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CREDIT OPINION
12 October 2020

Update

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RATINGS

Walaa Cooperative Insurance Company

Domicile	Al Khobar, Saudi Arabia
Long Term Rating	A3
Type	Insurance Financial Strength - Fgn Curr
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Walaa Cooperative Insurance Company

Update to credit analysis

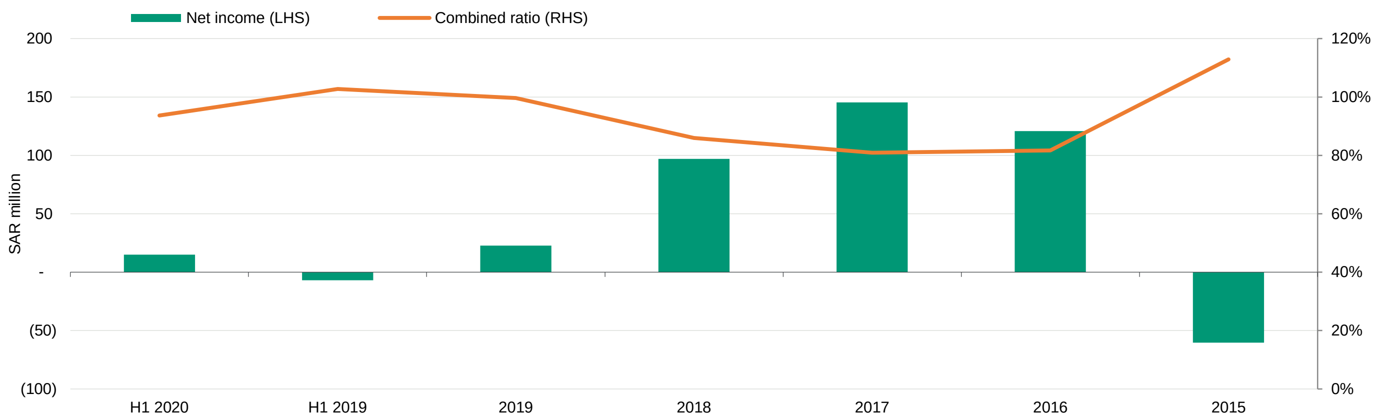
Summary

Walaa Cooperative Insurance Company's (Walaa) is rated A3 for insurance financial strength. Based in Saudi Arabia, Walaa is a medium sized property and casualty insurer, underwriting motor, medical, property and engineering, as well as various other personal lines products with now the added lines of life protections and savings business post the merger with Metlife AIG ANB Insurance Company (Metlife AIG ANB). The A3 of Walaa reflects its: (i) strong market position and brand; (ii) strong asset quality; (iii) strong capital adequacy level; and (iv) good and sophisticated reserve adequacy. However these strengths are partially constrained by Walaa's concentration to Saudi Arabia and more specifically very competitive motor and medical lines of business.

Walaa has completed its merger with Metlife AIG ANB, a small composite insurer in Saudi Arabia. The negative outlook reflects the short-term downside risks that the merger poses to Walaa's underwriting profitability, given the loss-making history of Metlife AIG ANB. In addition, to readdress this business to return to profitability, the merged entity should also resolve various deficiencies raised by the regulator, particularly concerning Metlife AIG ANB's internal controls and risk management of the company. However the potential benefits in the long term includes diversification benefits, given Walaa successfully executes the merger. In addition the merged entity will be able to save costs in the short term. We expect the short term benefits to materialise in 6 to 12 months from the merger.

During 2019, the company reported gross premiums of SAR1.2 billion, 10% growth compared to 2018. Its combined ratio was high in 2019 at 99.7% compared to 85.9% in 2018 as claims expenses increased. With this, net income lowered to SAR22.7 million from SAR96.9 million in 2018. However, the COR improved in the first half of 2020 (H1 2020) to around 94% compared to over 100% for the same period last year aided by better claims, seen across Saudi Arabia as a result of coronavirus pandemic and government imposed lock downs (Exhibit 1).

Exhibit 1
Walaa's profitability indicators



Sources: Moody's Investors Service and Company's filings

Credit strengths

» Strong market position and brand in the Saudi Arabian insurance market

» Strong asset quality, driven by a conservative investment strategy

» Strong capital adequacy level

» Good recent profitability

» Good reserve adequacy

Credit challenges

» Increasingly competitive Saudi Arabian property and casualty insurance market

» Concentration to Saudi market's most competitive lines, motor and medical

Rating outlook

The negative outlook reflects the short-term downside risks that the merger poses to Walaa's underwriting profitability, given the loss-making history of Metlife AIG ANB. In addition, to readdress this business to return to profitability, the merged entity should also resolve various deficiencies raised by the regulator, particularly concerning Metlife AIG ANB's internal controls and risk management of the company.

