Kenya H1'2021 Listed Insurance Report, & Cytonn Weekly #45/2021

Executive Summary

Fixed Income: During the week, T-bills recorded an undersubscription, with the overall subscription rate declining to 69.3%, from the 131.1% recorded the previous week, attributable to investors shifting to the bond market in search of higher yields. The 91-day paper recorded the highest subscription rate, receiving bids worth Kshs 3.99 bn against the offered Kshs 4.00 bn, translating to a subscription rate of 99.8%, an increase from the 85.9% recorded the previous week. The subscription rate for the 364-day and 182-day papers decreased to 74.3% and 52.0%, from 192.4% and 87.9%, respectively, recorded the previous week. In the Primary Bond Market, the government re-opened two bonds namely; FXD1/2019/20 and FXD1/2021/5 for the month of November, which recorded an oversubscription of 168.3%. The government sought to raise Kshs 50.0 bn for budgetary support, received bids worth Kshs 84.2 bn and accepted bids worth Kshs 69.5 bn, translating to an 82.6% acceptance rate.

During the week, the Kenya National Bureau of Statistics (KNBS) released the Quarterly Gross Domestic Product Report, highlighting that the Kenyan economy recorded a 10.1% growth in Q2'2021 up from a 0.7% growth in Q1'2021 and the 4.7% contraction recorded in Q2'2020, pointing towards an economic rebound. Consequently, the average GDP growth rate for the 2 quarters of 2021 is a growth of 5.4%, an increase from the 0.2% decline recorded in 2020;

Equities: During the week, the equities market recorded mixed performance, with NASI and NSE 25 gaining by 0.3% and 0.7%, respectively, while NSE 20 declined by 1.5%, taking their YTD performance to gains of 12.8%, 2.5% and 10.9% for NASI, NSE 20 and NSE 25, respectively. The equities market performance was mainly driven by gains recorded by banking stocks such as Equity, KCB and Diamond Trust Bank (DTB-K) which gained by 5.2%, 2.3% and 1.8%, respectively. The gains were however weighed down by losses recorded by stocks such as EABL and Bamburi which recorded losses of 4.0% and 2.9%, respectively;

During the week, Equity Group released their Q3'2021 financial results, recording a 78.6% increase in their core earnings per share to Kshs 7.1 in Q3'2021, from Kshs 4.0 recorded in Q3'2020. Also, during the week, I&M Group PLC announced the rebranding of Uganda's Orient Bank Limited (OBL) to I&M Bank (Uganda) Limited following the acquisition of the bank in Uganda. Additionally, HF Group announced the invitation of strategic investors to acquire a stake in the Company following a Proposed Transaction disclosure in their published FY'2020 Financial Statements;

Real Estate: During the week, the Kenya National Bureau of Statistics (KNBS) released the Quarterly GDP Report for Q1'2021 and Q2'2021 highlighting that the Real Estate Sector grew by 4.9% in Q2'2021 and 4.5% in Q1'2021. In the infrastructure sector, Kenya National Highway Authority, (KeNHA) announced the commencement of construction of the 29.0 Km Kinango-Kwale road in Kwale County. In the Mixed Use Developments, Sheria SACCO announced plans to begin the construction of Sheria Towers in Upperhill, Nairobi before the end of 2021;

Focus of the Week: Following the release of H1'2021 results by insurance companies, this week we analyze the performance of the 5 listed insurance companies in the country, identify the key factors that influenced their performance, and give our outlook for the insurance sector going forward;

Company updates

Investment Updates:

- Weekly Rates:
    - Cytonn Money Market Fund closed the week at a yield of 10.58%. To invest, just dial *809#;

- Cytonn High Yield Fund closed the week at a yield of 14.03% p.a. To invest, email us at sales@cytonn.com and to withdraw the interest you just dial *809#;

- We continue to offer Wealth Management Training Monday through Saturday, from 9:00 am to 11:00 am, through our Cytonn Foundation. The training aims to grow financial literacy among the general public. To register for any of our Wealth Management Trainings, click here;
- If interested in our Private Wealth Management Training for your employees or investment group, please get in touch with us through wmt@cytonn.com;
- Any CHYS and CPN investors still looking to convert are welcome to consider one of the five projects currently available for conversion, click here for the latest conversion term sheet;
- Cytonn Insurance Agency acts as an intermediary for those looking to secure their assets and loved ones' future through insurance namely; Motor, Medical, Life, Property, WIBA, Credit and Fire and Burglary insurance covers. For assistance, get in touch with us through insuranceagency@cytonn.com;
- Cytonnaire Savings and Credit Co-operative Society Limited (SACCO) provides a savings and investments avenue to help you in your financial planning journey. To enjoy competitive investment returns, kindly get in touch with us through clientservices@cytonn.com;

Real Estate Updates:

- For an exclusive tour of Cytonn's real estate developments, visit: Sharp Investor's Tour, and for more information, email us at sales@cytonn.com;
- Phase 3 of The Alma is now ready for occupation. To rent please email properties@cytonn.com;
- We have 8 investment-ready projects, offering attractive development and buyer targeted returns; See further details here: Summary of Investment-ready Projects;
- For recent news about the group, see our news section here;

Hospitality Updates:

- We currently have promotions for Staycations. Visit cysuites.com/offers for details or email us at sales@cysuites.com;
- Share a meal with a friend during the Sunday Brunch at The Hive Restaurant at Cysuites Hotel and Apartment. Every Sunday from 11.00 AM to 4.00 PM at a price of Kshs 2,500 for Adults and Kshs 1,500 for children under 12 years;

Kenya's 2022 Election Campaign Promises Tracker

Election Watch:

Kenya's next Presidential Elections are set to be held in August 2022 and with less than a year left, we have seen the political temperatures in the country continue to rise. As such, we shall be analyzing the economic campaign promises made by the politicians and the impact these promises will have on the economy. To read more on the same, click here;

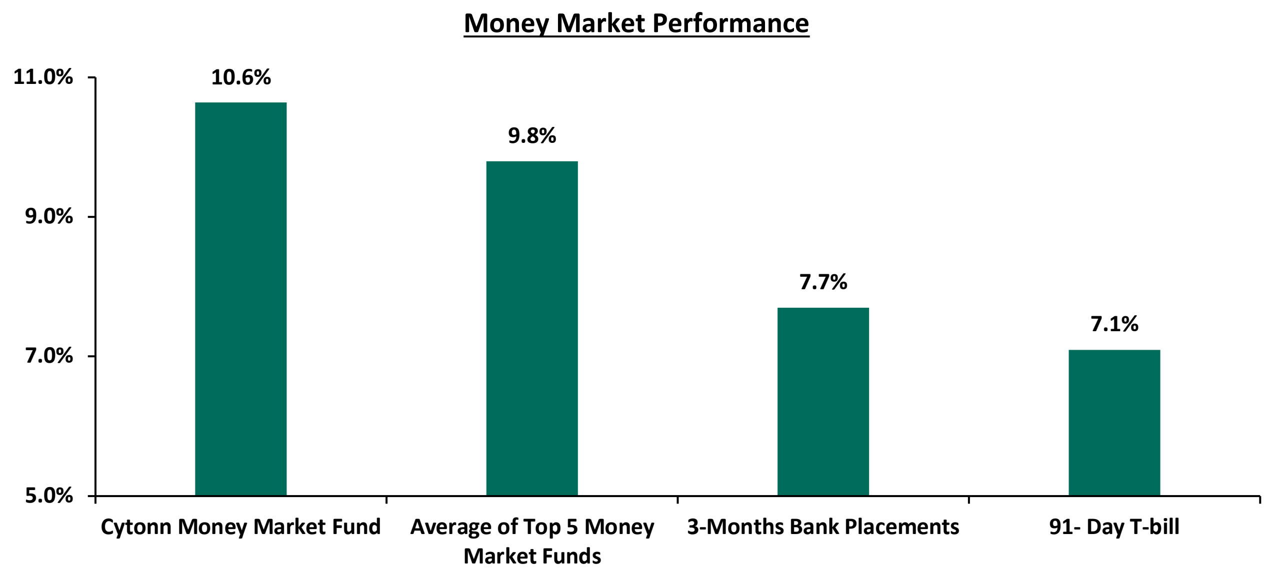
Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills recorded an undersubscription, with the overall subscription rate declining to 69.3%, from the 131.1% recorded the previous week, attributable to investors shifting to the bond market in search of higher yields. The 91-day paper recorded the highest subscription rate, receiving bids worth Kshs 3.99 bn against the offered Kshs 4.00 bn, translating to a subscription rate of 99.8%, an increase from the 85.9% recorded the previous week. The subscription rate for the 364-day and 182-day papers decreased to 74.3%

and 52.0%, from 192.4% and 87.9%, respectively, recorded the previous week. The yields on the 182-day and 364-day papers increased by 12.9 bps and 12.4 bps, to 7.7% and 8.8%, respectively, while that of the 91-day paper declined by 2.7 bps to 7.1%. The government accepted Kshs 16.5 bn of the Kshs 16.6 bn worth of bids received, translating to an acceptance rate of 99.4%.

In the Primary Bond Market, the government re-opened two bonds namely; FXD1/2019/20 and FXD1/2021/5 for the month of November, which recorded an oversubscription of 168.3%. The government sought to raise Kshs 50.0 bn for budgetary support, received bids worth Kshs 84.2 bn and accepted bids worth Kshs 69.5 bn, translating to an 82.6% acceptance rate. The oversubscription of the bonds could be attributed to the ample liquidity in the market as well of their attractive yields. Investors preferred the shorter-tenure issue i.e. FXD1/2021/5, which received bids worth Kshs 66.6 bn, representing 79.1% of the total bids received. The coupons for the two bonds were; 12.9% and 11.3%, and the weighted average yield for the issues were; 13.5% and 11.3%, for FXD1/2019/20 and FXD1/2021/5, respectively.



