

**CREDIT OPINION**

6 May 2021

Update

 Rate this Research

**RATINGS**
**Walaa Cooperative Insurance Company**

Domicile	Saudi Arabia
Long Term Rating	A3
Type	Insurance Financial Strength - Fgn Curr
Outlook	Stable

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 following the change in outlook to stable

**Summary**

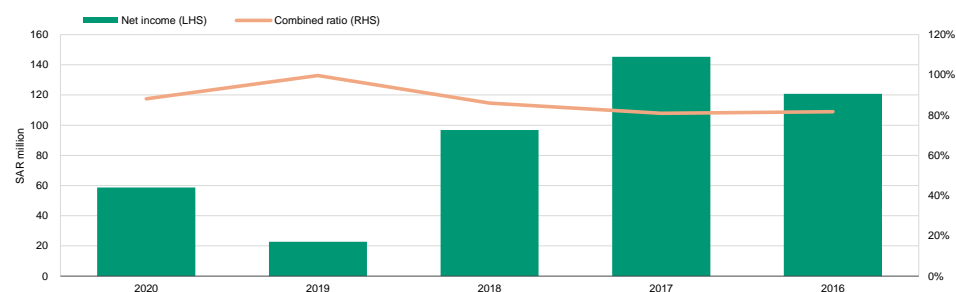
Walaa Cooperative Insurance Company's (Walaa) is rated A3 for insurance financial strength. Based in Saudi Arabia, Walaa is a medium sized composite insurer underwriting property and casualty as well as more recently life insurance post the merger with Metlife AIG ANB Insurance Company (Metlife AIG ANB). The A3 of Walaa reflects its: (i) strong market position and brand; (ii) strong asset quality; (iii) strong capital adequacy level; and (iv) good profitability; and (v) 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.

The change in outlook to stable from negative reflects Walaa's successful execution of its merger with Metlife AIG ANB Insurance Company (Metlife AIG ANB). In particular, Walaa has improved the profitability of MetLife AIG ANB's business and addressed the company's regulatory deficiencies. Additionally, the merger has provided Walaa with diversification into health, protection and savings, which are key growth areas in Saudi Arabia.

In January 2021, Walaa's board of directors recommended a SAR775 million (\$206 million) rights issue to increase the company's paid capital by 120%, in order to maintain the company's solvency margin as it pursues its growth plan for the next three to five years.

During 2020, the company reported gross premiums of SAR1.5 billion, 21% growth compared to 2019. Its combined ratio improved in 2020 at 88.1% compared to 99.7% in 2019 as claims expenses decreased, better claims, seen across Saudi Arabia as a result of coronavirus pandemic and government imposed lock downs (Exhibit 1). With this, net income increased to SAR58.7 million from SAR22.7 million in 2019.

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 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 stable rating outlook reflects Moody's expectation that Walaa will maintain good levels of profitability, will grow its business with underwriting discipline and adjust its growth plan if necessary to maintain its capital adequacy.

## Factors that could lead to an upgrade:

- » Reaching a top three position in Saudi Arabia in terms of premiums whilst maintaining ROC of over 15% and COR of under 90%
- » A profitable improvement in business diversification, with for example a balanced mix of revenues between several major lines of business.

## Factors that could lead to a downgrade:

- » A weakening in profitability with ROC's below 4% and combined ratios over 100% consistently
- » Its market position in Saudi Arabia falling out of the top seven in terms of premiums
- » A deterioration in asset quality with high risk assets (HRA) as a percentage of consolidated (shareholders' and policyholders') equity of over 60%, or there is deterioration of the bank deposit ratings in Saudi Arabia to which Walaa is exposed to, or the loss of A-rated reinsurance support
- » A weakening of capital adequacy with GUL over 3x
- » Reserve adequacy deteriorates with consistent reserve strengthening required in subsequent years
- » Undertakes significant borrowings with leverage levels reaching or over 15%
- » A long-lasting negative impact of the coronavirus and of low oil prices on the Saudi Arabian economy, with negative implications on Walaa's profitability and capital.

