FAIDA INVESTMENT BANK

INVESTMENT RECOMMENDATIONS REPORT

29th January 2021

Equity Recommendations

Overall Overview

The adverse economic outlook as result of the COVID-19 pandemic has seen prices of most counters decline significantly, into bear market territory. The NASI, NSE 20 and NSE25 are up 2.29%, 0.72% and 0.56% YTD to 155.59, 1,881.91 and 3,434.52 respectively.

In the short term, we expect significant pressure on companies' operating performance as a result of economic shocks. In our view, investors with a long-term view (ideally equity investors should have a long-term outlook anyway) and don't have short term liquidity constraints can take advantage of the attractive trading multiples for the capital gains potential.

High dividend yielding stocks are also good investing opportunities. However, with a need to conserve cash, this is a high-risk strategy due to the lower dividend safety (a number of companies have either reduced or deferred dividends or issued stock dividends instead of cash dividends).

A safer alternative for income investors is allocate funds to fixed income securities/money market fund.

Overall, the current market presents a buying opportunity for companies with strong fundamentals. We highlight some of these in the next section.

INSURANCE SECTOR:

Kenya Re

We assign a **HOLD** recommendation on Kenya Re. The counter is currently trading at a trailing P/B multiple of 0.09x (at a price of KES 2.47 as at 29th January 2021) compared to the industry average of P/B ratio of 3.42x.

The company has a return on average equity (ROaE) of 13.2% (third highest amongst listed insurance companies) and a dividend yield of 4.2% -- the highest amongst listed insurance companies.

Counter	ROaE	Dividend Yield
Britam	13.3%	3.4%
CIC	4.1%	0.0%
Sanlam	6.9%	0.0%

Jubilee	13.9%	3.1%
Liberty	9.5%	0.0%
Kenya Re	13.2%	4.2%

Our recommendation is based on the following factors:

Investment Considerations

- Despite increasing competition in foreign markets, Kenya Re still maintains a leading position in its domestic market (it is the national re-insurer in Kenya) and is supported by the national government (which owns 60.0% stake through the National Treasury).
- Kenya Re has robust levels of capital and liquidity; as at 1H2020 total equity stood at KES 33.1 billion with retained earnings accounting for KES 20.2 billion. Kenya Re recently (in July 2020) received a national scale financial rating of AA+ with a stable outlook from Global Credit Ratings (GCR) on the back of a strong capital base and healthy liquidity. We believe the strong capital and liquidity position provides the company with the requisite financial muscle to further its diversification strategy (Kenya Re plans to venture into Egypt post-pandemic).

Risks

- We expect rising competition to continue being a major challenge to Kenya Re going forward. In the last few years, the company has persistently encountered increased competition from local and international markets occasioned by:
    - rising domestication of reinsurance in several key markets and setting up of national re-insurance companies in countries where they didn't exist before
    - price undercutting amongst re-insurers
- In 1H2020, investment income dipped by 2.1% y/y to KES 1.9 billion. This is attributable to the effect of the COVID-19 pandemic which has resulted in a depressed investment environment. We expect to continue to witness depressed earnings from the investment portfolio due to challenges in the investment climate (low yields and low equity returns).
- In 1H2020, net claims and benefits from the short-term business eased by 1.8% to KES 4.6 bn – bucking trend witnessed since FY2017 (i.e. double digit growth). This resulted in a decrease in the loss ratio to 59.2% (1H2019: 70.0%). We opine that the lower claims and benefits witnessed in the short-term business were influenced by reduced activities (transportation, business activities) due restrictions imposed to curb the spread of COVID-19. With the easing of COVID-19 restrictions, there is a high likelihood that claims and benefits in the short-term business may once again rise in 1H2020. Thus, we remain cautiously optimistic about the improvement in underwriting results.
- We also note that Kenya Re's reinsurance receivables have once again come under pressure in the 1H2020 despite the improvement witnessed in the collection of reinsurance receivables in FY2019 (which declined by 28.5% to KES 2.6 billion in FY2019). We opine that collection efforts will continue to be hampered in FY2020 owing to the economic challenges brought on by the COVID-19 pandemic, consequently resulting in higher provisions

Summary

Counter	Recommendation	YTD Change	Price as at 29-01-2021
Kenya Re	Hold	6.250%	2.47

For Online Share Trading (OST) via browser, please click here:
For the Faida M-Trader Application, please click here:

E-mail: research@fib.co.ke

Recommendation Guide:

LONG-TERM BUY: The company has strong fundamentals (strong financial performance, clear/reasonable strategy, competent management team etc.). However, there are certain investments or strategies that would require an investor to have a long-term view of the company to allow for capital appreciation. Also, the company may be facing head wings which we view as short term.

BUY: Strong fundamentals. Minimal risks to the catalysts/growth drivers

NEUTRAL: This is where the positives and negatives in a company almost balance out. You can accumulate for the long term.

SELL: Deteriorating fundamentals. Risks outweigh the catalyst/growth drivers.

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