

Apollo Insurance Company Limited

Kenya Insurance Analysis

June 2008

Security class	Rating scale	Currency	Rating	Rating watch	Expiry date
Financial strength	National	Kshs	A	Yes	06/2009

Financial data:

(US\$'m Comparative)

	31/12/06	31/12/07
Kshs/US\$ (ave.)	72.6	67.8
Kshs/US\$ (close)	69.9	64
Total assets	26.1	26.7
Total capital	10.5	11.4
Cash & equiv	1.3	0.8
GPI	2.8	2.4
NPBT	0.5	0.1
NPAT	(0.3)	(0.3)
Op. cash flow	n.a.	n.a.

Market share* 2.6%

Market cap n.a.

*Based on life business gross premiums for year ended December 2006

Fundamentals:

Apollo Insurance Company Limited ("Apollo") was established in 1977 as a family owned and managed insurer. Apollo is 75% owned by Kenmac Limited. In 2003, the general insurance businesses of Apollo and Pan Africa Insurance Co. merged to form a specialist general insurance company called APA Insurance Ltd ("APA"), with Apollo having a 60% shareholding in APA.

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Rating rationale

The rating is based on the following key factors:

- Apollo has been operating for over 3 decades, during which it has gained a significant amount of technical capacity. This, together with the strong management team was positively considered.
- The insurer maintains a strong balance sheet, with shareholders funds maintained above 80% of policyholder liabilities.
- The company's growth has been constrained by the low penetration and slow growth of the Kenya life insurance market. Accordingly, the company has not yet gained economies of scale. This has resulted in net profits being supported by unrealised investment gains in recent years.
- Notwithstanding operating losses over the review period, dividends cumulatively totalling Kshs57m have been declared.
- Cognisance was taken of the company's significant exposure to the volatile equity markets, with listed equities comprising 50% of the investment portfolio. In addition, significant concentration risk is noted.
- The assurer's reliance on a small base of group life books was noted. This concentration risk was evidenced during F07 where the loss of a single account resulted in a large decline in gross premiums.

Solvency and actuarial valuation

A transfer of Kshs136m from the life fund supported an increase in shareholders funds. The company paid dividends of Kshs23m in F07, which saw shareholders funds increase by 9% to Kshs731m. Apollo's actuarial valuation for the 2007 financial year reflected a decline in life fund investments (following decreased income and higher expenses). Following losses on the equity markets, the assurer reflected gross investment returns (as per the actuarial report) on life fund investments of 5.7% in F07 (F06: 7.7%). The increased business manifested in actuarial liabilities increasing by 14%, whilst the actuarial surplus decreased by Kshs204m to Kshs245m. This saw the actuarial surplus decrease to 41% of actuarial liabilities from a previous 86%. Apollo has a comprehensive reinsurance programme for group life, which while not having been altered since F01 limits the assurer's losses to less than 1% of capital.



Industry overview

Demand for life assurance in Kenya has remained relatively subdued. According to the Association of Kenyan Insurers the industry reflected a penetration rate of 0.76% in 2006 (2005: 0.78%) compared to the 1.78% penetration by the general insurance sector. Growth of the life sector has been constrained by high unemployment levels and low disposable income in the past. In addition, many of the high net worth individuals who can afford life assurance have tended to place the business offshore in hard currencies. Strong economic growth, with average per capita income increasing by 50% to US\$630 between 2002 and 2007, has driven substantial increases in employment levels in the formal and informal sectors, which bodes well for the life assurance industry.

Group life business has historically been subject to high rates pressure (priced to one year loss horizon, in some cases lengthened to two years), which continues to undermine the development of individual life policies where employed members are not prompted to buy outside the scheme. However, Kenyans are increasingly turning to direct equity investments as a means of wealth creation, as the excess returns on these securities have surpassed the smoothed interest declarations offered by life funds. This comes on the back of the Nairobi Stock Exchange's ("NSE") bull run, increasing by 320% between 2003 and 2007. Increased equity investment has been supported by several large IPO's since 2006, which have boosted the number of estimated private investors on the NSE from 100,000 to 800,000, and an expected 1.4 million following the Safaricom IPO. The long term insurance industry has also been hampered by a poor savings culture, with financial institutions encouraging consumptive expenditure financed by credit. This has been exacerbated by the perceived wealth gains achieved on the market encouraging further credit based consumption, rather than long term savings.

