MMC CAPITAL NICOZ DIAMOND HY13 RESULTS REVIEW

Equity Research

22 Arundel Road
Alexandra Park Harare
Tel: +263 4 783 069-71
research@mmccapital.co.zw
www.mmccapitalzim.com

(Members Of The Zimbabwe Stock Exchange)

The Market Making Corporation

Nicoz Diamond Insurance: Half-Year ending 30 June 2013

''Towards prudent and profitable underwriting''

28 August 2013

mmc CAPITAL

Market Moving Insights!

Rating	BUY
Date	23-Aug-13
Reuters code	NICO.ZI
Bloomberg code	NICO:ZH
Current Price US cent	1.6
Fair Price	2.7
Implied upside	66%
Shares in issue 'm	566.76
Market Cap US$'m	9.07
Free float %	43%
52 week range -cent	8c-15c
Book Value US$m	15.08
Price to book	0.6

	HY2013	HY2012
	US$m	US$m
Gross premiums written	15.99	14.05
Net Premiums written	10.76	8.03
Net premiums earned	8.11	6.84
Total Revenues	8.61	7.49
Net claims Incurred	3.51	3.06
Investment Income	0.54	0.38
% of Revenues		
EBITDA	57.6%	18.9%
Finance costs	14.4%	1.1%
PBT	32.0%	13.2%
Net profit	24.8%	9.0%

Metric	Nicoz	Sector
Mkt cap $m	9.1	
EV $m	40.4	
P/E (+1)	3.08x	5.11x
P/Bk	0.6	2.4
EV/EBITDA	2.0	9.2
Gearing	1%	2%

Business Model-P&C Insurance

Segment	Activity
Nicoz Diamond	Largest short term insurer in Zimbabwe by both premiums written, assets and earnings with a market share of c.13%
FICO	Provision of short term insurance contracts in Uganda
Key markets	Zimbabwe, Uganda and Mozambique (beg. 2014)

Leading property and casualty (P&C) insurer Nicoz diamond reported an improved set of financial results for the half-year ended June 2013. The performance is commendable considering that the insurance sector's fundamentals are currently compromised.

Policy growth spurring premiums growth

The group's gross premium written for the half year grew by 14% to US$15.99mln driven by a 17% growth in policy counts to 33,167 policies. The group has made strides in clawing back lost market share due to increased competition and now has a market share of c.16%. The Zim insurance sector has 28 registered short term insurers with 23 operational insurers making a case for cut throat competition. Insurers have largely been competing on prices and the growing GPWs and policy counts for Nicoz are a positive sign.

Worth noting though is the fact that the insurance market has been generally soft in terms of pricing due to high competitive pressures. This has compromised the quality of premiums collected in the sector and Nicoz has not been spared either. Nicoz has embarked on a drive to ensure that it underwrites profitable business by revamping its underwriting practices.

There has been a notable growth in premium receivables of c.30% to US$8.23mln which in our view is a cause of concern. The soft prices prevailing in the market warrants cautioned growth in the number of policies but Nicoz management is confident that Nicoz has been underwriting profitable business only. Premium retention rate increased to 67% from the prior period's rate of 57% giving rise to a 34% growth in net premiums written (NPW).

Net earned premiums (NEP) grew by 19%, which is faster than GPW growth of 14%, to US$8.11mln. NEP growth was guarded by a 122% growth in changes in unearned premium reserves (UPR). The growth in UPR is attributable to a change in the term of cover bought by clients. Clients have since moved from purchasing short term cover to annual cover resulting in growth in UPR. This indicates a return of confidence to the insurance sector and improving consumer income positions.

Claims under control, Investment income rising

In the period under review Nicoz's operating expenditure grew by 5.6% to US$3.2mln driven by an 11% growth in management expenses to US$3.18mln. The management expenses ratio in turn declined to 39% of NEP. The 16% increase in claims and acquisition costs to US$4.25mln is attributable to a 15% growth in net claims incurred (NCI) and a 20% growth in commission expenses.

Key Forecasts	FY11A	FY12A	FY13E	FY14E	FY15E	FY16E	FY17E
Total Revenue ' USm	15.5	15.5	16.3	17.2	18.2	19.3	20.5
EBITDA Margin %	10.4%	11.8%	12.0%	12.0%	12.0%	12.0%	12.0%
EBITDA 'USm	1.61	1.83	1.96	2.06	2.19	2.32	2.46
Operating Income %	8.7%	9.8%	10.0%	10.0%	10.0%	10.0%	10.0%
Operating Income	1.3	1.5	1.6	1.7	1.8	1.9	2.0
EPS - cents	0.29	0.43	0.52	0.62	0.72	0.79	0.87
DPS - cents	0.05	0.06	0.08	0.09	0.11	0.12	0.13

The distribution channel remains dominated by brokers but there has been a decline in broker dominance to c.58% as Banc Assurance and direct insurance's role is growing. The group's loss ratio improved by 2 percentage points in the period under review to 43% in the face of an increased retention rate. The decline in the loss ratio is due to declines in the loss ratio in the major classes of motor and fire which contribute 73% to GPW. The loss ratio for motor and fire declined to 50% and 53% from 61% and 62% respectively. The group's combined loss ratio (CR) declined by 5 percentage points in the period under review to 92% from the prior period's figure of 96% leading to an underwriting profit margin of 8% relative to the 4% achieved in H1 2012. The improvement in the CR is due to improved underwriting practices that have resulted in improved risk rating and pricing for the group.