Factors that could lead to an upgrade:

Upward pressure on the rating is unlikely given the negative outlook, however factors that could return Walaa to a stable outlook are if:

» The merger is executed successfully with post merger maintained profitability of ROCs over 12% and CORs of under 90% consistently

» If, despite the merger, overtime Walaa maintains its capital adequacy with GUL below 3x

Factors that could lead to a downgrade:

- Profitability weakens with ROC's of below 5% and combined ratios of over 95% consistently
- Loses significant market position in Saudi Arabia falling out of the top seven in terms of premiums
- Asset quality deteriorates with HRA as a % percentage of consolidated equity of over 30% or there is deterioration of the bank deposit ratings in Saudi Arabia to which Walaa is exposed to and or loss of A-rated reinsurance support
- Capital adequacy levels weaken with GUL of over 3x
- Reserve adequacy deteriorates with consistent reserve strengthening required in subsequent years
- Undertakes significant borrowings with leverage levels reaching or over 15%

Key indicators

Exhibit 2

Walaa Cooperative Insurance Company [1][2]	2019	2018	2017	2016	2015
As Reported (Saudi Riyal Millions)					
Total Assets	2,033	1,997	1,780	1,538	1,185
Total Shareholders' Equity	670	682	600	450	325
Net Income (Loss) Attributable to Common Shareholders	23	97	145	121	(60)
Gross Premiums Written	1,215	1,105	1,102	1,017	753
Net Premiums Written	750	746	851	766	539
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	38.0%	23.9%	16.1%	24.4%	26.1%
Reinsurance Recoverable % Shareholders' Equity	62.4%	53.3%	47.1%	63.8%	90.9%
Goodwill & Intangibles % Shareholders' Equity	2.7%	3.7%	6.2%	7.2%	7.0%
Gross Underwriting Leverage	2.5x	2.3x	2.6x	3.3x	3.6x
Return on Average Capital (ROC)	2.8%	13.9%	25.8%	29.4%	-22.6%
Sharpe Ratio of ROC (5 yr.)	47.1%	41.8%	38.9%	NA	NA
Adv. (Fav.) Loss Dev. % Beg. Reserves	-22.5%	-26.6%	-50.9%	-21.0%	-9.9%
Adjusted Financial Leverage	3.6%	5.4%	5.4%	5.5%	6.0%
Total Leverage	3.6%	5.4%	5.4%	5.5%	6.0%
Earnings Coverage	NM	107.9x	222.1x	194.9x	-105.4x
Cash Flow Coverage	NA	NA	NA	NA	NA

[1] Information based on IFRS financial statements as of the fiscal year ended 31 December. [2] Certain items may have been relabeled and/or reclassified for global consistency.
Sources: Moody's Investors Service and Company's filings

Profile

Walaa was incorporated in 2008 as a property and casualty insurer in Saudi Arabia. Headquartered in Al Khobar, Walaa has over 70 branches in Saudi Arabia and provides a broad range of general and health insurance lines of products within the country.

Detailed credit considerations

Market position and brand: A - Strong market position in Saudi Arabia

Walaa has a strong market position in Saudi with 3.2% market share and ranks as the 6th largest player in this market in 2019 by premiums, improving from the 11th position in 2014. Saudi insurance market is highly competitive, given the dominant position of the top 5 insurers which represented 66% of the market in terms of premiums in 2019.

In 2019 Walaa's gross premiums written (GPW) remained stable at SAR1.2 billion and in H1 2020 wrote SAR631 million. Further, in 2019, the company opened 10 branches widening its branch network to over 70.

The successful merger of Metlife AIG ANB would benefit the market position of Walaa with the client and business-partner base in the short term, whilst the ability to sell life products will benefit it in the medium - long term.

