

BUPA: Growth in GWP, strong market share, low risk portfolio, we initiate with an “Overweight” recommendation.

Bupa Arabia is the largest healthcare insurance provider in the kingdom. The company's GWP (Gross written premiums) in 1H-2016 stood at SAR 4.3bn depicting a market share of 20.4% in total GWP. In 2015, BUPA accounted for 39% of the total health GWP. The company GWP has shown a 5 year CAGR of 33.2%. Net written premium (NWP) for the company in 2015 stood at SAR 7.3bn depicting a 5 year CAGR of 33.1%.

Healthy growth in premiums: Bupa's gross written premiums in 2015 stood at SAR7.3bn as compared to SAR1.7bn in 2010, depicting a CAGR of 33.2%. In 2015 alone GWP showed an increase of 27.7%YoY. The company has ceded very little business to re-insurance as the company's retention ratio on average (2010-2016) has stood around 99.2%. In 2015, retention ratio for BUPA stood at 99.4% which is slightly above the industry average of 96% (for 2015). Hence the growth in NWP have closely replicated the growth in GWP. The high retention ratio is due to the perceived low risk of the healthcare sector, as single claims are usually not significant. Going forward we expect GWP to post 5year CAGR of 20.9%.

Loss ratio better than industry average: BUPA's loss ratio (Net Claims/ Net premium) in 2015 stood at 74% as compared to industry average of 77%. The company's loss ratio has generally remained below 80%. The highest it reached since 2010 was 79.5% in 2013. Whereas a low of 72% was witnessed in 2014. We expect loss ratio to stand at 74% for 2016. Net claim incurred have posted a 5 Year CAGR of 31.8%, as compared to 5 year CAGR of 33.1% in net written premiums.

Combined ratio on solid footing: The company's combined ratio ((incurred losses+ expenses)/Earned Premiums) on average stood at around 94%(average from 2010-2015). In 2015, it showed a significant drop to 90% from 94% in 2014. The company has been able to optimize its cost base, along with that the growth in Net earned premiums(5 year CAGR 33.2%) has outpaced the growth in Net claims incurred. However, it should be noted that the combined ratio for 2H-2016 stood at 96% as compared to 95% in 1H-2015.

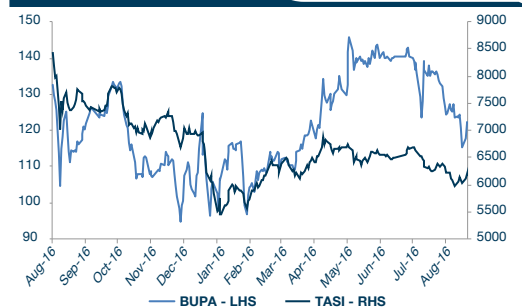
Low risk low yielding investment portfolio, however rising interest rates to improve yield: Bupa's investment strategy is fairly conservative given its investment portfolio. The major component of its portfolio is murabaha deposits accounting for almost 56.8% of the total assets and 87% of the total investment portfolio. The rest 13%(out of total investment portfolio) is in the marketable securities (Sukuks and equity).

The income from investment income has accounted for less than 3% of the total net income in the last 6 years (2010-2015). Yield on total investment has varied from -0.2% to 1.2%(2010-2015). The low yield is indicative of the conservative nature of the portfolio. However given the rise in the interest rates (6M SAIBOR has increased from 0.78% in July-2015 to 2.6% in 1H-2016), the yield on the investment can be expected to improve.

Recommendation	Overweight
Current Price* (SAR)	123.25
Target Price (SAR)	137.6
Upside / (Downside)	11.7%

*Prices as of 6th of September 2016

Price Performance



Key Financials

SARmn (unless specified)	FY15	FY16E	FY17E
GWP	7,328	8,409	10,154
Growth %	28%	15%	21%
Net earned premiums	6,740	7,417	8,814
Growth %	47%	10%	19%
Net claims paid	4,959	5,464	6,495
Growth %	51%	10%	19%
Net claims incurred	5,212	5,737	6,820
Growth %	43%	10%	19%
Net income for the year	645	676	814
Growth %	114%	5%	20%
EPS	8.06	8.45	10.17

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16E	FY17E
Net Profit Margin	8.8%	8.0%	8.0%
Underwriting Profit Margin	10.0%	8.8%	8.8%
Net Claims/Net Premiums	74%	74%	74%
Retention Ratio	99%	99%	99%
Management Exp/ Net Premiums	90%	91%	91%
Underwriting Exp / Net Premiums	71%	68%	67%
Underwriting Profit/ Gross Premium	10%	9%	9%
ROE	39%	32%	30%
ROA	10%	9%	8%
PE(x)	14.29	13.94	11.58
PB(x)	5.53	4.43	3.47
DPS	2.0	2.0	2.0
Dividend Yield	1.7%	1.7%	1.7%

Source: Company reports, Aljazira Capital

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Dividend policy sustainable as balance sheet consolidates: Bupa's balance sheet have shown significant improvement as it has grown at a 5 year CAGR of 29.8% standing at SAR 6.1bn towards the end of 2015. The company's cash position showed a significant drop of 56.7% in 2015 as it stood at SAR 798.9 mn, was due to the increase in Murabaha deposits, which jumped from SAR 1.26bn in 2014 to SAR 3.5bn in 2015.