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## Key indicators

Exhibit 2

Walaa Cooperative Insurance Company [1][2]	2020	2019	2018	2017	2016
<b>As Reported (Saudi Riyal Millions)</b>					
Total Assets	2,880	2,033	1,997	1,780	1,538
Total Shareholders' Equity	925	670	682	600	450
Net Income (Loss) Attributable to Common Shareholders	59	23	97	145	121
Gross Premiums Written	1,473	1,215	1,105	1,102	1,017
Net Premiums Written	864	750	746	851	766
<b>Moody's Adjusted Ratios</b>					
High Risk Assets % Shareholders' Equity	31.5%	38.0%	23.9%	16.1%	24.4%
Reinsurance Recoverable % Shareholders' Equity	78.8%	62.4%	53.3%	47.1%	63.8%
Goodwill & Intangibles % Shareholders' Equity	9.1%	2.7%	3.7%	6.2%	7.2%
Gross Underwriting Leverage	2.2x	2.5x	2.3x	2.6x	3.3x
Return on Average Capital (ROC)	6.7%	2.8%	13.9%	25.8%	29.4%
Sharpe Ratio of ROC (5 yr.)	135.2%	47.1%	41.8%	38.9%	NA
Adv. (Fav.) Loss Dev. % Beg. Reserves	NA	-22.5%	-26.6%	-50.9%	-21.0%
Adjusted Financial Leverage	3.9%	3.6%	5.4%	5.4%	5.5%
Total Leverage	3.9%	3.6%	5.4%	5.4%	5.5%
Earnings Coverage	265.5x	NM	107.9x	222.1x	194.9x
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 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. It also sell life insurance products post the merger with Metlife AIG ANB in 2020.

## Detailed credit considerations

### Market position and brand: A - Strengthening market position in Saudi Arabia

Walaa has a strong market position in Saudi with 3.9% market share and ranks as the 5th largest player in this market in 2020 by premiums having gross premiums written (GPW) of SAR1.5 billion. The market position has continued to strengthen, improving from 2019's 6th position with a market share of 3.2% which in itself was a significant improvement over the 11th position it held back in 2014.

In 2019, the company had opened 10 branches widening its branch network to over 70. Furthermore the successful merger with Metlife AIG ANB will benefit the market position of Walaa with the addition of other underwriting lines of health, protection and savings, which are key growth areas in Saudi Arabia.

However we remain watchful of Walaa's continued growth as the Saudi insurance market is highly competitive, given the dominant position of the top 3 insurers which represented 59% of the market in terms of premiums in 2020.

### Product focus and diversification: Baa - Concentrated to Saudi market and to motor, albeit diversification into health and life expected in the medium term

Walaa's GPW mix is similar to most GCC insurers with large contribution from motor (47% in 2020) and medical (8% in 2020). Despite the merger with Metlife AIG ANB we do not expect the product mix to change considerably in the short term thus the company will remain concentrated in motor, reflecting the wider Saudi market concentration to medical and motor (comprising c.80% of premiums). However over the medium term we expect medical and life insurance to grow aiding Walaa's product diversification. 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 remains conservative 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.

