Post-Election Business Environment, & Cytonn Monthly – July 2017

Executive Summary

Fixed Income and Macroeconomic Review: During the month of July, the yield on the 91-day paper declined to 8.2% from 8.3% at the end of June, whereas yields on the 182 and 364-day papers remained unchanged at 10.3% and 10.9%, respectively. The Monetary Policy Committee (MPC) maintained the Central Bank Rate (CBR) at 10.0% during the meeting held on 17th July 2017, while Kenya's inflation rate for the month of July declined to 7.5% from 9.2% in June, driven by a drop in food and fuel prices;

Equities: During the month of July, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 5.5%, 5.3% and 4.9%, respectively, taking their YTD performance as at end of July to 21.0%, 19.2% and 21.0%, respectively. KCB Group released H1'2017 results with profit after tax remaining relatively unchanged at Kshs 10.26 bn from Kshs 10.28 bn in H1'2016, but core Earnings per Share (EPS) declined by 3.6% to Kshs 6.7 from Kshs 6.9 in H1'2016, attributed to a scrip dividend issue carried out last year;

Private Equity: During the month of July, we witnessed investments in all major sectors, including financial services, education, and FMCG, with the highlight transaction being the set acquisition of 100.0% stake in Java House Group by Dubai-based Abraaj Group. Firms continue to fundraise and commit funds indicating investors' confidence in the positive performance of the African private equity space, with Kenya's Twiga Foods having raised Kshs 1.3 bn in their Series A funding round;

Real Estate: House prices increase slowed down in Q2'2017 as per Hass Consult and Kenya Bankers' Association reports, which indicate a 3.1% decline and a 1.0% increase in prices from a 0.1% decline and 1.1% increase, respectively, the previous quarter. Supply of office spaces in Nairobi is expected to continue rising with continued construction of office complexes, including a business park at Garden City, while in the industrial sector, there was a recorded increase in uptake of industrial land in Special Economic Zones;

Focus of the Week: In order to try and predict the immediate business environment post-elections, we looked at five key indicators of a peaceful election, relative to the past two elections: integrity and independence of the electoral body, integrity and independence of the judiciary, election preparedness, international presence and monitoring, and market sentiment, and try to assess whether we have the right foundations to run a free and fair election. We conclude that we are likely to have a peaceful election and a peaceful business environment post-election.

Company Updates

- Following the passing of a special resolution by shareholders in our Annual General Meeting held on 3rd March 2017, Cytonn Investments Management Ltd converted to a public company, Cytonn Investments Management Plc. This move is mainly driven by our quest to hold ourselves to best governance practices and protect our shareholders' and clients' interests. Having now converted from a private to a public company, the next step is to explore a listing on an exchange. See the press release detailing this here
- Our Company Secretary and Head of Legal, Patricia Wanjama, discussed the conversion of Cytonn Investments Management Ltd to a public company and the effective change of name to Cytonn Investments Management Plc. Watch Patricia Wanjama on K24 here
- Our Investments Analyst, John Ndua, discussed the significance of Equity Bank's move to close down eleven ATMs in a bid to shift customers to agency and mobile banking. Watch John Ndua on CNBC here
- Connecting to our clients is very important and this is made possible through both our in-house and independent teams of Financial Advisors. In our continuous effort to recognize and award

their excellence & dedication, Cytonn Investments held an award ceremony for its top performers in Q2'2017 on Thursday, 3rd August at Sarova Stanley Hotel. See Event Note

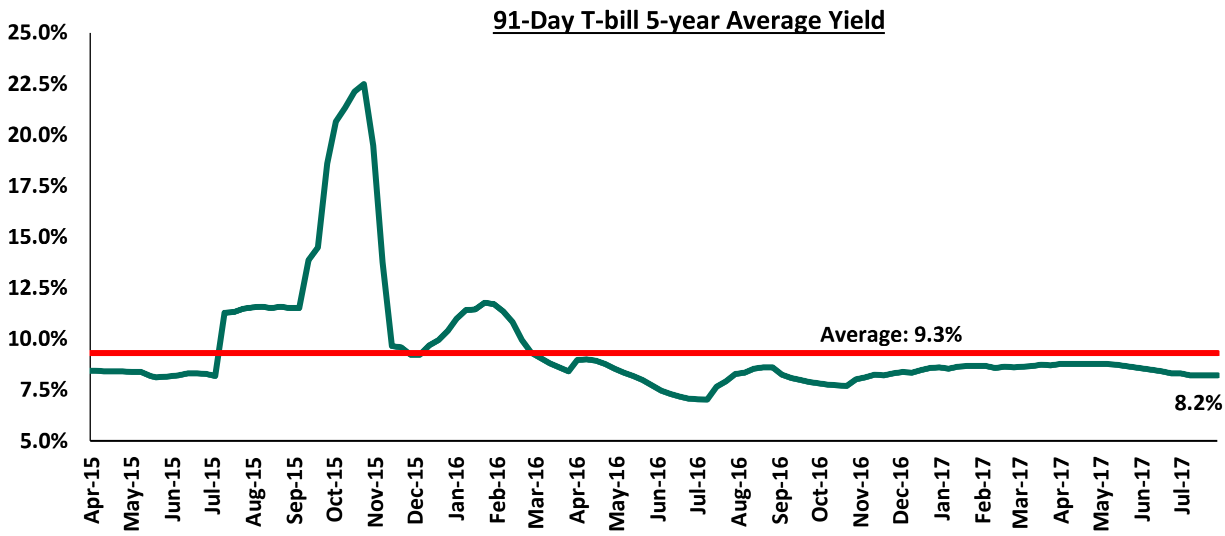
- We continue to showcase real estate developments by our real estate development affiliate, Cytonn Real Estate, through weekly site visits. Watch progress videos and pictures on The Alma, Amara and Taraji Heights. The site visits target both investors looking to invest in real estate directly, and also 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 trained on Financial Planning. 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 10 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 over 20.0% p.a. returns to investors. See Amara Ridge
    - Situ Village is currently 15.0% sold. See Situ Village
    - The Ridge (Phase One) is currently 31.0% sold. See The Ridge
    - Taraji Heights is currently 10.0% sold. See Taraji Heights
    - RiverRun Estates (Phase One) is currently 8.7% sold after the recent launch. See RiverRun Estates
- We are currently looking for 5-10 acres in Kikuyu, Lower Kabete, Upper Kabete, Loresho or Mountain View, and 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 ongoing hires: Careers at Cytonn

Fixed Income and Macroeconomic Review

T-bills subscription rates remained low throughout the month of July due to liquidity anomalies in the market, with subscription rates declining to an average of 63.8% from 156.4% in June. The subscription rates for the 91, 182 and 364-day papers came in at 59.9%, 76.5% and 52.6% from 246.5%, 172.4% and 104.5% the previous month, respectively. The yield on the 91-day paper decreased to 8.2% from 8.3% in June, whereas yields on the 182 and 364-day papers remained unchanged at 10.3% and 10.9%, respectively. The Central Bank of Kenya (CBK) remained disciplined in stabilizing interest rates in the auction market by rejecting aggressive bids that were priced above market, leading to a decline in the overall bids acceptance rate to 87.4% during the month, compared to 92.7% in June.

For this week, T-bills were undersubscribed for the 4th week in a row, with the overall subscription rate declining to 40.5% from 64.6% recorded the previous week, attributed to reduced liquidity in the money market, which came in at a net liquidity reduction of Kshs 1.3 bn. The subscription rates for the 91, 182 and 364-day papers came in at 39.8%, 47.0%, and 34.3% compared to 24.1%, 47.5% and 97.8%, respectively, the previous week. Yields on the 91, 182 and 364-day papers remained unchanged from the previous week at 8.2%, 10.3% and 10.9%, respectively. The overall acceptance rate remained flat at 94.3% compared to 94.5% the previous week, with the government accepting a total of Kshs 9.2 bn of the Kshs 9.7 bn worth of bids received, against the Kshs 24.0 bn on offer in this auction.

The 91-day T-bill is currently trading below its 5-year average of 9.3%. The lower yield on the 91-day paper is mainly attributed to the low interest rates environment we have been experiencing, and we expect this to continue in the short-term given (i) the government is expected to meet its domestic borrowing target for the 2017/18 fiscal year, as reduced credit to the private sector will see institutions channel funds more actively towards government securities, and (ii) the government is expected to meet its foreign borrowing target in the 2017/18 fiscal year, which was set downwards to Kshs 206.0 bn from Kshs 462.3 bn in the previous financial year.



During the month, the government issued a 10-year fixed-coupon bond (FXD 1/2017/10), and a market-determined coupon rate, in a bid to raise Kshs 30.0 bn for budgetary support. The bond issue received a 63.5% subscription rate, with the market average rate for the bids coming in at 13.3%, 30 bps above the accepted rate of 13.0%. Just like in the previous bond auctions held this year, where the government only accepted 71.3% of total bids on average, the government did not accept expensive bids, accepting only Kshs 5.2 bn out of the Kshs 19.0 bn worth of bids received, translating to an acceptance rate of 27.3%. The government consequently issued a tap sale at the accepted weighted average yield of 13.0% to raise Kshs 25.0 bn, and investors put in bids worth Kshs 7.0 bn, which were all accepted. This led to a total acceptance rate on the bond to 46.9%.

