

Pan Africa Life Assurance Limited

Kenya Insurance Analysis

November 2009

Security class	Rating scale	Currency	Rating	Rating watch	Expiry date
Financial strength	National	KShs	A+	No	11/2010

Financial data:

(US\$m Comparative)

	31/12/07	31/12/08
KShs/US\$ (avg.)	67.8	71.5
KShs/US\$ (close)	64.0	84.0
Total assets	73.1	60.9
Total capital	7.9	6.9
Cash & equiv	14.6	10.5
GPI	30.5	35.1
Income : outgo	10.5	10.6
Shareholders profit	1.8	1.9
Op. cash flow	n.a.	n.a.
Market share*	21.5%	
Market cap	n.a.	

*Based on life GPI for 2008.

Fundamentals:

Pan Africa Life Assurance Limited ("Pan Africa") was founded in Mombasa in 1946 and is the primary operating subsidiary of Pan Africa Insurance Holdings Limited ("PAIHL"). It is currently the largest life insurer in Kenya by GPI, with a strong presence in both the group and individual life classes. Pan Africa did include a short term insurance operation but the group was split into two separate entities: Pan Africa Life Assurance Ltd and Pan Africa General Insurance Ltd in 2002. The general business was amalgamated with Apollo's general business in 2003, to form APA Insurance Ltd, in which PAIHL has a 40% stake. In 2001, African Life acquired a 50% stake in PAIHL, before it was in turn acquired by the Sanlam Group ("Sanlam"). The remaining 50% is listed on the Nairobi Stock Exchange. PAIHL has a 17% share in Sanlam Investment Management Kenya.

GCR contacts:

Eyal Shevel

+27 11 784-1771

shevel@globalratings.net

Melanie Brown

+27 11 784-1771

brown@globalratings.net

Website: www.globalratings.net

Rating rationale

The rating is based on the following key factors:

- Pan Africa's leading position in the Kenyan life assurance market. Its position is enhanced by its association with Sanlam, which provides substantial management and technical support.
- The assurer has reported strong growth in GPI over the review period, supported by a large agency force and close relationships with key banking groups. Sources of GPI are well diversified, with no undue concentration by broker or employer groups.
- The actuarial surplus increased to 14% of actuarial liabilities in F08 (F07: 13%). Moreover, the assurer has been conservative regarding distributions to shareholders, with profits maintained to bolster shareholders equity.
- Pan Africa maintains a relatively conservative investment portfolio, largely comprising government securities, cash and a diversified equity portfolio. However, investment yields have trended downward since F05.
- The life assurance industry remains highly competitive, with rate undercutting presenting a challenge in terms of achieving profitable growth. Nevertheless, the assurer has demonstrated an ability to grow its market share, while consistently increasing profitability.

Solvency and actuarial valuation

Total investments supporting the life fund increased by 15% in F08, in line with the rise in actuarial liabilities. Accordingly, the actuarial surplus for the year rose by 14% to KShs312m. As a relatively low transfer to shareholders occurred in F07, a large surplus was carried forward. Combined, the total actuarial surplus amounted to KShs566m in F08, equating to 14% of the life fund (F07: 13%). In order to build up the statutory reserves required to expand the business, Pan Africa has limited allocations and dividends paid to shareholders over recent years. Accordingly, shareholders interest has risen from KShs230m in F05 to KShs581m in F08 (F07: KShs504.2m), reflecting the reported net asset value ("NAV"). A higher NAV, combined with an 18% increase in the value of in-force business to KShs1.5bn (albeit offset by a much higher tax provision), supported a 5% increase in embedded value to KShs1.7bn in F08. Higher shareholders equity covered capital adequacy requirements ("CAR") by 2.6x in F08 (F07: 2.2x). However, group policy dictates that excess capital be disbursed to shareholders and accordingly CAR cover is forecast to decline to 2.2x in F09.