In the money markets, 3-month bank placements ended the week at 7.7% (based on what we have been offered by various banks), while the yield on the 91-day T-bill decreased by 2.7 bps to 7.1%. The average yield of the Top 5 Money Market Funds remained relatively unchanged at 9.8% while the yield on the Cytonn Money Market Fund decreased by 0.1% points to 10.6%, from 10.7% recorded the previous week.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 12th November:

Money Market Fund Yield for Fund Managers as published on 12th November 2021		
Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.58%
2	Zimele Money Market Fund	9.91%
3	Nabo Africa Money Market Fund	9.70%
4	Madison Money Market Fund	9.38%
5	Sanlam Money Market Fund	9.36%
6	CIC Money Market Fund	9.06%
7	Apollo Money Market Fund	8.95%
8	GenCapHela Imara Money Market Fund	8.91%

9	Co-op Money Market Fund	8.73%
10	Dry Associates Money Market Fund	8.58%
11	Orient Kasha Money Market Fund	8.50%
12	British-American Money Market Fund	8.49%
13	NCBA Money Market Fund	8.34%
14	ICEA Lion Money Market Fund	8.33%
15	Old Mutual Money Market Fund	7.33%
16	AA Kenya Shillings Fund	6.65%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets remained ample, with the average interbank rate coming in at 4.7%, unchanged from the previous week, partly attributable to government payments which partly offset tax remittances. The average interbank volumes traded increased by 90.5% to Kshs 9.9 bn, from Kshs 5.2 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on all Eurobonds declined, with the 10-year bond issued in 2018, the 30-year bond issued in 2018 and the 12-year bonds issued in 2019 and 2021 all declining by 0.2% points to 5.6%, 7.8%, 6.6% and 6.4%, respectively, while the yields on the 10-year bond issued in 2014 and the 7-year issued in 2019 both declined by 0.1% points to 3.8% and 5.4% respectively. Below is a summary of the performance:

Kenya Eurobond Performance						
	2014	2018		2019		2021
Date	10-year issue	10-year issue	30-year issue	7-year issue	12-year issue	12-year issue
31-Dec-20	3.9%	5.2%	7.0%	4.9%	5.9%	-
29-Oct-21	3.7%	5.7%	7.9%	5.5%	6.7%	6.5%
4-Nov-21	3.8%	5.8%	7.9%	5.4%	6.8%	6.6%
8-Nov-21	3.7%	5.6%	7.8%	5.3%	6.6%	6.4%
9-Nov-21	3.7%	5.6%	7.7%	5.3%	6.6%	6.4%
10-Nov-21	3.7%	5.5%	7.7%	5.3%	6.5%	6.4%
11-Nov-21	3.8%	5.6%	7.8%	5.4%	6.6%	6.4%
Weekly Change	**(0.1%)**	**(0.2%)**	**(0.2%)**	**(0.1%)**	**(0.2%)**	**(0.2%)**
M/m Change	**0.1%**	**(0.2%)**	**(0.1%)**	**(0.1%)**	**(0.2%)**	**(0.1%)**
YTD Change	**(0.1%)**	**0.4%**	**0.8%**	**0.5%**	**0.7%**	**-**

Kenya Shilling:

During the week, the Kenyan shilling depreciated by 0.2% against the US dollar to close the week at Kshs 111.8, from Kshs 111.5 recorded the previous week, mainly attributable to increased dollar demand from commodity and energy sector importers outweighing the supply of dollars from exporters. On a YTD basis, the shilling has depreciated by 2.4% against the dollar, in comparison to the 7.7% depreciation recorded in 2020. We expect the shilling to remain under pressure for the remainder of 2021 as a result of:

a. Rising uncertainties in the global market due to the Coronavirus pandemic, which has seen investors continue to prefer holding their investments in dollars and other hard currencies and commodities,
b. Increased demand from merchandise traders as they beef up their hard currency positions in anticipation for more trading partners reopening their economies globally, and,

c. Rising global crude oil prices on the back of supply constraints at a time when demand is picking up with the easing of COVID-19 restrictions and as economies reopen.

The shilling is however expected to be supported by:

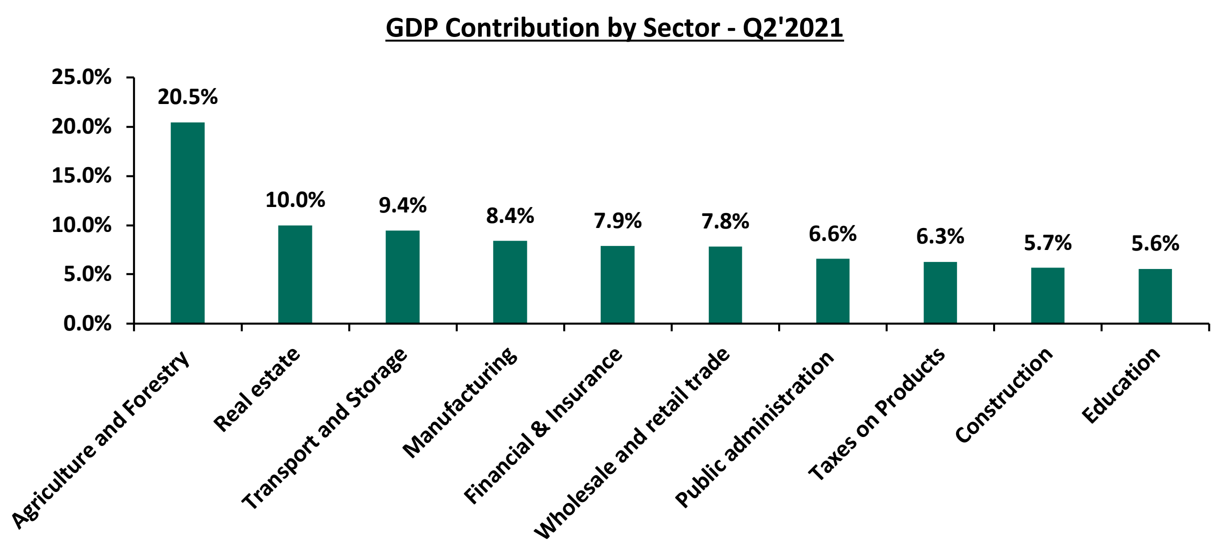
i. The Forex reserves, currently at USD 9.1 bn (equivalent to 5.6-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region's convergence criteria of 4.5-months of import cover. In addition, the reserves were boosted by the USD 1.0 bn proceeds from the Eurobond issued in July, 2021 coupled with the USD 407.0 mn IMF disbursement and the USD 130.0 mn World Bank loan financing received in June, 2021, and,
ii. Improving diaspora remittances evidenced by a 28.2% y/y increase to USD 337.4 mn in October 2021, from USD 263.1 mn recorded over the same period in 2020, which has continued to cushion the shilling against further depreciation.

Weekly Highlight:

I. KNBS Quarterly GDP Report

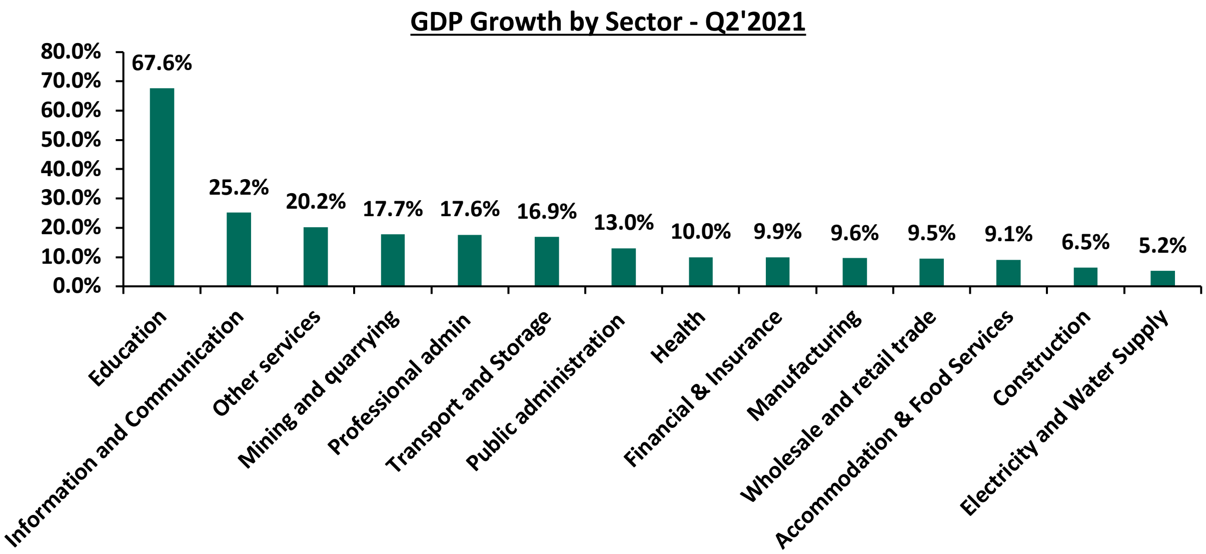
During the week, the Kenya National Bureau of Statistics (KNBS) released the Quarterly Gross Domestic Product Report, highlighting that the Kenyan economy recorded a 10.1% growth in Q2'2021, up from a 0.7% growth in Q1'2021 and the 4.7% contraction recorded in Q2'2020, pointing towards an economic rebound. Consequently, the average GDP growth rate for the 2 quarters in 2021 is a growth of 5.4%, an increase from the 0.2% decline registered during a similar period of review in 2020. The key take outs from the report include;

i. **Sectoral Contribution to Growth.** Education, and Transport & Storage sectors were the biggest gainers in terms of sectoral contribution to GDP, with education increasing by 1.9% points to 5.6%, from 3.7% in Q2' 2020, while the Transport and Storage sectors increased by 0.6% points to 9.4%, from 8.9% in Q2' 2020. Agriculture was the biggest loser, declining by 2.3% points to 20.5% in Q2'2021, from 22.7% in Q2'2020, attributable to a decline in agricultural products due to erratic weather conditions. Despite this, the agriculture sector still continues to be the main driver of economic growth in the country. The chart below shows the top contributors to GDP by sector in Q2'2021:



ii. **Subdued Growth in the Agricultural Sector** – Agriculture, Forestry and Fishing activities recorded a decline of 0.9% in Q2'2021, compared to a 4.9% growth in Q2'2020 and a 0.9% contraction in Q1'2021. The contraction during the quarters is mainly attributable to unfavorable weather conditions witnessed during the period. However, the sector's performance was cushioned by a notable increase in milk production, horticultural exports and sugarcane production, and,

iii. **Growth in the manufacturing sector** - The manufacturing sector recorded a 9.6% growth in Q2'2021 in comparison to the 1.5% recorded in Q1'2021 and the 4.7% contraction recorded in Q2'2020. Additionally, the sectoral contribution remained unchanged at 8.4%, as was recorded in Q2'2020. The chart below shows the different sectoral GDP growth rates for Q2'2021:



Going forward, we expect Kenya's GDP to continue growing as most sectors of the economy continue to recover. The lifting of the dawn to dusk curfew that was put in place since March 2020 is expected to boost economic recovery in sectors such as accommodation and food services sector as well as the manufacturing sector as most business will use the opportunity to increase production. For more details on the GDP Report, see our Kenya Q2'2021 GDP Note.