For the month of August, the government has issued a 5-year bond (FXD 1/2017/5) and re-opened a 10-year bond (FXD 1/2017/10) in a bid to raise Kshs 30.0 bn for budgetary support. Investors will participate until the 22nd of August, and we shall provide our view on the bidding ranges for the bonds in our next report.

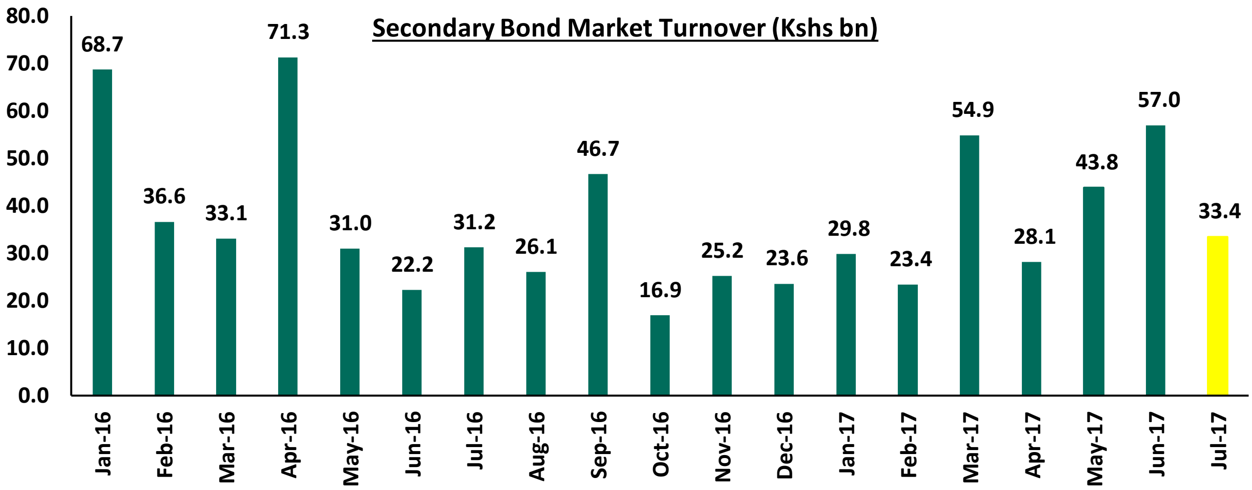
During the month, the average interbank rate closed at 7.2%, up from 4.8% at the end of June due to liquidity being skewed towards a few large banks. During the month there was a net liquidity injection of Kshs 61.8 bn in the money market with the bulk of it coming from government payments. The net liquidity position was an increase from a net liquidity injection of Kshs 22.5 bn in June.

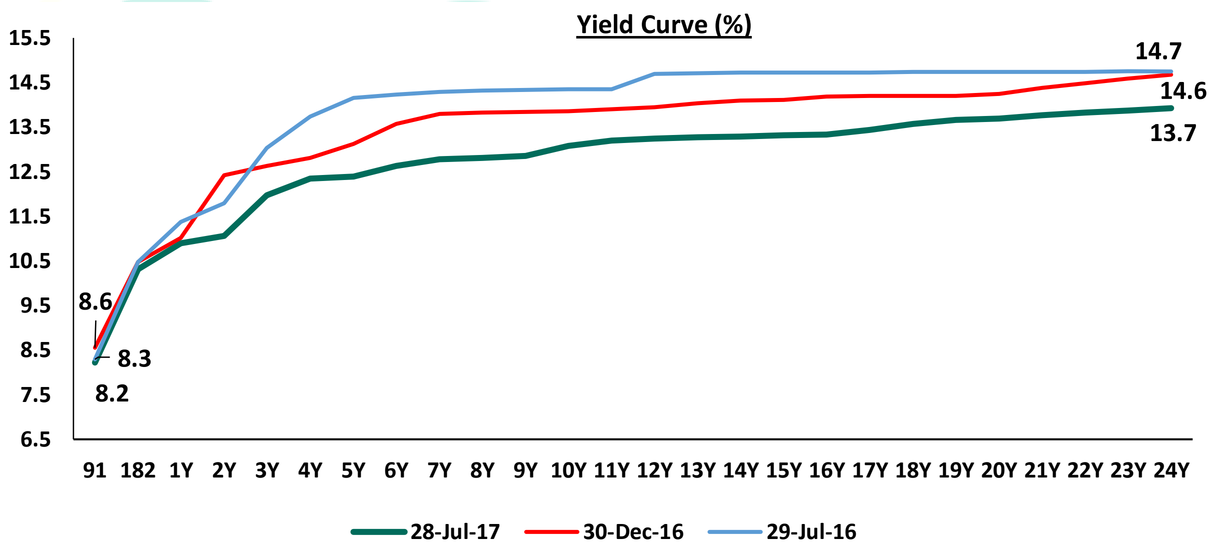
Below is a summary of the money market activity during the month:

all values in Kshs bn, unless stated otherwise

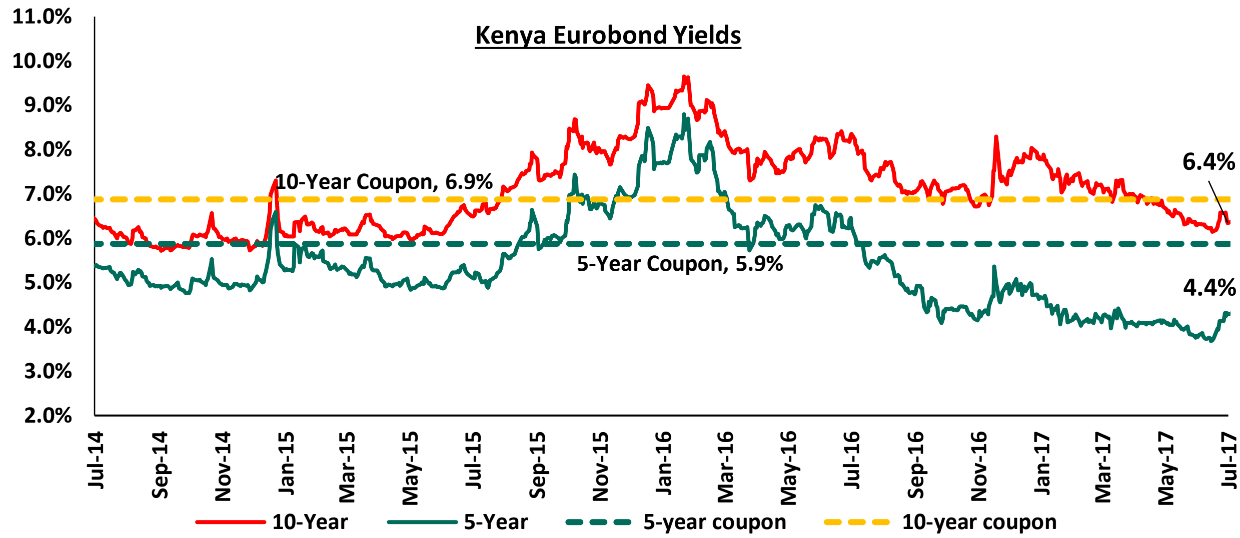
July Monthly Liquidity Position – Kenya			
Liquidity Injection		**Liquidity Reduction**	
Term Auction Deposit Maturities	53.1	Transfer from Banks - Taxes	83.5
Government Payments	136.6	T-bill (Primary issues)	56.3
T-bill Redemption	58.9	Reverse Repo Maturities	15.0
T-bond Interest	6.2	Term Auction Deposit	53.1
Reverse Repo Purchases	14.9	Repos	26.5
Repos Maturities	26.5		
Total Liquidity Injection	**296.2**	**Total Liquidity Withdrawal**	**234**
		Net Liquidity Injection	**61.8**

The secondary bond market recorded reduced activity during the month of July, with turnover dropping by 41.3% to Kshs 33.4 bn in the month of July, from Kshs 57.0 bn recorded in June. The yields on government securities have declined since the beginning of the year, and during the month of July, as highlighted in the yield curve below. According to the FTSE NSE Bond Index, Treasury bonds listed at the Nairobi Securities Exchange (NSE) recorded a gain of 1.1% during the month.





According to Bloomberg, yields on the 5-year and 10-year Eurobonds, with 2-years and 7-years to maturity, respectively, have remained unchanged during the month of July to close at 4.4% and 6.4%, respectively. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.4% points and 3.2% points for the 5-year and 10-year Eurobonds, respectively, due to stable macroeconomic conditions in the country. The stable Eurobond yields and stable rating (Fitch Ratings having affirmed Kenya's long-term foreign and local currency issuer default ratings (IDRs) at "B+"), are indications that Kenya remains stable and hence an attractive investment destination.



