Executive Summary

The scope of this report is to study the insurance sector in Saudi Arabia and analyze current trends with the objective of ascertaining where the industry is placed amid intense competition, profitability and capitalization pressures.

Remarkable growth for the insurance industry: Though relatively young, as indicated by the low penetration and density, the insurance market grew 18% per annum over 2008–12 and was the second largest market in GCC. It contributed 33.5% to the region's total Gross Written Premiums (GWP) in 2012. Several growth drivers are in place for the insurance industry.

Highly fragmented industry, intensifying competition: The sector comprises nine segments, with health and motor accounting for over three-quarters of total GWP. The industry is highly fragmented; of the 33 insurance companies, the top three contributed 52.7% to the total GWP and 87.5% to the industry's profits in 2012. High concentration is fueling competition in the sector.

Company analysis: We analyzed insurance companies' financial performance by classifying 30 firms into three categories based on their equity capitalization (shareholders' equity). The first set of 11 companies with capitalization over SAR200 mn accounted for a market share of 70% in 2012. The second set of 12 companies with capitalization between SAR 100 mn and SAR 200 mn reported an improvement in financial strength in 2012, and a few exhibited the potential to gain market share and scale. The third group consisted of seven companies with capitalization less than SAR 100 mn, where several exhibited weak financial strength and may need to be recapitalized, going forward.

New growth avenues and availability of capital delaying consolidation: Several avenues, such as compulsory insurance for motor and health, and product evolution, have been exhausted to a certain extent. These factors coupled with the existence of a large number of smaller players are limiting economies of scale within the industry. However, consolidation, which appears imminent, has been delayed mainly due to newer growth avenues such as the enactment of the mortgage law and easy access to funding.

As the industry attains critical mass, companies would seek to realign their business goals, increase focus, and improve profitability to remain competitive. For a few of these companies, the best alternative would be to evaluate inorganic growth options.

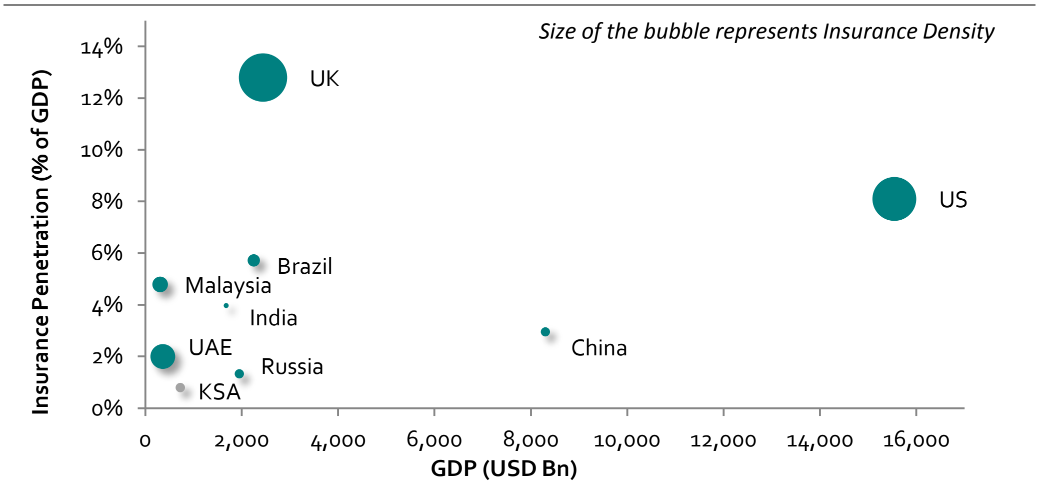
1. Industry Overview

The insurance market in Saudi Arabia grew 18% per annum over 2008–12. GWP totaled SAR21.2 bn in 2012 vis-à-vis SAR18.5 bn in 2011. Non-life insurance was the key contributor to the industry's growth. The segment expanded 10.6% year-on-year in 2012, while growth in the life insurance segment remained subdued. Factors such as strong economic growth, structural reforms, favorable demographics and regulatory environment have been vital for the industry's growth. Regulatory changes undertaken with the adoption of the cooperative insurance model in 2005 and measures implemented by the government (mandatory health insurance for expatriates) have been the key growth drivers for the insurance industry. The life insurance market, on the other hand, remains weak due to religious beliefs, lack of awareness and presence of a large expatriate population for whom life insurance is not a priority.

Saudi Arabia: Second largest and relatively young market in GCC

The Saudi insurance industry is the second largest in GCC, contributing 33.5% to the region's total GWP in 2012. Yet, it is young vis-à-vis the UAE, the largest market in GCC, as well as emerging and developed markets, as reflected by the low penetration and insurance density. As of 2012, the Kingdom's insurance penetration was equivalent to 0.8% of GDP compared to the UAE's 2.0%, while Brazil, Russia, India and China (BRIC countries) had an average penetration of 3.5%.

Figure 1. Comparison of Insurance Penetration[1], Insurance Density[2] and GDP.



Source: The Saudi Insurance Market Report 2012 – SAMA

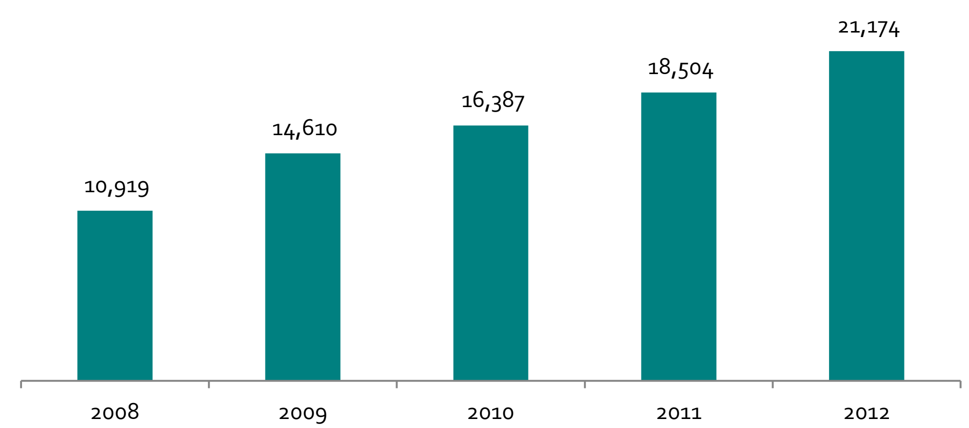
[1] It is obtained by dividing gross written premiums by GDP
[2] It is obtained by dividing gross written premiums by population

As of 2012, Saudi Arabia had an insurance density of USD188.1 compared to USD1299.0 in the UAE, USD4045.0 in the US and USD4924.0 in UK. The low insurance density in the country compared to other markets (UAE) in the GCC region and developed economies (such as UK and the US) indicate significantly high potential for growth.