Product focus and diversification: Baa - Concentrated in motor and Saudi market

Walaa's GPW mix is similar to most GCC insurers with large contribution from motor (51% in 2019) and medical (8% in 2019). We do not expect the product mix to change considerably in the medium term thus the company will remain concentrated in motor, reflecting the wider Saudi market concentration to medical and motor (comprising 82% of premiums). In terms of product risk, the motor and medical portfolio generally presents low severity but high frequency risk. The company is also exposed to some negligible CAT risk arising from rare flood events, but it is sufficiently covered by A-rated reinsurance excess of loss cover across all LoBs. Additionally in terms of high severity risks (property, casualty, engineering and energy which contributed for roughly 41% of GPW), Walaa's retention is nominal in these lines.

In terms of geographic diversification, similar to most GCC peers, Walaa is concentrated to a single country. However Saudi Arabia benefits from a much larger population than other GCC countries, thus having more potential and geographic spread. We think Walaa will be able to reap the benefits of operating in a large country due to its extensive branch network.

In June and July 2020, Walaa signed three insurance agreements with Arab National Bank to provide insurance coverage on the Directors and Officers Liability, the property and group life, and auto lease finance, this will add to diversification of its business.

If Walaa successfully executes the merger, there are potential benefits in the medium-long term with the diversification of its line of business into protection and savings.

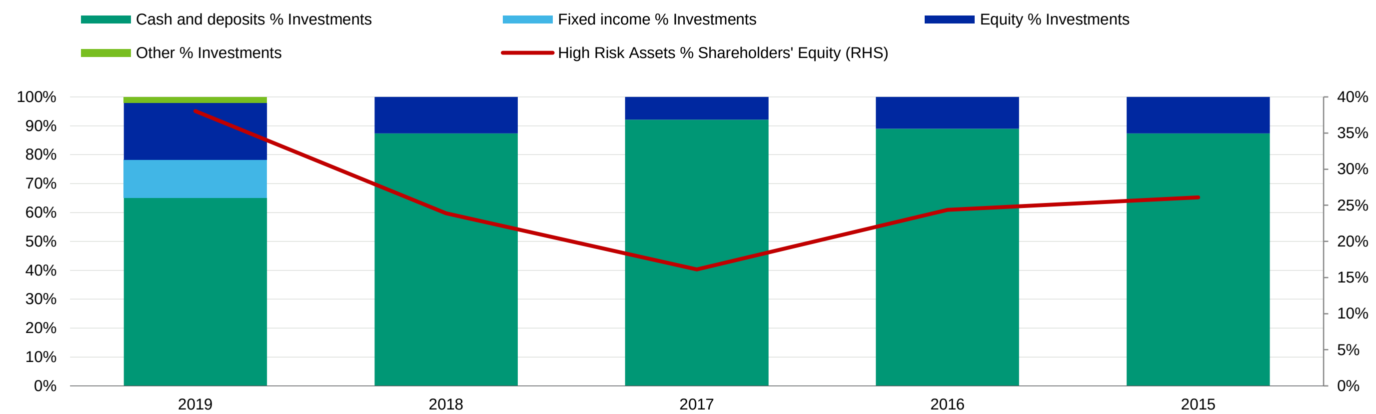
Asset Quality: A - Equity investments increased in 2019, but the mix is still conservative

Walaa's strong quality of invested asset is a result of the management's decision to maintain strong regulatory solvency levels. About 69% of the invested assets was in cash and bank deposits as at YE 2019. Equity investments accounted for 20% of invested assets as at YE 2019, and fixed income investments was 11% of total investments. It had no real estate exposure. Although, equity investments marginally increased, the conservative investment profile remains a constant feature of the company. However, all investments are within Saudi Arabia and deposits are with local banks which leads to concentration risk albeit similar to Saudi peers.

The HRA % SH Equity was strong at 38.0% at YE 2019 but was higher than the 23.9% reported at YE 2018, the increase was due to higher equity exposure (Exhibit 3). Reinsurance recoverable % Shareholders' equity increased slightly to 62.4% at YE 2019 from 53.3% at YE 2018. Similar to most other Gulf Cooperation Council (GCC) insurers, Walaa has a strong reinsurance coverage from A rated reinsurers. The panel includes Everest Re (A1, STA), Saudi Re (A3, STA), Sirius and SCOR (Aa3, Negative).

Goodwill and intangibles comprise deferred acquisition costs and the ratio was low at 2.7% as at YE 2019 however post the merger rose c.8% largely on account of the SAR35 million of goodwill thus far recognised.

