



## Recovery amid global crises

During Q1'22, optimistic projections of accelerated economic recovery from the effects of the pandemic were dampened by soaring geopolitical tensions. The war in Ukraine has negatively affected the global energy market, commodity prices and disrupted supply chains weighing down the global economy. As economic activity gradually resumed, rising fuel and commodity prices, necessitated hawkish stances from Central Banks as they sought to mitigate inflationary pressure. Locally, government interventions aimed at alleviating the effects of the global crises have come under increased pressure as the economy reels out of the pandemic-induced slump. Going forward, we anticipate decelerated economic recovery, held back by the prevailing global crises and the looming General Election.

- **Subdued Inflation:** Headline inflation during the quarter declined to an average of **5.34%** from **5.99%** in Q4'2021 and **5.79%** in Q1'2021. This was due to stabilized fuel prices which remained largely unchanged, supported by the government's fuel stabilization programme. The government also instituted a 15% reduction in electricity tariffs which led to a decrease in electricity prices during the period. The food inflation index rose to an average of **9.17%** compared to **6.98%**, over a similar period in 2021, attributable to unfavourable weather conditions. We expect inflation to remain within the CBK's target range of 2.5%—7.5%, with the rising global prices of crude oil exerting increased pressure on the fuel stabilization programme.
- **Confident Monetary Policy:** During the quarter, the Central Bank of Kenya (CBK) maintained the Central Bank Rate (CBR) at **7.00%** (for the thirteenth time in a row) while the Cash Reserve Ratio (CRR) was set at **5.25%**, signalling confidence in the resilience of the local economy in the face of elevated global risks. Regionally and globally, Central banks raised their rates in an attempt to tame surging inflation, due to rising fuel and commodity prices and disrupted supply chains, worsened by global crises including the Russia-Ukraine war.
- **Equity Market:** Activity in Q1'2022 slowed down with companies presenting a mixed bag of FY'21 Results with the banking sector posting positive financial performance. Overall, due to the Russia-Ukraine war, there were increased foreign investor outflows during the period, which has seen increased capital flight by foreign participants from emerging and frontier capital markets across the world. We anticipate that this trend will persist, as the uncertainty occasioned by the conflict persists compounded by the upcoming general elections.

**May 9<sup>th</sup>, 2022****Sovereign Credit Rating:****Moody's: B2 (Negative)****Fitch: B+ (Negative)****S&P: B (Stable)****GDP Est. (2021):** 7.50%**Inflation: (April)** 6.47%**Interbank Rate (Ave):** 4.60%**CBR (March 2022):** 7.00%

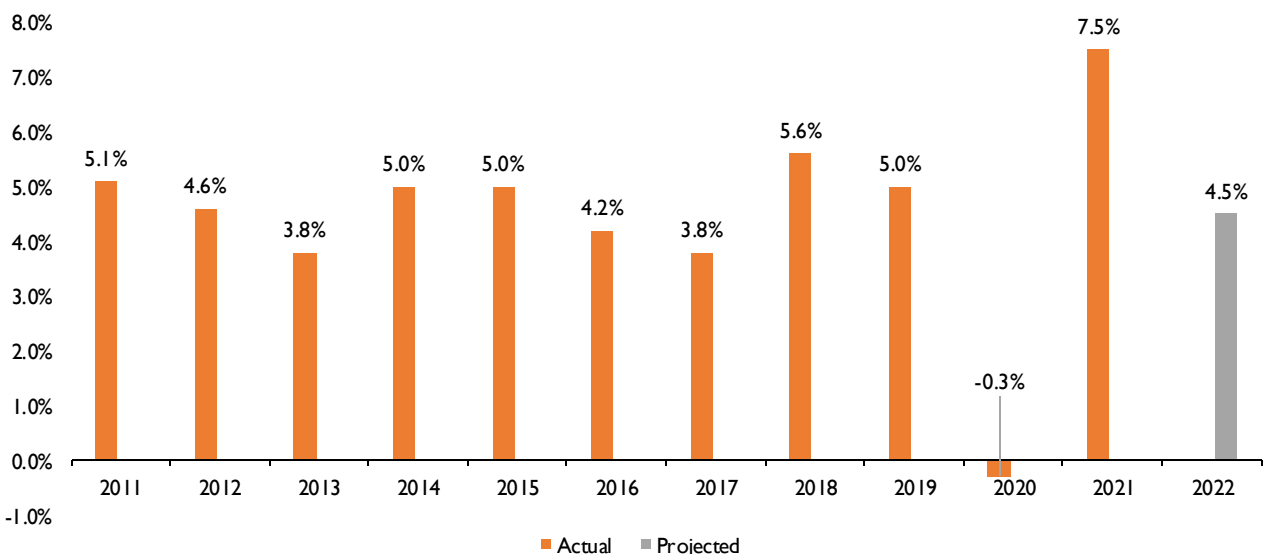
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## Economic Performance

- **Global Economic Activity:** Earlier in Q1, the global economy was set to continue recovery from the effects of the pandemic, as policymakers prioritized economic revival amid the uncertainty of the resurgence of infections. Globally, after a rebound of an estimated average of **5.68%** in 2021, there were optimistic projections of global economic growth of **6.00%**, in 2022. However, global economic recovery briskly lost momentum during the quarter; supply chain constraints emerged, affecting global production. Food and energy costs rose sharply, setting the stage for increased inflationary pressure and in February, Russia invaded Ukraine. Western economies imposed economic sanctions against the aggressor, targeting Russian oil, gas, and financial systems leading to elevated prices of crude oil, commodities and food, and disrupted global supply chains, further increasing inflationary pressures as the global prices of fuel, food and commodities rose. The war in Russia, geopolitical tensions in the Middle East and trailing effects of the pandemic have since cast aspersions on the earlier global growth projections.
- **Local Economic Activity:** As per the Kenya National Bureau of Statistics (KNBS) estimates the economy expanded **7.50%** in 2021, the fastest in 11 years, and is projected to grow by **4.50%** in 2022. However, global headwinds have similarly affected these projections with sections of east Asia still facing lockdowns, dampening growth from the effects of the pandemic. Furthermore, poor weather conditions, with an ongoing drought since 2021, and the cautionary stance by investors, possibly due to the August General Elections, continue to weigh down these projections. Additionally, high fuel prices, unfavourable weather conditions; the looming elections and slow sectoral revival from the effects of the pandemic.