Rates in the fixed income market have remained relatively stable due to the sufficient levels of liquidity in the money markets. The government is 36.7% ahead of its prorated borrowing target of Kshs 253.3 bn having borrowed Kshs 346.3 bn of the Kshs 658.5 bn borrowing target for the FY'2021/2022. We expect a gradual economic recovery going into FY'2021/2022 as evidenced by KRAs collection of Kshs 631.1 bn in revenues during the first four months of the current fiscal year, which is equivalent to 104.5% of the prorated revenue collection target. However, despite the projected high budget deficit of 7.5% and the lower credit rating from S&P Global to 'B' from 'B+', we believe that the monetary support from the IMF and World Bank will mean that the interest rate environment may stabilize since the government will not be desperate for cash.

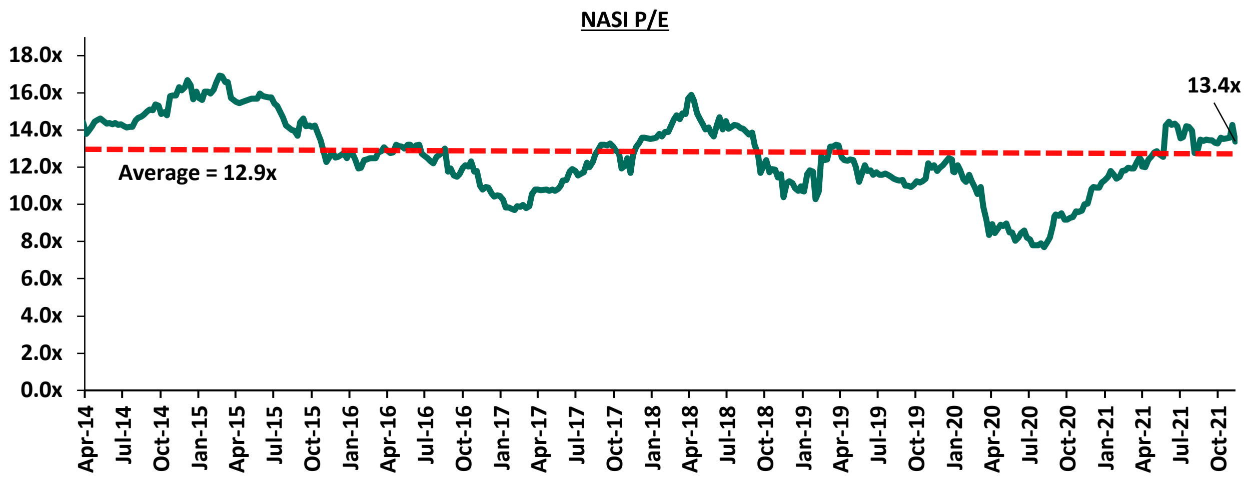
Equities

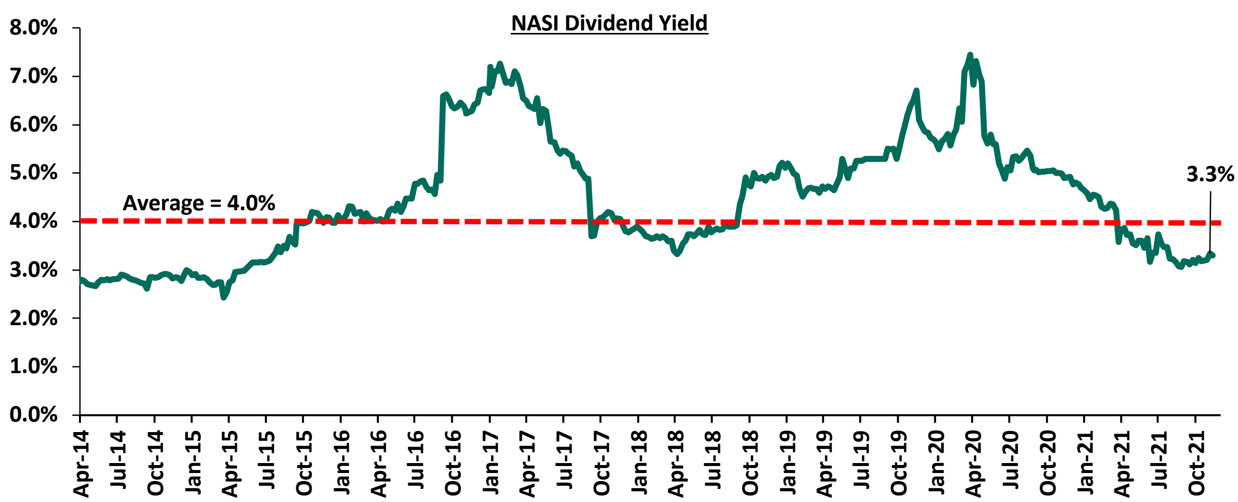
Markets Performance

During the week, the equities market recorded mixed performance, with NASI and NSE 25 gaining by 0.3% and 0.7%, respectively, while NSE 20 declined by 1.5%, taking their YTD performance to gains of 12.8%, 2.5% and 10.9% for NASI, NSE 20 and NSE 25, respectively. The equities market performance was mainly driven by gains recorded by banking stocks such as Equity, KCB and Diamond Trust Bank (DTB-K) which gained by 5.2%, 2.3% and 1.8%, respectively. The gains were however weighed down by losses recorded by stocks such as EABL and Bamburi which recorded losses of 4.0% and 2.9%, respectively.

During the week, equities turnover increased by 89.2% to USD 31.3 mn, from USD 16.5 mn recorded the previous week, taking the YTD turnover to USD 1.1 bn. Foreign investors remained net sellers, with a net selling position of USD 7.6 mn, from a net selling position of USD 0.3 mn recorded the previous week, taking the YTD net selling position to USD 36.0 mn.

The market is currently trading at a price to earnings ratio (P/E) of 13.4x, 3.4% above the historical average of 12.9x, and a dividend yield of 3.3%, 0.7% points below the historical average of 4.0%. Key to note, NASI's PEG ratio currently stands at 1.5x, an indication that the market is trading at a premium to its future earnings growth. Basically, a PEG ratio greater than 1.0x indicates the market may be overvalued while a PEG ratio less than 1.0x indicates that the market is undervalued. Excluding Safaricom, which is currently 61.1% of the market, the market is trading at a P/E ratio of 11.9x and a PEG ratio of 1.3x. The current P/E valuation of 13.4x is 73.8% above the most recent trough valuation of 7.7x experienced in the first week of August 2020. The charts below indicate the historical P/E and dividend yields of the market.





Earnings Releases

During the week, Equity Group released their Q3'2021 financial results. Below is a summary of their performance;

I. **Equity Group**

Equity Group Q3’2021 Key Highlights			
Balance Sheet			
Balance Sheet items	**Q3’2020 (Kshs bn)**	**Q3’2021 (Kshs bn)**	**y/y change**
Government Securities	185.3	233.2	25.8%
Net Loans and Advances	453.9	559.0	23.2%
Total Assets	**933.9**	**1,184.3**	**26.8%**
Customer Deposits	691.0	875.1	26.6%
Deposits Per Branch	2.1	2.6	25.9%
Total Liabilities	796.3	1,020.9	28.2%
Shareholders’ Funds	**130.7**	**156.3**	**19.6%**
Income Statement			
Income Statement Items	**Q3’2020 (Kshs bn)**	**Q3’2021 (Kshs bn)**	**y/y change**
Net Interest Income	39.3	48.5	23.3%
Net non-Interest Income	24.8	32.0	28.8%
Total Operating income	**64.1**	**80.5**	**25.5%**
Loan Loss provision	(14.8)	(5.1)	(65.2%)
Total Operating expenses	(45.3)	(43.8)	(3.2%)
Profit before tax	19.8	36.6	85.3%
Profit after tax	**15.0**	**26.9**	**78.6%**
Core EPS	**4.0**	**7.1**	**78.6%**
Key Ratios			
Ratios	**Q3’2020**	**Q3’2021**	**% point change**
Yield from interest-earning assets	10.1%	9.6%	(0.5%)
Cost of funding	2.6%	2.8%	0.2%
Net Interest Margin	7.6%	7.0%	(0.6%)
Non-Performing Loans (NPL) Ratio	10.8%	9.5%	(1.3%)
NPL Coverage	52.0%	60.6%	8.6%
Cost to Income with LLP	70.6%	54.5%	(16.1%)
Loan to Deposit Ratio	65.7%	63.9%	(1.8%)
Return on Average Assets	2.5%	3.0%	0.5%
Return on Average Equity	16.9%	22.2%	5.3%
Equity to Assets	14.8%	13.5%	(1.3%)
Capital Adequacy Ratios			
Ratios	**Q3’2020**	**Q3’2021**	**% point change**
Core Capital/Total Liabilities	16.1%	15.3%	(0.8%)
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	**8.1%**	**7.3%**	**(0.8%)**
Core Capital/Total Risk Weighted Assets	14.5%	13.5%	(1.0%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	**4.0%**	**3.0%**	**(1.0%)**
Total Capital/Total Risk Weighted Assets	17.5%	16.8%	(0.7%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	**3.0%**	**2.3%**	**(0.7%)**

Key take-outs from the earnings release include;

i. Core earnings per share increased by 78.6% to Kshs 7.1 in Q3’2021, from Kshs 4.0 recorded in Q3’2020, higher than our projections of a 65.7% increase to Kshs 6.6. The performance was driven by a 25.5% growth in total operating income to Kshs 80.5 bn, from Kshs 64.1 bn in Q3’2020, coupled with a 3.2%

decline in total operating expenses to Kshs 43.8 bn, from Kshs 45.3 bn in Q3’2020. The variance in core earnings per share growth against our expectations was due to the Non-Funded Income increasing by 28.8% to Kshs 32.0 bn in Q3’2021, from Kshs 24.8 bn in Q3’2020, against our expectation of a 13.3% growth in Q3’2021 to Kshs 28.1 bn,

ii. Interest income increased by 28.7% to Kshs 67.0 bn, from Kshs 52.1 bn in Q3’2020 driven by a 34.2% increase in interest income from government securities to Kshs 20.7 bn, from Kshs 15.4 bn in Q3’2020, coupled with a 24.4% increase in interest income on loans and advances to Kshs 44.8 bn, from Kshs 36.0 bn recorded in Q3’2020,

iii. The Yield on Interest-Earning Assets (YIEA), declined by 0.5% points to 9.6%, from 10.1% in Q3’2020, as the average interest-earning assets grew faster by 35.2% to Kshs 919.8 bn, from Kshs 680.3 bn in Q3’2020 compared to the 28.5% increase in trailing interest income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,

