



**TP and Upside**

Stock	Rating	Price Target	Upside
Tawuniya	OW	SAR94.0	+13.7%
AXA	OW	SAR43.0	+12.1%

## Saudi Insurance Sector

### Initiate with OW ratings on Tawuniya and Axa

**Further consolidation expected in motor insurance; Market share to accrue to larger players.** We expect the recent trend of M&As to continue in the Saudi motor insurance space paving the way for market share gains for the larger players. Improving trend in Saudi car sales (1H 2020 growth at 6.9%, source: focus2Move) is positive for GWP growth, and extension of COVID restrictions are likely to improve loss ratios in H1. Insurance premiums (third party) are higher for smaller players than for the larger players. Despite this, the financial position of the smaller players is weaker than the larger players, implying further market share erosion given the dominance of online sales channels. We expect Tawuniya, AXA (Fig. 3, 4) to be among the main beneficiaries (Fig. 7, 8) in motor insurance.

**Regulator's approach for motor insurance:** In our view, the regulator aims to reduce the number of players in the motor insurance segment. This is the reason for the significant number of discount programs and is likely to continue till the competition decreases, implying a perform or perish approach. Structural changes such as auto issuance of fines on cars (in traffic violation) without insurance, the introduction of bancassurance in the Kingdom, conversion of lease products into retail are all likely to materially improve the insurance penetration rate, ensuring higher organic growth for the larger players.

**Expect a further drop in insured lives before a pick up:** With regards to the medical segment, the number of insured lives is expected to further decline at the current run-rate, i.e., by more than 200k by 1H21, but after an initial drop we expect lost insured lives to partially recover eventually.

**Loss ratios to improve significantly.** We believe that there is significant scope for improvement in the motor segment loss ratios as the number of fraud cases and competition are likely to reduce. When compared to regional markets, loss ratios are highest for Saudi (Figure 13 and 16). A scenario analysis of 1% change shows an improvement in net profit by 11-25% for our motor insurance coverage companies (Figure 9 and 10). The companies in the medical domain are also expected to improve loss ratios gradually as seen from the past trends.

**Valuation and risks:** We favour the larger names and initiate on Tawuniya and Axa with Overweight ratings. We find these two stocks to be trading at the attractive levels (Tawuniya - 3.2x on our 2021E BVPS vs 3Y average of 3.8x and 3Y historical high of 4.6x and Axa - 1.9x on our 2021E BVPS vs 3Y average of 1.9x and 3Y historical high of 2.7x), not commensurate to its return metrics (Tawuniya 2022E RoE: ~17% and Axa: ~13%). We expect an EPS CAGR of 21% for Tawuniya (2019-22) and 16% for Axa during the same period.

**Figure 1 Valuation summary**

Companies	Mcap (SARmn)	2021E EPS	2022E EPS	2021E BVPS (SAR)	2022E BVPS (SAR)	2021E P/E	2021E P/B	Rating	TP (SAR)	CMP (SAR)*	Upside / (downside)
Tawuniya	10,338	3.8	4.7	25.9	29.6	21.7x	3.2x	OW	94.0	82.7	13.7%
Axa	1,918	2.7	2.7	20.1	22.8	14.0x	1.9x	OW	43.0	38.4	12.1%

Source: Bloomberg, Al Rajhi Capital. As of 15 Feb 2021

**The key upside risks** include better-than-expected economic recovery, a quicker than expected improvement in loss ratios, further regulatory steps to strictly enforce mandatory insurance, re-initiation of dividends. On the other hand, **the key downside risks** include a lower-than-expected market size for compulsory motor insurance, a higher-than-expected loss ratio, lower credit rating, non-renewal of major existing insurance contracts, and pricing pressure amid stiff competition remain the downside risks.



## Motor insurance

### Pricing difference

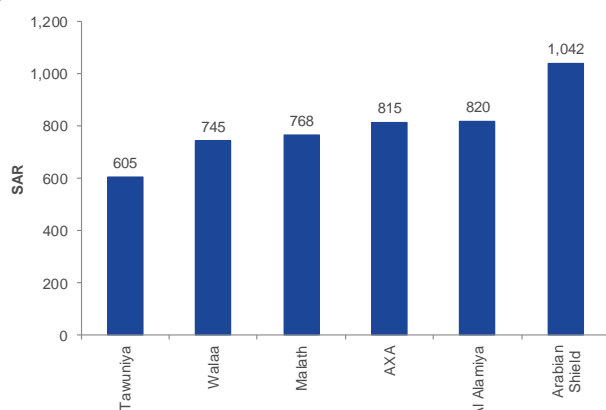
Within the motor insurance segment, there are a few companies, which are charging relatively higher TPL motor insurance premiums and still incurring losses. We believe that such companies, with lower equity, are likely to be acquired by mid-size insurance companies in the coming periods, or else customers would eventually move to cheaper alternatives given that every product is available online to be chosen. The smaller players mainly operate in the TPL segment which is a price-sensitive segment and hence we expect customers to migrate to the cheaper alternatives. Companies with healthy financials, decent equity bases, and catering to the lower end are in fact the ones with lower prices and will be the biggest winner from consolidation. Accordingly, among the major winners are Tawuniya and AXA, in our view (Figure 2, 3, and 4).

**Figure 2 Motor insurance premium benchmarking**

Companies	9M20 total GWP (SARmn)	TPL Premium (SAR)*	Comprehensive Premium (SAR)*	NCB (%)	NCB amount (SAR)	Deductible Choices (SAR)	9M20 Profitability (SARmn)	9M20 Equity (SARmn)
U C A	518	2,005	NA	20%	436	NA	(24)	355
Alinma Tokio M	266	1,486	1,189	20%	323	5,000	1	208
Salama	340	1,284	NA	20%	274	NA	5	208
AICC	283	1,228	1,708	20%	262	1,000	5	221
Solidarity	281	1,143	NA	20%	186	NA	(22)	189
AlRajhi Takaful	2,160	1,140	1,997	20%	260	2,000	177	1,062
Trade Union	510	1,128	NA	20%	239	NA	72	551
Wataniya	642	1,093	2,785	20%	238	3,000	(4)	253
Allianz SF	532	1,090	NA	20%	237	NA	(19)	712
MEDGULF	1,934	1,075	1,361	20%	234	4,000	31	761
Arabian Shield	427	1,042	1,595	20%	227	10,000	24	457
Gulf Union	383	941	NA	NA	NA	NA	(8)	137
Sagr Insurance	302	930	NA	20%	186	NA	(81)	316
Gulf General	241	882	NA	20%	192	NA	12	171
Al Alamiya	136	820	2,300	20%	178	500	4	413
AXA	1,201	815	1,410	20%	197	2,500	105	808
ACIG	376	798	1,518	20%	174	3,000	5	153
Malath	617	768	2,665	20%	167	2,000	1	460
Walaa	1,045	745	NA	20%	162	NA	27	884
Amana	273	728	NA	20%	158	NA	(25)	134
Tawuniya	6,362	605	NA	20%	121	NA	350	2,734