In terms of pension fund administration, insurers are experiencing a degree of competition from asset managers who tend to attract the larger accounts through more aggressive rates of return. In this regard, Old Mutual Asset Management has the largest mandate in the market, given the economies of scale benefits (which effectively enables them to be more competitive with their rates). This has been enhanced by the company's brand appeal and successful unit trust offering.

The financial services industry has seen management shake-outs as evidenced by the leading asset managers and life offices, with executive changes evidenced at Old Mutual, Britak, Pan Africa, CFC Life as well as Jubilee. This reflects a maturity in the industry given the fact that trustees are moving

towards a position where they want more of a say (thus moving towards the smaller funds). Linking of investment performance with individual effort and expertise residing with senior portfolio managers will most likely have an impact on where mandates are placed in the future.

High yielding government bonds have enabled the competitive bonus and interest declarations evidenced across the industry. With interest rates declining, doubt has been raised as to whether current yields can be maintained. Nevertheless, the requirement to finance post election violence relief as well as an enlarged government should underpin the government's activity in the debt markets. Aiding the fixed income investment process has been the introduction of the AIG bond index. Although not reflective of the whole market, the index has given fund managers a benchmark to measure performance. The index considers the most liquid bond per tenor over a 3 month period (representing prices/yields per tenor, including only bonds with an outstanding value of Kshs3bn or more) and includes 15 bonds. Given the volatility and highly illiquid nature of the market prior to 2008, the base date of the index is set at January 2008.

The most recent Alexander Forbes Pension Funds Performance Attribution Analysis for March 2008 reflects the following salient features:

- On both the weighted and average basis, large schemes (greater than Kshs500m) outperformed on a one year and 3 year basis. Weighted average returns amounted to 10.3% and 13.1% respectively for the 1 and 3 year horizons. Similarly, the highest returns in the category were 16.1% and 20%.
- The average asset allocation for all schemes reflected a concentration in fixed income (64%) followed by equity at 28.6%. Residual weightings were allocated to offshore investments (6.4%) and property (1%).
- However, on a relative class performance basis, property has outperformed all asset classes, at 12.4%, with equity reflecting performance of 10.1% (below fixed income of 10.8%). Due to the strengthening shilling and weak global markets, offshore investments delivered a loss of 9.5%.
- It was noted that the range of returns in respect of bonds was considered wide, with the highest at 22% whilst the lowest was recorded at 5.5% for the large scheme category.

The Kenyan pension fund market remains buoyant given the performance of asset portfolios in the recent past. Going forward, it is uncertain whether employers will retain surpluses or factor in pension contribution holidays. In respect of pensions taken up, the capitalised values have been large given the high proportion of retirees post independence and

higher income levels in the growing economy. Accordingly, insurers have been quoting on the forced 2/3^{rds} annuity portion.

Operations

Apollo transacts in life assurance business in Kenya, offering individual and group life assurance as well as deposit administration. Given the industry's low penetration rate (especially at an individual level), the bulk of Apollo's business pertains to group life insurance, which accounted for 76% of total gross premiums in F07 (F06: 82%). Going forward, the pension mandates owned by Apollo (which are increasingly subject to a higher level of retirees) are considered to have a higher rate of conversion, with quotations based on age, interest rates and escalation rates fused across nine product categories (four single and five joint survivorship).

Under individual life business, Apollo provides with-profit endowment policies. A reversionary bonus is allocated with respect to premiums paid on these policies. In this regard, a reversionary bonus of 4% of sums insured was issued in F07 (F06: 4.8%). The unit linked portion of the individual life products is currently managed by Old Mutual Asset Managers who have the largest mandate in the market.

The deposit administration arm of the business manages both group and individual pension policies. Apollo's deposit administration has provided an average net investment return of 10.3% over the past 7 years (compared to the peer average of 9.4%). The company allocated interest of 11% on the deposit administration business in F07, from a previous 12.5%.

