Cytonn H1'2021 Kenya Listed Insurance Sector Report

"Improved Earnings In A Higher Loss Ratio Environment"

Cytonn

13th November, 2021

Table of Contents

1 Overview of the Firm

2 Economic Review and Outlook

3 Kenya Insurance Sector Review

4 Cytonn Insurance Sector Report

5 Cytonn's Insurance Sector Report

6 Appendix

1. Introduction to Cytonn

About Us

Cytonn Investments is an alternative investment manager, with real estate development capability, and a primary focus on private equity and real estate investments in the high growth Kenyan Region. Cytonn has a unique strategy of coupling two compelling demand areas - the lack of high yielding investment products and the lack of institutional grade real estate. We provide high yielding investment instruments to attract funding from investors, and we deploy that funding to largely pre-sold investment grade real estate. With offices in Kenya and Washington, DC - USA, we are primarily focused on offering alternative investment solutions to global and local institutional investors, individual high net-worth investors, and diaspora investors interested in the East-African region. Real estate investments are made through our development affiliate, Cytonn Real Estate, where we currently have over Kshs. 82 billion (USD 820 mn) of projects under mandate across ten projects. In private equity, we invest in banking, education, and hospitality.

82	Over Kshs. 82 billion worth of projects under mandate	**3**	Three offices across 2 continents	**200**	Over 200 staff members, including Cytonn Distribution	**8**	8 investment ready projects in real estate

A unique franchise differentiated by:

Independence & Investor Focus

Focused on serving the interest of clients, which is best done on an independent platform to minimize conflicts of interest

Alternative Investments

Specialized focus on alternative assets - Real Estate, Private Equity, and Structured Solutions

Strong Alignment

Every staff member is an owner in the firm. When clients do well, the firm does well; and when the firm does well, staff do well

Committed Partners

Strong global and local partnerships in financing, land and Cytonn Real Estate, our development affiliate

Why We Exist

Africa presents an attractive investment opportunity for investors seeking attractive and long-term returns. Despite the alternative markets in Africa having high and stable returns, only a few institutional players serve the market. Cytonn is focused on delivering higher returns in the alternative markets, while providing the best client service and always protecting our clients' interests.

WE SERVE THREE MAIN CLIENT SEGMENTS:

- High Net-worth Individuals through Cytonn Private Wealth. This is done through our captive Distribution Network
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional Clients. These clients are served from our Investment & Fundraising Team

WE INVEST OUR CLIENT FUNDS IN:

- Real Estate, and Real Estate Related Businesses
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions

Our Business Structure

Cytonn Investments Management Plc

Cytonn Capital Partners (Private Markets)

- Private Offers and Real Estate Investments
- Cytonn Hospitality
- Superior Homes Kenya

Cytonn Asset Managers (Regulated by CMA & RBA)

- Unit Trust Funds
- Cytonn Africa Financial Fund
- Cytonn Advisory
- Pension Fund Management

Cytonn Real Estate

- Research and Deal Origination
- Project Management
- Quality Assurance/ Control
- Cytonn Procurement - Cymatt
- Cytonn Real Estate Legal
- Cytonn Properties
- Cytonn Centre for Affordable Housing

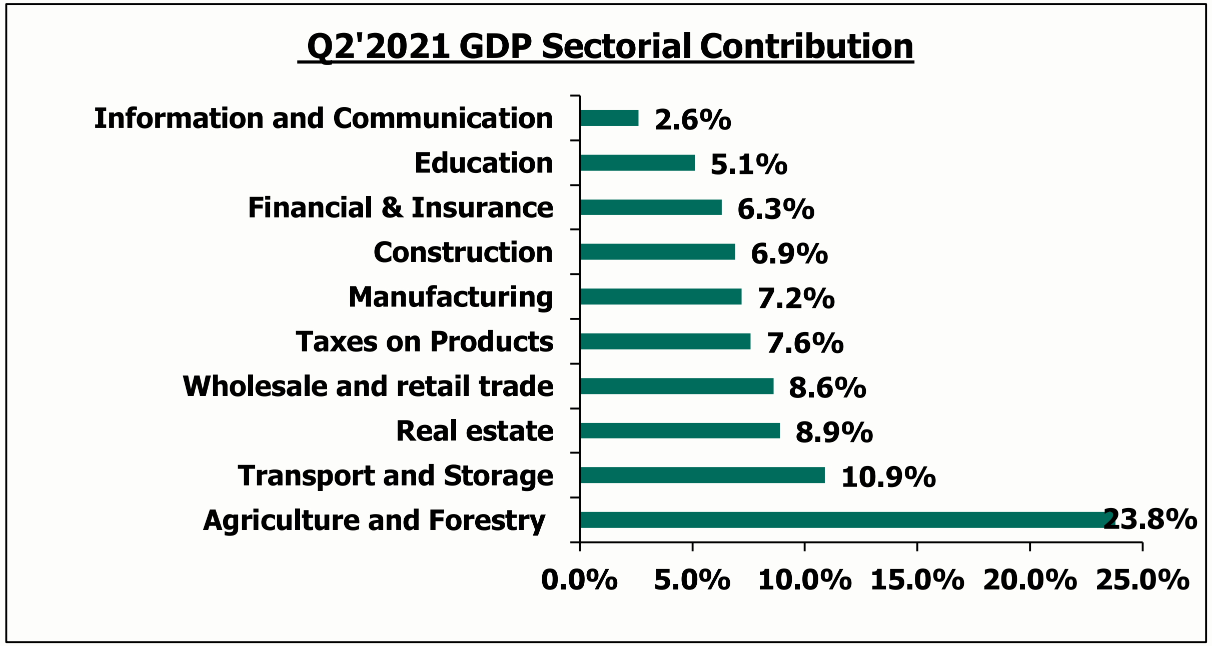
Other Strategic Initiatives

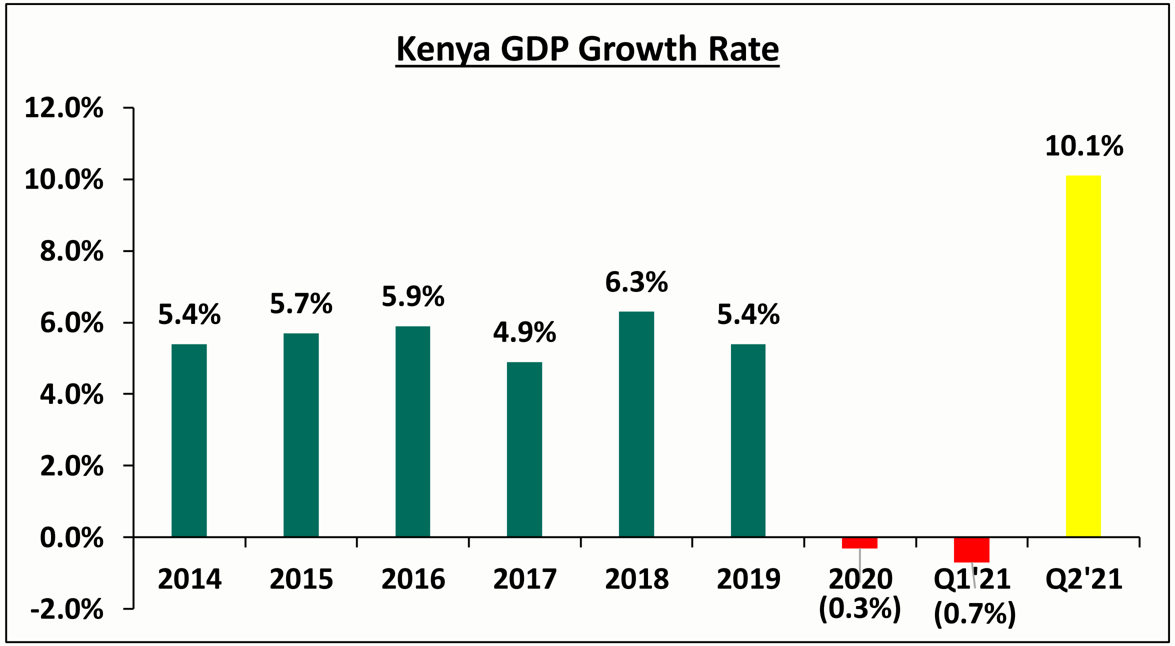
- Cytonn Distribution
- East African Forum for Alternative Investments

