Structured High Yield Investment Products, & Cytonn Weekly#43/2017

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Executive Summary

Fixed Income: T-bills were undersubscribed for the 7th week in a row, with the overall subscription rate coming in at 34.2%, compared to 46.7% recorded the previous week, as the liquidity in the money market remained tight due to payment of taxes and reverse repo maturities. Yields on the 91-day paper declined to 8.0% from 8.1%, while that of the 182-day paper rose to 10.4% from 10.3%, with that of the 364-day paper remaining unchanged at 11.0%. Meanwhile, the National Treasury has cut Kenya's GDP growth projection for 2017 down to 5.0%, from 5.5% previously;

Equities: During the week, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 3.2%, 2.9% and 2.4%, respectively, taking their YTD performance to 19.9%, 17.4% and 14.5% for NASI, NSE 25 and NSE 20, respectively. Global Rating Agency, Fitch, supported the Central Bank of Kenya's (CBK) intention to push for the repeal of the Banking (Amendment) Act, 2016 that has been in effect for a year now, due to the negative effect it has had on private sector credit growth;

Private Equity: Mace, a UK-based global construction and consultancy firm, has acquired an undisclosed stake in Kenya's quantity surveying firm YMR, highlighting continued foreign investor interest in the Sub Saharan Africa region. On exits, Quantum Global, the Africa-focused private equity and infrastructure investment manager, has exited its investment in Saruji, a building construction company after the sale of its 49.0% stake in the company. Saruji is the majority shareholder in Savannah Cement;

Real Estate: The electioneering period continues to negatively impact the property market resulting in 1.9% and 0.3% decline q/q in asking prices and rents, respectively, in Nairobi according the **Error! Hyperlink reference not valid.**;

Focus of the Week: Following growing interest and equally growing public inquiries on Structured Products and their returns, this week's focus note is on Structured Products with a view to educate on what they are and their essence.

Company Updates

- We shall be hosting an Open Day for one of our developments, The Alma, on Saturday 4th November, 2017. This platform will give our clients and prospects an opportunity to see the show-houses for each of the unit typologies. To attend the open day, please register here

- Our Q3'2017 newsletter, Sharp Cents, is now out. To get a copy, kindly send an email to communications@cytonn.com. The newsletter theme was on Governance. The next newsletter for Q4'2017 will be themed around the year 2017 in review; we encourage our clients and partners to be part of submitting articles to be considered for publishing. If you would like to contribute an article please email us at communications@cytonn.com
- We continue to showcase our real estate developments through weekly site visits. Watch progress videos and pictures of The Alma, Amara, The Ridge and Taraji Heights. The site visits target both investors looking to invest in real estate directly and those interested in high yield investment products to familiarize themselves with how we support our high yields. Key to note is that our cost of capital is priced off the loan markets where all-in pricing ranges from 16.0% to 21.0% and our yield on real estate developments ranges from 23.0% to 25.0%, hence our top-line gross spread is about 6%. If interested in attending the site visits, kindly register here
- We continue to see very strong interest in our Private Wealth Management training (largely covering financial planning), which is at no cost, and is held bi-weekly, but is open only to pre-screened participants. We also continue to see institutions and investment groups interested in the trainings for their teams. The Wealth Management Trainings are run by the Cytonn Foundation under its financial literacy pillar, and if interested in the training for your employees or investment group please get in touch with us through clientservices@cytonn.com or book through this link Wealth Management Training. To view the wealth management training topics click here
- 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 23.0% to 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
    - Cytonn Towers, where we are only selling residential units in the first phase of residential apartments, is currently about 20.0% sold. See Cytonn Towers
    - The Alma, which is 55.0% sold. See The Alma
    - Amara Ridge is currently 100.0% sold. See Amara Ridge
    - Situ Village is currently 22.0% sold. See Situ Village
    - The Ridge (Phase 1) is currently 31.0% sold. See The Ridge
    - Taraji Heights is currently 14.0% sold. See Taraji Heights
    - RiverRun Estates (Phase 1) is currently 11.0% sold. See RiverRun Estates
- With over 10 investment ready projects with over Kshs 82.0 billon of project value, we shall be very selective on new real estate projects going forward, only focusing on Joint Ventures and opportunities with deep value. We are increasingly focused on private equity deals. Should you have any deals in banking, insurance, education, hospitality and technology sectors, kindly email a teaser to PE@cytonn.com
- We continue to beef up the team with ongoing hires: Careers at Cytonn . This week we commence a key search for a Financial Controller, see here

Fixed Income

During the week, T-bills were undersubscribed, with the overall subscription rate coming in at 34.2%, compared to 46.7% recorded the previous week, due to relatively tight liquidity in the money market; the tight liquidity was due to heavy transfer of taxes from banks and reverse repo maturities that came in at Kshs 29.0 bn and Kshs 17.4 bn, respectively. The subscription rates for the 91, 182 and 364-day papers came in at 12.7%, 13.7%, and 63.3% compared to 41.8%, 45.9% and 49.5%, respectively, the previous week. Yields on the 91-day paper declined to 8.0% from 8.1%, while that of the 182-day paper rose to 10.4% from 10.3% with that of the 364-day paper remaining unchanged at 11.0%. The overall acceptance rate came in at 87.4%, compared to 97.6% the previous week, with the government accepting a total of Kshs 7.2 bn of the Kshs 8.2 bn worth of bids received, against the Kshs 24.0 bn on offer in this auction. The government is still behind its domestic borrowing target for the current fiscal year, having borrowed Kshs 67.5 bn, against a target of Kshs 134.1 bn (assuming a pro-rated borrowing target throughout the financial year of Kshs 410.2 bn budgeted for the full financial year as per the Cabinet-approved 2017 Budget Review and Outlook Paper **(BROP)**).

Liquidity in the money market remained tight during the week with a net liquidity withdrawal of Kshs 6.8 bn, compared to a net injection of Kshs 12.0 bn the previous week. The withdrawal was brought about by liquidity reductions of Kshs 29.0 bn and Kshs 20.1 bn in transfer of taxes from banks and T-bill primary issues, respectively. Injections of Kshs 30.1 bn in government payments, and Kshs 24.0 bn in reverse repo purchases were not enough to counter the high reductions during the week. The average interbank rate rose to 7.5% from 6.8% recorded the previous week, and the average volumes traded in the interbank market decreased by 7.4% to Kshs 24.3 bn from Kshs 26.1 bn the previous week. Of note is that this week, the banks' holding of excess liquidity improved to Kshs 3.8 bn above the 5.25% requirement, from a shortfall of Kshs 1.5 bn the previous week.

