

Walaa Cooperative Insurance Co.

Primary Credit Analyst:

Mario Chakar, Dubai + 44 20 7176 7070; mario.chakar@spglobal.com

Secondary Contacts:

Sachin Sahni, Dubai (971) 4-372-7190; sachin.sahni@spglobal.com

Emir Mujkic, Dubai + (971)43727179; emir.mujkic@spglobal.com

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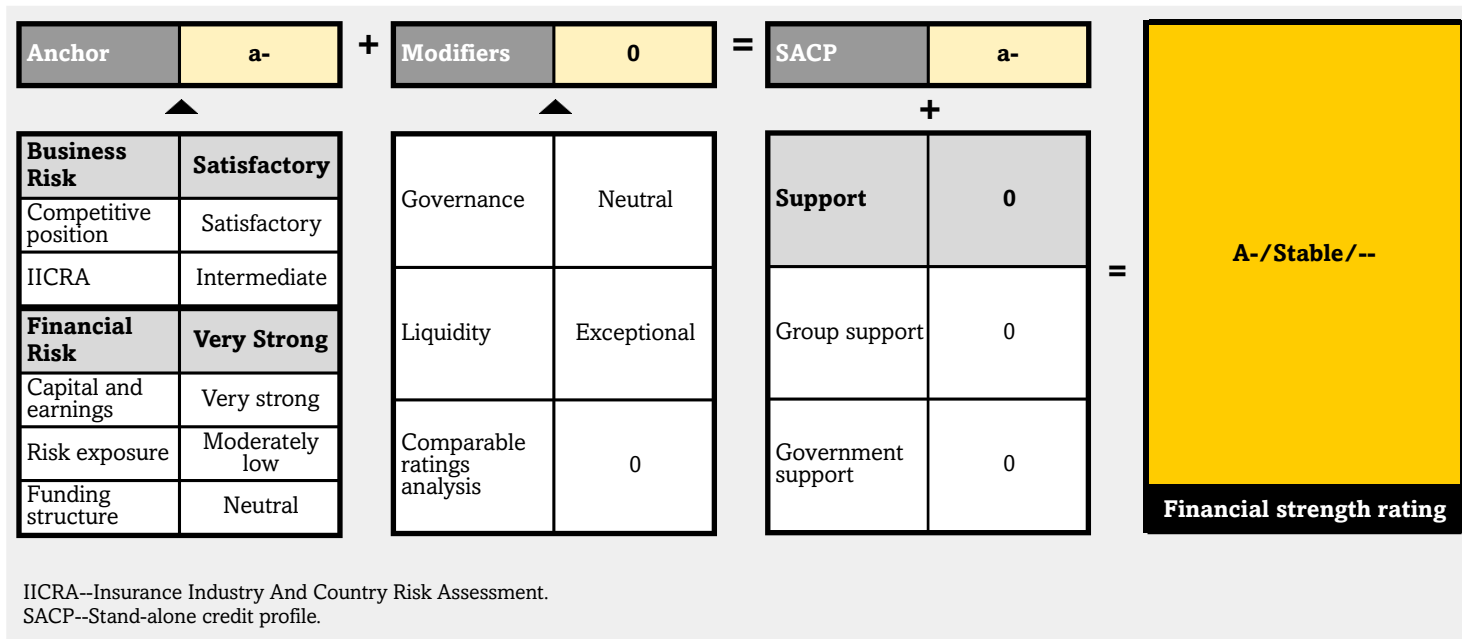
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Walaa Cooperative Insurance Co.



Credit Highlights

Overview	
Key strengths	Key risks
Track record of robust risk-based capital adequacy, which we expect will remain resilient despite recent earnings volatility and the merger announcement.	Ambitious growth strategy could result in capital and earnings volatility.
Relatively low tolerance to investment risk, evidenced by a primarily cash-denominated investment portfolio, which also contributes to its exceptional liquidity.	Exposure to highly competitive motor line, which is largely retained, could continue to exert pressure on underwriting performance.

S&P Global Ratings expects Walaa Cooperative Insurance Co. (Walaa) will maintain its robust capital adequacy over the two-year outlook horizon. Walaa's risk-based capital adequacy has been a key rating strength. While capital adequacy came under pressure due to losses in 2021, we expect the company will gradually improve its shareholders' equity over the next two years, as it executes its plan to increase its capital base by about Saudi riyal (SAR) 775 million (about \$207 million) via mergers and acquisitions (M&A) and rights issue. We believe Walaa will maintain sufficient capital buffers to support its expanding business volumes over the next two years.

