



Botswana Insurance Holdings Limited

FROM STRENGTH TO STRENGTH

Key points

Botswana Insurance Holdings Limited (BIHL), the financial services group and market leader in the Botswana life insurance industry is following a diversification strategy coupled with an operational efficiency plan of action to achieve earnings growth as a response to an uncertain economic environment paired with a heightened competitive life insurance arena. We believe BIHL's new operations are well positioned to take advantage of the group's established structures and strong brand image which we believe will lead to the company gaining market share.

- **Robust core business:** BIHL's core business operations in the life insurance segment, Botswana Life Insurance Limited (BLIL) remain strong with widespread broker and bancassurance relationships and country wide coverage. The insurance arm is a clear market leader with an above 80% market share. We believe maintenance of leadership position in various segments should lead to stable earnings. However, the division faces stiff competition primarily from South African multinationals competing on pricing and product offering.
- **Investment in IT is system to start bearing fruit:** Consumer-oriented IT system launched in 2011 expected to further stabilize lapse/persistency rates effectively improving turnaround times and further cementing relationships with clients.
- **Solid foundation for new operations:** BIHL has a first mover advantage as a result of over three decades of building lasting relationships and fulfilling Botswana specific financial needs. New operations (Short term insurance under the B Sure banner and unit trust under BIFM) are well positioned to use existing platforms to gain market share.
- **Regulatory environment providing growth impetus:** Botswana civil servants are taking advantage of the recently set early retirement age (45 years old). This is a plus for BLIL, as regulation has it that two thirds of retiring Botswana government officer's pensions to be invested in annuities.
- **Soaring Equity markets:** Q1 of 2013, the Botswana domestic equity index, DCI and MSCI Frontier Markets Africa Index have risen 11.84% and 6.87% respectively. Provided that equity markets continue trending in this trajectory one can foresee considerable improvements in earnings from BIFM.
- **Fair valuation:** We derive an intrinsic DDM valuation of P11.51 as we anticipate the group to return excess capital to shareholders. The stock is relatively cheap on the basis of its P/E ratio and P/BV in comparison to its peers. The counter is on a trailing and forward P/E ratio of 7.48X and 7.29X respectively. Our DDM valuation of P11.51 presents an upside potential of 9.62% to the current trading price. **HOLD**

Stockbrokers Botswana Ltd.

HOLD

18, June 2013

Value Estimate	P11.51
Current Market Price	P10.50
Discount to fair value	9.62%

Trading & Liquidity

Mkt cap (Pm)	2,937
Mkt cap (US\$m)	358
DCI Mst weight	7.6%
Shares in issue (m)	281
Free float	47%
Annual Liquidity	1.94%
12 month high	1050
12 month low	1020

Codes

BSE	BIHL
Reuters	BIHL.BT
Bloomberg	BIHL.BG
ISIN No	BW 0033

Results

Date of last report	1-Jun-11 1134t HOLD
Last result	Finals-Dec 2012 Interims- Jun 2013
Expected results	2013

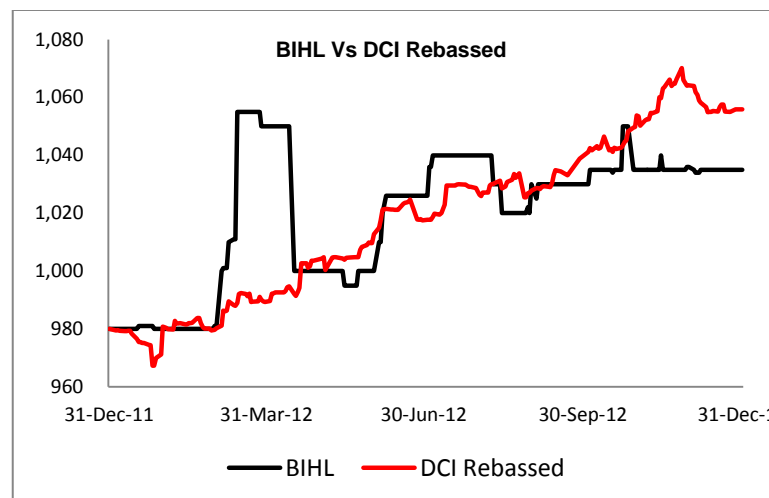
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Year ended 31-Dec (P)	2011	2012	2013F
Total premium income (m)	1,782,053	1,970,413	2,152,331
Premium income growth	10.0%	10.6%	9.2%
Earnings per share	1.68	1.40	1.44
P/E ratio (x)	5.82	7.48	7.29
Dividend per share	0.66	0.35	0.43
Dividend yield	6.8%	3.3%	4.1%
Net Asset Value	5.91	6.92	7.93
Return on equity	27.88%	20.28%	18.12%
Embedded Value per share	9.07	9.61	11.17