2. Kenya Economic Review and Outlook

Cytonn

The economic growth expected to rebound in 2021





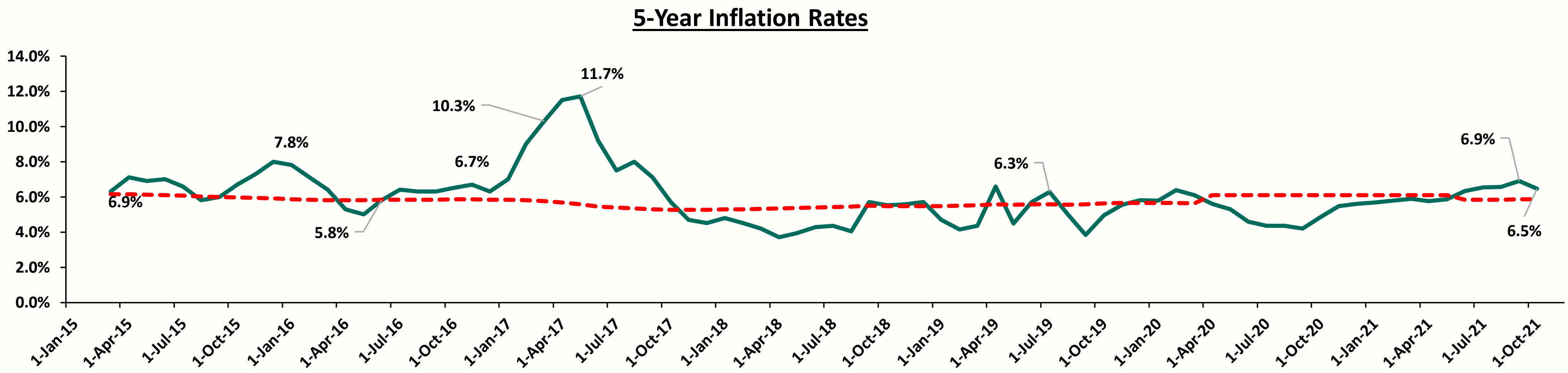
**Source: KNBS*

- According to Kenya National Bureau of Statistics (KNBS), the Kenyan economy recorded a growth of 10.1% in Q2’2021, up from a contraction of 5.7% recorded in Q2’2020 and the 0.7% contraction in Q1’2021
- We expect the growth rate to be sustained in the coming quarters following the relaxation of COVID-19 restrictions, and recovery in key sectors like education, transportation and storage, and information and communication

Cytonn

Inflation

Inflation averaged 6.2% in the first ten months of 2021

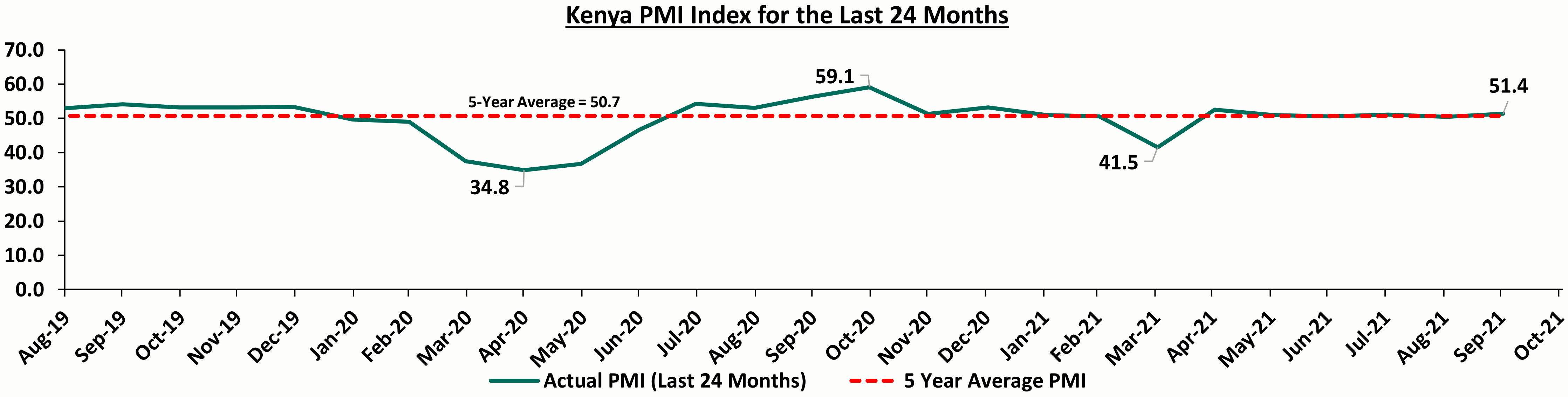


**Source: KNBS*

- Inflation averaged 6.2% in the first ten months of 2021, a 1.0% points increase from the 5.2% recorded over the similar period in 2020. Key to note, the September 2021 inflation increased to 6.9% which was a 48-month high. The rise in inflation rate during the year is attributed to the rising food and fuel prices
- We expect inflation to remain higher than 5.2%, which was the average in 2020, but remain within the government target range of 2.5% - 7.5%, mainly due to the rising global fuel prices and the new taxes introduced at the start of the year that will be transmitted to the final consumers

