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CREDIT OPINION
8 July 2019

Update

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Walaa Cooperative Insurance Company

Update following the change in outlook to negative

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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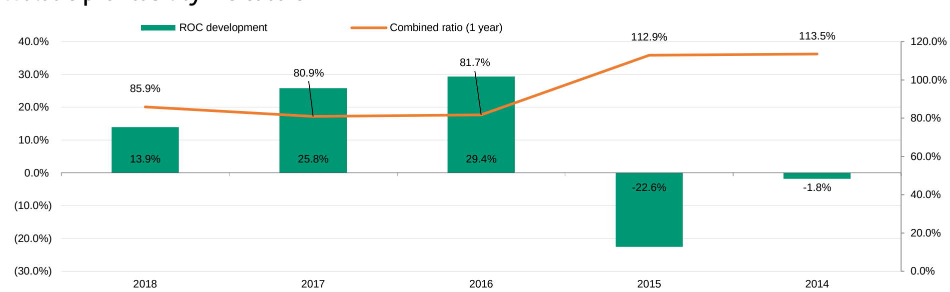
Summary

Walaa Cooperative Insurance Company's (Walaa) is rated A3, Negative. 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. The A3 of Walaa reflects its: (i) strong market position and brand, as the sixth largest player in the Saudi Arabian insurance market with a 3.1% market share in terms of premiums; (ii) strong asset quality, driven by a conservative investment strategy with high risk assets (HRA) as a % of consolidated (shareholders' and policyholders') equity of 23.9% at YE 2018; (iii) strong capital adequacy level, with gross underwriting leverage (GUL) of 2.3x at YE 2018; (iv) good profitability, with the return on capital (ROC) of 13.9% in 2018 supported by a good combined ratio (COR) of 86% (see below exhibit); and (v) good reserve adequacy with the sophistication of setting and monitoring underpinned by in-house actuaries. However these strengths are partially constrained by Walaa's more concentrated exposure to the Saudi Arabian market's most competitive lines of motor and medical.

In June 2019 Walaa's announced that it signed a non-binding Memorandum of Understanding with Metlife AIG ANB Insurance Company (Metlife AIG ANB) to evaluate a potential merger between the two companies. Metlife AIG ANB is small composite (life and non-life) insurer in Saudi Arabia. The change in outlook to negative from stable 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 there are potential benefits in the long term if Walaa successfully executes the merger, starting with the diversification of its line of business into protection and savings

Exhibit 1
Walaa's profitability indicators



Sources: Moody's Investors Service; Company 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 change in outlook to negative from stable 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 not agreed following the Memorandum of Understanding

» The merger is executed successfully with 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]	2018	2017	2016	2015	2014
As Reported (Saudi Riyal Millions)					
Total Assets	1,997	1,780	1,538	1,185	890
Total Shareholders' Equity	682	600	450	325	171
Net income (loss) attributable to common shareholders	97	145	121	(60)	(4)
Gross Premiums Written	1,105	1,102	1,017	753	650
Net Premiums Written	746	851	766	539	335
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	23.9%	16.1%	24.4%	26.1%	46.5%
Reinsurance Recoverable % Shareholders' Equity	53.3%	47.1%	63.8%	90.9%	210.4%
Goodwill & Intangibles % Shareholders' Equity	3.7%	6.2%	7.2%	7.0%	10.1%
Gross Underwriting Leverage	2.3x	2.6x	3.3x	3.6x	6.2x
Return on avg. capital (1 yr. avg ROC)	13.9%	25.8%	29.4%	-22.6%	-1.8%
Sharpe Ratio of ROC (5 yr. avg)	41.8%	38.9%	NA	NA	NA
Adv./(Fav.) Loss Dev. % Beg. Reserves (1 yr. avg)	-26.6%	-50.9%	-21.0%	-9.9%	-7.1%
Financial Leverage	5.4%	5.4%	5.5%	6.0%	9.4%
Total Leverage	5.4%	5.4%	5.5%	6.0%	9.4%
Earnings Coverage (1 yr.)	107.9x	222.1x	194.9x	-105.4x	12.3x
Cash Flow Coverage (1 yr.)	NA	NA	NA	NA	NA

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

Profile

Walaa was incorporated in 2008 as a property and casualty insurer in Saudi Arabia. Headquartered in Al Khobar, Walaa has over 60 branches in Saudi Arabia and provides a broad range of general and health insurance lines of products within the country. In 2018, Walaa wrote SAR1.1 billion of premiums and its motor portfolio accounted for more than 55% of the GPW.

Detailed credit considerations

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

Walaa has a strong market position in Saudi with 3.1% market share and ranks as the 6th largest player in this market in 2018 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 64% of the market in terms of premiums in 2018.

