Capital Markets

Market set to be a regional financial services centre
Investors keeping an eye on wider economic trends
Sector reforms kick off with demutualisation process
Improved transparency for secondary trading

The NSE had 64 listings, in 11 categories, as of the end of 2015

Market movers

With the sector set for further reforms the future looks bright

Following demutualisation in 2014, the medium and long-term outlook for Kenya's capital markets is bright, with an increasing number of tradeable instruments on offer and work on a new securities settlement platform under way.

Both the Nairobi Securities Exchange and the Capital Markets Authority are taking steps to create the foundation for long-term growth under the Capital Markets Master Plan for 2014-23.

The country's capital markets have seen some bright spots in 2015 amid the broader turbulence affecting emerging markets around the world. While the bourse was not untouched by the strengthening US dollar and macroeconomic headwinds, trading volumes – which are often low on African exchanges – were up year-on-year, and the market's long-term fundamentals remain comparatively attractive. More general economic pressures – including currency depreciation, fiscal deficits and rising sovereign debt levels – along with a spate of high valuations and profit warnings in the first half of 2015 led to a slight decline in the Nairobi Securities Exchange (NSE) All-Share Index. The equity index peaked at 176.82 in February before ending September at 146.92, down 10% from 162.89, where it started the year.

However, the medium- and long-term outlook is fairly bright. On the back of demutualisation in 2014, the authorities are rolling out a number of tradeable instruments, work is ongoing on a new securities settlement platform and the Capital Markets Authority (CMA) has officially given the NSE approval to set up a new derivatives market. With the flurry of activity in agriculture, construction and transport, there remains a significant need for capital.

SIZE & SCOPE: The NSE had a total of 64 listings as of October 2015. They were split into 11 categories: agricultural; automobile and accessories; banking; commercial and services; construction and allied; energy and petroleum; insurance; investment; investment services; manufacturing and allied; and telecommunication and technology. Of these, banking had the most listings, with 11. Total market capitalisation stood at KSh1.955trn ($21.5bn).

As of late 2015 the NSE had authorised a total of 22 trading participants, which operate on the Main Investment Market Segment, and 23 nominated advisors, which are authorised to trade on the Growth Enterprise Market Segment (GEMS). GEMS was established in 2013 with the goal of attracting more small and medium-sized enterprises (SMEs) to the capital markets (see analysis).

STRUCTURE: The sector's regulator is the CMA, an autonomous organisation that reports to the Treasury. It is self-financing, generating income via licensing fees, trading levies and processing of public and private issue approvals. However, regulatory reform is on the horizon in the form of a proposal to merge several Kenyan financial services regulatory bodies and agencies. The NSE, which is more than 60 years old, serves as the bourse, and, in line with global trends, it has recently demutualised and listed itself.

REFORMS AFOOT: The NSE and the CMA are taking a series of steps to support long-term growth in the exchange (see analysis) as part of the Capital Markets Master Plan (2014-23). Among the initiatives being rolled out are new products to boost liquidity and help attract more domestic retail investors, given that only 4% of the population currently participates in the local market.

One such investment vehicle is exchange-traded funds (ETFs), which are due to be launched in the first quarter of 2016, with the NSE having already submitted proposed trading rules for review. A Practice Guidance Note to facilitate the launch of ETFs in Kenya was completed in June 2015. Other initiatives include a new securities settlement platform that is expected to go live in the first quarter of 2016, and will feature functionalities such as same-day trading, settlement services for government securities, and securities lending and borrowing to facilitate short-selling and other investment strategies.

The country also plans to launch a derivatives market by the end of 2015, which will make the NSE the second bourse in sub-Saharan Africa after the Johannesburg Stock Exchange to offer such instruments. Initial offerings on the long-awaited market will initially focus on financial derivatives and subsequently move on to commodities. "There is great demand and appetite for the derivatives market in Kenya, from both investors and market participants," Geoffrey Odundo, CEO of the NSE, told OBG. "Derivatives will offer a wider range of investment channels and give individuals, corporates and farmers a view of the future prices of currencies, interest rates, minerals and agricultural products. We believe this market will revolutionise Kenya's capital markets industry."

Additionally, as with other alternative and smaller-cap markets across the continent – including the NILEX in Egypt and the GAX in Ghana – drawing SME listings is not easy in Kenya, but GEMS has attracted four companies since opening in January 2013, and more are expected in the coming years as awareness and training campaigns expand.

The government has also sought to encourage activity on the capital markets in other ways, including rolling back a capital gains tax (CGT). In a bid to help reduce the fiscal deficit, the government unveiled a CGT at 5% on equities and bond sales from January 1, 2015 after an absence of 30 years. According to local press, trading activity initially slumped by 70% as a result of the new tax and uncertainty over the nature of its assessment. The Kenya Association of Stockbrokers and Investment Banks took the issue to court, and in May the Institute of Certified Public Accountants called for the tax to be reviewed.

In June 2015 Cabinet Secretary for the National Treasury Henry Rotich said that the government was listening and that the gains tax would be replaced with a 0.3% withholding tax. When the president, Uhuru Kenyatta, subsequently signed the Finance Bill in September, after months of debate in parliament, both CGT and withholding tax were removed for NSE-traded equities and bonds starting in 2016.

