

Initiation Coverage

November 22, 2020

Recommendation	Neutral
Current Price (SAR)	12.1
Target Price (SAR)	13.2
Upside/Downside (%)	9.3

As of October 21, 2020

Key Data (Source: Bloomberg)

Market Cap (SAR mn)	978.5
52-Wk High (SAR)	13.7
52-Wk Low (SAR)	6.8
Total Outstanding shares (in mn)	81.0
Free Float (%)	94.4%

Saudi Re Vs TASI (Rebased)



Price Performance (%)	Absolute	Relative
1m	5.2%	2.7%
6m	59.4%	28.6%
12m	35.9%	26.4%

Major Shareholders (%)	%
Al Qasabi Contracting Co. Ltd	5.00%

GWP (SAR mn) and Loss Ratio (%)



Source: Bloomberg, Company Financials, Falcom Research; Data as of October 21, 2020

Established in 2008, Saudi Reinsurance (Saudi Re) was the first reinsurance company in Saudi Arabia to offer comprehensive reinsurance solutions to insurers. In FY19, the company's gross written premiums (GWPs) increased 9.9% YoY to SAR 792.8mn, after dropping 23.4% YoY in FY18. Net earned premiums rose 4.7% YoY in FY19, leading to a 30.4% YoY improvement in net underwriting income. The company's net income grew in FY19, mainly owing to an increase in shareholders and policyholders' net investment incomes.

We initiate Saudi Re with a "Neutral" rating, as despite the pandemic, the Saudi insurance sector is likely to be resilient and the company seems to be fairly priced.

Government's push to insurance industry may boost growth

The insurance sector forms an integral part of the KSA financial industry, well supported by government policies to encourage greater insurance coverage for the general population at large. Total GWPs in KSA amount to more than SAR 37.0bn per year with insurance penetration of only around 1.3%, which offers significant scope for growth. The government is also enforcing stricter rules to develop a small number of strong market players having significant capital and robust internal risk controls. These moves are likely to drive demand for reinsurance protection further.

High capitalization promotes financial flexibility

The home-grown reinsurer with a capital of SAR 810.0mn is among the highest capitalized reinsurers in the MENA region, with four times the minimum capital required as per SAMA regulations. The company has a diverse client base in over 40 countries, with KSA contributing ~40% to GWPs in FY19. Saudi Re has underwriting expertise across domains, with the fire segment accounting for ~26% of total FY19 GWP. The company commands an A3 rating from Moody's with a stable outlook and AA+ rating from Tassnief with a stable outlook, backed by its strong asset quality and financial flexibility.

Diversification efforts likely to improve margins

Saudi Re is planning to achieve an economically scaled business book that can withstand large losses and absorb operational expenditure. The company is also working on expediting its digital transformation plan. We anticipate Saudi Re's diversification efforts to improve its retention ratio and margins. We also expect a gradual decline in the loss ratio and improvement in return on equity in the medium term.

Inherent Defects Coinsurance Program to drive long-term growth

In August 2020, Saudi Re signed an agreement with Malath Cooperative Insurance Co. to provide reinsurance coverage on the Inherent Defects Coinsurance Program (IDCP) in Saudi Arabia. The Inherent Defects Insurance (IDI) under IDCP will be a mandatory insurance cover in the Kingdom for contractors in the private sector construction space. The program is projected to be implemented in four phases over FY20–23 and will provide Saudi Re a new business line, enabling it to become the exclusive reinsurer for the program. We expect revenue from the IDI program to have a gradual boost on GWP in the long term and lead to improvement in margins.

Valuation: We valued Saudi Re using residual income valuation approach to arrive at a fair value of SAR 13.2 per share.

	2019	2020e	2021e	2022e
GWP (SAR mn)	792.8	936.6	1,042.0	1,154.8
NWP (SAR mn)	646.6	774.4	830.2	850.8
Net claims incurred (SAR mn)	(417.1)	(417.8)	(516.9)	(538.2)
Net income (SAR mn)	45.4	35.4	50.9	57.0
EPS (SAR)	0.56	0.44	0.63	0.70
Loss Ratio	64.9%	62.7%	66.9%	67.9%
Expense Ratio	32.3%	31.8%	29.0%	26.4%
Combined Ratio	97.2%	94.4%	95.9%	94.3%

Source: Company Financials, Falcom Research

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Valuation Summary

Explanation of the valuation methodology and assumptions

We valued Saudi Re using the residual income valuation-approach to arrive at a fair value of SAR 13.2 per share. We considered cost of equity of 8.1% with a terminal growth rate of 2.0%.

In relative terms, Saudi Re is trading at a P/E of 16.6x, trading at a discount of 18.8% to its sector peers.