Consistent growth over the past three years

The insurance sector has witnessed consistent growth, averaging 13% over the past three years. In 2012, the industry expanded 14.4%. Growth was predominantly driven by the non-life insurance segment; the latter's contribution to GWP increased 15.3% over the same period.

Figure 2. GWP for the insurance market in Saudi Arabia (SAR, million)



Source: The Saudi Insurance Market Report 2012 - SAMA

Non-life GWP accounted for nearly 96% of the total insurance GWP in 2012, whereas the life insurance segment continued to contract after peaking in 2009. This is largely due to the low acceptance of life insurance by Saudi residents and slow development of life insurance products compliant with Islamic principles. Consequently, non-life insurance is likely to remain the key growth driver for the country's insurance sector. The life insurance segment may also witness strong traction with an increase in awareness levels, rising insurance penetration and launch of new products. Given this backdrop, Saudi Arabia's insurance market is poised to become the largest market in the GCC region.

Key growth drivers

- **Economic growth**

The Kingdom witnessed strong economic growth in the past few years, primarily due to increasing exports of oil and gas products, sustained government spending on infrastructure projects, strong focus, and growth in the non-oil segment and social welfare. This buoyancy augurs well for the insurance industry as GDP per capita is expected to rise 4.3% during 2012–17 (based on IMF estimates) which is the highest growth in the GCC region. Continued high infrastructure spending by the government and surging investments in the private sector are likely to enhance insurance activity in Saudi Arabia.

- **Compulsory insurance**

Governmental regulations mandating motor and health insurance have been the key driver for the industry in the past few years.

- **Favorable demographics**

Demographics is one of the key demand drivers for the insurance industry. In Saudi Arabia, a huge expatriate population and the relatively young local population are the main contributing factors. The Saudi Labor Ministry estimates nearly 70% of the population was below the age of 30 in 2010 compared to other GCC countries such as the UAE (44%), Kuwait (48%), Qatar (50%), and Bahrain (54%). Also, Business Monitor International (BMI) estimates the Saudi population would double by 2023. A young and growing population creates additional opportunities for the insurance sector.

- **Increasing awareness**

One of the key reasons for low insurance penetration has been reduced awareness levels. However, over time, the industry has benefited from an increase in awareness. This has been ascribed to better understanding of insurance benefits and governmental initiatives to mandate certain insurance products. This, in turn, led to more clarity in terms of the cultural and religious aspects of insurance. Going forward, an increase in awareness would be the key factor for proper dissemination of the benefits from insurance and associated inclusion in the future.

- **Conducive regulatory environment**

Saudi Arabian Monetary Agency (SAMA) has been instrumental in creating a well-defined regulatory environment for the insurance industry. SAMA mandated all of the insurance companies operating in Saudi Arabia to follow the domestic cooperative insurance model. Regulatory changes initiated by SAMA in the last 10 years have helped in ring-fencing operations as well as creating a level-playing field for entities operating in the industry.

- **New growth avenues**

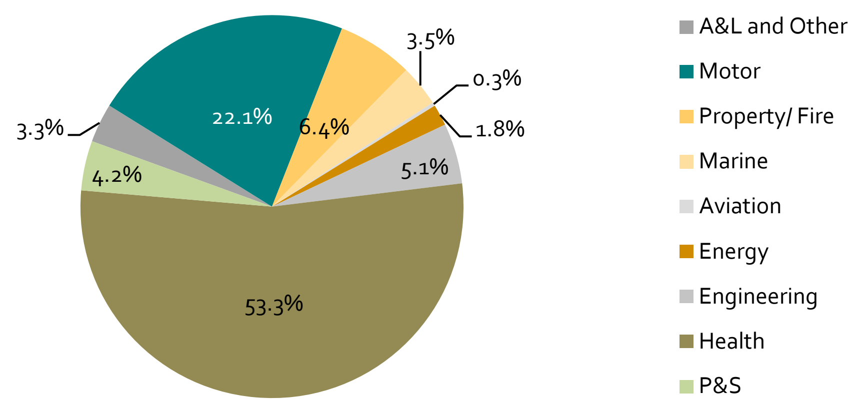
The mortgage law of 2012 is expected to be a significant trigger for residential real estate. From an insurance perspective, it is a significant opportunity as it could open up new avenues such as: (i) providing insurance cover for building materials and fixtures that are expected to be imported; (ii) fire insurance to secure households; and (iii) term life insurance to cater to any eventuality arising before the expiry of the residential loan term.

2. Industry Landscape

2.1. Industry composition: Compulsory lines of insurance dominate the market

The Saudi insurance industry has nine broad segments: A&L and Other, motor, property/fire, marine, aviation, energy, engineering, health, and protection and savings (P&S). It is dominated by the health and motor segments that jointly accounted for over three-quarters of the industry's total GWP in 2012.

Figure 3. Compulsory lines of business dominate the market, 2012



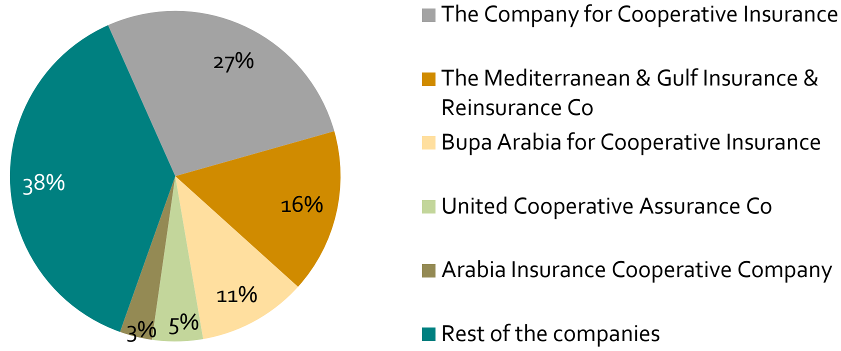
Source: The Saudi Insurance Market Report 2012 - SAMA

Among the nine segments, health insurance, the largest segment, accounted for 53% of the total GWP in 2012, followed by motor insurance (22.1%). The contribution of the remaining seven segments was less than 10% each, with Property & Fire being the biggest contributor at 6.4%.