Walaa will maintain its competitive position while gradually increasing its market share over the next two years by diversifying its lines of business with a focus on long-term profitability. With the acquisition and successful integration of MetLife AIG ANB Cooperative Insurance Co. (Metlife KSA), Walaa gets access to write life business, which will help it expand in the still-underdeveloped life market in Saudi Arabia. Walaa also plans to expand and retain more business in other property/casualty (P/C) lines of business. Although this growth trajectory might result in thinner profit margins in the next two years, we expect Walaa will remain profitable over the next two years.

Walaa will gradually reduce its concentration in motor lines of business, which was one of the key reasons for losses in 2021. While Walaa's concentration in motor has significantly reduced in terms of gross written premiums, it still contributed about 50% of the net written premiums in 2021. We expect Walaa to manage this concentration risk and

gradually reduce it over the next two years.

Outlook: Stable

The stable outlook reflects our expectation that Walaa will maintain its robust capital adequacy while strengthening its competitive position and diversifying its operations over the next two years.

Downside scenario

We could consider a negative rating action over the next two years if Walaa's:

- Operating performance deteriorates rapidly and steadily due to underwriting or investment losses;
- Capital and earnings weaken as a result of its growth or acquisition strategy; or
- We take a negative rating action on Saudi Arabia and Walaa fails to pass our sovereign default stress test.

Upside scenario

We see a limited likelihood of an upgrade during the outlook period. However, we could consider a positive rating action over the next two years if Walaa expands significantly in terms of premium income, which would lead us to reassess its business risk profile as strong, while maintaining its excellent capital adequacy and low risk tolerance in the investment portfolio.

A positive rating action would be possible only if we took similar action on our sovereign ratings on Saudi Arabia, or if we believe Walaa could pass our hypothetical sovereign default stress test, allowing us to rate it above the sovereign.

Assumptions

- Real GDP growth in Saudi Arabia of 5.8% in 2022 followed by 2.9% in 2023-2024.
- Saudi Arabia's insurance sector will show premium growth of up to 5% per year in 2022-2023.

Walaa Cooperative Insurance Co.--Key Metrics

	--Year-ended Dec. 31--				
(Mil. SAR)	2023f	2022f	2021	2020	2019
S&P Global Ratings' capital adequacy	Excellent	Excellent	Very strong	Excellent	Excellent
Gross premium written	2,700	2,500	2,339	1,473	1,215
Net income	~50	~10	(122)	51	21
Return on shareholders' equity (%)	~6	~1.0	(14.1)	6.4	3.2
Net combined ratio (%)	97-99	97-99	114.7	91.8	99.2
Net investment yield (%)	~2	~2	2.2	1.2	2.0

SAR--Saudi riyal. f--S&P Global Ratings' forecast.

