Investments, established its Advisory Board. The board was elected by the investment partners of Cytonn CMS to represent the investment partners' interest and exercise oversight over the Principal Partner, Cytonn Investments. The Cytonn CMS board will be led by Mr. Shaka Kwach as Chairman. Commenting on the establishment of the board, Elizabeth Nkukuu, CFA, noted that, "this completes our initiative to make Cytonn CMS the best governed investment partnership in the region. We now hold annual AGM for our members, we issued audited financial statements to our partners to know exactly the status of the partnership and where their funds are invested, and now they have the board in place." **See Event Note**
- In order to better serve our clients, we will open our Westlands office on Thursday November 17th, 2016
- Maurice Oduor, our Investments Manager, discussed the move by Kenya Airways to renegotiate its 16-year venture agreement with majority shareholder KLM Airlines, and

Kenya Power's expected fall in its capital expenditure by 16% in the current financial year. **See Maurice on CNBC**

- Cytonn Investments held a pension trustees training on real estate investments at the Windsor Golf Hotel and Country Club. The training took the pension trustees through the attractive real estate investment opportunities that pension schemes can invest in, to grow and stabilize their portfolios. **See Event Note**
- We continue to see very strong interest in our Private Wealth Management Training, which is at no cost, held bi-weekly and is open only to pre-screened individuals. Kindly visit **Cytonn Private Wealth Management Training** to register
- Cytonn Real Estate has launched an innovative payment plan for all it projects and currently for **The Alma**, its aspirational apartment community development in Ruaka. The "0% Down & 10-year Payment Plan" is targeted at enhancing ownership and affordability for both prospective home owners and real estate investors who may not be able to afford the monthly payments over a 3-year construction period. The 0% Down & 10-Year Payment starts as low as Kshs 90,400 per month for 1-bedroom apartments. See table below for various plans:

(all values in Kenya Shilling unless stated otherwise)

The Alma 10-Year Payment Plan

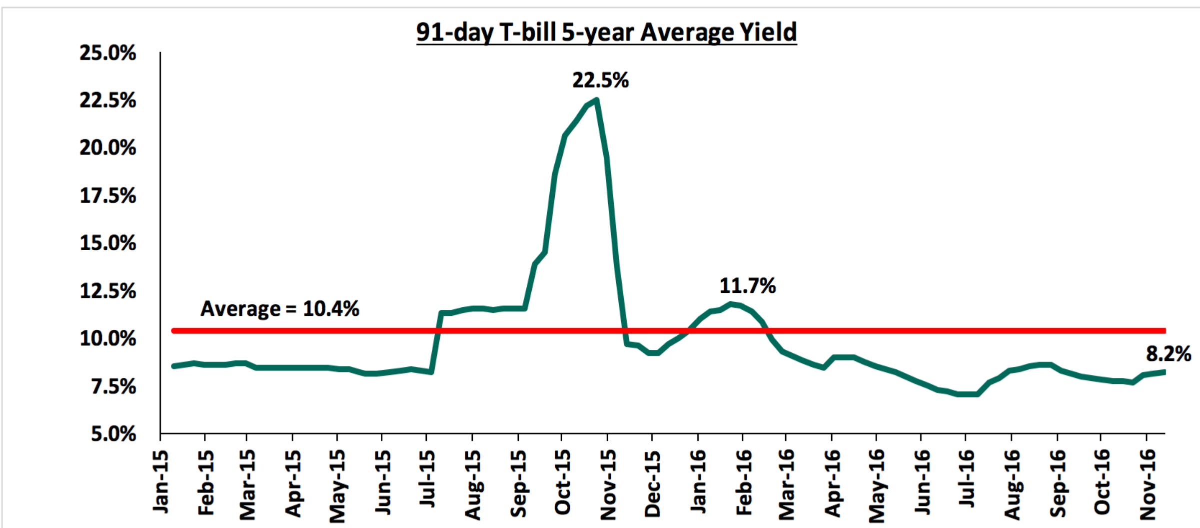
Unit Typology	Principal Amount	Payment Period (Months)	Monthly Installment Amount
1-Bedroom	5,018,160	120	90,400
2-Bedroom	7,700,000	120	138,700
3-Bedroom	11,300,000	120	203,600

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

Fixed Income

During the week, T-bills were oversubscribed with overall subscription increasing to 167.4%, compared to 145.2% recorded the previous week, driven by increased subscription on the 364-day paper. Subscription rates on the 91-day and 182-day papers decreased during the week coming in at 107.0% and 160.0% from 126.1%, and 170.4%, respectively, the previous week, whereas the subscription rate on the 364-day paper increased to 215.0%, from 132.8% the previous week. Interesting to note is that the 364-day received the fewest number of bids, at 189 bids, compared to 219 and 438 for the 91 and 182-day, respectively, indicating fewer, but larger, investors looking to lock-in duration on the 364-day paper. Yields on the 91 and 364-day T-bills were on an upward trend, coming in at 8.2% and 10.7% this week up from 8.1% and 10.6% the previous week, respectively, while yields on the 182-day T-bill remained unchanged at 10.3%. The 182-day paper continues to offer investors the highest return on a risk-adjusted basis.

