FUNGUO INVESTMENTS LTD

ABRIDGED ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 30TH JUNE 2018

Contents

CHAIRMAN'S STATEMENT

Dear Shareholder,

It is gives me great pleasure, on behalf of the Board of Directors of Funguo Investments Limited, to present to you the Annual Report and Financial Statements for the year ended 30th June 2018.

1) Global Economy

In its *June 2018 Global Economic Prospects report*, the World Bank Despite forecasts that in spite of recent softening, global economic growth will remain robust, and post a 3.1% growth in 2018. Growth rates are expected to thereafter to slow gradually over the following two years, as advanced-economy growth decelerates and the recovery in major commodity-exporting emerging market and developing economies levels off.

Advanced economies are expected to grow by 2.2% in 2018 before easing to a 2% rate of expansion in 2019, as central banks gradually remove monetary stimulus, according to the *June 2018 Global Economic Prospects* report. Growth in emerging market and developing economies overall is projected to strengthen to 4.5% in 2018, before reaching 4.7% in 2019 as the recovery in commodity exporters matures and commodity prices level off following this year's increase.

June 2018 Global Economic Prospects report projects growth in Sub-Saharan Africa to pick up to 3.1% in 2018, from 2.6% in 2017. This upswing reflects rising oil and metals production, encouraged by higher commodity prices, improving agricultural conditions, and increasing domestic demand. Growth is expected to firm to an average of 3.6% in 2019-20, as the recovery strengthens in Angola, Nigeria, and South Africa—the region's largest economies.

The *June 2018 Global Economic Prospects* cautions that the outlook is subject to considerable downside risks. The possibility of disorderly financial market volatility has increased, the *June 2018 Global Economic Prospects* reports, and the vulnerability of some emerging market and developing economies to such disruption has risen. Trade protectionist sentiment has also mounted, while policy uncertainty and geopolitical risks remain elevated.

The cautious optimism about recovery and stronger growth of global economy, as well as the economy of our region, the Sub-Saharan Africa bodes well for Kenya and economic players in Kenya such as Funguo. Of course it does not guarantee better days for Kenya or Funguo. As we will see later, Kenya's economy has actually performed better than the aggregated global and Sub-Sharan Africa economies.

2) Kenya

a) Overall Economy's Growth

The *Economic Survey 2017* by Kenya National Bureau of Statistic (KNBS) reports that Kenya's GDP is estimated to have expanded by 4.9% in 2017 compared to a revised growth of 5.9% in 2016.

This slowdown in the performance of the economy was in part attributed to uncertainty created by the prolonged electioneering period as the country went through general elections and also to adverse weather conditions.

The KENBS report notes that performance across sectors of the economy varied widely, with Accommodation and Food services; Information and Communication Technology; Education; Wholesale and Retail trade; and Public Administration registering accelerated growths in 2017 compared to 2016 while on the other hand, growths in Manufacturing; Agriculture, Forestry and Fishing; and Financial and Insurance decelerated significantly over the same period.

b) Interest rates

Interest rates given by commercial banks and deposit taking microfinance institutions on deposits and charged on corporate and retail loan products have continued to be stable on the back of the interest rate control regime.

The reference Central Bank Rate that is the barometer for monetary policy intentions has declined marginally over the recent past.

Expected repeal/easing of interest rate capping law is expected to result in upward adjustment of interest rates for most borrowers.

c) Government Finances

Stock of government debt has continued to creep upwards and increasingly the ability of Kenya to afford the debt it has picked up domestically and from international lenders is being questioned.

The national government's budget for the year 2018/19 continues on a growth trajectory that recent budgets have recorded.

Financing the budget remains a challenge, with tax revenue targets in recent years coming short, and government's reliance on domestic borrowing has thus remained relatively high.

Balance of Trade and Current Account have posted deficits in the recent past.

The above are expected to continue to have adverse effect on valuation of the KShs, and the pricing of debt.

d) Exchange Rate

The Kenya shilling has, against major currencies, stayed within narrow ranges and in some cases marginally appreciating in the recent past

e) Inflation

Inflation has largely been within the government's target (single digits), helped by a number of factors including improved weather in the last half of 2017.

The expected imposition of VAT on fuel in September 2018 may lead to an increase in inflation.

f) Capital Markets

The Nairobi Securities Exchange, our benchmark for the capital markets as well as platform for limited investment by FIL, had posted strong recovery in the first half of the calendar year 2017. The electoral period in Q3 and Q4 2017 and reported struggle in performance by a number of listed counters however seemed to have lead to a slow down in that trend.