2.2. Top three companies dominate the insurance landscape

High growth in the Saudi insurance industry in the past few years and the conducive environment with timely issuance of guidelines pertaining to compulsory insurance have resulted in several players entering the market. Currently, 35 companies are operating in Saudi Arabia. Of these, 32 are licensed insurance companies, one reinsurance company (Saudi Reinsurance Company) and two start-ups which are awaiting clearance from the regulator.

Figure 4. Individual insurance companies' GWP contribution to total GWP in 2012



Source: Tadawul

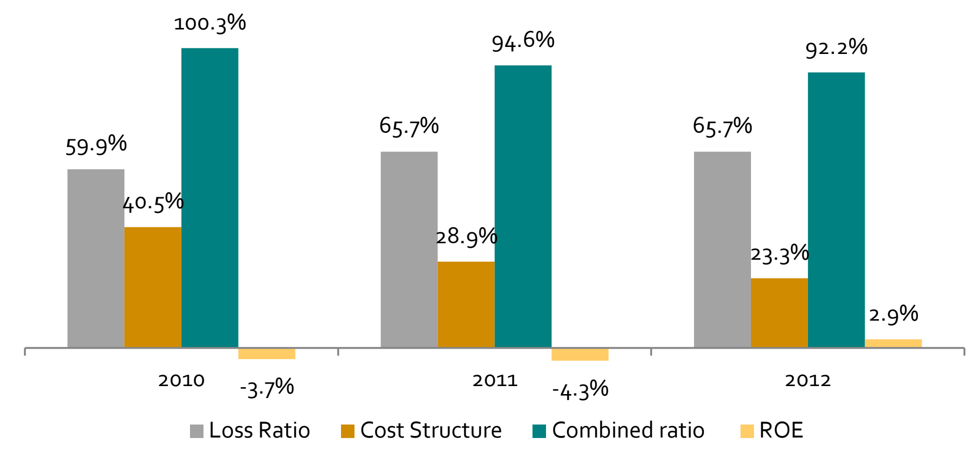
Saudi Arabia's insurance industry is concentrated at the top, with the three biggest companies – The Company for Cooperative Insurance, The Mediterranean & Gulf Insurance & Reinsurance Company and Bupa Arabia for Cooperative Insurance – dominating the insurance landscape, while it is relatively fragmented at the bottom. The top five companies contributed 62% (as of 2012) to the total industry GPW and 87.5% to industry profits in 2012. The larger share of the top five companies in the industry's profits is due to the fact that many of the remaining 28 insurance firms reported losses owing to high operating costs as they are continuously scaling up their operations in a highly competitive environment.

2.3. Industry profitability on an uptrend

The Overall profitability as measured by combined ratio[3] has improved since 2010. From 100.3% in 2010, indicating slight underwriting loss, it gained strength to 92.2% in 2012. This is mainly on account of improvement seen in the cost structure ratio[4], which has almost halved from 40.4% in 2010 to 23.3%. Improving profitability trend has seen the return on equity go up from -3.7% in 2010 to 2.9% in 2012. However, the rising trend observed in loss ratio[5], which surged from 59.9% in 2010 to 65.7% in 2012, is a point of concern. If this trend were to continue, it could put pressure on underwriting profitability.

[3] Sum of loss ratio and cost structure ratio. A ratio of more than 100% indicates an underwriting loss.
[4] Operating expenses as a percentage of net premiums earned.
[5] Total losses paid by an insurance company as claims to total premiums earned

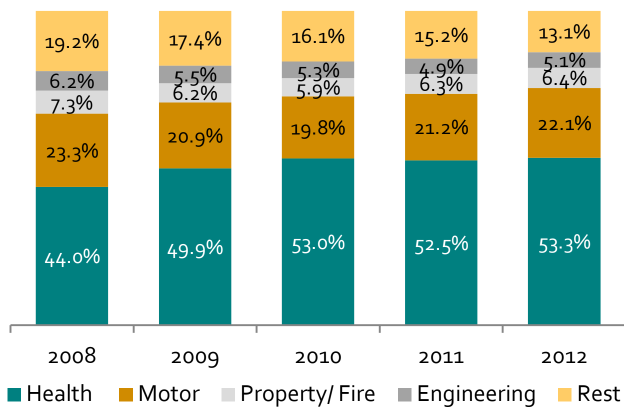
Figure 5. Insurance industry's profitability



Source: Tadawul

3. Insurance sub-sectors and their performance

Figure 6. GWP contribution to total contribution of each segment over the five-year period



Segments	CAGR (2008-2012)
Industry	18%
Health Insurance	24%
Motor Insurance	17%
Prop/fire insurance	14%
Engineering insurance	12%
Rest of the segments	7%

Source: The Saudi Insurance Market Report 2012 – SAMA

3.1. Health – Fastest growing insurance business line

Saudi Arabia's population has been estimated at 26 million, growing at an annual rate of 2.2% as of 2012, with a relatively young local population. This coupled with a favorable regulatory environment implies demand for health insurance has been robust.

The health insurance segment's GWP increased at a CAGR of 24% over 2008–12. This is substantially higher compared to the insurance sector, which recorded 18% CAGR in GWP during this period. Consequently, health insurance's share in total GWP rose from 44% in 2008 to 53% in 2012.

On the flip side, growth in the health insurance segment has been stagnating over the last two years. Norms that made insurance compulsory – a key driver of growth – have lost their bite with the passage of time; also, the number of companies offering health insurance has increased over the last few years.

Governmental initiatives both at broader policy level as well as those taken by various individual ministries would be vital for growth of this segment going forward. Broader policy level initiative to move away from state dominated health care and encourage the development of private medical services is expected to benefit insurers. On the other hand, specific ministerial initiatives like Education Ministry indicating that 5,00,000 teachers would be enrolled into a health insurance which would translate to SAR750 mn in premiums annually would also benefit insurers. These factors coupled with increase in premium rates (as healthcare costs continue to rise) makes this segment interestingly poised going forward.

3.2. Motor – Second fastest growing insurance business line

Motor insurance, the second biggest contributor to overall GWP, expanded at a CAGR of 17% during 2008-12, more or less in line with the industry average CAGR for the same period. Motor insurance which was the second fastest growing insurance business line, has emerged as the fastest growing segment since 2011. The segment's GWP grew 21.1% YoY in 2011 and 19.6% in 2012 due to high car ownership levels and surging sales of new vehicles.