Cytonn

Stanbic PMI Index

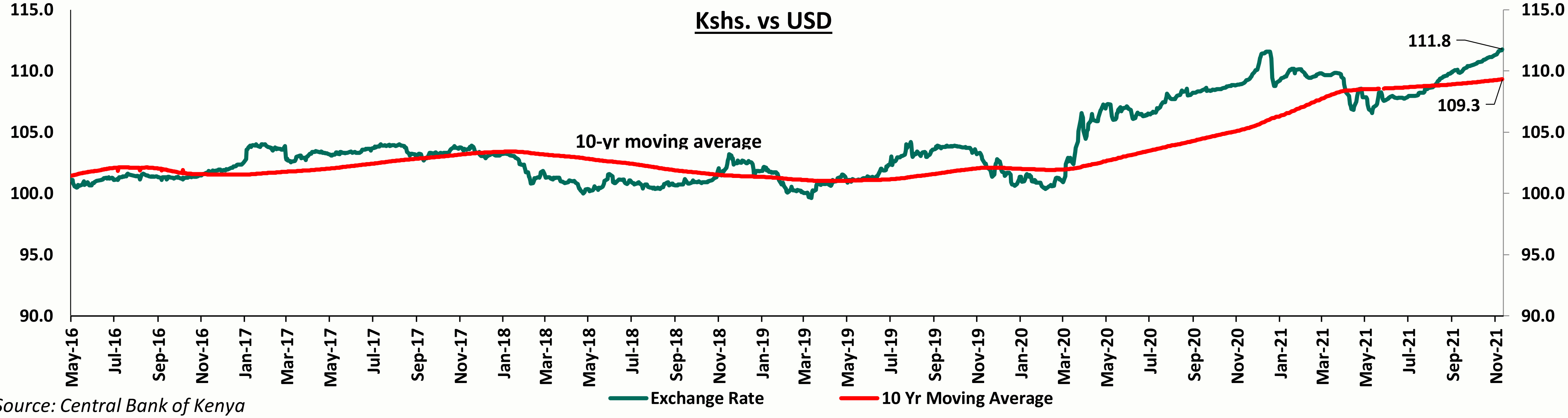


**Source: Markit Economics*

- In 2021, the economic prospects of the country improved, with the Stanbic PMI index averaging 50.3, an improvement from the 47.7 recorded over a similar period in 2020. In October 2021, the PMI Index increased to 51.4 from the 50.4 recorded in September 2021
- Key to note, a PMI reading of above 50 indicates improvements in the business environment, while a reading below 50 indicates a worsening outlook. Despite the stronger growth seen in the period under review, the level of sentiments was weak, as firms were concerned that the economy could face a setback from the pandemic

Currency

Year-to-date, the Kenyan shilling has depreciated by 2.4% against the US Dollar

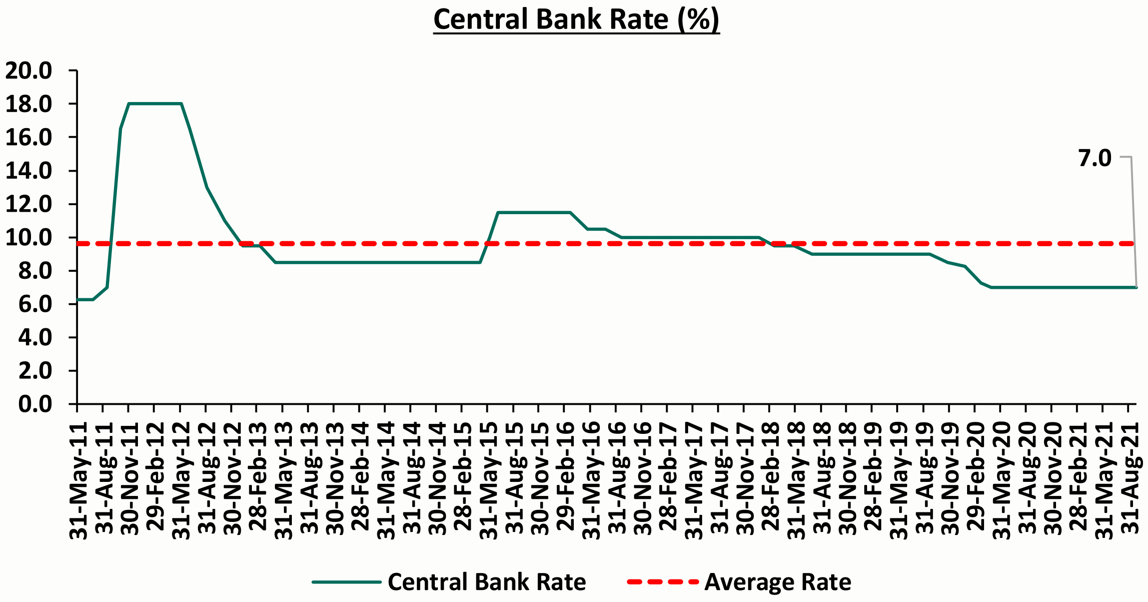


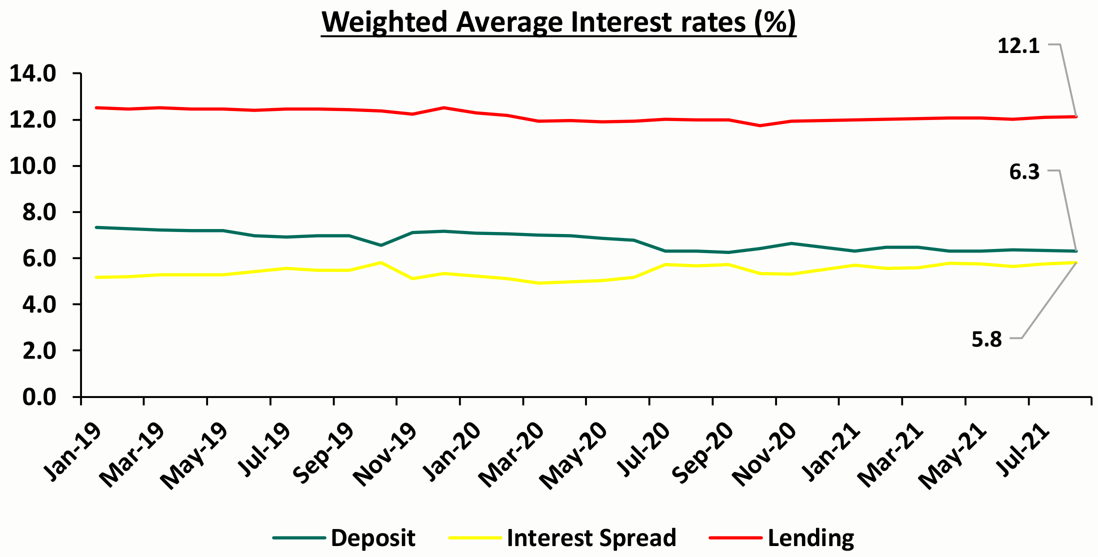
**Source: Central Bank of Kenya*

- On a YTD basis, the Kenya Shilling depreciated against the US Dollar by 2.4%, to close at Kshs 111.8. The depreciation is partly attributable to increased import activities by local traders as well as increased dollar demand across various sectors including energy amidst weak inflows
- In our view, the shilling will come under pressure due to continued uncertainty globally making people prefer holding dollars and other hard currencies. The local currency is however expected to be supported by the Forex reserves, currently at USD 9.4 bn (equivalent to 5.8-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover

Cytonn

Interest Rates and Monetary Policy



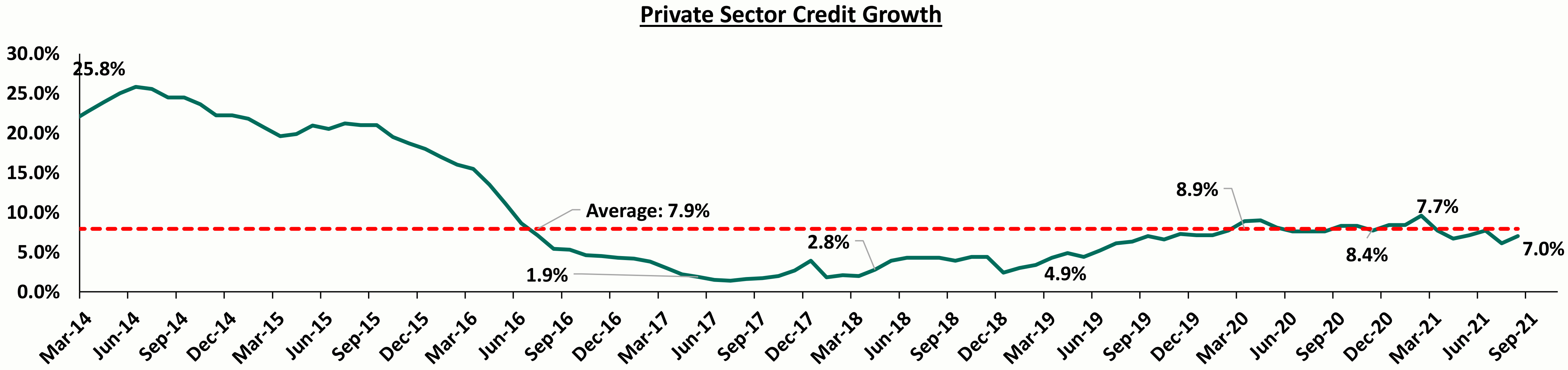


**Source: CBK*

- Since the start of the year, the Monetary Policy Committee has met thrice and held the Central Bank Rate stable at 7.0% in all instances and the Cash Reserve ratio also remained unchanged at 4.25%
- The MPC concluded that the current accommodative monetary policies together with the package of policy measures implemented over the last year have protected the economy from substantial decline and supported vulnerable citizens. As a result of the adoption of the accommodative policy in 2020, commercial banks' lending rates declined to 12.1% in August 2021 from 12.3% seen in January 2020.