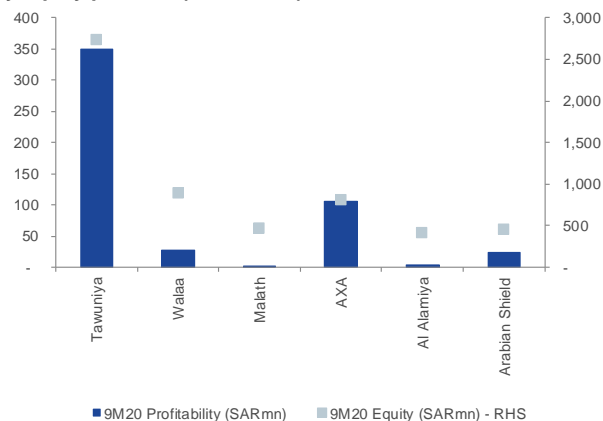
Source: Company data, Tameeni, bcare, Al Rajhi Capital. \* Per vehicle. The numbers are based on a 8 year old Toyota Corolla

**Figure 3 Companies charging the lowest TPL motor insurance premium ...**



Source: Company data, Tameeni, bcare, Al Rajhi Capital. \* Not considered the companies incurring losses/minimal earnings with low equity base despite lower TPL premium

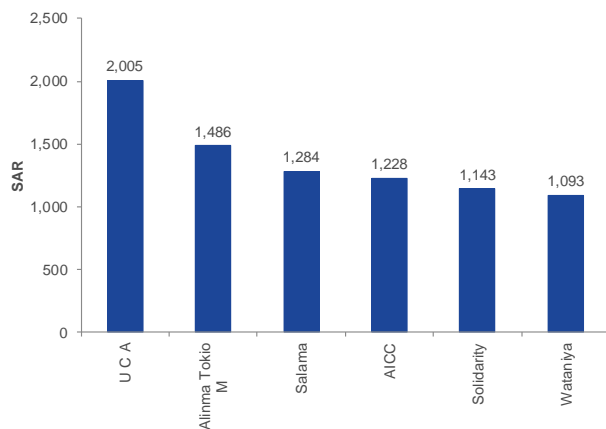
**Figure 4 ... and still able to make decent profits while maintaining a healthy equity position (as of 9M20)**



Source: Company data, Al Rajhi Capital. \* Not considered the companies incurring losses/minimal earnings with low equity base despite lower TPL premium

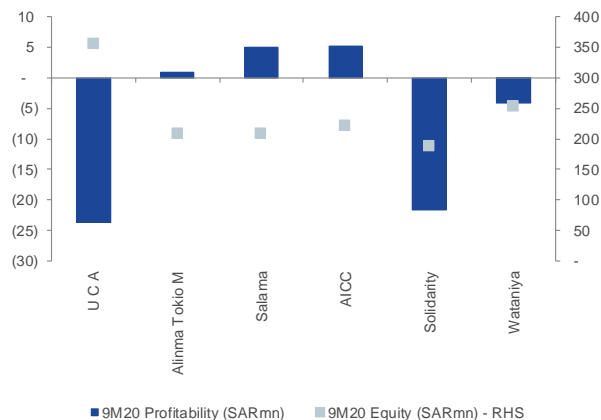


**Figure 5 Companies charging the highest TPL premium ...**



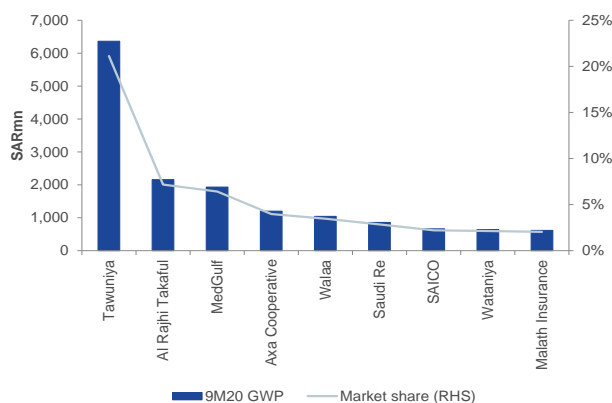
Source: Company data, Tameeni, bcare, Al Rajhi Capital. \* Not considered the companies having decent net profit and equity position despite higher TPL premium

**Figure 6 ... and still not able to make decent profits (as of 9M20)**



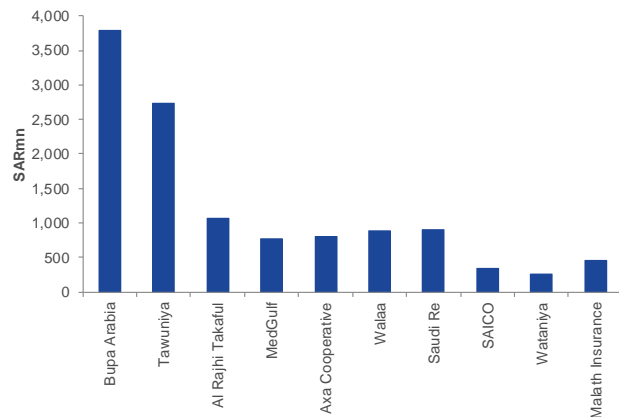
Source: Company data, Al Rajhi Capital. \* Not considered the companies having decent net profit and equity position despite higher TPL premium