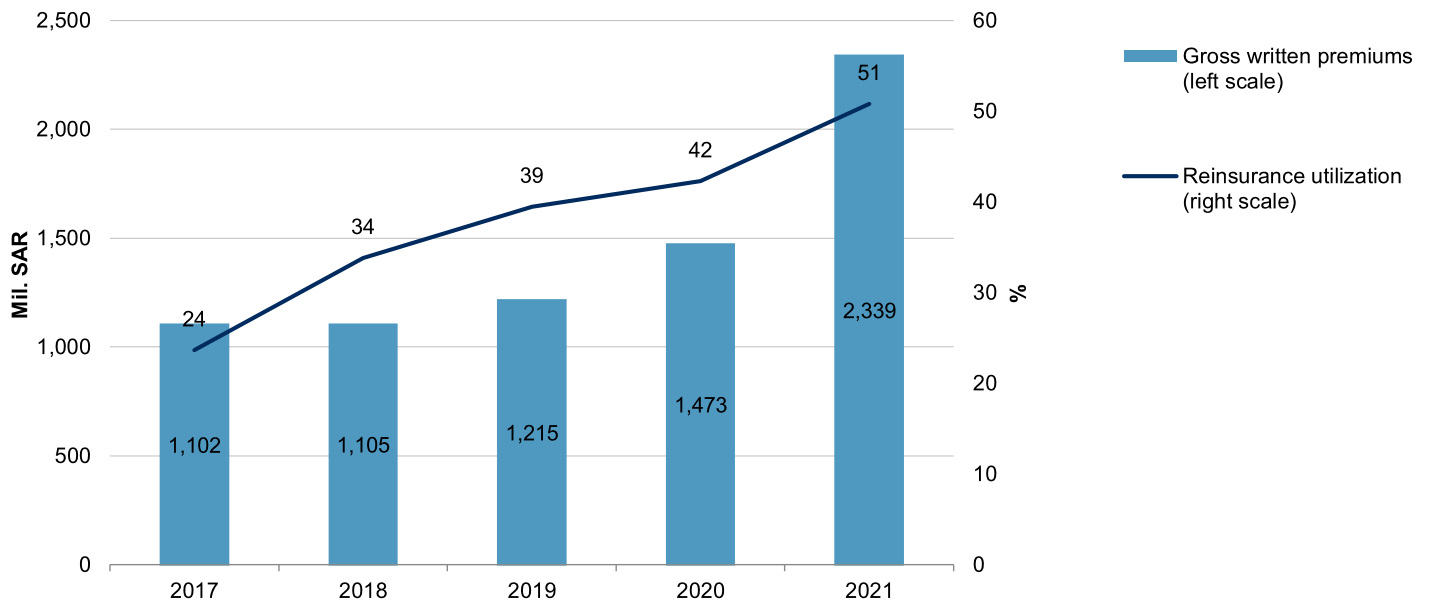
Business Risk Profile: Satisfactory

Established in 2007, Walaa is based in Al Khobar in the Eastern Province of Saudi Arabia. The company's shares are listed on the Saudi stock exchange with no single dominant shareholder. Walaa derives its business solely from Saudi's P/C insurance market, which we think has modest growth prospects over the next two-to-three years. Walaa operates in both commercial and retail lines of business. Although significant volumes are generated from motor, which are largely retained, the share of energy, property and engineering business which are heavily reinsured, has gradually increased. This is evident from Walaa's increasing reinsurance utilization. Walaa also benefits from being a preferred partner for some global insurance companies to service their local clients.

In 2021, Walaa reported strong growth of about 59% in its gross written premiums, backed by the acquisition of a large energy account and growth in the medical, and protection and savings, lines. It also successfully completed the integration with Metlife KSA during 2021. Over the next two years, we expect Walaa will maintain a high premium growth rate of about 10%, since it plans to expand both organically and through its M&A strategy.

Chart 1

Walaa's Premium Growth And Reinsurance Utilization



SAR--Saudi riyal. Source: S&P Global Ratings.

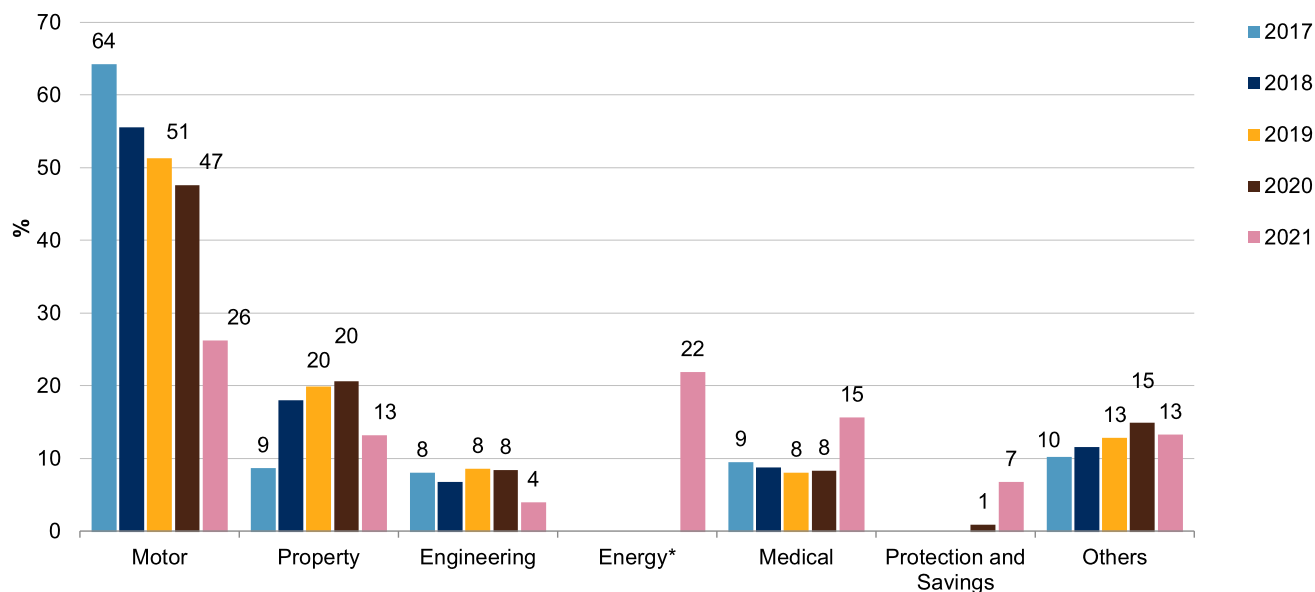
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In recent years, Walaa has also executed on its diversification strategy, with the share of motor insurance gradually decreasing to 26% at December 2021 from 47% in 2020. Meanwhile, the share of other lines of business, such as