Recent performance has taken a severe downward trend , against our expectations.

g) Political Climate

The general elections held in the last half of 2017 led to a substantial uptick in political temperature, and the attendant uncertainties in the business environment that usually follow.

The 'handshake' between President Kenyatta and Raila Odinga has substantially cooled political temperatures signaling a period of constructive engagement rather than confrontation.

Although electioneering with eyes on the 2022 elections seems to be taking root, the current political environment is not seen as a threat to business.

h) Crackdown on Corruption

Recent actions by a reenergized office of the Director of Public Prosecutions has seen high profile moves against serving politicians, former public office bearers and office bearers mostly in public sector organizations but also some from the private sector who are accused of abuse of office and related acts of corruption.

The outcomes of the court cases against these individuals are highly anticipated because of the impact they have on perception of seriousness of the government in tackling corruption and the attendant burden to businesses.

These actions as well as the related crackdown in parts of the country on erected structures deemed to have violated the law places emphasis on the need for FIL to select its investments carefully, where necessary carry out due diligence and have them managed in a kosher manner too.

i) Economic Growth Outlook

KNBS notes that the macroeconomic fundamentals remain strong. In addition, the structure of Kenya's economy, which is reasonably diversified and not commodity dependent, continues to serve Kenya well when it comes to insulation from extreme volatility in performance.

The *June 2018 Global Economic Prospects* report forecasts the GDP growth rate at 5.5% in 2018, 5.9% in 2019 and 6.1% in 2020.

3) Highlights from Our Financial Statements for The Year 2017/18

a) Total Assets

In the year 2017/2018; the total assets increased by 5.3% % to KES 1,238 Million as at 30th June 2018 from KES 1,176 Million as at 30th June 2017. The increase was accounted for by:

- the net growth in value of of investments in our unquoted portfolio;
- retained earnings; and
- an injection of new equity capital through a rights issue.

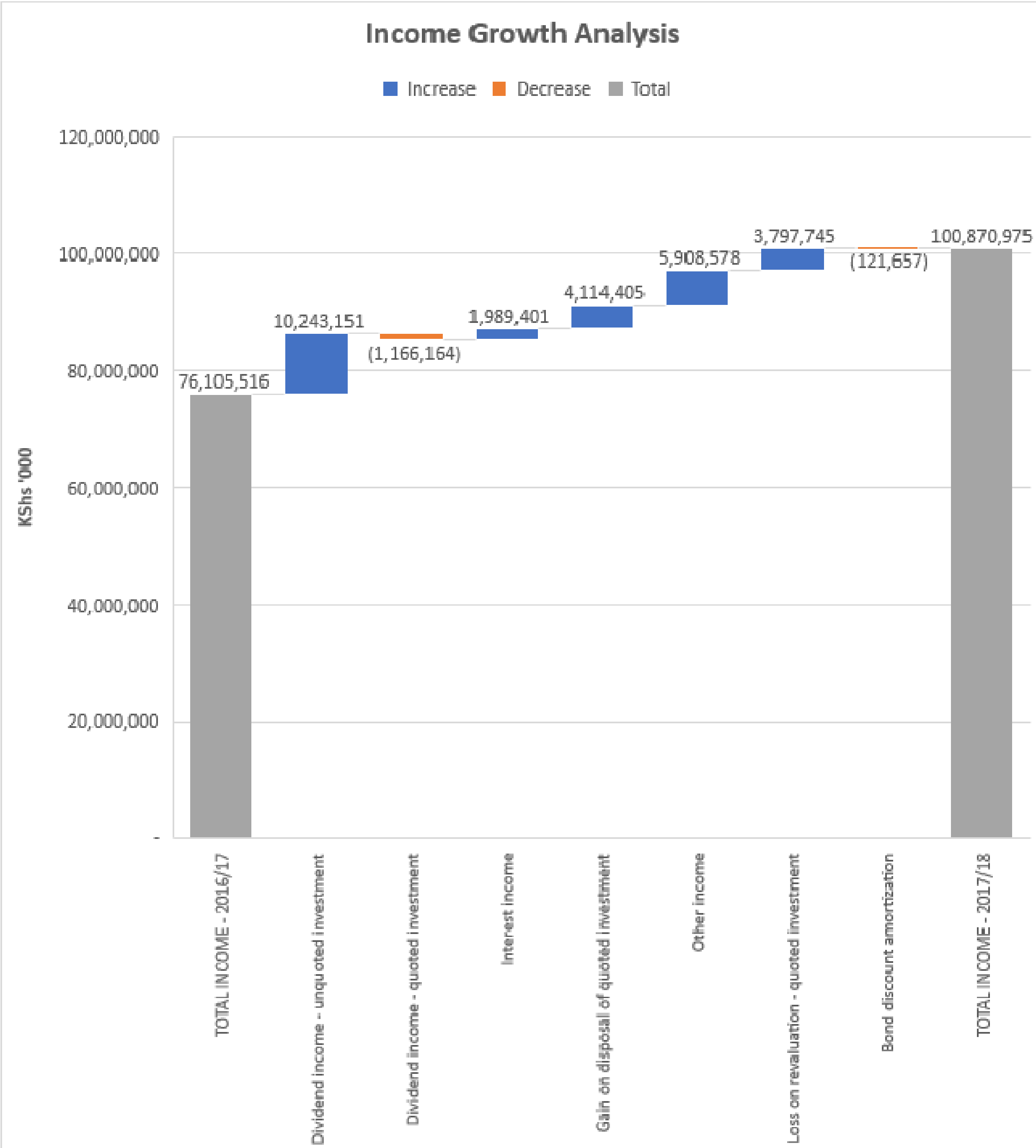
Our pursuit of growth of our assets, and specifically the earning assets was faced and continues to face these key challenges:

- Access to new capital from our shareholders; and
- the volatile and generally low valuation of equities listed on the Nairobi Securities Exchange ('NSE') which impacts our portfolio of listed equities as well as valuation of some of our investments in unquoted equities.

We remain resilient in this environment, looking for and lining up alternative investment strategies and alternative funding options.

b) Financial Performance

Income, at KES 100.9 Million for the year ended 30th June 2018, grew by 32.5% from the income of KES 76.1 Million recorded in the year to 30th June 2017.



An analysis of our incomes shows that this improvement in incomes booked arose principally from modest improvement in four income streams.

In the year ended 30th June 2018, we earned KShs 51.9 Million in dividends from our investments in unquoted equities, up from KShs 41.7 Milllion in the year ended 30th June 2017. Improved dividend payout by some of the counters we are invested in: Minet Kenya Insurance Brokers, Minet Financial Services Limited and Almasi Beverages Limited contributed to this.

We earned interest income of KShs 36.3 Million in the year ended 30th June 2018, up from KShs 34.6 Million for the year ended 30th June 2017.

Taking advantage of positive movements in the valuation in some of the counters in which we invested at the NSE, we locked gains of KShs 5 million in the year ended 30th June 2018, up from KShs 0.9 Million in the year ended 30th June 2017.

In the year ended 30th June 2018, we booked KShs 8.0 Million in other income, an improvement from KShs 2.2 Million booked in the year ended 30th June 2017.

On the back of improvements in valuations across most of the counters on the NSE during the year ended 30th June 2018 as well as exits from some of the counters, the unrealized loss on listed equities fell to KShs 2.1 Million for that year, compared to KShs 5.9 Million in the year ended 30th June 2017.