Motor insurance helps provide security to drivers. In the past few years, there has been an increase in road accidents in Saudi Arabia. As of 2012, data from Intelligent Transport Systems Arab (ITS Arab), a Saudi Arabia-based non-profit organization, indicated around 19 people die in traffic accidents every day. Over the last few years, the government has undertaken several initiatives to mitigate this; of these, some prominent ones are listed below.

- In April 2010, Saudi Arabia's General Department of Traffic (GDT) launched a program, Saher, a real-time traffic control and management system. It is enabled with strategically positioned digital cameras that, in turn, are connected to the National Information Center at the Ministry of Interiors, which is the oversight authority for GDT. It automatically registers traffic violations and issues tickets.
- One of the more recent measures to overcome the rise in accidents is Najm Net, which was initiated by Najm, in conjunction with SAMA and GDT, in 2013. Najm Net is a repository for all accidents in Saudi Arabia. This system is followed in many countries and would be helpful in fixing premium rates based on a driver's track record, thereby ensuring imprudent driving would translate into higher premium outgo.

Over the long term, these initiatives are expected to reduce the number of motor accidents as well as premiums. In the near-term, there would be an upward pressure on premium, as reflected by the April 1, 2013 directive, where insurance premiums were revised higher and are expected to increase further, going forward. This would, to a certain extent, offset the impact of waning of compulsory insurance. Going forward, growth in the motor insurance segment is expected to be very closely linked to a rise in automobile sales, which is expected to surpass 1 mn in 2018 from 700,000 in 2010.

3.3. Non-compulsory lines offer solid growth prospects

Property & fire, the third largest segment, registered a CAGR of 14% during 2008–12, lower than the industry average. The segment's contribution to total GWP increased from 5.9% in 2010 to 6.4% in 2012. Engineering is the fourth largest segment; its contribution to overall GWP has been consistent at 5%.

Protection & savings is the smallest segment in the insurance industry. Its contribution to overall GWP was a miniscule 4% in 2012. Beyond 2009, there was steady erosion in GWP growth for this segment, though the pace of decline at 1.8% for 2012 was by far the smallest.

Expansion in non-compulsory lines of business, led by new factors such as the mortgage law of 2012, would be the key growth driver for the insurance industry.

3.4. Profitability of insurance segments

Overall profitability has improved over the past two years. However, health insurance and motor insurance have seen a consistent rise in loss ratio, according to data provided by the SAMA. This is mainly due to high competition in the insurance industry and decreasing impact of compulsory insurance norms. In the motor insurance segment, profitability could further decline, considering the rise in claims paid and rise in loss ratio as well as the expected slowdown in new vehicle sales.

Loss ratio of health insurance segment has risen consistently from 71.5% in 2010 to 81.4% in 2012, while, in case of motor insurance segment, it has gone up from 67.1% to 78.5%. The third largest segment – property and fire – has seen considerable volatility in loss ratio. For 2011, the loss ratio was 103%, which dipped to 50.5% in 2012. This indicates that improvement in profitability is mainly on account improvement in expense/ cost structure ratio. Gross claims paid contribution to total gross claims paid pool for health insurance has remained steady at 63%, while gross claims paid by the motor insurance segment increased from 22% in 2010 to 25.9% in 2012.

3.5. Retention ratios[6] high in compulsory lines of business

Retention ratio is generally high in the compulsory lines of businesses and life. The health insurance segment has seen a steady rise in retention ratio from 76.2% in 2009 to over 88% in

[6] It is the ratio of net written premium divided by gross written premium

2012, whereas the motor segment's retention ratio has remained constant at around 94%. In case of life (protection and savings), the retention ratio stood at 86.3% in 2012. Retention ratios in other commercial lines of insurance are generally low in Saudi Arabia; for instance, retention ratios for the property & fire and engineering segments were 15% in 2012, while those for the energy and aviation segments stood at less than 5%. Low retention rates have been a cause for concern. This prompted SAMA recently to make it compulsory for all newly licensed insurance companies to have a minimum retention ratio of 30%.

4. Financial performance of insurance companies

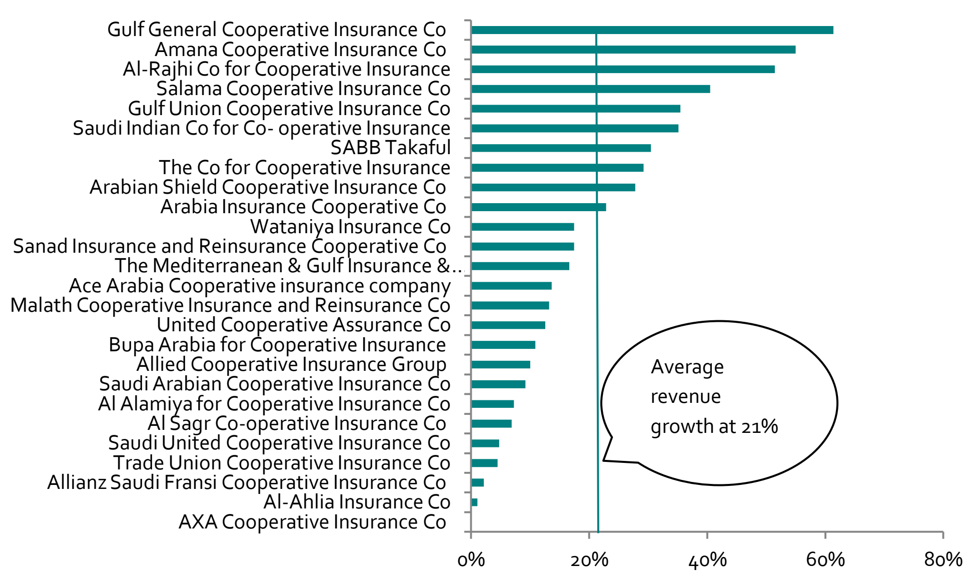
4.1 Revenue growth

To analyze the performance of individual companies from the revenue growth and net income growth perspectives, we removed the outliers; this, in case of revenue growth perspective, would mean companies with more than 100% yoy growth in revenues in 2012.