INDICATORS: Strong volumes of equity market trading were seen over the first half of 2015, with equity turnover worth KSh107bn ($1.18bn), up from KSh101bn ($1.11bn) a year earlier. Full-year equity trading volumes climbed from KSh86bn ($946m) in 2012 to KSh155bn ($1.7bn) in 2013 and KSh215bn ($2.4bn) in 2014. Meanwhile, bond trading dropped significantly and in the second quarter of 2015 averaged nearly KSh20bn ($220m) a month, down from the KSh42bn ($462m) average a year earlier.

The top 10 stocks by volume traded are Safaricom, Kenya Commercial Bank, Equity Bank, Coop Bank, Barclays, Mumias, Britam, Kenolkobil, Kenya Power and Lighting Company, and CIC. Liquidity does remain a constraint, yet trading is robust.

Kevin Tuitoek, macroeconomic analyst at Genghis Capital, told OBG that positives include determined action to improve security and rising power generation, which is likely to reduce electricity costs and stimulate economic activity. Negatives include profit warnings after pressure from increasing interest rates and high import costs, both linked to the decline in the currency; increased competition in sectors such as insurance; and slowing growth among leading banks. He added that the effects of a rise in the US target federal funds rate "are likely to cause some short-term ripple effect to emerging markets, including Kenya, with some risk of further currency shock and possible investor flight".

Other markets saw equally encouraging indicators for investors. Soaring money market rates saw the October 5 auction pricing a 91-day treasury bill at 20.637%, up from 18.607% on September 28, according to the Central Bank of Kenya (CBK). The government's one-year KSh30bn ($330m) bond sold at a record rate of 19.062%, offering the biggest returns for investors in three years.

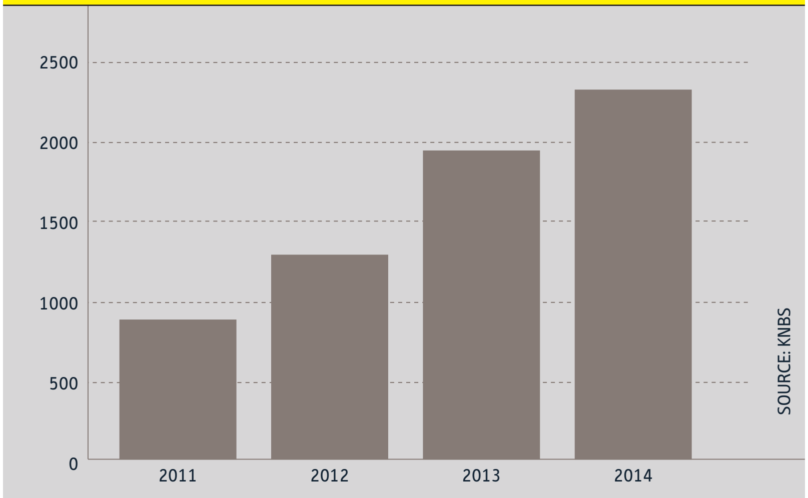
MERGERS & ACQUISITIONS: The pace of corporate mergers and acquisitions (M&As) initially slowed in the first part of 2015 compared to a year earlier, but by August things had picked up, with 37 M&As at a total value of $767m, according to Burbridge Capital.

Larger trades included the Aviation Industry Corporation of China investing KSh6.7bn ($73.7m) in equity as NSE-listed Centum Investment Company attracted KSh14.7bn ($161.7m) for its Two Rivers development. East Africa Breweries sold Central Glass Industries to South Africa's Consol Glass for KSh4.5bn ($49.5m). Seruji bought a 60% stake in Savannah Cement from two Chinese firms, while Africa Oil closed a $50m equity sale to the International Finance Corporation for its Kenya operations. Hong Kong-listed logistics firm Frontier Services Group used its Nairobi base as a bridgehead to buy South Africa's Transit Freight Coordinators for $3.7m.

The financial sector has also witnessed a significant spate of activity. I&M Holdings did not disclose the total amount it spent when it bought lender Giro Commercial Bank in September 2015, and a month later it snapped up a majority stake in Burbridge Capital, while insurer Old Mutual acquired a 37.3% stake in local insurer UAP Holdings for $155.5m in cash, after investing a total of $253m during the month, taking its holding up to 60.7%. Previously, in November 2014, the private equity (PE) firm LeapFrog Investments purchased a majority stake in Kenya's fourth-largest health insurance group, Resolution Insurance, with a bid valued at KSh1.6bn ($17.6m).

The government has sought to encourage more activity in the market by rolling back a recently introduced capital gains tax after trading slumped by 70%.

NSE market capitalisation, 2011-14 (KSh bn)



Kenya, on the road to being the heart of African Capital Markets

CAPITAL
MARKETS AUTHORITY
Promoting Capital Markets Integrity

The Capital Markets Authority (the Authority) is inspired and driven by the goal of positioning, through responsive and innovative regulation, Kenya's capital markets as an attractive destination for domestic, regional and international issuers and investors to invest in and realize their investments in Kenya, within East Africa, across Middle Africa and the African continent as a whole.

At the core of this aspiration lies the Capital Markets Master Plan, a 10-year blueprint for the development of the capital markets in Kenya, which aims to position Kenya as the heart of African capital markets. The Master Plan is currently under accelerated implementation under key underpinning pillars namely: supporting developmental and economic transformation; deepening the product and services range and strengthening the infrastructure of the markets; continuously improving the legal and regulatory environment and improving Kenya's connectivity to global markets and its competitiveness as a financial centre.