Group Overview

Botswana Insurance Holdings Limited (BIHL), which was formed 38 years ago is one of the largest financial institutions in Botswana. JSE listed Sanlam Limited is the majority shareholder in the BIHL group with a 53% shareholding while 47% of its equity is publicly held on the Botswana Stock Exchange.

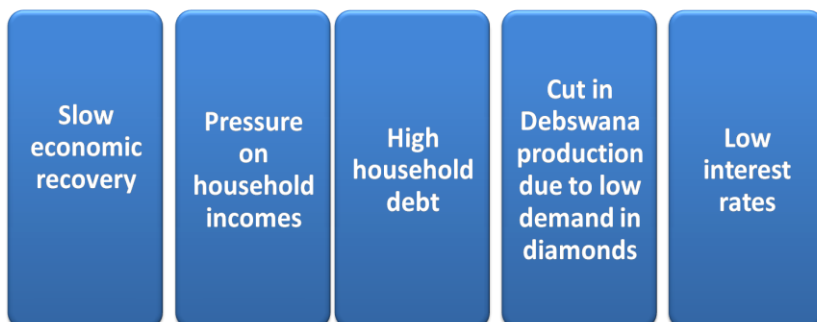
BIHL manages institutional and private investments, distributes and underwrites all classes of long-term insurance and administers life and pension funds together with deposit administration schemes. Traditionally BIHL focused on life insurance and asset management through its subsidiaries Botswana Life Insurance Limited (BLIL) and Botswana Insurance Fund Management (BIFM), Today the group has grown into a more diversified financial services provider; recently launching its short-term insurance business in 2012 under the banner B Sure! and its unit trust business to BIFM's product offering in 2013. The life insurance and asset management companies hold leading positions in their respective market sectors with Botswana Life being the largest and oldest insurance company in Botswana. The group's total assets are valued at P15.4billion.

BIHL recently had a face lift to the group structure by executing two transactions. **Transaction one:** BIFM Capital, of which the group subsidiary Botswana Insurance Fund Management Ltd previously held 51% ownership while Capital Management Africa (CMA) Ltd held 49% sold 100% of one of its subsidiaries, Bifm Capital Fund 1 (BCIF1) to Botswana Life Insurance limited. This was to enable BLIL to directly control BCIF1 and allow it to bring the assets currently held by BCIF1 into the Botswana Life Annuity Fund (BLAF). **Transaction two:** BIFM's 51% stake in BIFM Capital was sold to CMA. However, BIFM Capital management, Rhys Carr and Tim Marsland will still be responsible for managing the fund.