Graph 1: Kenya Real GDP Growth

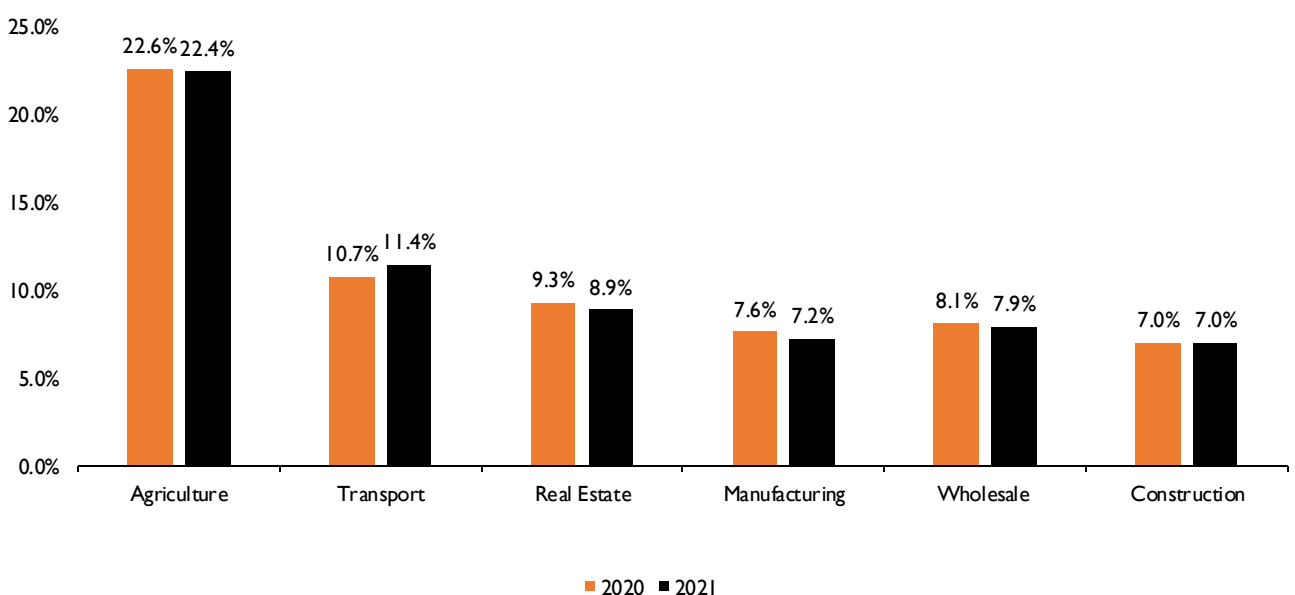


Source: KNBS, National Treasury, AIB-AXYS Africa Research

## Economic Performance

- **Pandemic – affected sectors drive recovery:** The Kenya National Bureau of Statistics (KNBS) released the economic growth figures for 2021, where real GDP is estimated to have expanded by **7.50%** compared to a **0.30%** contraction in 2020. The improvement was driven by recovery in sectors such as; Manufacturing (**6.90%**), Wholesale and Retail Trade (**7.90%**), Real Estate (**6.70%**), Transportation and Storage (**7.2%**), and Financial and insurance activities (**12.50%**). Growth in the Construction sector slowed down in 2021, to grow by 6.60% in 2021, compared to 10.10% in 2020, supported mainly by public investment in road infrastructure. A revival of domestic tourism and increased international tourist arrivals, following the removal of most of the pandemic mitigation measures, saw the tourism sector record marginal growth of **0.26%**. The sector is however yet to return to the pre-covid levels of activity.
- **Agriculture dominant but declining:** Agriculture remains the key contributor to the local economy at **22.43%**, experiencing a marginal drop from **22.62%** in 2020, due to unfavourable weather conditions, whose persistence is likely to contribute to a further drop in the coming quarters as food security faces further adverse challenges due to the soaring cost of farm inputs. The Transport and Storage sector contributed **11.44%** to GDP from **10.75%** in 2020, due to the resumption of movement after the pandemic. We continue to be worried about the decline in contribution from the Manufacturing sector which declined to **7.24%** from **7.61%** in 2020.

Graph 2: Sectoral Contributions



Source: KNBS, AIB-AXYS Research

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## Global Outlook

- **Triple Threats:** We continue to see the global economy facing three major threats in the coming quarter;
  - a) **The Russia—Ukraine war**, and the uncertainty toward its peaceful resolution, will likely continue to adversely affect global energy prices. Western sanctions against Russian oil and natural gas, and Europe’s deliberate efforts to wean themselves off Russian energy will increase global demand for energy in the coming quarters. OPEC+ members are likely to persist in their refusal to increase their production capacities translating to continued elevated prices of crude oil and gas.
  - b) **Threat of a resurgence of infections or the emergence of new Covid-19 variants** that could prolong the pandemic and further hinder economic growth is still alive. Policymakers in the health sector, especially, in Sub-Saharan Africa, should revamp their efforts to vaccinate their citizens to either curb this threat or mitigates its adverse effects on the economy.
  - c) **Rising energy, food and commodity prices** due to the geopolitical events and disrupted supply chains are likely to lead to elevated increases in inflation across the world, in the coming quarter. Monetary policymakers will be closely watched on how they will react as they attempt to curb rising inflation. Raising base lending rates in develop economies will likely further increase capital flight from emerging markets. Overall the global economy is projected to grow at a moderate pace in 2022.