The 91-day T-bill is currently trading below its 5-year average of 10.4%. The downward trend on the 91-day paper is mainly attributed to the expected low interest rate environment following (i) the operationalization of the Banking Act Amendment 2015, which has led to more liquidity in the market, and (ii) reduced pressure from the government borrowing program as they are currently ahead of the pro-rated domestic borrowing target of Kshs 88.3 bn, having borrowed Kshs 113.4 bn, which is 128.4% of the pro-rated target. It is important to note that the government is in the process of revising its domestic borrowing target upwards to Kshs 294.6 bn, which will take the pro-rated borrowing target to Kshs 113.3 bn, in line with what is has borrowed thus far. Key to note is that as indicated in our **Cytonn Weekly #42**, the interest rates have bottomed out and we expect them to persist at the current levels.



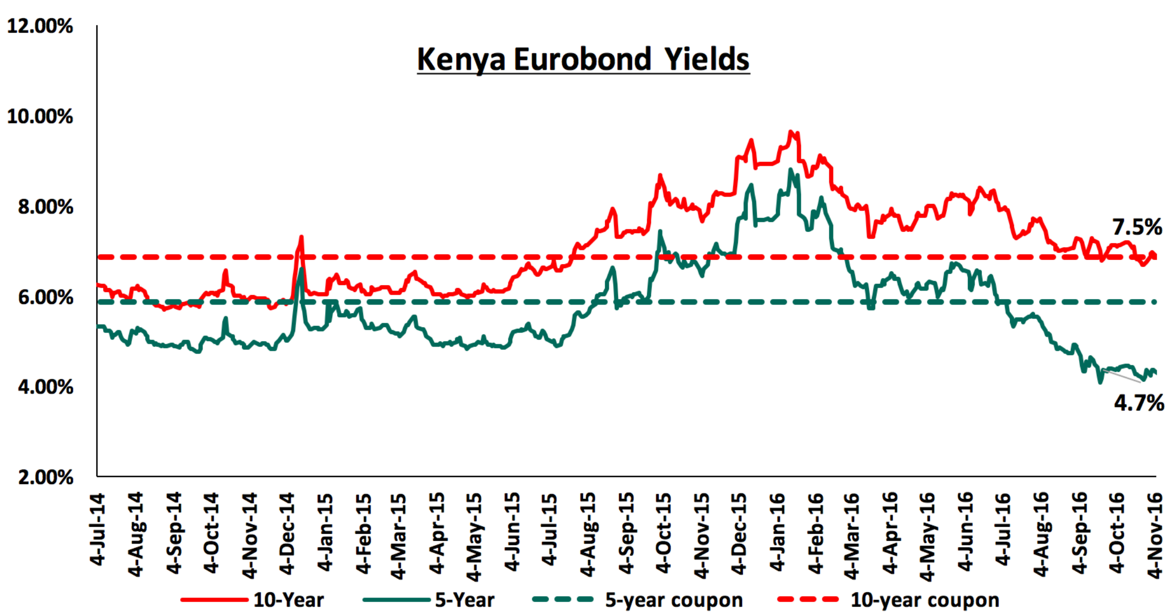
The Central Bank Weekly report revealed that the interbank rate declined by 30 bps to 3.9%, from 4.2% registered the previous week, despite decreased liquidity in the market. Decreased liquidity can be attributed to (i) an increase in T-bill primary issues that rose 32.2% to Kshs 22.6 bn, from Kshs 17.1 bn the previous week, and (ii) repos which stood at Kshs 27.3 bn, to manage liquidity in the market and reduce speculation on the Kenya Shilling. As highlighted in our **Cytonn Weekly Report #28** the interbank rate is often determined by the liquidity distributions within the banking sector as opposed to the net liquidity position in the interbank market.

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

all values in Kshs bn, unless stated otherwise

Weekly Liquidity Position – Kenya			
Liquidity Injection		**Liquidity Reduction**	
Term Auction Deposit Maturities	0.0	T-bond sales	0.0
Government Payments	41.4	Transfer from Banks - Taxes	17.8
T-bond Redemptions	0.0	T-bill (Primary issues)	22.6
T-bill Redemption	27.3	Term Auction Deposit	0.0
T-bond Interest	0.0	Reverse Repo Maturities	19.2
Reverse Repo Purchases	`16.5	Repos	27.3
Repos Maturities	0.0	T-Bills/T-Bonds Tap Sale	2.5
Total Liquidity Injection	**68.7**	**Total Liquidity Withdrawal**	**89.4**
		Net Liquidity Injection	**(20.7)**