BIHL has grown into a more diversified financial services provider

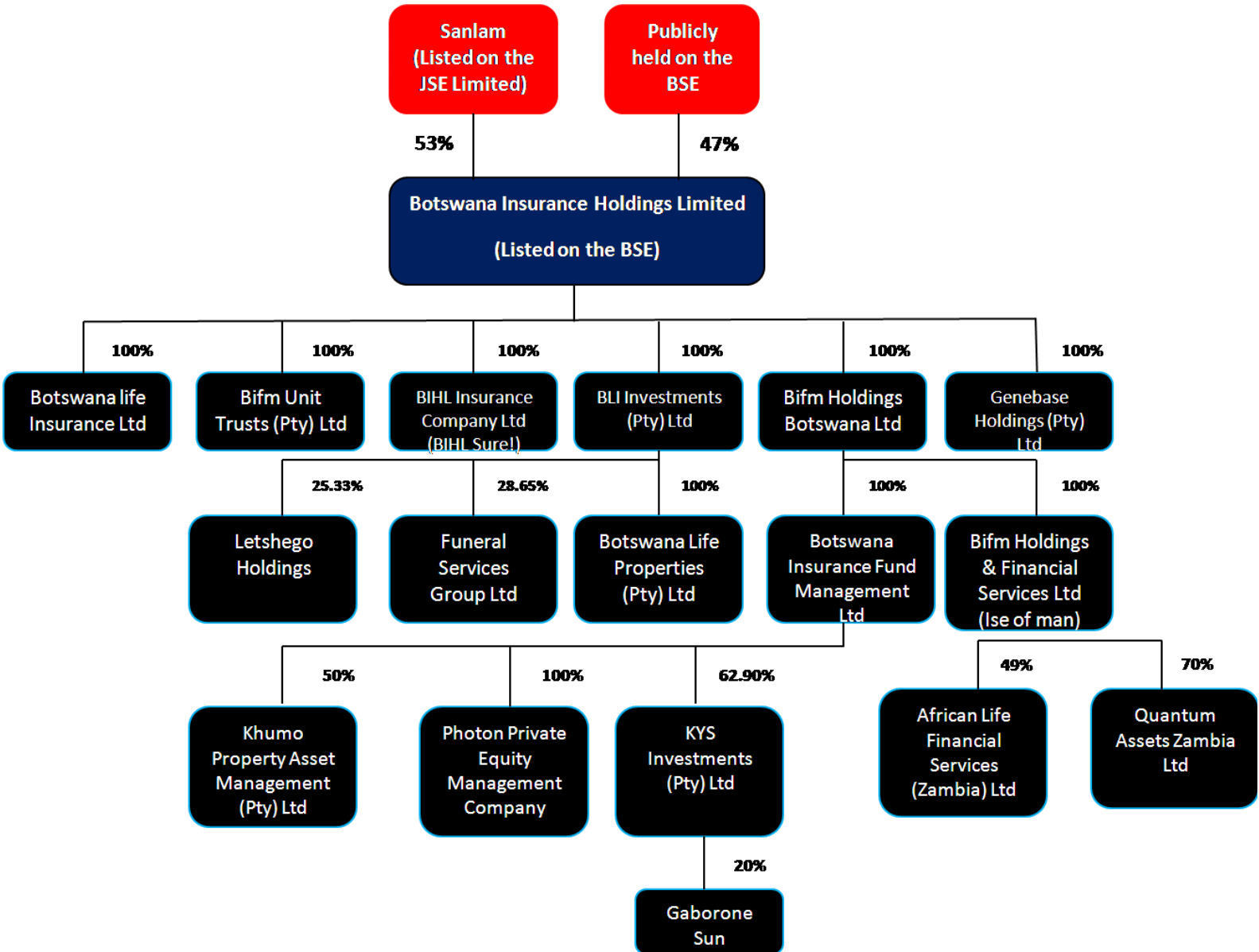
BLIL and BIFM hold leading positions in respective industries

FY2012 Economic Environment





Group Structure





FY2012 Operational Overview

Botswana Life Insurance Limited (BLIL)

The life insurance arm continues its strong contribution to the overall Group, clinching a 63% lion's share of BIHL revenues. On an annualized basis, BLIL recorded a net premium growth of 9.4% to P1.9billion. This was on the back of a 23% increase in the annuity portfolio, particularly on the individual life (retail) side which increased by 26% versus a 6% increase on the group and employee benefit (corporate) side. The growth in the annuity portfolio is a consequence of a high retirement rate during 2012 as it appears that Batswana civil servants seem to be taking advantage of the early retirement age (45 years old) recently set by the government. On a segmental view, corporate premiums grew a mere 3.6% while market share dropped to 35% (FY2011: 65%) due to competitive pricing by competitors, whereas retail premiums grew 11% and the segment maintained its above 80% share of the market. Glancing forward, management looks to further focus on growing the retail segment, mainly through the recently established bancassurance channels. Over the period, bancassurance relationships (bullet list below) contributed positively recording a 6% growth on the corresponding period last year.