SAR Mn	FY 2019A	FY 2020E	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E	FY 2026E
Net income	49	40	56	63	74	94	119	151
Beginning equity value	877	930	999	1,081	1,180	1,274	1,393	1,544
Equity charge	71	75	81	88	96	103	113	125
Discount Factor		1.0	0.9	0.8	0.8	0.7	0.7	0.6
PV of Residual Income at discount rate		(35)	(23)	(21)	(17)	(7)	4	16
Net Present Value (A)								(83)
PV Terminal Value (B)								263
Assumed Terminal Growth Rate								2.0%
Discount Rate								8.1%
Existing Business - Enterprise Value (A+B)				181	Cost of Equity Assumptions			
Shareholder's equity				889	Risk free rate			2.3%
Equity Value in SAR mn				1,070	Equity Risk Premium			6.3%
Number of shares in mn				81	Beta			0.9x
Target Price in SAR per share				13.2	Cost of equity			8.1%
CMP in SAR as on October 21st 2020				12.1				
Upside/(Downside) to current market price				9.3%				

Source: Company Financials, Falcom Research Estimates

Risks

Upside Risks:

- A sharp economic recovery following the COVID-19 pandemic containment, or a timely vaccination availability can significantly boost economic activities in the region leading an uptick in the insurance sector

Downside Risks

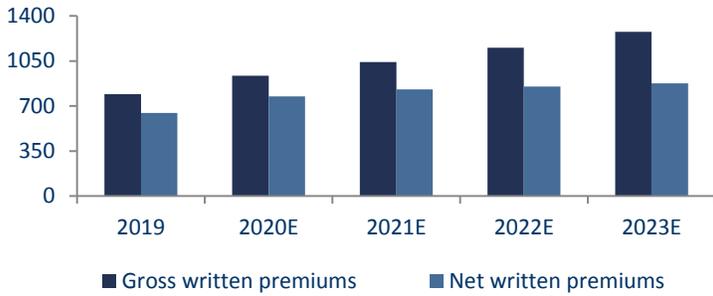
- Accumulation, concentration, catastrophe exposure, high exposure to single large losses, and increased frequency and severity of claims that can lead to concentration of risk.
- Risks arising from inaccurate projections, where established reinsurance liabilities are understated can lead to higher claims settlement.

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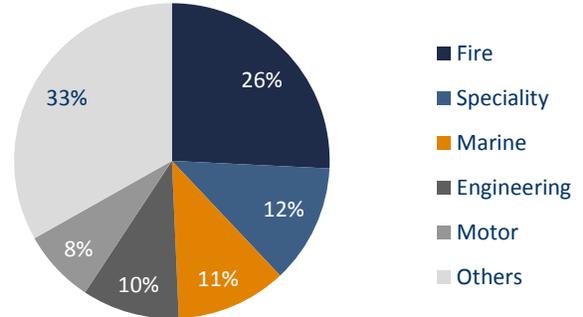
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Key Charts

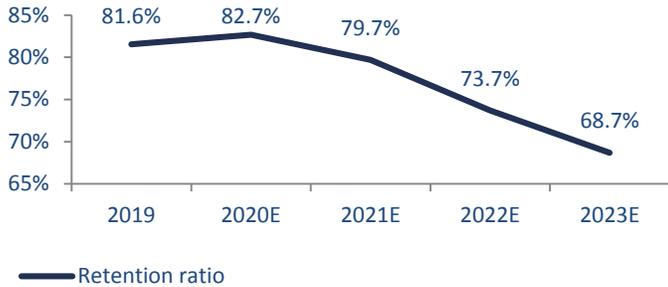
GWP vs NWP (SAR mn)



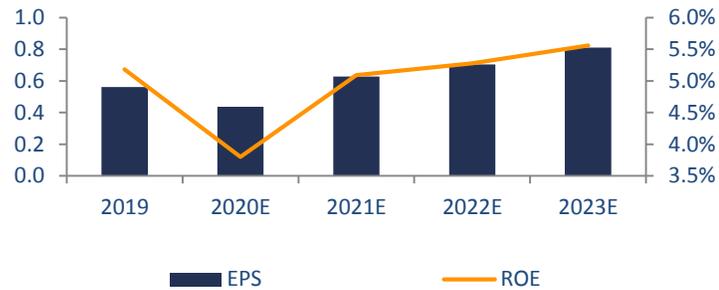
GWP Split (2019)



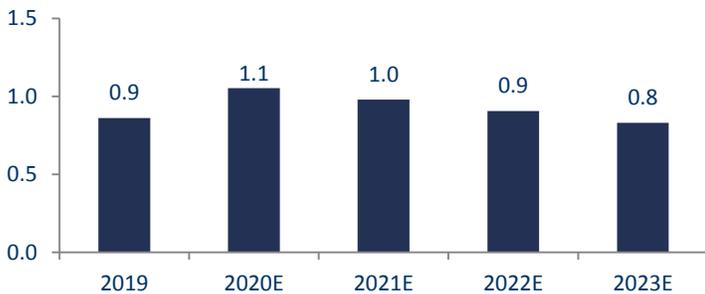
Retention Ratio (%)