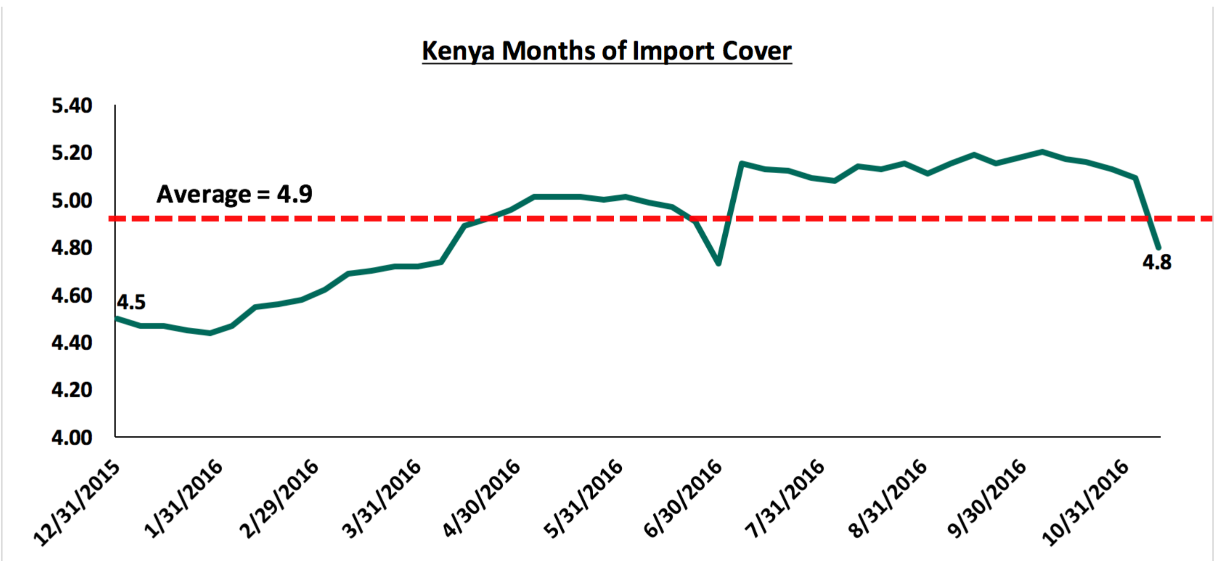
According to Bloomberg, yields on the 5-year and 10-year Eurobonds increased by 0.4% and 0.6%, respectively, week on week to 4.7% and 7.5% from 4.3% and 6.9%, respectively, the previous week. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 2.1% and 4.1%, respectively, for the 5-year and 10-year bond due to improving macroeconomic conditions.



The Kenyan Shilling was relatively stable against the dollar, closing the week at Kshs 101.8, from Kshs 101.6 the previous week. However, interesting to note is that:

1. The Central Bank of Kenya (CBK) has openly stated their stance to protect the shilling against short-term fluctuations owing to the volatility from the recently concluded US general elections, and,
2. CBK actively supported the currency, with the forex reserves reducing by USD 92 mn in support of the shilling, leading to a decline in the months of import cover from 5.1 last week to 4.8 this week.

The recent decline in the months of import cover is worrying, as 1-month ago on 6th October 2016, there was 5.20 months of import cover, and the months of import cover is now below the 1-year average of 4.9 months. This could be a sign of the shilling being artificially propped-up, and with increased dollar demand from oil importers as well as corporates to meet their foreign dividend obligations, alongside the global market volatility, we may witness short-term weakening on the shilling.



The IMF has reported that Kenya's current account deficit improved by 1.3% to 5.5% as at September 2016, from 6.8% recorded in 2015, with the improvement mainly attributed to (i) lower oil prices, (ii) improved tea and horticultural exports brought about by high prices in the international markets, (iii) a pickup in the tourism sector, and (iv) higher remittance inflows. Key to note is that:

1. Horticultural exports increased over the first eight months of the year, by 11.5% to Kshs 56.8 bn from Kshs 50.9 bn registered previously,
2. Diaspora remittances increased by 14.5% over the first six months of the year, to Kshs 86.2 bn from Kshs 75.3 bn registered previously,
3. After the first seven months of the year, imports stood at Kshs 807.2 bn with exports at Kshs 347.1 bn, representing an improvement of 20.3% to a trade gap of Kshs 460.1 bn, as compared to Kshs 577.6 bn registered over the same period in 2015.

Despite the narrowing current account deficit, the IMF has urged Kenya to cut down on the fiscal deficit. In line with the recommendation from IMF, the government in the most recent 2016 Budget Review and Outlook Paper (BROP) proposed to cut down on foreign borrowing and hence (i) improve external debt sustainability, and (ii) enhance low risk towards external debt distress.

The Institute of Certified Public Accountants of Kenya (ICPAK) is mounting pressure on the government to fast-track the reform of the income tax structure. This follows research conducted by ICPAK analyzing revenue growth and tax rates over the past five-years in a bid to inform budget planning. Findings from the research indicated that income tax revenue contributes approximately 90.0% of the revenue collection in the country. The institute has recommended that government apply a graduated Value Added Tax (VAT) approach in a bid to (i) simplify administration, and (ii) enhance progressiveness of the taxation process. Part of the proposal will see VAT applied at different rates, with luxury goods poised to have the highest tax rates. ICPAK noted that a shift from direct taxes to an indirect tax structure would have a positive standing on employment and will further enhance economic growth in the process by ensuring a larger portion of the economy contributes to the taxation process as consumption increases. We believe that the move to introduce an indirect tax system will narrow down on tax evaders and in the process, help the government in meeting its revenue collection target. This might take time to implement and therefore it is more of a much longer-term issue for the government.