Industry overview

The Kenyan life insurance industry comprises 23 participants, 18 of which are composite insurers. Unlike the short term industry, which is highly fragmented, the life insurance market is dominated by six large players, each with GPI of more than KSh900m, and which collectively account for almost three quarters of total industry premiums. A similar distribution is evidenced in terms of deposit administration, with four insurers holding a market share of approximately 80% in terms of revenue inflow. This notwithstanding, the industry is still subject to a relatively high degree of competition, given that demand remains fairly limited. In an effort to improve the financial stability of the insurance industry, new capital requirements were introduced under the Finance Bill of 2007, which was passed into law in October 2007. Life insurance companies will be required to increase their paid up capital to KSh150m by 2010, from the current KSh50m capital requirement, while composite players will need to have paid up capital of KSh450m. This is expected to drive consolidation in the industry, which should alleviate pricing pressure to a degree.

Life insurance penetration in Kenya is very low (estimated at less than 1% of GDP), due to a lack of savings culture and relatively low average income levels. Life and annuity business constitutes approximately 64% of industry revenue, with deposit administration making up the balance. Around two thirds of life business is sourced from the individual market, with the remainder derived from group schemes. Competition in the individual life arena is relatively intensive, since the small size of risk exposures enables players with lower capital bases to compete in this market. Furthermore, group life business is very price sensitive and subject to a high degree of policyholder churn, while participants have encountered pressure to increase free cover limits to retain existing contracts, which has adversely impacted claims experience. Prior to the equity market downturn over the past 18 months, the life insurance industry encountered significant competition from segregated fund managers, as pension administrators moved their portfolios to market linked products to benefit from the equity market run. However, the market downturn saw a reversal in this trend, given the capital losses that were made on these portfolios.

Both the life and pension administration books posted revenue growth of more than 20% in 2008 (2007: 24% and 20% respectively), albeit below average inflation of around 26% (2007: 10%). Following robust equity market performance in 2006, a large portion of the gains posted by insurers have been reversed in the past two years, with 2008 reflecting a pronounced 35% contraction in the Nairobi Stock Exchange. This has placed pressure on life

companies' operating profitability and policyholder returns. Strong property market performance has partly offset the equity market losses, although the sustainability of current property prices (and rental returns) will hinge on sustained economic growth. In this regard, GDP growth eased to 1% in 2008 from almost 7% in the prior year, although it is projected to recover to around 4% in 2009.

Competitive positioning

Pan Africa's strong growth over recent years has seen it overtake British American Insurance Kenya ("Britak") as the largest life assurance company by GPI in Kenya. The assurer garnered 21.5% of industry premium in 2008, slightly higher than Britak's 20.1% market share. However, both insurers enjoy market leadership in their respective sectors, with Britak holding the larger individual life book, while Pan Africa leads the group life market. Notably, Pan Africa's deposit administration business is very small compared to similar sized insurers.

Table 1: Peer comparison (KSh's'm)	Pan Africa	British American	CFC Life	Co-op. Life
Group	1,007.6	475.2	95.4	1,000.6
Individual	1,502.4	1,872.7	913.8	88.7
GPI	2,510.0	2,348.0	1,009.2	1,089.4
NPI	2,318.1	2,178.0	967.2	994.6
Invest. & other income *	224.0	565.5	229.5	125.5
Total income	2,542.1	2,743.5	1,196.7	1,120.1
Claims paid**	(1,525.8)	(1,145.0)	(480.1)	(650.4)
Expenses & comm.	(858.9)	(1,235.2)	(504.4)	(394.0)
Excess income : outgo	157.4	363.3	212.2	75.7
Key ratios (%)#				
GPI growth	21.2	26.1	12.8	18.6
Outgo : income	93.8	86.8	82.3	93.2
Benefits paid : outgo	64.9	57.7	60.2	64.2
Expenses : NPI	37.1	56.7	52.1	39.6
Market share: group	22.1	10.4	2.1	21.9
Market share: individual	21.1	26.3	12.9	1.2

* Includes unrealised gains and losses.

** Includes changes in policyholder liabilities.

Based on the figures above, which included unrealised gains and losses and changes in policyholder liabilities.

While Britak evidenced the strongest premium growth in F08, Pan Africa has been more successful than it peers at managing costs. As is evidenced in the above table, the assurer reported the highest ratio of benefits paid to outgo and lowest management expense ratio in F08. However, outgo as a percentage of income was the highest of the peer group, due primarily to relatively weaker investment income and a high claims ratio.