The group's operating ratio as measured by the difference between the CR and net investment income ratio (NIIR) marginally improved to 86% from 87% in H1 2012. This was a result of a decline in the NIIR - net investment income to NEP – from 9% to 5%. The decline in the NIIR signals a reduced contribution of the group's float – funds that arise from the time gap between the receipt of premiums and payment of claims. The group's ability to sweat the float declined as a result of refurbishments that were done to an investment property hence the 5% NIIR. The group's NIIR has been on the mend since 2010 but is likely to be adversely affected by the increasing market risks as interest rate and equity risks have been on the rise. Credit default risks have also been increasing following the slowdown in economic activity in Zimbabwe threatening money market investment returns.

Balance sheet growth spurred by a surge in receivables

Nicoz recorded a 14% growth in total assets to US$28.54mln largely driven by a 30% growth in insurance receivables. The surge in receivable was twice the total revenues and NEP growth rate of c.15%. This development is worrisome as it results in declining cash flows and hence liquidity for a business that requires a high level of liquidity. The growth in premium receivables is attributed to the slow payment of premium debtors due to the liquidity challenges that are obtaining in the market. Worth noting is that there were reductions in other payables for the group reflecting a weakened ability to manage cash flows in the first half of the year.

The quality of the balance sheet was slightly compromised but this was guarded by a 51% growth in insurance provisions due to a 78% rise in the unearned premiums.

The group's capital grew by 5% in the period under review to US$15.08mln showing an increased ability to take risks hence improve profitability by the insurer. Deferred acquisition costs (DAC) - upfront costs incurred in issuing new business, such as commissions to sales agents, underwriting, bonus interest and other acquisition expenses – inline wiith growth in UPR increased by 83% in the period under review signaling increased premium growth potential for the insurer. The growth in DAC though signals lower earnings quality but the disclaimer worth noting is the quality of the new business.

Nicoz ability to underwrite new business has been growing as reflected by the growing balance sheet hence the higher retention rate of 67% against an industry average of 52% though still below the international benchmark of 80%. Asset growth has largely been organic relative to acquired signaling an increased future earnings growth potential for the insurer. Cash and cash equivalents make up c.18% of the asset base and current assets are c.55% of the balance speaking to an adequate liquidity level.

Outlook and Valuation

The GPW for the local industry has been on the mend since 2010 after falling from an all-time high of US$600mln to around US$117mln. As at year end 2012 GPW was US$194mln and is projected to grow to US$250mln in 2013. Nicoz management is of the view that the business will end the year with a GPPW of c.US$25mln and we concur. The key risks to GPW growth will be the persistent liquidity challenges in the economy in the face of increased competition in the P&C insurance sector. Total revenue growth will likely be negatively impacted by a decline in the NIIR due to poor capital markets performance.

Our relative valuation model based on a discounted sectoral P/E of 5.11x for Nicoz and a projected EPS of 0.52c in FY13 yields a value of 2.66c. At forward PER of 3.08x Nicoz is trading at a 40% discount to its peers and presents a 66% upside potential. We recommend investors to **BUY.**

Disclosure appendix

Analyst Certification

The following analyst(s) who is (are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: **Tawanda Mazorodze and Kudzanai Samudzi.**

Important disclosures

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Additional disclosures

1 This report is dated as at 30 August 2013

2 All market data included in this report are dated as at close of t 30 August 2013, unless otherwise indicated in the report.

MMC Capital
22 Arundel Road
Alexandra Park
P. O. Box BW 1797
HARARE, ZIMBABWE

Tel: +263-4-783069-71, +263-4-744467

Tellular: +263-0 -772 020 279
www.mmccapital.co.zw

Managing Director
Edward Mapokotera
edward@mmccapital.co.zw
+263 772 128 203

Executive Director
Itai Walter Chirume, CFA
itai@mmccapital.co.zw
+263 773 336 832

Sales & Trading
Edmond Mupfapairi (Head)
edmond@mmccapital.co.zw
+263 772 282 932

Tinashe Mapara, CFA
tinashe@mmccapital.co.zw
+263 773 413 288

Research and Advisory
Tawanda Mazorodze, CFA (Head)
tawanda@mmccapital.co.zw
+263 773 485 143

Kudzanai Samudzi
kudzanai@mmccapital.co.zw
+263 774 716 014