In line with our commitment to broadening the range of products and services available to issuers, investors and market intermediaries, the Authority has facilitated the introduction of products such as Real Estate Investment Trusts (REITs), Asset Backed Securities (ABS), Exchange Traded Products (ETPs) such as Exchange Traded Funds (ETFs) and Derivatives which are expected to be rolled out by the end of December 2015. This has been complemented by the recent lifting of restrictions on foreign investment in listed securities; introduction of a listing segment targeting SMEs; the approval of a trading platform for derivative instruments; the introduction of a global standard corporate governance code for listed companies and stewardship code for institutional investors and the design and introduction of industry certification standards in conjunction with the Chartered Institute for Securities and Investment (CISI).

In pursuit of establishing a harmonized single market for securities in the East African Community, the Authority has been at the forefront of developing East African Community Council Directives to define region wide legal and regulatory convergence standards for the capital markets as well as spearheading initiatives to support the integration of market infrastructure to facilitate the free movement of capital and services within the EAC.

The Authority is proud to be an active player in the development of global standards on securities regulation as a board member of the International Organization of Securities Commissions (IOSCO). The Authority is also engaged in informing regional responses to support systemic stability as one of the securities markets members of the Financial Stability Board (FSB) Regional Consultative Group for Sub-Saharan Africa.

With Kenya's growing visibility as the global leader in mobile money solutions and innovation, the Authority is facilitating the roll out of "M-Akiba", a mobile phone based platform through which investors will register, purchase, trade and settle government bonds from as low as US $30 targeted to support financial market inclusion and higher national savings levels.

Full implementation of the identified activities in the Master Plan is targeted to position Kenya's market to be deep and dynamic so as to stimulate domestic development and provide a gateway for international capital flows in line with Kenya's Vision 2030.

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PERFORMANCE: The financial sector continues to represent a major attraction for investors, although some institutions have seen pressures on profit margins, with share prices declining as a result. With increased capital requirements on the horizon and strong premium growth in the insurance sector, the outlook is favourable. Kenyan banks are spreading across the region and will eventually come to the market for capital to satisfy regulators. "The biggest challenge right now is meeting the capital requirements," Richard Mambo, head of global financial institutions (East Africa) at Standard Bank, told OBG. "A lot of banks are issuing corporate bonds or doing rights issues. There are a lot of calls for capital."

In agriculture, which represents more than a quarter of Kenya's GDP, drought and below-average short rains for October to December 2014 hit tea production in the first quarter of 2015, but the March to May 2015 long rains were better, and some share prices have been climbing back in 2015. The weakening shilling boosted profits for exporters of horticultural and other products, many of which are paid for in euros or pounds. Kakuzi, a producer of tea, avocados, livestock and pineapples that is listed both in Nairobi and London, has seen a strong share price performance, up 75% by the end of September. Kapchorua Tea was also strong, climbing 43% to KSh198 ($2.18) per share during the same period.

Property development is also booming, particularly around Nairobi, as suburbs and new towns linked by motorways sprout in former coffee plantations. Land investments have outperformed other commodities over the past seven years, according to HassConsult, and the launch of real estate investment trusts (REITs) will make this sector more accessible to investors. In October 2015 Fahari I-REIT (investment REIT), issued by Stanlib Kenya, was approved by the CMA and announced plans for a KSh2.6bn-12.5bn ($28.6m-137.5m) initial public offering (IPO). Several more are likely to follow. However, many Kenyans still prefer direct investment in property and land, instead of the stock market, bank deposits or bonds.

FOREIGN PARTICIPATION: The Kenyan market is actively courting foreign investment in the bourse, with notable results, although external events have made 2015 more of an uphill climb. The strengthening US dollar, for example, has had ramifications for emerging and frontier markets around Africa, resulting in two of the worst performing currencies in Ghana and South Africa. Kenya fared much better, although the CBK still had to take active measures to defend the shilling-dollar exchange rate, hiking interest rates twice since June 2015 to 11.5%. The shilling opened the year at KSh90.55:$1, then slipped for the first three quarters to peak at KSh106.12:$1 in September before starting to edge back.

These sorts of macroeconomic pressures have had an expected impact on the level of portfolio inflows. "Until recently, around 70% of stock market turnover was generated by foreign investors, but this has since declined to around 60%," Jimnah Mbaru, chairman of

While IPOs have slowed since the NSE's own offering in 2014, several are expected in the next few years

Dyer and Blair, a local investment bank, told OBG. "Part of this is likely due to the steadily declining shilling, though regulatory uncertainty and global macroeconomic instability have also played their part." However, this is expected to be a temporary trend, and most market participants interviewed by OBG said that the long-term trend is growing foreign investment. Jacqueline Mwiti, senior officer of corporate finance at the NSE, told OBG that, "There has been a lot of interest in listed and unlisted equities in the Kenyan market with funds from the Middle East, North America and Europe directing funds into the Kenyan asset markets."