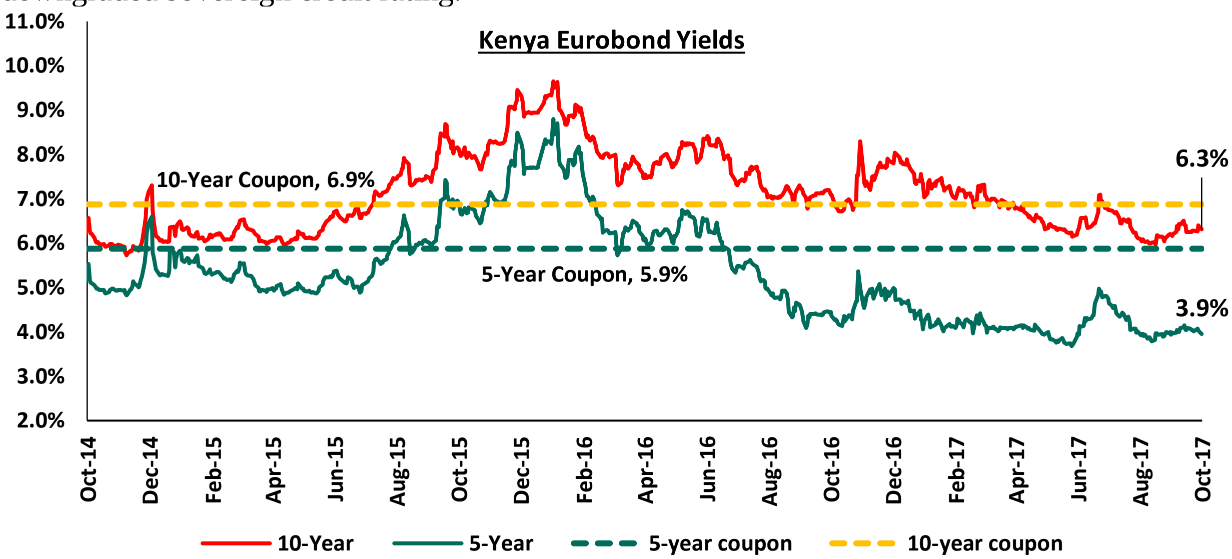
Below is a summary of the money market activity during the week:

all values in Kshs bn, unless stated otherwise

Weekly Liquidity Position – Kenya			
Liquidity Injection		**Liquidity Reduction**	
Government Payments	30.1	T-bond sales	13.5
T-bond Redemptions	11.6	Transfer from Banks - Taxes	29.0
T-bill Redemption	7.5	T-bill (Primary issues)	20.1
Reverse Repo Purchases	24.0	Reverse Repo Maturities	17.4
Total Liquidity Injection	**73.2**	**Total Liquidity Withdrawal**	**80.0**
		Net Liquidity Injection	**(6.8)**

Following the issuance of the new 5-year bond by the government early this month, the government has moved back to the market with a tap sale amounting to Kshs 16.5 bn. The last bid was undersubscribed, at a subscription rate of 66.9%, with the government accepting bids worth Kshs 13.5 bn at a weighted average yield of 12.5% as highlighted in our Cytonn Weekly #42. The tap sale will maintain the 12.5% coupon, with a yield of 12.5% already set from the primary auction. The tap sale is running from Tuesday 24th October 2017 to Thursday 2nd November 2017, and will provide an opportunity for investors who missed out in the issue to participate.

According to Bloomberg, yields on the 5-year and 10-year Eurobonds increased by 10 bps during the week to close at 3.9% and 6.3%, from 3.8% and 6.2%, the previous week, respectively, which can be attributed to the increased political uncertainty in the country as a result of the fresh presidential election held during the week. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.9% points and 3.3% points for the 5-year and 10-year Eurobonds, respectively, due to the relatively stable macroeconomic conditions in the country. The declining Eurobond yields and stable rating by Standard & Poor (S&P), in spite of the political uncertainty around the presidential poll re-run, are indications that Kenya's macro-economic environment remains stable and hence an attractive investment destination. However, concerns from Moody's around Kenya's rising debt to GDP levels may see Kenya receive a downgraded sovereign credit rating.



The Kenya Shilling depreciated against the US Dollar during the week to close at Kshs 103.7, from Kshs 103.6 recorded the previous week, as importers accumulate more dollar holdings due to increased political uncertainty, awaiting the presidential re-run election outcome. On a year to date basis, the shilling has depreciated against the dollar by 1.2%. In our view, the shilling should remain relatively stable against the dollar in the short term, supported by (i) the weakening of the USD in the global markets, and (ii) the CBK's activity, as they have sufficient forex reserves, currently at USD 7.2 bn (equivalent to 4.8 months of import cover). The key factor to watch is the current account deficit that worsened to 6.2% of GDP in Q2'2017, as compared to 5.3% of GDP in a similar period last year.

We are projecting the inflation rate for the month of October to decline to a range of between 6.4% - 6.7%, from 7.1% in September, mainly due to an expected decline in food prices following favorable weather conditions in the month, despite an increase in fuel prices during the month. Going forward to the end of 2017, we expect inflationary pressures to be subdued given food prices are expected to stabilize on account of the ongoing rains. We expect inflationary pressures to ease in the last two months of 2017, but average 8.4% over the course of the year, which is above the upper bound of the government target range of 2.5% - 7.5%.

The National Treasury has revised further downwards its 2017 GDP growth projection for Kenya to 5.0% from 5.5% previously to reflect the adverse effects of prolonged uncertainty around the electioneering period. This follows a previous downward revision in September to 5.5% from 5.7% after an assessment of the effects of the drought that the country was facing, which spilled over beyond Q1'2017. This comes after the World Bank and IMF cut their 2017 Kenya GDP projections to 5.5% and 5.3% from 6.0% and 5.7%, respectively, citing the drought's effect on inflation and agricultural production, and slowing private sector credit growth. In our view, we maintain our expectation that 2017 GDP growth will slow down and come in between 4.7% and 5.2%, as highlighted with a detailed analysis here.

Following the Supreme Court's decision to annul the August 8th 2017 Kenyan Presidential poll, the Independent Electoral and Boundaries Commission (IEBC) moved to begin the organization of a fresh presidential elections within 60-days of the annulment date, as per the Kenyan Constitution. With all 8 presidential candidates on the ballot, elections were held on 26th October. This move was met with mixed reactions across the country as voters turned up in polling stations in some parts of the country, while in other areas, protests prevailed as the opposition party held up its announcement to boycott the repeat presidential poll, citing non-implementation of reforms that were proposed to the IEBC that would ensure a fair and credible elections. This has led to a heightened state of insecurity in some parts of the country and political uncertainty continues to prevail resulting to subdued activity in the market. However, we maintain the view that the market should normalize once the election is concluded, post-election fears and uncertainty dissipates, the president elect gets sworn in, and the government takes charge, with the Kenya growth fundamentals remaining strong and intact.

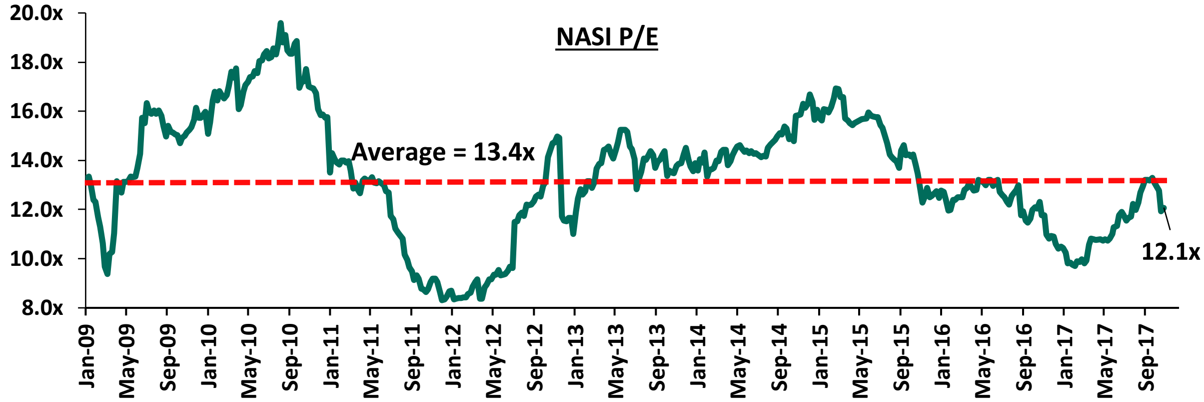
Rates in the fixed income market have remained stable, and we expect this to continue in the short-term. However, a budget deficit that is likely to result from depressed revenue collection creates uncertainty in the interest rates environment as any additional borrowing in the domestic market to plug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