The top three players by market share recorded double-digit revenue growth in 2012 over 2011. The biggest company in insurance industry, The Co. for Cooperative Insurance recorded 29% growth in revenues in 2012 over 2011. The second largest company in 2012, The Mediterranean & Gulf Insurance & Reinsurance Co., registered a growth of 17% in revenues in 2012 over 2011. The third largest company, Bupa Arabia, recorded a growth of 11% in 2012 over 2011. Average revenue growth for the sample of 26 companies was 21% for 2012.

Mid- to small-sized companies like Al-Rajhi Co. for Cooperative Insurance, Amana Cooperative Insurance Co., Gulf General Cooperative Insurance Co., and Saudi Re for Cooperative Reinsurance Co. have seen an astounding growth of over 50% in revenues for 2012 owing to a lower base. On the other end of the spectrum, we have companies like AXA Cooperative Insurance Co., Al-Ahlia Insurance Co., and Allianz Saudi Fransi Cooperative Insurance Co., which have grown less than 2% despite a relatively smaller base.

Figure 7. Revenue growth of insurance companies in 2012 over 2011



Source: Tadawul

Market share trend in 2012

The high growth witnessed by the insurance industry over the past few years has seen numerous companies applying for insurance and reinsurance licenses. Except for a few companies majority of the large companies have reported a rise in market share in 2012. The Company for Cooperative Insurance is the oldest and largest insurance company in Saudi Arabia with a market share in terms of GWP at 26.97%. The company for cooperative insurance and Gulf Union Cooperative Insurance Company were the biggest gainers in market share for 2012, both seeing 27% increase in market share over that in 2011. The market share trend for top three players constituting 53.35% of GWP in Saudi Arabia has seen a steady growth in 2012. Market share trend clearly indicates the fragmented nature of insurance industry in Saudi Arabia. Gulf General Cooperative Insurance Company saw the biggest drop in market share for 2012, falling over 57.8% in comparison to 2011.

Figure 8. Insurance companies market share trend based on GWP

Company Name	2011 Market share	2012 Market share	Market share trend
The Co for Cooperative Insurance	21.21%	26.97%	↑
The Mediterranean & Gulf Insurance & Reinsurance Co	13.46%	15.88%	↑
Bupa Arabia for Cooperative Insurance	9.54%	10.50%	↑
United Cooperative Assurance Co	5.12%	4.90%	↓
Arabia Insurance Cooperative Co	2.71%	3.13%	↑
Allianz Saudi Fransi Cooperative Insurance Co	3.27%	2.97%	↓
Al-Rajhi Co for Cooperative Insurance	2.36%	2.88%	↑
Saudi Arabian Cooperative Insurance Co	2.63%	2.72%	↑
Trade Union Cooperative Insurance Co	2.58%	2.68%	↑
Malath Cooperative Insurance and Reinsurance Co	2.88%	2.67%	↓
AXA Cooperative Insurance Co	2.05%	2.20%	↑
Gulf Union Cooperative Insurance Co	1.57%	2.00%	↑
Gulf General Cooperative Insurance Co	4.20%	1.77%	↓
Wataniya Insurance Co	1.54%	1.74%	↑
Arabian Shield Cooperative Insurance Co	1.31%	1.59%	↑

Source: Tadawul

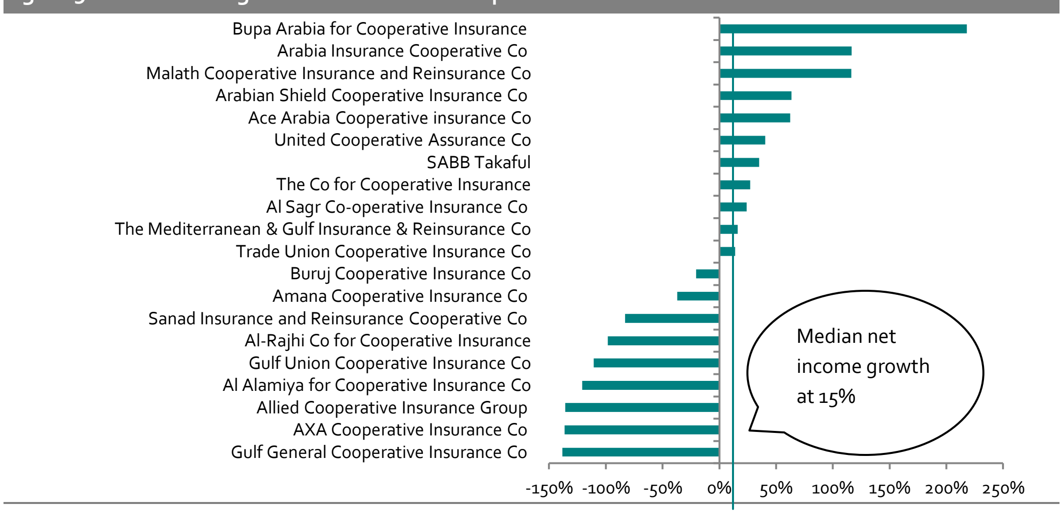
4.2 Profitability

To analyze the performance of individual companies from net income growth perspective, we removed the outliers, which would be companies with net income growth outside the +250% and -250% ranges.

Top three players by market share recorded a double-digit net income growth in 2012 over 2011. The Co. for Cooperative Insurance recorded 27% growth in net income in 2012 over 2011. The Mediterranean & Gulf Insurance & Reinsurance Co. recorded a growth of 16% in revenues in 2012 over 2011. Bupa Arabia recorded a growth of 218% in 2012 over 2011.

Despite the top three players performing well, net income growth has been a mixed bag. Medium-sized players along with large-sized players have seen growth in net income in 2012 over 2011, whereas smaller sized players are impacted negatively and have recorded de-growth in net income for 2012 over 2011. Median net income growth for our sample of 20 companies is 15%. For a selected sample of 20 companies, nine recorded de-growth in 2012. The prominent ones witnessing a de-growth were smaller sized players like Gulf General Cooperative Insurance Company, AXA Cooperative Insurance Company, Allied Cooperative Insurance Group, Al Alamiya for Cooperative Insurance Company, and Gulf Union Cooperative Insurance Company. Among the 11 companies seeing net income growth in 2012, the prominent ones were all medium-sized players who ranked among the top 10 in terms of size, such as Malath Cooperative Insurance and Reinsurance Company, Arabia Insurance Cooperative Company, and Bupa Arabia for Cooperative Insurance.

Figure 9. Net Income growth of insurance companies in 2012



Source: Tadawul

In terms of overall performance, in 2012, nine companies reported a loss, which is a significant improvement compared to 17 companies reporting losses in 2011. Also, seven companies reported losses in both 2011 and 2012.