Foreign interest is also being actively encouraged by the government. In June 2015 Rotich announced the end of the 75% cap to the share that foreigners could own in NSE-listed companies. Changes to the capital markets (foreign investors) regulations meant limits would only be retained where there is a "strategic interest". The impact of this could be noticeable in the short term, given that in March 2015 the CMA was required to hold further transactions for foreigners wishing to buy into British American Tobacco, which was already 76% foreign owned, and Total Kenya, which was 94% foreign owned.

PRIMARY MARKETS & IPOS: No equity listings have followed the NSE's own IPO in 2014, as low valuations deterred enterprises that had considered a share offer. However, the demand for capital remains, according to Marcel Mballa-Ekobena, executive head of investment products sales East Africa at CfC Stanbic Bank, because "the private sector is so dynamic". Access to fresh capital is critical in most sectors, including banking and insurance, among others.

The NSE's Odundo said he expected some major IPOs and listings in the next five years, mainly due to the government's drive to build ports, roads, railways and power plants, some via a public-private partnership. A requirement for oil and gas firms to have 40%

The sector is also looking to encourage more foreign investors to enter the bourse, and the government announced in June 2015 that it would end the 75% cap on foreign ownership in NSE-listed companies.

Equity turnover increased from $1.11bn in the first half of 2014 to $1.18bn for the same period in 2015

local ownership will also boost listings. Despite the limited activity for new equities, the debt market has been very active, with a number of new listings.

INSTITUTIONALS: Pension industry assets were KSh750bn ($8.25bn) in June 2014, after climbing 18.4% in a year. Returns have been especially good for funds with substantial offshore holdings, although most Kenyan funds focus primarily on listed equities, government securities and real estate. Poor performance in both the currency and equity markets in the first half of 2015 may be encouraging them to reconsider. Banks have proved keen to buy stockbrokerages so that they can offer clients a fuller range of financial services. The NSE reduced licence fees for brokers to KSh25m ($275,000) after its 2014 demutualisation, as previously the only routes for would-be stockbrokers was to buy trading rights in an opaque market or buy a broker.

In October 2015 I&M Bank signed a deal to buy a 65% holding in corporate finance and investment firm Burbridge Capital, subject to approval by regulators. Two months before, Mauritian fund manager Axis had acquired Kenyan stockbroker ApexAfrica Capital for KSh470m ($5.2m) through local unit Mauritius Kenya Investment Holding, making it the highest price paid for a market intermediary in East Africa. Earlier, in 2014, Equity Bank had bought a majority in collapsed stockbroker Francis Thuo & Partners for a suggested KSh150m ($1.65m) and Commercial Bank of Africa is said to have paid the same for a trading seat. Meanwhile, Renaissance Capital was reported to have paid KSh250m ($2.75m) for a seat in 2007.

While private equity in Africa is limited, it has been growing rapidly in the past few years and Kenya has started to attract more attention, with 29 PE transactions for the year up to September 2015.

PE: PE activity in Africa is still fairly limited but it is growing rapidly, and while South Africa remains the dominant sub-Saharan market for funds looking at the continent, Kenya is attracting its fair share of attention. Kenya-based Burbridge Capital lists 29 PE transactions for 2015 up to September, totalling $1.3bn. Estimated at a total of $897m, 11 transactions were successful exits by funds, building a track record and encouraging new investors to join the sector. Key deals included those in the banking, insurance, education, energy and real estate sectors.

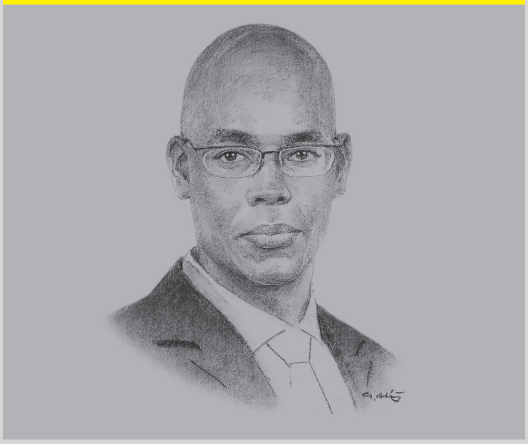
One of the biggest deals was the sale by Helios of a 12.22% stake in Equity Bank to Norwegian funds Norfund and NorFinance for KSh23bn ($253m) and another 5.58% stake to Kenya's National Social Security Fund for KSh9.7bn ($106.7m). Burbridge Capital estimates that Helios quadrupled the KSh11bn ($121m) it paid in 2007 to acquire its 24.99% stake and also collected KSh6.5bn ($71.5m) in dividends, giving a 4.6 times exit cash multiple.

Another KSh23bn ($253m) changed hands when PE firms Abraaj Group, AfricInvest and Swedfund, along with Centum, sold a combined 60.7% shareholding in UAP Holdings to Old Mutual. The UK's Actis sold its 30% stake in Mombasa's Tsavo Power to Globeleq Africa, CDC Group and Norfund for KSh23.8bn ($261.8m). In July 2015 Norfund made an equity investment of KSh476m ($5.2m) in Vertical Agro, the biggest exporter of organic vegetables. Several PE funds are also working successfully with SMEs. In September 2015 GroFin launched a regional small and growing businesses fund. Other segment players include Business Partners International, which has a Kenya SME fund; Acumen Fund, which has been operating since 2001; Investeq Capital; and Uganda-based African Agricultural Capital.