The Kenya Shilling depreciated by 0.2% to the USD during the month of July to close at Kshs 103.9, from Kshs 103.7 in June. 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 1.4%.

In the global markets, the US Fed met during the month and decided to maintain the rates in the band of 1.00%-1.25%, and also stated that it would start unwinding its quantitative easing efforts as highlighted in our Cytonn Weekly #30/2017. This move could have the effect of strengthening the dollar against other major currencies, with foreign flows into the US debt market and the scarcity in dollars that will arise from the program. However, in the coming months, given the high forex reserve level, currently at USD 7.5 bn (equivalent to 5.0 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 shall remain stable despite the increase in the current account deficit.

The inflation rate for the month of July declined by 1.7 percentage points to 7.5%, from 9.2% in June. The decline was driven by (i) a drop in food prices, which dropped by 2.1% m/m, due to better than expected effects of the long rains season, and (ii) a decline of 0.3% m/m in fuel prices following the reduction of diesel and petrol pump prices. See below a summary on key changes on the Consumer Price Index (CPI) in July;

Key Changes on the Consumer Price Index (CPI) during the month of July			
Broad Commodity Group	**Price change m/m**	**Price change y/y**	**Reason**
Food & Non-Alcoholic Beverages	(2.1%)	12.2%	Decline in food prices attributable to the favorable weather conditions being experienced in some parts of the country, and government intervention to reduce prices
Transport Cost	(0.3%)	2.8%	Decreased pump prices of petrol and diesel
Housing, Water, Electricity, Gas and other Fuels	(0.1%)	3.0%	Decreased cost of electricity, kerosene and cooking gas

Going forward, we expect reduced inflationary pressures in the second half of the year, supported by (i) continued decline in food prices, with improved weather conditions in some parts of the country, and (ii) a decline in fuel prices, as a result of rising US oil production, which has suppressed the global recovery of oil prices, countering 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 at 8.0% over the course of the year, which is above the upper bound of the government target range of 2.5% - 7.5%.

The Monetary Policy Committee (MPC) met during the month, 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, given (i) declining inflation, (ii) a relatively stable foreign exchange market, and (iii) a resilient banking sector, which reported the average commercial banks liquidity and capital adequacy ratios at 44.7% and 19.6%, respectively, as at June 2017. For more comprehensive analysis on this, see our previous weekly report here.

During the month, the International Monetary Fund (IMF) released the World Economic Outlook Update for July 2017, raising Sub-Saharan Africa's growth expectation in 2017 to 2.7%, from 2.6% previously, primarily due to an upgrade on South Africa's growth prospects to 1.0% from 0.8%. The upgraded outlook on Sub-Saharan Africa's growth prospects is expected to improve investor sentiment and encourage investment in the region. See a more comprehensive analysis on the IMF World Economic Outlook Update, and Kenyan Economic growth here.

Fixed Income Conclusion:

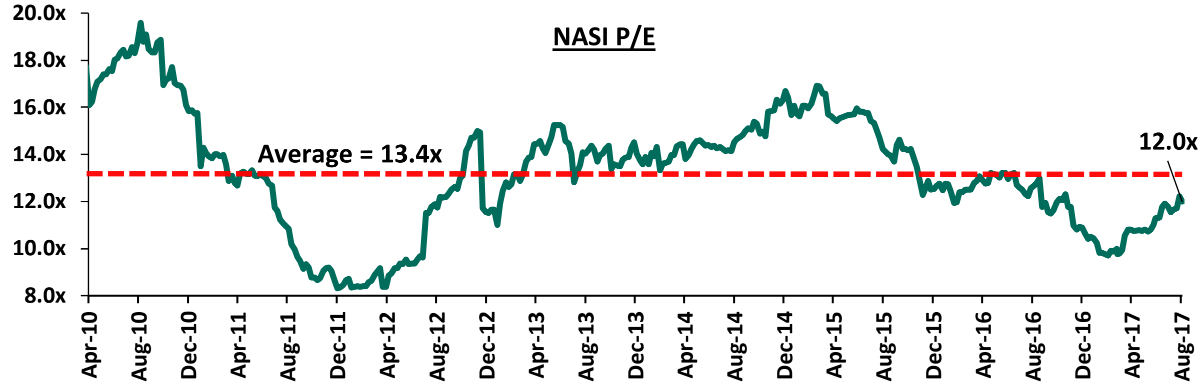
Rates in the fixed income market have remained stable, and we expect this to continue in the short-term. However, a budget deficit that is likely to result from depressed revenue collection creates uncertainty in the interest rates environment as any additional borrowing in the domestic market to plug the deficit could lead to upward pressures on interest rates. Our view is that investors should be biased towards short-term fixed income instruments to reduce duration risk.

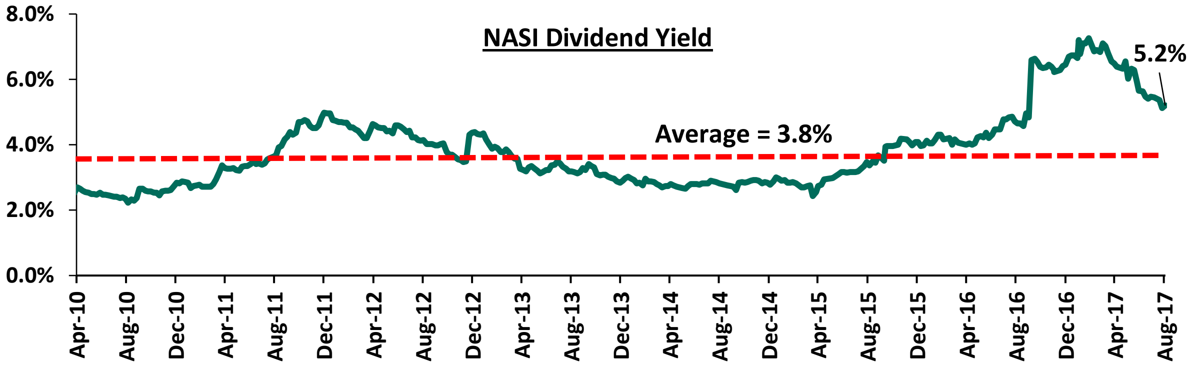
Equities

During the month of July, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 5.5%, 5.3% and 4.9%, respectively. As at the end of July, the YTD performance was 21.0%, 19.2% and 21.0% for NASI, NSE 20 and NSE 25, respectively. For this week, the equities market was on a downward trend with NASI, NSE 25 and NSE 20 losing 1.9%, 1.4% and 0.6%, respectively, taking their YTD performance to 18.6%, 19.4% and 18.5%, respectively. The equities market performance during the month was driven by gains in large caps, led by Diamond Trust Bank, KCB Group, Equity Group and Safaricom, which gained 15.0%, 7.9%, 7.9% and 7.7%, respectively. Since the February 2015 peak, the market has lost 10.9% and 31.3% for NASI and NSE 20, respectively.

Equities turnover increased by 23.9% during the month to USD 205.0 mn from USD 165.4 mn in June 2017, taking the YTD turnover to USD 996.7 mn. Foreign investors were net sellers for this month with net outflows of USD 19.7 mn, compared to net inflows of USD 7.7 mn witnessed in June 2017. YTD, foreign investors are net sellers with net outflows of USD 24.7 mn. We expect the market to remain bullish despite the slower corporate earnings growth in 2017 and the forthcoming general elections, as investors take advantage of the attractive valuations in the market, which is a temporary situation as we expect valuations to pick up after elections, if the elections are peaceful.

The market is currently trading at a price to earnings (PE) ratio of 12.0x, versus a historical average of 13.4x, with a dividend yield of 5.2% versus a historical average of 3.8%. The current 12.0x valuation is 23.6% above the most recent trough valuation of 9.7x experienced in the first week of February of 2017, and 44.3% 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.





As highlighted in our Cytonn Weekly #29/2017, during the month, the directors of Kenya Airways called for an Extraordinary General Meeting (EGM) to pass resolutions to allow for a balance sheet restructuring and a subsequent capital raise. We view the conversion as a positive move for the airline as it will boost the firm's equity position, reduce its overall debt burden, result in a significant boost in liquidity and cause changes in governance, which we believe will be beneficial for the firm, to drive the implementation of its turn-around strategy.

The office of the Attorney-General of Kenya published a new set of rules, the 'Companies (General) (Amendment) Regulations, 2017', that requires companies listed on the Nairobi Securities Exchange (NSE) to publish in their annual reports a breakdown of directors' pay, in a bid to increase transparency and strengthen corporate governance. As highlighted in our Cytonn Weekly #30/2017, this move is beneficial to investors since it will ensure information symmetry amongst shareholders, and is expected to result in greater disclosure, which is key to investors for decision-making thus boosting investor confidence. In line with these new rules, we recognise the efforts by 7 NSE listed firms, KenolKobil, Sanlam Kenya, Sameer Africa, KenGen, Deacons Kenya, Kenya Re-Insurance Corporation and Nairobi Securities Exchange, in setting the pace on transparency and disclosures by revealing what their CEOs earned last year, even though not required to publish such information by the regulation.