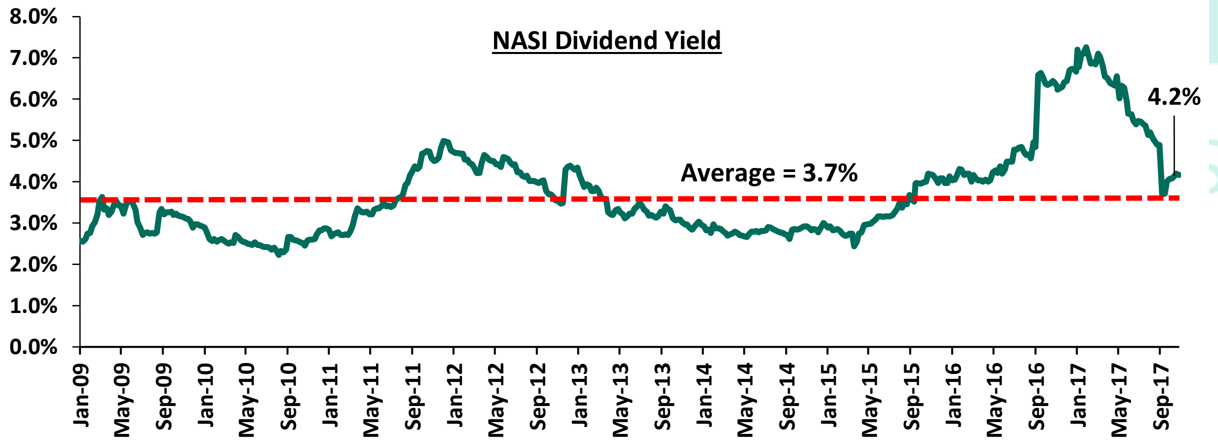
Equities

During the week, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 3.2%, 2.9% and 2.4%, respectively, taking their YTD performance to 19.9%, 17.4% and 14.5% for NASI, NSE 25 and NSE 20, respectively. This week's performance was attributable to gains by select large cap stocks such as KCB Group and Safaricom, which gained 5.5% and 5.2%, respectively. Since the February 2015 peak, the market has lost 9.9% and 33.7% for NASI and NSE 20, respectively.

Equities turnover increased by 6.8% to USD 20.4 mn from USD 19.1 mn the previous week. Foreign investors turned net buyers with a net inflow of USD 7.8 mn compared to a net outflow of USD 0.7 mn recorded the previous week. We expect the market to record subdued activity over the coming few weeks as market players remain cautious of the renewed political uncertainty in the country. Despite this, we expect the market to remain supported by improved investor sentiment once the polls for the presidential elections are completed and uncertainty dissipates, as investors take advantage of the attractive stock valuations.

The market is currently trading at a price to earnings ratio (P/E) of 12.1x, versus a historical average of 13.4x, and a dividend yield of 4.2%, compared to a historical average of 3.7%. Despite the valuations nearing the historical average, we believe there still exist pockets of value in the market, with the current P/E valuation being 28.6% below the most recent peak in February 2015. The current P/E valuation of 12.1x is 24.5% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 45.4% above the previous trough valuation of 8.3x experienced in December 2011. The charts below indicate the historical P/E and dividend yields of the market.





Fitch, a global rating agency, supports the review of the law on interest rate capping, terming it as unusual in that it is a blanket rate cap on all loans unlike in other markets where rate caps typically apply only to specific segments, such as retail lending, generally for the purpose of consumer protection. This comes after the Central Bank of Kenya (CBK) signalled its intention to push for the repeal of the interest rates cap law that has been in effect for a year now, due to the negative effect it has had on private sector credit growth and the expected negative impact to the economy. The Central Bank of Kenya (CBK) Commercial Banks' Credit Survey for the second quarter of 2017 showed that most commercial banks, 54.0%, revealed that interest rate capping negatively affected their lending to SMEs. CBK has expressed interest to have this law reversed and go back to a regime where interest rates are freely determined, but in a disciplined commercial banking environment. However, given that CBK has in the past failed in ensuring there is discipline in the market, it would be unwise to expect banks to voluntarily become disciplined. We are therefore of the view that a reversal of the rate caps regime should be accompanied with the following specific actions around consumer protection and improved competition to ensure banks remain disciplined in pricing of loans: (i) Establishment of a strong consumer protection agency to specifically develop and enforce a consumer protection framework for the financial services sector, (ii) Establishment of a specialized tribunal that shall specifically handle consumer financial services matters and complaints, and (iii) Development of capital markets and alternative sources of funding to bring down the 90% business funding dominance by banks compared to 60% business funding by banks in developed markets, in order to spur private sector growth. For a detailed analysis of the specific actions around consumer protection, kindly see our Cytonn Weekly #37/2017.

In an effort to keep our rankings of companies on the Cytonn Corporate Governance Ranking (Cytonn CGR) Report up-to-date, we continually update the rankings whenever there are changes on any of the 24 metrics that we track, and how this affects the company ranking. During the week, Standard Chartered Bank appointed Mr. Richard Etemesi as a Non-Executive Director of the company, and announced the resignation of Mr. Angarai Ganesh Dorairajan from the company's board. Standard Chartered Bank's score has maintained at 83.3%; the average age of the board increased slightly to 54.3 from 53.6 years but still maintained a score of 0.5, the board size maintained at an odd number 11, with its gender and ethnic diversity both maintained at 27.3%. There being no changes in the scores of the metrics tracked, Standard Chartered Bank therefore retains its ranking at Position 3.

Below is our equities universe of coverage:

all prices in Kshs unless stated otherwise

No.	Company	Price as at 19/10/17	Price as at 27/10/17	w/w Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**
1.	NIC***	37.0	38.0	2.7%	46.2%	58.2	3.4%	56.5%
2.	KCB Group***	36.5	38.5	5.5%	33.9%	57.1	5.5%	53.8%
3.	Barclays	9.0	9.2	1.7%	7.9%	12.5	11.1%	47.7%
4.	Liberty	12.2	12.0	(1.6%)	(9.1%)	16.4	0.0%	36.7%
5.	DTBK	179.0	178.0	(0.6%)	50.8%	234.1	1.4%	32.9%
6.	HF Group***	10.6	11.1	5.2%	(20.7%)	14.2	2.1%	30.0%
7.	Kenya Re	19.8	20.0	0.8%	(11.3%)	24.4	3.8%	26.1%
8.	I&M Holdings	124.0	124.0	0.0%	37.8%	149.6	2.4%	23.1%
9.	Jubilee Insurance	481.0	494.0	2.7%	0.8%	575.4	1.8%	18.3%
10.	Sanlam Kenya	27.0	27.0	0.0%	(1.8%)	31.4	1.1%	17.3%
11.	Equity Group	36.3	36.3	0.0%	20.8%	40.5	5.5%	17.2%
12.	CIC Group	5.0	5.5	10.0%	44.7%	6.2	2.0%	14.7%
13.	Co-op Bank	16.1	16.1	0.0%	22.0%	17.5	5.7%	14.4%
14.	Britam	13.8	14.0	1.5%	39.5%	15.2	1.7%	10.6%
15.	Stanbic Holdings	79.0	79.0	0.0%	12.1%	79.1	5.2%	5.3%
16.	Standard Chartered	216.0	215.0	(0.5%)	13.8%	199.8	4.8%	(2.3%)
17.	Safaricom	24.0	25.3	5.2%	31.9%	19.8	4.7%	(17.0%)
18.	NBK	9.7	9.2	(5.7%)	27.1%	5.2	0.0%	(43.4%)