iv. Interest expense rose by 45.0% to Kshs 18.5 bn, from Kshs 12.8 bn in Q3’2020, following a 181.4% increase in interest expense on deposits and placements to Kshs 1.5 bn, from Kshs 0.5 bn in Q3’2020, coupled with a 33.8% increase in interest expense on customer deposits to Kshs 12.8 bn, from Kshs 9.6 bn in Q3’2020. Cost of funds rose by 0.2% points to 2.8%, from 2.6% in Q3’2020, owing to the faster 43.3% growth in trailing interest expense, which outpaced the 33.3% growth in the average interest-bearing liabilities. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months,

v. Net Interest Margin (NIM) declined to 7.0%, from 7.6% in Q3’2020, attributable to the 35.2% growth in average interest-earning assets, which outpaced the 23.7% growth of trailing Net Interest Income (NII),

vi. Total operating expenses declined by 3.2% to Kshs 43.8 bn in Q3’2021, from Kshs 45.3 bn recorded in Q3’2020, mainly due to a 65.2% decline in Loans Loss Provision to Kshs 5.1 bn in Q3’2021, from Kshs 14.8 bn recorded in Q3’2020. The reduced provision level is attributable to the economic recovery witnessed in 2021 so far and as evidenced by the 10.1% growth in Kenya’s GDP recorded in Q2’2021. The lifting of many Covid-related restrictions and the subsequent economic recovery has alleviated many of the uncertainties surrounding the business environment and bank borrowers’ ability to repay their loans hence the reduced provisions. On the other hand, Staff Costs grew by 24.9% to Kshs 13.5 bn in Q3’2021 from Kshs 10.8 bn recorded in Q3’2020,

vii. The balance sheet recorded an expansion as Total Assets increased by 26.8% to Kshs 1.2 tn in Q3’2021, from Kshs 0.9 tn recorded in Q3’2020. This growth was largely driven by the 23.2% growth of the loan book to Kshs 559.0 bn, from Kshs 453.9 bn recorded in Q3’2020, coupled with a 25.8% growth in Government securities to Kshs 233.2 bn in Q3’2021, from Kshs 185.3 bn in Q3’2020. The remarkable expansion in the balance sheet is also partly attributable to the 66.5% stake acquisition of Banque Commerciale Du Congo (BCDC) in August 2020. BCDC contributed Kshs 328.3 bn worth of assets in Q3’2021 to the Group,

viii. Total liabilities rose by 28.2% to Kshs 1.0 tn, from Kshs 0.8 tn in Q3’2020, driven by a 26.6% increase in customer deposits to Kshs 875.1 bn, from Kshs 691.0 bn in Q3’2020. Key to note, the strong growth in customer deposits is mainly attributable to the acquisition of BCDC, with the subsidiary contributing Kshs 304.6 bn to the total deposits,

ix. Deposits per branch increased by 25.9% to Kshs 2.6 bn, from Kshs 2.1 bn in Q3’2020, with the number of branches increasing by 2 to 337 branches in Q3’2021, from 335 in Q3’2020, with Equity Bank Rwanda and Equity Bank Uganda contributing 1 additional branch each,

x. Gross Non-Performing Loans (NPLs) increased by 8.5% to Kshs 56.2 bn in Q3’2021, from Kshs 51.8 bn recorded in Q3’2020. The group’s asset quality improved, with the NPL ratio declining to 9.5% in Q3’2021, from 10.8% recorded in Q3’2020, attributable to the faster 23.4% growth in gross loans, compared to an 8.5% growth in Gross Non-Performing Loans (NPLs),

xi. General Loan Loss Provisions increased by 28.1% to Kshs 27.0 bn, from Kshs 21.1 bn in Q3'2020, higher than the 8.5% rise in the Gross Non-Performing Loans. Consequently, the NPL coverage improved to 60.6%, from 52.0% in Q3'2020, an indication of sufficient provisioning, and,

xii. Equity Group is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 13.5%, 3.0% points above the minimum statutory requirement. In addition, the total capital to risk-weighted assets ratio was 16.8%, exceeding the minimum statutory requirement by 2.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 13.5% while total capital to risk-weighted assets came in at 16.8%.

For a comprehensive analysis, please see our Equity Group H1'2021 Earnings Note

Weekly Highlight:

I. Rebrand and Launch of I&M Bank (Uganda) Limited

During the week, I&M Group PLC announced the rebranding of Uganda's Orient Bank Limited (OBL) to I&M Bank (Uganda) Limited following the launch of the bank's operations in Uganda. The rebrand comes six months after I&M Holding PLC announced the completion of the 90% acquisition of Orient Bank Limited Uganda (OBL) on 30th April 2021 and after receiving all the required regulatory approvals. As highlighted in our Cytonn Weekly #18/2021, I&M Holdings was to take over 14 branches from Orient Bank Limited Uganda (OBL), taking its total branches to 80, from 66 branches as at the end of 2020. In our view, the entry of I&M Group PLC into the Ugandan Market will see the bank diversify its operations thus further reduce its reliance on the Kenyan Market. The launch also will also see I&M cement its position as a regional bank, with Uganda becoming the 4th country I&M operates in the East African region with the rest being Kenya, Tanzania and Rwanda. We believe that Uganda will continue to attract more Kenyan banks given its attractive lending interest rate spread which stood at 17.0% in June 2021, higher than Tanzania's 13.8% and Kenya's 12.1% over the same period. Currently, banks such as KCB Group, Equity Group and DTB Group have ventured into the Ugandan market, making I&M Holdings the fourth Kenyan bank to tap into the market.

II. HF Group PLC invitation of Strategic Investors

During the week, HF Group announced the invitation of strategic investors to acquire a stake in the Company following a Proposed Transaction disclosure in their published FY'2020 Financial Statements. The Proposed Transaction aims to inject capital to the company so as to increase its liquidity and enable expansion into mainstream banking including retail and SME lending, while also reducing reliance on the Real Estate market segment. This comes after the Kshs 1.0 bn capital injection the group received from its top shareholder, Britam Holdings Plc, in January this year, which aimed at growing the firm's full-service banking offering. The price at which an investor will buy a stake in the company is expected to be based on negotiations with the issuer. In H1'2021, HF Group recorded a core capital to risk-weighted assets ratio of 8.8% which is 1.7% points lower than the 10.5% minimum statutory requirement, hence the need for more capital in order to meet the regulatory requirement. In our view, even if the capital injection is achieved, it will not resolve the key strategic challenge for HF Group, which is poor deposit gathering ability. The deposits to loan ratio of HF Group stood at 98.2% compared to the 153.0%, 124.8% and 120.2% recorded by Equity Group, Cooperative Bank and KCB Group, respectively, in H1'2021. The most logical step would be to sell HF Group to a stronger deposit gatherer who can then fund the housing loan book.

Universe of Coverage

Company	Price as at 05/11/2021	Price as at 12/11/2021	w/w change	YTD Change	Year Open 2021	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
I&M Group***	21.8	22.0	0.9%	(51.1%)	44.9	32.0	10.3%	56.0%	0.6x	Buy
Kenya Reinsurance	2.3	2.3	0.4%	0.9%	2.3	3.3	8.6%	50.9%	0.2x	Buy
NCBA***	24.1	24.0	(0.6%)	(10.0%)	26.6	31.0	6.3%	35.7%	0.6x	Buy
ABSA Bank***	10.3	10.2	(0.5%)	7.1%	9.5	13.8	0.0%	35.3%	1.1x	Buy
KCB Group***	43.5	44.5	2.3%	15.9%	38.4	53.4	2.2%	22.2%	1.0x	Buy
Co-op Bank***	12.5	12.6	0.4%	0.0%	12.6	14.1	8.0%	20.3%	0.9x	Buy
Standard Chartered***	129.8	130.5	0.6%	(9.7%)	144.5	145.4	8.0%	19.5%	1.0x	Accumulate
Diamond Trust Bank***	57.0	58.0	1.8%	(24.4%)	76.8	67.3	0.0%	16.0%	0.3x	Accumulate
Jubilee Holdings	343.8	340.0	(1.1%)	23.3%	275.8	376.2	2.6%	13.3%	0.7x	Accumulate
Equity Group***	49.9	52.5	5.2%	44.8%	36.3	57.5	0.0%	9.5%	1.4x	Hold
Liberty Holdings	7.5	7.0	(6.4%)	(8.8%)	7.7	7.6	0.0%	8.2%	0.5x	Hold
Stanbic Holdings	87.0	94.0	8.0%	10.6%	85.0	96.6	4.0%	6.8%	0.9x	Hold
Sanlam	12.4	11.5	(7.3%)	(11.5%)	13.0	11.7	0.0%	1.5%	1.0x	Lighten
Britam	7.8	7.5	(4.1%)	7.1%	7.0	7.6	0.0%	1.2%	1.4x	Lighten
HF Group	3.8	4.2	8.6%	32.2%	3.1	3.1	0.0%	(25.3%)	0.2x	Sell
CIC Group	2.4	2.4	(0.4%)	13.3%	2.1	1.7	0.0%	(27.0%)	0.8x	Sell

Target Price as per Cytonn Analyst estimates
****Upside/ (Downside) is adjusted for Dividend Yield**
*****For Disclosure, these are stocks in which Cytonn and/or its affiliates are invested in**
Key to note, I&M Holdings YTD share price change is mainly attributable to the counter trading ex-bonus issue

We are "Neutral" on the Equities markets in the short term. With the market currently trading at a premium to its future growth (PEG Ratio at 1.5x), we believe that investors should reposition towards companies with a strong earnings growth and are trading at discounts to their intrinsic value. We expect the discovery of new COVID-19 variants coupled with slow vaccine rollout in developing economies to continue weighing down the economic outlook. On the upside, we believe that the recent relaxation of lockdown measures in the country will lead to improved investor sentiments in the economy.