Operations

Pan Africa's primary distribution channel is through its large agency force, which is responsible for writing around 60% of the assurer's GPI. Direct sales account for a further 13% of GPI. Accordingly, the assurer is not overly dependent on the broker market for business. While the largest broker group accounts for 10% of premiums, the top five brokers account

for a relatively low 19%. Moreover, with the predominance of individual life policies, no employer group contributes inordinately to premiums.

	F05	F06	F07	F08
Individual life	831.3	1,016.8	1,218.5	1,502.4
Group life	337.3	380.1	851.9	1,007.6
Total	1,168.6	1,396.9	2,070.4	2,510.0

Pan Africa has evidenced robust growth in both group and individual life premiums over the review period. Growth has been relatively stronger within the group life sector, which has seen its contribution to overall GPI climb from 27% in F06 to 40% in F08. The establishment of strong working relationships with major Kenyan banking groups, helped group life GPI double in F07, before rising 18% in F08. This was largely due to Pan Africa's expanding credit and mortgage life book, with the assurer now the largest provider of such products in Kenya. Additional bank assurance relationships are being considered and will form an increasingly important distribution channel going forward.

Similarly, a focus on specific high growth products within the individual life segment enabled Pan Africa to increase gross premiums by 81% over the review period. The assurer has continued to introduce new products, with some of the more popular ones being an education product and a high premium savings plan. Almost all the individual life business is derived from recurring premium products.

Benefits paid	F07		F08	
	KShs'm	%	KShs'm	%
<i>Individual life</i>	287.0	61.1	707.5	66.2
Life claims	51.1	10.9	41.8	3.9
Surrenders	67.0	14.3	424.6	39.7
Maturity	168.2	35.8	241.1	22.6
Other	0.7	0.1	-	-
<i>Group life</i>	159.6	34.0	361.6	33.8
Life claims	305.6	65.1	467.3	43.7
Reinsurance	(146.0)	(31.1)	(105.7)	(9.9)
D/A interest	23.0	4.9	-	-
Total benefits	469.6	100.0	1,069.1	100.0

Claims paid more than doubled to KShs1.1bn in F08, with increased payments evidenced across all business segments. Within group life, gross claims paid climbed 53% to Kshs467m, although the increase must be considered in light of the three fold rise in premiums over the review period. Nevertheless, net claims paid more than doubled to KShs362m in F08, as the amount covered by reinsurance was lower. With regard to individual life, the higher value of maturities in F08 could also be attributed to the greater number of in force contracts.

The largest increase in claims was evidenced in individual life surrenders. This was partly due to the weak economic environment throughout F08, which precipitated an increase in surrenders. However, the

greater part of the surrenders resulted from a change in accounting policies. The change in accounting policy saw some items previously classified as policy loans being reclassified as unit withdrawals, since these amounts would have been recovered from the existing policy units when the policy matured.

Actuarial valuation and solvency

Investments supporting the life fund increased by 15% in F08, in line with the growth in actuarial liabilities. Accordingly, the actuarial surplus for the year rose by 14% to KShs312m. As a relatively low transfer to shareholders occurred in F07, a large surplus was carried forward. Combined, the total actuarial surplus amounted to KShs566m, equating to 14% of the life fund (F07: 13%). While the transfer of actuarial surplus to shareholders of KShs91.5m in F07 was below the maximum 30% of the surplus permitted to be transferred in a given year, the F08 distribution was in line with the maximum.

	F07	F08
Life fund investments	3,705.8	4,260.1
Actuarial liabilities	(3,432.7)	(3,948.6)
Actuarial surplus for year	273.1	311.5
Surplus brought forward	170.3	254.4
Total surplus	443.4	565.9
Recommended Allocation		
With-profit policyholders	74.5	71.8
Deposit administration interest	23.0	25.6
Shareholders	91.5	169.0
Surplus carried forward	254.4	299.5

In order to build up the statutory reserves required to expand the business, Pan Africa has limited allocations and dividends paid to shareholders over recent years. Accordingly, shareholders interest has risen from KShs230m in F05 to KShs581m in F08 (F07: KShs504.2m), reflecting the reported net asset value ("NAV"). The higher NAV combined with an 18% increase in the value of in-force business to KShs1.5bn (albeit offset by a much higher tax provision), supported a 5% increase in embedded value to KShs1.7bn in F08. Higher shareholders equity covered capital adequacy requirements ("CAR") by 2.6x in F08 (F07: 2.2x). However, group policy dictates that excess capital be disbursed to shareholders and accordingly CAR cover is forecast to decline to 2.2x in F09.

