Real Estate Investment Trusts (REITs) Performance in Kenya, & Cytonn Weekly #14/2022

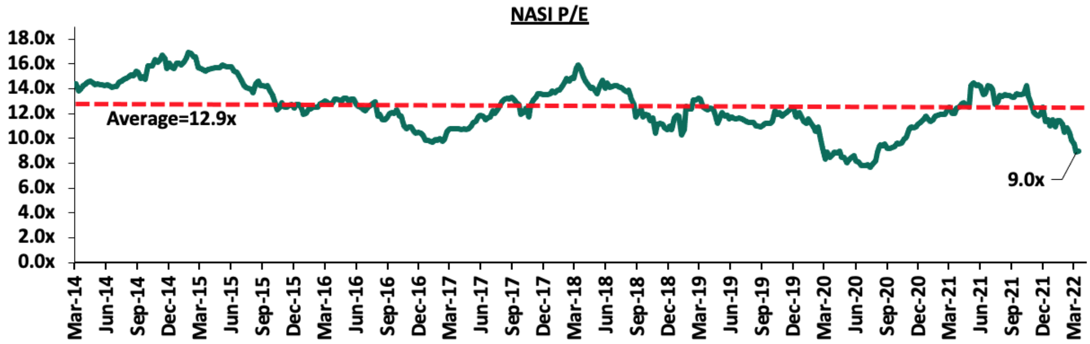
Equities

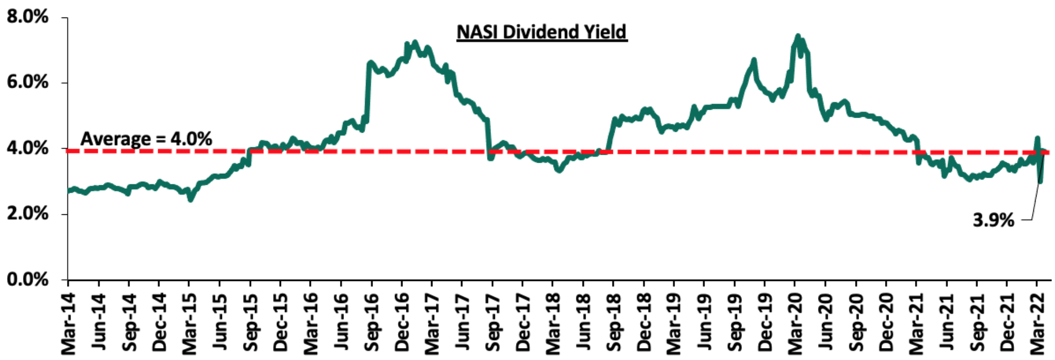
Markets Performance

During the week, the equities market was on an upward trajectory, with NASI gaining by 0.8%, while NSE 20 and NSE 25 both gained by 0.4%, taking their YTD performance to losses of 5.9%, 3.3% and 5.1% for NASI, NSE 20 and NSE 25, respectively. The equities market performance was driven by gains recorded by large cap stocks such as NCBA Group, Safaricom and ABSA of 3.7%, 1.4% and 1.2%, respectively. The gains were however weighed down by losses recorded by other large cap stocks such as Bamburi, Diamond Trust Bank (DTB-K) and KCB of 4.9%, 3.8% and 2.3%, respectively.

During the week, equities turnover declined by 43.2% to USD 9.6 mn, from USD 17.0 mn recorded the previous week, taking the YTD turnover to USD 257.8 mn. Foreign investors remained net sellers, with a net selling position of USD 2.7 mn, from a net selling position of USD 3.0 mn recorded the previous week, taking the YTD net selling position to USD 17.4 mn.