4.3 Analyzing financial strength of insurers in Saudi Arabia

Objective

In this section, we will analyze companies in terms of capitalization (shareholders' equity), market share, and profitability characteristics to gauge the financial performance amid intense competition.

Methodology

We will analyze all insurance companies listed on Tadawul. For our analysis, we have not included Alinma Tokio Marine Co., Saudi Enaya Cooperative Insurance Company, and Solidarity Saudi Takaful Co. as these companies lack the requisite historical data (recently established). The period for consideration is 2010–12, both years inclusive. For our analysis, calendar year-end annual data is taken from Tadawul.

We divided the list of 30 insurance companies into three buckets on the basis of capitalization data available for 2012. The first bucket comprises 11 companies having shareholders' equity above SAR 200 mn. The second bucket comprises 12 companies with shareholders' equity of SAR 100–200 mn. The third bucket comprises the remaining seven companies having shareholders' equity less than SAR 100 mn. SAMA stipulates that insurers should have a capitalization of SAR 100 mn and insurers with reinsurance license should have a capitalization of SAR 200 mn; hence, these capitalization values have been used as thresholds while arriving at the three buckets.

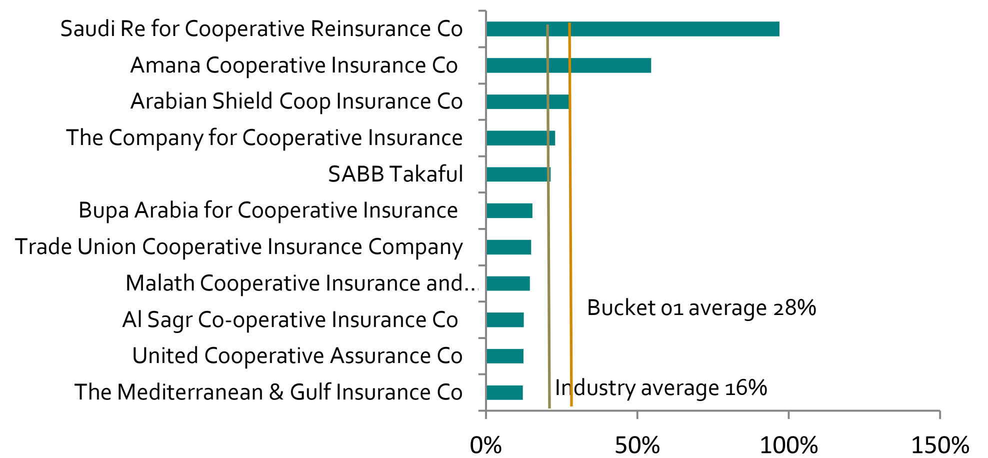
Bucket 01: Market leaders accounting for 70% of overall market share as of 2012

This bucket includes companies that exhibit strong profitability, large market share, and a consistent growth profile. The top five names are The Company for Cooperative Insurance, The Mediterranean & Gulf Insurance & Reinsurance Co., Saudi Re for Cooperative Reinsurance Company, Bupa Arabia for Cooperative Insurance, and SABB Takaful.

Key highlights:

- These 11 companies accounted for 70% of the market share in 2012.

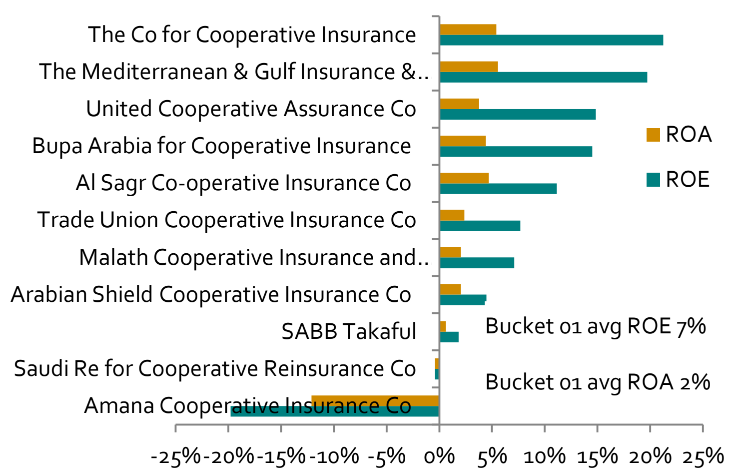
Figure 10. Bucket 1 average revenue growth in the past 2 years was above the industry average



Source: Tadawul. Note: Revenue growth numbers mentioned are post adjusting for outliers.

- Despite a huge base, companies in this list have seen an average revenue growth of 28% for the period 2011-2012.
- These companies have the strongest ROE and ROA characteristics across the three buckets, averaging 7% and 2%, respectively, for the past three years.

Figure 11. Bucket 1 ROE and ROA has been consistent across 2010 to 2012



Source: Tadawul.

- Nearly 72% of these companies have had consistently positive ROA and ROE profiles for the past three years.
- The Company for Cooperative Insurance (Tawuniya), the leading insurer in Saudi Arabia, has been rated "A" for past seven years by S&P. Mediterranean & Gulf Cooperative Insurance & Reinsurance Company, the second largest insurer in Saudi Arabia, has been rated "A-" by S&P. These superior ratings by S&P further reaffirm the financial strength of these companies.

Going ahead, the advantage of scale, market share, profitability, and capitalization that these companies possess, coupled with consistency in performance, augur well for their growth in an otherwise fragmented and challenging insurance market.

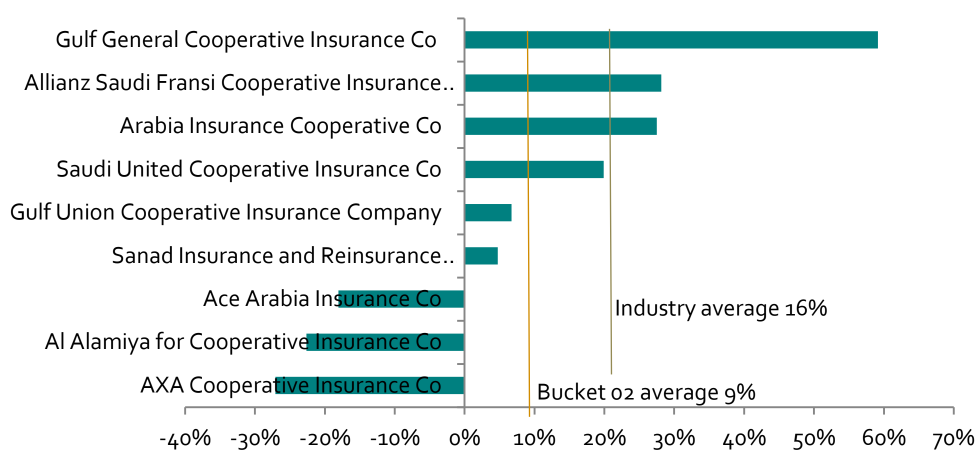
Bucket 02: Mid-sized companies saw a turnaround in financial strength in 2012

This bucket has 12 companies. The top five names in terms of capitalization are AXA Cooperative Insurance Company, Gulf General Cooperative Insurance Company, Saudi United Cooperative Insurance Company, Arabia Insurance Cooperative Company, and Allianz Saudi Fransi Cooperative Insurance Company.