Reinsurance

Pan Africa utilises reinsurance to cover its exposure to group life risk products, although within the individual life class a small amount of premium is ceded in respect of catastrophe cover. The programme is led by Kenya Re, with other participants being Africa Re and EA Re. The treaty programme comprises surplus cover, which limits Pan Africa's liability to KShs2m per group life and

KShs1m per individual life. Catastrophe cover further limits Pan Africa's retention to three lives per single event, equating to just 1% of shareholders funds.

	Retention	Lines	Limit
Group	KShs2m	60	KShs120m
Individual	KShs1m	20	KShs20m

Prior to F08, group life cover extended from KShs1m per life, with the increased retention being responsible for the decline in premiums paid and recoveries in F08, compared to F07.

	F07	F08
Premiums ceded	236.8	191.9
Recoveries	(146.0)	(105.7)
Net premium ceded	90.7	86.2

Asset management

Pan Africa's investment management is outsourced to Sanlam Investment Management Kenya ("SIM"), in which Pan Africa Investment Holdings has a 17% stake. Nevertheless, transactions are conducted on an arms-length basis, and the assurer is entitled to change investment managers if required. While investment policy is set by Pan Africa's board, the actual decisions on how best to construct an investment portfolio adhering to the mandate provided is entrusted to SIM. Similarly, savings and annuity products are designed in-house, before the investment requirements are presented to SIM. To limit its investment risk, Pan Africa has avoided issuing guaranteed return products. Where a guaranteed return is provided, such as in pension products, the assurer first determines what rates of return can be secured on the appropriate government bonds before offering a yield to investors.

	F07		F08	
	KShs'm	%	KShs'm	%
Cash	40.3	0.9	66.9	1.4
Short term deposits	891.7	20.1	811.2	16.9
<i>Cash & equivalents</i>	<i>932.0</i>	<i>21.0</i>	<i>878.1</i>	<i>18.3</i>
Mortgages	100.5	2.3	117.2	2.4
Other loans	297.6	6.7	77.2	1.6
Policy loans	304.0	6.9	131.6	2.8
<i>Total loans</i>	<i>702.1</i>	<i>15.9</i>	<i>326.0</i>	<i>6.8</i>
Quoted equity	837.2	18.9	837.1	17.5
Government securities	1,699.5	38.3	2,237.0	46.7
Commercial paper	41.1	0.9	147.7	3.1
Investment property	224.0	5.0	364.0	7.6
Total investments	4,435.9	100.0	4,789.9	100.0

The composition of Pan Africa's investment portfolio changed somewhat during F08. This was partly due to the aforementioned change in accounting treatment of investment withdrawals. As such, policyholder loans decreased substantially, as did loans to the holding company (recorded under other loans).

The largest asset class in F08 was government securities, as these provide the most secure and liquid

investment alternative over the medium to long term. Holdings of government securities increased by 32% in F08, to account for a greater 47% of the investment portfolio (F07: 38%). However, the importance of government securities within the portfolio in previous years was distorted by the loan accounts, which if excluded would have seen government securities comprise 44% of the investment portfolio in F07, compared to 49% in F08. While the value of commercial paper held more than tripled in F08, the class remains very small within the portfolio context.

Pan Africa also maintains a fairly sizable equities portfolio, accounting for 18% of the portfolio value in F08. Despite recording unrealised losses in excess of 30% of value on its equity portfolio during F08, additional purchases resulted in the value of equity holdings remaining stable. The portfolio is well diversified, comprising Kenya's leading listed entities, but remains subject to substantial systematic risk. Total liquid assets declined by 6% in F08, accounting for a lesser 18% of investments (F07: 21%). Given the long-term nature of its liabilities, Pan Africa has historically maintained a relatively low cash and equivalents weighting in its portfolio, of between 10% and 15%.

Pan Africa's property investments comprise several properties around Nairobi, managed by a specialist property management company. Over the past two years the assurer has been involved in a housing development on one of its tracts of land. Improvements to this land, as well as fair value gains on the property, were thus largely responsible for the 63% rise in property values in F08.

