

(BUY; TP at KES 22.17)

Funguo Investment has made positive strides in its initiatives and strategies laid out by balancing their portfolio optimally to ensure returns for their shareholders thereby achieving a net asset value per share of KES 19.73 against their previous target price of KES 15.78. Investments made in unquoted segment have realised a trajectory growth (4yr-CAGR 22.7%) which have enabled total portfolio re-allocation to strengthen as shocks brought about by quoted investments are contained by unquoted portfolio.

With a target price of KES 22.17 above the current NAV/share, an upside potential of 12.4% represents a good potential investment return with assets under management growing 21% year on year to KES 1.2Bn in FY 2017 from KES 972Mn in FY 2016. Prudent management and asset allocation through actively and passively adapting relative strategies will in the long run have positive returns and capital gain potential for investors when attaining the Funguo 2.0 strategy. Despite the negative performance of the equities market, management took a cautious stance in reducing the negative effect of the overall quoted portfolio on earning assets; dividend income from both quoted and unquoted investments was 56% up year on year boosting the bottom line performance.

Latest financial performance

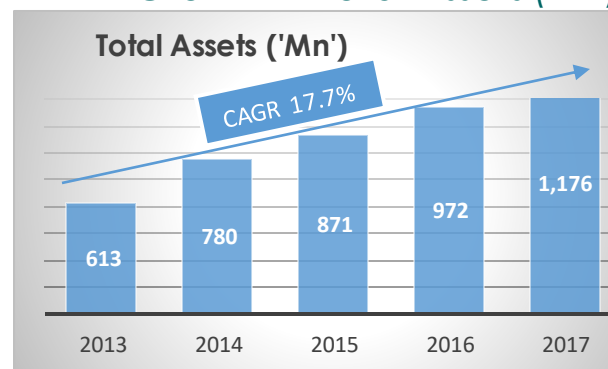
- Income from financial assets:** FIL registered a 111% growth year on year boosted by income in dividends from unquoted investment from KES 25.7Mn in 2016 to KES 41.7Mn in 2017 as well as other income. Unquoted investment represent 55% of all income from financial assets followed by bonds and fixed deposits at 45%.
- Improvement in margins to drive profitability:** Gross profit margin has greatly improved from 50% in FY16 to 71% in FY17 on continued focus on higher margin portfolio asset allocation coupled with efficient cost management. Operating expenses grew as a result of provision for impairment loss (from KES 3.3Mn in 2016 to KES 6Mn in 2017). We expect further efficiency gains and foresee gross margin to continue growing.
- Investment income: Interest** income was subdued during the year because of financial investment of quoted equities largely affected by capping of interest rates, and gains realised from disposal of quoted investments came at a very low valuation compared to the previous year. However unquoted investments made up for losses seen in quoted equities hence profitability and shareholder value increased by greater margins.

Summary Statistics

Key Metrics	FY13	FY14	FY15	FY16	FY17
Total income	74,125	76,141	46,353	36,129	76,106
%chg.		3%	-39%	-22%	111%
Gross Profit	64,434	63,169	25,714	18,036	53,626
%chg.		-2%	-59%	-30%	197%
EBIT	62,190	57,514	20,177	14,769	47,704
%chg.		-8%	-65%	-27%	223%
EPS	1.41	0.97	0.13	0.01	0.41
%chg.		-31%	-87%	-91%	3569%
DPS	0.09	0.13	0.09	0.10	0.10
%chg.		48%	-31%	10%	4%

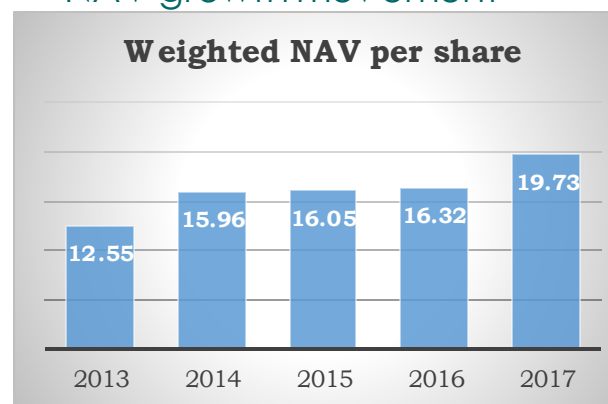
Recommendation
Buy

Growth in Total Assets (Mn)