#### Asset Quality: A - Equity investments increased in 2020, but the mix is still conservative

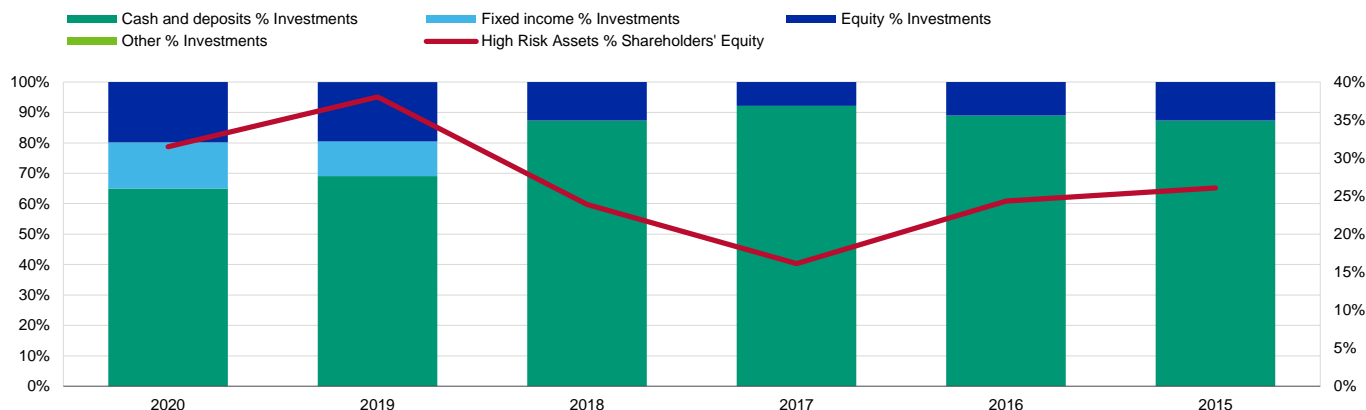
Walaa's strong quality of invested asset is a result of the management's decision to maintain strong regulatory solvency levels. About 65% of the invested assets was in cash and bank deposits as at YE 2020. Equity investments accounted for 20% of invested assets as at YE 2020, and fixed income investments was 15% 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 % of shareholders' equity was strong at 31.5% at YE 2020 and was lower than the 38.0% reported at YE 2019 due to improvement in shareholder's equity (Exhibit 3). Reinsurance recoverable % of shareholders' equity increased slightly to 78.8% at YE 2020 from 62.4% at YE 2019. 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, STA).

Goodwill and intangibles previously comprised of deferred acquisition costs however the ratio increased to 9.1% as at YE 2020 from 2.7% at YE 2019, with the increase largely on account of the goodwill recognised post the merger.

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, with further strengthening on the cards

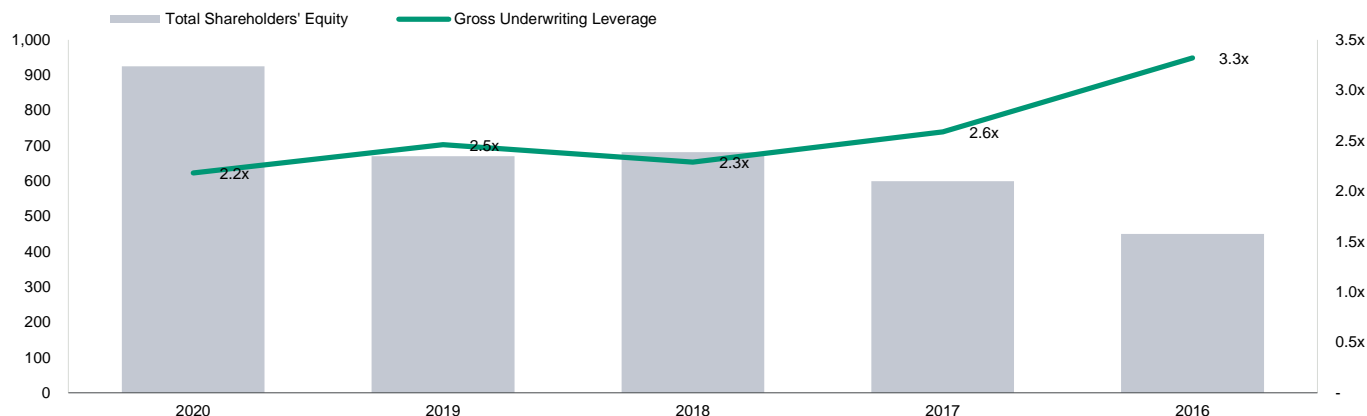
As concerns capitalisation, we view Walaa's capital adequacy as strong, with a GUL of 2.2x as at YE 2020, having strengthened from 3.6x as at YE 2015 (see below exhibit). In 2020, total equity increased to SAR925 million aided by an increase in paid up capital and share premium stemming from the merger 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 meet the regulatory solvency requirement.

On 11 January, Walaa's board of directors recommended a SAR775 million rights issue to increase the company's paid capital by 120%. Pending regulatory and shareholder approvals, the rights issue would likely take place by the end of 2021 and boost shareholders' equity by around 78% from YE 2020's SAR925 million.