**Figure 7 Larger players stand to benefit from consolidation**



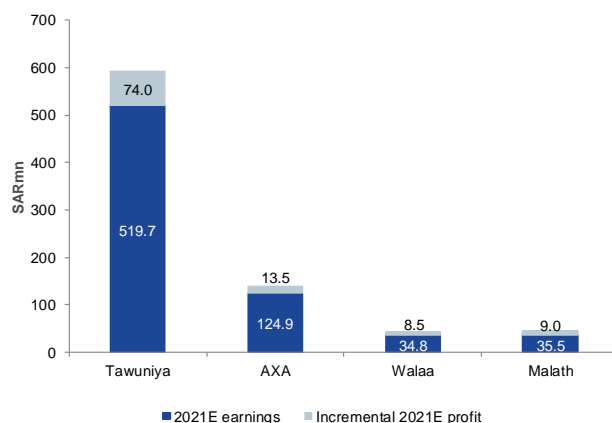
Source: Company data, Al Rajhi Capital

**Figure 8 Equity position of top players (as of 9M20)**



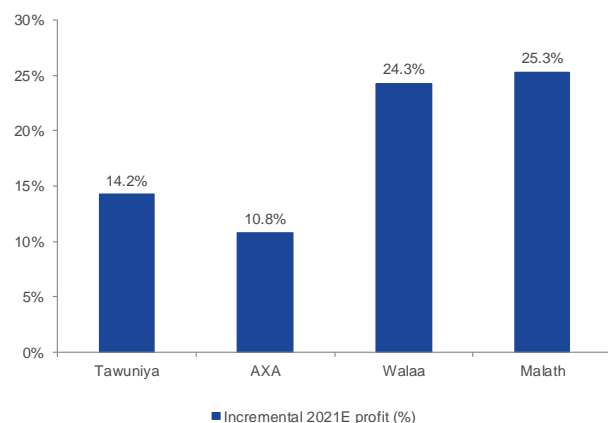
Source: Company data, Al Rajhi Capital

**Figure 9 Incremental 2021E profit per 1pps improvement in the loss ratio**



Source: Company data, Al Rajhi Capital

**Figure 10 Incremental 2021E profit % per 1pps improvement in the loss ratio**



Source: Company data, Al Rajhi Capital

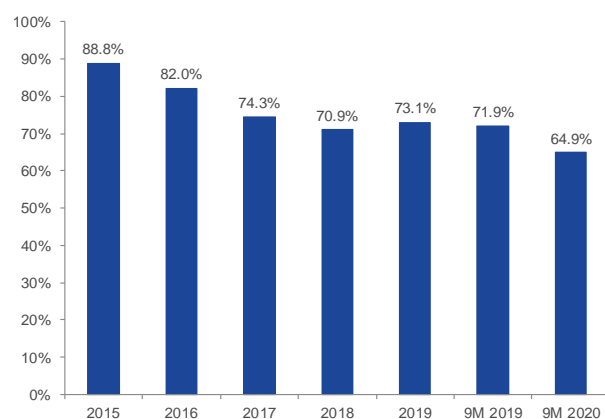


After the consolidation in the KSA insurance industry, we expect price pressure to ease due to less competition in the market. This will improve the loss ratio of the merged entities and the overall sector. Likewise, benefits of economies of scale (due to cost efficiencies; closure of branches/cutting down policy acquisition costs) will also accrue.

### Motor loss ratios to structurally improve

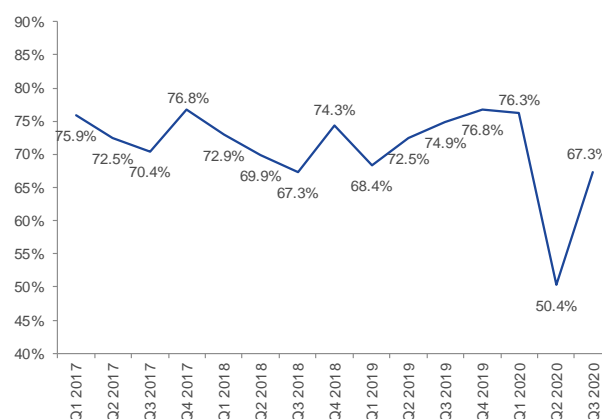
One of the key aspects of an investment case in the insurance sector in Saudi is the improvement in loss ratios. While driving behavior has been a major reason for high loss ratios, many companies attribute to the high extent of fraud prevalent because of the long tail of insurance claims. Loss ratios are only likely to get better each year as companies and regulator work together to bring down the frauds and is improving. To play only on loss ratio improvement, one would need to choose the winners where the operating leverage is the highest. Figures 9 and 10 show the improvement in 1pps improvement to profits.

**Figure 11 Motor loss ratio**



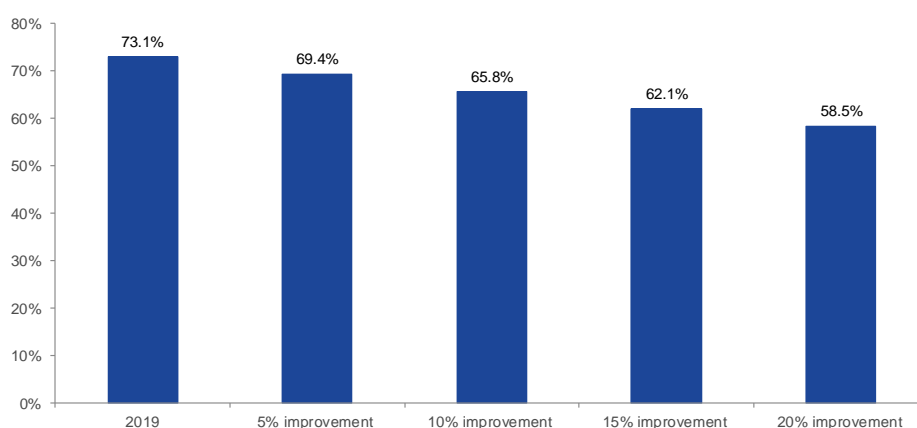
Source: Saudi Central Bank, Al Rajhi Capital

**Figure 12 Quarterly Motor loss ratio**



Source: Saudi Central Bank, Al Rajhi Capital

**Figure 13 Motor loss ratio – Significant scope for improvement**



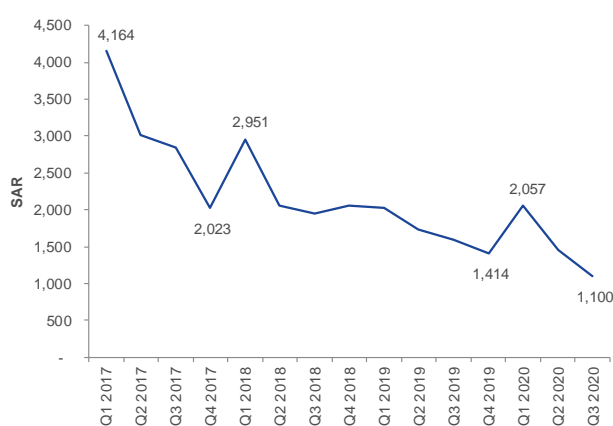
Source: Saudi Central Bank, Al Rajhi Capital



## What happens after consolidation?

Motor premiums have been declining continuously for many periods (Figure 14). Premiums have been declining because of the intense competition due to the high number of players and regulatory changes such as loyalty discount, no claim bonus, along with the presence of online channels. So far, there has been some consolidation (Figure 15) but still, there is more consolidation to take place. We believe that motor premiums can only improve when the number of players in the market reduces or the regulatory approach changes. As we expect the consolidation theme to play out into 2021, we expect the reversal of pricing decline only from 2022.