	Gross premiums		Net premiums	
	F06	F07	F06	F07
Individual life	36.5	38.5	36.5	38.6
Group life	168.6	123.0	41.7	32.1
Total premiums	205.1	161.5	78.2	70.7
Pension fund contributions	68.0	83.1	n.a.	n.a.

The Kenyan group life assurance industry has evidenced significant rates pressure, which has seen some market players lose large contracts. Given the large concentration of the book, with the top 10 clients accounting for 80% of premiums in F07 (F06: 87%), the loss of a group life contract was primarily responsible for a 27% decline in group life business premiums to Kshs123m. The role of reinsurance, with the assurer retaining only 26% of group life premiums in F07 (F06: 57%) must be considered, as the reinsurer's asking price for writing the business is based on an original terms basis as opposed to a risk premium basis.

Given the low volumes that individual life cover attracts, individual life is considered expensive to run per policy (marketing and distribution costs are high). In this regard, the management expenses to NPI ratio reflected by individual life remained very high at 64% in F07, albeit lower than F06's 74%. Following the lower group life premiums and notwithstanding 9% lower management expenses of Kshs10m, group life management expenses were recorded at 31% in F07 (F06: 12%).

Benefits paid	F06		F07	
	Kshs'm	%	Kshs'm	%
Individual life	20.4	22.0	52.1	46.0
Life claims	1.6	1.8	1.7	1.5
Surrenders	1.3	1.4	1.1	1.0
Maturities and part maturities	13.7	14.6	25.9	22.8
Personal accident	0.0	0.0	0.1	0.1
Change in provisions	3.8	4.1	23.3	20.6
Group life	38.5	41.1	22.1	19.5
Life claims	25.6	27.4	32.3	28.5
Change in provisions	12.9	13.8	(10.2)	(9.0)
Deposit administration	34.5	36.9	39.0	34.4
Interest payable				
Total benefits	93.4	100.0	113.3	100.0

An actuarial adjustment that decreased policyholder liabilities by Kshs10m was partially responsible for the 42% reduction in group life benefits payable of Kshs22m compared to F06. The assurer's individual life business recorded an overall increase in benefits to 64% of total outgo in F07 (F06: 39%). This was largely on the back of the increase in maturity benefits paid out as tabulated. Non-risk benefits increased by 13% to Kshs39m in F07. Accordingly, overall benefits were recorded at a 21% higher Kshs113m for the year.

Actuarial valuation and solvency

	F06	F07
Life fund investments	970.0	840.4
Actuarial liabilities	(521.2)	(595.9)
Actuarial surplus	448.8	244.6
Recommended Allocation		
With-profit policyholders	10.7	8.5
Deposit administration interest	36.7	39.5
Shareholders	89.8	73.4
Surplus carried forward	311.7	123.2
Life fund per actuarial valuation	970.0	840.4
Less transfer to shareholders	(89.8)	(73.4)
Life fund per AFS	880.2	767.1

Apollo's actuarial valuation for the year ending December 2007 reveals that the company's actuarial surplus reduced to Kshs245m during the year (F06: Kshs449m). The reduction came on the back of a reduction in overall income (both net premiums and

investment income), while net benefits paid grew at a higher than historical rate. In this regard, investment returns (as per the actuarial report) on life fund assets were reflected at 5.7% in F07 from a previous 7.7%, continuing the declining trend that has been evidenced over the past 3 years.

Following retained earnings and a Kshs73m transfer from the life fund, Apollo's shareholders interest increased to Kshs754m. A Kshs23m dividend in F07 saw shareholders interests amount to Kshs731m for the year (F06: Kshs672m). Given the 9% rise in shareholders interests and the aforementioned decline in the life fund, the ratio of shareholders interests to the life fund was recorded at a review period high of 95%.

As of June 2010 the minimum capital requirement for a Kenyan life assurer will be increased to Kshs150m. With share capital of Kshs150m, the assurer already adheres to the law and has capacity to write up to Kshs1.5bn in premiums (based on the regulators requirement of assurers writing a maximum of 10x share capital).