- BancABC (retail Bank)
- Standard Chartered
- Letshego (microlender)

Contrary to its 5year growth trajectory, outlay of claims and benefits took a 1.4% dip from the previous year as a result of concrete risk management functions. This was coupled with a drop in loss-ratio from 52.51% to 46.93%, below the 2011 industry average of 49%. On the whole, the insurance arm improved its underwriting quality (refer to table.1), as a response to management's deliberate "quality over-quantity" strategy.

Focus on growing retail segment through bancassurance channels

Quality over quantity

Table 1.

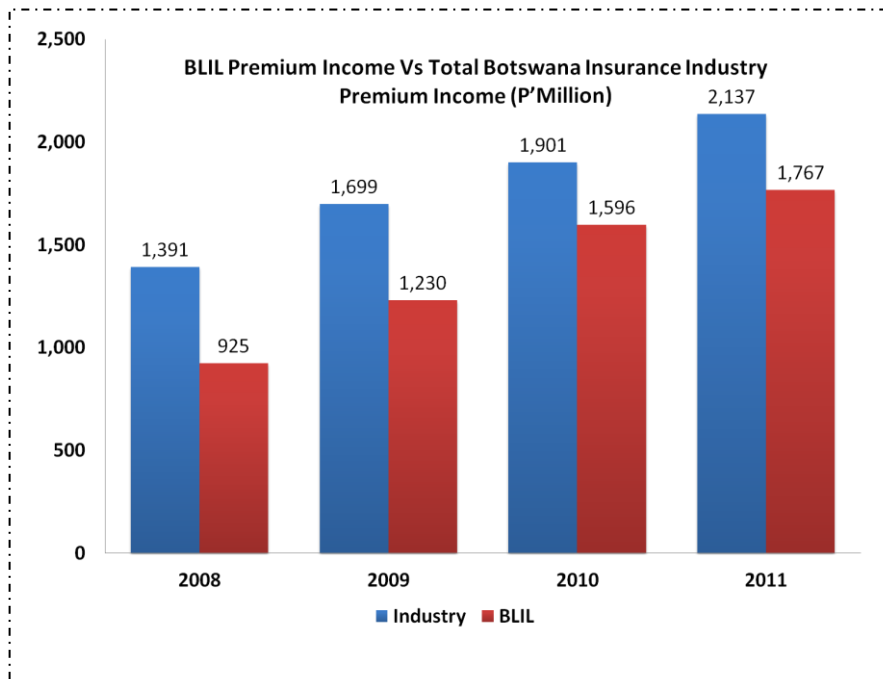
UNDERWRITING RATIOS	2008	2009	2010	2011	2012
Loss Ratio (gross insurance benefits & claims/Premiums Earned)	46.50%	42.51%	46.13%	52.51%	46.93%
Expense Ratio (Underwriting Expenses/ Net Premium Written)	35.92%	36.40%	33.50%	26.33%	26.09%
Reinsurance Ratio (Reinsuarance premium paid/ Premium Earned)	3.68%	1.89%	1.51%	0.85%	1.07%
Combined Ratio	82.42%	78.92%	79.63%	78.84%	73.02%

Source: BIHL financials

With the back-drop of an increasingly competitive arena and a challenging economic environment, BLIL's signature has been to outperform the industry. Although life insurance policies have been on a declining growth trend over the past 5 years, BLIL still maintains superior premium income growth than the industry. This is confirmed by a 91% growth in premium income over the period 2008-2011 compared to a 53% average growth in premium income of the Botswana insurance industry (refer to Figure.1).



Figure 1



Source: NBFIRA & BIHL financials

To further improve client services, operational efficiencies and turnaround times BLIL launched a life insurance system in October 2011, which experienced initial teething problems but its benefits gradually became apparent over FY2012, as lapse/persistency rates stabilized y-o-y. Management expects the full benefits of the new system to become more elaborate as the years progress.

