Newsletter

Horizon Africa Capital

Quarter 2 | 2016

In This Issue

Economic Roundup:

SUB-SAHARAN AFRICA

The World Bank reported that slumping commodity prices, weak global growth, rising borrowing costs, and adverse domestic developments have brought the currencies of SSA down with them, thus driving up inflation in the region. According to a preliminary estimate, inflation jumped from January's 9.3% to 11.5% in February, which represented the highest reading in seven years. A strong recovery would have to wait until between 2017 and 2018, the World Bank said, predicting a return to a 4.5% average growth rate. The increased IMF lending activity across the continent highlights the higher borrowing costs these countries are facing in international capital markets, a sharp change since 2013 when Eurobond issuance by African sovereigns was becoming a growing trend. The World Bank report warned of "downside risks," meaning that its predictions for growth in 2016 and 2017 were still vulnerable due to the falling commodity prices as well as China's industrial slowdown.

(continued)

Economic Roundup: (continued)

Kenya

World Bank singles out Kenya as "bright spot"

KENYA

Economic Update

The World Bank singled out Kenya again as among the few "bright spots" where growth continued to be robust in 2015, having been among the key recipients of the oil price decline dividend. The World Bank report cites private consumption and public infrastructure investment growth as key cushions for the East African economic giant. Kenya has lived within its means; According to the World Bank, Kenya has never sought or received debt relief, but has opted for better economic policy - raising revenues, liberalizing trade and the forex market.

Kenya's economy is projected to grow at 5.9% in 2016, recording an improvement over the 5.6% estimate for 2015. According to a World Bank Group economic report issued in December 2015, the Gross Domestic Product (GDP) is expected to improve further to 6% in 2017. Diarietou Gaye, the World Bank Country Director for Kenya, said that the prevailing global conditions call for a more vigilant policy stance which is supportive of growth. According to the report, Kenya's economy remains vulnerable to domestic risks that could moderate the growth prospects.

Exchange Rates

The Shilling strengthened against the USD closing at KES 100.57 on May 5th 2016. CBK's foreign exchange reserves, which currently stand at USD 7.38 billion (equivalent to 4.7 months of import cover), together with the Precautionary Arrangements arranged through the International Monetary Fund (IMF), continue to provide an adequate buffer against short-term shocks.

Inflation and Interest Rates

The average interbank rate rose to 3.8% in the week ending April 27 2016, from 3.5% in the previous week. The CBK continues to urge banks to reduce their operating costs and further enhance transparency in the pricing of credit. As such, the CBK has commenced the quarterly publication of individual banks' lending rates across loan categories and maturities.

Month-on-month overall inflation fell to 5.3% in April 2016, from 6.5% in March. The MPC decided to retain the CBR at its current level of 11.5% to continue to anchor inflationary expectations and further enhance the credibility of its policy stance.

Economic Roundup: (continued)

Uganda

Uganda on course to grow at 5% in 2016

UGANDA

Economic Update

According to the International Monetary Fund, Uganda's economy continued to perform well in a complex global, regional, and domestic environment, affected by election-related uncertainties. The electoral commission confirmed that Yoweri Museveni won the presidential elections that were held on 18 February and thus extended his 30-year rule.

Indicators for the first eight months of the FY 2015/16 are consistent with the real economic growth forecast of 5% for the period. However, Uganda's balance of payments in the short to medium-term remains vulnerable to the turbulent global economic environment.

Inflation & Interest rates

Annual headline and core inflation declined to 6.2% and 6.9% respectively in March 2016 after peaking at 8.5% and 7.6% in December 2015. Monthly core inflation however edged up slightly in March 2016 by 0.1% compared to February 2016. This was in part due of the revision of school fees in the Consumer Price Index basket. The decline in annual headline inflation is largely because of the fall in food crops inflation, which declined to 0.8% in March 2016 from 7.1% and 16.2% in February 2016 and December 2015, respectively.

The Bank of Uganda ("BoU") forecasts that both headline and core inflation will remain in the range of 6.5± 1% in H1 2016 before gradually declining to the BoU's medium-term target of 5% in Q1 2017. Citing slowing inflationary pressures and below-potential economic growth, the BoU reduced the CBR by 1% point to 16% in April 2016.