property and engineering, has increased. In 2021, Walaa acquired a large account of Saudi ARAMCO with gross written premiums of about SAR500 million mainly covering the energy business. While this boosted Walaa's top line, it was largely reinsured. With the acquisition of Metlife KSA, Walaa now has a license to write life business in addition to medical, motor, and reinsurance. We expect Walaa will further improve its diversification by lines of business.

Chart 2

Walaa's Gross Written Premiums By Line Of Business



*Walaa was writing energy before 2021, but only started reporting it separately from property last year as the line became more significant. Source: S&P Global Ratings.

On the operating performance side, Walaa reported poor underwriting performance for 2021 due to intense competition in motor and medical lines, which led to the company reporting a net loss of SAR122 million. We understand Walaa has taken actions to ensure these lines remain technically profitable. In our base-case projections, we expect the company will return to modest underwriting performance and report net combined ratios of 97%-99%. While we expect underwriting margins will remain thinner due to Walaa's growth strategy, profitability over the next two years will be supported by modest investment income and relatively lower operational expenses due to economies of scale and operational efficiency.

Financial Risk Profile: Very Strong

Our assessment of Walaa's financial risk profile is underpinned by its robust capital adequacy, which is a key rating strength. It is further supported by the company's low tolerance to investment risk.

Walaa's capital adequacy has remained above the 'AAA' level of our risk-based capital model over the past few years. While it came under marginal pressure due to reported losses in 2021, we expect it to return above the 'AAA' level over 2022-2024 backed by Walaa's plan to increase its capital base by about SAR775 million (about \$207 million) via an ongoing M&A transaction with SABB Takaful, which should be concluded in 2022 followed by a rights issue in late 2022 or early 2023. We believe these steps demonstrates proactive management that would provide the company with sufficient capital resources for its growth strategy and to absorb any unexpected volatility.