Operating profits declined 3% during the FY to P239.5million, which is a reflection of the difficult trading environment. Management attributes this decline to the slow economic recovery in Botswana. The unfavorable trading conditions were further exacerbated by an increasingly competitive landscape whereby competitors who are mainly South African multinationals compete on pricing and product offering, particularly on the corporate side, allowing consumers to shop around for more cost-effective policies. Nonetheless, going forward management is looking to focus more on the retail business, through strengthening the bancassurance channels to improve business volumes.

New system to become more elaborate going forward

Competition from South African multinationals



Botswana Insurance Fund Management

BIFM too had a difficult year, merely contributing 17% (FY2011: 31%) to total group revenues, although assets under management (AUM) increased by 21% to P21.6billion on the back of effective client retention. Fee and investment income decreased by 33% to P74.7million and 40% to P442.6million respectively as a result of the sale of the 21% stake in the Zambia business and the slow recovery of global and domestic equity markets. As a result of the sale, operating profits of the asset management arm declined by 21% to P36.5million.

During FY2012 BIFM went through a restructuring process as well as implementing a new operating system in order to improve client service and realize operational efficiencies which should further strengthen the retaining of clients going forward. Outside of that, the investment arm launched Botswana's first property index, the BIFM-IPD property index building on the successful development of Airport Junction and Rail Park malls.

After establishing BIFM unit trust in 2011, the group launched its unit trust business in Q1 of 2013. BIHL being the oldest and largest financial services company in Botswana, with over three decades of building lasting relationships and looking after funds for institutional and retail client's, is well positioned to use existing platforms to gain market share. Looking forward, the division is looking to launch a private-equity fund as well as reviewing their property portfolio in preparation for a major investment towards the end of 2013

Overall, BIFM's business base remains solid with good growth opportunities locally, particularly for the unit trust business. Q1 of 2013 the Botswana equity market and the MSCI Frontier Markets Africa Index has risen 11.84% and 6.87% respectively. Provided that equity markets continue trending in this direction we can foresee considerable improvement in earnings from BIFM operations.

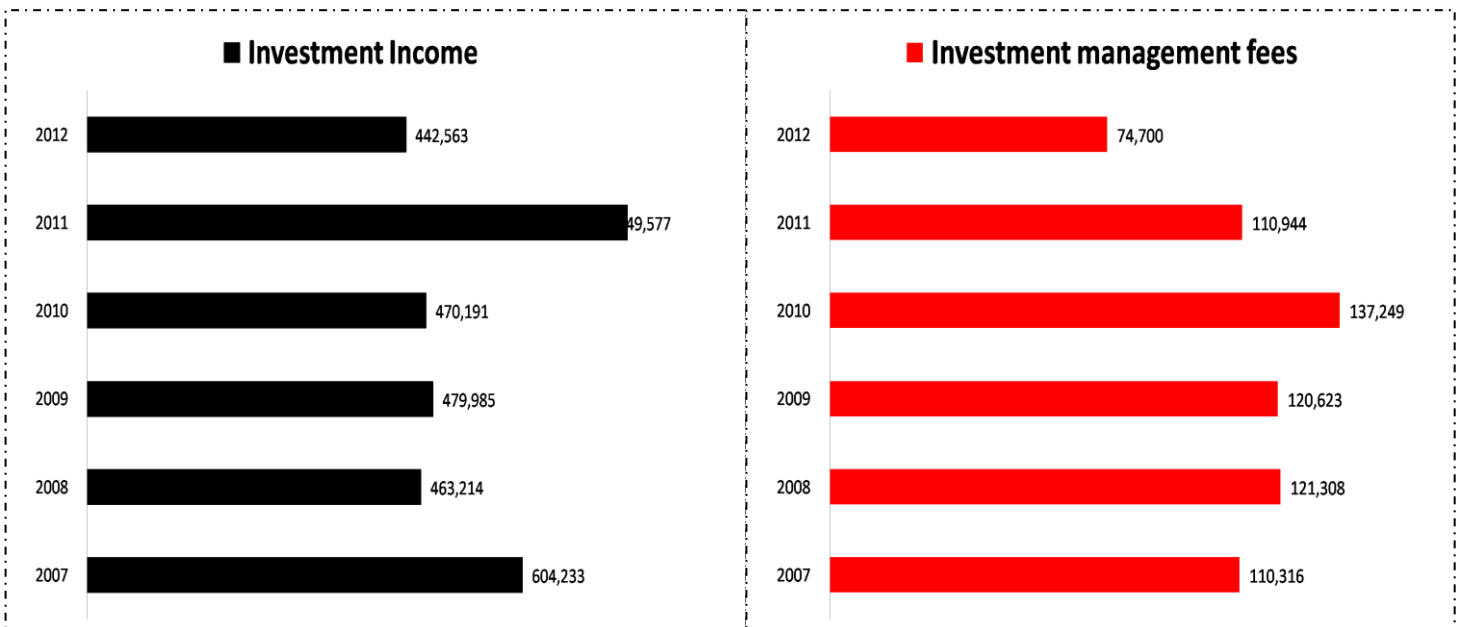
Lost business from sale 21% sale of stake in Zambian operations