**Target Price as per Cytonn Analyst estimates*

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

****Banks in which Cytonn and/or its affiliates holds a stake*

For full disclosure, Cytonn and/or its affiliates holds a significant stake in KCB Group and NIC Bank, ranking as the 5th largest local institutional investor and the 9th largest shareholder, respectively

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

Mace, a UK-based global construction and consultancy firm, has acquired an undisclosed stake in Kenya's quantity surveying firm, Integrated YMR Partnership (YMR). YMR, which has worked on projects such as Two Rivers, Garden City and The Hub in Karen, is headquartered in Kenya and has operations in Uganda, Tanzania, Rwanda, Burundi, Sudan, Ethiopia, Mauritius, Djibouti and Seychelles. The acquisition will see the business operate under the brand name MaceYMR. The acquisition is beneficial to both firms as (i) it will see Mace improve its regional presence, which is part of its strategic plan, having acquired a stake in MMQS, a South African quantity surveying firm in 2016, creating MMQSMace, and (ii) YMR will leverage on Mace's global network, sector knowledge and experience, to improve on its service offerings and presence in the region. The acquisition is strategic as it comes at a time when Kenya's real estate and construction industry is on the rise, with its contribution to GDP over the last 7-years having grown from 12.6% in 2010 to 13.6% in 2016. The acquisition also highlights foreign investor interest in Africa driven by strong economic growth fundamentals in Sub Saharan Africa.

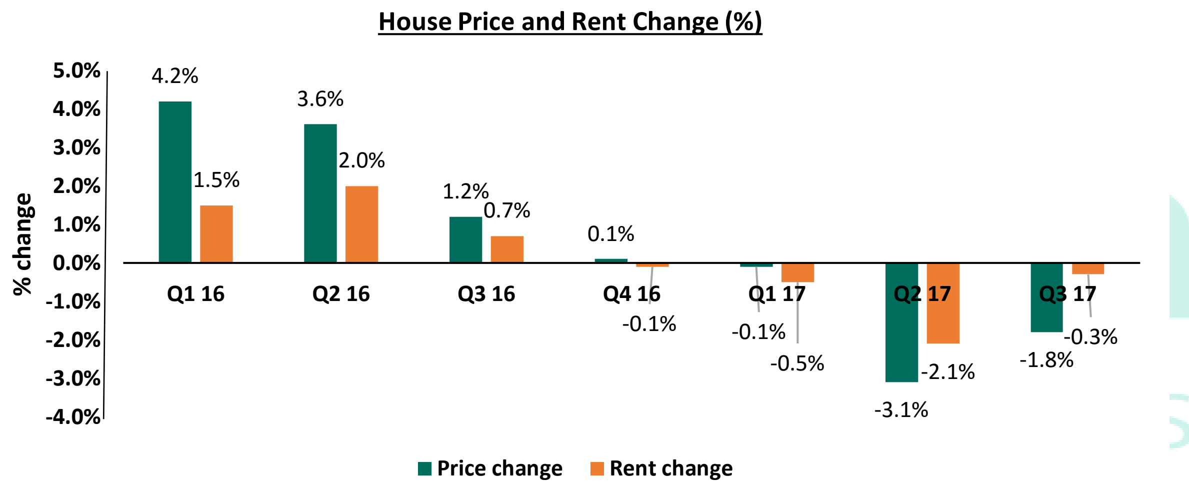
Quantum Global, the Africa-focused private equity and infrastructure investment manager, has exited its investment in Saruji, a building construction company which is the majority shareholder in Savannah Cement after the sale of its stake in the company, which owns 60.0% of Savannah Cement. The remaining 40.0% stake is owned by Savannah Heights. Quantum, through its USD 1.1 bn Infrastructure Fund, invested in Saruji in 2015 through the acquisition of a 49.0% stake in the firm, which still owned 60.0% of Savannah Cement then. The investment by Quantum global supported the development of Savannah Cement's USD 100 mn clinker plant and the firm's investment into green technology. The successful exit by Quantum affirms our view of positive performance of private equity as an asset class in the region, indicated by the increasing number of exits. In 2016 only, Africa recorded 48 exits, a 9.1% increase from the 44 exits achieved in 2015. The exits were achieved by 31 PE firms, compared to 30 firms in the prior year. By Industry and sectors, the Industrial sector was the best performing with 21% of the exits. Exits to trade buyers, where the private equity investor sells all of its shares held in a company to a third party, often operating in the same industry as the company itself, still represent the most common exit route. Comparing exits' performance over the last ten years, the top 5 countries, South Africa (42%), Nigeria (9%), Egypt (9%), Kenya (6%) and Ghana (5%), accounted for 70% of PE exits.

Private equity investments in Africa remains robust as evidenced by the growing number of successful exits. The increasing investor interest is attributed to (i) rapid urbanization, a resilient and adapting middle class and increased consumerism, (ii) the attractive valuations in Sub Saharan Africa's private markets compared to its 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 African markets.

Real Estate

During the week, Hass Consult released their Q3'2017 report on the land and house prices in the market. According the report, asking property prices dropped by 1.8% q/q while asking rents dropped by 0.3% q/q, compared to a 1.2% q/q asking price increase and a 0.7% q/q asking rent increase in Q3'2016. This was attributed to reduced investment activity as a result of political uncertainty following the Supreme Court ruling that annulled the presidential election results, and low levels of credit to the private sector. Gigiri was the best performing suburb in the third quarter of the year with property prices increasing by 4.8% q/q while Kileleshwa was the worst performing with 4.7% decrease in sale prices. On an annual basis, Muthaiga was the best performing with prices increasing by 12.5%. This was as a result of sustained demand from the expatriate community and diplomatic corps.



Source: Hass Consult

As shown in the graph above, the market has been on a declining trend in 2017, with the largest decline recorded in Q2'2017 in the run-up to the August 2017 elections. In a similar electioneering period in 2013, house asking prices also recorded a negative growth of 1.5% q/q. The Q3'2017 findings are in tandem with [Cytonn Investments Research Q3'2017](), which indicated that prices appreciated by 3.8% y/y in 2017 compared to 7.4% y/y appreciation in 2016. However, we expect the sector to recover after the conclusion of the fresh presidential elections in the short and medium term, supported by (i) high demand due to the huge cumulated housing deficit estimated at 2.0 mn units, (ii) rapid urbanization rate of 4.4% p.a. compared to a global average of 2.0%, (iii) government incentives such as the 50% tax cut for developers who supply 100 affordable units annually, and (iv) Central Bank of Kenya's (CBK) intention to push for the repeal of the interest rates cap law that has been in effect for a year now, which may lead to growth in credit flows to private sector.