**Figure 14 Motor insurance premium (SAR)\***



Source: Saudi Central Bank, Al Rajhi Capital. \* Per vehicle

**Figure 15 Recent/ongoing M&A deals in the sector**

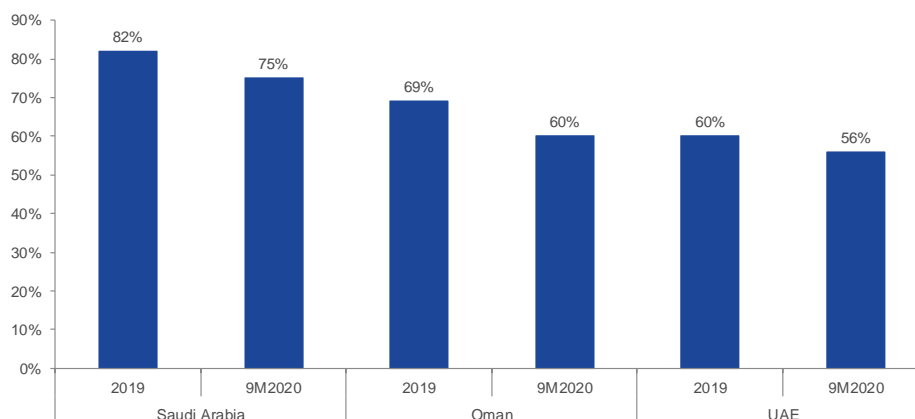
Announced date	Companies	Type	Status
7-Jun-20	Al Ahlia and Gulf Union	Merger	Completed
27-Jun-19	Solidarity and Aljazirah Takaful	Merger	Certain
18-Jun-19	Walaa & MetLife AIG ANB	Merger	Completed
5-Oct-20	Enaya & Amanah	Merger	Negotiation

Source: Company data, Tadawul, Al Rajhi Capital

## What is the approach of the regulator?

In our view, the regulator wants the efficiency and loss ratios to improve significantly (Saudi insurance market avg. loss ratio at 75% vs UAE 56%, Oman 60% as of 9M 2020; Figure 16) and create an environment of perform or perish for the smaller insurance players which is the reason for the significant number of regulatory changes. We expect conditions to remain tight enough for the smaller players to perish while the large players will continue to outperform.

**Figure 16 Total loss ratio - Saudi vs. Other regional markets**



Source: Badri Consultancy, Al Rajhi Capital



Apart from this, there are common structural drivers

### Structural drivers for motor insurance

- **Automatic fines for insurance:** Drivers if caught in a traffic violation will now be fined for not having insurance. However, without a violation, there is no fine for not being insured yet. As per Tawuniya's Q2 2020 presentation, there were around 7.1mn vehicles insured (out of 14.2mn vehicles) in the Kingdom as of Q2 2020, implying a 50% penetration rate for the segment. While the enforcement on vehicle insurance could double the segment's penetration rate (from 50% to ~90-100%) in the coming period, we believe that the segment's GWP will not increase at a similar pace. This is because the incremental additions through enforcement would have a relatively lower premium of around US\$100-250. In addition, the prevalence of online intermediaries also can help improve the penetration with its cheap packages and transparency.

As of Q2 2020, there were around 7.1mn vehicles, which were uninsured in the Kingdom. Assuming SAR800 premium on average, the incremental GWP for the segment would be around SAR5.7bn, implying a 66% growth in GWP from 2019 levels (2020 was an exception). We believe that this growth would mostly be captured by the major five insurers (Al Rajhi Takaful, AXA, Tawuniya, Walaa, and Malath) for the motor segment. Assuming a proportionate distribution based on the 2019 market share (total and retail), we see Al Rajhi Takaful be the biggest beneficiary from this enforcement, followed by AXA and Tawuniya.

- **Govt. cars insurance:** In the event of Govt. cars required to be insured, there is further potential, mainly for the larger companies.

**Figure 17 Growth potential for the motor segment**

	1H20	2019	Potential opportunity	Pro-forma 2019
Total vehicles (mn)	14.2	15.3	14.2	14.2
Insured vehicles (mn)	7.1	6.9	7.1	14.0
Vehicle penetration (%)	50%	45%	100%	99%
Average premium (SAR)*	1,301	1,247	800	1,020
<b>Motor GWP (SAR 'mn)</b>	<b>4,620</b>	<b>8,604</b>	<b>5,680</b>	<b>14,284</b>

Source: Tawuniya, Al Rajhi Capital. \* Annualized for 1H20

**Figure 18 Based on total market share in the motor segment**

	2019 Motor GWP (SARmn)	2019 Motor GWP Market share	Incremental Motor GWP (SARmn)*	1H20 EPS (EPS)	2019 EPS (SAR)	Pro-forma EPS (SAR)	EPS upside	1H20 BVPS (SAR)	2019 BVPS (SAR)	Pro-forma BVPS (SAR)
Al Rajhi Takaful	1,821	21.2%	1,202	2.98	2.15	5.16	140%	24.4	21.91	24.92
AXA	804	9.3%	531	1.16	1.73	2.79	61%	15.01	13.93	14.99
Tawuniya	639	7.4%	422	2.04	2.62	2.96	13%	20.84	19.2	19.54
Walaa	622	7.2%	411	0.2	0.4	1.04	159%	12.83	12.68	13.32
Malath	489	5.7%	323	0.04	0.1	0.75	646%	9.17	9.11	9.76
Others	4,229	49.1%	2,792							
<b>Motor segment</b>	<b>8,604</b>	<b>100.0%</b>	<b>5,680</b>							

Source: Company data, Al Rajhi Capital. \* Assumed based on the current market share.

**Figure 19 Based on retail market share in the motor segment**

	2019 Retail Motor GWP (SARmn)	Retail market share	Incremental Motor GWP (SARmn)*	1H20 EPS (EPS)	2019 EPS (SAR)	Pro-forma EPS (SAR)	EPS upside	1H20 BVPS (SAR)	2019 BVPS (SAR)	Pro-forma BVPS (SAR)
Al Rajhi Takaful	511	13.5%	767	2.98	2.15	4.07	89%	24.4	21.91	23.83
AXA	131	3.5%	197	1.16	1.73	2.12	23%	15.01	13.93	14.32
Tawuniya	551	14.6%	827	2.04	2.62	3.28	25%	20.84	19.2	19.86
Walaa	551	14.6%	827	0.2	0.4	1.68	320%	12.83	12.68	13.96
Malath	120	3.2%	180	0.04	0.1	0.46	360%	9.17	9.11	9.47
Others	1,921	50.8%	2,883							
<b>Motor segment</b>	<b>3,786</b>	<b>100.0%</b>	<b>5,680</b>							

Source: Company data, Al Rajhi Capital



- **Bancassurance:** The introduction of Bancassurance in the Kingdom is likely to push further increase in insurance penetration. The impact is as follows:
  - Increase the distribution network for insurance products through banking channels in KSA, which will help in improving the sector penetration further.
  - Insurers may also have lower direct distribution costs (lower branches/agents/staff; generally fixed in nature) but will start incurring indirect sales linked distribution costs (commission to banks)
  - Overall, this new regulation allows the domestic insurers access to a new segment and reach to a wider customer base, leading to a new source of additional GWP. It may be also marginally positive for the banking sector as it will start providing one-step financial solutions to its customers. This will also lead to higher commission income for banks.
- **Conversion of leased product into retail products:** Last year, Saudi Central Bank issued rules for comprehensive insurance of auto lease finance for individuals, effective November 2020. As per the rule, leasing companies/NBFCs, that used to charge a lump sum amount to customers, are now required to offer the best premium rates after obtaining offers from at least three insurers. Earlier, leasing companies used to charge a higher amount to the customer without considering driving history/discounts, etc. However, post this rule, pricing is based on vehicle value, various pricing factors, and customers' driving behavior. In addition, leasing companies have to pass on the various benefits (including no claim discount and others) if applicable, eliminating the additional income for leasing companies. Overall, we believe that this is negative for the leasing companies mainly which currently dominate the leasing business. However, this is very positive for individuals, as this will boost the transparency in the market with customers would be able to check the prevailing premium rates and challenge the company if they charge an unduly high amount.

