

Rating Action: Moody's assigns Baa1 insurance financial strength rating to Al Dhafra Insurance Company; Stable Outlook

12 Apr 2018

London, 12 April 2018 -- Moody's Investors Service has today assigned a Baa1 insurance financial strength rating (IFSR) to Al Dhafra Insurance Company P.S.C. (Al Dhafra), based in United Arab Emirates (UAE). The outlook is stable.

Al Dhafra is a medium sized insurer operating primarily in the United Arab Emirates since 1979, and is focused on non-life insurance, providing motor, medical, property and engineering, and various personal lines products.

RATINGS RATIONALE

Moody's Baa1 rating reflects Al Dhafra's: (i) good stable mid-market position and well-established reputation and brand, being number thirteen with a market share of 1% in 2017 in the UAE insurance market; (ii) strong capitalisation with a gross underwriting leverage (GUL) of 2.3x at YE 2017; (iii) strong profitability with a return on capital (ROC) of 15.8% in 2017, driven by a strong underwriting combined ratio (COR) of 74%; and (iv) improving sophistication in reserving with actuarial-led reserve setting and monitoring. More negatively, Al Dhafra has large investments in equities and property, such that high risk assets (HRA) as a percentage of shareholders' equity was relatively elevated at 90% at YE 2017. In addition relatively elevated reinsurance recoverable impacts Al Dhafra's asset quality: reinsurance recoverable as a percentage of shareholders' equity was 92% at YE 2017, exposing the company to the counterparty credit risk of the reinsurers.

Despite the fierce competition that exists in the UAE market, Al Dhafra has consistently maintained its mid-market position as it maintains high customer retention, with many of whom Al Dhafra has direct access to business via its five branches and various points of sales, such that c.60% of its premiums distribution is direct. Al Dhafra is heavily focused on personal lines business -- in particular the motor segment. This, along with its small size in comparison to the major insurers in the UAE, limits its ability to influence the market and drive pricing levels, albeit this risk is mitigated by Al Dhafra's strong management as evident from the strong underwriting and overall profitability.

Profitability is a key strength of Al Dhafra thanks to its conservative underwriting approach which translates to its strong performance with a COR of 74% in 2017. However we note that in 2015 and 2016, Al Dhafra had to strengthen its insurance reserves in accordance with actuarial levels, similar to other insurers in UAE, following the introduction of actuarial-led reserving regulation in 2015. As concerns capitalisation, Moody's views capital level as strong with a gross underwriting leverage (GUL) of 2.3x at YE 2017. However Moody's notes that, with the exception of 2015 and 2016, Al Dhafra has been distributing high levels of dividends (of between 30%-40%); the high dividend policy does slow the pace of organic growth of its capital.

Moody's also notes that the elevated reinsurance recoverable at YE 2017 is a result of the aforementioned conservative underwriting approach of Al Dhafra, which increased its purchase of reinsurance and widened its pool of reinsurers in 2016 in order to further protect its results and capital from any underwriting volatility.

The stable rating outlook reflects Moody's expectation that Al Dhafra will maintain its strong profitability aiding the gradual organic growth of its capital.

According to Moody's, the rating could be upgraded if: (i) Al Dhafra's market position improves and the company increases its market share becoming a top-ten insurer in the UAE market while maintaining similar levels of profitability; and/ or (ii) there is an improvement in asset quality either in terms of invested assets with HRA equating to below 70% of shareholders' equity or reinsurance recoverable equating to below 70% of shareholders' equity or an improvement in the reinsurance panel in terms of credit ratings; and/ or (iii) capitalisation improved further with GUL falling below 2x.

Conversely, the rating could come under negative pressure as a result of: (i) a significant reduction in the company's share of the UAE market; and/ or (ii) a meaningful deterioration in underwriting performance, with the COR above 100% for consecutive years; and/ or (iii) a greater than expected deterioration in invested asset quality, with HRA equating to over 100% of shareholders' equity; and/ or (iv) its strong capitalisation

deteriorates with GUL rising over 3x.

The following rating was assigned:

Al Dhafra Insurance Company P.S.C.: Insurance Financial Strength Rating of Baa1

The outlook is stable.

Based in UAE, Al Dhafra reported a 23.5% growth in its premiums to AED415.3 million for 2017 from AED336.3 million in 2016 and thereby reported a 236.4% growth in net income to AED51.5 million in 2017 from AED21.8 million in 2016. As a result, even after paying a dividend of AED15.0 million, Al Dhafra's shareholders' equity increased by 9.9% to AED341.9 million at YE 2017 from AED311.0 million at YE 2016.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Global Property and Casualty Insurers published in May 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The Local Market analyst for this rating is Mohammed Ali Riyazuddin Londe, +971.4.237.9503.

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