For the land price index, according to the report, the following were the key take-outs;

i. Land prices in Nairobi suburbs increased by 0.4% while in satellite towns recorded a 1.7% declined in Q3'2017, compared to an increase of 1.4% and 7.0%, respectively, in Q3'2016.
ii. All satellite towns in Kiambu recorded a drop in asking prices with Limuru and Juja recording a 5.7% and 5.0%, respectively. The sharp drop in prices in Kiambu was due to the adoption of spatial planning by the County Government in June 2017, which resulted into regulation of land use by the government, with the aim of preventing further loss of agricultural land to real estate developers. Investors are therefore holding back on buying land in satellite towns in Kiambu County until they are certain that purchases will not be affected by the proposed policies on land use;
iii. Kilimani was noted to be the best performing area with prices increasing by 2.5%, despite the house asking prices in the same area recording a negative growth of 9.2%. This decoupling in the land and housing prices in Kilimani can be attributed to optimistic investors buying land for commercial, residential and mixed use development. On the other hand, Lavington registered a land price decrease of 2.6% over the same period. Lang'ata was the best performing suburb on an annual basis with 8.5% increase in asking prices while Ridgeways recorded a 0.5% drop. We attribute the increase in prices to the increased demand for land in the high-end areas. However, for the decrease, we attribute this to the uncertain political environment that has resulted in slowed down in activities in the real estate sector.

Hass Consult Land Price Index summary 2016-2017									
	Q1 16	Q2 16	Q3 16	Q4 16	Annual 2016	Q1 17	Q2 17	Q3 17	Annual 2017
Nairobi Suburbs	(0.2%)	2.5%	1.4%	0.8%	5.1%	1.3%	0.7%	0.4%	3.2%
Nairobi Satellite Towns	1.1%	8.1%	7.0%	2.3%	21.8%	3.4%	1.0%	(1.7%)	5.0%
Average	**0.5%**	**5.3%**	**4.2%**	**1.6%**	**13.5%**	**2.4%**	**0.9%**	**1.1%**	**4.1%**
Land prices in Nairobi suburbs bucked the trend in houses recording a 0.4% q/q and 3.2% y/y. In Satellite towns however, land prices recorded declines of 1.7% q/q and 5.0% y/y attributable to reduced demand from investors as a result of the political risk due to the extended electioneering period.									

Source: Hass Consult

In the construction sector, foreign contractors are partnering with local firms under regulations put in place by the National Construction Authority (NCA) in 2015 requiring foreign contractors to cede at least 30% of their ownership to Kenyans or sub-contract a third of their works to local firms to qualify for registration in the country. This is in order to protect and promote local contractors. In line with the same, during the week, the following activities were recorded;

i. Four Kenyan companies that were contracted by a Chinese firm, Nanchang Foreign Engineering, to put up 150 masionettes estimated at Kshs 1.3 bn in Runda Paradise earned Kshs 307.0 mn, accounting for 24.5% of the construction costs. According to the regulatory disclosures, Josswa Plumbers earned Kshs 60.0 mn (4.8%), Maha Properties Kshs 169.0 mn (13.5%), Greenrays Energy Kshs 12.4 mn (1.0%) and Jupiter Electricals, Kshs 65.0 mn (5.2%);

ii. At Nairobi's Karen Waterfront project, five Kenyan firms have been contracted to take approximately 25.8% of the Kshs 2.8 bn project. The selected contractors include; Mehta Electricals at a cost of Kshs 395.3 mn (14.1%), Grosec Solutions at Kshs 96.5 mn (3.4%), Nairobi Botanical Graden's at Kshs 11.6 mn (0.4%), Northstar cooling systems at Kshs 93.4mn (3.3%), and Plumbing Systems at Kshs 126.0mn (4.5%). CJRE East Africa, a subsidiary of China Railway Group Company, is the main contractor of the Phase 1 of the project which upon completion will cover 50 acres.

This regulation comes at a time when Kenya's real estate and construction industry has been on the rise over the last 7-years with the contribution to GDP increasing from 12.6% in 2010 to 13.6% in 2016. This has led international firms such as China Wu Yi, CATIC and AVIC International setting up operations in the country. This regulation is a move in the right direction as it will enable;

i. Kenyan firms to acquire the necessary skills in the management of large projects,
ii. Creation of a track-record for local firms that will support their ability to bid for large projects in future, and,
iii. Creation of jobs in the local construction industry.

The real estate industry continues to experience a slowdown of activities due to the extended electioneering period in the country. However, 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 five-years and estimated to grow at between 4.7% - 5.2% in 2017, relatively high returns in real estate, the growing middle-class and high urbanisation rate at 4.4% that have created demand for real estate products.

Structured High Yield Investment Products – The Next Frontier in East Africa

We first wrote about structured high yield investments products in the Cytonn Weekly Report #19 on 17th May, 2015. We revisit the topic in depth this week following social media enquiries in the public domain where we continue to get questions as to how one of our Structured Products, Cytonn Cash Management Solutions (Cytonn CMS), is able to deliver an 18% per annum return to investors. *Please note that this Focus Note is meant for general information only and has been prompted by the need to provide more information about structured products and respond to questions we are getting from the general public; it is not a warranty, representation, advice or solicitation of any nature. Readers are advised in all circumstances to seek the advice of a registered investment advisor.*

In this Focus Note, we deal with a couple of key issues about structured high yield products:

1. What is a Structured Product (SP), and specifically a Structured High Yield Product?
2. What is the history of SPs, and their experience in the Kenyan market?
3. Why do we need SPs in the Kenyan market? What are the opportunities and challenges to SPs in the Kenyan market?
4. What is the regulatory framework for SPs, and associated legal jurisprudence around Structured Products?

5. We then use our own Cytonn CMS as an example of a local SP, including FAQs.

What is a Structured Product?

Typically, investments can be broadly classified into two categories:

- **Traditional Investments** – These are also sometimes called 'public markets investments'. The traditional investments are the commonly known and easily accessible investments such as stocks, government and corporate bonds and bank deposits. Anyone can easily call their broker or stop by a bank and access them. They are usually in the public domain and can be distributed through public avenues such as TV, newspaper ads, and banking halls, hence are highly regulated, and,
- **Alternative Investments** – As an "alternative" to traditional / public market investments, there are alternative investments, which typically include private equity, real estate, commodities and Structured Products. These investments are usually not in the public domain, they tend to be complex and illiquid, but also tend to have higher and more stable returns compared to traditional investments. They tend to be distributed through private avenues such as pre-screened investors and investment clubs.

As per the definition of Alternative Investments, Structured Products are a subset of Alternative Investments. Simply defined, a Structured Product is a highly customized / tailor made investment product that is packaged by investment professionals to enable the investor access returns or meet investment objectives that are not accessible in the traditional / public / conventional markets such as stocks, bonds and bank deposits.

The process of structuring starts by traditional products such as equities, bonds and bank deposits, either alone or in combination with a non-traditional product, such as real estate, and creating cash flows and returns that are supported by the underlying products, but whose features are different from the underlying product because of the structuring that is done.