Weak implementation of the new 2015 VAT Act drags Tanzania's Q1 revenue.

Economic Roundup: (continued)

Tanzania

TANZANIA

Economic Update

ECONOMY

The World Bank projects that Tanzania's economy will grow at 7.2% in 2016. Although revenue performance in 2015/16 has been better than in the past few years, a shortfall has been experienced in the first quarter of the financial year. This has been driven largely by the weak implementation of the new 2015 VAT Act. The government faces additional expenditure needs equivalent to 0.7% of GDP due to: expenditures carried over from last financial year, payment of government arrears to the Tanzania Electric Supply Company (TANESCO), and additional fiscal space needed for provision of free basic education and expansion of higher education students' loans program (new presidential initiatives).

Inflation and Interest Rates

On the basis of the rebased CPI, the Bank of Tanzania reported a decline in headline inflation to 5.6% in the year ending February 2016 from 6.5% in January 2016. The decrease was driven by moderation in price increases of consumer goods under the food and non-alcoholic sub-group. Major components of the headline inflation recorded diverse patterns, on year-to-year and month-to-month basis.

Interest rates will continue to be market determined. The Bank will continue to work closely with market players to improve transparency of monetary policy operations and instil greater efficiency in the determination of market based interest rates. This will further improve the function of the money market and reduce volatility in the interbank cash market, while increasing the role of interest rates in assessing the impact of monetary policy actions.

Newsletter feature...

In this quarter's newsletter, we feature an interview with Mr. John Ngumi, a distinguished banker and graduate from the University of Oxford whose most recent role in the industry was the Head of Investment Banking (East Africa) at CFC Stanbic. He currently serves as the Chairman of Kenya Pipeline Company. John recently left the banking world to start an independent boutique advisory firm called Eagle Africa Capital Partners Limited.

A transcript of the interview with Mr John Ngumi is found below.

Given what has happened over the last 12 months in the Kenyan banking industry, what is your take on the current state of the sector?

I like to see it as the beginning of a process of squeezing out many bad habits. It has always been evident that an economy cannot grow sustainably if the banking system is perpetually growing at a much faster pace. That gap means stresses are being built up. In our market, those stresses are overleveraging and the malpractices that have been allegedly unearthed. Warren Buffet once said that "it's only when the tide goes out that we see who's been swimming with no underwear". The warning signs were there but weren't heeded – Citibank issued a report as early as 2012 on the dangers of under provisioning. The other warning signs were in the interbank market, which narrowed down to only a few banks. I think, as bankers, we were guilty of feeling something wasn't right but not quite doing anything about it because it was the Central Bank's business to look at the banking system. So we're in for a squeeze in terms of reshaping the industry and arriving at fit for purpose banks. We didn't merge voluntarily. Now mergers are being done under the barrel of a gun. That basically is the situation.

In your opinion what have been the main contributors to the increased level of non-performing loans?

There is a drive for growth yet pressure to post stellar results. There is no real constituency to let me run a small or a very conservative bank. That competition for growth is a major contributor to the increase in non-performing loans and will continue to be. Secondly, the NPLs are an unnatural corollary of the stresses the economy itself has been undergoing. Let me give you a good example, pending bills. Government is a huge spender and those bills not being paid on time have a knock on effect everywhere. That inability to pay tends to cease up the liquidity system and go all the way down. So as long as credit remains the lubricant of the economy, banks were always going to be caught in an NPL rising scenario in an economy with stresses.

Do you think stricter provisions may curb economic growth?

If our bridge of provisioning is raised and banks become more conservative, then you would see a constriction on growth. I see larger provisioning as a one-time adjustment which will mean that banks will probably be more careful in the sectors and the customers that they are lending to…but not necessarily a permanent constriction on lending. But what's driving growth here is a combination of non-traditional services like telecommunications and mobile money plus all the bigger infrastructure projects. So, I would rather look at a bigger issue and say if those infrastructure projects don't pay off, then that will really hit growth.

Newsletter feature… (cont.)

If you were the current CBK Governor, what could you have done differently to effectively manage this crisis?