CREDIT RATINGS: In July 2015 Moody's affirmed a "B1" rating and stable outlook, balancing the positives of growth prospects, leadership in East Africa and commitment to reform with the negatives of government and current account deficits, and security challenges. However, the public budget weighed on the economy more generally. In October 2015 Standard & Poor's downgraded the outlook on Kenya's "B+" rating to "negative" from "stable", citing risks from currency depreciation, deficits and rising debt. Fitch moved Kenya from stable "B+" to negative "BB-" due to deteriorating finances.

OUTLOOK: There are interesting times ahead for Kenya's capital markets. Mballa-Ekobena said valuations are now looking tempting in the context of future growth, even with short-end rates above 20% in the last quarter of 2015. "We should not look at them in isolation but as a longer-term growth story for Kenya," he said. "Growth alone is not the key value driver. Corporate action is most important; you need to see what management is doing differently in their specific sectors." Some PE firms had been delaying their exits and could now consider using the bourse.

"There's no better time to be in Kenya. Investors should focus on the government's financial support for transport and energy, the country's oil discoveries and economic growth above the sub-Saharan average," said Michael Kafe, economist at Morgan Stanley. "In the next three to five years Kenya is going to be a producer and likely an exporter of oil, which changes the economy. Kenya, in the context of sub-Saharan Africa, is one of the better-run ones."



Paul Muthaura

A new normal

OBG talks to Paul Muthaura, CEO, Capital Markets Authority (CMA)

How can Kenyan companies be encouraged to use capital markets as a financing option?

MUTHAURA: We have invested time and resources in a joint initiative with the Nairobi Securities Exchange conducting a diagnostic assessment around new listings and the Growth and Enterprise Market Segment (GEMS). We considered things such as eligibility requirements, to discover what the most significant obstacles are. In Kenya it is not so much barriers as it is our underlying culture – many of the companies that would be prime listing candidates are family-run, and they are not necessarily prepared for increased openness and governance. We are beginning to see this change, which is a positive development for the future growth of the market.

In terms of our public awareness and education initiatives, we are broadening our partnerships with key private sector organisations in the country. Through these partnerships, we organise seminars for the prime listing candidates amongst their ranks, informing them about the listing process and explaining to them what steps are required. The Nairobi Securities Exchange is also taking a more active role in supporting and tightening the supervision of nominated advisors that are effectively the connection between the bourse and potential GEMS candidates.

We see these actions as really playing a role in catalysing more companies to come to market, and we are quite confident that we will see a few listings in early in 2016, if the macroeconomic fundamentals hold.

What is the potential for real estate investment trusts (REITs) in the Kenyan market?

MUTHAURA: The first Kenyan REIT launched in October 2015, and it saw positive uptake and easily exceeded its minimum targets. We really see REITs as one of the high-growth areas in terms of new products. There is a Kenyan obsession with real estate, and thus, the creation of a product that can introduce liquidity and greater transparency, as well as democratise ownership, was very significant for the market.

This new release also opened up a conversation between the CMA and other regulators, such as the Retirement Benefits Authority (RBA), to ensure that our investment guidelines are better aligned. The news that the REITs would be treated as a listed equity by classification – as opposed to real estate, which is considered illiquid – was received enthusiastically by the pensions sector, and it significantly broadened the scope of investors interested in the REIT.

Going forward, with the benefit of those clarifications, we are likely to see development REITs come next. If anything, these are much more relevant to the Kenyan economy. Compared to income REITs, which are based on income-generating property, development REITs provide a transparent structure for raising public capital for construction and development making them much more interesting considering all of the projects that are occurring across the country. We see providing greater public market financing as a great tool to bring down the cost of capital, and thus the cost of development, in this country.

To what extent do you see pension funds becoming more important market players?

MUTHAURA: As a result of the introduction of the REIT, there has been a running discussion between the CMA, the RBA and the Insurance Regulatory Authority around bringing in a bit more room and flexibility to the current investment guidelines. We have already seen positive results from REITs, and are optimistic about the release of the first exchange-traded funds, which could potentially launch in the first quarter of 2016. These advances will be followed by some new securitised listed products that will go into the next budget cycle. We are in broad agreement that the investment guidelines should be reviewed to ensure we are effectively taking advantage of pension funds.

Geoffrey Odundo

New listings

OBG talks to Geoffrey Odundo, CEO, Nairobi Securities Exchange (NSE)

Which areas have the most potential for new listings on Kenya's capital markets?

ODUNDO: The capital markets industry in Kenya has come a long way and is gaining substantial traction among corporates seeking to raise capital. In 2014 the exchange saw KSh6.1bn ($67.1m) in additional equity issues and KSh19.84bn ($218.2m) in corporate debt from various listed companies, as well as three new listings on its Growth Enterprise Market Segment (GEMS). These events show that our companies are gradually opting to raise capital for their various initiatives through the capital markets.

We are currently having one-on-one meetings with listed companies to ensure that they understand the capital-raising opportunities available on the exchange. In 2015 we expect an increase in listings as we gear up to launch derivatives, real estate investment trusts and exchange-traded funds.

What can be done to bolster growth in GEMS?

ODUNDO: It is anticipated that any new market such as GEMS takes time to pick up. However, we are encouraged by several listings since the segment was launched in 2013, including the three new ones in 2014. In the aggregate, the newly listed GEMS companies added KSh6.7bn ($73.7m) to the NSE's market capitalisation as of end-2014. To support the growth of the segment, we are conducting various marketing campaigns to increase listings. We are engaging with strategic partners to educate potential firms on the benefits of listing, as well as organising forums and meetings with advisers and potential firms to demystify the market and guide them through the process. We should see some new listings in 2015.