Here is a very simplified example of two scenarios of how a Traditional / Conventional Transaction can be structured to become a Structured Transaction:

Traditional / Conventional Transaction Scenario: A saver with money takes it to the bank and gets little to no return on their deposit. The bank in turn lends the money to, say, a developer and charges market rate cost of borrowing. The bank enjoys the difference between the cost of the deposit paid to saver and the yield on loan received from the developer. This is illustrated below:

- Mr. Saver has Kshs. 10 million; he can go deposit it in a bank and get at best 7% per annum return on the deposit,
- Mr. Developer can then go to the bank and borrow the Kshs. 10 million from the bank. Remember the bank will be lending to Mr. Developer the same Kshs. 10 million that the bank got from Mr. Saver, but the all-in cost after all bank charges and loan fees comes to about 18% per annum,

- Mr. Developer will then use the money to develop a house and sell it for Kshs. 12.5 million, essentially making a gross return of 25%, or Kshs. 2.5 million on the Kshs. 10 million loan,
- Mr. Developer will then pay to the bank the Kshs. 10 million loan plus 18% total cost of loan, equal to Kshs. 1.8 million, so a total of Kshs. 11.8 million goes back to the bank, leaving Mr. Developer with Kshs. 0.7 million of profit.

A Structured Transaction Scenario: In the structured scenario, the facts remain essentially the same, except that the intermediary is not a bank but an investment vehicle; the saver with money takes it to an investment professional, through an Investment Vehicle, who gives the money directly to the developer. The developer will still pay the usual cost of borrowing, but instead of paying it to the bank, it will be paid to the Investment Vehicle, which will pass the returns to the saver. By structuring out the bank, the saver has been able to increase the returns from the typical rate of return given on deposits, to the typical rate of borrowing paid by developers. This is illustrated below:

- Mr. Saver has changed to Mr. Investor and channels his Kshs. 10 million to an Investment Vehicle managed by an investment professional,
- Mr. Developer can then go borrow the Kshs. 10 million from the Investment Vehicle and pay the same 18% per annum they would have paid to the bank in the conventional scenario,
- Mr. Developer will then use the money to develop a house and sell it for Kshs. 12.5 million, essentially making a gross return of 25% or Kshs. 2.5 million on the Kshs. 10 million loan,
- Mr. Developer will then pay to the Investment Vehicle the Kshs. 10 million loan plus 18% total cost of loan, or Kshs 1.8 million, which will be paid to Mr. Investor,
- As a result, a total of Kshs 11.8 million goes to Mr. Saver turned Mr. Investor, leaving Mr. Developer with Kshs 0.7 million of profit.

The difference between the Traditional Transaction and the Structured Transaction is that the parties with money have come up with a private Investment Vehicle to be able to transact directly, by structuring out the bank. For the party with money, they get a much higher return, and for the party needing the money, the developer, they are able to transact very quickly and move faster than other developers relying only on conventional bank funding; that is the key essence of a Structured Product / Transaction: Using highly customized features, it brings together two parties through innovative features and delivers to them superior results than they would otherwise get in conventional channels.

The History of Structured Products Globally and Locally:

Structured Products originally became popular in Europe and then gained acceptance in the United States (U.S.). Because they are now well known and accepted, they are now frequently offered as products registered by regulators such as the Securities and Exchange Commission (SEC) in the U.S., which means they are accessible to retail investors in the same way as stocks, bonds, and other traditional products. But globally, Structured Products are still marketed mainly to high net worth individuals through targeted wealth management platforms and private banks.

They are usually not listed on any securities exchange, but may trade on secondary markets offered by the issuer.

In Kenya, the most commonly known example of Structured Products are publicly placed structured notes, such as Centum and ARM’s Equity Linked Notes, which are Structured Products featuring traditional assets such as corporate bonds and an equity link. However, Structured Products in Kenya and in developing markets remain exceedingly rare. Other examples of privately placed Structured Products include structured notes backed by high yielding assets such as real estate and commercial paper. The most common examples in this market are real estate backed notes and Cash Management Solutions, which yield anywhere from 12% p.a. to 18% p.a. depending on the underlying alternative asset class and the duration of the investment. Common examples of underlying alternatives are investment grade real estate, which yields 20% - 25% returns per annum.

In both local and developed markets, Structured Products have been a welcome alternative to banks for businesses seeking capital for growth. They have been better received in developed markets where the ratio of businesses seeking financing from banks versus capital markets funding is 60% to 40%; which means banks finance up to 60% of business funding, the balance comes from capital markets. In developing markets such as Kenya, capital markets – whether public / regulated capital markets or private capital markets – remain under-developed, hence businesses are forced to source up to 90% of funding from banks, leaving only 10% of funding from the capital markets. In fact, the entire 10% of funding from capital markets is coming from regulated capital markets such as Capital Markets Authority registered offerings and SACCOs, with local private capital markets providing negligible funding. Given the need for funding businesses in a growing economy where SMEs create majority of jobs, private markets such as Structured Products offer a compelling alternative for investors to seek financing. Their adoption would enable businesses to grow and create jobs. They also offer local investors access to above average returns in opportunities that are often unavailable in public markets.

Thus far, Kenyan markets have seen little adoption of Structured Products due to their esoteric nature and the lack of investor education on Structured Products. Recent corporate governance concerns have also dented the investing public’s confidence in private markets investments, especially structured solutions.

The Regulatory Framework Governing Issuance of Structured Products:

Having now clarified how Structured Products generate superior returns, the next question tends to be the regulatory framework governing the issuance of Structured Products. Given the many types of Structured Products, we shall limit ourselves to High Yielding Structured Products, such as Cytonn CMS.

When dealing with the regulatory framework, we first have to figure out what is the appropriate governing law, and then, once we figure out the governing law, then how do we issue under that appropriate governing law?

What is the Governing Law? The law regulating financial instruments more often than not overlaps and usually has a couple of grey areas. A look at the definition of Securities in the CMA Act, Kenya (the Act) shows that promissory notes (IOUs), Bills of Exchange e.g. Cheques and certificates of deposit issued by banks are expressly excluded from consideration as Securities for the purposes of the Act. The age-old tussle has however been the constant conflict between securities and banking law, and to better illustrate this we shall use the example of certificates of deposit issued by banks and the evolution of the law that lead to their exclusion from the definition of Securities.

Certificates of Deposit are instruments that originated in the United States banking industry in 1978 to stem the steady outflow of bank deposits by introducing a high-yield time deposit. In addition to the offering of these instruments by banks, they were also offered by savings and loans associations, which are the equivalent of our SACCOs. As shown in this focus, the United States, unlike Kenya, is an economy where the securities and investments industry rather than the banking industry sets the pace. The players in the securities and investments industry therefore lead the way in terms of the 'go to place' for the placing of funds by potential investors. It is therefore not surprising that in order to woo investors the American banks advertised the certificates as 'investments' and depositors characterised as 'investors', a clear parallel with Kenya where the certificates would gain more traction as banking rather than investment products.

With the Certificates gaining public confidence (banks issued some USD 9.5 billion during the first 30-days of availability) litigation followed with the SEC adopting the position that the Certificates were securities and therefore should be under their jurisdiction, while the Banking Lobby took the position that the same was squarely within the jurisdiction of banking laws. Well, with United States Courts persistently holding that these Certificates were indeed Securities, the matter was finally settled by the Supreme Court in *Marine Bank vs Weaver, 1982*, in a unanimous opinion holding that the Certificates of Deposit at issue did not fall within the statutory definition of "security" because *"the holders of bank certificates of deposits are abundantly protected under the federal banking laws*". This was indeed the premise that the Kenyan Act adopted on the passing of the Capital Markets Authority Act 7- years later in 1989.