Wow (chuckles)! On Imperial Bank, there is a case for saying that while the alleged criminality had to be stopped at once, did we have to stop the whole bank? Now the argument, which is a reasonable argument, is that you had to send a very strong signal that these practices will not be tolerated. The multiplier impact was going to be clear that (a) any bank with a customer profile similar to Imperial's was going to see a rush for the exits by their clients and (b) banks which were not seen as absolute kosher would foresee that pressure.

So, if the action had been taken to send that very strong signal, then the Central Bank should also have been prepared to support those banks that would suffer collateral damage. Looking at the trajectory of the Central Bank's actions, they seem to have been on a very steep learning curve and what they have done in the Chase Bank case with the liquidity provision for banks and the swift reopening even under management have been as a result of lessons learnt. So, I think the fair way of summing this up is that we will contract, but it is to the authority's credit that they have learnt that we can.

In your view how can consolidation be effectively managed to ensure stability in the sector?

The capital increase leading to consolidation is just one arrow. I know that it's absolutely imperative that we get right the management and supervision of banks in addition to the size of banks. Secondly, there is a fetish growing about the size of banks. There is a very important place for sizable banks but there is a place also for specialist banks. I hear the argument that you need ten giant banks to finance the infrastructure, the oil industry etc. Yes and no. You do, but we also tend to forget that Kenya alone, leave alone the world is awash with capital. Banks are just one way of channelling capital. I would say we've got hundreds of billions of shillings sitting in formal and informal collective investment structures, which can't be deployed, either because the rules don't allow it or there is no formal channel for it. So it's not just the size, it's also how the market is structured.

There is also a counterargument coming out of the UK, Switzerland and, to a lesser extent, Holland that banks can become too big for their economies. It is not impossible to see a situation where our banks, encouraged to grow by this consolidation wave, can become too big for the economy and their fortunes dictate the fortunes of the wider economy. So I would say we can fall into the danger of over relying on consolidation as a panacea for the challenges we face in getting our banking system fit for purpose.

What steps need to be taken to restore confidence in the Kenyan banking sector?

It goes back to the earlier question of those two elements; supervision and proper management…and overlaying that with better communication to the public. Clearly you've got to communicate that there is a grip on the supervision and on monitoring of the banks.

Newsletter feature… (cont.)

And I suppose one day we may have to confront this question of "what are banks for?". It is eminently possible to say that we need a very clear banking system like they have in Europe where, if all 'Wanjiku' is looking for is a place for her money to be paid into, stored, and for her to access it, that utility, just like water or electricity, is separated from the racier stuff like investment banking, treasury management and global markets which should be done with someone else's capital. Is it right for all these banks to get all these deposits and put them into what is clearly a growing property asset bubble? Or should we say that the business of a medium of exchange is very boring low margin business and that the flipside of 'Wanjiku's' cash will be lending in vanilla products like Treasury bills… In fact we could say that the people with a future in banking now are risk and compliance managers. If I was much younger and I wanted a banking career, that's where I would go!

What's your take on the proposed acquisition of Chase Bank by KCB?

Very smart move by KCB because 'Chase' the product had tapped into a certain market and had an emotional connection to that market. A very difficult thing for any big bank to achieve with any/all of its products. So if Chase the product is maintained intact, it would be a beautiful thing, it would be a great thing.

What's your take on the potential exit of Barclays (your former employer) from the African continent?

The reality is that when I was working for Barclays in 1992/4 we were the undisputed number one bank in Kenya. When I went several years later to Citibank, we began to chip away at their captive corporate business which we at CFC Stanbic and others accelerated. What am I saying is that it has been a failure of strategy, of execution, and of lacking a reason for being in Africa. I see it not as an exit but as a retreat from a situation they created for themselves. Barclays became neither fish nor fowl in this market, took the market for granted, became inward looking many years ago and lost their adventurous spirit on this continent. I'm sad as I worked at Barclays but I'm not surprised.

We've seen disruptors like M-PESA in our market. Do you see this as risk to the banking sector or as a potential area of growth and further collaboration?

Of course they carry risks. However, not only is it a potential area for growth but also I would say that digitalisation opens the door for convergence within the financial services sector. I'm seeing the opportunity on the convergence of various financial services which can be delivered down the same channel. So we are going to have to leap from the segregation of banking and insurance into a more diffused offering with technology being the glue holding it together. This is no different from the old days where you would walk into a bank and buy your car loan, mortgage, all under one roof. That's the exciting part; and I think that we are well positioned for this having leapfrogged the branch banking stage.