Table:1 Global GDP Growth Projections

Organization	2021 Estimates	2022 Projections
1 International Monetary Fund	5.90%	4.40%
2 OECD	5.60%	4.50%
3 S&P Global	5.70%	4.20%
4 World Bank	5.50%	4.70%
<b>Average</b>	<b>5.68%</b>	<b>4.45%</b>

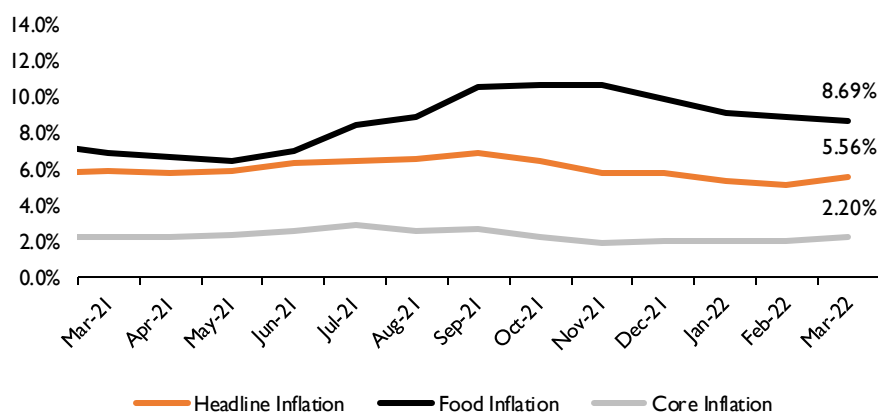
## Local Outlook

- **General Elections:** The Government endorsed the Supplementary Budget for the current fiscal whose focus will be on the upcoming General Elections on 09<sup>th</sup> August 2022. Rising electioneering temperatures are likely to herald investors to the Fixed Income market factoring in risks in the local market, especially in the short term, due to the elections as well as the global uncertainties. The looming Elections will likely be partly responsible for the muted economic activity during the tail end of the next quarter. The Government indicated that it will also focus on the fuel stabilization programme (**KES 34.44Bn**) to curb further inflationary pressure.
- We expect the agricultural production to slow down in the better parts of 2022 given the rising cost of farm inputs. Additionally, erratic rainfall will continue adding unpredictability to the food production cycle and capacity. However, the fertilizer subsidy by the government is expected to partly cool down any adverse effects on farmers.

## Inflation

- **Tail-end Inflation jump:** Headline inflation, during the quarter, declined to an average of **5.34%** from **5.99%** in Q4'2021 and **5.79%** in Q1'2021. This was attributable to largely unchanged fuel prices supported by the government's fuel stabilization programme. Furthermore, the government reduced electricity tariffs by 15% during the quarter. The food inflation index rose to an average of **9.17%** compared to **6.98%**, over a similar period in 2021, attributable to unfavourable seasonal factors that limited food production in the country. Core inflation (Non-food, Non-fuel inflation) rose marginally to an average of **2.07%** from **2.03%** in the preceding quarter, reflecting muted demand pressures in the economy.

Graph 3: Historical Inflation Rates



Source: KNBS, AIB-AXYS Africa Research

- **Inflation Outlook – Difficult Decisions:** In Q2'22, taming soaring inflation will be the major priority for Central Banks across the world. Elevated global prices of crude oil, food, commodities and disrupted supply chains will persist in Q2. Policymakers must strike a balance between creating a supportive environment for economic revival and mitigating high inflation rates. We expect most Central Banks to hike their base lending rates, which may lead to a contraction of their economies. Further, we expect headline inflation to peak in most developed and emerging markets by the end of Q2'22, before moderating gradually in Q3'22, driven by the prevailing global risks– especially the war in Ukraine and uncertainty of the resurgence of Covid-19 infections, as vaccination efforts taper off.

Table 2: Inflation Outlook

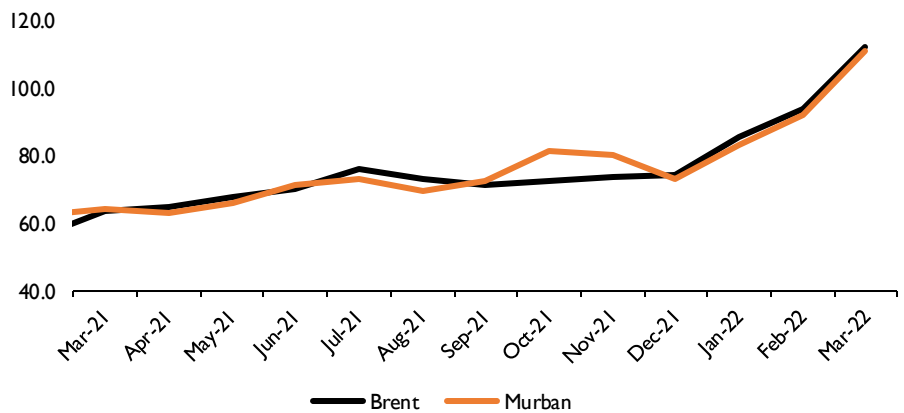
Country	Inflation Rate			Base Lending Rate	
	Jan 21/22	Feb 21/22	Mar 21/22	Decision	Current Rate
1. USA	7.50%	7.90%	8.50%	25bps Hike	0.50%
2. UK	5.50%	6.20%	7.00%	25bps Hike	0.75%
3. Ghana	13.90%	15.70%	19.40%	250bps Hike	17.00%
4. Rwanda	4.30%	5.80%	7.50%	50bps Hike	5.00%
5. South Africa	5.70%	5.70%	5.90%	50bps Hike	4.50%
6. Kenya	5.39%	5.08%	5.56%	No change	7.00%
7. Uganda	2.70%	3.20%	3.70%	No Change	6.50%
8. Tanzania	4.20%	3.70%	3.60%	No Change	5.00%

Source: National Statistics, AIB-AXYS Africa Research

## Inflation – Effect from Oil Prices

- **Elevated Crude Prices:** Global crude oil prices were on the rise during the quarter, as supply lagged the progressive reopening of the economy and was further exacerbated by Russia’s invasion of Ukraine. Economic sanctions against Russia by Western countries further reduced supply with OPEC+ members indignant to intervene by ramping up their supply quotas during the quarter. Murban Crude, used locally, broke the **100USD/Barrel** barrier at the end of the month, to trade at its highest. Global crude oil prices are likely to remain elevated during and after the course of the conflict.