**Figure 20 Example of how the premium will be calculated for motor vehicle insurance governed by the lease contract.**

	First-year	Second-year	Third-year	End of the lease period
Motor Vehicle Value (SAR)	100,000	80,000 (after applying depreciation)	70,000 (after applying depreciation)	
Amount of premium paid by lessees (SAR)	4,000	3,200	2,800	10,000
Non claim discount	30%	40%	0% (for having an accident)	
Amount of premium paid by lessor to insurers (SAR)	2,800 (4,000 * (1-30%))	1,920 (3,200 * (1-40%))	2,800	7,520
<b>Discount to be credited to lessee announce (SAR)</b>	<b>1,200</b>	<b>1,280</b>	<b>0</b>	<b>2,480 (to be paid back to lessee)</b>

Source: Saudi Central Bank, Al Rajhi Capital

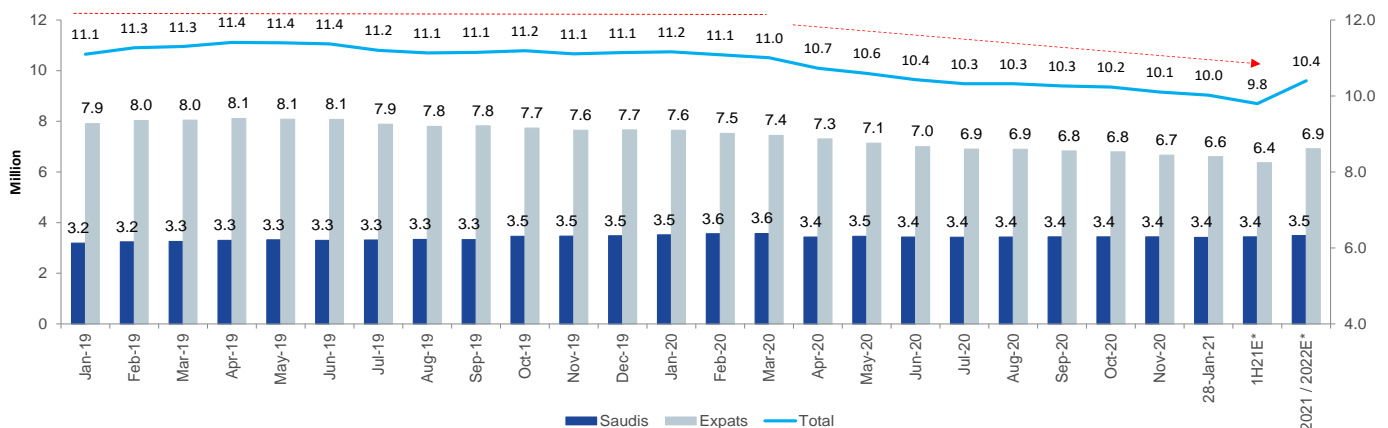


## Health insurance

### Further decline in insured lives likely but partially could reverse from the end of 2021.

As per CCHI data, the total number of insured lives was down 10% y-o-y (1,123k drop) to ~10mn in 2020 (till Nov), led by a decline in expats insured lives (-13% y-o-y to 6.7mn lives). Saudi insured lives remained broadly stable, down by 1.2% (-43k lives) to 3.4mn. We observed that the numbers of expats lives remained broadly stable over Jan-19 to Mar-20, however, it started declining from April 2020 till date, on account of i) the extension of expats residency card renewals without insurance, ii) and slowing down economic activities amid the pandemic. These trends pose a near-term challenge for the health segment with the downtrend likely to continue, with another 59k expats having already left the Kingdom or the insurance market during Nov 2020-Jan 2021 period. This could even go down further once international flights resume operations, which may lead to a further decline in expats numbers to 9.7-9.8mn by end of the year (as per our expectation). In addition, the end of the current academic period could also trigger further expats exodus.

**Figure 21 Health insured lives trend**



Source: CCHI, Al Rajhi Capital.\* ARC estimates

Nonetheless, as the economy returns to normalcy, we expect the number of expats lives to gradually improve later this year as GOSI data suggests only a decline of ~29k jobs in the private sector during 9M 2020. Accordingly, we expect the total insured lives to reach 10.4mn by the end of 2022. Longer-term fundamental factors are intact, and we believe there is visibility for a stable growth trajectory because of stricter enforcement of Saudi insurance, ii) mandatory insurance for Hajj/Umrah/business visitors.

**Future Growth Opportunities in the Health Insurance segment by 2023:** Despite the near-term headwinds, according to Bupa estimates, there is a potential addition of ~23mn lives to the private healthcare sector by 2023E, through the current mandate and addition of new segments, amounting to an incremental GDP of ~SAR8bn (based on avg. premium; Figure 22).

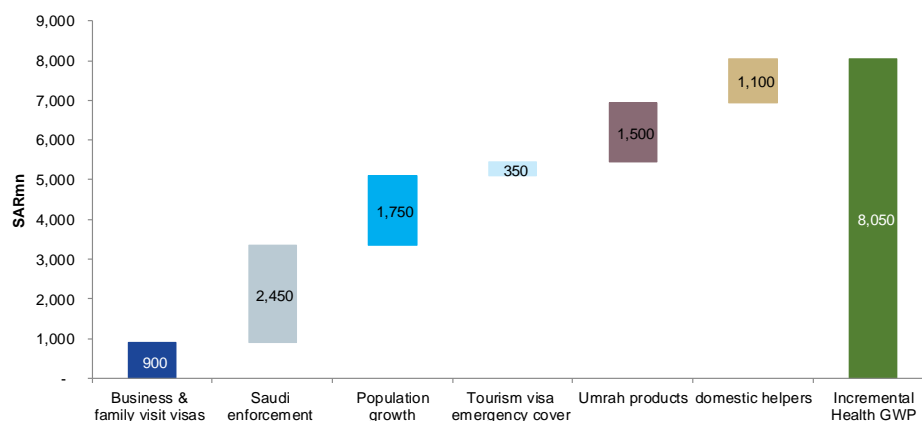
- Business & family visit visas could add 6m lives to the insured market with GWP per life of SAR 100-200.
- Saudi enforcement to add more 1.4mn insured lives at GWP per life of SAR 1,500-2,000.
- Population growth to add 1mn insured lives at GWP per life of SAR 1,500-2,000.
- Tourism visa emergency cover (started Sep 27, 2019) to add 2.5mn insured policies annually by 2023 at GWP per life of SAR 140.
- Umrah product is likely to add 10mn insurance policies annually by 2023 with GWP per life of SAR 100-200.