During the month a number of Kenyan listed banks received ratings from various global rating companies, as highlighted in our Cytonn Weekly #27/2017. These include (i) KCB Bank whose long-term and short-term national scale ratings of AA and A1+, respectively, were affirmed by Global Credit Ratings, with a stable outlook for the fourth straight year, and (ii) Co-operative Bank and Equity Bank whose capacity to continue mobilizing deposits from the domestic and global institutional investors in a capped interest rate environment was rated as "strong" by Moody's Investors Service. Rating is beneficial to the Kenyan banking sector as (i) banks with high ratings such as KCB Bank can easily raise capital at a lower cost due to the low risk associated with the firm, and (ii) it improves the image of the sector thus building investors' confidence.

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

KCB Group released H1'2017 results

KCB Group released H1'2017 results, recording a stable profit after tax of Kshs 10.26 bn from Kshs 10.28 bn in H1'2016, which translates to a 3.6% decline in core earnings per share to Kshs 6.7 from Kshs 6.9 in H1'2016, taking into effect a scrip dividend issue carried out last year; without the scrip shares, the core earnings per share would have remained flat at Kshs 6.9. Key highlights for the performance from H1'2016 to H1'2017 include:

- Total operating income grew by 2.8% to Kshs 34.6 bn from Kshs 33.7 bn in H1'2016, supported by a 2.9% growth in Net Interest Income (NII) and a 2.5% growth in Non-Funded Income (NFI),
- NII grew by 2.9% to Kshs 23.1 bn from Kshs 22.5 bn in H1'2016, following a 20.8% decline in interest expense to Kshs 7.2 bn from Kshs 9.1 bn in H1'2016, brought about by the effective management of the cost of funding, outpacing a 3.9% decline in interest income to Kshs 30.4 bn from Kshs 31.6 bn in H1'2016. This resulted in the Net Interest Margin (NIM) increasing to 8.7% from 8.1% in H1'2016,
- NFI increased by 2.5% to Kshs 11.5 bn from Kshs 11.2 bn in H1'2016, attributed to a 28.6% increase in fees and commissions on loans that came in at Kshs 3.1 bn from Kshs 2.4 bn in H1'2016, despite a 30.1% decline in other income to Kshs 1.6 bn from Kshs 2.3 bn in H1'2016. The revenue mix remains unchanged at 67:33 funded to non-funded income,
- Total operating expenses grew by 5.3% to Kshs 19.9 bn from Kshs 18.9 bn in H1'2016, on account of a 12.5% growth in staff costs to Kshs 9.1 bn from Kshs 8.1 bn in H1'2016, despite a decline in loan loss provision (LLP) by 2.4% to Kshs 2.0 bn from Kshs 2.1 bn in H1'2016. Without LLP, operating expenses grew by 6.3% to Kshs 17.9 bn from Kshs 16.8 bn in H1'2016,
- Cost to Income ratio worsened to 57.4% from 56.0% in H1'2016, as a result of increase in staff costs. Without LLP, the Cost to Income ratio worsened to 51.6% from 49.9% in H1'2016,
- Profit before tax decreased slightly by 0.5% to Kshs 14.75 bn from Kshs 14.83 bn in H1'2016, while profit after tax remained relatively unchanged at Kshs 10.26 bn from Kshs 10.28 bn in H1'2016,
- The loan book expanded by 16.7% to Kshs 407.0 bn from Kshs 348.7 bn in H1'2016, just above our expectations of a 15.7% growth, underpinned by strong performance in the retail and corporate segments,
- Customer deposits grew by 1.3% to Kshs 482.8 bn from Kshs 476.5 bn in H1'2016, with the slow growth attributable to the restatement of H1'2016 figures due to the devaluation of the South Sudanese Pound (SSP). Without H1'2016 restatement, customer deposits grew by 11.4% to Kshs 482.8 bn from Kshs 433.4 bn,
- Consequently, the faster growth in loans compared to deposits (when factoring in the restated H1'2016 figures) resulted into the loan to deposit ratio increasing to 84.3% from 73.2% in H1'2016.

Going forward, we expect KCB Group's growth to be driven by;

i. Review of the regional expansion strategy, with a key focus on consolidation of its regional business by optimizing performance in the existing markets while reducing the overall impact from South Sudan. The exit from non-profitable regional businesses would reduce the bank's costs by 5.4% points, translating to a 6.1% rise in profit before tax. KCB Group needs to focus on the much more profitable and stable Kenyan business,
ii. Revenue diversification with new business lines such as Bancassurance through KCB Insurance, as well as investment banking through KCB Capital and investment management. In our view, KCB Group is strong and can compete in fee income businesses. They should now focus more on fee-based business in order to grow non-funded income, which now accounts for 33.2% of the total operating income. Just pushing this to 40.0% would mean an additional 24.4% in revenues, and,
iii. Continued implementation of cost reduction measures through adoption of digital platforms and other alternative channels of distribution for both loan disbursement and deposit mobilisation, with 86.0% of transactions now carried out outside the branches. This will help the bank achieve efficiency and keep the cost to income ratio at manageable levels. Bringing the cost to income ratio to 48.4%, comparable to the average of Coop Bank and Equity Holdings, would deliver an additional 15.9% in revenues.

For a more comprehensive analysis, see our KCB Group H1'2017 Earnings Note.

Other releases in the month include:

- National Bank released H1'2017 results, recording a 42.2% decline in core earnings per share to Kshs 0.6 from Kshs 1.0 in H1'2016, attributed to a 29.8% decline in total operating income to Kshs 4.1 bn from Kshs 5.8 bn in H1'2016, but was cautioned by a 28.8% decline in total operating expenses to Kshs 3.8 bn from Kshs 5.4 bn in H1'2016. See NBK Earnings Note for details on National Bank results.
- Kenya Re-Insurance Corporation released H1'2017 results, posting a 4.0% growth in core earnings per share (EPS) to Kshs 2.3 from Kshs 2.2 in H1'2016, driven by a 7.1% growth in total income to Kshs 8.8 bn from Kshs 8.2 bn in H1'2016. This is despite an 8.3% growth in total costs to Kshs 6.5 bn from Kshs 6.0 bn in H1'2016. See Kenya Re H1'2017 Earnings Note for a more comprehensive analysis.
- CIC Group released H1'2017 results, recording a 3.5% decline in core earnings per share to Kshs 0.16 from Kshs 0.17 in H1'2016, attributed to a 25.5% increase in total expenses to Kshs 7.1 bn from Kshs 5.7 bn in H1'2016, despite a 24.2% increase in total revenue to Kshs 7.9 bn from Kshs 6.3 bn in H1'2016. See CIC Group Earnings Note for details on the results.
- Insurance Regulatory Authority released Q1'2017 numbers for the insurance industry with the market recording growth in total gross insurance premiums by 14.9% y/y to Kshs 67.2 bn from Kshs 58.5 bn in Q1'2016, compared to a 9.6% y/y growth registered the previous year. See Cytonn Weekly #28/2017 for details on insurance industry results.

Last month, we released the Cytonn Corporate Governance Index Report – 2017, which analyses the state of corporate governance in Kenyan listed entities, and ranks 50 of the listed firms with a market capitalization above Kshs 1.0 bn using 24 metrics based on their corporate governance structure. In order to ensure that the ranking of companies in the Cytonn Corporate Governance Report (Cytonn CGR) is up to date, we shall continually be updating the rankings whenever there are changes on any of the 24 metrics that we track and how they impact on the ranking. This week TransCentury Limited (TCL) appointed Mr. Wanjuki Muchemi to join its board as a Non-Executive director. TCL's score has now improved to 66.7% from 64.6% following increase in number of board members to odd number 9 from an even number 8. This improves TCL's score to position 22 from position 27. As highlighted in our Cytonn Weekly #27/2017, TCL has made gains towards better governance in the recent past following acquisition of 25.0% stake by Kuramo Capital, which highlights the benefits that private capital plays in better governance for companies with management, liquidity and capitalization issues.