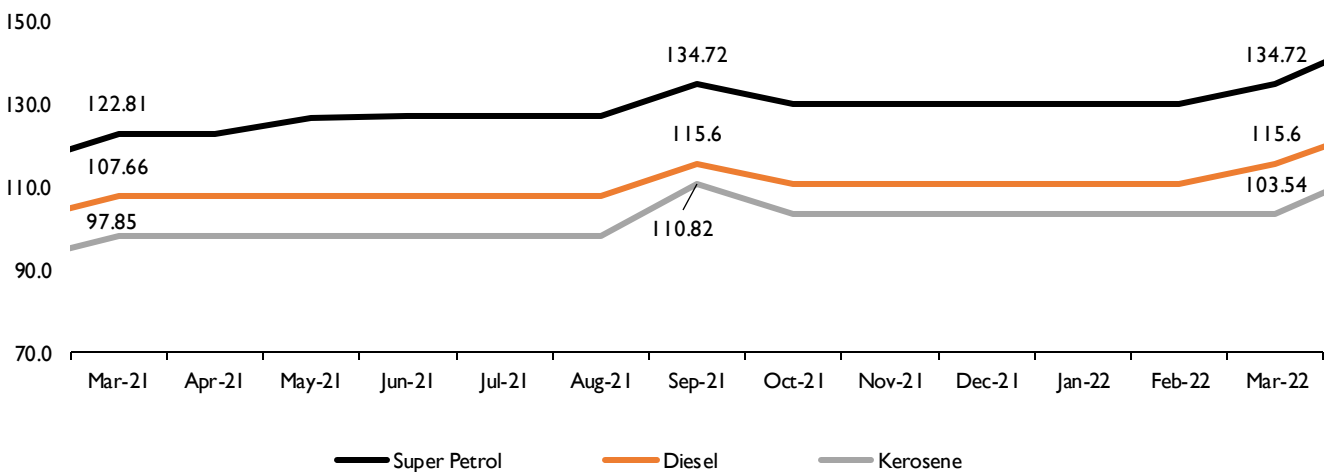
Graph 4: Global Crude Oil Prices



Source: Nasdaq, Bloomberg, AIB-AXYS Africa Research

- **Tail end rise in local pump prices:** Locally, the Petroleum Development levy, shielded consumers from the high prices by providing a subsidy. The programme has been under immense pressure to keep up with the high prices of crude oil, which will likely continue, and will severely stretch the government’s ability to cushion consumers from the real prices of super petrol, diesel and kerosene in the coming months.

Graph 5: Local Pump Prices

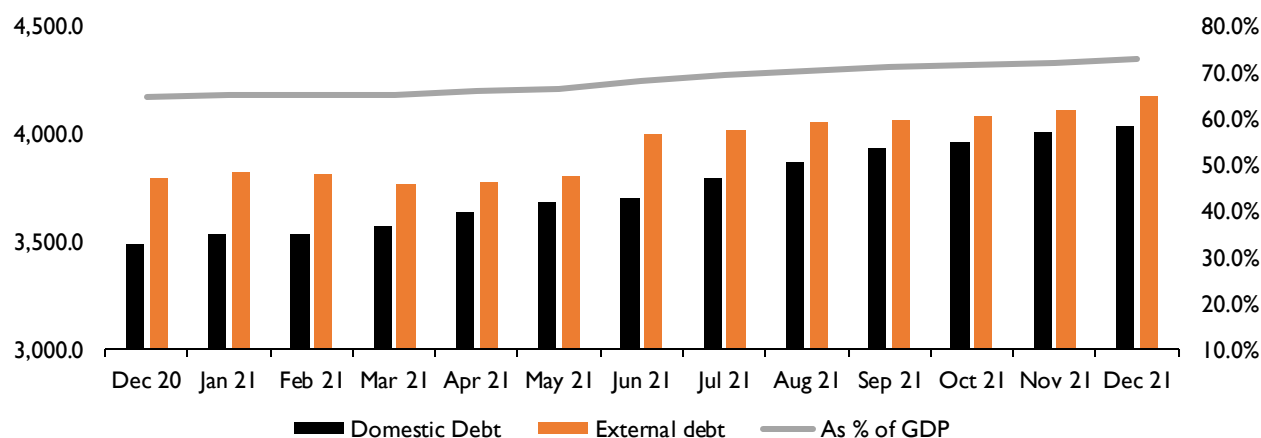


Source: EPRA, AIB-AXYS Africa Research

## Fiscal Policy

- **Revenue Collection:** Improvement in economic performance, Jul'21-Jan'22 (FY'2021/22), compared to Jul'20-Jan'21 (FY'2020/21) corresponds with enhanced revenue collection during the period. Total Revenue (exc. Grants) grew by **28.91%** to **KES 4,605.64Bn** from **KES 3,572.87Bn**. This was mainly driven by Value Added Tax (VAT) collection, which grew by **40.36%** to **KES 1,146.13** from **KES 816.58Bn**; Income Tax, grew by **30.97%** to **KES 1,790.34** from **KES 1366.97** indicating a resumption in economic activity and return to work for citizens after the removal of covid-19 restrictions. We expect enhanced revenue collection to persist in H2 of FY'21/22 as economic activity gradually but steadily recovers. We anticipate better performance from Import Duty and Excise Duty as the manufacturing sector gathers pace in the next quarter. We expect enhanced revenue collection to be translated into improved budgetary implementation.
- **Expenditure:** Enhanced government expenditure mirrored the improvement in revenue collection. Total Expenditure improved by **16.36%** to **KES 5996.48Bn** from **KES 5,153.59Bn**. Total Recurrent expenditure grew by **21.63%** to **KES 4,378.10Bn** from **KES 3,599.45Bn**. However, Development expenditure, marginally dropped by **0.43%** to **KES 1,008.99Bn** from **KES 1,013.36Bn** as absorption of these funds was affected by disbursement hitches and lagging effects of the pandemic. We expect a significant increase in development expenditure as the current administration rushes against time to deliver on some of its pending electioneering promises.
- **Fiscal Deficit:** The government's propensity to live above its means continued. Domestic debt interest payments rose **20.83%** to **KES 1,016.02Bn** from **KES 840.89Bn**; Foreign-debt interest servicing declined **4.31%** to **KES 280.6Bn** from **KES 293.24Bn**. However, the government's appetite for debt remains unsated. Borrowing increased and is set to increase in the coming quarters, which remains concerning. Total outstanding public debt increased to **KES 8.21Tn** or **72.79%** of GDP as at the end of H1 of FY21/22.