The Government is ahead of its domestic borrowing for this fiscal year having borrowed Kshs 113.4 bn for the current fiscal year against a target of Kshs 88.3 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 229.6 bn budgeted for the full financial year). It is important to note, however, that the government is in the process of revising its domestic borrowing target upwards to Kshs 294.6 bn which will take the pro-rated borrowing target to Kshs 113.3 bn, in line with what is has borrowed thus far. Interest rates, which had reversed trends due to the enactment of The Banking Act Amendment, 2015, appear to have bottomed out and we expect them to persist at the current levels. It is due to this that we revise our recommendation from medium-term papers, and think it is prudent for investors to be biased towards short-term fixed income instruments.

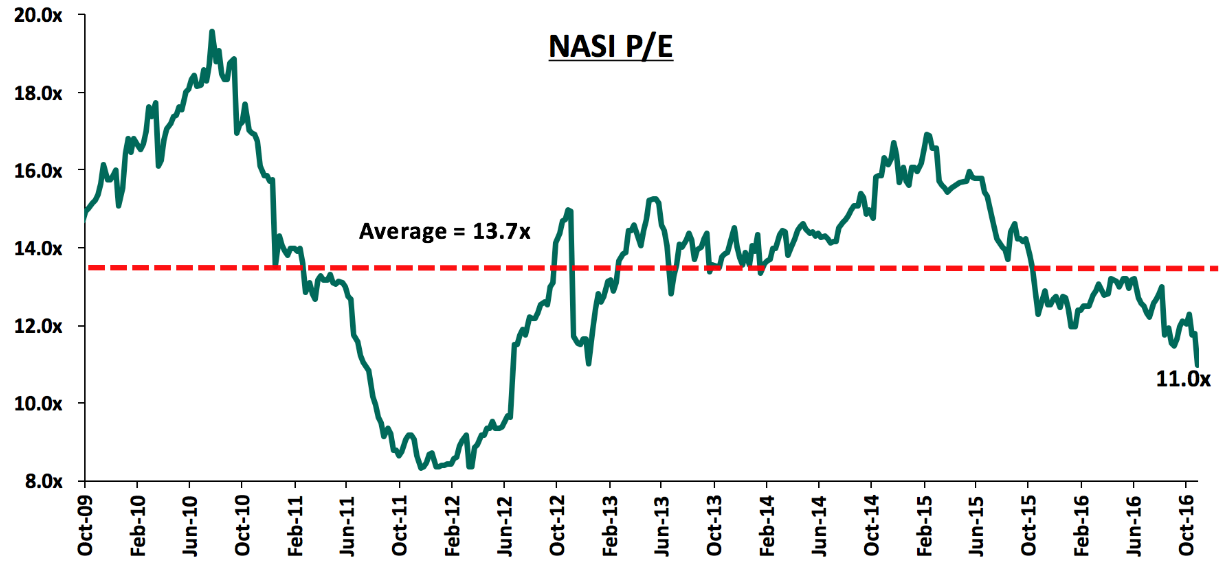
Equities

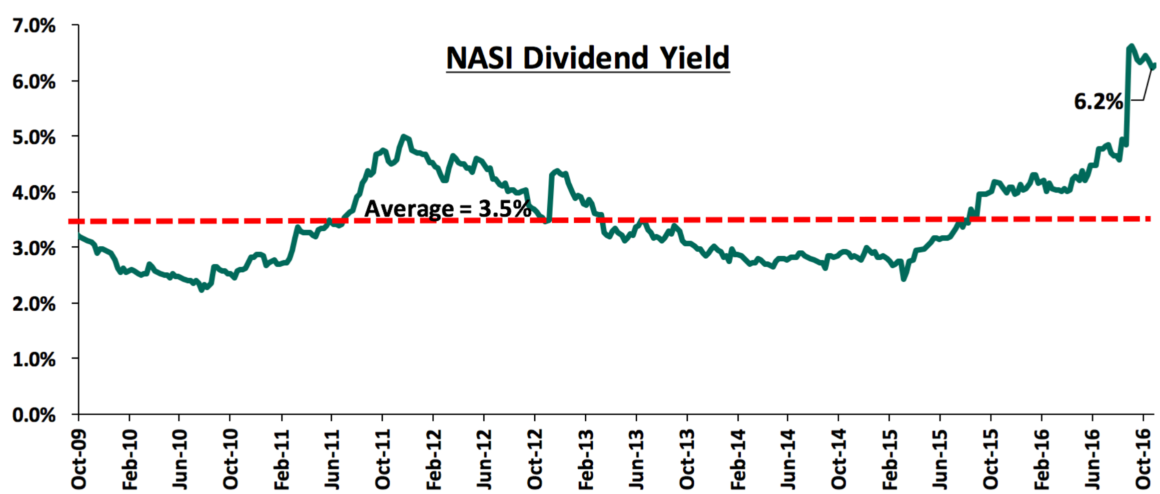
During the week, the Kenyan equities market was on a downward trend, with NASI and NSE 25 declining 1.1% and 0.6%, respectively, while NSE 20 was on an upward trend gaining 0.4%, taking their YTD performances to (3.9%), (19.2%) and (12.0%)%, respectively. Since the February 2015 peak, NSE 20 and NASI have lost 40.6% and 21.1%, respectively.