Worth Noting...

Kenya leads East Africa in Infrastructure Developments

The 2015 African Construction Trends report, states that there are 61 infrastructure projects in Sub-Saharan Africa worth approximately, US$ 57 bn. Of the 61 projects, 20 are in Kenya, making it the lead country in infrastructure developments within East Africa. The main drivers are the transport sector, real estate such as shopping malls, modern office blocks and the power sector. The Shop Africa 2016 report by Knight Frank states Nairobi as the hottest retail property market outside South Africa and currently has the largest development pipeline.

Kenya Seeks China to partly fund its budget deficit

In an attempt to reduce local borrowing and ease domestic interest rates, the Government has borrowed US$ 600 mn from China as a measure to reduce the budget deficit which stood at US$ 6 bn in the current fiscal year. This brings the Country's total international debt to US$ 1.35 bn. The loan is being arranged by CFC Stanbic, Standard Chartered and Citi.

Fitch casts negative outlook for Sub-Saharan African Banks

Fitch reports a negative outlook for the banking sector in 2016. This is mainly attributed to increased sovereign risk. Other factors that have contributed to the gloomy outlook are: falling commodity prices, faltering GDP growth, weaker currencies and greater political risks that are adversely affecting bank risk profiles. These increased risk exposures will result in deteriorating asset quality, tighter liquidity and capitalisation. This will however, not affect the existing 'B' credit rating in the region. On the other hand, these headwinds have led to scarcity of foreign currency liquidity making refinancing risk on USD borrowing challenging within the region.

Rise in Retail Space in Sub-Saharan Africa

Shopping malls are springing up across African countries in greater numbers, attracting international retail chains and boosting the construction industry. The African Development Bank reported that middle class Africans stand at 350 mn and has been a significant stimulant to the growth of the retail market space through increased disposable income giving the sector a rosy outlook.

Uganda partners with Tanzania in oil pipeline development

Security concerns have altered Uganda's earlier plan to develop an oil pipeline that ran through Kenya. Uganda, having recently discovered oil reserves at an estimated 6.5bn barrels will partner with Tanzania and develop a 1,400 km oil pipeline that will terminate at the Tanzanian Tanga port. This would open up an alternative route to the sea for landlocked Uganda other than the Kenyan port of Mombasa.

Transaction Highlights in East Africa

Sector	Acquirer	Seller	Transaction Description
February 2016			
Agribusiness	Schulze Global	MB PLC	Schulze Global, an American based investment firm, announced the completion of its 45% equity stake purchase in Ethiopia's dairy processor MB plc. - A family owned business. The investment will be used to increase operating efficiencies and also as growth capital.
Pharmaceuticals	Strides Shasun	Kenya Universal Corporation	A 51% equity stake of Kenya Universal Corporation has been purchased for approximately US$ 14 mn. Through this investment Strides Shasun has established a foothold in the East African market.
March 2016			
Financial Services	Progression Capital , Equator Capital	Jamii Bora Bank	Progression Capital Africa and Equator Capital Partners, a Chicago based firm have invested US$ 12 mn in Jamii Bora Bank, a Kenyan bank. The investment is aimed at an expansion programme to reach SMEs within the regions that are not sufficiently served by the current banking sector.
Infrastructure	Kuramo Capital Partners	TransCentury	Kuramo Capital Partners, an investment management firm, rescued TransCentury, a Kenyan based infrastructure investment firm, from defaulting on its US$ 75 mn convertible bond that fell due on 25th March. TransCentury received US$ 20mn in equity to partly settle the convertible debt.
Plastic Manufacturing	AfricInvest	Silafrica	AfricInvest, a private equity firm that is part of Tunisian based Integra Group has invested in Silafrica, a plastics and packaging firm with operations based in Tanzania, Kenya, Ethiopia, Uganda and India. The investment will be used to expand its product line and venture into new growth markets in Africa.
April 2016			
Logistics	Kibo Capital	General Cargo Group	Kibo Capital, a regional private equity firm, in partnership with Velogic, a Mauritian logistics company, acquired a stake in Kenyan based General Cargo Group.
Financial Services	CDC	DEG, Proparco	CDC, a UK government owned agency, acquired a 10.69% equity stake of I&M bank from DEG and Proparco development finance institutions at premium on the prevailing market price. This transaction occurred when there are high expectations for equity buys in the Kenyan banking industry due to a freeze on licensing of new lenders.
Telecoms	Orange	Millicom	Orange, a French based company, acquired Tigo DRC, a subsidiary of Milicom for an estimated US$ 160mn. This is one of the four African acquisitions this year by Orange in its bid to increase its African market presence.
Manufacturing	Catalyst	Orbit Chemical Industries	East Africa focused PE firm Catalyst Principal Partners have announced its investment in Orbit Chemicals Industries Ltd. The funding will be used to increase manufacturing capacity, regional operations and product range within the region.
Agribusiness	8 Miles	Verde Beef Processing	Africa-focused PE firm 8 Miles has bought a significant minority stake in Ethiopia's agribusiness firm Verde Beef Processing. The injected funds are aimed at increasing its base of 6,000 animals with the objective of meeting the growing market demand in Middle East, Africa and Asia. Also in the pipeline is the development of an abattoir and meat processing facility.