How much demand is there for a futures market?

ODUNDO: There is great demand and appetite for the derivatives market in Kenya, from both investors and market participants. We have so far approved three clearing members and seven trading members to participate in the market, with others in the pipeline. We are currently gearing up to launch the derivatives market, which should occur in 2015. Derivatives will not only offer a wider range of investment channels, but also give individuals, corporates and farmers a view of the future prices of currencies, interest rates, minerals and agricultural products. We have conducted intensive training for market intermediaries and clearing banks, which are eager to participate in this new segment. We will also be embarking on a public education and awareness campaign for investors and the public at large. We believe this market will revolutionise Kenya's capital markets industry.

What is being done to boost local market liquidity?

ODUNDO: We are working on day trading for equities and have been conducting various initiatives to boost market liquidity. We are also working on a platform for borrowing and lending securities, which will allow stock, derivatives and other securities to be loaned to an investor or firm. The Capital Markets Authority is developing rules to guide this process, which should support growth in short selling and derivatives.

How can one encourage cross-listing on the NSE?

ODUNDO: Cross-listing is a major step towards our goal of ensuring that companies with substantial operations in Africa are accessible to both Kenyan and international investors, while also increasing their liquidity. We currently work with various international exchanges and participate in local and international roadshows to encourage cross-listing, and have even signed memoranda of understanding with several exchanges, including those in Seoul and Johannesburg. We recently hosted a forum in Nairobi with a number of partners, where stakeholders were educated on the benefits of cross-listings and the process for doing so. Additional awareness forums are also in the pipeline.

The bourse raised $6.9m by selling 31% of its equity at $0.10 a share

Listing the benefits

Demutualisation of the exchange kicks off a round of reforms

The Nairobi Securities Exchange (NSE) demutualisation in 2014 marked the beginning of a period of rapid innovation in East Africa's capital markets. Together with the Capital Markets Authority (CMA), the sector's regulator, the reforms should put the country's markets on track for steady growth over the long term. The framework for reforms is the 10-year Capital Market Master Plan, which was launched in November 2014 by the cabinet secretary of the National Treasury and links to other major national projects, including Vision 2030.

There have, however, been challenges. Obstacles to progress include foreign investors selling in 2015 and locals switching out of equities into high-yielding short-term debt instruments. Trading volumes suffered in early 2015 after a capital gains tax (CGT) was reintroduced on equity and bond sales. However, the government responded positively and the Finance Bill of 2015, signed into law in September, removed both CGT and its successor, withholding tax, on NSE-traded securities, as well as a stamp duty on property transferred into real estate investment trusts (REITS).

DEMUTUALISATION: The NSE's successful demutualisation in June 2014 took five years of planning before the exchange was transformed from a mutual association of stockbrokers to a company with a board and governance. The bourse raised KSh627m ($6.9m) by selling 31% of the equity at KSh9.50 ($0.10) a share in a heavily oversubscribed (764%, according to the CMA) offer that closed in August. It listed on its own main board in September 2014, and within a year had more than doubled the share price to KSh20.50 ($0.23), after a peak of KSh28 ($0.31).

The NSE reported profit before tax for the first half of 2015 of KSh219m ($2.41m), up 22% from KSh179m ($1.97m) a year earlier, boosted by improved levies from the equity market and increased income from data sales and post-trade services. Equity trading remained flat in the half year, and bond market turnover fell by 17%. Full-year income for 2014 was up 32% to KSh822m ($9.04m), on the back of a 39% increase in equity turnover to KSh431bn ($4.7bn).

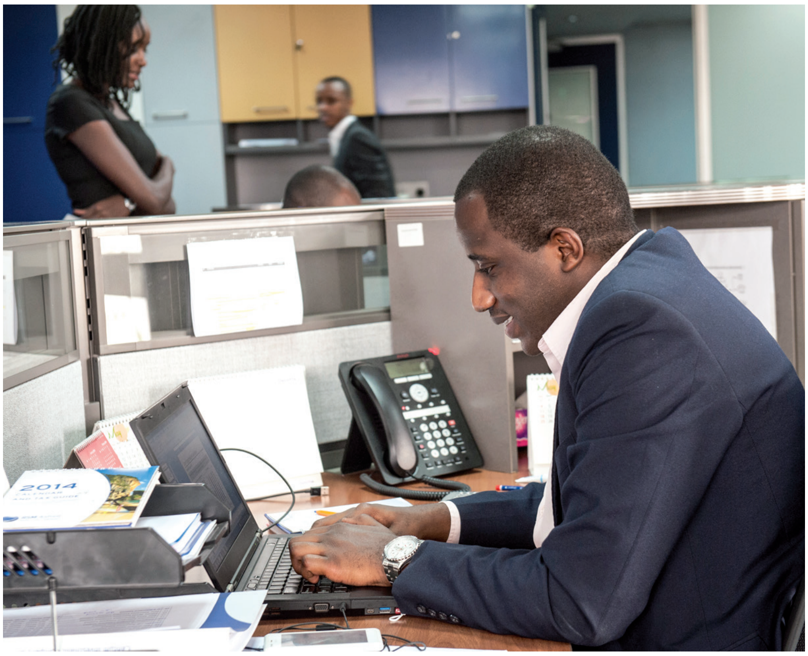
Joseph Mwenda, senior infrastructure and product development officer at the CMA, told OBG that the demutualised and listed NSE would be competitive globally and open the way for technology and regulation change. Jacqueline Mwiti, senior officer for corporate finance at the NSE, pointed to new standards of corporate governance. "The new regulations will align corporate governance standards between listed and non-listed firms. Coupled with the better systems at the NSE and the new products, the new standards will also help the NSE add value to its shareholders following from its listing in 2014." The NSE is upgrading its automated trading system and expects to complete in early 2016.