The week's performance was driven by losses in select large cap stocks such as EABL and Safaricom, which lost 3.9% and 2.8%, respectively, despite gains of 4.7% and 2.9% by Co-operative Bank and KCB Group, respectively.

Equities turnover increased by 10.6% to close the week at Kshs 26.1 mn from Kshs 23.6 mn the previous week. Foreign investors turned net buyers with net inflows of USD 1.7 mn, compared to a net outflows of USD 1.1 mn recorded the previous week, with foreign investor participation increasing to 68.1% from 55.7% recorded the previous week. Safaricom was the top mover during the week accounting for 33.0% of market activity and losing 2.8% during the week.

The market is currently trading at a price to earnings ratio of 11.0x, versus a historical average of 13.7x, with a dividend yield of 6.2% versus a historical average of 3.5%. The charts below indicate the historical PE and dividend yields of the market.





During the week, KCB Group and East African Portland Cement, released results:

KCB Group released Q3'2016 results

KCB Group released Q3’2016 results, recording core earnings per share (EPS) growth of 16.1% to Kshs 5.2, from Kshs 4.4 in Q3'2015, exceeding our projection of a 11.8% growth. The growth in earnings was driven by a 10.2% growth in total operating revenue, which outpaced a 4.3% growth in total operating expenses.

Key highlights for the performance from Q3’2015 to Q3’2016 include;

- Operating revenue grew by 10.2% to Kshs 50.4 bn from Kshs 45.7 bn in Q3’2015. This was supported by Net Interest Income, which grew by 27.4% to Kshs 36.1 bn from Kshs 28.4 bn in Q3’2015. Non-Funded Income distracted revenue growth, given a decline of 17.9% to Kshs 14.2 bn from Kshs 17.3 bn in Q3’2015,
- The growth in Net Interest Income was supported by a 22.5% growth in interest income to Kshs 48.6 bn from Kshs 39.7 bn, outpacing interest expense growth of 10.1% to Kshs 12.5 bn from Kshs 11.3 bn. This led to an increase in the net interest margin to 9.2% from 7.1% in Q3’2015,
- The decline in Non-Funded Income was driven by an 18.0% decline in forex income to Kshs 2.4 bn from Kshs 2.9 bn in Q3’2015, and an 8.1% decline in fees earned to Kshs 9.5 bn from Kshs 10.3 bn in Q3’2015. The current revenue mix stands at 72:28 Funded to Non-Funded Income, from 62:38 in Q3’2015. We believe KCB Group has a huge untapped opportunity to grow fee income through related businesses such as investment banking and asset management, which remain, surprisingly, untapped for such a strong brand
- Operating expenses grew marginally by 4.3% to Kshs 27.4 bn from Kshs 26.3 bn in Q3’2015 following a 13.0% y/y growth in staff costs to Kshs 12.6 bn from Kshs 11.1 bn. Loan loss provision (LLP) declined 11.2% to Kshs 3.4 bn from Kshs 3.9 bn in Q3’2015, leading to a decline in the cost to income ratio to 54.4% from 57.6% in Q3’2015. Without LLP, cost to income ratio came in at 47.7% from 49.1% in the same period last year
- The faster growth in operating income than operating expenses led to an increase in reported profit after tax by 16.1% to Kshs 15.9 bn from Kshs 13.7 bn in Q3’2015, exceeding our expectations of an 11.8% rise
- Loans and advances grew 4.9% to Kshs 364.5 bn from Kshs 347.6 bn in Q3'2015, supported by increased use of alternative channels to drive loan disbursement. Growth was strongest in Kenyan operations, with the loan book rising by 7.5% to Kshs 332.3 bn from Kshs 309.1 bn in Q3’2015
- Customer deposits declined by 7.3% to Kshs 436.8 bn from Kshs 471.1 bn in Q3’2015, driven by the impact of devaluation of the South Sudan business. Considering the Kenya business alone, deposits grew by 14.0% to Kshs 372.6 bn. This led to an increase in the loan to deposit ratio to 83.5%, from 73.8% in Q3’2015, compared to the industry average of 87.4%.

Key to note is that KCB Group earnings for Q3’2016 were largely supported by the Kenyan business with net interest income growing by 34.4% to Kshs 33.2 bn from Kshs 24.7 bn, and earnings rising 27.6% to Kshs 15.2 bn from Kshs 11.9 bn. Owing to these developments, we continue be skeptical about the regional expansion strategy which seems to distract rather than enhance value.