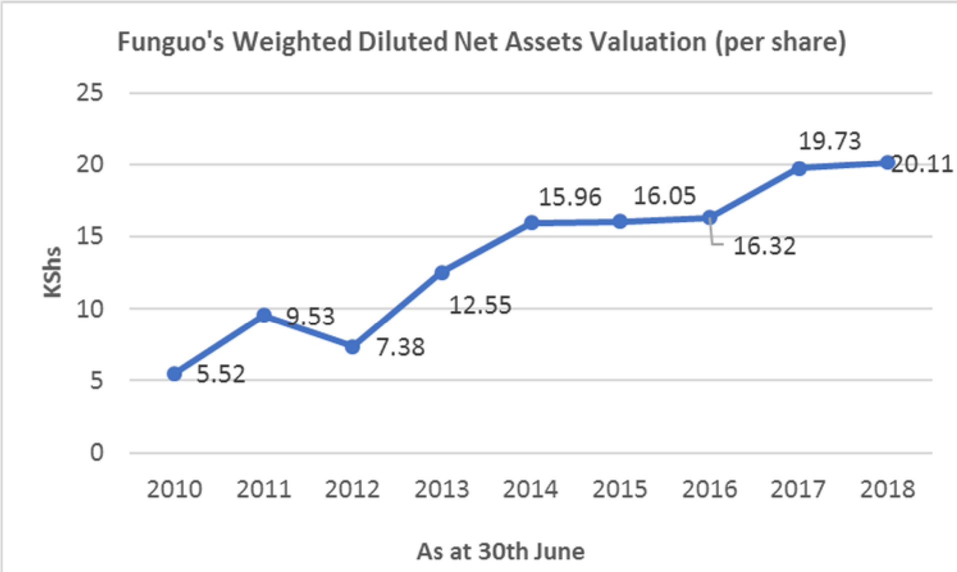
We recorded a decline in dividends earned in the year under review, at KShs 1.6 Million, compared to KShs 2.8 Million in the year ended 30th June 2017. This reflects a combination of factors: decline in dividends paid by some counters and the effect of our exit from others.

Operating profit before tax increased by 71% to KES 43.7 Million in the year under review, mainly due to the improvement in total incomes mentioned above, as well as cost control that saw our total expenses decline to KShs 37.4 Milllion in the ended 30th June 2018 compared to KShs 39 Million in the year ended 30th June 2017.

c) Shareholder Value & Trade in the FIL Share

The Net Asset Value ('NAV') per share increased by 1.9% to KES 20.11 as at 30th June 2018 from KES 19.73 as at 30th June 2017.

This extends a trend that the company has been on since 2010, whereby efforts to increase shareholder value as measured by value per share has generally improved, in spite of the successive share issues (through rights issue, private placement and a scrip issue) that have had a dilutive effect as well as pockets of challenging macroenvironment factors. The graph below depicts the trend in shareholder's wealth per share over the last 9 years.



We have managed to achieve a 264% growth in value per share during that period.

The FIL share traded close to 819, 101 units (or 1.41% of shares in issue) in the year ended 30 June 2018 in 4 transactions.

FIL Shares – Trading Volumes and Prices in the Year 2017/18		
Month of Trade	**No. of shares traded**	**Price (Average) KShs**
Nov-17	182,614	14.50
Feb-18	450,000	16.00
Mar-18	177,487	17.50
Jun-18	9,000	17.50

This represents a significant rise in volumes of the FIL share traded on the OTC compared to the immediate preceding years.

The share price rose by KShs 3 (or 20.7%) during the year 2017/18.

The last price recorded represents a 13% discount to the weighted NAV per share of KShs 20.11 as at 30 June 2018.

4) Dividends

The Board has recommended a dividend of KES. 0.1 per share for the financial year ended 30th June 2018.

The proposed dividend, which is subject to your approval, is equivalent to the dividend per share paid in the preceding 2 years.

The proposed dividend, if approved, builds on a tradition that your company has to pay a predictable dividend whenever operations are profitable. It is further proposed that this be paid as a scrip dividend to give you an option either to take cash or shares in the company.

The table below shows the trend in dividend per share, and total dividend payout over the last 9 years.

Year ended 30th June	Dividend Per Share	Number of Shares	Total Dividends Paid Out
	KES	**KES**	**KES**
2010	1.500	8,193,699	12,290,549
2011	1.000	8,193,699	8,193,699
2012	0.500	4,096,850	2,048,425
2013	0.125	39,329,424	4,916,178
2014	0.150	48,355,493	7,253,324
2015	0.093	53,862,650	4,998,454
2016	0.100	54,733,990	5,473,399
2017	0.100	57,037,060	5,703,706
2018	0.100	58,032,879	5,803,288

5) Corporate Governance

Your Board has diligently discharged its duties during the year ended 30th June 2018, with the support of the Management and in accordance with the Board Work Plan, Board Charter and the Code of Conduct for Directors.

Our largest shareholder, ICDC, effected a change in their alternate directors, which saw Mr. William Haggai join the board in place of Mr. Kennedy Wanderi effective 6th June 2018.

We are grateful to Mr. Wanderi for the service he gave our company during the period he served on our board, and heartily welcome Mr. Haggai.

6) Key Highlights of the 2018-19 Business Plan

To guide operations in the year 2018/19, the company is being guided by a business plan that has as key themes the following:

i. Higher income levels;
ii. Diversification of income streams;
iii. Stabilised expense levels;
iv. New capital mobilization;
v. Portfolio restructure to obtain optimization of returns for our portfolio.