Source: Company fillings, OMS Research

NAV growth movement



Source: Company fillings, OMS Research

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Investment Case

Strong set of full year 2017 numbers boosted by robust positive topline growth since 2014

Funguo's profit before tax registered positive growth to settle at KES 37Mn: FIL's net sales rose by 111% from a -4% growth in full year 2016. This is largely because of income booked from gains in dividend income from unquoted investments as well as other income. On the other hand, dividend income from quoted investments, interest income and gain on disposal of quoted investment declined year on year. With planned initiatives to increase revenue at a growing pace by management, we anticipate uptick of the equities market which will foster growth among the company's portfolio performance in turn ensuring higher returns for shareholders who will generate income due to greater return potential.

Key diversification strategy

Funguo's portfolio asset allocation has enabled it to stay ahead despite the economic and market turmoils experienced within the year: The Company's capital portfolio restructuring to obtain optimization of returns in their investments would properly enable it to withstand potential negative effects or shocks beyond its control as it strides to achieve Funguo 2.0 5-year strategy. Asset allocation provides a diverse opportunity for investment returns to be positively achieved and we believe Funguo has the mandate, ability and resources and adequate liquidity to undertake more investments. Realised income from unquoted investments enabled Funguo to realise potential growth in earnings despite a negative drop in income from quoted investments.

Investments/shareholding in investee companies

Investing in other companies to continue to boost Funguo's shareholding: The Company's strategic and forward looking investment in other companies generates positive returns which grew 32.6% year on year from KES 630.6Mn in 2016 to KES 836.1Mn in 2017. The company is on the lookout to increase its shareholding and also invest in other potential companies which seem viable.

Potential Risks

Decline in value of listed equity investments

The year under review has experienced negative returns especially in the stock market: Stock market volatility and uncertainty of returns occasioned largely by elections that have come to pass made investors cautious of their investments. This, together with the interest rate capping law affecting the banking sector contributed to the cautious stance undertaken by investors. Funguo's investment in quoted investments in fair value declined by 13.5% from KES 74.3Mn to KES 64.3Mn.

Concentration and holding period risk

All of Funguo's investments are situated in Kenya: The company primarily invests in Kenya only and thus is subject to any economic shocks experienced by the country and therefore will not get to enjoy any returns from outside its country of operations. At the same time, the company has to position itself and evaluate its exit strategy which may pose a risk and constraints realised when it comes to disposal of investments made.

Valuation methodology

NAV/ SHARE

We have incorporated a Net Asset Value methodology as the company invests in various sectors of the economy and a price-to-book valuation and applying a 70:30 ratio respectively on the prices to obtain our target price per share. We have used a four-year average terminal annual growth rate in all the segments to come up with our forward multiple to capture the downside or upside potential as investments are accounted for at cost and not fair value. Then the forward multiple was multiplied with the portfolio value to obtain the forward portfolios in each segment.

Quoted investments	As at 2017
Portfolio Value FY 2017	64,289,299
Target annual growth rate	-15%
CAGR 2013-2017	-17%
Forward Multiple to capture upside , x	0.9
Forward Value of portfolio	54,916,182
Subtotal Quoted Investments	54,916,182
Unquoted investments	
Portfolio Value FY 2017	810,923,100
Target annual growth rate	21%
CAGR 2013-2017	21%
Forward Multiple to capture upside , x	1.2
Forward Value of portfolio	983,624,549
Subtotal unquoted Investments	983,624,549
Bonds	
Portfolio Value FY 2017	61,023,985
Target annual growth rate	4%
CAGR 2013-2017	3%
Forward Multiple to capture upside , x	1.0
Forward Value of portfolio	63,250,348
Subtotal Quoted Investments	63,250,348
	1,101,791,079
Total Asset Value	
shares	57,037,058
NAV/share	KES 19.32

Assumptions:

- Double digit growth to continue in unquoted investments and will continue to provide above average returns in the total portfolio investments.
- We anticipate a decline in quoted equities as management intends to re-align its portfolio to withstand any negative effects and thus a cautious stance employed in investing in the same as a result of recent trends. However, quoted investments could revamp as tighter regulations are lessened.
- Fixed income securities to perform better than equity investments as recovery of amortization and fair value gains expected to revamp and outweigh downside effects seen in previous year in anticipation for bond market upside.