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

East African Portland Cement released FY'2016 results

East African Portland Cement released their full year results, recording a decline in reported EPS by 42.1% y/y to Kshs 46.1 from Kshs 79.5 in FY'2015, attributed to an increase in operating expenses of 24.4% that outpaced the increase in operating revenue of 5.3%. Adjusting for the inventory provision of Kshs. 790 mn, operating expenses declined 5.8% to Ksh 2.5 bn in FY'2016, resulting in a 31.1% decline in core EPS to Kshs 54.8 from Kshs 79.5 in 2015. Key points to note include;

- Operating revenue increased by 5.3% y/y to Kshs 8.9 bn from Kshs 8.4 bn while operating expenses decreased by 5.8% y/y to Kshs 2.5 bn from Kshs 2.6 bn in FY'2015. The growth in revenue was supported by higher sales volumes as a result of improved cement production. Cost of sales grew by 10.5% y/y to Ksh 7.3 bn from Kshs 6.5 bn as a result of increase in sales volume and increased plant maintenance
- This led to a 174.4% increase in the loss from operations to Kshs 1.6 bn from Kshs 577.6 mn in FY'2015. The EBITDA margin thus declined further to (17.9%) from (6.9%) in 2015
- Finance costs increased by 67.4% y/y to Ksh 0.6 bn from Ksh 0.4 bn as a result of increased use of debt to finance capital projects, while foreign exchange losses came in at Ksh 0.3 bn compared to a gain of Ksh 0.2 bn last year, as a result of a weakening shilling against the dollar and Japanese Yen
- The fair value gains after re-valuation declined by 14.2% y/y to Ksh 6.2 bn from Ksh 7.2 bn. Moreover, EAPC did not benefit from land sale proceeds this year as they did in FY'2015 when the government paid it Ksh 0.8 bn for land acquired compulsory for the standard gauge railway project
- Profit before tax recorded a decline of 49.1% to Kshs 3.7 bn from Kshs 7.3 bn. Profit after tax declined 42.1% to Kshs 4.1 bn from Kshs 7.2 bn, despite a tax credit of Ksh 0.4 bn in the period, compared to a charge of Ksh 0.2 bn in FY' 2015.

Moving forward, we expect East African Portland Cement to sustain its revenue streams given Kenya's growing demand for cement which will be driven by infrastructural projects and the growing real estate sector. In Kenya, the housing demand still remains higher than supply, especially in the lower segment of the market. However, cement prices are lower due to competition, and this is likely to continue in the short to medium term. East African Portland Cement will focus on (i) restructuring its operations through capping additional borrowing, and paying down the Yen denominated loan which matures in 2020, and (ii) the implementation of a structured plant maintenance program, in order to enhance its competitive edge.

In other areas to cover this week, Safaricom has sought an extension till June 2017 on a directive by the Competition Authority of Kenya (CAK) requiring all mobile money providers to disclose all transaction fees to be charged prior to customers completing a transaction. CAK had stated that mobile money providers had until the end of 2016 to implement the directive following allegations that some petrol stations were passing on the transactional costs to the customers. In response, Safaricom introduced a USSD code *234# to enable customers check on the charges before transacting. Additionally, banks such as Equity Bank, Co-op bank, DTB, NIC, Bank of Africa and Family Bank, which offer mobile money services, have indicated they are in the process of complying. As per CAK, there are 26.3 mn mobile money subscribers as at the end of June 2016 with the World Bank reporting last year that 3 of 4 adults in Kenya have access to financial services. We believe that these measures by CAK will aid in transparency and cut down on additional costs that are often passed on to clients in the process making access to credit cheaper than it would have otherwise been.

In a move to enhance trading, the Central Depository & Settlement Corporation (CDSC) is set to launch a new trading platform, in April 2017, that will allow trades to be settled in one day. CDSC, which provides clearing, settlement and depository services for listed securities, is looking to add stocks from other African countries, starting with Nigeria. Currently, the NSE uses a system known as T+3, in which transactions are completed in three days. This move to trade and settle the same day will (i) enhance the number of transactions carried out in a day hence increase liquidity in the market, (ii) make the pricing of bonds and shares easier as it will improve price discovery mechanisms in the NSE, and (iii) increase both foreign and local investor participation.

Below is our equities recommendation table. Key changes from our previous recommendation are:

- NIC has moved to a "Sell" recommendation with a downside of 2.6%, from an "Accumulate" recommendation, with an upside of 13.5%, following a 17.1% w/w price increase
- Barclays has moved to an "Accumulate" with an upside of 19.4%, from a "Buy" recommendation with an upside of 20.9% following a 1.2% w/w price increase