	F05	F06	F07	F08
Realised income	125.1	189.3	146.7	392.1
Unrealised gains/(losses)	107.0	235.0	218.7	(163.2)
Total income	232.1	424.3	365.4	228.9
Realised yield (%)	8.0	6.7	3.8	8.5
Total yield (%)	14.9	15.0	9.5	5.0

Between F05 and F07, Pan Africa's investment yield declined substantially, despite the rates on interest bearing securities increasing. The weakening investment yield could partly be attributed to rising equity values within the portfolio, which resulted in a high base off which to calculate returns. The yield was also impacted by lower interest charged on some of the policyholder loans. While the poor yield in F07 was largely the result of a KShs63m realised loss on the sale of investments, F08 investment income was bolstered by a KShs73m realised profit. Excluding these amounts the yield from recurring income would have been 5.6% and 6.7% in F07 and F08 respectively. Unrealised losses on the equity portfolio saw total yields almost halve in F08.

Financial performance

A five year summary of Pan Africa's financial performance is appended to the end of this report and brief comment follows.

Pan Africa has reported robust growth over the review period, more than doubling GPI. While GPI rose by 21% to KShs2.5bn in F08, lower premium ceded resulted in NPI increasing by a stronger 26%. A slightly higher 60% of GPI related to renewal business (F07: 57%), with new business GPI amounting to KShs1bn (F07: KShs888m). Combined with the much higher investment income, total income climbed 35% to KShs2.8bn.

However, total outgo rose by a greater 51% to KShs2bn in F08. The increase is attributed to substantially higher claims paid and surrenders, which amounted to a combined KShs1.1bn in F08, compared to KShs447m in F07. Expenses were well controlled, rising by a modest 8% in F08. Tight expense management has resulted in a consistent decline in the ratio of management expenses to NPI over the review period to 20% in F08, from 32% in F05. Commissions paid remained unchanged at KShs386m in F08, translating into a lower commission ratio of 17% (F07: 21%).

Overall, Pan Africa reported a KShs755m operating surplus in F08 (F07: KShs712m). Notwithstanding, the ratio of total outgo to total income increased to 73% (F07: 65%). After accounting for a large unrealised loss on investments (compared to a profit in F07) and further increases in policyholder liabilities, profit attributable to shareholders amounted to KShs135m (F07: KShs122m).

Future prospects

Pan Africa is forecasting GPI growth of 21% per annum over the next three years. This would see GPI double from the current KShs2.5bn to KShs5bn in 2012. Similarly, total income is forecast to double from KShs2.6bn (including the unrealised loss) in F08, to KShs5.5bn in F12. Budgeted growth in outgo largely reflects that of income. Policyholder benefits will continue to increase in accordance with rising premiums, as will policyholder liabilities. However, continued emphasis on cost containment is expected to see the management expense to NPI ratio decline to 13% by F12, from 20% in F08. Accordingly, total outgo is expected to rise by around 19% per annum, slightly less than for income, translating into greater profits attributable to shareholders.

Table 9: Income statement (KShs'm)	YTD 3Q F09	Budget F09	YTD % of budget	Budget growth F09
Gross premiums	2,294.9	3,038.0	75.5	21.0
Net premiums	2,114.6	2,750.4	76.9	18.6
Inv. & other inc.	260.5	368.8	70.6	55.6
Total income	2,375.1	3,119.2	76.1	22.1
Benefits	(720.4)	(947.4)	76.0	(11.4)
Mgmt & other exp	(326.5)	(394.3)	82.8	(8.2)
Commission	(341.1)	(546.4)	62.4	41.8
Tax	(11.2)	(34.1)	32.7	(57.2)
Total outgo	(1,399.2)	(1,922.2)	72.8	(2.1)
Excess income : outgo	975.8	1,196.9	81.5	102.5
Policyholder liabilities	(949.8)	(1,117.4)	85.0	144.7
Profit to shareholders	26.0	79.5	32.7	(40.9)
Key ratios (%)				
Mgmt exp / NPI	15.4	14.3		
Comm / NPI	16.1	19.9		
Benefits / outgo	51.5	49.3		

Pan Africa's results for the 9-months to 30 September 2009 were in line with management's forecast for 21% growth in GPI and total income. Similarly total outgo was largely in line with expectations, despite outgo having been budgeted to decline for the year. The only measure to exceed budget somewhat at the year-to-date was management expenses, although the management expense ratio of 15% was still well below the F08 level. However, while excess income over outgo is on track to double to KShs1.2bn in F09, profit attributable to shareholders is likely to decrease as a result of a much higher increase in policyholder liabilities.