Graph 6: Debt-to-GDP

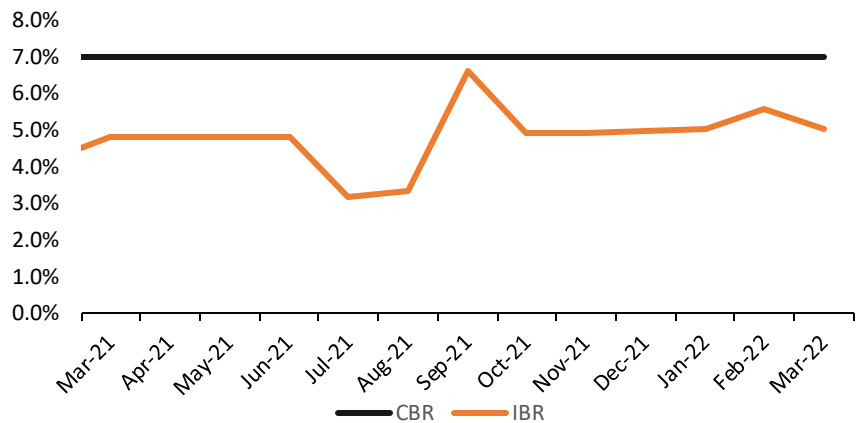


Source: CBK, AIB-AXYS Africa Research

## Monetary Policy

- **Confident Stance:** The Monetary Policy Committee (MPC) maintained the CBR at **7.00%** on both occasions during the quarter. In the region and around the world, Central Banks hiked their base rates in response to rising inflation as geopolitical tensions in Eastern Europe and the Middle East and the resurgence of the Covid-19 pandemic in China and South-East Asia, prevailed. In maintaining the CBR, the MPC signalled confidence in the local economy's resilience and recovery in the wake of the prevailing global crises. Consequently, we anticipate that the CBK will be reluctant to raise the CBR in the next quarter, despite mounting pressure to do so, as inflation remains within its target region of 2.5% - 7.5%.

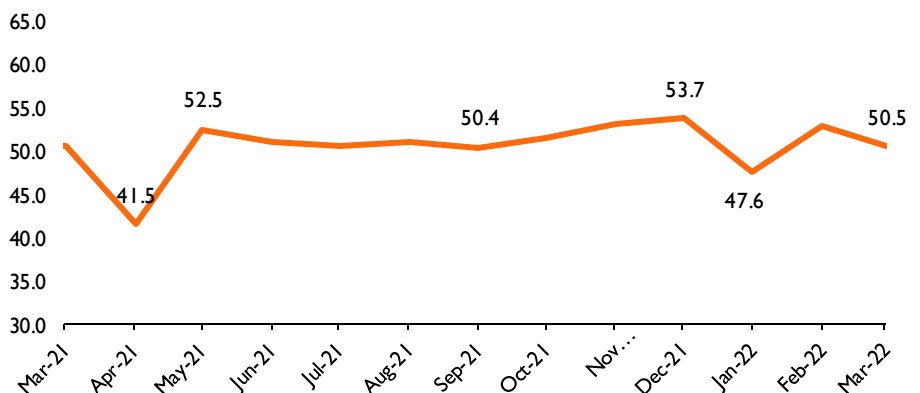
Graph 7: Central Bank Rate (CBR) and Interbank Rate (IBR)



Source: CBK, AIB-AXYS Africa Research

- **Purchasing Managers Index (PMI):** The Stanbic Kenya PMI dropped to an average of **50.33%** in Q1'2022 compared to **52.70%** in Q4'2022, affirming slow growth in the private sector's outlook on the business environment. The PMI index closed the quarter at **50.50%** from **47.6%** in January 2022. We expect managers' outlook in the private sector to continue to be dampened by the global crises and election jitters with the PMI likely to average below 50.00% in the coming quarter.

Graph 8: Stanbic Kenya PMI



Source: Stanbic PMI, AIB-AXYS Africa Research



## Currency

- **Shilling maintains losing streak against the USD:** During the quarter, the shilling depreciated by 1.60% against the US Dollar to close at **KES 114.95** from **KES 113.14** at the end of the preceding quarter. Depreciation against the dollar is mainly attributed to increased dollar demand as global fuel prices rose.

Table 3: KES Performance

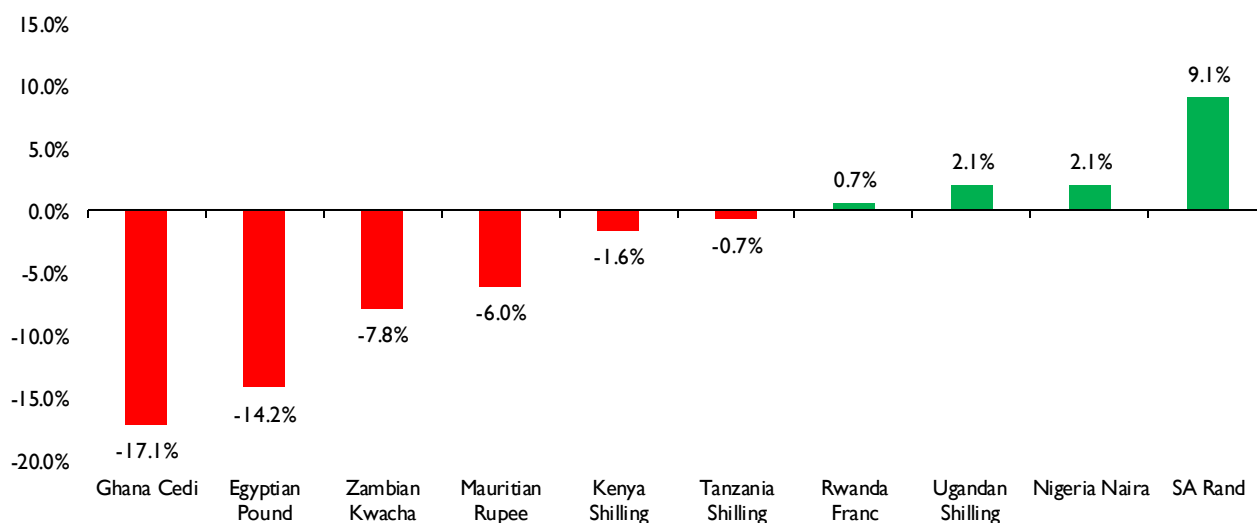
	USD	EUR	GBP	RAND	KES/UGX	KES/TSH
2Q21	1.52%	0.29%	0.98%	-2.74%	1.51%	-1.54%
3Q21	-2.44%	-0.61%	-0.30%	2.46%	2.93%	2.76%
4Q21	-2.40%	0.79%	-1.61%	2.92%	2.15%	2.56%
1Q22	-1.60%	0.15%	0.61%	-11.62%	0.24%	0.93%