- The domestic helpers' count is around 2.2mn. The GWP per life is expected SAR400-600. However, Bupa doesn't expect this to be enforced till Q3 2021 due to current challenging market conditions.

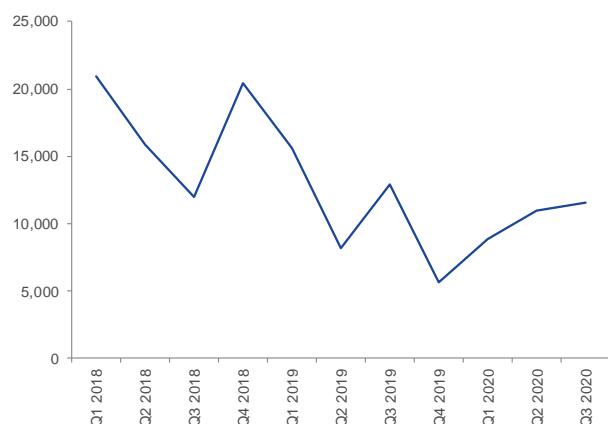
**Figure 22 Incremental Health GWP by 2023E**



Source: Bupa, Al Rajhi Capital. \* Calculated based on the average premium

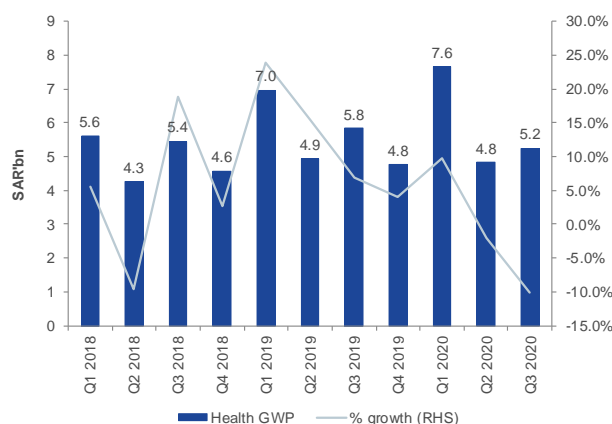
**Medical pricing to remain subdued.** We see pricing to remain under pressure this year, given the volume pressure, economic weakness, and likely discount expectations from corporates due to the current low claims ratio. Accordingly, the maximum growth in the pricing could be limited to the medical inflation, which large insurers like Bupa and Tawuniya may be able to pass on to the customers. Accordingly, considering the volume and pricing pressure, we see a limited GWP growth potential for 2021.

**Figure 23 Average health insurance premium (SAR)\***



Source: SAMA, Al Rajhi Capital. \* Per health insurance policy

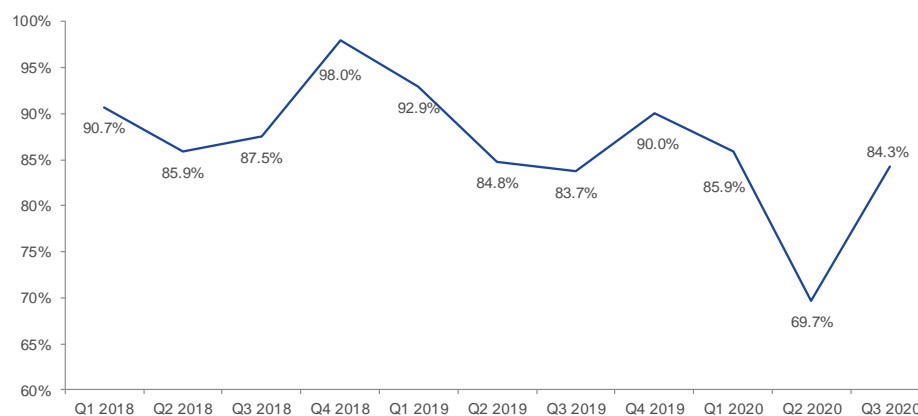
**Figure 24 Health GWP and growth trend**



Source: SAMA, Al Rajhi Capital



**Figure 25 Medical loss ratio trend**



Source: Saudi Central Bank, Al Rajhi Capital



## A quick comparison with other GCC markets (Motor insurance)

- **Motor pricing:** Saudi has largely prices similar to UAE but has a higher motor loss ratio.

**Figure 26 GWP and no. of policies, 2019**

	Saudi Arabia	Oman	UAE
<b>GWP (US\$bn)</b>			
Health	5.99	0.18	5.28
Motor	2.29	0.33	1.65
General	1.51	0.58	2.59
P&S	0.30	0.16	2.47
<b>Total GWP</b>	<b>10.10</b>	<b>1.25</b>	<b>12.0</b>
<b>No. of policies ('000)</b>			
Health	2,252	23	3,028.0
Motor	4,996	1,547	3,413.5
General	287	139	767.3
P&S	117	224	368.0
<b>Total Policies</b>	<b>7,652</b>	<b>1,933</b>	<b>7,576.8</b>

Source: Saudi Central Bank, Badri Consultancy, UAE Insurance Authority, Oman CMA, Al Rajhi Capital.

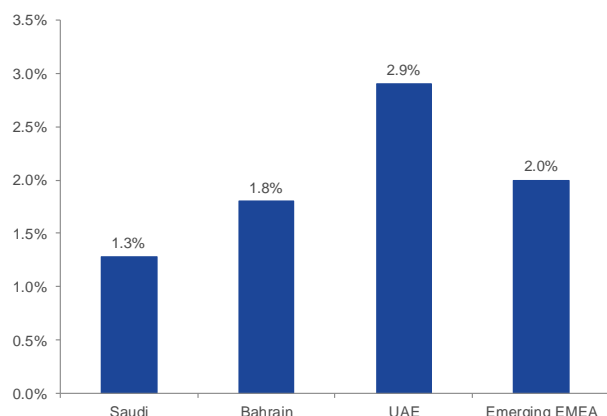
**Figure 27 Insurance pricing and sector KPIs, 2019**