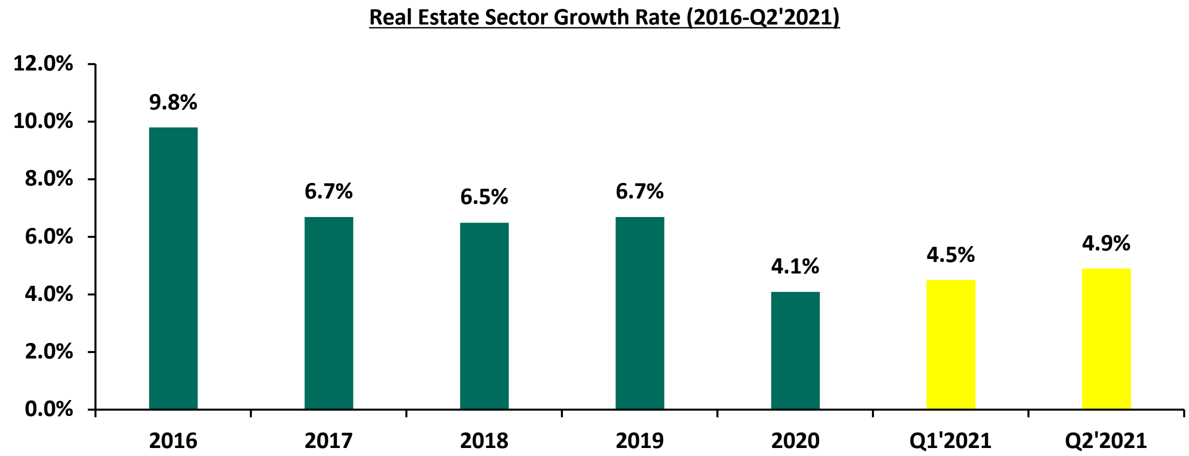
Real Estate

I. Industry Reports

During the week, the Kenya National Bureau of Statistics (KNBS) released the Quarterly GDP Report for Q1'2021 and Q2'2021. The key take-outs related to the real estate sector are as outlined below:

i. The Real Estate sector in general grew by 4.9% in Q2'2021 compared to a growth of 4.6% recorded in Q2'2020. The sector's performance was a 0.4% points q/q increase from the 4.5% growth recorded in Q1'2021. The improved performance during the quarters was attributable to the relaxation of COVID-19 measures which enhanced the return of major real estate and related activities.

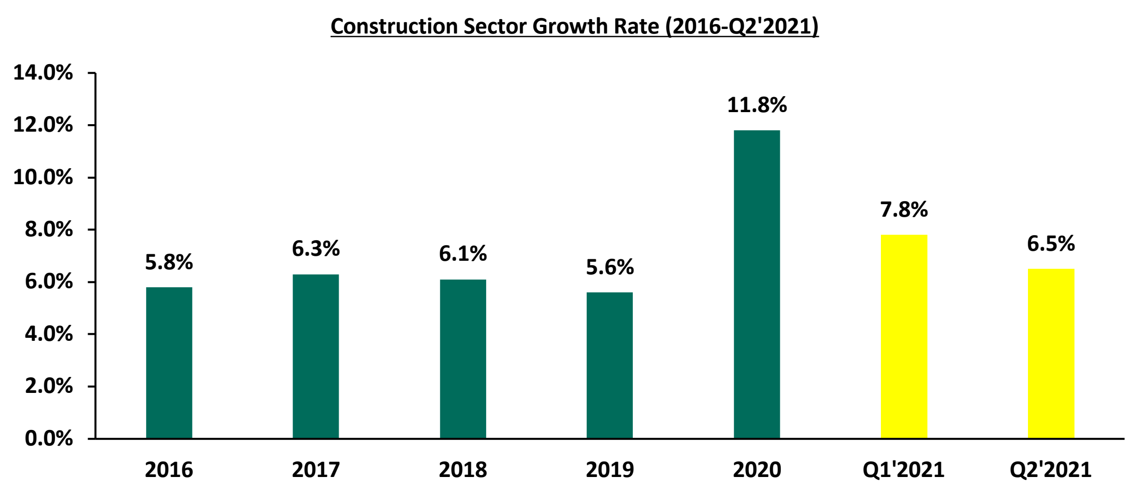
The graph below shows Real Estate sector growth rate from 2016-Q2'2021;



Source: Kenya National Bureau of Statistics

ii. The Construction sector recorded a growth of 6.5% in Q2’2021 compared to 8.2% growth in Q2’2020. This performance represented a 1.3% points q/q drop from 7.8% growth recorded in Q1’2021. The decline can be partly attributed to the current oversupply in select themes such as the commercial office and retail sectors at 7.3 mn and 3.0 mn SQFT, respectively, in the NMA as at 2021, causing investors to hold investing into such Real Estate themes as they await absorption of the current supply. Cement consumption increased by 29.3% to 2.1 bn metric tonnes in Q2’2021, from 1.6 bn metric tonnes in Q2’2020 attributable to the major infrastructural and affordable housing projects currently underway in the country, which raised the demand and consumption of cement.

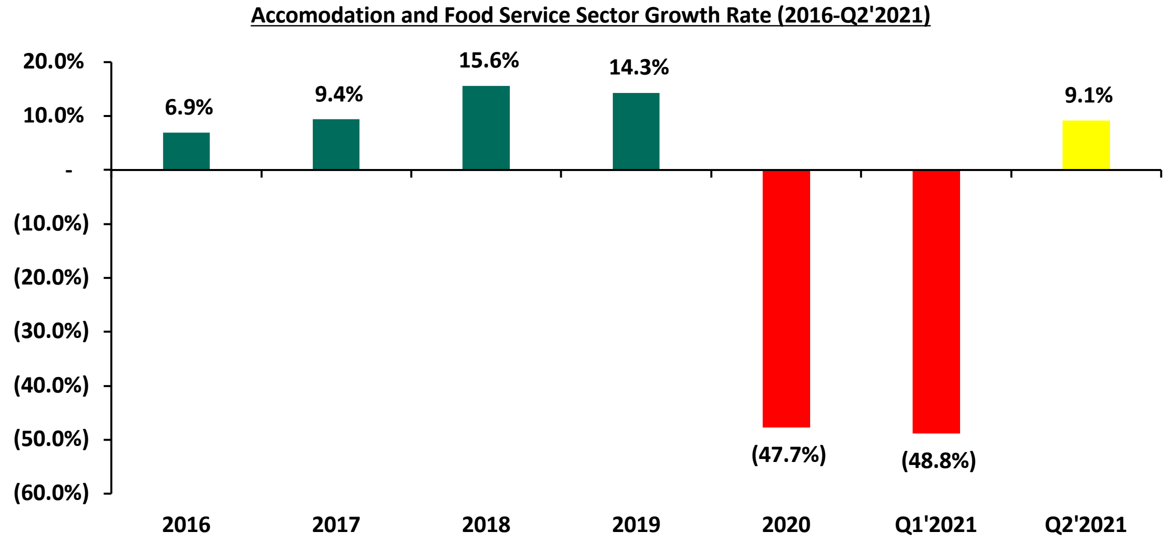
The graph below shows the Construction Sector growth rate from 2016-Q2’2021;



Source: Kenya National Bureau of Statistics

iii. Accommodation and Food Service sector grew by 9.1% in Q2’2021 compared to a 56.8% and 48.8% contraction recorded in Q2’2020 and Q1’2021, respectively. The sector has been one of the worst hit by the pandemic following the decline in the number of international arrivals, scaling down of hotels in operations and closure of some hospitality facilities in Q2’2020. However, this improved tremendously in the review period after relaxation of most of the restrictions such as travel bans from key source markets and resumption of international flights.

The graph below shows the Accommodation and Food Service growth rate from 2016- Q2’2021;



Source: Kenya National Bureau of Statistics

The Real Estate and construction sector contributions to the economy are expected to improve attributable to reopening of the economy thereby boosting Real Estate transactional volumes and investments. The hospitality sector is also expected to be on an upward trajectory with an expected increase in the number of hotels in operations and bed occupancies, attributable to return of international flights that had initially stalled from COVID-19 travel guidelines, aggressive hospitality sector marketing and the massive COVID-19 vaccination.

II. Infrastructure

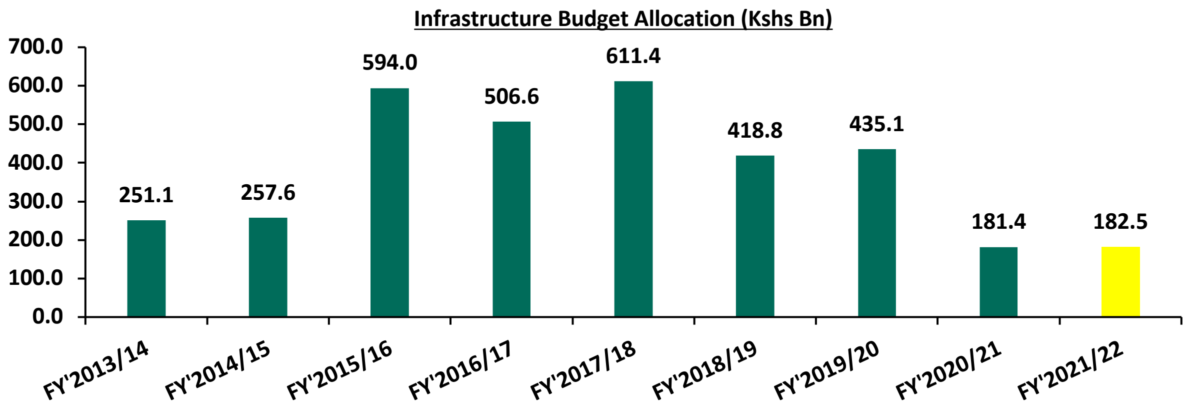
During the week, the Kenya National Highway Authority, (KeNHA) announced commencement of construction of the 29.0 Km Kinango-Kwale road in Kwale County. The Kshs 3.0 bn project being undertaken by China Civil Engineering Construction Corporation is set to be completed by December 2024. The government has been aggressively developing infrastructure in the Coast Region with projects such as Dongo Kundu bypass, Mto Mwagodi-Mbale-Wundanyi-Bura road and Lamu Port and South-Sudan Ethiopian Transport (LAPSSET) corridor currently underway in the region. Once complete, the Kinango-Kwale road is expected to;

i. Boost economic activities in the region by enhancing transport of goods and services,
ii. Enhance easy accessibility of services from Kinango to Kwale, which is the county’s headquarters,
iii. Boost tourism activities by facilitating accessibility to areas such as Diani beach hotels and Shimba Hills National Reserve among others, and,
iv. Open up the area for investment. The road will also reduce overreliance on the Likoni ferry which is a key access to the South Coast.

Additionally, KeNHA announced plans to expand the 25.0 Km Kiambu Road into a dual-carriage highway, in an aim to reduce traffic congestion on the busy road. The state owned body filed for Environmental and Social Impact Assessment with the National Environment Management Authority (NEMA) for approvals after a 2-year feasibility study by Apec Consortium and Span Engineers. On the Thika Super Highway, Kiambu Road begins at the Pangani and Muthaiga interchanges and continues through Kiambu Town to Ndumberi Township, covering a significant residential location for the Nairobi Metropolitan Area working class. The project is not only expected to reduce traffic currently experienced along this route but also spur more real estate investments.

Successful Infrastructure developments are expected to provide safe, efficient, accessible and sustainable transportation services aimed at stimulating the economic growth. We expect the sector to continue registering more developments as a result of the government's commitment to develop quality and adequate infrastructure for economic growth. Some of the major ongoing projects include the Nairobi Express Way, which the Ministry of Transport has announced to be 68.0% complete, and the Western Bypass, among others. In the FY'2021/2022, the government supported the infrastructure budget through a 0.6% increase to Kshs 182.5 bn from Kshs 181.4 bn allocation for FY'2020/2021.