7) Which Way Forward?

Your company, Funguo Investments Limited, like any other company in our environment is faced with the challenge of remaining afloat and ahead. Indeed, a company as old as we are (31 years old) has the added challenge of having to remain relevant and competitive because of the added expectation that old businesses are less nimble and therefore poor at responding to the dynamics in their environment. But we believe that our economy will continue to grow; in the process ushering in opportunities which we must be prepared to seize. Accessing capital will be key if we are to succeed.

In light of these challenges, the board and management of Funguo has been reviewing its operations and strategy in context of developments in the investments industry. This process has resulted in a relook at the strategy that we are currently using (Funguo 2.0) and we are convinced that we need to tweak aspects of this strategy to ensure that our investment operations are more responsive to the opportunities and threats in our environment.

We reckon that on one hand significant opportunities exist in provision of patient capital to entrepreneurs and their businesses in Kenya, and on the other, mobilization of local capital to invest in local opportunities.

We will keep you informed on developments in this matter.

8) Appreciation

Finally, I wish to take this opportunity on behalf of the Board to thank the Shareholders for their continued support, the Board Members, the Management, Investee Companies and all our partners for your cooperation, support and understanding without which the growth and performance recorded during the year may not have been possible.

No doubt exists in my mind that Funguo will continue to flourish and grow the fortunes of our shareholders and business partners. With 30 years behind us, our journey continues. With our goals clear, the challenges identified and the options to confront them developed, we are firmly set to increase the pace and intensity of our actions.

May God Bless you all

Dr. John P. N. Simba, OGW, MBS, EGH.

<u>Chairman</u>

FUNGUO INVESTMENTS LIMITED

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 30 JUNE 2018

	2018 KShs	2017 KShs
INCOME	100,870,975	76,105,516
EXPENSES:		
Administrative expenses	23,869,836	22,479,945
Operating expenses	4,851,628	5,922,037
Finance costs	8,645,042	10,619,011
	37,366,505	**39,020,993**
PROFIT BEFORE TAXATION	63,504,471	37,084,523
TAXATION	(19,835,092)	(13,468,642)
PROFIT FOR THE YEAR	**43,669,379**	**23,615,881**
OTHER COMPREHENSIVE INCOME:		
Fair value gain on bonds and treasury bills	41,244	261,854
Loss on redemption of bonds and treasury bills	(2,108,364)	-
Fair value gain on unquoted investments	16,091,959	157,059,695
TOTAL COMPREHENSIVE INCOME	**57,694,218**	**180,937,430**
EARNINGS PER SHARE:		
Basic and diluted EPS	**0.76**	**0.43**

FUNGUO INVESTMENTS LIMITED

STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2018

	2018 KShs	2017 KShs
NON-CURRENT ASSETS		
Equipment	1,111,869	1,170,814
Intangible assets	25,914	43,482
Unquoted investments	822,063,679	810,923,100
Quoted investments	48,624,441	64,289,299
Investment in associate	25,135,062	25,135,062
Investment in subsidiaries	39,405,333	3,935,564
Deferred tax	-	1,165,635
Bonds and treasury bills	18,380,509	61,023,985
Advances to associate	-	71,394,609
	954,746,806	**1,039,081,550**
CURRENT ASSETS		
Advances to associate - current portion	124,263,664	35,697,305
Tax recoverable	-	-
Trade and other receivables	94,410,600	58,438,333
Cash and cash equivalents	64,898,025	42,793,958
	283,572,289	**136,929,596**
TOTAL ASSETS	**1,238,319,095**	**1,176,011,146**

EQUITY AND LIABILITIES		
EQUITY		
Share capital	290,164,395	285,185,290
Reserves	870,430,850	808,481,526
	1,160,595,245	**1,093,666,816**
NON CURRENT LIABILITIES		
Borrowings	**52,379,863**	**62,673,288**
CURRENT LIABILITIES		
Borrowings - current portion	10,293,425	9,772,583
Tax payable	11,257,621	4,246,476
Dividends payable	377,617	509,632
Trade and other payables	3,415,324	5,142,351
	25,343,987	**19,671,042**
TOTAL EQUITY AND LIABILITIES	**1,238,319,095**	**1,176,011,146**