	Saudi Arabia	Oman	UAE
<b>Avg. premium (US\$)</b>			
Health	2,662	7,782	1,743
Motor	459	215	485
General	5,269	4,162	3,376
P&S	2,588	694	6,716
<b>Avg. premium</b>	<b>1,320</b>	<b>645</b>	<b>1,583</b>
<b>Sector KPIs</b>			
Motor retention ratio	94%	91%	74%
Motor loss ratio	73%	67%	55%
ROE*	9%	12%	8%
Expense ratio*	19%	25%	32%
Combined ratio*	101%	94%	92%

Source: Saudi Central Bank, Badri Consultancy, UAE Insurance Authority, Oman CMA, Al Rajhi Capital. \* For the overall sector

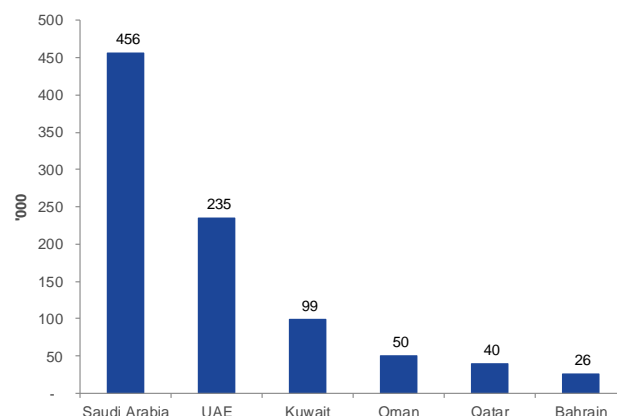
- **Motor insurance size:** KSA Motor insurance market size is almost 1.4x of the UAE motor insurance market and almost 7x of the Omani market (Figure 26).
- **% GDP:** Saudi has a low insurance penetration rate compared to the regional market (Figure 28), implying a significant growth potential.

**Figure 28 Insurance penetration (% of GDP), 2019**



Source: Tawuniya, Al Rajhi Capital

**Figure 29 New passenger car registrations/sales, 2019**



Source: OICA, Al Rajhi Capital

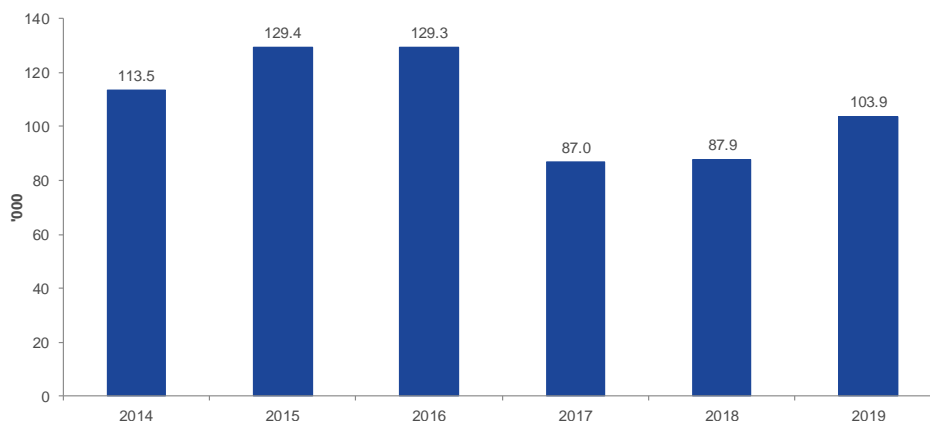
- **Car market size:** Saudi Arabia is the biggest market for car sales, significantly higher than the other regional peers, and even more than the combined car sales of the regional countries (Figure 29).



## Other regulatory factors

- Construction permits and mortgage growth.** Historically, the Saudi government, on average, issued 100k new construction permits every year and is likely to improve gradually, on the back of improvement in economic activities in the coming years. In addition, mortgage volumes have grown by 60% in 2020 and are expected to be up 30% CAGR in the next 3 years. Further, recent comments from the housing minister that the implementation of the second phase of the housing program - a component of Vision 2030 - will begin in early 2021 and shall continue for 5 years, gives us confidence in the potential growth opportunity for the P&C segment. As per SAMA, the total market size (in terms of GWP) of the general insurance segment reached SAR5.7bn, up by 23% y-o-y in 2019. The upward trend continued in 9M2020 as well with GWP rising by 24% y-o-y, despite slowing down the domestic economic activities amid the COVID-19 pandemic. Overall, we believe that the introduction of IDI, coupled with increased demand for the property, may continue to support the P&C segment growth going forward.

**Figure 30 Construction Permits in Saudi Arabia**



Source: Construction Permits data from MOMRA, Al Rajhi Capital

**Figure 31 Estimated 0.51mn new houses to be supplied in next three years**

Year	2020	2023e
Saudis Population (mn)	21.5	22.9
No. of Household (mn)	3.6	3.8
Penetration	60%	70%
No. of Households owning house (mn)	2.2	2.7
New House owners (mn)		0.51

Source: IMF, GASTAT, Al Rajhi Capital.

- New products:** In order to develop the domestic insurance market and offer diversified insurance products, the Saudi Central Bank has approved many new insurance products. This includes the insurance coverage for cancellations/suspension/postponement of live events, the launch of new solutions for motor leasing providers, construction warranty insurance (bagged by Malath), among others.
- Najm** (a cooperation between the SAMA and the General Authority of Traffic) that supports the motor insurance claims in the Kingdom, has revised its fees effective July 2020, which could increase costs for motor insurance companies, in our view. Earlier, Najm used to charge a fee of SAR3 per policy apart from SAR280 per accident from insurance companies. However, now, irrespective of the number of accidents, Najm could be likely to have started charging SAR63 per Third Party policy and ~SAR83 per comprehensive insurance policy. Besides, if the same client meets with an accident for the



third time or more within the tenure of the policy, then Najm will also charge SAR280 per accident from the insurance company to facilitate the claim process.

We believe that this fee revision is in the general negative for the motor insurance companies especially that SAMA has asked insurance companies to lower their premiums while costs are increasing.

**Calculation:** Since we had data for 2018 for the number of accidents and motor policies, we have used that as a reference. As per our calculations, in 2018, motor insurers might have paid around SAR84mn to Najm for claim management, assuming 252k number of accidents (source: GAS) and ~4.3mn motor policies (source: Saudi Central Bank). If we were to calculate the costs under the revised pricing structure, then it would increase to SAR314mn, almost a three-fold jump. This would increase the overall underwriting costs, resulting in pressure on profitability going forward.

**How does this impact the companies:** Most companies do not disclose this separately and club it within gross claims. One needs to know the number of accidents and the number of policies to calculate the impact. Companies with a low number of claims (and hence more profitable) will see the impact more than the ones with a higher number of claims. The breakeven ratio (claims/ policies) should be somewhere 25% based on our understanding. Also from what we understand for two large motor names, we believe it could be negative while for another one it is neutral.