all prices in Kshs unless stated										
				EQUITY RECOMMENDATION						
No.	Company	Price as at 4/11/16	Price as at 11/11/16	w/w Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**	Recommendation
1.	Bamburi Cement	159.3	156.0	(2.1%)	(10.9%)	231.7	7.8%	56.3%	Buy
2.	KCB Group***	28.9	29.8	2.9%	(32.0%)	42.5	7.5%	50.4%	Buy
3.	HF Group	14.3	14.5	1.4%	(34.8%)	19.8	9.2%	45.8%	Buy
4.	Centum	41.2	40.8	(1.1%)	(12.4%)	56.7	2.4%	41.5%	Buy
5.	Britam	10.4	10.0	(3.8%)	(23.1%)	13.2	2.4%	34.4%	Buy
6.	DTBK***	137.0	133.0	(2.9%)	(28.9%)	173.2	1.8%	32.0%	Buy
7.	Kenya Re	21.5	21.5	0.0%	2.4%	26.9	3.6%	28.7%	Buy
8.	BAT (K)	832.0	826.0	(0.7%)	5.2%	970.8	6.2%	23.7%	Buy
9.	Co-op Bank	12.7	13.3	4.7%	(26.1%)	15.2	6.8%	21.1%	Buy
10.	ARM	25.7	31.0	20.6%	(25.7%)	37.0	0.0%	19.4%	Accumulate
11.	Equity Group	30.9	31.3	1.3%	(21.8%)	34.2	7.7%	17.0%	Accumulate
12.	Barclays	8.5	8.6	1.2%	(36.8%)	9.2	9.7%	16.7%	Accumulate
13.	Stanbic Holdings	70.0	69.5	(0.7%)	(15.8%)	75.5	7.9%	16.5%	Accumulate
14.	CIC Insurance	4.1	4.1	0.0%	(33.9%)	4.4	2.5%	9.8%	Hold
15.	I&M Holdings	97.7	97.0	(0.7%)	(3.0%)	101.1	3.9%	8.1%	Hold
16.	Jubilee Insurance	471.8	476.0	0.9%	(1.7%)	482.2	1.8%	3.1%	Lighten
17.	SCBK***	191.5	185.0	(3.4%)	(5.1%)	169.9	6.6%	(1.6%)	Sell
18.	NIC	28.0	32.8	17.1%	(24.2%)	30.8	3.5%	(2.6%)	Sell
19.	Liberty	14.6	14.6	0.0%	(25.1%)	13.9	0.0%	(4.8%)	Sell
20.	Sanlam Kenya	34.0	33.0	(2.9%)	(45.0%)	30.5	0.0%	(7.6%)	Sell
21.	Safaricom	21.4	20.8	(2.8%)	27.6%	16.6	3.6%	(16.5%)	Sell
22.	NBK	6.8	7.1	4.4%	[illegible]	2.7	0.0%	(62.0%)	Sell

**Target Price as per Cytonn Analyst estimates*

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

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

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

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

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

Private Equity

During the week, there were a number of announcements on the fundraising front, continuing the trend witnessed over the last month, as can be seen below:

- International Finance Corporation (IFC) proposed to commit USD 10 mn to Maris Capital's planned USD 70 mn investment vehicle Africa Logistic Properties (ALP). ALP is looking to invest its funds in developing and managing Grade-A warehouses in sub-Saharan Africa. In its first investment phase, the Nairobi based Maris Capital plans to develop three new projects at key strategic points around the Kenyan Capital. In future phases, the firm plans to develop other warehousing assets in other parts of Kenya and Sub-Saharan African Region. Maris Capital is a venture capital firm with interest in mining, real estate, agriculture and forestry. Some of its key projects are the Kenyan Karebe Gold Mining Limited, Commoner Mines in Zimbabwe and warehousing and office facilities in Northern Mozambique.

In our view, investments in development of Grade-A warehousing is a well thought out opportunity. According to the Knight Frank Africa Logistic Report, there is an increase in demand for quality warehousing in sub Saharan Africa, fueled by growth of e-commerce in the continent. According to the report, prime logistics space in the capital currently commands a rent of USD 4.2 per square metre per month, a relatively low figure largely due to the quality of existing structures. Occupiers are however ready to pay up to USD 6 per square meter for the same quality of space they would find in South Africa or Eastern Europe.

- Impact Investment firm Capria Ventures has relaunched the Emerging Managers Fund, a USD 100 mn fund-of-funds launched in June this year. The fund will invest in early-stage equity and debt fund managers in Africa, Asia and Latin America. The fund is expected to hold its first close during the first half of 2017. These efforts are in line with the funds goalto invest in at least 15 impact funds in the next 5 years. By 2025, Capria's efforts are expected to unlock over USD 500 mn in local and global capital to invest in businesses that will cumulatively serve more than 5 million low-income people across diverse emerging economies.

On exits this week:

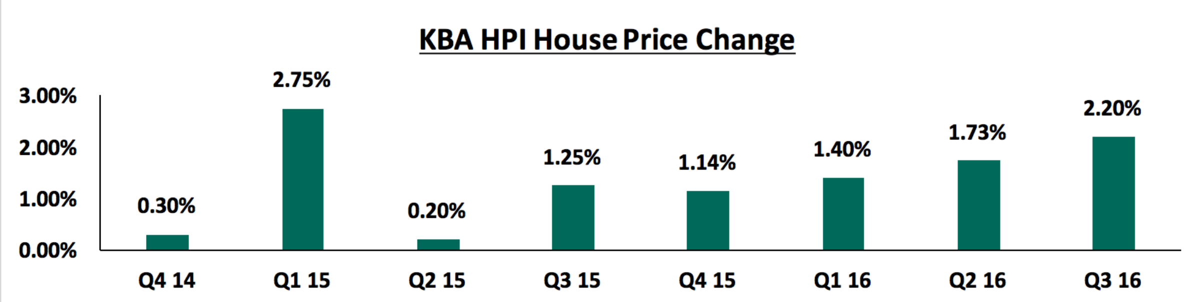
Actis plans to exit from Umeme, a Ugandan electricity distribution company, by offloading 232.3 million shares equivalent to 14.3% of the issued ordinary shares to the Uganda Social Security fund, who have already bought 122 million shares, and other institutional investors. Umeme, which is a subsidiary of Umeme holdings, took over the distribution and supply of electricity in Uganda from Uganda Electricity Distribution Company Limited (UEDCL), under the concession for a period of 20-years commencing on 1st March 2005. Umeme has a total of 1.6 bn issued ordinary shares. With one share currently trading at UGS 525 an equivalent of USD 0.15, the total value of shares to be offloaded is USD 34.8 mn. The transaction is expected to close on November 17th and it will leave the National Social Security Funds the majority shareholder in the electricity distributor with 23%. The book runner in charge of the private placement are expected to reveal the other buyers of Actis stake by close of the transaction.