Looking to launch private-equity fund

Rising equity markets

Figure 2

Figure 3



Source: BIHL Financials

Source: BIHL Financials



Associate and Joint ventures

Share of profits of associates and joint ventures increased by 47% to P196.5million on the back of increased stake in Letshego (9% increase) in 2011, paired with good underlying performance of the companies. As at 31 December 2012 investment in associates and Joint ventures stood as follows:

- Letshego-----25.33%
- Funeral Services Group (FSG)-----28.65%
- KYS----- 62.90%
- African Life Financial Services (Zambia)---49%

Through a number of cautionary announcements the Group has expressed interest in acquiring the remaining outstanding shares in Funeral Services Group (FSG). FSG is a funeral services company, with a dominate position in the Botswana funeral services industry and has operations in Zambia. It is a holding company of subsidiaries with operations that are engaged in the following core business:

- Provision of funeral services through their network of funeral parlours across Botswana
- Provision (as an agent of BLIL) of affordable funeral insurance cover of various types
- Manufacture of coffins and caskets
- Development of private cemeteries

FY2012 Financial Overview

Income Statement

Total premium income was up 10% y-o-y to P1.9billion (FY2011:P1.77billion) on the back of significant gains in single premium income, which was up 20% to P1.1billion. Traditionally recurring premium income has registered stronger growth as compared to single premium. FY2012 was an exception with recurring premium merely increasing 2% to P909million. Single premium growth was driven largely by growth in the annuity portfolio The growth in income comes on the back of well maintained persistency levels, retention of clients and increased annuity income.

Fee income and investment income were down 33% to P74.7million and 41% to P443million respectively as a result of lost business from the sale of the Zambia business. On the other end turnaround fortunes of the domestic and international equity markets resulted in 380% increase in fair value gains in financial assets to P645million (FY2011: P134million). This boosted income growth outside of premium income up 13% to P1.2billion.

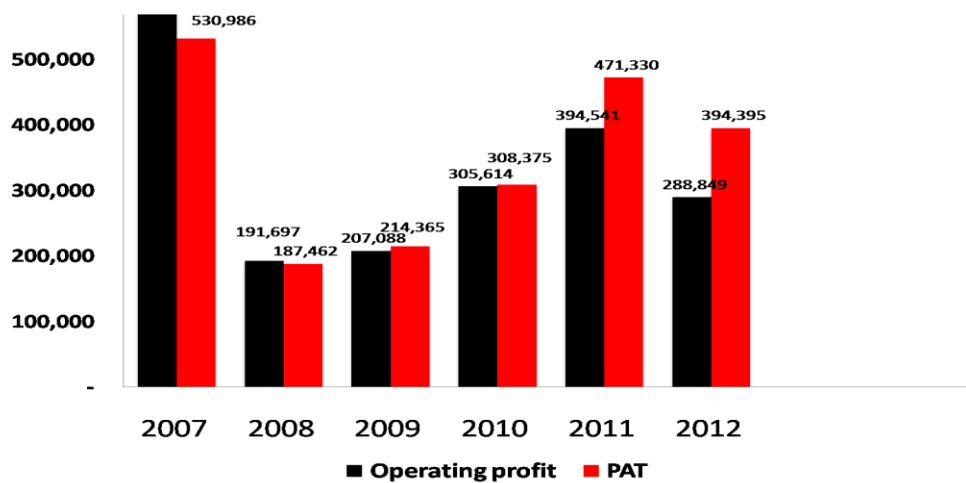
Operationally, expenses were well maintained within single digit growth of 9% slightly above the year's inflation of 8% and below the increase in income for the group. Selling expenses made up of commissions on new and renewable business, and fund contributions to insurance contracts were lower than the previous year at P219million (FY2011: P220million). Administration expenses were up 17% to P289million due to the expansion into the short term insurance industry, investments in improved IT systems to further improve customer service and increased regulatory compliance. These costs should be non-recurrent and fully absorbed during FY2013