Peer comparable:

Name	Mkt Cap (KES)	Last Px	P/E	ROE	Dvd Yld	P/B
CENTUM INVESTMENT CO LTD	29,778.52	44.75	4.57	23.45	2.68	0.86
SALAM INTERNATIONAL INVESTME	21,461.27	187.73	18.92	2.50	11.96	0.49
AFRICAN EQUITY EMPOWERMENT	25,887.11	52.68	6.89	42.23	0.31	2.50
AL-OMANIYA FINANCIAL SERVICE	20,472.77	73.96	15.98	6.98	6.16	1.14
MIVTACH SHAMIR HOLDINGS LTD	20,236.72	2,125.67	-	(0.17)	9.03	0.65
NAWI BROTHERS LTD	16,493.40	503.89	8.81	16.55	1.52	1.28
TRANSNATIONAL CORP OF NIGERI	16,535.22	0.41	5.68	19.63	-	0.98
IBI INVESTMENT HOUSE LTD	16,265.12	1,284.67	12.54	11.09	12.70	1.44
NATIONAL LEASING	15,357.28	310.36	-	(2.14)	4.52	0.57
NILE CITY INVESTMENT	14,396.04	1,985.57	46.36	8.14	-	3.14
INTL COMPANY FOR LEASING	12,341.46	617.04	-	-	1.05	3.97
OMAN ORIX LEASING CO.	12,244.17	46.90	7.84	15.36	4.95	1.12
NATIONAL FINANCE CO	11,084.61	38.59	6.62	13.27	9.44	0.88
Average	17,888.74	559.40	13.42	13.07	5.85	1.46

Source: Bloomberg, OMS Research

Relative Valuation

Funguo limited is currently trading on high P/E of (36.2x) and having a ROE of 2.4% compared to its regional peers with an average P/E of 13.42x and average ROE of 13.07%. The subdued returns were as a result of slowdown and eventual bear run on the listed equities asset class. However we are optimistic on the strategy plan to be undertaken that will ensure revenue diversification and increased contribution to returns by private equity portfolio. It trades on a P/B (0.78x)-(based on market price of KES 15.00) which is below the peer comparable average of (1.46x).

Using the Price to Book valuation:

Book value per share = 19.73, P/B multiple = 1.46x, Implied price = 28.84

Applying 70:30 ratio, $19.32 * 70\% = 13.52$ and $28.84 * 30\% = 8.65$

Methodology	Price
Net Asset Value	13.52
P/B	8.65
Total	22.17

Potential upside realized 12.4% based on current NAV/share of KES 19.73

Unquoted Investments

Fair Value	As at 30/06/2017	As at 30/06/2016
AON KENYA INSURANCE BROKERS LTD	493,435,100	384,796,293.12
ALMASI BEVERAGES LIMITED	248,270,000	152,251,397.54
HERI LIMITED	12,641,000	12,077,981.52
KWA HOLDINGS (EAST AFRICA) LIMITED	5,916,000	4,452,660
ROYAL NGAO HOLDINGS LTD	2,331,000	2,188,800
AFRICA ENERGY LIMITED	25,135,062	25,135,062
UAP HOLDINGS LTD	48,330,000	49,672,500
Total	836,058,162	630,574,694.18

Source: Company Filings

Shareholding as at 31/12/2017

Name : Top 10 shareholders	No. of shares	Shareholding
I.C.D.C	10,773,922	18.65%
SETA HOLDINGS LIMITED	8,066,223	13.96%
YCEO HOLDINGS LIMITED	3,666,075	6.34%
MOUNT KENYA INVESTMENTS LTD	3,662,809	6.34%
GEOFFREY.A.G. KIMARU	2,934,566	5.08%
JAPHETH OSUNGA	2,275,552	3.94%
PETER KING`ORI MWANGI	1,905,716	3.30%
VINCENT H. L. OPANGA	1,680,816	2.91%
JOSEPH MUNYIRI MUNENE c/o OLIVE MUNENE	1,241,204	2.15%
CHARLES NJUGUNA WAIGI	876,329	1.52%

Source: Company Filings

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