Cytonn

Private Sector Credit growth



**Source: KNBS*

- In the 12 months to August 2021, growth in private sector credit stood at 7.0%, a decline from the 8.4% recorded in January 2021 and 7.6% recorded over the same period in 2020, reflecting the persistent uncertainty in the economy on account of the toll of the COVID-19 pandemic on the business environment
- We expect to see continued caution on lending as credit risk remains elevated amidst uncertainties in the business environment brought about by COVID-19 pandemic

Cytonn

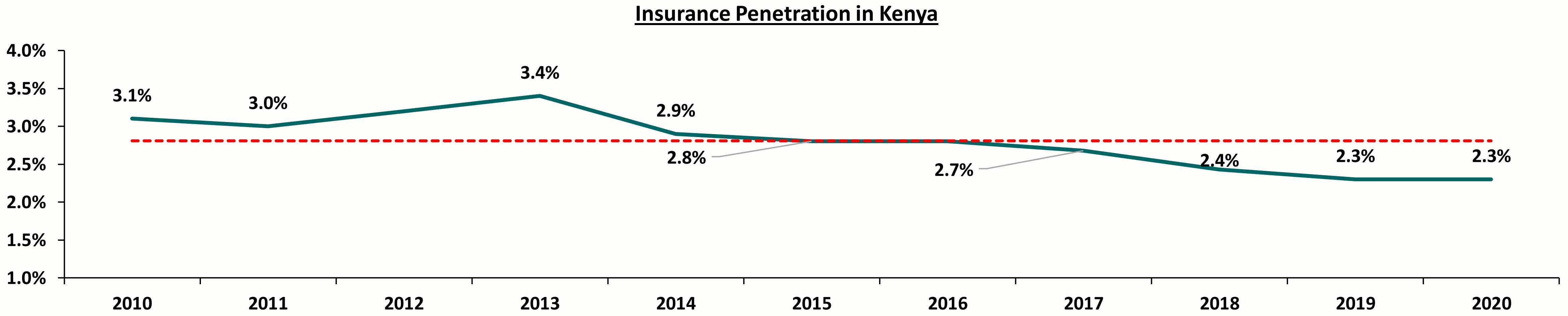
3. Kenya Insurance Sector Overview

Cytonn

Kenyan Insurance Sector Overview

The Insurance penetration in Kenya stood at 2.3% as at the end of 2020

- The industry is regulated by Insurance Regulatory Authority which is responsible for licensing, regulating and developing the insurance sector
- In the last five years, the life insurance market in Kenya has experienced growth in both the level of direct premiums as well as in the equity held by the industry constituents
- In H1'2021, Kenya had 56 insurance companies, 5 reinsurance companies, 220 insurance brokers and 10,522 insurance agents (which includes 26 Bancassurance agents)
- Insurance penetration in Kenya stood at 2.3% of Gross Domestic Product (GDP) in 2020, unchanged from what was recorded in 2019, on the back of price undercutting in an industry where players are facing increasingly tough competition

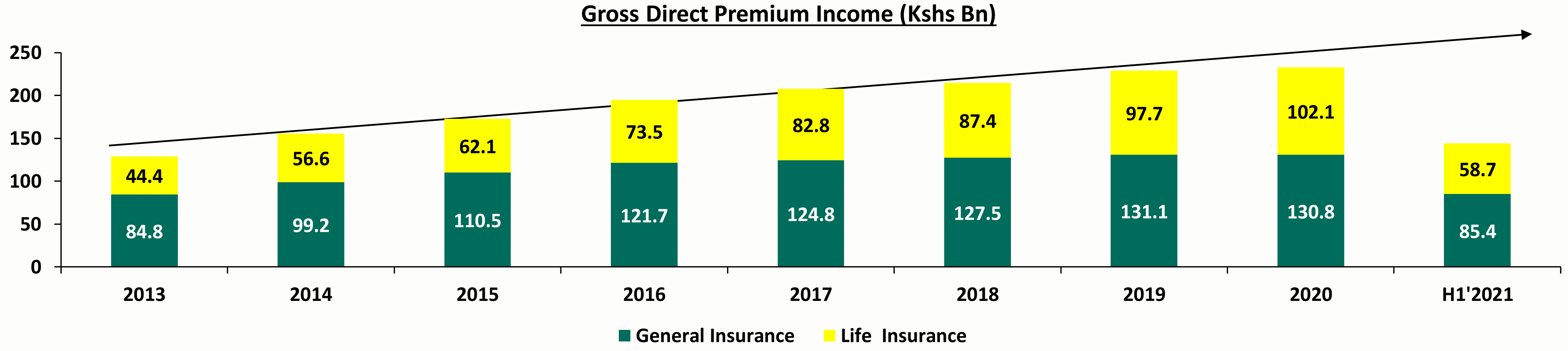


Cytonn

Source: Central Bank of Kenya, FinAccess report

Kenyan Insurance Sector Overview

General insurance business remains the largest contributor to industry insurance activity at 59.3%



- Industry gross written premium stood at Kshs 144.1 bn as at end of H1’2021, representing an increase of 19.0% from Kshs 121.0 bn in H1’2020. Long term insurance segment grew by 22.6%, while general Insurance recorded a growth of 16.6%
- General insurance business remained the largest contributor to industry insurance activity contributing 59.3% of the total premium. Motor insurance and medical insurance classes of business account for 62.3% of the gross premium income under the general insurance business
- In the long term insurance segment, pensions and life assurance classes were the biggest contributors to the life gross premium income, accounting for 65.4% in Q2’2021, compared to the 67.6% contribution by the two classes recorded in Q2’2020

Cytonn

Insurance Sector Growth Drivers

Alternative channels for both premium distribution and claims verification and disbursement is driving the sector

The drivers of growth in the insurance sector in H1'2021 include;

a) **Technology and Innovation**: The industry players continue to innovate products while leveraging on technology to remain competitive. the onset of the COVID-19 pandemic in FY'2020 saw the adoption of digital distribution of insurance products become a matter of necessity. Consequently, many insurance companies increasingly took advantage of the available digital channels to drive growth and increase insurance penetration in the country. An example is Liberty Holdings which has been using AI to rollout e-policy documents, self-services for retail customers and collect customer feedback

b) **Adoption of Alternative Distribution Channels**: Insurance companies have been dynamic and fast in adopting new alternative channels for both distribution and premium collection with financial sector deepening leading to an improved method of distribution of insurance products, collection and payment of premiums like bank assurance, online and mobile payment

c) **Post pandemic recovery:** Continued recovery from the economic shocks that shrouded 2020 that has seen both individuals and businesses seek insurance uptake to cover for their activities, leading to growth in net premiums which increased by 18.9% to Kshs 113.5 bn, from Kshs 95.4 bn in H1'2020