Below is our Equities Universe of Coverage:

all prices in Kshs unless stated otherwise

No.	Company	Price as at 30/06/17	Price as at 31/07/17	m/m Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**
1.	NIC	33.5	33.8	0.7%	29.8%	51.2	3.7%	55.4%
2.	KCB Group***	37.8	40.8	7.9%	41.7%	54.7	7.4%	42.7%
3.	HF Group	10.5	10.5	0.0%	(25.4%)	13.9	3.5%	36.6%
4.	Barclays	10.0	9.9	(1.0%)	16.2%	12.1	10.2%	33.0%
5.	DTBK	160.0	184.0	15.0%	55.9%	241.1	1.7%	32.7%
6.	I&M Holdings	103.0	114.0	10.7%	26.7%	147.5	3.2%	32.6%
7.	Co-op Bank	17.0	15.7	(7.7%)	18.6%	18.5	4.9%	23.1%
8.	Jubilee Insurance	440.0	430.0	(2.3%)	(12.2%)	490.5	1.8%	15.9%
9.	Stanbic Holdings	71.0	80.0	12.7%	13.5%	77.0	5.9%	2.1%
10.	Liberty	11.4	12.8	11.8%	(3.4%)	13.0	0.0%	1.8%
11.	Kenya Re	20.8	21.3	2.4%	(5.6%)	20.5	4.4%	0.9%
12.	Standard Chartered	208.0	221.0	6.3%	16.9%	209.3	4.7%	(0.6%)
13.	Equity Group	37.8	40.8	7.9%	35.8%	38.4	4.9%	(0.9%)
14.	Britam	12.7	14.5	14.2%	44.5%	13.0	1.9%	(8.2%)
15.	Safaricom	22.8	24.5	7.7%	27.9%	19.8	4.7%	(14.6%)
16.	CIC Group	4.1	4.9	18.3%	27.6%	3.7	3.2%	(20.3%)
17.	Sanlam Kenya	28.8	27.0	(6.1%)	(1.8%)	21.1	0.0%	(22.0%)
18.	NBK	8.9	9.6	7.3%	32.6%	4.0	0.0%	(57.9%)

**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 5th largest local institutional investor*

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

Private Equity

During the month, we witnessed investment activity in the education and FMCG sectors, and fundraising activity focused on the technology, financial services and FMCG sectors.

In the Education Sector:

1. Actis, a London based private equity firm, launched the first African private higher education network, Honoris United Universities, bringing together the leading tertiary education institutions in North and Southern Africa. Actis is expected to spend at least USD 275.0 mn to acquire leading universities across nine African countries, which include Tunisia, Morocco, South Africa, Namibia, Mauritius, Botswana and Zimbabwe. For more information, see our Cytonn Weekly #29/2017.
2. Verod Capital Management, a Nigerian based private equity firm, through Oreon Education, has committed to acquire an undisclosed minority stake in Greensprings Educational Services Ltd (Greensprings). Greensprings is a Nigerian based educational service provider established 32-years ago and provides pre-primary, elementary, secondary and post-secondary schooling for both day and boarding students. For more information, see our Cytonn Weekly #30/2017

We expect to see an increase in investment in the education sector in Sub-Saharan Africa, as investors are motivated by (i) Increasing demand for quality and affordable education, with the Gross Enrolment Ratio (GER) having doubled in the last 10-years to 8.5% in 2016 from 4.5% in 2006 according to a report, “The Business of Education in Africa” by Caerus Capital, and (ii) support, such as ease of approvals, offered to investors in the education sector by governments looking to meet Sustainable Development Goals (SDGs) targets of universal access to tertiary education.

In the FMCG Sector:

1. The Abraaj Group, a Dubai-based private equity investor is set to acquire a 100% stake in Kenya’s Java House Group (Java) after it emerged the top bidder among a group of institutional investors including Actis, headquartered in London, Washington-based Carlyle Group and San Francisco-based TPG, who were all looking to acquire the food chain. The transaction, whose value is undisclosed, but is estimated at Kshs 13.0 bn, will see Washington-based Emerging Capital Partners (ECP) give up their 90.0% stake in the business and the food chain’s founder Kevin Ashley his 10.0% stake. For more information, see our Cytonn Weekly #27/2017.
2. South African based firm, Coca-Cola Beverages Africa Proprietary Limited (CCBA), which is Africa’s largest Coca-Cola bottler, acquired Kisumu based Equator Bottlers, an authorized Coca-Cola Bottler, for an undisclosed amount. The acquisition was through a share purchase agreement between Equator Bottlers and Coca-Cola Sabco East Africa Limited (CCSEAL), which is a fully owned subsidiary of CCBA. The acquisition is in line with CCBA’s expansion plan into other African countries and will also provide Equator Bottles with an opportunity to leverage on CCBA’s resources and expertise to improve its operations and distribution. For more information, see our Cytonn Weekly #27/2017.

This continued investment in the FMCG sector in Sub- Sahara Africa is driven by (i) increase in disposable income spent on consumables, such as beverages and processed food products, (ii) infrastructural developments, such as improved road and transport networks, (iii) ease of access to FMCG products, and (iv) growth in the retail sector.

Other Key PE Highlights:

1. EFG Hermes Holding S.A.E, through its subsidiary Egyptian investment bank, EFG Hermes, has acquired a 51.0% stake in Frontier Investment Management Partners LTD (FIM) for USD 21.5 mn, effectively valuing FIM at USD 43.0 mn. FIM is an asset manager that operates in Middle East and has USD 1.6 bn of assets under management. For more information, see our Cytonn Weekly #29/2017.
2. Centum Investments is set to acquire Aureos East Africa Fund's 6.8 mn shares in Deacons, equivalent to a 5.53% stake for an undisclosed amount. Aureos East Africa is part of the Abraaj Group, a Dubai-based private equity investor. With the Deacons' shares trading at Kshs 3.50, at a P/B of 0.3x, the total value of shares set to be acquired by Centum will equal Kshs 23.5 mn.
3. According to a report by I&M Burbidge, Mergers and Acquisitions dominated East Africa's deals in the first seven months of 2017. There are 35 deals recorded so far in the year, with a disclosed value of USD 1.1 bn. 23 of the recorded deals are Mergers and Acquisitions, accounting for 65.7% of the total deals, while the private equity deals stand at 12. There is a 30.0% decline in number of deals and a 6.7% decline in deal volume from the same period last year. By July 2016, there were a total of 50 deals with a disclosed deal value of USD 1.2 bn; 24 Mergers and Acquisitions and 26 private equity deals. The decline can be attributed to a slowdown in private equity activity in Kenya mainly due to the forthcoming elections. In 2016, Kenya contributed 61.0% and 80.0% of the East Africa's total deal volume and deal value, respectively. Despite the decline in the number of deals, we maintain our outlook on Kenya and East African region as an attractive destination for investors looking for long-term investments.

On the Fundraising Front:

1. Kenya's Twiga Foods Ltd, a mobile based business to business food supply platform has successfully raised USD 12.78 mn (Kshs 1.3 bn) in funding. The investment which is made up of USD 6.3 mn in equity, USD 4.0 mn in debt and USD 2.8 mn in grant funding from will go toward expansion of the business by enabling it to increase the number of vendors, diversify its product portfolio, and introduce advanced supplier services. 11 firms have contributed into the investment including Dutch PE firm DOB Equity and South African based private equity investor, Uqalo, who had previously bought stake in Twiga Foods. Uqalo bought 5.5% stake in Twiga in May 2016 for USD 375,000 effectively valuing the business at USD 6.9 mn, while DOB Equity bought a minority stake for an undisclosed amount in August 2016.
2. Digital Cabinet, a technology firm based in South Africa, offering cloud-based paperless document and workflow management solutions, is looking to raise USD 379.7 mn capital. Digital Cabinet has mandated HAVAÍC, a South Africa based investment and advisory firm, to undertake the capital raise. Funds from the capital raise will be utilised to (i) undertake a brand campaign through marketing to create its product and brand awareness, and (ii) improve on operational efficiency of the company. The raise will be done through the issue of shares and the conversion of the convertible loan, extended to investors in July 2016, into equity. For more information, see our Cytonn Weekly #28/2017.
3. Yeelen Capital, a West African based private equity fund manager set up by Cauris Management and Finactu, announced the first close of the Yeelen financial Fund at USD 34.2 mn. Yeelen Capital was selected by the West African Development bank to raise, operate and invest the fund in companies in the financial services sector at all stages of development in countries in the West African Economic and Monetary Union (WAEMU) area. The funds will be invested in quasi-equity investments that range from USD 2.2 mn to USD 17.1 mn in size. The newly set up fund manager targets to have its second close at the end of 2017 at USD 85.6 mn and the final close at USD 171.2 mn by the end of the year 2018. For more information, see our Cytonn Weekly #28/2017.

The successful fundraising activity by Private Equity firms indicates a positive outlook by investors in the Sub-Saharan Africa private equity space, motivated by the continued growth in the sector and an increasing number of successful exits, with a 9.1% increase in the number of successful exits recorded in 2016.

Private equity investments in the Sub-Sahara African Region remains robust as evidenced by the increased deal flow in a number of sectors that support growth. The increasing investor interest in private

equity investment in sub-Sahara Africa is attributed to (i) rapid urbanization, a resilient and adapting middle class and increased consumerism, (ii) the attractive valuations in the private markets compared to the public markets, (iii) the attractive valuations in Sub Saharan Africa's markets compared to global markets, and (iv) better economic projections in Sub Sahara Africa compared to global markets. We remain bullish on PE as an asset class in Sub-Sahara Africa. Going forward, the increasing investor interest and stable macro-economic environment will continue to boost deal flow into the market.