Reinsurance

With the exception of the Group Life Savings and Credit Cooperative book ("SACCO"), which is led by East Africa Re, Apollo's reinsurance lead is Kenya Re. The company also utilises cover from African Re on its reinsurance programme.

Reinsurance programme F07	Quota share		Surplus	
	Retention	Capacity (Kshs'm)	Sharing ratio	Limit (Kshs'm)
Individual life	50%	1.0	--	--
Group - SACCO	25%	0.1	--	--
Group life	50%	0.4	1:14	6.0

The company has made no adjustments to its reinsurance programme in six years. Individual life cover is based on risk premium in F02 and has a capacity of Kshs1m. Group cover, with premium based on original terms, is reinsured through the use of Quota Share treaties for both Group SACCO and group life. In addition to the quota share, group life reinsurance is extended by a surplus treaty, which is utilised up to a maximum of Kshs6m. The insurer has in place facultative reinsurance for claims in excess of Kshs6m, which is negotiated with Kenya Re. Given that group life cover is usually linked to salaries, this has seen some volatility in retention levels as well as actuarial liability provisioning over the review period, although the increasing risks are covered by the aforementioned facultative reinsurance, which limits exposure to 7% of capital.

Asset management

Apollo's total investments declined by 9% to Kshs1.5bn in F07. Changes to the asset mix include lower government securities of Kshs171m (F06:

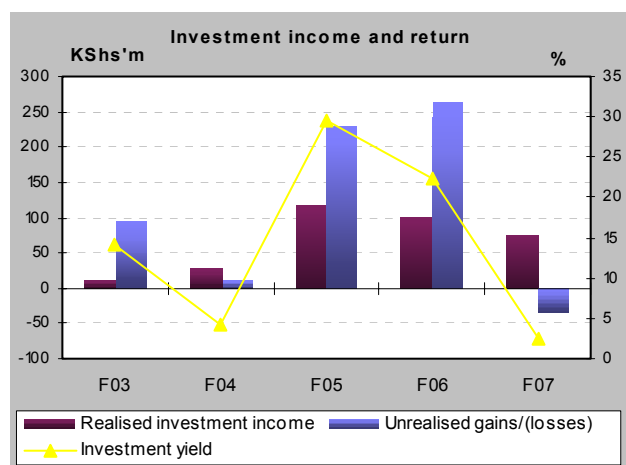
Kshs240m) and cash holdings, which fell to Kshs54m (F06: Kshs90m). During F07 Apollo purchased 59% of unlisted Gordon Court Limited for a consideration of Kshs78m (with the Group's effective shareholding amounting to 83%), which saw investments in subsidiaries rise to 16% of total investments. Gordon Court is a property development company. Investment properties were revalued at a higher Kshs231m in F07, which together with the Gordon Court investment increases the assurer's property exposure to 21% of the asset base (F06: 15%).

Investments	F06		F07	
	Kshs'm	%	Kshs'm	%
Cash	49.0	2.9	28.7	1.9
Short term deposits	44.9	2.7	39.5	2.6
Overdraft	(3.9)	(0.2)	(14.1)	(0.9)
Cash & equivalents	90.0	5.4	54.1	3.6
Quoted equity	884.8	53.1	756.9	49.7
Unquoted equity	36.1	2.2	36.1	2.4
Government securities	239.8	14.4	170.9	11.2
Commercial paper	24.8	1.5	10.1	0.7
Investment property	207.4	12.4	230.6	15.2
Investments in subsidiaries	168.9	10.1	246.8	16.2
Loans	16.0	1.0	16.2	1.1
Other investments	1,577.8	94.6	1,467.6	96.4
Total investments	1,667.9	100.0	1,521.7	100.0

The company's equity investment portfolio (Kshs757m), representing the majority of the portfolio at 50% and 44% of its asset base in F07 (F06: 48%), reflects high concentrations. Five equity stocks namely EA Breweries, Kenya Airways, Kenya Commercial Bank, CMC Holdings and Mumias Sugar collectively accounted for 74% of the equity portfolio. The company advises that EA Breweries is a core holding, Kenya Airways will be sold down over the recovery phase of earnings to value, whilst CMC is considered a growth shareholding. The downturn of the Nairobi Stock Exchange at the end of 2007 saw the assurer recording Kshs59m in unrealised losses on quoted equities (F06: Kshs239 gain). Apollo disposed of a lower Kshs12m in shares in F07 (F06: Kshs54m), which together with the significant unrealised losses for the year, were responsible for the lower investment yield of 2% from a previous 22%. The company's exposure to equities was made note of in its actuarial report, with mention of the fact that including unrealised gains and losses, the rate of return on the life fund's assets would amount to 0.2% for F07 compared to 41% in F06.