The company's retained earnings have shown growth on the back of improvement in its earnings. Retained earnings posted a 5 Years CAGR of 52.4%, standing at SAR 592mn 2015.

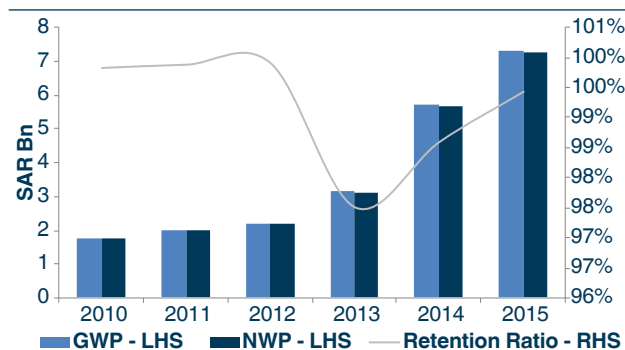
On the back of strong income statement and balance sheet growth Bupa has shown an improvement in its dividend payout. For 2016 the company paid a DPS of SAR 2 (Payout ratio of 25%). We believe given the expected strong growth in earnings and a low payout ratio of 25%, dividend sustainability for the company will not pose a challenge.

Valuation: Bupa Arabia with strong growth in GWP and market share of 39% of total health GWP is the premier healthcare insurance provider in the kingdom. With comparatively low penetration of health insurance in the Kingdom, the company looks set to benefit from any GWP expansion in the segment. BUPA is currently trading at trailing PE of 14.0x and current PB of 5.62 against forward PE of 13.9x and 2016 PB of 4.4x. We have used the residual income technique to value BUPA. We initiate with a price target of SAR 137.6 with an "Overweight" recommendation.

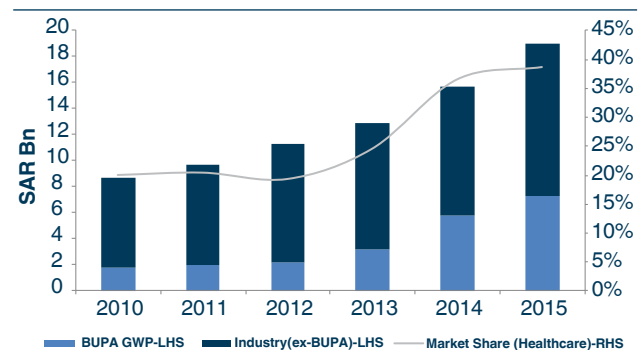
Risks to Valuation

- Loss of Market Share:** Bupa controls nearly 39% of the total healthcare GWP, a contraction in the market share in case of intense competition can potentially put downwards pressure on our forecast and price target.
- Higher claims in case of an epidemic.**
- Lower return on investments,** however in our view it is unlikely given the rising interest scenario.
- Customer retention:** BUPA's business is primarily dependent on its sales to corporate, any non-renewal will impact the company's GWP growth and its market share.

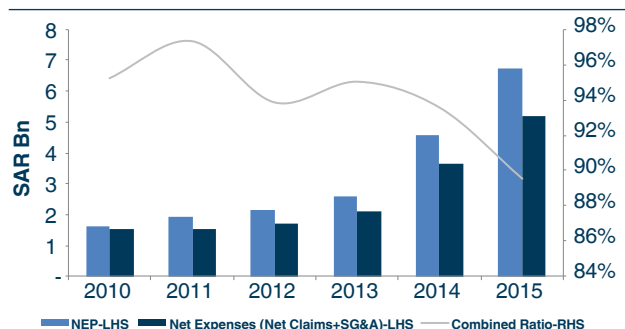
Retention Ratio



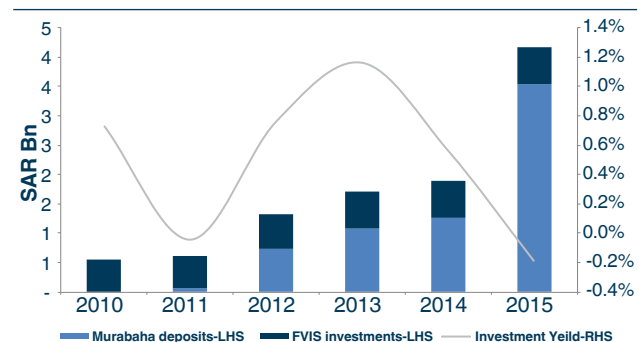
GWP Market share



Combined Ratio



Investment Portfolio



Source: Company Financials

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1. **Overweight:** This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. **Underweight:** This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. **Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. **Suspension of rating or rating on hold (SR/RH):** This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

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