DERIVATIVES: The NSE was licensed by the CMA in October 2015 to launch a derivatives exchange modelled on the Johannesburg Stock Exchange. Initially due by June 2015, deadlines were extended to allow for delays in the clearing house and settlement guarantee and investor protection funds. The bourse has also provided training for traders, asset managers, banks, risk managers and operations teams, and three banks and seven traders are registered.

The first instrument was to be a single-stock future, initially linked to the local currency, although going forward other currencies would be allowed. Other securities will include interest rate and foreign exchange derivatives, commodity futures, currency futures and an equity index. Ian Gachichio, research analyst at Kestrel Capital, said that currency and interest rate hedges are likely to be the most exciting instruments initially. According to the CMA, the regulatory framework has been aligned to the principles of the International Organisation of Securities Commissions and to Kenya's status as a developing economy. Geoffrey Odundo, CEO of the NSE, told

For the first half of 2015 the NSE reported that profit before tax was $2.41m, up 22% from $1.97m a year before, while equity trading remained flat and bond market turnover decreased by 17%.

The NSE was awarded a provisional licence by the CMA to establish a derivatives exchange, modelled on South Africa's own, and the bourse has provided training for traders, asset managers, banks, risk managers and operation teams.



New regulations for the market allow for income-paying I-REITS, which pay 80% of earnings as dividends

The country is also home to the Growth and Enterprise Market Segment, which was launched in 2013 to attract more SMEs. While it has attracted only a few listings, this is expected to change as awareness grows among Kenyans.

OBG, "There is great demand and appetite for the derivatives market in Kenya, from both investors and market participants. Derivatives will not only offer a wider range of investment channels, but also give individuals, corporates and farmers a view of the future prices of currencies, interest rates, minerals and agricultural products. We believe this market will revolutionise Kenya's capital markets industry."

MOBILE BONDS: Another reform due in October 2015, delayed by market conditions, is a KSh5bn ($55m) tax-free five-year infrastructure bond that can only be bought by mobile phone. Minimum investment in the treasury's M-Akiba bond will be KSh3000 ($33), down from the KSh50,000 ($550) minimum of other treasury bonds, to encourage public participation. Rates were not known at time of press, but Henry Rotich, cabinet secretary of the National Treasury, said it would pay more than commercial banks (rates were up to 5.5% on savings accounts) but less than Treasury bills, which had rates of 20.6% by October 2015. NSE chairman Eddy Njoroge said, "Our bond market is currently dominated by foreign and local institutional investors. M-Akiba is in line with the NSE's strategy of enhancing financial inclusion by driving retail investor participation." 27.7m Kenyans use some form of mobile money subscription.

GEMS: The Growth and Enterprise Market Segment (GEMS) was launched in 2013 to attract small and medium-sized enterprises (SMEs). It started with bold plans to list five companies a year, but Nairobi builder Home Afrika was the only company to list in 2013 and it was followed in 2014 by manufacturer Flame Tree and Kurwitu Ventures, which offers sharia-compliant investment products. Atlas Development and Support Services, which provides oilfield logistics services, became the first dual-listing, with its stock also present on London's Alternative Investment Market.

The government is also offering a $55m, tax-free, five-year infrastructure bond that can only be bought via mobile phone, with a minimum investment of $33, a decrease from a minimum of $550 for other Treasury bonds in the past.

The slow start is not unexpected and is likely to change as awareness grows. Many Kenyan SMEs are family owned, and it may take time before public disclosure and sharing control become attractive. Some business owners feel banks are easier to deal with, but Vimal Parmar, head of research at Burbridge Capital, feels that the tide is turning: "Business companies are quite excited about GEMS for raising public equity, including family businesses," he said. Although there are low listing costs and few barriers, corporate governance standards are high, as GEMS requires nominated advisors. Companies such as Genesis Analytics, Bourse Consult and Burbridge advise on new listings and help ensure a firm complies with ongoing listing and governance requirements.

REITS: Kenya's vibrant property market has been introduced to the securities exchange through REITs. New rules allow for income-paying I-REITs, which pay 80% of earnings as dividends, and D-REITs, which are likely to prove popular for financing developments, as well as Islamic REITs. In October 2015 the CMA approved the first I-REIT, issued by Stanlib Kenya and named Fahari I-REIT. The fund planned an initial public offering for KSh2.6bn-12.5bn ($28.6m-137.5m). Meanwhile, stockbroker Burbridge Capital is advising on the listing of property firm St Paul's, due later in 2015. St Paul's says it will list on GEMS but invest in the UK commercial market. In addition, Mwenda said that the CMA is processing other applications.