Insurance Sector Growth Drivers

New regulations and the use of block chain have also contributed to growth in the insurance sector

d) **Investment Income :** Increased investments income which significantly increased by 93.9% to Kshs 32.6 bn in H1'2021 from Kshs 16.8 bn in H1'2020, mainly attributable to the fair value gains on investments on equities in the capital markets

e) **Regulation:** The newly introduced regulations in the insurance sector have helped most companies improve their capital management systems. The new compliance requirements as stipulated in IFRS 17 come at a high implementation cost but they also assist companies manage their risks and capital in a better way

f) **Redirection in Core Operations-** With the limited growth of the insurance industry, insurers are moving their focus to growing investment income which involves and increase in the assets under management segments and investments in property. Most insurance companies are now moving into asset management to boost their group revenues

Recent Developments in the Kenyan Insurance Sector

The following are the most recent developments witnessed in the Insurance sector;

1. **IFRS 17 Implementation:** The standard, having replaced IFRS 4, is expected to give better information on profitability by providing more insights about current and future profitability of insurance contracts. Separation of financial and insurance results in the income statement will allow for better analysis of core performance for the entities and allow for better comparability of insurance companies. However, as a way to protect the insurance industry from the negative effects of the pandemic the International Accounting Standards Board (IASB) deferred its implementation to be effective from January 2023 or earlier

2. **Increasing Price Wars**: Insurers have seen a decline in group life business as well as ordinary business as a result of price wars that have been prevalent among the players in the industry. Price wars have negatively impacted performance in the insurance sector. The price wars are as a result of low penetration rate in the country which has led to players in the market undercutting product pricing in order to gain market share. The undercutting continues to be a major challenge in the industry as well as increasing the risk that comes with product mispricing

Recent Developments in the Kenyan Insurance Sector

The Insurance sector has seen mergers and acquisitions mainly with companies trying to protect their market share in a competitive environment

3. **Merger & Acquisition activity:** The insurance sector is booming with mergers and acquisitions mainly with companies trying to protect their market share in a competitive environment. Some of the M&A deals include Jubilee Holdings announcing a strategic transaction with Allianz, a German multinational Underwriter and asset manager, in September 2020, for the sale of 66.0% stake in the general business excluding medical for a total consideration of Kshs 10.8 bn. We expect that this amount will be ploughed back in to the company as part of the capital boost to grow other business lines

4. **Revenue Diversification -** There has been need for diversification necessitated by the slow growth in premiums against an increase in underwriting expenses, leading to insurers pursuing non-traditional asset classes. For example the FY'2020 saw Jubilee Holdings invest Kshs 4.2 bn in Bujagali Power Plant in Uganda, thus increasing the ownership stake to 18.2% from 8.8%

Cytonn

Insurance Sector Market Share

UAP Old Mutual leads in General Insurance business, while Britam dominates in Long term Insurance market

Market Share as at H1'2021			
Insurer	**General Insurance Business Market Share**	**Insurer**	**Long-Term Insurance Business Market Share**
UAP Old Mutual	8.6%	Britam Holdings	21.3%
CIC Group	8.0%	ICEA Lion Insurance	16.2%
GA Insurance	7.7%	Jubilee Insurance	11.5%
APA Insurance	7.4%	Kenindia Assurance	8.1%
Jubilee Insurance	7.2%	Sanlam Insurance	6.9%
Others	**61.1%**	**Others**	**35.7%**
Total	**100.0%**	**Total**	**100.0%**

Source: IRA Q2'2021 report

- The top 5 insurance companies control 38.9% of the General Insurance market share
- In terms of long term insurance, the top 5 insurers control 64.3% of the market share

Cytonn

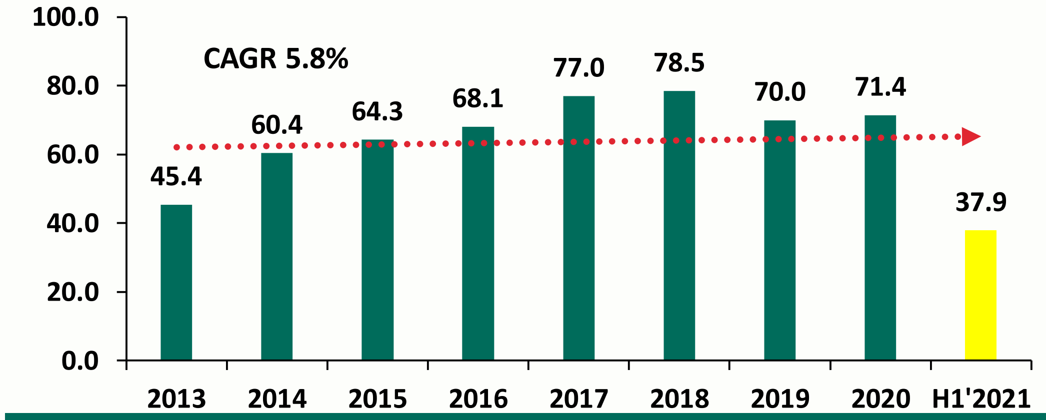
4. Listed Insurance Sector Metrics

Cytonn

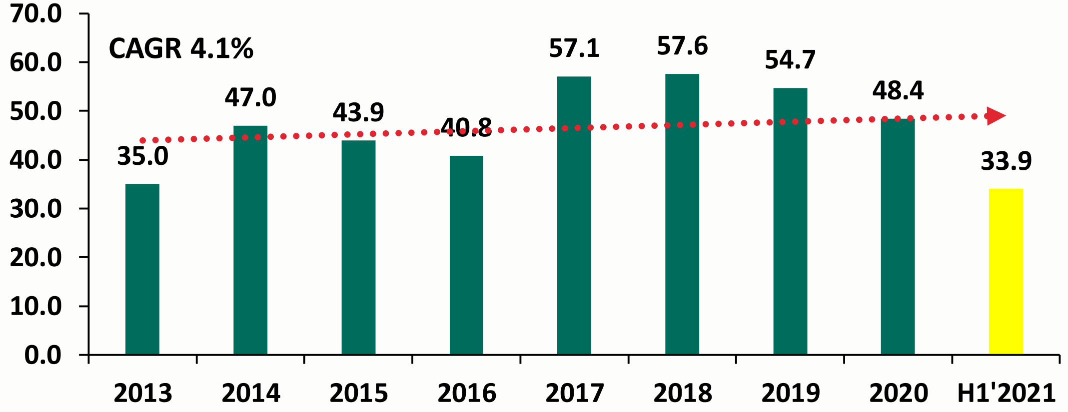
Listed Insurance Sector Metrics

Total Assets and Shareholder Equity have recorded all steady growth over the years