Walaa's proactive risk and capital management is credit positive because it aims to maintain the company's solvency margin as it pursues its growth plan for the next three to five years. Despite increasing competition in the Saudi Arabian insurance market and

uncertainty over the profitability of new business, the increased capital buffers would allow Walaa to manage execution risks and adjust its growth plan if necessary.

Exhibit 4

**Walaa's capitalisation indicators**

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

**Profitability: A - Improved in 2020 but volatility remains**

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 owing to higher claims. Nevertheless, 2020 results improved aided by lower reported claims, resulting in a COR of 88.1% (2019: 99.7%). The loss ratio for 2020 was around 64% compared to 74% for 2019. As a result 2020's RoC of 6.7% also improved compared to the last year's 2.8%.

Largely the improvements in the 2020 loss ratio is in line with what was seen across the region and Saudi Arabia as motor and health claims lowered due to government imposed lock downs and lower activity driven claims.

However, whilst the 5-year average combined ratio remains good at 87% (2020-2015), we remain watchful given the Saudi market-wide competitive pressures specifically in motor which Walaa is expected to remain exposed to as well as in medical which Walaa is expected to grow.

More positively, the recent change in outlook to stable from negative reflects Walaa successfully executing its merger with MetLife AIG ANB having improved the profitability of MetLife AIG ANB's business and addressed the company's regulatory deficiencies. Also going forward we expect that Walaa will maintain good levels of profitability whilst growing its business with underwriting discipline and adjust its growth plan if necessary.

**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 (1) low, albeit rising, government debt; (2) robust fiscal and foreign currency reserve buffers and prudent financial regulation; and (3) large stock of proved oil reserves and low extraction costs. The credit challenges Saudi Arabia faces include (1) an economy that is still heavily dependent on oil; (2) a narrow tax base that is vulnerable to oil price volatility; (3) relatively high unemployment; and (4) geopolitical tensions with Iran.

The Saudi Insurance market is regulated by the Saudi Central Bank (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 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. However the insurance market is still in a developmental stage, with growth potentially volatile and with some large risk concentrations particularly to compulsory lines such as motor and medical. This along with oversupply of insurance products leads to significant levels of price competition. In addition to the pressures of competition, Saudi insurers are facing macroeconomic and regulatory headwinds which will continue to pressure the sector's profitability, liquidity and capital, making consolidation likely.

## 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 composite (P&C and Life) insurer 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.

Furthermore, medical insurers have elevated social risks related to their integral role in society and position as the front line for most people in managing their medical care costs, and being regarded as at least partly responsible for the cost structure and access to medical care for the public. As a medical insurer, Walaa is exposed to such risks, however during the coronavirus pandemic the risks have abated with the Saudi Arabian government undertaking all coronavirus related expenses.

### 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	ScoreAdj	Score
Business Profile								A	A
<b>Market Position, Brand and Distribution (25%)</b>								A	A
-Relative Market Share Ratio			X						
-Underwriting Expenses % Net Premiums Written	18.1%								
<b>Product Focus and Diversification (10%)</b>								A	Baa
-Product Risk		X							
-P&C Insurance Product Diversification			X						
-Geographic Diversification									
Financial Profile								Aa	A
<b>Asset Quality (10%)</b>								Aa	A
-High Risk Assets % Shareholders' Equity		31.5%							
-Reinsurance Recoverable % Shareholders' Equity			78.8%						
-Goodwill & Intangibles % Shareholders' Equity	9.1%								
<b>Capital Adequacy (15%)</b>								Aa	A
-Gross Underwriting Leverage		2.2x							
<b>Profitability (15%)</b>								A	A
-Return on Capital (5 yr. avg.)	15.7%								
-Sharpe Ratio of ROC (5 yr.)				135.2%					
<b>Reserve Adequacy (10%)</b>								Aaa	A
-Adv. (Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd. avg.)	X								
<b>Financial Flexibility (15%)</b>								A	Baa
-Adjusted Financial Leverage	3.9%								
-Total Leverage	3.9%								
-Earnings Coverage (5 yr. avg.)	197.6x								
-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, 2020. [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
<b>WALAA COOPERATIVE INSURANCE COMPANY</b>	
Rating Outlook	STA
Insurance Financial Strength	A3

Source: Moody's Investors Service



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