News from Horizon

Transaction Update: 2016

Selected Completed Transactions in 2016

- Restructure and refinancing of bank facilities for a manufacturing company in Kenya
- Restructuring advisory for a hospitality group in Kenya

Selected Ongoing Transactions: 2016

Mergers & Acquisitions

- Sell-side advisor for a logistics company in East Africa
- Sell-side advisor for a data management company in East Africa
- Sell-side advisor for a building products manufacturer and trading business

Corporate Finance

- Debt raise for three agribusiness projects in East Africa
- Debt raise for the development of three real estate projects in East Africa
- Refinancing of bank facilities for a hospitality business in Kenya
- Restructure and refinancing of a manufacturing business in Kenya

Advisory

- Buy side advisory for a financial services firm in East Africa
- Financial feasibility for a large mixed use development in Kenya
- Project management, structuring and financial modelling for a commercial development in Kenya
- Advisory and valuation services for a hospitality company in Kenya
- Tax structuring for a services company in Kenya
- Business plan development for a textile commodity trader in Kenya
- Financial modelling for a hospitality venture in Kenya

Horizon's Sector Expertise

Agriculture & Agro-processing

Real Estate

Energy, Oil & Gas

Fast-Moving Consumer Goods

Financial Services

Hospitality

Heavy & Light Manufacturing

Information and Communication Technology

Infrastructure

Telecommunications

Transport & Logistics

About Horizon Africa Capital

Horizon Africa Capital is a boutique mergers and acquisitions (M&A) advisory firm headquartered in Nairobi, Kenya.

Horizon's primary activities are M&A advisory, capital raising and corporate financial brokerage in Sub-Saharan Africa. Our approach is based on providing differentiated, integrated financial advisory services throughout the life of a transaction, from inception to execution. We have expertise in a number of sectors including Energy, Real Estate, Technology, Heavy and Light Manufacturing, Hospitality and Agro-processing.

Horizon Africa Capital Limited

Apollo Centre | 2nd Floor | Ring Road Parklands

P.O. Box 103646- 00101, Nairobi, Kenya

Telephone: +254 20 3742614/5

www.horizonafrica.com

Charles Omanga
Managing Principal
T: +254 722 248 272
E: co@horizonafrica.com

Shanif Dewany
Managing Principal
T: +254 733 939 699
E: sd@horizonafrica.com

Nyokabi Manguyu
Head of Mergers & Acquisitions
T: + 254 717 444 178
E: nm@horizonafrica.com

Pareet Shah
Head of Corporate Finance
T: +254 735 544 554
E: ps@horizonafrica.com

Hursh Shah
Head of Advisory
T: +254 733 237 368
E: hs@horizonafrica.com

Kenrick Kambo
Senior Analyst
T: +254 716 153 612
E: kkk@horizonafrica.com

Salome Muthoni
Senior Analyst
T: +254 704 892 020
E: sm@horizonafrica.com

Patrick Mwangi
Analyst
T: +254 723 885 164
E: pm@horizonafrica.com

Clara Mwangola
Analyst
T: +254 713 909 198
E: cm@horizonafrica.com