It is clear that it is a thin line when it comes to determining where a financial instrument falls, as even in the above case, the Court did not conclusively answer the question as to whether the Certificates were Securities but chose to adopt a position that sought to avoid the over-regulation of the banking industry and inter-agency conflict. The Court however held that the rule of thumb is that the instrument in question must be analysed in light of:

i. The content of the instrument in question – Does the investor, directly or indirectly, purchase investment assets and what participatory rights do they have? A right to participate in decision making of the venture as a typical shareholder for example through Annual General Meetings (AGMs)? The right to vote and view financial statements? Or they are just a mere consumer?... as in the case of a depositor in a bank? In the case of Cytonn CMS, investors can appoint their Investment Manager, they elect and have a Board of Directors, they have to be accepted into the Investment Partnership by an existing Partner, and they hold AGMs; a whole host of participatory rights that depositors do not have.

ii. The purpose intended to be served – Was the advancement of money in reliance of the entrepreneurial skills for successfully forming and operating a successful business in pursuit of profits, or are the tasks, for example, loan monitoring tasks that generated no expectation of profit? and,

iii. The factual setting as a whole – How is the product offered? Was it in an investment context e.g. was the Investor approached with the purpose of securing an investment for the Investor? The use of words such as *'your funds are going to be used to promote one of the greatest stock developments ever heard of'* for example have been used to hold that short term instruments with fixed returns are securities.

In conclusion, Structured Products, except for the cases of Certificates of Deposits, regardless of whether the Investors may have bargained a return or that the same may be structured to make regular payments, such as monthly or quarterly payments, are Securities. This is provided they meet the test as summarized in *SEC vs W. J Howey Co* (i) they are an investment of money, (ii) in a common enterprise, (iii) with profits, (iv) to come solely from the efforts of the manager. That Structured Products are securities rather than banking products is now a firmly settled matter in pretty much all jurisdictions. The same has never been litigated locally, but the legal jurisprudence on the matter is ample.

If Structured Products are Securities, how then do you issue Structured Products under Securities Law? Having seen that structured offerings are in their true form securities, we then examine the various ways through which the same are offered. Securities are issued in Kenya by way of either private or public offerings.

- Public offers are defined in the Capital Markets Act, Sections 30A, 30B and 30C, as read together. So an issuer or Investment Manager of a Structured Product can issue it under the public offers regulations. The challenge is that public offers tend to be highly standardized, and that is why public offers work well for standardized products such as equities, bonds, and unit trust funds. Structured Products by their nature, are highly customized and that is why they tend to be offered to high net worth investors through private offers. To provide for private offers, Section 30A (3) of the CMA Act then goes ahead to specify that *"An offer shall not be considered a public offer if – (a) the offer is not calculated to result, directly or indirectly, in the securities of the company being available to persons other than those receiving the offer; or (b) otherwise being a private concern of the person receiving the offer and the person making the offer"*. So it is clear that the CMA Act contemplates offers that are not public, hence private offers.
- The meaning of Private Offers is then provided for in The Capital Markets Regulations, 2002, Section 21, which provides conditions under which an offer will be deemed a private offer.

Structured Products have typically been offered in the private markets through the enterprising efforts of persons looking for a cost efficient, effective and flexible mode of fundraising.

While we may be familiar with public offerings because we encounter them on a day-to-day basis (the government bonds, securities trading in the stock exchange, money market funds in our daily newspapers), Private Placements may seem new, despite them being as simple as offering 1 or 3 of your friends or family a chance to invest in a business idea you want to pursue. This is because in the true nature of Securities Law nothing is concretely defined, and many definitions remain flexible with the clear objective being to be able to extend investor protection to the largest extent possible. Securities Law in general runs away from boxing itself in a corner as can be seen from the definition of 'Securities' as discussed above; there is no specific definition of 'security', it just depends on the features and circumstances. The same applies to 'Private Offers' or 'Private Placements'.

Private Placements the world over have therefore generally been interpreted in contrast to public offerings, and by referring to the exemptions from either (i) the requirement to publish a prospectus, or (ii) the requirement to procure approval by the investment / asset manager running the privately placed fund. This is the position in the United Kingdom, United States, Australia and at least thirty-one (31) members of the European Union. Our own Kenyan laws, The Capital Markets Regulations, 2002, Section 21 envisions Private Placements. The Laws in these countries provide for the marketing or offering of certain investment offerings and particularly Structured Products to a class of investors i.e. clients who possess the experience, knowledge and expertise to make their own decisions and properly assess the risks thereof. The restrictions are therefore with regard to the nature of the investors, minimum investment or number of investors as exemplified in the American Supreme Court decision of *Securities Exchange Commission vs Ralston Purina Company 346 US 119 Supreme Court*, where it was held that *'***An offering to those who are shown to be able to fend for themselves is a transaction not involving any public offering.'**

In conclusion, Structured Products are securities, as opposed to bank deposits, not only due to the Investor's expectation of a return higher than the market average but also that the Investor's depend on investment teams with the requisite knowledge and experience for the structuring of the products to deliver exceptional returns.

Cytonn Cash Management Solutions, "Cytonn CMS":

Having discussed Structured Products, why they are essential to funding businesses, their history and the regulatory product, we now discuss Cytonn CMS, our own structured note product, which has been highly discussed in the public domains, as an example of a structured note. *(This example is meant for general information only and has been prompted by the need to provide more information about structured products and respond to questions we are getting from the general public; it is not a warranty, representation, advice or solicitation of any nature. Readers are advised in all circumstances to seek the advice of a registered investment advisor.)*

Cytonn Cash Management Solutions (Cytonn CMS) is a privately placed high yield product that offers investors higher returns than they would get in other competing investment cash management options. CMS is structured as a Limited Liability Partnership, and investors come in as Investment Partners. The Cytonn CMS investors have their elected Board where they elect Partners among themselves to represent them in the Board. The Board then directs investment decisions. Cytonn Investments Management Plc, the group company, serves as the Principal Partner mandated to execute the decisions of the Board. The Board is responsible for convening the Annual General Meeting, which discusses and ratifies the Audited Annual Financial Statements and makes other decisions and passes resolutions; for example, a resolution by 70% of the investors can appoint another investment manager that is not Cytonn Investments. Additional oversight of Partner assets is provided by a custodian, Standard Chartered, while an annual audit of the fund is prepared by Grant Thornton.

The high returns on CMS are supported by:

- **Alternative Investments in the Portfolio:** Alternative investments such as real estate have historically outperformed traditional asset classes such as shares (equities) and fixed income. Real estate, for example, has generated 25%-28% p.a. over the past 10-years, comprising 5% rental yield and 20% - 23% capital gains, p.a.
- **Consolidation**: Private client funds are aggregated and then invested. The economies of scale lead to the Investment Manager having a greater bargaining power with financial institutions than if the investor approached a bank themselves,
- **Disintermediation / Structuring**: CMS cuts out the middleman, passing maximum value to the client. Banks, for example, will finance loans to developers at 14% - 18% p.a. These loans are funded by deposits sourced from retail clients at a 7% p.a cost of deposits, at best. Through Cytonn CMS, the investor can now access the same returns earned by the bank on loans to developers, (referring to our example earlier, disintermediation / structuring effectively turns Mr. Saver to Mr. Investor)
- **Market Knowledge:** Investment Managers are able to understand liquidity needs in the market for banks and corporates, and hence place funds where they would attract the highest risk-adjusted return,
- **Quick Decision-Making**: Some investment opportunities require quick decision-making capability, and with Investment Managers having analysis and dealing capabilities, it is easy to execute faster hence taking advantage of the glaring opportunities,
- **Credit Analysis**: Some privately placed opportunities such as high yielding private commercial paper and real estate mezzanine notes require specialized analytical capability to incorporate into a portfolio. For example, a portion of the funds in Cytonn CMS are invested as mezzanine notes in The Alma in Ruaka, a 450-unit mixed use development in one of Nairobi's fastest growing satellite towns. The Alma is a Kshs. 3.0 billion, 3-year project with an annualized return of 25% p.a. The high IRR also supports CMS' returns at 12% to 18% p.a.