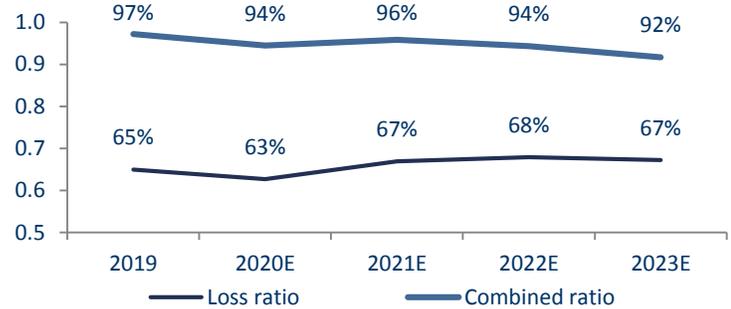
EPS & ROE (%)



Price to Book Value



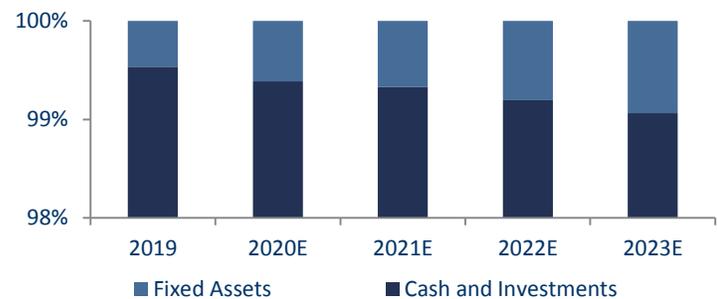
Loss & Combined Ratio (%)



ROA (%)



Asset Breakup



Source: Falcom Research Estimates

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Summary Financials

P&L (SAR mn)	2019	2020e	2021e	2022e
Gross written premium	793	937	1,042	1,155
Net written premium	647	774	830	851
Net claims paid	(377)	(379)	(474)	(491)
Net claims incurred	(417)	(418)	(517)	(538)
Shareholders' share of surplus from insurance operations	(32)	(40)	(42)	(55)
Net income	45.4	35.4	50.9	57.0
EPS	0.56	0.44	0.63	0.70

BS (SAR mn)	2019	2020e	2021e	2022e
Investments	557	584	632	672
Total ins. Ops. assets	1,641	1,795	2,133	2,282
Total shareholders' assets	1,014	1,047	1,096	1,157
Total assets	2,654	2,842	3,229	3,440
Total ins. Ops. Liab. and surplus	1,643	1,773	2,086	2,209
Total shareholders' liabilities	137	137	137	137
Shareholders Equities	877	930	999	1,081
Total liabilities	2,654	2,842	3,229	3,440

CF (SAR mn)	2019	2020e	2021e	2022e
Shareholder's Operating Cash Flow	(5)	54	70	82
Capex	(3)	(4)	(4)	(5)
Shareholder's Cash Flow from Investing Activities	64	(27)	(48)	(40)
Dividends paid	0	0	0	0
Shareholder's Cash Flow from Financing Activities	20	20	20	20

Growth	2019	2020e	2021e	2022e
Gross written Premium	9.9%	18.1%	11.2%	10.8%
Net earned Premium	4.7%	3.7%	15.9%	2.6%
EPS	NM	(22.2%)	43.9%	12.1%
Investments	(14.3%)	4.8%	8.3%	6.4%

Ratios (%)	2019	2020e	2021e	2022e
Retention ratio	81.6%	82.7%	79.7%	73.7%
Loss ratio	64.9%	62.7%	66.9%	67.9%
Expense ratio	32.3%	31.8%	29.0%	26.4%
Combined ratio	97.2%	94.4%	95.9%	94.3%
ROA	1.7%	1.2%	1.6%	1.7%
ROE	5.2%	3.8%	5.1%	5.3%

Valuation	2019	2020e	2021e	2022e
P/E	16.6x	27.7x	19.2x	17.2x
P/B	0.9x	1.1x	1.0x	0.9x
P/S	1.1x	1.0x	0.9x	0.8x

Peer Valuations	P/E	P/B
The Company for Co-op Insurance	33.0x	4.1x
BUPA Arabia for Co-op Insurance Co.	19.2x	4.1x
Al Rajhi Co. for Co-op Insurance	26.6x	2.9x
Walaa Co-op Insurance Co.	6.3x	1.3x
Buruj Co-op Insurance Co.	NA	1.3x
Malath Co-op Insurance and Reinsurance Co.	20.4x	1.2x
Saudi Reinsurance	16.6x	0.9x
Sector Median	20.4x	2.1x
Premium/ (Discount)	(18.8%)	(59.6%)

Source: Bloomberg, Company Financials, Falcom Research

Falcom Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

- Overweight:** The Target share price exceeds the current share price by $\geq 10\%$.
- Neutral:** The Target share price is either more or less than the current share price by 10%.
- Underweight:** The Target share price is less than the current share price by $\geq 10\%$.
- To be Revised:** No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

FALCOM Financial Services

Contact us on the below phone numbers:

Customer Services: **8004298888**

Brokerage Services: **920004711**

Fax or Email us at the below number:

Fax: **+966 11 2032546**

Email: **addingvalue@falcom.com.sa**

Mail us at the following address:

P.O. Box 884

Riyadh 11421

Kingdom of Saudi Arabia

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