Real Estate

In July 2017, there was increased activity in the commercial office and industrial sectors with the launch of projects in various parts of the country. Researchers, at Hass Consult and Kenya Bankers' Association, however highlighted a slowdown in house prices and sales in Q2'2017, citing reduced demand as investors and prospective house-buyers put off house-purchase decisions due to political uncertainty as we near the 2017 General Elections. The following are the main highlights in the various real estate themes in July 2017.

Commercial

A. Office

Supply of office space in Nairobi is set to increase in the next 2 to 3-years despite the looming oversupply in the market of approximately 3.2 mn square feet in 2017. This month we saw the following activities that are likely to increase office space supply:

i. It was announced that the World Bank would fund construction of a USD 30 mn office complex at an undisclosed location that will house various parastatals such as Kenya National Highways Authority (KenHA), Kenya Urban Roads Authority (KURA), Kenya Rural Roads Authority (KERRA), the Engineers Board of Kenya, the National Construction Authority and the National Transport and Safety Authority. The complex, developed by Chinese firm, AVIC, will include 350,000 square feet of office space, a 500-seater auditorium and a service building, and,
ii. Kasarani Investments Holdings Ltd, a subsidiary of Garden City developer Actis, announced plans to start construction of a business park comprising of 600,000 square feet of office space, a hospital, hotel and a residential village adjacent to the Garden City Mall along Thika Road, in November 2017.

In our Nairobi Commercial Office Report 2017, we projected an addition of 3.49 mn square feet of office space in Nairobi in 2017 and a further 4.32 mn square feet in 2018 as seen through building approvals obtained against a market uptake of 88%, resulting to an oversupply of approximately 3.2 mn square feet in 2017 and 3.9 mn square feet in 2018. The above shows that the office sector has continued to attract investment, and this can be attributed to high yields of 9.3% on average in commercial offices, compared to other sectors such as residential, which average 6.0%, and the warehousing sector at a 5.9% yield in 2016. Considering the oversupply, developers ought to invest in research before embarking on office space development. According to our Cytonn Real Estate research, the opportunity in office space lies in i) Grade A offices, which still have the lowest market share at 10.0%, despite having average rental yields of 10.0% and average occupancies of 85.7%, ii) differentiated concepts such as Mixed Use Developments, which have multiple revenue streams hence diversifying risk, iii) serviced offices, which have an average rental yield of 13.5% at a 66.0% occupancy level, and iv) development in zones with low supply such as Gigiri, which has a market share of only 1.8%, thus showing opportunity for development.

Also, this month, Nairobi Business Park, a Grade A office park along Ngong' Road was put up for sale at Kshs 2.6 bn. The development is said to have Kshs 152.0 mn in rental income annually, translating to a 5.8% yield to an investor, with an 85.0% average occupancy in 2016. This is low compared to the market average, with Grade A offices delivering a 10.0% rental yield and 85.7% occupancy, according to Cytonn Research. In our view, prospective investors will have to bid lower to achieve the best returns on investment.

B. Industrial

In the industrial sector, we witnessed an increase in investment and uptake of warehouse and industrial space in Special Economic Zones in Eldoret and satellite towns away from traditional zones such as Industrial Area and Mombasa Road. This month the following activities were noted:

i. The Kenyan Government signed a USD 1.9 bn project with a Chinese firm, Gongdong New South Group Ltd, to construct a 700-acre special industrial zone in Eldoret as highlighted in Cytonn Weekly #27/2017,
ii. Gallagher Power Fence Systems Limited, a New Zealand security company, announced plans to construct 24 warehouses in Tatu City, commencing September 2017, and,
iii. Friendship Container Manufacturer's Limited (FCML) is establishing a metal and plastic packaging plant at the Tatu City covering an area of 15,000 square metres.

We attribute the migration of industrial firms to satellite towns to availability of affordable land for development, improved infrastructure, the need for more space for storage, expansion, parking and circulation and cheaper rents with areas such as Athi River charging an average of Kshs 25.0 per square foot for warehouse space, with rent in the traditional Industrial Area and Baba Dogo in the city ranging from Kshs 38.0 to Kshs 44.0 per square foot. With the expansion of the Kenyan port, the launch of the Standard Gauge Railway (SGR), development of the dry port in Naivasha and development of the LAPPSET Corridor, we expect to witness increased uptake of industrial space in Nairobi's satellite towns and other industrial zones.

C. Retail

In the retail sector, local supermarket chain, Naivas continued its expansion strategy as it officially opened its newest store at Kiambu Road's Ciata mall, occupying 35,000 square feet of floor space as the anchor tenant. This comes at a time when other retailers such as Uchumi and Nakumatt have come under severe financial strain with large supplier debts. In our view, retailers ought to optimise their returns through research on the target market, the population size, income and shopping characteristics to meet their needs whereas developers need to address circulation and parking space requirements so as to sustain foot-fall and thus boost revenues. There is also need for proper management given that supermarkets are often the anchor tenants to malls in Kenya, thus impacting the performance of other retailers within malls.

In our view, there is an opportunity in retail investment given the increasing disposable incomes and the expanding middle class population in Kenya. According to our Kenya Retail Report 2016 neighbourhood malls in Karen and Kilimani have the highest yields at 14.9% and 10.6%, respectively, with average occupancy at 94.0% and 86.0%, respectively.

Residential

The residential sector is likely to witness an increase in en-masse housing development as the Kenyan Government this month announced the lowering of the threshold for real estate development entitlement for the 15% corporate tax relief from 400 units annually to 100 units. It is a move in the right direction as it will enable more developers including cooperative societies provide the much-needed affordable housing especially to the middle and lower income segments.

In line with our projection of lower transaction volumes and prices in Q2 and Q3 of 2017 in our Focus of the Week dated 19th February 2017, on The Effect of the Elections on the Real Estate Environment in Kenya, two reports were released indicating a slow-down in market prices in Q2 of 2017. Hass Consult released their House Price Index showing a 3.1% q/q drop in sale prices, and a 2.0% q/q drop in rental prices. Detached houses recorded the biggest q/q price drop at 4.0%, while apartments recorded a 1.4% q/q price drop.

House Price Change (%) q/q from 2015 to 2017			
House Price Index	**Q2 2015**	**Q2 2016**	**Q2 2017**
Hass Composite Sales Index	2.2%	3.6%	(3.1%)
Hass Composite Letting Index	2.4%	2.0%	(2.0%)

*Q2 2017, recorded a negative price change, compared to positive price change in Q2'2015 and Q2'2016, mainly associated with the upcoming general elections, that have made investors shy away.

Source: Hass Consult

Kenya Bankers' Association also released their Housing Price Index for Q2'2017 highlighting a slower growth in property prices at 0.99% compared to a 1.10% increase in Q1'2017. Other key highlights from the index were;

i. Apartments registered the highest rise at 1.0% compared to prices of bungalows and maisonettes at 0.3% and 0.4%, respectively, indicating higher demand for more affordable units given the lower cost of construction per unit on the developers' side and therefore relatively lower prices for sale,
ii. Apartments accounted for 82.7% of the total number of units sold in Q2'2017 with maisonettes and bungalows accounting for 10.7% and 6.6%, respectively, mainly due to affordability,
iii. The main house price drivers remain to be the size of the house, number of bedrooms, bathrooms, a backyard presence, parking space, balcony and a separate dining area, with buyers willing to pay higher for more space, whereas the presence of a Domestic Servants Quarters (DSQ) and swimming pool had an insignificant effect on prices during the quarter.

House Price Change (%) from 2016 to 2017						
House Price Index	**Q1 2016**	**Q2 2016**	**Q3 2016**	**Q4 2016**	**Q1 2017**	**Q2 2017**
KBA HPI	1.40%	1.72%	2.20%	1.58%	1.10%	0.99%
The KBA HPI shows the slowdown in price increase from 1.58% in Q4 2016 to 1.1% in Q1 2017 to 0.99% in Q2 2017 due to political sentiments as investors wait to see the outcome of the elections						

Source: Kenya Bankers' Association

The slow-down in market prices and sales can be attributed to slow economic growth given political sentiments as we are in an election year and thus investors and prospective buyers have adopted a wait and see approach. In addition, there has been a decline in credit growth from 18.0% in 2015 to 2.1% as at May 2017 in the private sector with the enactment of the banking act that capped interest rates at 4.0% above the Central Bank Rate. This has made it more difficult for those who wish to finance real estate transactions to secure mortgages, as banks are now unable to factor in 'high risk borrowers' within the stipulated margins.

In our opinion, this is a temporary phase and we expect the market to stabilise on back of relatively strong GDP growth, on average 5.4% in the last 5-years, the relatively high returns in real estate, the middle-class growth and urbanisation rate at 4.4%, that have created demand for real estate. However, in the near-term, there will be price stagnation in selected markets with surplus supply. Investors therefore need to invest in proper market research and trend analysis to identify specific market niches.