Key highlights:

- These companies have performed well in terms of maintaining a high level of reserve adequacy and investment yield. These companies have had an average investment yield of 5% for the past three years.

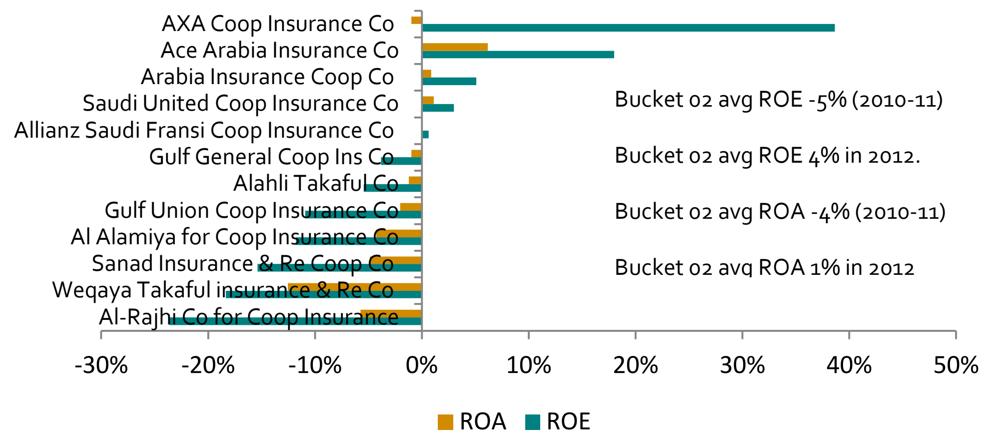
Figure 12. Bucket 2 average revenue growth over the past two years was below the industry average



Source: Tadawul. Note: Revenue growth numbers mentioned are post adjusting for outliers.

- Average revenue growth for bucket 2 in 2011- 2012 period has been 9%, which is below the industry average of 16%.

Figure 13. Bucket 2 average ROE and ROA for the past 3 years



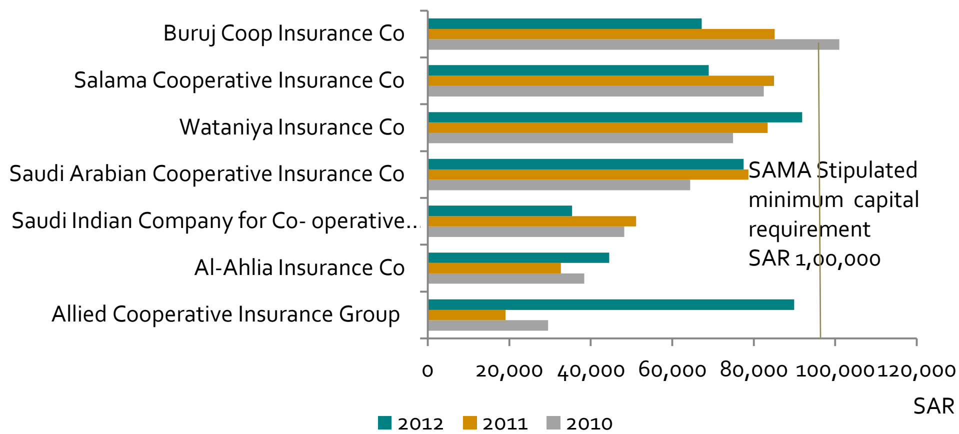
Source: Tadawul.

- ROA and ROE, which at an aggregate level for this bucket, were consistently negative till 2011, have seen an upswing to the positive territory and averaged 1% and 4%, respectively, in 2012.
- This list includes companies such as Gulf Union Cooperative Insurance Company, AXA Cooperative Insurance Company, and Arabia Insurance Cooperative Company that witnessed an increase in market share in 2012, while Gulf General Cooperative Insurance Company saw a drop in market share in 2012. Moreover, companies such as Al-Rajhi Company for Cooperative Insurance and Sanad Insurance and Reinsurance Cooperative Company have seen consistent capital erosion since 2010, but are above the minimum threshold of SAR 100 mn stipulated by SAMA.

Given this backdrop, we believe that the key differentiating factor to determine the future growth trajectory would be consistency in obtaining both scale and profitability. Companies adopting strategies that encompass both would not only help them obtain quality growth, but could also turn out to be future leaders. Furthermore, given the fragile nature of capital base for some companies, this segment could see a few companies tapping the market to shore up their capital base.

Bucket 03: Smaller players feeling the impact of intense competition

Figure 14. Average equity capitalization for Bucket 3 has been weak



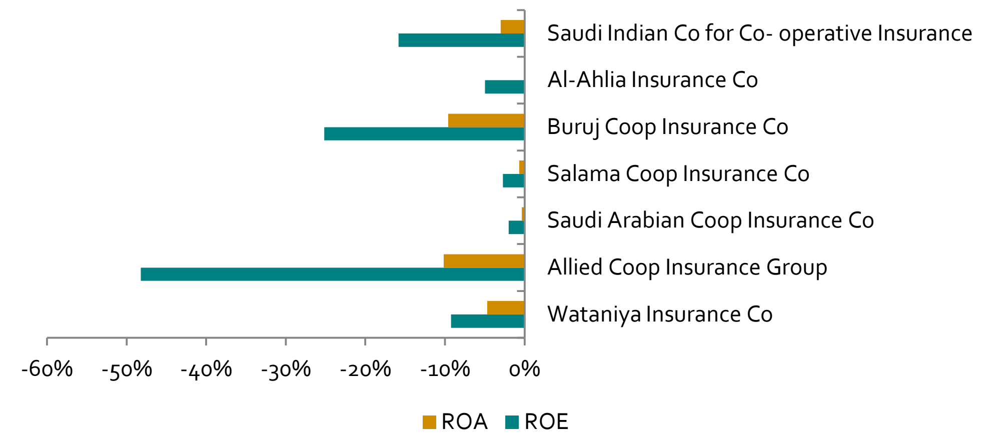
Source: Tadawul.