Net Insurance benefits and claims relating to actual benefits paid out to policyholders in the form of claims, surrenders, and annuities less recoveries from reinsurers were at P888.7million, down 2.06% on last year. Change in liabilities under insurance contracts were up 67% to P1billion whereas change in liabilities under investment contracts were down 4% to P400.1million. In all total outlays were up 20% to P2.3billion which dampened pre-tax profits to P485million (FY2011:P528million).

An effective tax bill of 18.8% (FY2011:14.9%) for the 12 month results in a profit after tax of P394million (FY2011:P471million), 14% lower than the corresponding period last year.

Figure 4

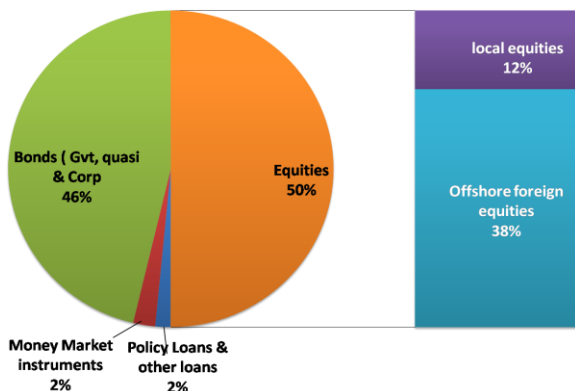


Source: BIHL Financials

Balance sheet

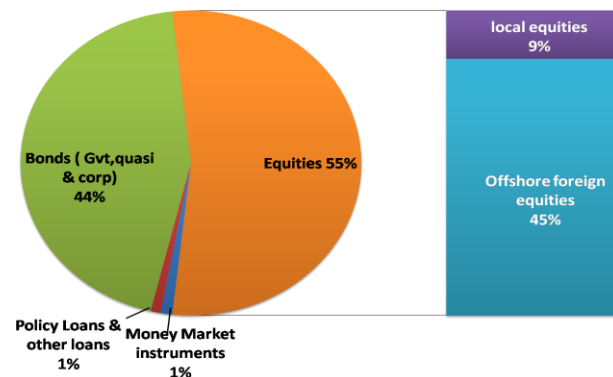
Total assets grew 21% to P15.4billion from P12.7billion over the period. The growth is driven by a 28% rise in investments held at fair value through profit or loss and asset allocation of invested funds reflects an increased weighting in offshore equities which increased 51% to P5.5billion (FY2011: P3.7billion) to take up 45% of the portfolio compared to 38% the prior year. This was due to the group's revised offshore strategy to increase its offshore weighting in order to compensate from the lost business from the Zambian operations. This will benefit the group provided that global equities continue performing and the pula weakens. On the whole equities comprised 55% of securities and bonds comprised 44%.

Figure 5 BIHL Asset Allocation FY2011 (P9.8bn)



Source: BIHL Financials

Figure 6 BIHL Asset Allocation FY2012 (P12.5bn)



Source: BIHL Financials



On the liabilities front, liabilities grew 22.5% to P13billion (FY2011:P11billion) with policyholder liabilities accounting for 96% (FY2011: 96%) of total liabilities. Liabilities under insurance contracts increased to P5.6billion (FY2011:P4.6billion) in line with the P1.02billion transfer from the income statement as result of movements in the number of policies due to new business (from all manners such as death, surrenders and maturities), change in valuation assumptions and economic conditions such as investment returns and level and shape of the yield curve. Shareholder's equity of P1.979billion (FY2011: P1.727billion) produces a NAV per share of P7.04.