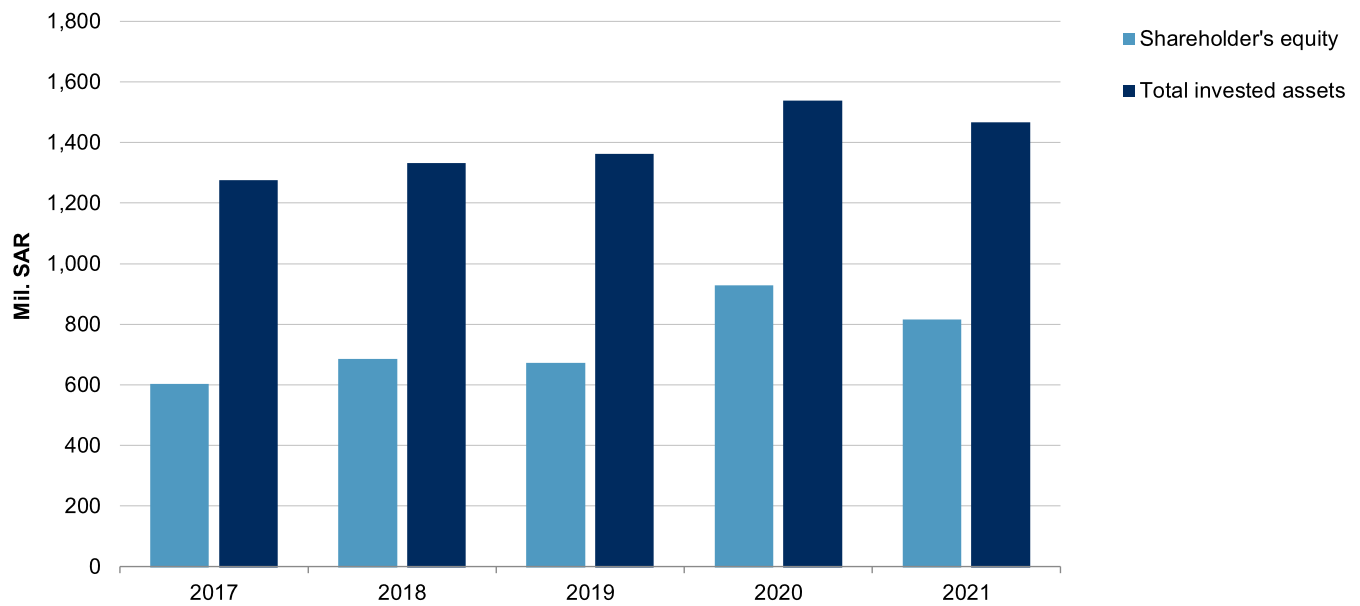
Our capital and earnings assessment is also moderated by the absolute size of its capital base, which remains modest in global terms and could potentially be sensitive to large-loss events or market volatility. At year-end 2021, shareholder equity stood at SAR811 million (about \$217 million).

Walaa has consistently expanded its share capital over the past couple of years, both by injecting capital and retaining the majority of its earnings. At the time of incorporation, Walaa's share capital was SAR200 million. In 2015, Walaa raised an additional SAR200 million via a rights issue, which was followed by a SAR40 million bonus issue in 2018 and a SAR88 million bonus issue in 2019. These took its total share capital to SAR528 million. In 2020, Walaa further increased its share capital to SAR646 million to merge with Metlife KSA and transfer all of its assets and liabilities through a securities exchange offer.

In 2021, Walaa also announced it had signed a binding merger agreement with SABB Takaful, through which the two will combine through a share swap transaction. We expect that, upon completion, Walaa's shareholders' equity will strengthen further and remain sufficient to support the company's ambitious growth plans. These capital injections, along with retained earnings over the past five years, resulted in growth of Walaa's shareholders' equity. Walaa's strategy to retain the majority of its earnings has also helped the company preserve cash and consistently expand its invested asset base.