The graph below shows the budget allocation to the infrastructure sector over the last nine financial years:



Source: National Treasury

III. Mixed Use Developments (MUDs)

During the week, Sheria Savings and Credit Cooperative Society (SACCO) announced plans to begin construction of Sheria Towers in Upperhill, Nairobi before the end of 2021. The Kshs 2.0 bn project will comprise of residential units, shopping centres, and commercial offices sitting on a one-acre piece of prime land along Matumbato Close near their offices. The project aims to; i) ensure the prime parcel of land is converted into an income-generating asset that is beneficial to its 15,000 members, ii) increase the SACCO's asset base currently at Kshs 6.7 bn as at FY'2020 even as the firm continues to grow its customer base, and, iii) diversify their investment portfolio with Real Estate being a stable investment.

In terms of performance, according to Mixed-Use Developments Report 2020, MUDs recorded average rental yields of 7.1% in 2020, 0.3% points higher than the respective single-use retail, commercial office and residential themes with an average yield of 6.8%. This was attributed to the MUDs prime locations, mostly serving the high and growing middle class who have been attracted by the mixed-use concept due to convenience as a result of incorporated working, shopping and living spaces. Additionally, due to the relatively large scale of most MUDs, developers are able to offer amenities and services at a relatively lower unit cost, therefore benefiting both the developer and the buyer.

The table below shows the thematic comparison of rental yield performance between Single Use Themes and Mixed Use Developments;

Thematic Performance of MUDs in Key Themes 2020		
Theme	MUD Themes Average Rental Yield 2020	Single-Use Themes Average Rental Yield 2020
Retail	7.8%	7.5%
Offices	7.3%	7.2%
Residential	6.2%	5.6%
Average	**7.1%**	**6.8%**
• ***Mixed-Use Developments recorded average rental yields of 7.1%, 0.3% points higher than the respective single-***		

useretail, commercial office and residential themes with 6.8% in 2020

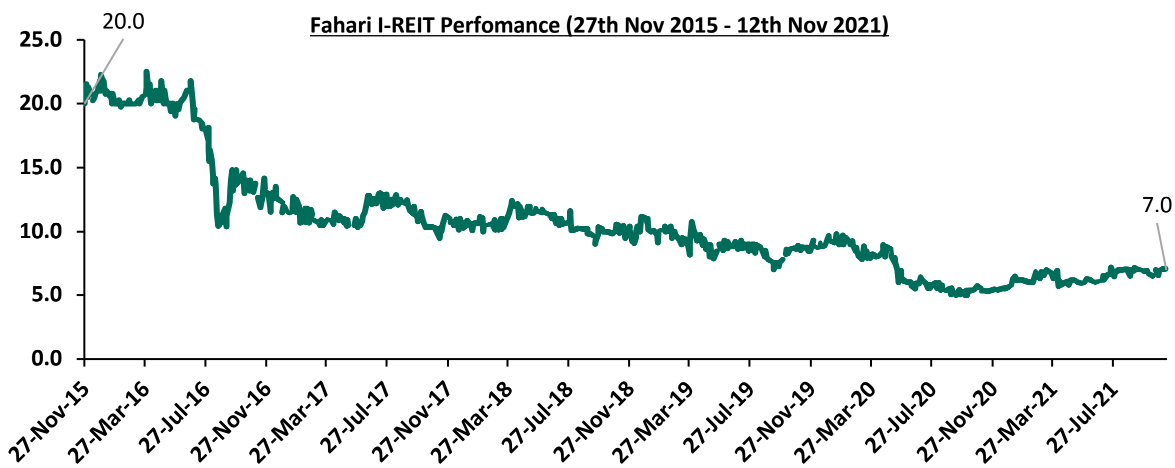
Source: Cytonn Research 2020

Mixed-use developments are expected to continue gaining traction from most contemporary developers due to higher returns compared to single-use themes, high demand, thematic diversification and economies of scale. We shall be releasing the 2021 MUDs report in the coming week.

IV. Listed REIT

During the week, the Fahari I-REIT declined by 1.1% to close at Kshs 7.0 per share, from Kshs 7.1 recorded the previous week. On a YTD basis, the listed REIT has gained by 23.8% from the Kshs 5.6 per share recorded at the beginning of the year. The REITs closing price also represented a loss in the Inception to Date (ITD) performance, declining by 65.1% from the inception price of Kshs 20.0 per share. The REIT market continues to record subdued performance when compared to the inception price attributable to the general lack of knowledge about the instrument, lengthy requirements approval processes and the high minimum investment amount set at Kshs 5.0 mn for a D-REIT.

The graph below shows the performance of the REIT from 27th November 2015- 12th November 2021;



The Real Estate sector is expected to record improved performance attributed to the improving real estate and hospitality sector performances, ongoing infrastructure developments in the country and mixed-use developments gaining traction due to operational synergies. However, the subdued performance of the listed REIT is expected to impede the performance of the sector.

Focus of the Week: Kenya H1'2021 Listed Insurance Report

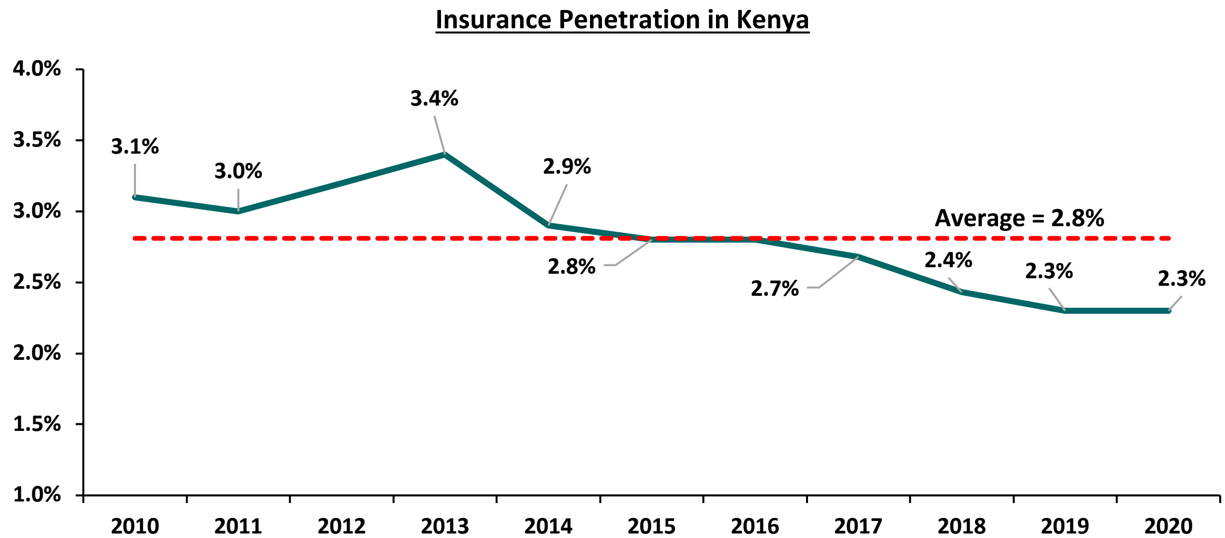
Following the release of the H1'2021 results by Kenyan insurance firms, the Cytonn Financial Services Research Team undertook an analysis on the financial performance of the listed insurance companies and the key factors that drove the performance of the sector. In this report, we assess the main trends in the sector, and areas that will be crucial for growth and stability going forward, seeking to give a view on which insurance firms are the most attractive and stable for investment. As a result, we shall address the following:

I. Status of the Insurance Penetration in Kenya
II. Key Themes that Shaped the Insurance Sector in H1'2021,
III. Industry Highlights and Challenges,
IV. Performance of The Listed Insurance Sector in H1'2021, and,

V. Conclusion & Outlook of the Insurance Sector.

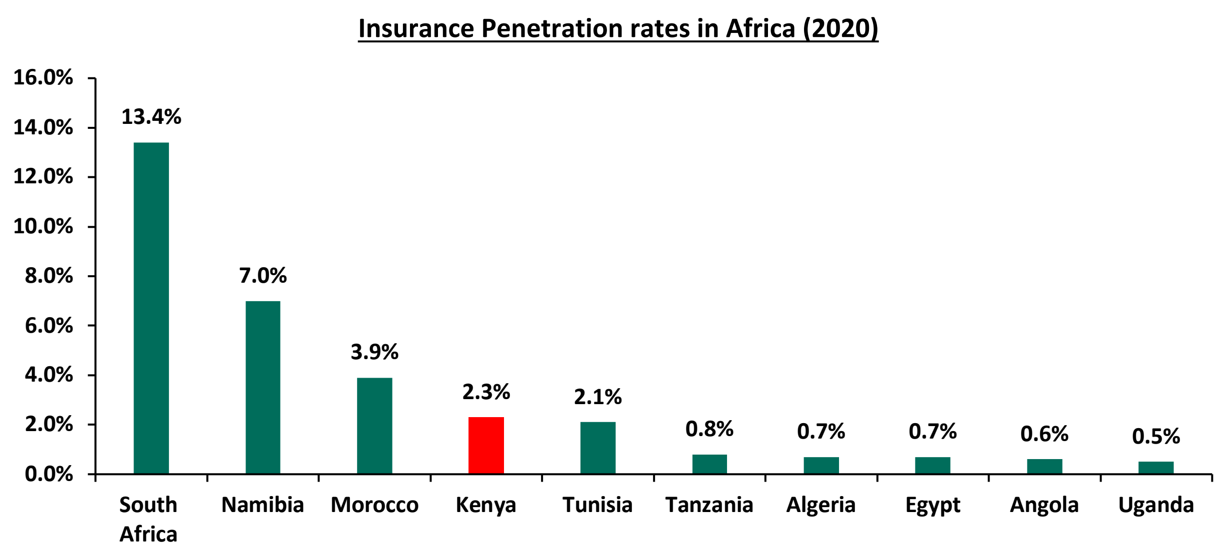
Section I: Status of the Insurance Penetration in Kenya

Insurance uptake in Kenya remains low compared to other key economies with the insurance penetration coming in at 2.3% as at December 2020, according to the [September 2021 Financial stability report] by Central Bank of Kenya (CBK). The low penetration rate, which is below the global average of 7.4%, is attributable to the fact that insurance is still seen as a luxury and mostly taken when it is necessary or a regulatory requirement. Insurance penetration in 2020 remained equal to 2019's at 2.3% despite individuals and businesses cutting back on discretionary expenditure including insurance in the face of income volatility in the pandemic environment.