In 2018 Walaa's gross premiums written (GPW) remained stable at SAR1.1 billion. For the three months period ended March 31 (Q1 2019), the company reported GPW of SAR276 million, lower than the same period in 2018 of SAR311 million. In the medium term, we expect the company to grow by about 10% per annum. In 2018, the company opened 47 branches widening its branch network to over 60.

The successful merger of Metlife AIG ANB could benefit the market position of the merged entity (Walaa-merged) 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 (55% in 2018) and medical (9% in 2018). 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 85% 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 36% of GPW), Walaa's retention is nominal 3%-5%.

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.

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

Asset Quality: A - Conservative invested assets mix is credit positive

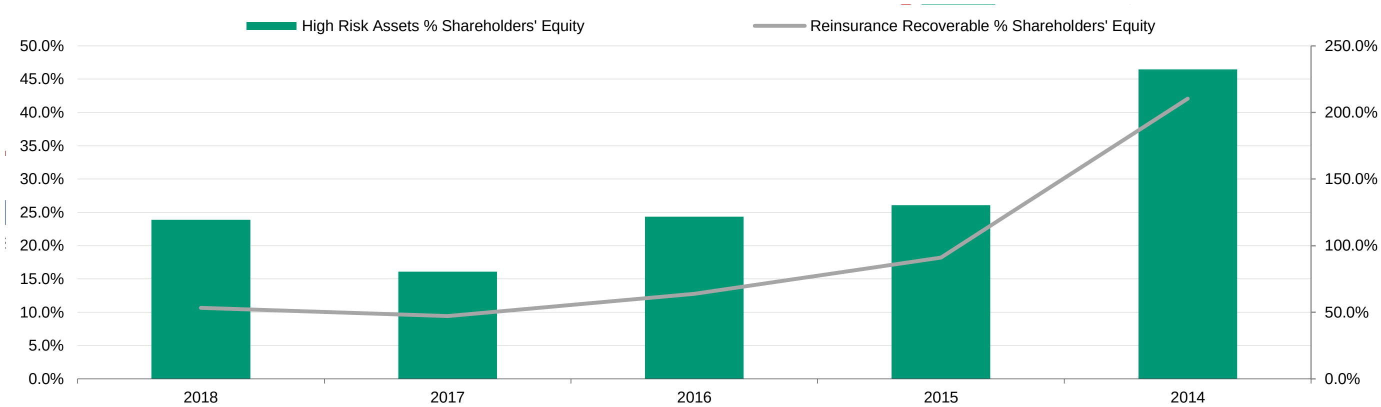
Walaa's strong quality of invested asset is a result of the management's decision to maintain strong regulatory solvency levels. About 87% of the invested assets was in cash and bank deposits as at YE2018. Equity investments accounted for 13% of invested assets as at YE2018, with no real estate exposure. This conservative investment profile has been a constant feature of the company. However, all investments are within Saudi and deposits are with local banks which, on average, have an Bank BCA of Baa1 and Long-term Deposit ratings of A2.

The HRA % SH Equity was strong at 23.9% at YE2018 but was higher than the 16.1% reported at YE2017, the increase was due to higher equity exposure. Reinsurance recoverable % Shareholders' equity increased slightly to 53.3% at YE2018 from . Similar to most other GCC companies, 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, STA).

Goodwill and intangibles comprise deferred acquisition costs and the ratio was low at 3.7% as at YE2018.

Exhibit 3

Walaa's asset quality indicators



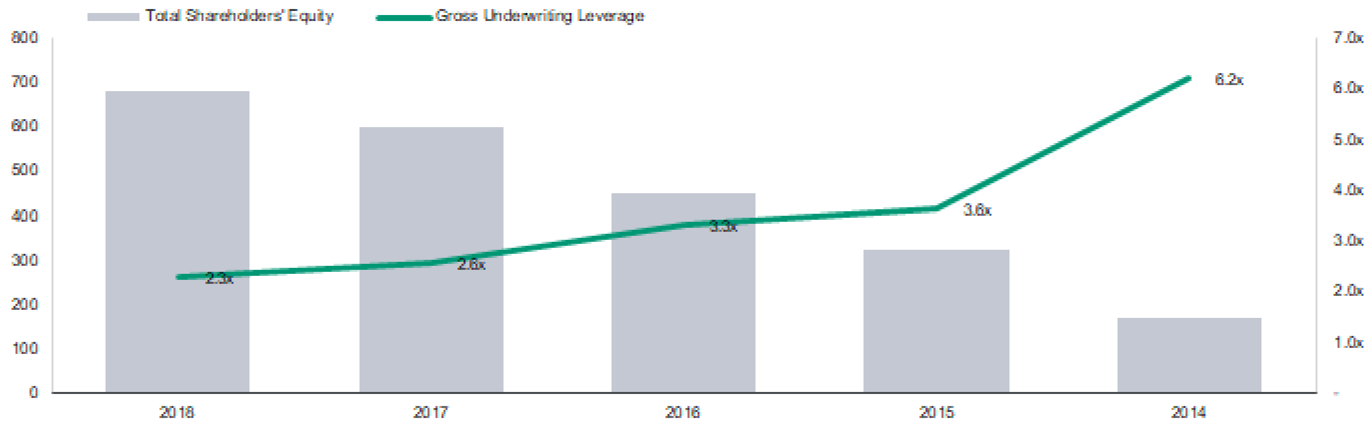
Sources: Moody's Investors Service; Company Filings