Because a portion of CMS funds is invested in long duration real estate backed mezzanine debt, liquidity risk is a key concern. Cytonn's CMS mitigates this risk by:

- **Liquid Pre-Sale Contracts:** Purchasers of our projects such as The Alma, a 450-unit development in Ruaka, typically pay in instalments on units bought off plan. The instalment payments are used to make regular interest payments to the investors of Cytonn CMS. This creates a liquid and high yielding structure despite the investment in illiquid brick and mortar real estate. Essentially the underlying asset is not the illiquid brick and mortar real estate, _but_ the liquid off plan sales contract behind each real estate unit. For this model to work, the development has to be sold off plan and the sales have to be ahead of the development. For example, in The Alma, sales are at 55% and construction is at 35%. Off plan sales require heavy investments in sales and marketing,

- **Project Management & Research**: Earlier in the project management cycle, Cytonn Real Estate identifies commercially viable areas and real estate themes (residential, commercial, mixed use etc.), making accurate assessments of demand through area research and assessing project risks through a team of on-site professionals and consultants. Once the project is approved by the Investment Committee, the development is launched to the public at the pre-sales / off plan phase, during which interested buyers make reservations and commit to purchasing units in customized payment plans. So in addition to heavy sales and marketing, differentiated market research and project management is key,
- **Conservative Asset Allocation**: The Investment Policy Statement mandates that 30% of CMS funds are invested in liquid public markets investments such as bank deposits and shares. Additionally, the fund has a retention rate of 80%; such that withdrawals are minimized, reducing the need for an aggressive liquidity buffer.

Frequently Asked Questions

Rather than respond to each public interest enquiry in social media, we have aggregated the questions we have often received:

- **Are you a bank?** We are not regulated by the Central Bank of Kenya and are not licensed to take deposits from the public. As discussed above, Cytonn CMS is an investment product not a banking product. Our investment solutions are privately offered investments through the private offers regulatory framework
- **Who regulates CMS?** Cytonn CMS is currently a privately offered solution, offered exclusively to high net worth individuals and is "self-regulated" through its own governance structure of the board, custodian, auditor and principal partner, Cytonn Investments, that is rated by Global Credit Rating (GCR) a credit rating agency
- **What happens when there is a default?** To evaluate a default, we need to look at the probability of default and the loss given default. The portfolio contains a highly diversified set of investment grade real estate assets that is selling off plan and liquid investments. Additionally, the corporate guarantee empowers investors to recover any amounts due from the promoter, Cytonn Investments Management Plc. A recent example is the minimal investments Cytonn CMS had in Imperial Bank and Nakumatt Commercial Paper; the defaults were taken up by the promoter, Cytonn Investments Management Plc, hence shielding our investors from any losses
- **How are you able to offer 18% yet banks offering much lower rates?** Cytonn CMS rate is priced off the loan price market, not off the money markets. Because the funds are mainly used for real estate development, which is mainly sold off plan, the appropriate benchmark is the cost of loans, and the typical real estate developer accesses bank financing at 14% - 18% per annum
- **How come no one else is offering these rates?** Offering higher than average rates requires a comprehensive platform; the Investment Manager has to have the asset yield that can support the return. The Promoter has to have an investment function that

interfaces with investors (Cytonn Investments), and a yield generating function that generates the yield (Cytonn Real Estate). Cytonn is the only brand in this market that has coupled up investment management and real estate development onto one platform. A promoter cannot offer high returns without a high yielding asset to support the return

- **Why does my bank or relationship manager talk badly about CMS?** First is possible that RMs don't understand how structured notes work. Secondly, CMS offers a very competitive private alternative to fixed term bank deposits, hence can be construed to be in direct competition. It is not the first time established players have opposed new products. The banking industry was hesitant when M-Pesa was introduced 10-years ago as a new means for money transfer, but today M-Pesa is the leading means to transact cash. Taxi owners and drivers opposed the introduction of Uber, but today Uber is the most used means of cabbing in Nairobi. And established banks ridiculed the transformation of Equity Bank from a building society to a commercial bank, and today it is the largest bank by market capitalization. History is littered with examples of established order talking down innovation and emerging technologies that are perceived as threatening
- **What is the difference between a deposit offering a rate and an investment offering a rate?** Deposit rates are fixed and guaranteed by the bank, which is regulated by the Central Bank of Kenya. The rate a bank can offer is largely determined by the rate at which they can lend the funds and still keep a margin. On the other hand, an investment rate is determined by the profit returns generated by the commercial enterprise in which the funds are invested, such as real estate development
- **Who does Cytonn CMS target?** Cytonn CMS targets high net worth individuals and institutions with the capacity to understand the risks and complexity of the investments. They have to go through a prequalification process and be admitted by an existing Partner into the Partnership. It is privately offered
- **How come other fund managers at some point stopped issuing CMS?** CMS is an unregulated investment solution offered through private channels. Our understanding is that Fund Managers, themselves CMA regulated entities, were issuing CMS in contravention of Section 26 (1) (b) of the Capital Markets Act, which prohibits carrying out *"any activity outside the scope of the licensed or approved activities"*. The placement has to be structured to conform to the private offers regulations. It is our understanding that other competitors are restructuring their offerings
- **What is the profile of investors in Cytonn CMS?** Cytonn CMS investors include local high net worth individuals, Kenyans and other East Africans in the Diaspora, local institutions such as SACCOs and chamas, as well as international institutional investors. The leading investor is Taaleri, a USD 7 billion investor based in Finland, whose representative also sits on the Board
- **Is CMS a Ponzi Scheme?** A Ponzi scheme involves offering high returns that are not supported by any underlying economic activity or enterprise. Essentially returns are paid out of cash flows from new investors. Any offer of above market returns has to be able to demonstrate the actual assets / underlying economic activity that supports the returns. In the case of Cytonn CMS, the returns are supported by the 10 ongoing and largely pre sold developments

By and large, Structured Products are critical to our economy, as they:

i. Provide funding for businesses that have trouble accessing funding from traditional bank funding sources. They also offer a compelling alternative to bank funding, even as banks retreat from lending to the private sector as a result of the interest rate cap. The growth of the economy also creates several opportunities for funding through Structured Products as businesses source capital for growth,
ii. They also provide investment opportunities for yield-hungry investors. These investment returns go into securing the financial well-being of retirees, families and individuals trying to improve themselves.

However, despite these clear advantages, their little availability in Kenyan markets can be attributed to a lack of investor education and limited industrywide experience and adoption. To support the growth of Structured Products, we propose the creation of the East Africa Association of Structured Products & Alternative Investments, an industry association to spearhead education initiatives and the creation of a standardized framework for issuing and classifying Structured Products.

To learn more about Structured Products, we invite you to attend our wealth management training sessions that are run by the Cytonn Foundation under its financial literacy pillar. You can book attendance by writing to wmt@cytonn.com or book through this link Wealth Management Training.