Source: CBK Financial Stability Reports

The chart below shows the insurance penetration in other economies across Africa:



Source: Swiss Re, AKI

Insurance penetration in Africa has remained relatively low, averaging 2.8% in 2020, mainly attributable to lower disposable income in the continent and slow growth of alternative distribution channels such as mobile phones to ensure wider reach of insurance products to the masses. South Africa remains to be a leader in insurance penetration in the continent, owing to a mature and highly competitive market, coupled with strong institutions and a sound regulatory environment.

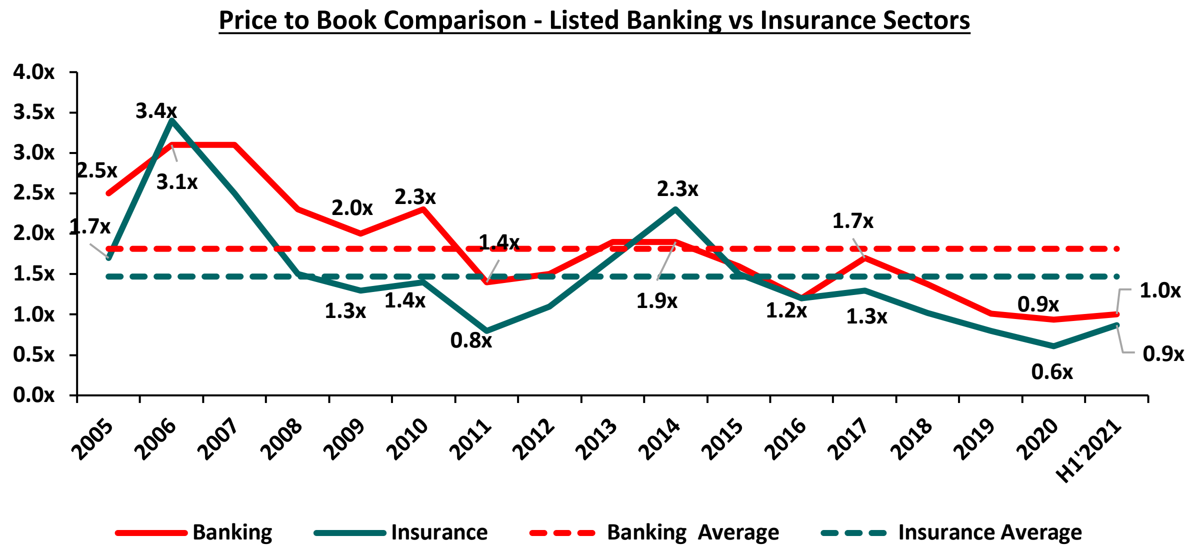
Section II: Key Themes that Shaped the Insurance Sector in H1'2021

In H1'2021, the country saw an improvement in the business environment, following the increased vaccine inoculation, coupled with the lifting and easing of COVID-19 measures that had been put in place in 2020. The improved operating environment led to the sector recording a 19.0% growth in gross premiums to Kshs 144.0 bn in H1'2021, from Kshs 121.0 bn in H1'2020. Insurance claims also increased by 22.5% to Kshs 71.8 bn in H1'2021, from Kshs 58.7 bn in H1'2020. During the period under review, the NASI index gained by 9.4% compared to a decline of 17.3% in H1'2020. This in turn helped to grow the insurance sector's bottom line as a result of fair value gains in the equities investments.

Key highlights from the industry performance:

i. Convenience and efficiency through adoption of alternative channels for both distribution and premium collection such as Bancassurance and improved agency networks,
ii. Advancement in technology and innovation making it possible to make premium payments and through mobile phones,
iii. 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 and,
iv. 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.

On valuations, listed insurance companies are trading at a price to book (P/Bv) of 0.9x, lower than listed banks at 1.0x, but both are lower than their 16-year historical averages of 1.5x and 1.8x, for the insurance and banking sectors respectively. These two sectors are attractive for long-term investors supported by the strong economic fundamentals.



The key themes that have continued to drive the insurance sector include:

A. Technology and Innovation

Although the industry has been slow in adopting digital trends, the onset of the COVID-19 pandemic in FY'2020 saw the adoption of digital distribution of insurance products as a matter of necessity. Consequently, majority of insurance companies increasingly took advantage of the available digital channels to drive growth and increase insurance penetration in the country. According to Communications Authority of Kenya (CAK), the number of mobile subscribers as at June 2021 stands at 64.4 mn against a population of 48.7 mn, translating to a mobile penetration of 132.2%. The high mobile penetration implies that mobile phones provide a headroom and increases opportunities to distribute insurance products to the younger generation of consumers and those consumers that have not been served through traditional distribution methods. Given that the process of handling and inspecting claims manually is cumbersome and imperfect, the use of Artificial Intelligence (AI) assists in investigating the legitimacy of claims and identifying those that are fraudulent. 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. Regulation

To ensure that the sector benefits from a globally competitive financial services sector, the regulator has been working through regulation implementations to address some of the perennial, as well as emerging problems in the sector. The COVID-19 environment proved challenging especially on the regulatory front, as it was a balance between remaining prudent as an underwriter and adhering to the set regulations given the negative effect the pandemic. Regulations used for the insurance sector in Kenya include the Insurance Act cap 487 and its accompanying schedule and regulations, Retirement Benefits Act CAP 197 and The Companies Act. In H1'2021, regulation remained a key aspect affecting the insurance sector and the key themes in the regulatory environment include;

i. **IFRS 9 -** IAS 39, Financial Instruments Recognition and Measurement was replaced with IFRS 9, Financial Instruments to address the classification and measurement of financial instruments, impairment, and hedge accounting. The guidelines introduce new classification and measurement especially for financial assets, necessitating insurers to make judgements to determine whether financial investments are measured at amortised cost or fair value and whether gains and losses are included in the profit or loss or other comprehensive income. The new impairment model under IFRS 9 is based on expected credit losses and subsequently, all financial assets will carry a loss allowance, meaning that insurers will have to provision higher for impairment losses. Many insurance companies have opted to use the temporary exemption from implementation of IFRS 9, by continuing to apply IAS 39, but the temporary exemption expires January 2023. IFRS 9 will enable insurance companies to develop appropriate models for their customer debtors and develop plans that will help them lower their credit risk in the future,

ii. **IFRS 17-** The standard establishes the principle for recognition, measurement, presentation and disclosure of insurance contracts with the objective of ensuring insurance companies provide relevant information that faithfully represents the contracts. However, as a way to protect the insurance industry from the negative effects of the pandemic the International Accounting Standards Board (IASB), the international body responsible for setting up financial reporting standards deferred its implementation to be effective from January 2023 or earlier. 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, and,

iii. **Risk Based Supervision** - IRA has been implementing risk-based supervision through guidelines that require insurers to maintain a capital adequacy ratio of at least 200.0% of the minimum capital by 2020. The regulation requires insurers to monitor the capital adequacy and solvency margins on a quarterly basis, with the main objective being to safeguard the insurer's ability to continue as a going concern and provide shareholders with adequate returns. We expect more mergers within the industry as smaller companies struggle to meet the minimum capital adequacy ratios. We also expect insurance companies to adopt prudential practices in managing and taking on risk and reduction of premium undercutting in the industry as insurers will now have to price risk appropriately.

C. Capital Raising and share purchase

The move to a risk based capital adequacy framework presented opportunities for capital raising initiatives mostly by the small players in the sector to shore up their capital and meet compliance measures. With the new capital adequacy assessment framework, capital is likely to be critical to ensuring stability and solvency of the sector to ensure the businesses are a going concern. In May 2021, Allianz and Jubilee Holdings announced the completion of acquisition of 66.0% stake in Jubilee General Insurance Company (property and casualty) with the exception of medical in Kenya, Uganda, Tanzania, Burundi and Mauritius, 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.

Section III: Industry Highlights and Challenges

Following the stable growth achieved by the insurance sector over the last decade, we expect the sector to experience sustained gradual growth on the back of an improving economy and subsequent growth in insurance premiums, which will enhance the capacity of the sector to sustain profitability. The following activities were undertaken by the Insurance Regulatory Authority (IRA), in line with their mandate of regulating and promoting development of the insurance sector;

I. Industry Circulars

In H1'2021, IRA issued 2 circulars to the industry focusing on the Private Security Regulations Act No. 13 of 2016 and enhanced medical insurance policy wordings. The circular on enhancing medical insurance policy wordings, was as a result of heightened complaints and enquiries from policyholders and beneficiaries of medical insurance covers where their claims were declined by insurers. The contentious issues were centered on; i) chronic and pre-existing conditions, waiting period of the medical insurance covers, and, iii) authorization for admission to hospital. IRA addressed the complaints by redefining the terms for the above issues and directed all medical underwriters to review their medical insurance contracts and harmonize as provided for in the circular. Additionally, as a risk mitigation measure, insurers were advised to provide for payment of COVID-19 vaccination for their medical insurance clients.

II. Recently Developed or Repackaged Insurance Products

In H1'2021, 10 new or repackaged insurance products were filed by various insurance companies and approved by IRA. The onset of COVID-19 and uncertainty that came along with the pandemic accelerated the repackaging of insurance products where 4 or 40.0% of the 10 products were medical plans, while life products accounted for 6 or 60.0% of the total new/repackaged products.