Government securities reflected a 29% decrease to Kshs171m in F07, as the bulk of its short dated treasury bills matured and were not reinvested. The average effective interest rate gained on these remained at 8%. The bulk of the remaining government securities (44%) have maturities in

excess of 5 years, with yields ranging between 8.5% and 13.5%.



Financial performance

A financial synopsis of Apollo's financial performance over the review period is attached at the end of this report and brief comment follows hereafter.

	Actual	Budget	Variance (%)
Gross premiums	161.5	338.5	(52.3)
Net premiums	70.7	103.9	(32.0)
Realised investment income	47.0	79.2	(40.7)
Total income	117.6	183.0	(35.7)
Benefits	(113.3)	(85.5)	32.5
Management expenses	(36.2)	(58.1)	(37.7)
Net commission	3.1	(10.9)	(128.2)
Total expenses	(146.4)	(154.5)	(5.3)
Excess income: outgo	(28.8)	28.5	(201.1)
Unrealised investment income	(34.1)	98.2	(134.8)

* Excludes non-underwriting and shareholders items.

Notwithstanding the higher number of contracts and policies, the loss of a large contract was responsible for gross premiums decreasing by 21% to Kshs162m in F07. The assurer's performance in F07 was well below budget, with both individual life and group life premium budgets not being met (shortfall of 53% in individual life and 52% in group life).

Despite a Kshs10m reversal in group life policyholder liabilities, claims paid and outstanding evidenced a 27% increase to Kshs73m. The growth was largely driven by the higher life and death claims increasing to Kshs34m (F06: Kshs27m). Together with surrenders and interest paid on deposit administration contracts of Kshs39m (F06: Kshs35m), total benefits paid amounted to a higher 65% of total outgo. Following a spike in growth in F06 to Kshs66m, management expenses receded to Kshs39m in F07, whilst tax paid amounted to Kshs26m (F06: Kshs51m). The lower ancillary expenses aided overall expenses, decreasing to Kshs175m (F06: Kshs202m), thus reducing the

budget shortfall significantly. Notwithstanding this, expenses were above income for a second consecutive year, with the outgo to income ratio increasing to 112% (F06: 110%). It is noted that the outgo to income ratio has only been below 100% once in the review period (in F05).

Following the slower investment markets the insurer recorded net unrealised investment losses of Kshs35m (F06: Kshs262m gains). Coupled with the net operating loss in F07, this saw a reduction in retained earnings. This was, however, supported by a transfer from the life fund of Kshs136m. As such, shareholders earnings for the year were recorded at Kshs82m in F07 (F06: Kshs161m). Accordingly, the return on average equity was reflected at a lower 12% for the year (F06: 27%).

Future prospects

The company has tabled a budget that envisages premium growth of 40% for F08, with a significant portion of the growth coming from individual life business. Gross premiums of Kshs227m will comprise individual life of Kshs85m and group life premiums of Kshs142m. This is set to be driven by the increasing focus on the agency force (with the company requiring each agent to have a minimum of a Certificate of Proficiency), who will be expected to increase client contact and activity. In view of the historical growth trend and lead time to market (with regard to the agency force), this budget is considered aggressive.

budget	1Q F08		F08
	Actual	Budget	Budget
Gross premiums	36.4	28.7	226.6
Net premiums	21.0	10.7	106.8
Realised investment income	5.5	15.0	60.0
Total income	62.8	54.4	393.4
Benefits	(17.5)	(19.2)	(76.8)
Management expenses	(6.7)	(15.5)	(51.0)
Net commission	2.8	3.6	24.0
Total expenses	(21.4)	(31.1)	(103.9)
Excess income: outgo	41.3	23.3	289.5
Unrealised investment income	(59.2)	14.4	56.3

GCR has considered the following factors:

- Apollo's urgent requirement to recruit a qualified head of the individual life business to drive the budgeted production as well as focus on building the competency of the agency force.
- The effect on post election violence as insurance companies would rather hold off the spend given the likely low policy take up rates.
- Delays in policy premium collections (bank dishonouring), with recursory action by the life office to protect policy persistency rates.