Source: CBK, AIB-AXYS Africa Research

We expect the shilling to remain under pressure as fuel and commodity prices continue to rise. Importers are also likely to shore up their hard foreign currency positions as external economies continue to recover and to hedge against the uncertainties associated with the looming General Election. The widening of the current account deficit, due to increased crude oil prices as foreign exchange-earners, tea and coffee, dwindle due to poor weather; and the government's settling of its debt obligations, especially of foreign currency-denominated commercial loans will further erode the shilling's position.

However, we anticipate that increased diaspora remittances, which has been growing admirably, will continue to support forex reserves. Additionally, dollar receipts from concessional loans from the government's foreign development partners aimed at supporting economic recovery from the effects of the pandemic.

Graph 9: Performance of select African Currencies vs USD

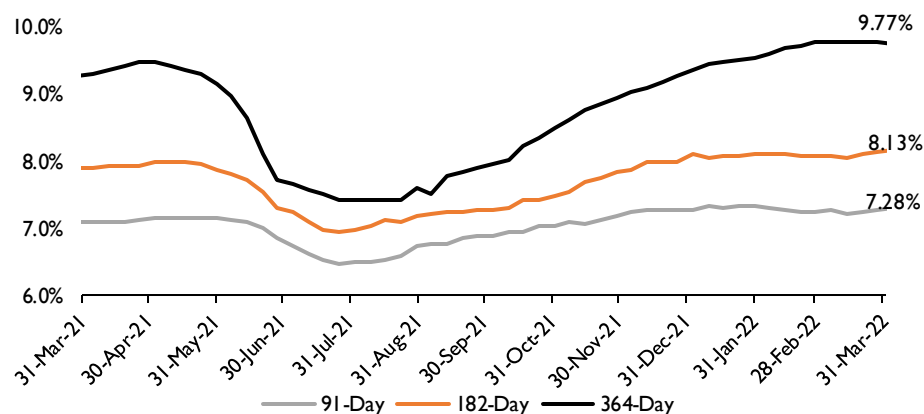


Source: Bloomberg

## Interest Rates Outlook

- **Preference for Fixed Income:** Activity in the Fixed Income market picked up as investors adopt a flight to safety attitude, as global and local risks heightened. Treasury bond issuances were generally oversubscribed at a rate of **122.36%**. Treasury bills were similarly oversubscribed with investors' preference for longer-term papers standing owing to higher risk-adjusted returns. The Government's appetite for debt remained high and was **8.76%** ahead of its prorated at the end of the quarter with a net borrowing at **KES 503.11Bn** against a prorated target of **KES 462.60Bn**.

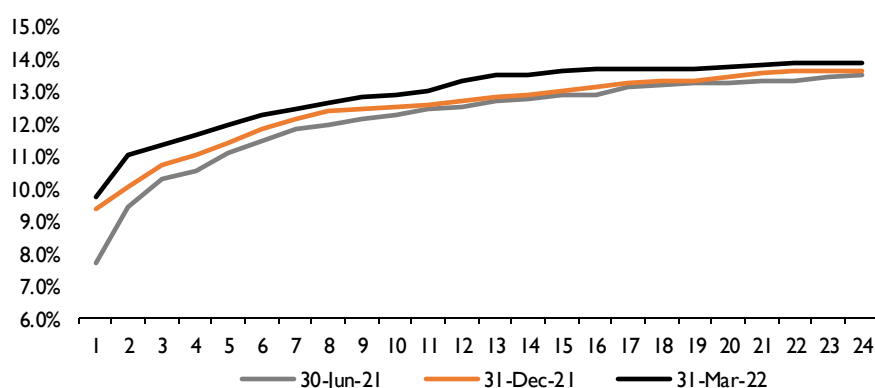
Graph 10: T-Bill rates



Source: CBK, AIB-AXYS Africa Research

- **Yield curve steepening continues:** The yields on government securities shifted upwards as investors sought higher returns in the face of increased uncertainty in the local and global economy. The two-year paper gained the most, by 134bps, during the quarter.