Exhibit 3
Equity investments increased, although investment quality continues to be good

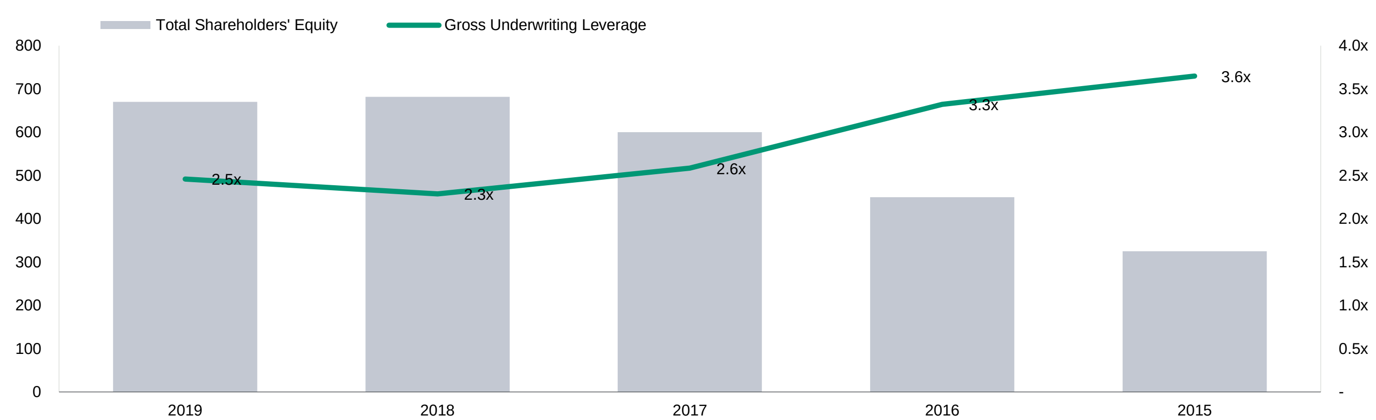


Sources: Moody's Investors Service and Company's filings

Capital Adequacy: A - Strong capital driven by good performance and quality investments
As concerns capitalisation, we view Walaa's capital adequacy as strong, with a GUL of 2.5x as at YE 2019, having strengthened from 3.6x as at YE 2015 (see below exhibit). At H1 2020, total equity increased to SAR826 million aided by an increase in paid up capital and share premium stemming from the merger whilst the retained earnings continued to grow organically in absence of dividends. Additionally, unlike most of its P&C peers in the wider GCC region, Walaa's capital adequacy is not pressured by a high risk investment portfolio. Furthermore, Walaa continues to comfortably meets the regulatory solvency requirement.

Looking ahead we expect Walaa to further bolster its capital as it continues to report good profitability.

Exhibit 4
Walaa's capitalisation indicators



Sources: Moody's Investors Service and Company's filings

Profitability: A - Some volatility in 2019 but improved in H1 2020, will be closely monitored due to the merger
Since 2016 Walaa has consistently reported strong profits aided by good underwriting discipline and stable investment income. However, in 2019, its profitability was somewhat weak owning to higher claims, reporting a COR of 99.7% (2018: 85.9%). The loss ratio for 2019 was roughly 79% compared to 64% for 2018. As a result the RoC of 2.8% was also weak compared to recent past (2018: 13.9% and 2017: 25.8%).

In H1 2020, Walaa's profitability improved aided by lower reported claims (COR of 94% vs 103% H1 2019). This was seen across the region and Saudi Arabia as motor and health claims lowered due to government imposed lock downs. However as Saudi insurers have had to provide two-motnhs free extension coverage to compensate for the lockdown one-off gains, we expect the claims to increase eroding at the gains of H1 2020.

Furthermore, whilst the 5-year average combined ratio remains good at 92% (2019-2014), we remain watchful given the challenges to profitably of the successful complete integration of the operations of Metlife AIG ANB, whilst at the same time facing Saudi market-wide competitive pressures. That said, Walaa has superior claims management and underwriting capabilities, which drove our prior to merger expectation that it would maintain CoRs of between 90%-95% and RoC of about 5%-8%. As discussed previously, we will closely monitor developments in this regard and the impact on profitability over the next 6-12 months.

Reserve Adequacy: A - Actuarial-led reserving is credit positive

The strengthening of the in-house and external actuarial led reserving setting and monitoring has brought sophistication to reserve setting as well as adequacy and has also driven adequate pricing changes at Walaa. Furthermore, given the company's low severity, high frequency book and short-tailed products (especially on a net basis), reserving risk is generally considered low.