Apollo Insurance Company Limited

(K'shs in Millions except as noted)

Year ended : 31 December

	2003	2004	2005	2006	2007	
LIFE ASSURANCE						
Income statement						
Gross earned premiums	50.3	51.0	167.9	205.1	161.5	
Net earned premiums	39.4	39.2	64.3	78.2	70.7	
Other income	1.1	7.1	0.0	5.0	9.1	
Investment income and realised profits	10.8	27.1	118.1	101.3	77.3	
Total income	51.2	73.4	182.4	184.6	157.1	
Claims paid and outstanding	(21.1)	(22.3)	(69.8)	(57.6)	(73.1)	
Surrenders	(1.9)	(1.0)	(1.1)	(1.3)	(1.1)	
Interest payable on pension administration	(18.0)	(32.9)	(29.9)	(34.5)	(39.0)	
Commissions	(1.0)	(6.4)	3.5	7.7	3.1	
Management & other expenses	(20.8)	(27.4)	(33.1)	(65.9)	(39.3)	
Tax	0.0	0.6	(0.4)	(50.5)	(25.8)	
Total outgo	(62.8)	(89.4)	(130.8)	(202.2)	(175.3)	
Excess income : outgo	(11.6)	(16.0)	51.5	(17.6)	(18.2)	
Non-underwriting income / (expenses)	0.0	(1.7)	(1.7)	(1.0)	(0.8)	
Unrealised investment gains / (losses)	96.4	11.3	228.4	262.2	(35.3)	
Transfer (to) / from life fund	(74.8)	41.7	(126.1)	(82.8)	136.3	
Shareholders earnings	10.0	35.2	152.1	160.8	82.0	
Dividends paid	(4.5)	(6.0)	(9.0)	(15.0)	(22.5)	
Balance Sheet						
Shareholders interest	353.7	382.9	526.0	671.8	731.3	
Life fund	414.0	420.8	655.5	828.0	767.1	
Other liabilities	100.6	114.3	256.3	327.1	211.9	
Total reserves and capital	868.2	918.0	1,437.8	1,827.0	1,710.2	
Fixed assets	2.6	3.7	3.2	2.9	3.4	
Investments	719.9	784.5	1,195.3	1,577.8	1,467.6	
Cash and equivalent*	38.9	83.0	65.7	90.0	54.1	
Other assets	106.8	46.9	173.7	156.2	185.1	
Total assets	868.2	918.0	1,437.8	1,827.0	1,710.2	
Operating Ratios						
Operating analysis						
Premium growth	%	(33.1)	1.5	229.2	22.2	(21.3)
Total outgo / Total income	%	122.7	121.8	71.7	109.5	111.6
Benefits paid / Total outgo	%	65.4	62.8	77.1	46.2	64.6
Commissions / NPI	%	2.4	16.5	(5.5)	(9.8)	(4.4)
Management & other expenses / NPI	%	52.7	69.9	51.5	84.3	55.6
Solvency						
Shareholders funds/policyholder liabilities	%	85.4	91.0	80.2	81.1	95.3
Investment returns						
Gross investment returns (total) / Average assets	%	14.1	4.3	29.4	22.3	2.4
Net investment returns (total) / Average assets	%	11.3	0.6	26.9	15.6	(1.1)
Growth rates						
Total assets	%	n.a.	5.7	56.6	27.1	(6.4)
Life fund	%	73.2	1.7	55.8	26.3	(7.4)
Profitability						
ROaE	%	3.3	9.6	33.5	26.8	11.7
Dividend cover	X	2.2	5.9	16.9	10.7	3.6