<u>Hospitality</u>

In the hospitality real estate market, Sarova Group officially opened a 3-star hotel in Nakuru on 2-acres in the up-market Milimani Estate. This will be their 2nd hotel, in addition to the Sarova Lion Hill Game Lodge, in the growing town that banks on wildlife, lakes and sceneries to attract tourists. In Nairobi, Mifta Holdings Ltd, a real estate developer, announced plans to build serviced apartments on a 0.4-acre plot in Kilimani behind Adlife Plaza. The increase in hotels and serviced apartments in tourist and business hotspots will foster healthy competition among service providers thus increase the level of innovation and services provided to the consumer,

<u>Listed Real Estate</u>

Stanlib Fahari I-Reit released their H1'2017 earnings, posting earnings per unit of Kshs 0.43 for the 6-month period ending June 2017, realizing a 220.8% y/y growth from Kshs 0.13 in H1'2016. This was mainly driven by a 30.0% decline in operating expenses to Kshs 112.5 mn from Kshs 160.8 mn in H1'2016. In addition, the REIT has no debt, thus no financing costs compared to the previous period, which had Kshs 23.0 mn in financing costs. Key highlights for the performance from H1'2016 to H1'2017 include:

- Rental income grew by 14.2% to Kshs 138.0 mn, from Kshs 120.9 mn in H1'2016 attributed to the rental income generated by the 3 real estate assets they manage; Greenspan Mall, Bay Holdings and Signature International Properties, with a total portfolio vacancy rate of 5.0%,
- Income from other sources declined by 39.4% to Kshs 52.9 mn from Kshs 87.3 mn in H1'2017. This is because during H1'2016, the REIT realized bargained purchase gains of Kshs 25.2 mn from acquisition of 2 of the properties in their portfolio,
- Operating expenses stood at Kshs 112.5 mn, of which 62.7% was attributed to fund-operating expenses such as audit, trustee fees and license fees, while property expenses accounting for 37.3% including maintenance of tenants and properties, filling vacancies, marketing and public relations. This remains concerning as it shows that approximately 60% of the revenues are going to professional fees, a clear indicator that the whole arrangement is primarily in the interest of the commercial interests around the REIT rather than the investor,
- Net Profit grew by 220.8% to Kshs 78.3 mn, from Kshs 24.4 mn in H1'2016. This is on account of the 30.0% decline in expenses and no financing costs,
- The Net Asset Value (NAV) closed at Kshs 19.8 per unit while the stock closed trading at Kshs 12.2 per unit on 31 July 2017.

The REIT is likely to maintain stable, albeit low, income streams in the next 2-years with a total portfolio vacancy rate of 5.0%. For the investor, the REIT has continued to deliver low returns, shedding 39.0% of its value since its listing in November 2015 at Kshs 20.0 per share. There is need to align its interests with those of the investors, as currently more than half of the income goes into fees.

To boost the listed Real Estate Sector, the Capital Markets Authority (CMA), in July, backed the exemption of Real Estate Investment Trusts (REITs) from Value Added Tax (VAT), which accrues to both rent and professional services, in addition to exemption from Stamp Duty and Capital Gains Tax. The regulator hopes that this incentive will spur interest in the product that opens up the property market for retail investors as the Stanlib Fahari i-REIT is the only REIT in the market. Despite these efforts, the tax exemptions remain difficult to access because the exemptions have not been automatically coupled up with the REIT product, and in most cases require a separate engagement with the Kenya Revenue Authority, KRA, to effect. The structure of the REIT ought to be such that an approval and registration of a REIT by CMA will automatically come with all the tax benefits.

This week, KENHA (Kenya National Highways Authority) with Bechtel International, a contractor based in the USA, signed the contract to start construction of the new 473 km Nairobi-Mombasa Superhighway. The project has been structured, under a fast-track delivery model, to be complete within 6-years and is expected to be financed by US Export Credit Agencies such as the US Export-Import Bank and the Overseas Private Investment Corporation (OPIC). The development highlights the continued focus of the government on improving infrastructure and is expected to bring about benefits such as (i) better connectivity between Nairobi and the country's main sea port of Mombasa, (ii) promotion of trade in Kenya and other land-locked countries that rely on the Mombasa port, (iii) creation of employment opportunities (iv) support development of a Master Plan for 3 Special Economic Zones, and (v) boosting development in the upcoming master-planned cities along the highway such as Newtown City, the Konza ICT City and the Leather City, as a result of 19 interchanges created between Nairobi and Mombasa. This is in addition to other road projects in the pipeline including the expansion of Waiyaki Way, the upgrade of Ngong Road into a dual-carriage way and the construction of the Changamwe-Mariakani dual carriageway.

While the real estate sector is witnessing lower transactions volumes, with peaceful elections, we expect the market to pick up on the back of relatively high returns in real estate averaging at above 20% in the last 5 years, government incentives to boost development, infrastructural development, an attractive demographic profile with 2.6% population growth and an expanding middle class, all positive factors that will drive the sector.

Focus of the Week: Post-Election Business Environment

On 8th August, 2017, Kenyans will take to their registered voting stations to elect their Government, in what will be Kenya's 6th General Election since they adopted a multi-party system, and the 2nd General Election under The Constitution of Kenya, 2010.

The Kenyan General Elections, 2017, is shaping to be a unique election for four main reasons:

- It has the highest number of contesting candidates at 16,259 compared to 12,400 in 2013,
- It is definitely the most hotly contested election in our history, so it raises the stakes, and from recent surveys, it is very closely contested, with the latest IPSOS polls placing Uhuru Kenyatta at 47% and Raila Odinga at 44%, and the latest Info track poll placing Uhuru Kenyatta at 48% and Raila Odinga at 48%,
- It is the most expensive election ever held with Kshs 49.9 bn expected to be expended by the electoral body, up from Kshs 35.0 bn in 2013, as per the Pre-Election Economic and Fiscal Report, and
- As a nation, we have never been more prepared in terms of electoral governance and oversight, with an independent judiciary, we have taken lessons from the last two elections, which have ended up being contested, and a lot of the electoral matters have been litigated upfront – we have had about 22 cases relating to electoral process, with 2 pending cases to be heard and determined this coming Monday, the eve of the election.

There has been a lot of discussion and anxiety about stability and business environment after the elections. Will we have post-election violence as we did after the 2007 elections? What should the business community expect after the elections?

In this note, Post-Election Business Environment, we take a look at election preparedness and try to assess whether we have the right foundations to run a free and fair election. Our view is that because of the significant institutional reforms that have taken place so far and the level of election preparedness, it is highly likely that we shall have a largely free, fair and credible election; and if that were to happen, we do not see post-election violence, contrary to popular sentiment.

To determine whether or not to expect post-election violence, we looked at five key indicators of a peaceful election, relative to the past two elections: integrity and independence of the electoral body, integrity and independence of the judiciary, election preparedness, international process and monitoring, and market sentiment;

Integrity and independence of the electoral body: The electoral body, being one of the bodies that carry the largest responsibility in any elections, need to be independent and impartial to any external influence or powers-that-be that may want to skew the process to their advantage. The previous body, The Electoral Commission of Kenya, was far from independent, as the members were appointed by the President. The Independent Electoral and Boundaries Commission (IEBC), constituted a year after the promulgation of The Constitution, 2010, is an independent body tasked with conducting elections of any elective body or office established by the Constitution, and any other elections as prescribed by an Act of Parliament. It's scope of duties is prescribed by The Independent Electoral and Boundaries Commission Act, 2011, which provides for the appointment and effective operation of the IEBC. Compared to 2007, where we witnessed widespread violence, having an independent electoral body is a **positive** step to ensuring a credible electoral process.

Integrity and independence of the judiciary: The pre 2010 judicial approach to litigation led to the distrust in the court system, a major reason that has been cited as a cause for the 2007 post-election violence. Pre 2010, the Judiciary served as a formalistic, technical and rule bound body, but the Constitution of Kenya, 2010, transformed it to a more purpose driven body that would enable the judiciary dispense substantive justice. There is no better way that this is exemplified than the following reasons;

- There is increased litigation space with Kenyans, in their personal capacities, able to approach The High Court to seek redress and/or guidance on all matters pertaining to the election;
- The Court has increasingly acted independently exercising its power not only to interpret statute but also request for information where it deems it necessary in making a decision. This can be

highlighted in the case of Raila Odinga vs IEBC & 3 Others (2013) where the main grievance was with regards to the irregularities involved in (i) the partial employment of the biometric system technology, before reverting to the manual process, (ii) the maintenance of a Voter Register, and (iii) the tallying of votes. The Supreme Court on its own motion ordered a scrutiny of all records (without being prompted by either side) used in the Counties 33,400 polling stations, to enable them rule that it was not evident, on the facts, that the candidate declared as the President-elect had not obtained the basic vote-threshold justifying his being declared as such.