Private equity investments in Africa remain robust as evidenced by the increased deals and deal volumes in the region's key sectors, namely financial services and real estate. Given (i) the high number of global investors looking to cash in on the growing middle class of Africa, (ii) the attractive valuations in private markets compared to global markets, (iii) better economic growth projections in Sub-Sahara Africa compared to global markets, and (iv) the high number of exits that is evidence of the attractiveness of the region, we remain bullish on PE as an asset class in Sub-Sahara Africa.

Real Estate

According to the Kenya Bankers Association (KBA) Housing Price Index for the 3-month period ending September, house prices continued to rise in the third quarter of the year, recording a 2.2% growth from prices in Q2'2016. This was an increase compared to the 1.7% growth recorded in the previous quarter. While the report supports Hass Consult's Q3'2016 Property Price Index findings on price increase during the quarter, it differs from the latter that recorded a

1.2% growth, slower than the 4.0% rise in Q2’2016. Below is a graph showing the prices increases quarter on quarter;



- Q3 2016 recorded the highest price change since Q2’2015
- The index indicates sustained price increase since Q4’2015

Key takes from the KBA HPI report are as follows;

i. Buyers have shown consistency in preference with the greatest factors influencing price movement still being (i) house size, including number of bedrooms, bathrooms and presence of detached staff quarters, (ii) security and privacy, and (iii) proximity to social amenities,
ii. Apartments had the largest share of market transactions at 58.6%, while maisonettes and bungalows accounted for 24.3% and 17.1% of total sales, respectively,
iii. Apartments had the largest number of transactions in lower and middle income markets. In particular, apartments in middle income areas such as Kiambu Road, Waiyaki Way, Langáta and Ngong Road recorded a 3.4% price change during the quarter compared to high end areas at 1.8%. This can be attributed to their affordability and therefore they are preferred by the low and middle income earners. The slow rise in apartments’ prices in the high end areas is due to relatively slow uptake indicating a possible oversupply in this market
iv. Maisonettes, on the other hand, recorded the highest price movement at 4% in high end areas such as Kileleshwa, Kilimani, Karen, Garden Estate and Muthaiga, driven by the high-net worth clientele in these areas.

In our view, the continued house price increase indicates sustained demand for housing. As developers put up units in response, we are likely to witness increased focus on the lower income segment that remains largely unsupplied. In addition to demand, other factors likely to positively impact real estate as an investment include;

i. Tax incentives for development of at least 400 low cost units, now at 15%,
ii. Financial Support - The banking industry has supported home acquisition and development through enabling access to credit and improved services. The recent capping of interest rates will also give potential borrowers incentives to seek mortgages, and,
iii. High returns - Real estate has consistently outperformed other asset classes, with returns of up to 25% making it attractive to investors. This is from rental yields ranging from 6-

12% for different real estate themes, and high price appreciation, especially for those who invest at development stage.

We therefore expect increased housing supply as developers aim to tap into the lucrative sector. Among other projects, the Kshs 300 bn Public-Private Urban Renewal Project involving development of more than 14,000 units in Ngara, Pangani, Ngong Road and other areas in Nairobi, is set to begin in January 2017. Developers will however need to put emphasis on research to determine the appetite for housing depending on regions and the income of the target market.

In an effort to improve infrastructure in the country, the government is in talks with private investors wishing to take part in construction and maintenance of roads under a Public-Private Partnership model. The main roads that have been earmarked include the Nairobi-Mombasa highway, Nairobi-Nakuru-Mau Summit, The 2nd Nyali Bridge, the Nairobi Southern Bypass and the Thika Superhighway. Already, KENHA has issued a tender for the construction of the Nairobi, Nakuru Mau Summit Highway under this framework. Public Private Partnerships enable use of the private sector to provide public services, due to their advantage over the government in terms of operational efficiency, expertise and funding. In the past, however, PPPs have failed to succeed due to:

1. Disparities in revenue sharing, and uncertainty in terms of returns, and,
2. Such projects tend to be long-term exceeding 10-years, while most private investors aim to exit investments in 3-5 years, due to the cost of capital.

Some of the projects that have significantly delayed or failed to take off under the PPP model include the KU hostels development and the Konza City Project. Under a new proposed financing plan, however, private investors will operate and charge fees on road users so as to recoup their investment over a pre-defined period of time. While involvement of the private sector in construction of the roads is likely to speed up and spur development in new areas, the move is likely to face opposition from the public who will be required to pay more for commuting, if the tolling plan is implemented. We remain skeptical on the implementation and sustainability of PPPs in the face of corruption and political interference. In addition, due to the long-term nature of such projects, PPPs are very risky to an investor as it is difficult to plan for unseen contingencies that may arise during the project period.