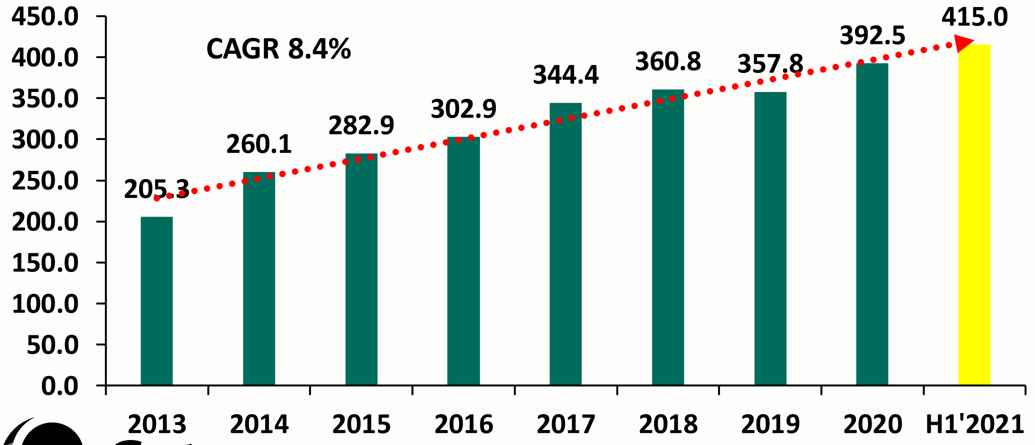
Net Premiums (Kshs Bn)



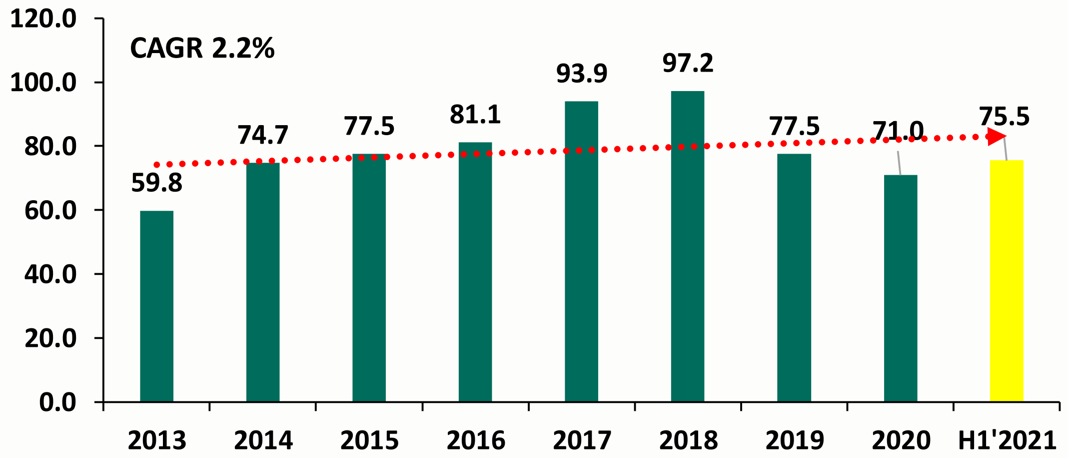
Net Claims (Kshs Bn)



Total Assets (Kshs Bn)



Shareholders Equity (Kshs Bn)

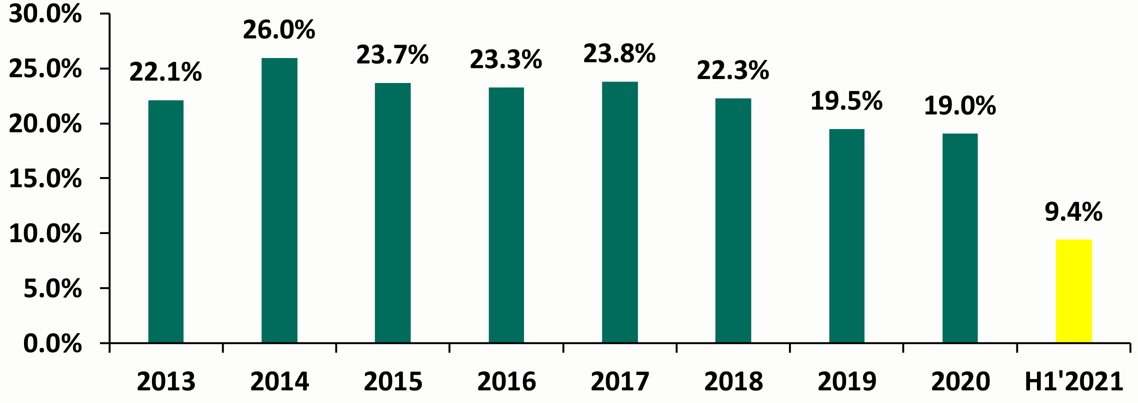


Cytonn

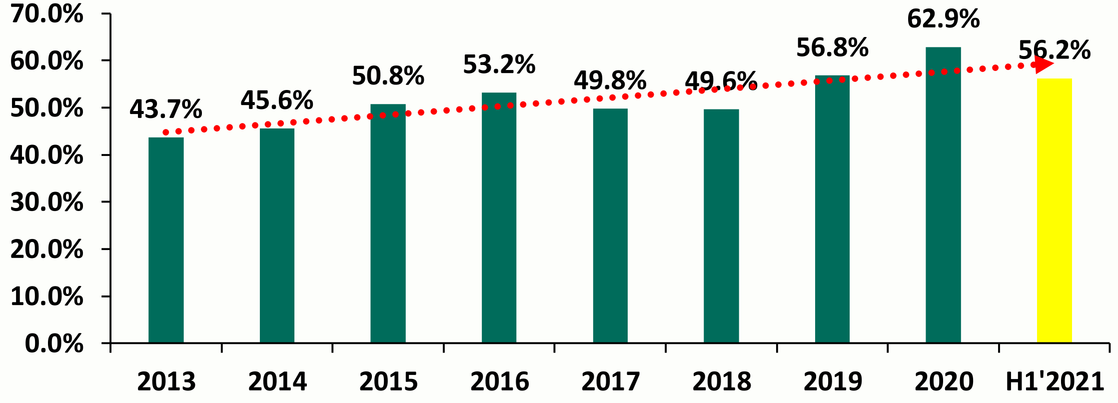
Listed Insurance Sector Metrics

Loss ratios remain under control, however, Solvency ratios have been on a decline