- The bringing forth of issues that would likely dispute the validity of an election process, prior to the running of the process thus providing clarity before election and reducing the incidences of disputes that may occur after the carrying out of an election and the declaration of the results. Examples include:
    a. In the case of Maina Kiai, Khelef Khalifa and Tirop Kitur vs IEBC (2016), where they challenged the powers of IEBC to make any alterations to the results from the Constituency Level, it was ruled at both the High Court and the Court of Appeal that the results from the Returning Officers at the Constituency Level be deemed as final;
    b. In the case of IEBC vs NASA, Al Ghurair Printing & Others (2017) where the petition, argued up until the Court of Appeal, already addressed the question as to whether the tender for the printing of the ballot papers was awarded in line with the principles of the constitution; Matter dispensed with and a question as to whether the ballot papers were compromised at printing cannot arise after the election; and
    c. In the case of NASA vs IEBC & 2 Others (2017) where the petition was also dispensed with and confirmed that the use of the manual system in identifying and transmitting results was in order with the Law that required a complementary system that adds on and improves the previous one to address any possible failures of the electronic system.

Going into the elections it is clear that the judicial body has a high degree of independence and objectivity, and this has a **positive** impact towards the electoral process.

Election Preparedness: With only a few days left to the 2017 Kenya General elections, the IEBC shared its preparedness strategy in line with its readiness to handle the upcoming elections in a smooth, free and fair process. Previous elections have largely been plagued by the following issues:

- Delays and irregularities of procurement of the integrated elections management system, which led to several polling stations receiving the election materials late,
- Laws, especially those skewed towards integrity and leadership left unenforced by relevant authorities, and
- Technological and administrative problems with regard to voter registration, leaving some voters having not exercised their voting rights.

The IEBC's 5-point strategy which involves (i) auditing electronic equipment, (ii) improving the ICT department, (iii) implementing electronic voting, (iv) earlier delivery of the devices to the polling stations, and (iv) having an election day plan, seeks to address this.

The main improvement has been the acquisition of a full proof system that shall identify voters biometrically reducing chances of human error - The Kenya Integrated Elections Management System (KIEMS) which serves to (i) identify and authenticate voters, (ii) monitor voter turnout (iv) transmit election results, and (v) stem election fraud. The IEBC has also invested a lot in voter education with regard to the electoral process, to ensure that the process runs smoothly with little issues. With an approval rating of 72.4% as per The Africa Centre for Open Governance (AfriCOG) Report on Kenya's preparedness to the 2017 General Elections, it indicates that the public is also confident in the IEBC delivering its mandate.

In addition to the aforementioned, IEBC has developed the Elections Results Management Framework which in turn clarifies the procedure of results management at each step and acts as a guide to managing elections results procedure. The level of preparedness towards the General Elections is a **positive** step, compared to the previous election years, in ensuring a free and fair election.

International presence and monitoring: The constant fear about violence every election year roughly translates into a one percent point drop in growth for Kenya's economy owing to investors, both foreign and international, waiting to witness the perception of the results. In spite of this, "*second tier*" economies in Africa such as Kenya, Tanzania, Mozambique and Egypt are expected to sustain high growth rates according to the Africa Attractiveness Report 2017 by EY. There has also been significant international presence and investment in the country and this increases the international observance on the Election process, with international companies such as GE, IBM, Google, Volkswagen and The World Bank setting up shop.

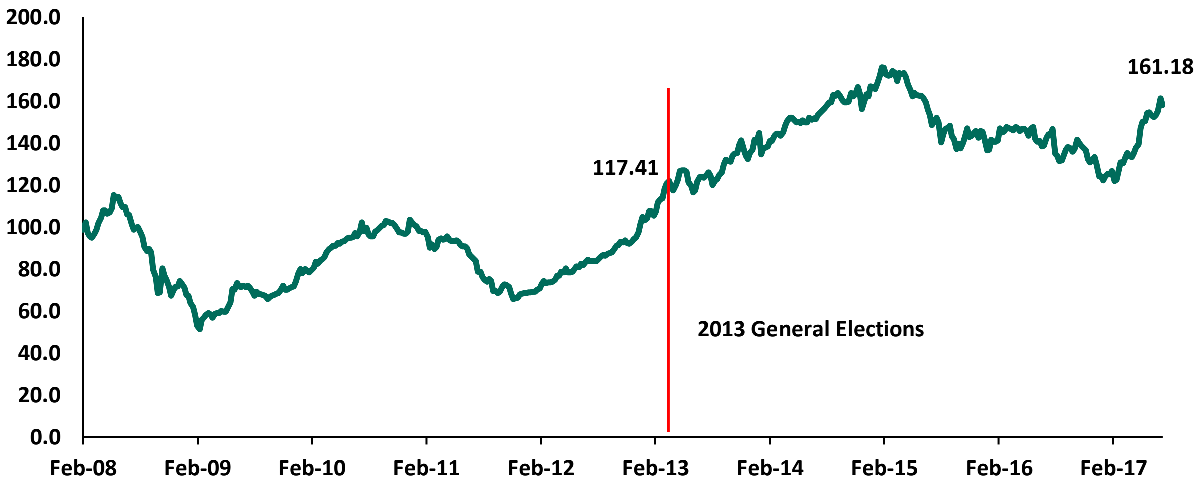
Prior to the Election, Kenya hosted over 200 global and continental meetings and high profile conferences inclusive of the United Nations Conference on Trade and Development (UNCTAD) and the Tokyo International Conference on African Development (TICAD) cementing its place as a key investment hub in East Africa. Foreign investors look at Kenya as their entry point into the East and Central African region, and given their massive investment and commitments to the country, the level of international observance and presence has never been this high, a **positive** indicator, in that it is in the best interest of both investors and Kenyans that the elections are carried out in a free and fair manner,

Market Sentiments: As markets are always forward looking, we used the NSE as a proxy for market expectations and sentiment. So far, the equities market has rallied 21.0% since the beginning of the year, however, asset valuations remain increasingly low and attractive for investment, as we have highlighted below. It is expected that the markets will continue to rally, with asset valuations rising further, if the elections are conducted in a peaceful and credible manner.

Historically, market valuations have remained independent of the effect of a general election. In the months surrounding the March 2013 election, the NASI P/E ratio was on the rise, attributable to a general rise in stock prices during the period, where between January 2012 and December 2014, the NASI experienced attractive levels of growth, gaining 59.5%. This was on the back of gains of 29.0%, 19.2%, and 3.8% in 2012, 2013, and 2014, respectively. It indicates that the market's confidence during this period was not swayed by the election.

With (i) the currency having held steady, only depreciating by 1.4% YTD against a globally strengthening dollar, and (ii) yields on the 5-year and 10-year Eurobonds, having declined by 0.3% and 1.4%, respectively, this highlights further the positive investor sentiment towards Kenya. Given that the market has rallied over 60.0% post 2007, it is clear that the market sentiment towards the Kenyan growth potential is high and independent of elections. This metric highlights a **positive** outlook towards the elections.

NASI Indexed Performance



Conclusion

Indicator	Description	Conclusion
Integrity and independence of the electoral body	The formation of an independent electoral body, The Independent Electoral and Boundaries Commission (IEBC), replacing the flawed and compromised Electoral Commission of Kenya, is a step in the right direction in ensuring that the Kenyan Electoral Process is conducted in a free and fair manner	**Positive**
Integrity and independence of the judiciary	The pre 2010 judicial approach to litigation led to the distrust in the court system, a major reason that has been cited as a cause for the 2007 post-election violence. Pre 2010, the Judiciary served as a formalistic, technical and rule bound body, but the Constitution of Kenya, 2010, transformed it to a more purpose driven body that would enable the judiciary dispense substantive justice	**Positive**
Election preparedness	Following the release of IEBC's 5 point strategy to tackle the electoral process and curb the issues faced during the last elections, it is clear that they are more prepared to conduct the election in a free and fair manner	**Positive**
International presence and monitoring	Given the degree and level of international investment in the country highlights the level of observance towards the General elections. This highlights that it is in the best interest of both investors and Kenyans that the elections are carried out in a free and fair manner	**Positive**
Market Sentiments	Given that the market has continued to rally, defying the electioneering period, it is a clear indicator that the foreign sentiment towards Kenya remains high and there is high expectation of a peaceful election and smooth transition thereafter	**Positive**

From the above factors, with all having a **positive** outlook towards the elections, it is clear that Kenya is ready for an election from both a legal, operational and oversight perspective. With (i) the electoral and judicial processes having undergone major changes to ensure their independence and integrity, (ii) the IEBC having a clearly thought out process for the election and having invested heavily in voter education, and (iii) the magnitude of foreign investment and confidence in the country, Kenya has the right foundations to run a smooth, free and fair election.

What Kenyans want is a fair, peaceful and credible election; for elections to be free and fair they must be (i) run by way of secret ballot, (ii) conducted by an independent body, (iii) administered in a transparent, impartial and accountable manner, and (iv) free from intimidation, corruption, threats, violence and other improper influence. If this is delivered, Kenyans are likely to accept the outcome and we shall have a peaceful transition to a new Government, or a peaceful continuation of leadership for the incumbent. A peaceful transition through an election is essential for any country, especially a developing nation. For Kenya as a nation, observing the equities market as an example to assess foreign investor sentiment towards the upcoming elections, it is clear that foreign investors have already priced in a peaceful elections and are invested in the Kenyan growth story.