Chart 3

Walaa’s Shareholder Equity And Total Invested Assets

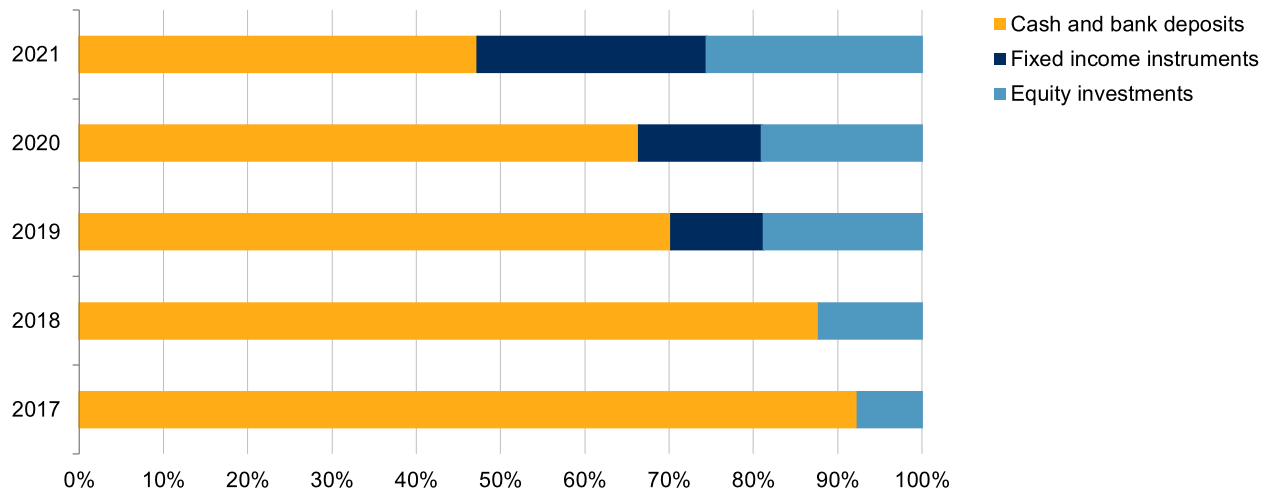


SAR--Saudi riyal. Source: S&P Global Ratings.
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We view Walaa's investment portfolio as conservative and in line with regulatory requirements. At Dec. 31, 2021, Walaa's total investment portfolio reached SAR1,465 million (SAR1,535 million at Dec. 31, 2020), comprising 47% held in cash and bank deposits, 26% in equities, and 27% in fixed income instruments. Since the majority of assets are invested in cash and fixed-income instruments with a selection of local banks, the company is susceptible to concentration in the local banking sector, similar to other local insurers.

Chart 4

Walaa's Investment In Equity Has Increased In Recent Years



Source: S&P Global Ratings.
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In our opinion, Walaa has adequate risk controls for its relatively modest size of operations. The company's track record in effectively mitigating and managing underwriting and operational risks bolsters our assessment of the effectiveness of the framework.

Walaa's need for additional capital and liquidity is modest. We view Walaa's plan to almost double its capital in 2022-2023 via the rights issue and M&A with SABB Takaful as a proactive step by management, which would enable the company to have sufficient capital resources for its growth strategy and to absorb any unexpected volatility.

Walaa could also cede more risk to its reinsurers or borrow from banks if required. The company currently has a debt-free balance sheet.

Other Key Credit Considerations

Governance

Walaa's senior management team and underwriters are well experienced, understand the local market, and continue to demonstrate a good track record of operational effectiveness. The company has a clear strategic plan, which management and the board are developing and implementing. In our view, the company's strategy is consistent with its organizational abilities and market conditions. Corporate governance practices also appear appropriate with no dominant shareholders or directors, and the use of independent board members helps protect the interests of those shareholders who acquired shares through Walaa's original public listing.

Liquidity

Wala maintains exceptional liquidity by global standards, largely reflecting its strong earnings, positive cash flows, and cash-oriented investment strategies. At Dec. 31, 2021, its cash and cash equivalents alone covered 3x net loss reserves.

Environmental, social, and governance

ESG Credit Indicators

E-1	E-2	E-3	E-4	E-5	S-1	S-2	S-3	S-4	S-5	G-1	G-2	G-3	G-4	G-5
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ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have no material influence on our credit rating analysis of Wala Cooperative Insurance Co.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Appendix

Wala Cooperative Insurance Co. Ltd.--Credit Metrics History

(Mil. SAR)	--Year ending Dec. 31--	
	2021	2020
S&P Global Ratings' capital adequacy	Very strong	Excellent
Total invested assets	1,465	1,535
Total shareholder equity	813	925
Gross premiums written	2,339	1,473
Net premiums written	1,151	850
Net premiums earned	1,042	797
Reinsurance utilization (%)	50.8	42.3
EBIT	(113)	73
Net income (attributable to all shareholders)	(122)	51
Return on revenue (%)	(12.1)	8.7

Walaa Cooperative Insurance Co. Ltd.--Credit Metrics History (cont.)

(Mil. SAR)	--Year ending Dec. 31--	
	2021	2020
Return on shareholders' equity (reported) (%)	(14.1)	6.4
P/C: net combined ratio (%)	114.7	91.8
P/C: net expense ratio (%)	23.4	22.0
EBITDA fixed-charge coverage (x)	N.M.	N.M.
EBIT fixed-charge coverage (x)	N.M.	N.M.
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	N.M.	N.M.
Financial obligations / EBITDA adjusted	N.M.	N.M.
Financial leverage including pension deficit as debt (%)	N.M.	N.M.
Net investment yield (%)	2.2	1.2
Net investment yield including investment gains/(losses) (%)	3.4	1.2

N.M.--Not meaningful. SAR--Saudi riyal. P/C--Property and casualty.

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bbb-	bb-/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of May 16, 2022)*

Operating Company Covered By This Report

Walaa Cooperative Insurance Co.

Financial Strength Rating

Local Currency

A-/Stable/--

Gulf Cooperation Council Regional Scale

gcAAA/--/--

Domicile

Saudi Arabia

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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