Graph 11: NSE Yield curve



Source: NSE, AIB-AXYS Africa Research

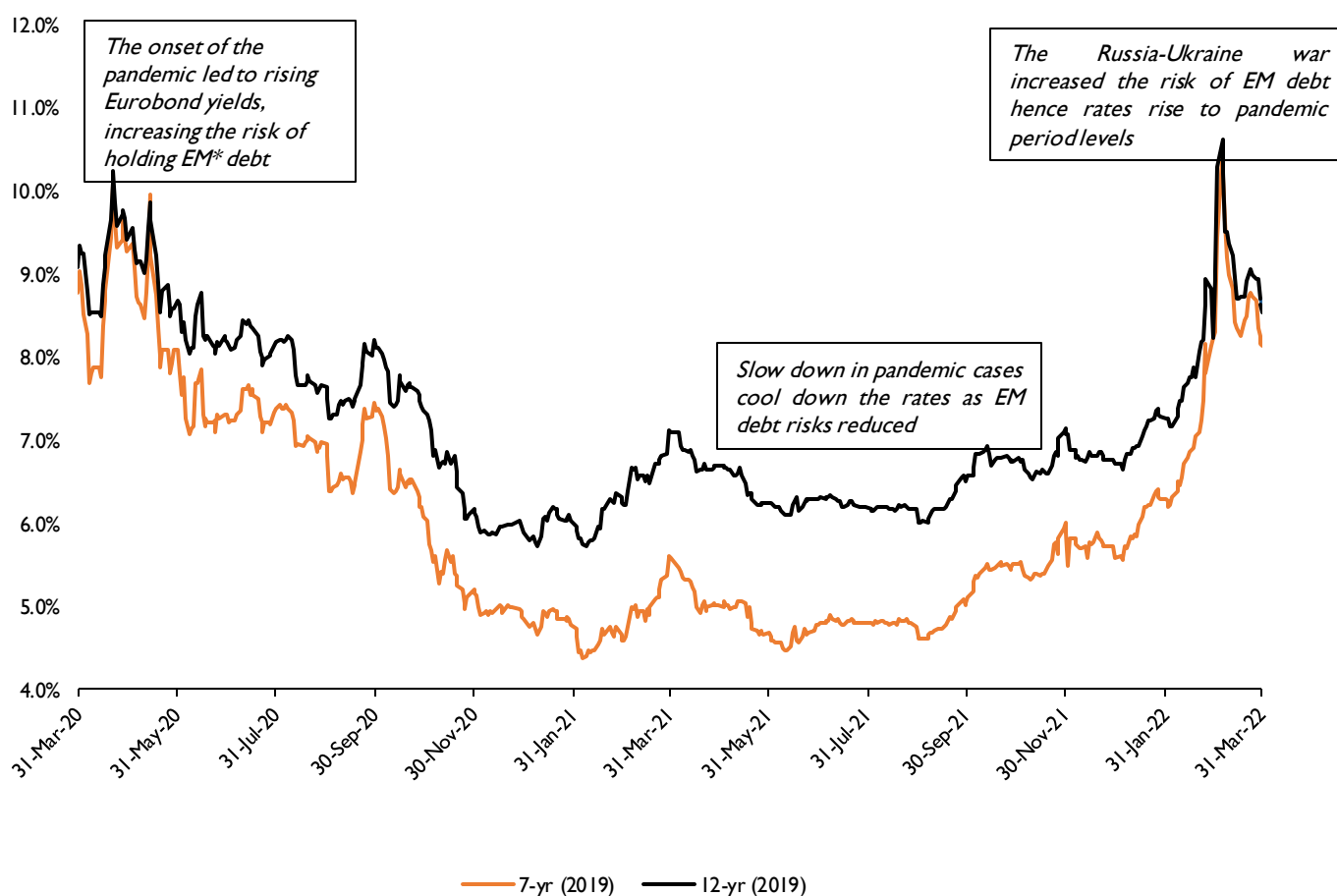
In the secondary market, bond turnover increased by **4.47%** to **KES 186.88Bn** from **KES 178.88Bn** in the preceding quarter as Infrastructure Bonds saw heightened interest. The FTSE NSE Bond Index closed at **95.67** with a YTD gain of **(0.41%)**. We anticipate further increased activity in the fixed income market as investors factor in electioneering risk, as well as risks associated with the global crises.

## Kenya Eurobond Performance

- **Increasing risk:** The escalated geopolitical sanctions between Russia and Ukraine saw foreign investors flee from emerging markets to 'safer' haven in developed markets; Kenya's negative outlook by Fitch Ratings and the spike in base lending rates to tame runaway inflation, further extended capital flight to developed debt markets. Consequently, Eurobonds were on an upward trajectory during the quarter, the yield on the seven-year Eurobond issued in 2019 rose by 250bps from **5.60%** to close at **8.10%**, with the 12-year Eurobond gaining 180bps from **6.70%** to **8.50%**. The 30-year paper, issued in 2018 gained 140bps from **8.10%** to **9.50%**.
- **Soaring cost:** The National Treasury indicated that its planned June Eurobond sale to raise **\$1.00Bn** was under consideration due to the high cost of raising funds due to the elevated global threats. We believe that the planned issue will go ahead, in the coming quarter, despite the elevated cost as the government races to complete infrastructure projects and implement the current fiscal year budget. This will likely add further pressure on the country's strained external debt position.

\* EM – Emerging Markets

Graph 12: Select Kenya Eurobond Performance (2019-Issue)



Source: Bloomberg

## Equity Market

- **Slower Activity:** Activity in Q1'2022 slumped with the benchmark indices declining as the **NSE 20** and **NASI** shed 2.93% and 6.44% to close at **KES 1,846.74** and **KES 155.74** from **KES 1902.57** and **KES 166.46** respectively. The YTD gain for the NSE 20 and NASI stood at **(2.93%)** and **(6.44%)** respectively. Equity turnover declined by 23.51% to **KES 27.77Bn** from **KES 36.30Bn** in the preceding quarter. The bourse's capitalization declined 6.46% to **KES 2.45Tn** from **KES 2.59Tn** in Q4'2021. This was driven by increased foreign investor outflows during the period, due to the Russia-Ukraine war which has led to increased capital flight by foreign participants from emerging and frontier capital markets across the world.