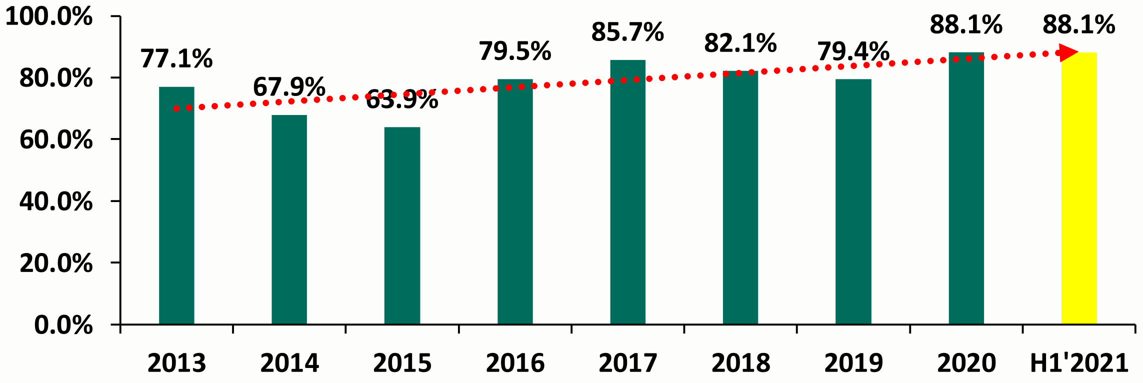
Solvency Ratio



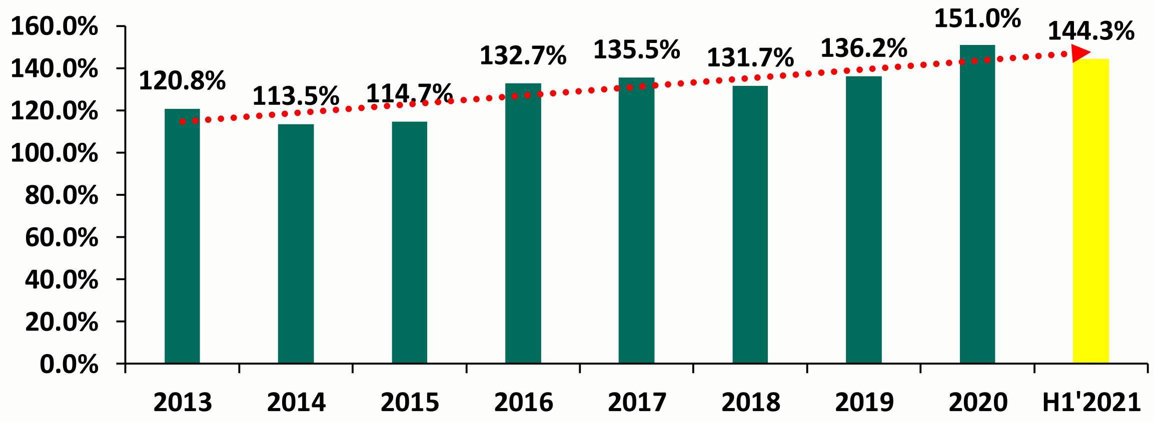
Expense Ratio



Loss Ratio



Combined Ratio



Cytonn

Listed Insurance Earnings and Growth Metrics

The Loss and Expense ratios increased across the Insurance sector to 92.8% and 53.8%, respectively

Listed Insurance Companies H1'2021 Earnings and Growth Metrics								
Insurance	Core EPS Growth	Net Premium growth	Claims growth	Loss Ratio	Expense Ratio	Combined Ratio	ROaE	ROaA
CIC Group	177.3%	0.5%	7.0%	81.3%	50.8%	132.1%	3.4%	0.6%
Jubilee Holdings	146.2%	10.0%	42.1%	109.6%	30.4%	140.0%	12.5%	3.1%
Britam Holdings	123.0%	2.4%	15.8%	78.5%	79.4%	157.8%	1.7%	0.3%
Sanlam Kenya	68.8%	45.9%	64.9%	92.8%	47.1%	140.0%	(19.3%)	(0.9%)
Liberty Holdings	(20.4%)	(5.7%)	32.5%	75.0%	84.3%	159.3%	3.1%	0.7%
***H1'2021 Weighted Average**	**127.6%**	**6.3%**	**29.1%**	**92.8%**	**53.8%**	**146.6%**	**6.2%**	**1.6%**
****H1'2020 Weighted Average**	**(280.5%)**	**5.1%**	**6.5%**	**75.0%**	**48.8%**	**123.8%**	**2.0%**	**0.6%**

Market cap weighted as at 11/11/2021

*****Market cap weighted as at 30/09/2020***

Cytonn

Listed Insurance Sector Trading Metrics

Kenya's Insurance sector is trading at an average P/TBV of 0.8x and a P/E of 13.2x

Insurance Company	Share Price*	No of Shares	Market Cap	P/TBV	P/E**
Jubilee Holdings	340.0	0.1	20.3	0.6x	11.6x
Sanlam Kenya	11.5	0.1	1.6	0.8x	10.6x
Liberty Holdings	7.4	0.5	3.8	0.4x	10.1x
CIC Group	7.5	2.6	5.5	0.8x	17.3x
Britam Holdings	2.4	2.5	18.2	1.2x	16.3x
Median				**0.8x**	**11.6x**
Weighted Average HY'2021* **				**0.8x**	**13.2x**

*Share Price as at 11th Nov 2021

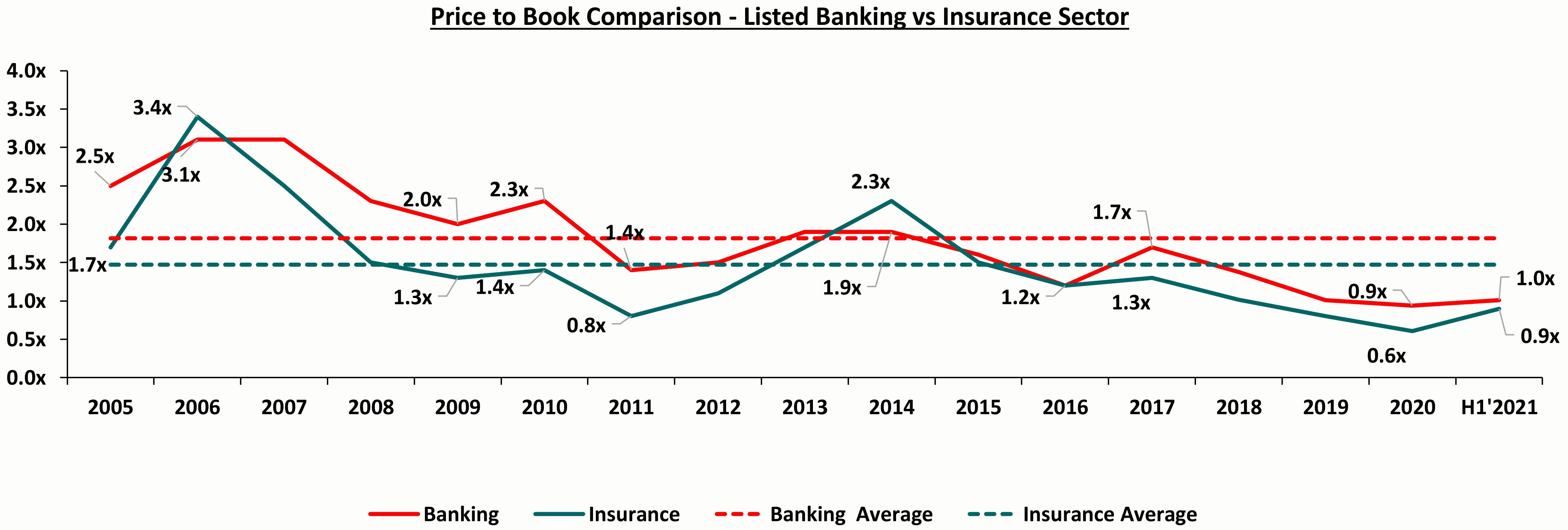
** 5 year normalized P/E

*** The weighted average is based on Market Cap as at 11th Nov 2021

Cytonn

Listed Insurance and Banks Trading Metrics

The listed Insurance sector is trading at an average P/B of 0.9x, lower than the banking sector which is priced at 1.0x. Both sectors are trading below their 16-year averages of 1.5x and 1.8x, respectively



On a price to book valuation, listed Insurance companies are currently priced at a PBV of 0.9x, lower than listed banks 1.0x, with both lower than their historical averages of 1.5x for the insurance sector and 1.8x for the banking sector

Cytonn

5. Cytonn's Insurance Sector Report

Cytonn

Executive Summary

- All listed insurance companies in the Kenyan market were analyzed by the Cytonn Investment Team
- The analysis was brought about by a need to be able to offer our investors, especially global investors, which insurance companies in our view are the most stable from a franchise value and from a future growth opportunity perspective
- The analysis covers the health and future expected performance of the financial institution, by highlighting their performance using metrics to measure Profitability, efficiency, diversification, risk appetite and solvency
- For insurance companies which are part of a group structure, the financials of the group were utilized to take into consideration the listed counter which an investor will purchase
- Ranking based on a weighted average ranking of Franchise value (40.0%) and Intrinsic value (60.0%)
- All the listed insurance companies are composite insurance companies, offering both life and general business