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 2.3x as at YE 2018, having strengthened from 3.6x as at YE 2015 (see below exhibit). This is the result of the increase in paid up capital by SAR40 million via a rights issue in 2018 and continued retained recent profits with the no cash dividend strategy leading to organic capital growth. Additionally, unlike most of its P&C peers in the wider Gulf Cooperation Council (GCC) region, Walaa's capital adequacy is not pressured by a high risk investment portfolio.

Walaa also comfortably meets the regulatory solvency requirement. Consolidated (shareholders' and policyholders') equity increased to SAR682mn as at YE 2018 from SAR600mn the year before due to organic growth of retained earnings. 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; Company Filings

Profitability: A - Recent strong profitability due to stable underwriting and investment income
Since 2016 Walaa has consistently reported strong profits aided by good underwriting discipline and stable investment income. The RoC was a very strong 13.9% and 25.8% respectively in 2018 and 2017 see below exhibit). However, the 5 year average Sharpe ratio (2018-2014), which measures the stability of RoC, was weak at 41.8% in 2018 owing to losses reported prior to 2016.

Since 2016, combined ratio has been below 90%, aided by its low loss ratio. In 2018, the company reported a combined ratio of 85.9% and in 2017 it was 80.9%. The 5-year average combined ratio was good as well at 95.0% (2018-2013). The loss ratio was 54.1% in 2018, marginally lower than the 56.5% reported in 2017. In addition, the use of telematics and driver behavior for pricing have also been useful.

As these results are expected to continue (given no change in business mix and thus underwriting profits, or investment income due to conservative investment policy), profitability metrics will improve further on a 5-year basis.

The potential merger discussed earlier also poses some short-term downside risks to Walaa's underwriting profitability, given the loss-making history of Metlife AIG ANB. As discussed previously, we will closely monitor developments in this regard and the impact on profitability.

Reserve Adequacy: A - Actuarial-led reserving is credit positive
The company had to strengthen reserves in 2014-2015 due to new actuary led reserve calculation requirements. 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 and the company has no plans to borrow.

Operating environment: Baa - Operate from Saudi Arabia
Walaa operates exclusively in Saudi Arabia, which is rated A1 with a stable outlook. The country's credit profile is underpinned by the government's robust balance sheet and supported by substantial external liquidity buffers. However, government revenues remain vulnerable to declines in oil prices, and the fiscal and structural reforms that the government has outlined to reduce this vulnerability will remain at risk from the socio-economic challenges posed by high unemployment and population growth. In addition, Saudi Arabia remains exposed to geopolitical event risks.

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 pro-actively 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.

Rating methodology and scorecard factors

Exhibit 5

Financial Strength Rating Scorecard [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adj Score
Business Profile								A	Baa
Market Position and Brand (25%)								A	A
- Relative Market Share Ratio			X						
- Underwriting Expense Ratio % Net Premiums		23.7%							
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	23.9%								
- Reinsurance Recoverable % Shareholders' Equity		53.3%							
- Goodwill & Intangibles % Shareholders' Equity	3.7%								
Capital Adequacy (15%)								Aa	A
- Gross Underwriting Leverage		2.3x							
Profitability (15%)								Baa	A
- Return on Capital (5 yr. avg)		9.0%							
- Sharpe Ratio of ROC (5 yr. avg)					41.8%				
Reserve Adequacy (10%)								Aaa	A
- Adv./(Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd avg)	-28.5%								
Financial Flexibility (15%)								A	Baa
- Financial Leverage	5.4%								
- Total Leverage	5.4%								
- Earnings Coverage (5 yr. avg)	86.4x								
- Cash Flow Coverage (5 yr. avg)									
Operating Environment								Baa	Baa
Aggregate Profile								A2	A3

[1] Information based on IFRS financial statements as of Fiscal YE December 31. [2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis.
Sources: Moody's Investors Service; Company Filings

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