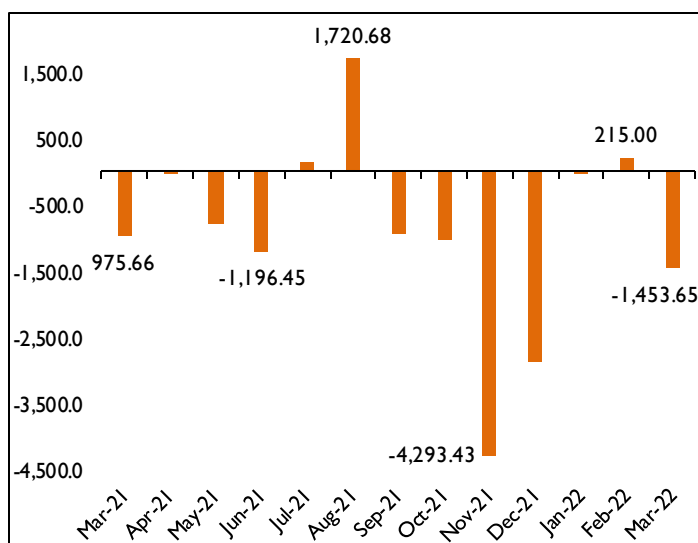
Table 4: NSE Indices Performance

	Q2'21	Q3'21	Q4'21	Q1'22
NSE 20	4.39%	5.38%	-6.33%	-2.93%
NASI	9.40%	2.75%	-6.65%	-6.44%

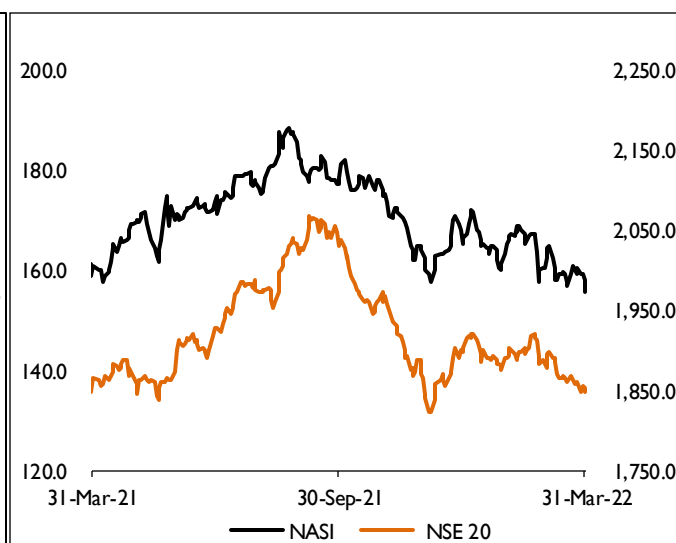
Source: NSE, AIB-AXYS Africa Research

- **Q2'22 Outlook:** The second quarter of the year is likely to see continued foreign investor sell-offs, which presents prime opportunities for local investors to exploit, especially those seeking entry positions. Settling of dividend payments will likely stir little if any activity on their respective counters. **SCOM's** much-awaited entry into the Ethiopian market is projected to commence early in the quarter. **EABL** is anticipated to release improved FY'21 results at the end of the quarter on the back of increased sales and adaption to consumer trends after lifting the lockdown and social contact restriction measures.

Graph I3: NSE Net Foreign Activity



Graph I4: NSE Indices Performance



Sources: NSE, AIB-AXYS Africa research

## Equity Market

- **Banking Sector:** Almost all banks reported improved financial performance in FY21 with returns to profitability and dividend payments. The industry average NPL ratio was **13.30%**, with asset quality improving as loan loss provisioning reduced due to a positive outlook on economic recovery in various sectors post the pandemic. Net Interest Income (NII) and Non-Funded Income (NFI) grew as banks expanded their investment in government securities and digital offerings offered significant returns in the local and regional markets.

Table 5: 2Q'22 Top Picks

Counter	4-May-2022	Target Price	Upside	Recommendation	Δ YTD	52 Week High	52 Week Low	Dividend Yield
ABSA	9.98	13.04	30.66%	BUY	-15.78%	12.70	8.66	11.02%
BAT	420.75	503.25	19.61%	BUY	-4.70%	40.75	33.55	12.33%
COOP	12.50	14.99	19.92%	BUY	-3.47%	13.95	11.80	7.87%
DTK	54.75	66.12	20.77%	BUY	-7.98%	69.00	54.75	5.45%
EABL	142.50	205.21	44.01%	BUY	-13.64%	193.75	144.00	2.60%
EQTY	47.50	61.17	28.78%	BUY	-9.95%	54.25	39.00	6.26%
IMH	18.00	24.62	36.78%	BUY	-14.69%	45.05	18.20	8.24%
JUB	265.50	325.85	22.73%	BUY	-16.18%	390.00	248.50	5.30%
KCB	36.95	52.45	41.95%	BUY	-18.70%	49.90	37.45	8.01%
KEGN	3.56	3.28	-7.87%	SELL	-15.04%	4.98	3.54	8.45%
NCBA	24.30	28.29	16.42%	BUY	-3.57%	2.68	2.10	11.54%
SBIC	105.50	105.00	-0.47%	SELL	20.92%	105.25	79.50	8.55%
SCBK	125.75	140.75	11.93%	HOLD	-1.95%	146.25	124.00	14.79%
SCOM	32.95	38.81	17.78%	BUY	-13.18%	44.95	33.70	1.90%

Source: AIB-AXYS Africa Research

- **Elections Outlook:** During the General Elections, the NSE 20 has tended to make gains in the election year, with the exemption of 2007. The period preceding and after the elections has tended to post mixed results. The General Elections, later this year, will likely see a drop in the NSE-20 index, as the market recovery from the effects of the pandemic, is and will likely be decelerated by increased global risks– the lagging effects of the pandemic, geopolitical plays, and soaring inflation across global economies that are likely to maintain capital flight from emerging markets, including the NSE. However, we anticipate a gradual revival in the equities markets after the Elections, even though, the global crises are likely to continue to hold back earlier optimistic projections. We reiterate our opinion that the current slump in share prices at the bourse and relinquishing of positions by foreign participants presents local investors a prime chance to enter the market at the lower prices that they should exploit.

Table 6: NSE-20 Performance during Elections

Pre-Election	NSE-20	Election Year	NSE-20	Post-Election	NSE-20
1991		1992	21.81%	1993	116.49%
1996	-10.30%	1997	0.12%	1998	-4.91%
2001	-29.18%	2002	0.58%	2003	100.87%
2006	42.10%	2007	-3.56%	2008	-35.33%
2011	-27.07%	2012	36.84%	2013	23.63%
2016	-15.74%	2017	25.02%	2018	-19.63%
2021	1.83%	2022		2023	

Source: NSE, AIB-AXYS Africa Research

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