Embedded Value

For the period embedded value (EV) was up 7% to P2.576billion (FY2011:P2.410billion) producing an EV per share of P9.61 (FY2011: P9.07). This rise comes on the back of a level increase in both net asset value (NAV) and value in force (VIF) each increasing 7% to P2billion and P537million respectively. Solvency also improved with the Capital adequacy cover increasing to 6.8x (FY2011:5.9).

Outlook

BIHL continues to tick off milestones set out in its strategic objectives in order to ensure competitiveness. Commendably the group's strategic goal of becoming a broad based financial services company appears to be taking shape with notable strategic achievements in FY2012:

- Short term business (BIHL Sure!) launched
- Unit Trust product line launched
- Group identity refreshed
- BIFM Capital Sale
- New Technology embedded across subsidiaries
- Strengthened bancassurance relationships

Group initiatives to protect market share have been ramped up, as the life insurance behemoth moves to leverage its relationships with associates to capitalize on synergies. More so, the ability to service its clientele locally with its Botswana based head offices awards the Group an edge over the competition.

For the group's core business, BLIL, we are optimistic that they will maintain market share in the retail and annuity segments. In the corporate segment, although BLIL has ceded market share to competitors, their ability to regain market share will be underpinned by bank assurance relationships. Furthermore, governments recently established early retirement age and a required investment of two thirds of civil servant pensions in an annuity will further underscore growth in the annuity portfolio. The divisions new quality over quantity strategy in underwriting new business coupled with the new customer oriented IT system can be expected to keep lapse rates subdued. However, there are concerns that the insurance industry might reach a point of asset and liability mismatching due to limited availability of long dated governments bonds (assets) to match annuities (liabilities), which begs the question whether growth in annuities will be sustainable.

For BIFM, there is a consensus that the recently launched unit trust business to the division's product offering is long overdue; however there is significant upside potential in AUM's if they can leverage their existing distribution channel. The stiff domestic competitive landscape should also stimulate existing plans with majority shareholder Sanlam to expand the business across Africa. The recent recovery in global equity markets, the upsurge in local equity markets, and the weakening of the pula against major currencies is expected to have a positive impact on investment income.

Strategic goals taking shape

Service clientele locally with Botswana based head office

Ceded market share to competitors on corporate segment

Limited long dated government bonds

Plans with majority shareholder to expand



For the coming period, we forecast modest growth in total premium income and investment returns y-o-y together with a significant rise in costs as a result of higher marketing and administration expense. With a subdued policyholder outlay, we forecast a net profit before tax for the year up 5.2% y-o-y. Currently BIHL has 6.8X the required capital reserves, which makes it well placed to return capital to shareholders consistently over the long term. In light of this situation, our view is that BIHL will increase their dividend payout policy going forward.

Well placed to return capital to shareholders over the long term

Valuation

Although there are differences between the local and the South African market we however decided a relative valuation with South African Listed life insurance companies to support our valuation of BIHL due to the fact that the counter does not have any listed peers on the domestic bourse. In view of that, BIHL is relatively cheap on a standard P/E ratio and P/BV ratio (refer to table 2) by comparison to its South African peer stocks. We derived a Dividend Discount Valuation of P11.51 while the counter is currently trading at P10.50, trailing PE ratio of 7.48X and forward PE multiple of 7.29X. BIHL's strong fundamentals and excess capital, underpins our 9.6% discount to fair value estimate. Accordingly, with limited upside potential we recommend a **HOLD** on the stock.

Relatively cheap on a P/E and P/BV

Limited upside potential

Table2

Peer comparison	P/E Ratio (X)	P/BV ratio (X)	ROE (%)	DY (%)
Clientele Life	12.3	9.8	87.96%	7.04%
Old Mutual	8.4	1.0	14.37%	4.93%
Discovery	13.4	2.7	29.70%	1.92%
Sanlam	16.8	2.3	15.99%	3.42%
Weighted average	11.99	1.85	18.57	3.97%
BIHL	7.5	1.5	20.28%	3.33%

Source: Bloomberg, Reuters and own estimates (As of 14th June 2013)

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