ETFS: In August 2015 the CMA put out guidance notes for exchange-traded funds (ETFs). This is a fund created by a sponsor to mimic the behaviour of another value, such as a stock exchange index or a commodity basket. Regulation is also being readied for asset-backed securities, with mortgage-backed securities likely to be among the first to apply.

SETTLEMENT UPGRADES: In January 2015 cash settlement on equities and corporate bonds moved to the Real-Time Gross Settlement (RTGS) system, run by the Central Bank of Kenya (CBK). In August 2014 the CBK had introduced same-day settlement for Treasury bonds and bills through the RTGS system, fed by trading information received from the NSE every two hours. The RTGS reduces default and other risks, and shortens transaction times.

Settlement for equities and corporate bonds securities continues to be handled by the Central Depository and Settlement Corporation, which is also upgrading. New systems will advance from the current four-day settlement (T+5) and allow investors to buy and sell the same day (intra-day settlement). Fast settlement allows day-traders and other margin traders, and the new system will include a securities lending tool, opening the market for short-selling and other strategies, which may increase liquidity.

In March 2015 the NSE joined the UN Sustainable Stock Exchanges, becoming the 18th member worldwide and the fourth in Africa after the exchanges of Egypt, Nigeria and South Africa. Odundo said, "We continue to strive to deliver the best service." He added that the NSE's goal is still to broaden offerings and deepen capital markets while strengthening Kenya's position as a financial services hub in East Africa.

Primary issues in the first half of 2015 included microfinance

Bonding process

Secondary trading has been slowing, despite improvements in transparency and efficiency

The country's bond market is the third-largest in sub-Saharan Africa after those of South Africa and Nigeria, with a trading volume of $70m-100m a day. However, during 2015 secondary trading has been slowing, largely due to changes in the economic environment and the lure of soaring interest rates for short-term debt instruments in the second half of the year. The slowdown comes despite the Nairobi Securities Exchange (NSE) making giant strides in improving transparency and efficiency in the trading of Treasury and corporate bonds. Ultimately, Kenya's persistently high interest rates and growing economy are likely to continue to attract global and local interest.

AUTOMATIC TRADES: In September 2014 the NSE and the Central Bank of Kenya (CBK) jointly launched an automated trading system (ATS) for the NSE's fixed-income securities segment. The system was built by South African software firm Securities Trading & Technology, which also supplied the Johannesburg Stock Exchange's bond trading platform. Most African bond markets still trade in the less regulated over-the-counter (OTC) market, the preferred venue for banks and other big traders.

The system is integrated with the Real-Time Gross Settlement system under the CBK's Kenya Electronic Payment and Settlement System. It offers true delivery-versus-payment to mitigate risk. The NSE increased the number of daily settlements for Treasury bonds to three per day, and a bond trader can buy a Treasury bond and sell it the same day. The ATS follows South African practice and quotes bonds by yield to maturity. It supports market making and a two-way quote trading model. OTC trades can be reported for settlement and the system can integrate with regulators' surveillance systems. It also supports trading in bonds in different currencies.

In July 2015 the NSE amended its trading rules for fixed-income securities and how they interact with the trading system. Geoffrey Odundo, CEO of the NSE, said this could lead to more diverse debt securities, including senior unsecured fixed-rate notes and equity-linked notes. Paul Muthaura, acting CEO of the Capital Markets Authority (CMA), called for more improvements, saying, "I would urge the National Treasury to continue spearheading the consolidation of the two domestic central securities depositories as we position ourselves towards integrating the capital markets infrastructure within the EAC."

NEW ISSUES: Investor interest in primary issues was strong for the first part of 2015. In January 2015 Commercial Bank of Africa listed a KSh7bn ($77m) medium-term note, which was oversubscribed by 40%. The listing exercised a KSh2bn ($22m) greenshoe option, allowing the underwriters to sell investors more shares than originally planned. This was followed in March by East African Breweries' issue of KSh5bn ($55m), which was oversubscribed by 81%. In May the CMA approved the issue of a KSh6bn ($66m) medium-term note by Centum Investment Company to fund new investments in power plants and real estate. It attracted bids worth over KSh8bn ($88m), and allowed separate listing of the bond and its equity-linked component. May 2015 also saw Chase Bank launch a seven-year KSh10bn ($110m) multi-currency corporate bond to strengthen its capital base and finance expansion, and the first KSh3bn ($33m) tranche was also oversubscribed, with the issue exercising a KSh1.8bn ($19.8m) greenshoe option.

In July microfinance lender Real People opened a KSh2.5bn ($27.5m) issue of five-year and three-year fixed-rate notes, but only attracted KSh1.6bn ($17.6m) in bids. Then, in August, Imperial Bank offered KSh2bn ($22m) in a 15% bond maturing in December 2020, but on October 13, the day it was supposed to start trading, the CBK announced that it was placing Imperial Bank under statutory management for "inappropriate banking practices", and the CMA immediately suspended the listing and trading.

In the second half of 2014 the NSE and the central bank partnered to launch an automated trading system for the bourse's fixed-income securities segment and the system has been integrated with the bank's Real-Time Gross Settlement structure.

The NSE has also changed trading rules for fixed-income securities, which could lead to more diverse debt securities and is part of a drive to better integrate capital markets with the rest of East Africa.