Financial flexibility: Baa - Listed insurer with no leverage

Walaa is listed in Saudi stock market. The main source of additional capital would be through the existing shareholders as the debt markets in Saudi remain relatively underdeveloped. However the lack of any existings borrowings aids Walaa's funding flexibility.

Operating environment: Baa - Operate from Saudi Arabia

Walaa operates exclusively in Saudi Arabia, which is rated A1 with a negative outlook. The country's credit profile is underpinned by the government's robust, albeit deteriorating, balance sheet and supported by substantial external liquidity buffers. However, government revenue remains vulnerable to declines in oil prices, such as the one triggered by the coronavirus pandemic. Furthermore, challenges posed by high unemployment and population growth risk slowing the reforms aimed at reducing this vulnerability. Saudi Arabia is also exposed to geopolitical risk.

The Saudi Insurance market is regulated by the Saudi Arabian Monetary Authority (SAMA), requiring that all Saudi insurers operate under the Cooperative model in line with Shari'ah principles. Since its inception, SAMA has proactively introduced numerous regulations to stabilise the Saudi Insurance market and for the benefit of the economy, and as a result we consider SAMA to be one of the most sophisticated insurance regulators in the GCC. Regulatory developments have had a markedly positive impact in Saudi Arabia, where the regulator introduced actuarial reserving, among other changes, in 2013 (Saudi Arabian Insurance Market Update). While this created short term pressures on profitability and capital, the medium-term effect was to harden motor and medical insurance prices, leading to improved underwriting profitability for many insurers.

Environmental, social and governance (ESG) considerations

Environmental

Like its P&C insurance peers, Walaa is exposed to the economic consequences of climate change, primarily through the unpredictable effect of climate change on the frequency and severity of weather-related catastrophic events, such as hurricanes, floods, convective storms, drought and wildfires. We assess Walaa's environmental risk to be low. Geographical area that the company operates has low climate related (NATCAT) events. In addition, its exposure is mostly short tail.

Social

Walaa is a medium sized P&C insurers in Saudi Arabia. As such and like its peers in these lines of business, the company faces social risks through the handling of customer information, the underwriting and business growth implications (positive and negative) of changing demographics, and the impact of changing consumer preferences on distribution channels.

Governance

Like all other corporate credits, the credit quality of the company is influenced by a wide range of governance-related issues, relating to financial, managerial, ownership or other factors, all of which can be exacerbated by regulatory oversight and intervention. Walaa has strong governance and a strong track record of management continuance, hence we view governance risk to be low.

Rating methodology and scorecard factors

Exhibit 5

Walaa Cooperative Insurance Company

Financial Strength Rating Scorecard [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adj Score
Business Profile								A	Baa
Market Position, Brand and Distribution (25%)								A	A
-Relative Market Share Ratio			X						
-Underwriting Expenses % Net Premiums Written	18.3%								
Product Focus and Diversification (10%)								A	Baa
-Product Risk		X							
-P&C Insurance Product Diversification				X					
-Geographic Diversification									
Financial Profile								Aa	A
Asset Quality (10%)								Aa	A
-High Risk Assets % Shareholders' Equity		38.0%							
-Reinsurance Recoverable % Shareholders' Equity		62.4%							
-Goodwill & Intangibles % Shareholders' Equity	2.7%								
Capital Adequacy (15%)								Aa	A
-Gross Underwriting Leverage		2.5x							
Profitability (15%)								Baa	A
-Return on Capital (5 yr. avg.)		9.9%							
-Sharpe Ratio of ROC (5 yr.)					47.1%				
Reserve Adequacy (10%)								Aaa	A
-Adv. (Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd. avg.)	X								
Financial Flexibility (15%)								A	Baa
-Adjusted Financial Leverage	3.6%								
-Total Leverage	3.6%								
-Earnings Coverage (5 yr. avg.)									
-Cash Flow Coverage (5 yr. avg.)									
Operating Environment								Baa	Baa
Preliminary Standalone Outcome								A1	A3

[1] Information based on IFRS financial statements as of fiscal year ended December 31, 2019. [2] The Scorecard rating is an important component of the company's published rating, reflecting the standalone financial strength before other considerations (discussed above) are incorporated into the analysis.

Source: Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
WALAA COOPERATIVE INSURANCE COMPANY	
Rating Outlook	NEG
Insurance Financial Strength	A3

Source: Moody's Investors Service

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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