This bucket comprises seven companies having capitalization below the minimum threshold of SAR 100 mn stipulated by SAMA. The companies are Wataniya Insurance Company, Allied Cooperative Insurance Group, Saudi Arabian Cooperative Insurance Company, Salama Cooperative Insurance Co., Buruj Cooperative Insurance Company, Al-Ahlia Insurance Company, and Saudi Indian Company for Co-operative Insurance.

Key highlights:

- Average investment yield dropped from 3% in 2010 to 1% in 2012.
- Despite their relatively small base, revenue growth for this bucket has been inconsistent over the past two years.
- The average ROA and ROE for this list have been consistently negative for the past three years.

Figure 15. Average ROA and ROE for Bucket 3 has been consistently weak over the past 3 years



Source: Tadawul.

These companies, owing to their relatively smaller size, lack the scalability advantage. This coupled with deteriorating financial strength meant that many companies in this list have seen their capital base being eroded. Considering this, going forward, these companies could tap the market to shore up their capital base to meet the minimum capital requirement. Moreover, given their lack of scale and fragmented nature of the market, we could eventually witness some consolidation with stronger and well-capitalized insurers as a means of achieving scalability.

5. Consolidation imminent but unlikely in the short term

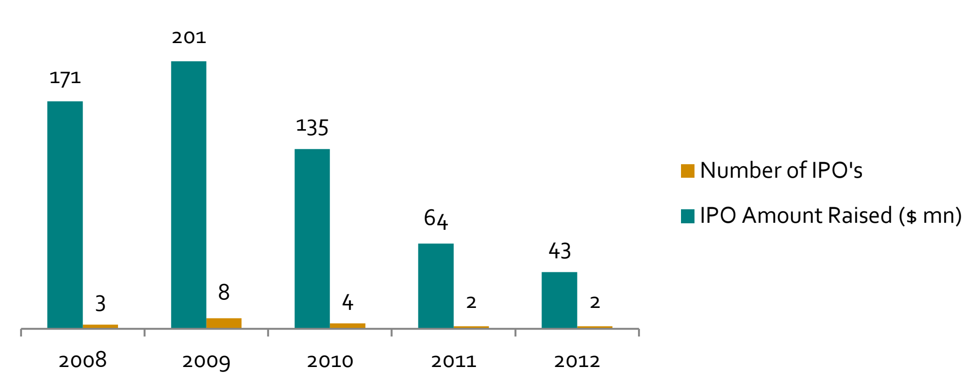
Saudi Arabia is a dominant market in the GCC region given the favorable demographics and economic prospects. For regional players in the GCC region, Saudi Arabian market presents an opportune landscape from insurance perspective. However, the key growth drivers so far, to some extent, are exhausted. These factors coupled with the top three insurance companies dominating the landscape and the remaining smaller players struggling with profitability are limiting the economies of scale within the industry. This, to an extent, is offset by newer product lines like mortgage law of 2012 and its associated three new lines of business, product innovation, and stringent regulatory environment could delay consolidation in the sector as smaller and lesser successful players remain hopeful of benefiting from better margins as well as a growing market in the future.

Going forward as the insurance industry matures and aligns itself with global best practices this would translate to higher cost particularly for segments like Health insurance where procedural requirements would rise. This coupled with rising competition would impact many of the insurers. Given this backdrop, eventually when consolidation does occur, health insurance space could be one of the first segments to see the impact.

Fund raising by insurance companies in Saudi Arabia

Availability and easy access to funding contribute to a delay in consolidation. In the past five years, given the mandatory listing norms by SAMA for insurance companies, there have been 19 IPO issuances through which insurance companies have been able to raise USD614 mn. The trend of issuances after 2009 has steadily declined owing to volatile market conditions.

Figure 16. IPOs in insurance sector in Saudi Arabia



Source: Zawya

The IPO trend in the insurance segment has declined since 2010. This is mainly due to a weak equity market sentiment, which has been impacted in the last few years by volatility arising from the global financial crisis. This resulted in a subdued sentiment for equity capital raising activity over the last three years. From USD135 mn raised in 2010, the equity capital reduced to USD43 mn in 2012. There have been six IPOs in the last two years, as listed in the table below:

Figure 17. IPOs in insurance sector in Saudi Arabia, 2011–13

Issuer	Subscription Period	Size Of Offering ($M)
AIG & Arab National Bank Cooperative Insurance Company	2013	14.0
Aljazira Takaful	2013	28.0
Allied Cooperative Insurance Group	2012	26.7
Alinma Tokio Marine	2012	16.0
Saudi Enaya Cooperative Insurance Company	2011	42.7
Alahli Takaful Company	2011	21.3

Source: Zawya

6. Conclusion

The insurance industry in Saudi Arabia has seen significant growth in the last few years owing to strong economic growth, favorable demographics, and an encouraging regulatory environment.

The insurance industry is currently in transition from a mid-development stage to late development stage. This transition would entail more focus on profitability and risk assessment, particularly in segments such as motor and medical, which have been the key drivers of GWP growth so far. SAMA's move toward conducting an actuarial review on pricing, which is a step in the right direction, is indicative of this. Insurers' capitalization is a major concern, with some failing to meet minimum capital requirements. In this backdrop, it is imperative from the insurers' perspective to remain competitive, align their business plans, build focus, and improve overall profitability of their portfolios.

Levers of growth which has helped the insurance industry reach this stage might not be able to propel them further. They would be replaced by newer avenues provided by the mortgage law and product innovation. Also as industry matures and aligns itself with best global practices, there would be extra costs that would need to be catered to particularly in segments like health insurance space, this coupled with intense competition would pose a challenge for companies looking to obtain both scale and profitability. Larger players on account of superior scale, profitability and capitalization characteristics would dominate the market and continue to do well. Many of the smaller players could realign their business plans to look at the option of focusing on niche market segments or innovation in product offerings to outperform. However, for a few players, the best possible alternative could be to explore the option of inorganic growth.

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