Industry Challenges:

- **Fraud:** Insurance fraud is an intentional deception committed by an applicant or policy holder for financial gain. Recent years have seen an increase in fraudulent claims especially in medical and motor insurance, with estimates indicating that one in every five medical claims are fraudulent mainly through inflated medical bills and hospitals making patients take unnecessary tests. In H1'2021, 45 fraud cases were reported, with fraudulent motor accident injury claims accounting for 15.6%, followed by theft by agents at 11.1%. The sector has been adopting the use of block chain and artificial intelligence to curb fraud within the sector, as well as most companies setting up their own assessment centres across the country so as to better determine the actual compensation,
- **Increased loss ratios:** the loss ratios have been increasing as the Insurers in the country have been facing losses in their core business, following the increase in claims outpacing increase in premiums.
  In H1'2021, under the long term business, net claims and policyholder's benefits increased by 29.0% to Kshs 39.4 bn, from Kshs 30.1 bn in H1'2020, while net premiums grew by a slower 22.9% to Kshs 54.6 bn from 44.4 bn in H1'2020. As a result, the loss ratios for long term business increased to 72.2% in H1'2021 from 68.8% in H1'2020. This may be attributable to higher pension payouts as a result of the pandemic's adverse effects on employment and income levels, as well as, higher life claims occasioned by cancellation of policies due to lower affordability.
  General business was also affected by the increase in loss ratios, with general insurance claims increasing by 15.3% to Kshs 32.4 bn in H1'2021, from Kshs 28.1 bn in H1'2020. On the other hand, premiums for general insurance business grew by a paltry 6.3% to Kshs 48.6 bn in H1'2021, from Kshs 45.6 bn in H1'2020. As a result, loss ratio for general insurers increased by 5.2% points to 66.8% in H1'2021, from 61.6% in H1'2020. The increase was attributable to increase in motor classes' claims by 52.7% in H1'2021, which can be partly tied to easing of travel restrictions around the country which allowed for unabated movement. As a result of this, accidents increased and claims increased too,
- **Cut throat competition**: The local insurance sector is served by 56 insurance companies offering the same products, despite the low insurance penetration in the country. The battle for market share has seen some insurers resort to underhand methods of gaining competitive advantage, such as premium undercutting which refers to the practice where an insurance company secretly offers clients unrealistically low premiums in order to gain competitive advantage and to protect their market share. This is a major driver of underwriting losses suffered by the industry. The regulator announced in March 2021, that plans to

engage a consultant to relook at the industry pricing are still underway. This however comes on the back drop of declining insurance penetration that could be worsened by increased premiums pricing. Some industry players have argued price fixing will kill innovation and that the industry players should be left free to set their own prices,

- **Dwindling trust from insurance consumers:** During H1'2021, IRA received 819 complaints, 360 in Q1'2021 and 459 in Q2'2021, lodged against insurers by policyholders and beneficiaries, with general insurance accounting for a lion's share of the complaints at 596 complaints (72.8%), while long term insurers recorded 223 (27.2%) complaints against them. The complaints range from insurance companies failing to settle claims and constant haggling over terms of insurance contracts, fueling the public mistrust against insurers and increasing insurance apathy in the country,
- **Regional regulators:** Subsidiaries of Kenyan insurance companies are facing challenges in the areas of operation. For instance, in Tanzania, insurance brokers are required to be at least two-thirds (67.0%) owned and controlled by citizens of Tanzania. In Kenya, regulation on capital has made it difficult for smaller insurance companies to continue operating without increasing their capital or merging in order to raise their capital base.

Section IV: Performance of the Listed Insurance Sector in H1'2021

The table below highlights the performance of the listed insurance sector, showing the performance using several metrics, and the key take-outs of the performance.

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***

The key take-outs from the above table include;

i. Core EPS growth recorded a weighted growth of 127.6%, compared to a weighted decline of 280.5% in H1'2020. The increase in earnings was attributable to increased premiums during the period following robust recovery by the sector from the COVID-19 pandemic, coupled with gains recorded in the equities markets and higher yields from government papers,
ii. The premiums grew at a faster pace of 6.3% in H1'2021, compared to a growth of 5.1% in H1'2020, while claims grew at an aggressive faster rate of 29.1% in H1'2021, from the 6.5% recorded in H1'2020 on a weighted average basis,
iii. The loss ratio across the sector increased to 92.8% in H1'2021, from 75.0% in H1'2020, owing to increased claims in insurance sub sectors such as motor and medical and perennial challenges facing the industry such as fictitious claims and increased benefit payments from the life business owing to job layoffs,
iv. The expense ratio increased to 53.8% in H1'2021, from 48.8% in H1'2020, owing to an increase in operating expenses,

v. The insurance core business still remains unprofitable, with a combined ratio of 146.6% as at H1'2021, compared to 123.8% in H1'2020, and,

vi. On average, the insurance sector delivered a Return on Average Equity (ROaE) of 6.2%, an increase from a weighted Return on Average Equity of 2.0% in H1'2020.

Based on the Cytonn H1'2021 Insurance Report, we ranked insurance firms from a franchise value and from a future growth opportunity perspective with the former getting a weight of 40.0% and the latter a weight of 60.0%.

For the franchise value score, we included the earnings and growth metrics as well as the operating metrics shown in the table below in order to carry out a comprehensive review (the lower the score, the better the franchise):

Listed Insurance Companies H1'2021 Franchise Value Score						
Insurance Company	Loss Ratio	Expense Ratio	Combined Ratio	Return on Average Capital Employed	Tangible Common Ratio	Franchise Value Score
Jubilee Holdings	109.6%	30.4%	140.0%	14.4%	18.4%	13
Sanlam Kenya	92.8%	47.1%	140.0%	(14.9%)	26.2%	22
Liberty Holdings	75.0%	84.3%	159.3%	4.9%	10.6%	23
Britam Holdings	78.5%	79.4%	157.8%	3.7%	4.1%	23
CIC Group	81.3%	50.8%	132.1%	4.5%	17.9%	24
Weighted Average H1'2021	**92.8%**	**53.8%**	**146.6%**	**7.2%**	**18.7%**	

The Intrinsic Valuation is computed through a combination of valuation techniques, with a weighting of 40.0% on Discounted Cash-flow Methods, 40.0% on Residual Income and 20.0% on Relative Valuation.

The overall H1'2021 ranking is as shown in the table below:

Listed Insurance Companies H1'2021 Comprehensive Ranking					
Insurance Company	Franchise Value Score	Intrinsic Value Score	Weighted Score	H1'2021 Ranking	FY'2020 Ranking
Jubilee Holdings	13	1	5.8	**1**	**2**
Sanlam Kenya	22	2	10.0	**2**	**3**
Liberty Holdings	23	3	11.0	**3**	**1**
Britam	24	4	12.0	**4**	**5**
CIC Group	23	5	12.2	**5**	**4**

Major Changes from the H1'2021 Ranking are;

1. Jubilee Holdings improved to position 1 in H1'2021 from position 2 in FY'2020 mainly due to the improvement in the franchise score in H1'2021, driven by reduction in expense ratio to 30.4% in H1'2021, from 56.3% in FY'2020. As a result, the combined ratio also declined to 140.0% in H1'2021, from 157.6% in FY'2020,

2. Sanlam improved to position 2 in H1’2021 from position 3 in FY’2020 mainly due to an improvement in its intrinsic value score wherein it recorded an upside of 4.0% on its share price of Kshs 11.5 as of 11th November 2021, outperforming Liberty, Britam and CIC Group,
3. Liberty declined to position 3 in H1’2021 from position 1 in FY’2020 mainly due to declines in both the franchise and intrinsic value scores,
4. Britam Holdings improved to position 4 in H1’2021 from position 5 in FY’2020 mainly due to the improvement in the franchise score in H1’2021, driven by reduction in loss ratio to 78.5% in H1’2021, from 85.7% in FY’2020,
5. CIC Group declined to position 5 in H1’2021, from position 4 in FY’2020, on the back of a weaker franchise score driven by deterioration of its loss ratio to 81.3% in H1’2021, from 71.4% in FY’2020, and combined ratio to 132.1% in H1’2021, from 121.5% in FY’2020.

Section V: Conclusion & Outlook of the Insurance Sector

The sector has continued to suffer from low penetration rates which has been worsened by the pandemic and its effects on the economy and Kenyans’ disposable incomes. However, the sector continues to undergo transition where traditional models have been disrupted, mainly on the digital transformation, innovation and regulation front, which have positively impacted the outlook. We expect a steady growth in premiums as underwriters come up with products suited to the planning for unforeseen events like COVID-19, mainly in the medical and life businesses. On the other hand, the recovery and lifting up of restrictions will continue to spur increased uptake of motor vehicle and marine insurance. Claims are also expected to grow aggressively with full resumption of economic activities, particularly due to an expected increase in motor claims as travel restrictions ease and medical claims which have been on a constant increase. The insurance sector will have to perform delicate balancing acts to ensure that they remain profitable. We are of the view that insurance companies have a lot they can do in order to register considerable growth and improve the level of penetration in the country to the 2020 world average of 7.4%, some of this include:

i. We expect insurers to look into portfolio optimization to re-evaluate their products and services to plot paths of growth post-pandemic in order to remain profitable. This will enable insurers to focus on their core and profitable offerings and disposing non-core offerings. This could manifest through sale of business units considered unprofitable. One such example is Jubilee Holdings sale of its general insurance unit with the exclusion of its medical unit to Allianz. We expect this portfolio optimization to extend into offloading or reducing stake in non-profitable subsidiaries and associates. Products are also set to be affected as the underwriters extend focus to profitable products,
ii. We expect most underwriters to continue their aggressive efforts towards increasing investment income through diversifying their investments through avenues such as pension schemes, unit trusts, fund management and investment advisories. This shift from only engaging in underwriting business is necessitated by the increasing combined ratios that have seen insurers’ suffer losses in their core business, with increase in underwriting expenses and claims outpacing the increase in premiums. On the investment front, we also expect insurers to continue to look into non-traditional asset classes such as infrastructure. An example is Jubilee Holdings investment in associates such as Bujagali hydropower plant in Uganda, PDM Holdings Ltd and IPS Cable Systems Ltd whose share of profits has been boosting its bottom-line. In H1’2021, Jubilee Holdings profits from associates increased by 92.9% to Kshs 0.8 bn in H1’2021, from Kshs 0.9 bn from Kshs 0.3 bn in H1’2020,
iii. We expect robust insurance awareness campaigns by the insurers in order to increase knowledge of insurance products, among the masses, as there still remains a gap on insurance understanding. According to a survey commissioned by the Association of Kenya insurers (AKI), the 2nd largest contributor to low insurance uptake at 27.0%, is lack of knowledge of the various insurance products

and their benefits. This gives a lot of headroom for insurers, to educate, repackage, and tailor their products to different institutions and individuals,

iv. We expect continued partnerships and alternative distribution channels, by linking with other financial services players including Fund managers who have ventured into offering insurance linked products as well as the current bancassurance relationship with Banks. Insurance companies will still want to leverage on the penetration of bank products to also push insurance products. Integration of mobile money payments to allow for policy payments is also expected to continue because of convenience which it provides and also mobile phone penetration in the country is high therefore insurance companies will want to leverage this to improve penetration,

v. We expect increased use of technological tools and innovations such as Artificial Intelligence and real time data in hyper personalization of insurance marketing so as to use customer information to customize content, products and services according to the customer wishes and preferences. This will also assist insurers in responding to changes in buying behaviours and tailoring products and services to the needs of the customers to ensure high customer retention in an era where new client acquisition remains difficult. We also expect to see increased inclusion of advancements like smart contracts through block chain that would help eliminate processing costs, reduce insurance fraud and fictitious claims and improve customer satisfaction through immediate claims payment, and,

vi. We also expect that there will be increased regulation in the sector from the regulatory body and other international players to ensure its solvency and sustainability. Insurers have to adjust their insurance contract recognition methods in preparation to the coming into effect of IFRS 9 and IFRS 17 in January of 2023 or earlier. The concerted push by the regulator to have the desired capital adequacy levels will likely see increased consolidations as insurers struggle to reinstate their capital buffers following the effects of the pandemic.

For the H1'2021 Insurance Report, please download it **here**

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