Reflecting the strong growth in premium, the life fund rose by KShs1bn to KShs5.1bn as at 3Q F09. As investments rose by a lesser KShs581m, net surplus assets declined to KShs297m (F08: KShs744m).

Pan Africa expects the operating environment to remain robust in the near term. Management indicated that the group life sector remained fairly robust through the economic downturn and that the large increase in surrenders evidenced in F08 were largely reversed during F09. While the weaker economic conditions had impacted the demand for risk products, particularly in the lower end of the market, there was still substantial appetite for savings products. Moreover, given the turmoil in the financial markets, investors were returning to more traditional savings products (as offered by life companies), which are perceived to carry lower risks. To ensure growth targets are met, Pan Africa has maintained its marketing spend through the market downturn and is looking to expand its agency force from 580 people to around 800. New opportunities to expand its bank assurance products are being explored, while a business development team has been tasked with developing life products for the lower end of the market.

Pan Africa Life Assurance Limited

(K'shs in Millions except as noted)

Year ended : 31 December	2005	2006	2007	2008
Income statement				
Gross premium income	1,168.6	1,396.9	2,070.4	2,510.0
Net earned premiums	1,031.4	1,248.2	1,833.7	2,318.1
Other income	17.1	3.5	65.4	52.2
Investment income and realised profits	125.1	189.3	146.7	392.1
Total income	1,173.6	1,441.0	2,045.8	2,762.4
Claims paid and outstanding	(277.1)	(286.5)	(379.8)	(644.5)
Surrenders	(54.3)	(89.2)	(66.7)	(424.2)
Interest payable on pension administration	(21.7)	(31.1)	(23.0)	(0.4)
Commissions	(195.9)	(198.6)	(386.4)	(385.5)
Management & other expenses	(326.0)	(348.0)	(440.4)	(473.4)
Tax	0.0	0.0	(38.0)	(79.6)
Total outgo	(875.0)	(953.4)	(1,334.4)	(2,007.7)
Excess income : outgo	298.6	487.7	711.5	754.8
Unrealised investment gains / (losses)	107.0	235.0	218.7	(163.2)
Net profit / (loss)	405.6	722.7	930.2	591.6
Profit / (loss) attributable to life fund	405.6	479.3	808.7	456.6
Profit / (loss) attributable to shareholders	(0.0)	243.3	121.5	134.9
Dividend declared	0.0	0.0	53.7	134.9
Balance Sheet				
Shareholders interest	230.3	474.9	504.2	581.1
Life fund	2,085.9	2,628.3	3,530.3	4,046.0
Other liabilities	456.6	448.5	646.3	486.6
Total reserves and capital	2,772.8	3,551.7	4,680.8	5,113.6
Fixed assets	49.8	62.1	59.5	64.8
Investments	2,041.9	2,888.6	3,503.9	3,911.8
Cash and equivalent	377.7	359.0	932.0	878.1
Other assets	303.4	242.1	185.4	258.9
Total assets	2,772.8	3,551.7	4,680.8	5,113.6
Operating Ratios				
Operating analysis				
Premium growth	%	n.a.	19.5	48.2
Total outgo / Total income	%	74.6	66.2	65.2
Benefits paid / Total outgo	%	40.4	42.7	35.2
Commissions / NPI	%	19.0	15.9	21.1
Management & other expenses / NPI	%	31.6	27.9	24.0
Solvency				
Shareholders funds/policyholder liabilities	%	11.0	18.1	14.3
Investment returns				
Investment yield (including unrealised movements)	%	14.9	15.0	9.5
Investment yield (excluding unrealised movements)	%	8.0	6.7	3.8
Growth rates				
Total assets	% n.a.		28.1	31.8
Life fund	% n.a.		26.0	34.3
Profitability				
ROaE	%	(0.0)	69.0	24.8
Dividend cover	X	(0.0)	10.8	6.7