Regulation and Consolidation to Drive Attractiveness

Focus Area	Summary	Effect on Insurance Sector
Regulation	• **Risk Based-Supervision:** The IRA is implementing risk-based supervision which looks at the risk exposure of a company • **IFRS 17**: Effective January 2023 or earlier, changes will encompass separation of financial and insurance results in the income statement	• Regulatory changes are foreseen to impact the sector positively in line with international best practices, thus buoying investor confidence in the capitalization and future position of the Insurance sector • IFRS 17 will affect the volatility of profits, net assets and equity in the Insurance sector
Digital Innovations	• **Digital Innovations:** High mobile phone penetration rates in Kenya have aided in the digitization of distribution channels, shifting focus to the customer. Insurtechs and bancassurance partnerships to continue to disrupt competition in the industry	• Leveraging more on technology will transform how the insurance business is conducted. The use of Blockchain technology, AI and Big Data will also help prevent fraudulent claims by enabling early detection and audit trails
Consolidation	• **Increase in Mergers & Acquisitions: I**ncreased competition amongst players in the insurance sector has seen companies looking for ways to protect their market share in an evolving environment	• Will be driven by capital adequacy requirements coupled by erosion of capital buffer erosion following the tough pandemic year FY'2020. We expect the more M &A activity as smaller players look to strengthen their capital and market positions
Insurance Fraud	• **Fraudulent claims:** It is estimated that 25.0% of the insurance industry's income fraudulently claimed. In H1'2021, 45 fraud cases were reported to the Insurance Fraud Investigation Unit, with Motor Insurance Claims being the most prevalent	• Fraudulent claims have had the effect of hurting the profitability, translating into high premium rates and huge claim reserve ratios. As a result, verification of claims has resulted in the slowing down of the settlement pace

Regulatory trends in the Insurance sector will very much determine growth and investments prospects. Newer minimum capital requirements are expected to set off mergers and acquisitions in the sector, with many insurers failing to meet the minimum. The regulatory reforms also present an opportunity to international firms to enter into the Kenyan market, given it has strong economic growth prospects

Rankings by Franchise Value

Jubilee Holdings presents the most attractive insurance franchise, with a Score of 13

Insurance Company	Loss Ratio	Expense Ratio	Combined Ratio	ROACE	ROaA	Total	Rank
Jubilee Holdings	5	1	2	1	1	13	1
Sanlam Kenya	4	2	3	5	5	22	2
Liberty Holdings	1	5	5	2	2	23	3
CIC Group	2	4	4	3	4	23	3
Britam Holdings	3	3	1	4	3	24	5

Cytonn

Valuation Summary of Listed Insurers

Jubilee presents the highest upside with an expected total return of 11.3%

Insurance Company	Current Price	Target Price	Upside/(Downside)	Dividend Yield	Total Potential Return
Jubilee Holdings	340.0	378.4	11.3%	2.6%	1
Sanlam Kenya	11.5	12.0	4.0%	0.0%	2
Liberty Holdings	7.4	7.7	3.7%	0.0%	3
Britam Holdings	7.5	7.7	2.9%	0.0%	4
CIC Group	2.4	1.9	(22.4%)	0.0%	5

Cytonn

Cytonn Insurance Report – Comprehensive Rankings

Jubilee Holdings emerged top of the rankings, leading in both Franchise & Intrinsic Valuation

CYTONN H1'2021 LISTED INSURANCE SECTOR COMPREHENSIVE RANKINGS TABLE				
Insurance	Franchise Value Score	Intrinsic Value Score	Weighted Score	H1'2021 Ranking
Jubilee Holdings	13	1	5.8	1
Sanlam Kenya	22	2	10.0	2
Liberty Holdings	23	3	11.0	3
Britam Kenya	24	4	12.0	4
CIC Group	23	5	12.2	5

- Jubilee Holdings took the Top Position, ranking top in the franchise score category on the back of a strong combined ratio, indicating better capacity to generate profits from its core business.
- Sanlam took 2nd Position, on the back of a strong franchise score, driven by the highest Return on Average Equity. The only factor holding Sanlam back is its loss ratio, which is the highest among listed companies,
- Liberty Holdings & Britam came in 3rd and 4th Position, respectively, with weaker franchise scores, as a result of high loss and expense ratios (Liberty), and lower returns on assets and equity (Britam), and,
- CIC Group came in 5th Position on the back of weak franchise rankings scores.

6. Appendix – Valuation Summaries

Valuation Summary – Jubilee Holdings

Jubilee Holdings is Undervalued with an upside of 13.9%

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	359.0	40.0%	143.6
Dividend Discount Model	398.1	40.0%	159.2
PBV Multiple	370.5	15.0%	55.6
PE Multiple	400.0	5.0%	20.0
Fair Value			**378.4**
Current Price			**340.0**
Upside/(Downside)			**11.3%**
Dividend Yield			2.6%
Total Upside/(Downside)			**13.9%**

Cytonn

Valuation Summary – Sanlam Insurance

Sanlam Insurance is Undervalued with an upside of 4.0%

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	12.1	75.0%	9.1
PBV Multiple	11.1	20.0%	2.2
PE Multiple	13.3	5.0%	0.7
Fair Value		**100.0%**	**12.0**
Current Price			**11.5**
Upside/(Downside)			**4.0%**
Dividend Yield			0.0%
Total Return			**4.0%**

Cytonn

Valuation Summary – Liberty Holdings

Liberty Holdings is Undervalued with an upside of 3.7%

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	6.7	40.0%	2.7
Dividend Discount	7.3	40.0%	2.9
PBV Multiple	11.1	15.0%	1.7
PE Multiple	7.6	5.0%	0.4
Fair Value		**100.0%**	**7.7**
Current Price			**7.4**
Upside/(Downside)			**3.7%**
Dividend Yield			0.0%
Total Return			**3.7%**

Cytonn

Valuation Summary – Britam Holdings

Britam Holdings is Undervalued with a upside 2.9%

Valuation Methodology	Implied Price	Weighting	Weighted Value
Dividend Discount	7.8	40.0%	3.1
Residual Income	8.6	30.0%	3.4
PBV	4.3	15.0%	0.4
PE	7.5	15.0%	0.8
Fair Value			**7.7**
Current Price			**7.5**
Upside/(Downside)			**2.9%**
Dividend Yield			0.0%
Total Return			**2.9%**

Cytonn

Valuation Summary – CIC Group

CIC Group is Overvalued with a downside of 22.4%

Valuation Summary:	Implied Price	Weighting	Weighted Value
Dividend Discount Model	2.0	40.0%	0.8
Residual Income	1.6	40.0%	0.6
PBV Multiple	2.4	15.0%	0.4
PE Multiple	1.8	5.0%	0.1
Fair Value		**100.0%**	**1.9**
Current Price			**2.4**
Upside/(Downside)			(22.4%)
Dividend Yield			0.0%
Total Return			**(22.4%)**

Cytonn

Thank You!

For More Information

- **Free Market Research: www.cytonnreport.com**
- **Follow on Twitter: @CytonnInvest**
- **On Facebook: Cytonn Investments**

For more information or any further clarification required, kindly contact the research team at investment@cytonn.com

Cytonn

Q&A / AOB

Cytonn