The market is currently trading at a price to earnings ratio (P/E) of 9.0x, 30.3% below the historical average of 12.9x, and a dividend yield of 3.9%, 0.1% points below the historical average of 4.0%. Key to note, NASI's PEG ratio currently stands at 1.2x, an indication that the market is trading at a premium to its future earnings growth. 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. The current P/E valuation of 9.0x is 16.6% 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:





Weekly Highlights:

A. **Britam Holdings and Britam Life's shares in Equity Group Holding sale**

During the week, Britam Holdings (the parent company), and Britam Life Assurance (subsidiary), jointly announced that the two firms are in the final stages of executing the sale agreement to sell their stakes in Equity Group Holdings to the International Finance Corporation (IFC) and the IFC Financial Institutions Growth (FIG) Fund, and expect to finalize the transactions by 29th April 2022. Britam Holdings is seeking to sell 166,390,750 shares in EGH (110,901,488 shares to IFC and 55,489,262 shares to the IFC FIG Fund), constituting 4.4% of EGH's issued shares, while Britam Life Assurance Company will be selling 86,719,611 shares (53,620,247 shares to IFC and 33,099,364 shares to the IFC FIG Fund), and constituting 2.3% of EGH's issued capital. Below is a summary of the transaction:

Seller	No. of Shares	Percentage of Ownership	Expected Amount to Britam and Britam Life (Kshs bn)	Purchaser	No. of Shares after the Sale	Percentage of Ownership
Britam Holdings	166,390,750	4.4%	9.2	IFC	164,521,735	4.4%
Britam Life Assurance	86,719,611	2.3%	4.7	IFC FIG Fund	88,588,626	2.3%
Total	**253,110,361**	**6.7%**	**13.9**		**253,110,361**	**6.7%**

As highlighted in our Cytonn Weekly 1/2022, IFC and IFC FIG Fund are expected to acquire the shares at Kshs 55.0 per share, which represents a 11.6% premium on EGH's current market price of Kshs 49.3 as at 8th April 2022. Britam Holdings is expected to receive Kshs 13.9 bn from the transaction. We expect that Kshs 3.3 bn of the sale proceeds will go towards paying the holding company's bank loan facility, secured with quoted ordinary shares, Kshs 5.0 bn will likely go to plugging the loss in the Wealth Management LLP portfolio, with the balance of Kshs. 5.6 bn going to shoring up the holding company's reserves. The sale, once approved by the necessary regulators, is expected to significantly improve the Group's bottom-line in FY'2022, with the group earning a profit of Kshs 72.3 mn in FY'2021, up from a loss of Kshs 9.1 bn in FY'2020. The FY'2021 performance was mainly weighed down by an effective tax rate of 92.9%, attributable to provisions for investment losses of Kshs 5.2 bn in FY'2020, which were not tax allowable.

We anticipate that completion of the sale will allow Britam Holdings to concentrate on its core offering in its insurance business, which has remained unprofitable and also simplifying the business model by making it more transparent. Britam Holdings posted a combined ratio of 149.4% in the recently released FY'2021 results, with total expenses coming in at Kshs 38.9 bn, while net premiums totalled a lower Kshs 25.7 bn. We also expect the boosted capital and liquidity to enable Britam to return value to its shareholders, through paying dividends, with the group failing to pay dividends in the last two financial years.

B. **Resolution Insurance Placed Under Statutory Management**

During the week, the Insurance Regulatory Authority (IRA), announced that Resolution Insurance Company had been placed under statutory management by the Commissioner of Insurance, following continued challenges by the insurer to meet its obligations such as settling claims to claimants, policyholders and other creditors, coupled with failure to mitigating inherent risks. The regulator appointed the Policyholders Compensation Fund (PCF) as the Statutory Manager of Resolution Insurance Company for a period of 12 months, commencing 5th April 2022, the date at which all existing policies ceased to exist.

The placing of Resolution Insurance under statutory management comes after the insurer announced the pausing of underwriting new or renewing non-medical business on 27th March 2022, as it continued to raise capital. Key to note, Resolution Insurance had entered into an agreement with Linkham Group, a UK-based global Insurance solutions firm to buy 100.0% of Resolution Insurance's stake held by Leapfrog Investments, a private equity firm. However, the sale did not materialize leaving Resolution Insurance to source for alternative sources of capital injection. According to IRA's Q4'2021 industry report, Resolution Insurance recorded a Profit after Tax (PAT) loss of Kshs 290.6 mn in FY'2021, a reversal from the Kshs 150.7 mn profit recorded in FY'2020 mainly attributable to a 28.7% increase in claims to Kshs 1.6 bn in FY'2021 from Kshs 1.2 bn in FY'2020 which outpaced the 5.1% increase in net premiums to Kshs 2.1 bn in FY'2021 from Kshs 2.0 bn in FY'2020. The loss recorded in FY'2021 took the insurer's accumulated losses to Kshs 2.5 bn, depleting its equity reserves to a net of (Kshs 392.2 mn). The sustained losses have been driven by aggressive growth in claims as compared to premiums, which has seen Resolution insurance record higher than industry claims ratios. In FY'2021, Resolution Insurance recorded a claims ratio of 77.4% as compared to an industry average of 68.8%. The table below highlights Resolution Insurance key ratios and metrics over the last five years:

Resolution Insurance Financial Performance FY'2017 – FY'2021

Metric (Kshs bn)	FY'2017	FY'2018	FY'2019	FY'2020	FY'2021	5-Year CAGR
Net Premium Amount	1.7	2.7	2.6	2.0	2.1	4.3%
Claims Amount	1.0	1.9	1.8	1.2	1.6	8.7%
Expenses	1.1	1.2	1.2	1.2	1.0	(1.1%)
Profit / (Loss) After Tax	**(0.4)**	**(0.4)**	**(0.3)**	**0.2**	**(0.3)**	**(5.4%)**
Total Assets	4.9	4.6	4.9	4.6	4.2	(3.0%)
Total Liabilities	5.2	4.8	5.3	4.9	4.6	(2.4%)
Key Ratios						
Claims ratio	62.8%	72.0%	69.8%	63.3%	77.4%	-
Expense ratio	64.9%	46.1%	47.0%	62.2%	49.9%	-
Combined ratio	**127.7%**	**118.1%**	**116.8%**	**125.5%**	**127.3%**	**-**
Overall Liquidity ratio	**94.3%**	**96.1%**	**91.9%**	**94.4%**	**91.4%**	-

It is evident that core insurance business in Kenya remains largely unprofitable and firms need to re-valuate their strategies to prevent further collapse of insurance companies. In addition to the increasing claims, Resolution Insurance has struggled to meet the minimum capital adequacy ratios of 200% above the minimum capital of Kshs 600.0 mn for general insurance as recommended by the regulator, IRA. As of FY'2021, Resolution Insurance's capital adequacy level stood at 186.2% above the minimum capital of Kshs 600.0 mn pointing towards insufficient capitalisation. Key to note, the statutory manager, PCF, can only compensate for claims, within the next 14 days, up to a maximum of Kshs 250,000 per policyholder, as provided for by law with claims. We also expect to see continued capital-raising activities especially by the smaller insurance and mergers in the sector as smaller firms try to reach the minimum levels set by the IRA as it implements the risk-based supervision through guidelines that require insurers to maintain the minimum specified capital adequacy ratios.

Cytonn Coverage:

Company	Price as at 01/04/2022	Price as at 08/04/2022	w/w change	YTD Change	Year Open 2022	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Kenya Reinsurance	2.2	2.2	1.4%	(2.2%)	2.3	3.2	4.5%	46.4%	**0.2x**	**Buy**
Jubilee Holdings	274.8	273.5	(0.5%)	(13.7%)	316.8	381.7	5.1%	44.7%	**0.5x**	**Buy**
Liberty Holdings	5.7	6.0	5.3%	(15.0%)	7.1	7.7	0.0%	27.6%	**0.4x**	**Buy**
Britam	6.7	6.7	0.6%	(11.1%)	7.6	7.9	0.0%	17.2%	**1.1x**	**Accumulate**
Sanlam	11.0	11.0	0.0%	(4.8%)	11.6	12.1	0.0%	9.6%	**1.2x**	**Hold**
CIC Group	2.2	2.1	(5.0%)	(3.2%)	2.2	1.9	0.0%	(10.3%)	**0.7x**	**Sell**

***Target Price as per Cytonn Analyst estimates**
****Upside/ (Downside) is adjusted for Dividend Yield**

We are currently reviewing our target prices for the banking sector coverage ahead of our FY'2021 Banking Report.

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 1.2x), we believe that investors should reposition towards value stocks with strong earnings growth and that are trading at discounts to their intrinsic value. We expect the discovery of new COVID-19 variants, the upcoming Kenyan general elections and the slow vaccine rollout to continue weighing down the economic outlook. On the upside, we believe that the relaxation of COVID-19 containment measures in the country will lead to improved investor sentiments.