**Figure 32 Impact of increased Najm's costs on the sector**

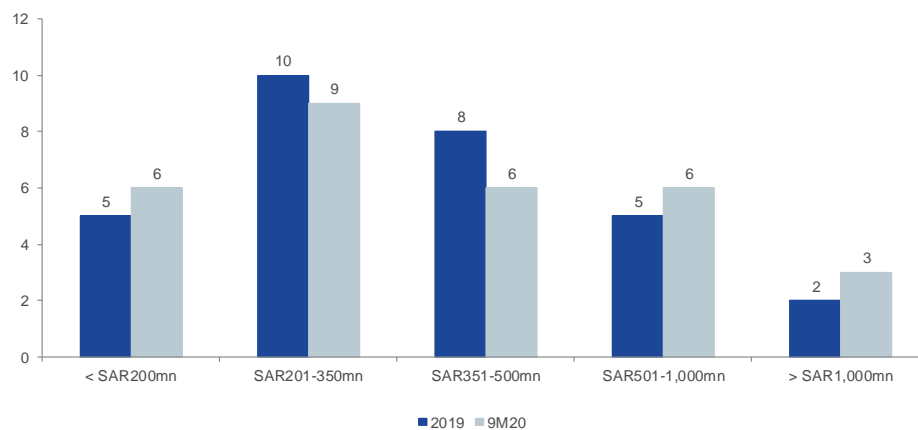
	Earlier method (per accident)	New method (based on policy)	
		TP	Comprehensive
No. of total accidents - 2018*	252,464	No. of total accidents - 2018*	252,464
No. of total motor policy - 2018	4,297,381	No. of total motor policy - 2018	4,297,381
% accident	6%	% accident	6%
Najm charges per accident (SAR)	280	Najm charges per accident (SAR)	0
Najm charges per policy (SAR)	3	Najm charges per policy (SAR)	63
<b>Fees paid to Najm (SARmn)</b>	<b>84</b>	<b>Implied fees paid to Najm (SARmn)</b>	<b>314</b>
<i>Implied rise in costs</i>			<b>275%</b>
2018 Motor segment GWP (SARmn)	9,267	2018 Motor segment GWP (SARmn)	9,267
<i>Implied fees as a % of GWP</i>	<i>0.9%</i>	<i>Implied fees as a % of GWP</i>	<i>3.4%</i>
2018 Motor segment NEPs (SARmn)	9,099	2018 Motor segment NEPs (SARmn)	9,099
<i>Implied fees as a % of NEPs</i>	<i>0.9%</i>	<i>Implied fees as a % of NEPs</i>	<i>3.4%</i>
2018 Motor segment NCIs (SARmn)	6,510	2018 Motor segment NCIs (SARmn)	6,510
<i>Implied fees as a % of NCIs</i>	<i>1.3%</i>	<i>Implied fees as a % of NCIs</i>	<i>4.8%</i>

Source: GAS, Argaam, Al Rajhi Capital. \* As per the latest data available

- **Higher capital requirement:** As per the current regulatory requirement, the companies, undertaking insurance activities, need to have a minimum capital of SAR100mn. Further, the current law stipulates a minimum capital of SAR200mn for the companies that undertake both insurance and reinsurance activities in the Kingdom. However, SAMA may increase (almost five-fold) the minimum capital requirement to SAR500mn for primary insurers and SAR1bn for both primary insurers and reinsurers. If implemented, which is most likely to happen in our view, then it will lead to a much-awaited wave of consolidation in the sector, eliminating smaller, less capitalized companies from the market. As of Q3 2020, there were only nine companies (including Tawuniya and AXA), which have higher capital than the proposed new requirement. On the other hand, around 21 companies need to raise the capital to meet the new capital requirement, if implemented.



**Figure 33 Around 21 companies may raise capital to comply with the proposed hike in capital requirement**



Source: Company data, Al Rajhi Capital



## Valuation

### Why do certain insurance companies trade at even higher levels than some banks despite not paying consistent dividends?

The multiples of some of the larger profit-making insurance companies are higher because of their higher RoEs. However, not all the companies are trading at multiples aligned to their return metrics. In our view, some midsized companies are overvalued with a significant improvement in earnings already factored in. Thus we find Tawuniya and Axa to be fair or cheaper relative to their RoEs.

Another reason is that there is an opportunity for higher growth compared to banks which grow mostly inline with GDP, esp. the corporate banks. Given that motor insurance penetration is only 50%, there are ample growth opportunities for the larger insurance players such as Tawuniya and Axa.

### Which is a better metric – P/B or P/E for insurance companies?

Both metrics ideally are aligned to its return ratios. For a sustainable RoE,  $P/E = P/B$  divided by RoE. We take a blended average of P/E and P/B.



## Tawuniya

**Initiate with OW with TP of SAR94/share and an upside of ~14%**

### Earnings

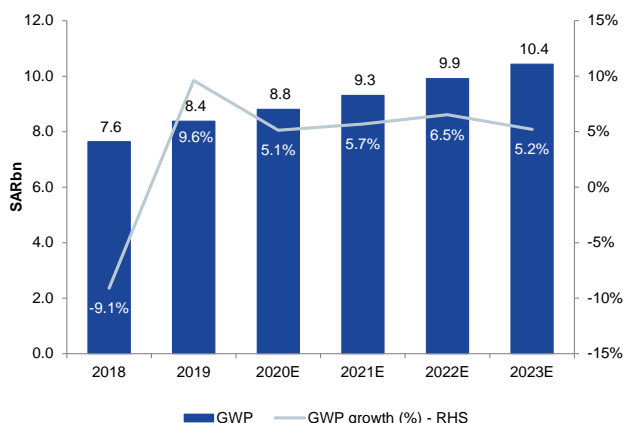
Period End (SARmn)	2019A	2020E	2021E
<b>GWP</b>	<b>8,376</b>	<b>8,805</b>	<b>9,306</b>
Growth (%)	10%	5%	6%
<b>NEP</b>	<b>6,877</b>	<b>6,989</b>	<b>7,389</b>
Growth (%)	-3%	2%	6%
<b>NCI</b>	<b>(5,813)</b>	<b>(5,435)</b>	<b>(5,858)</b>
Loss Ratio	84.5%	77.8%	79.3%
<b>Net Underwriting income</b>	<b>770</b>	<b>961</b>	<b>1,067</b>
Growth (%)	NM	25%	11%
<b>Net profit</b>	<b>328</b>	<b>402</b>	<b>476</b>
Growth (%)	NM	23%	18%
<b>EPS (SAR)</b>	<b>2.6</b>	<b>3.2</b>	<b>3.8</b>
EPS Growth	NM	23%	18%
P/E	31.6x	25.7x	21.7x
P/B	4.1x	3.8x	3.2x

Source: Company data, Al Rajhi Capital

We are positive on Tawuniya, due to i) its presence across most insurance segments including high-margin Umrah portfolio (20% loss ratio), ii) ability to capture market share, iii) healthy equity base, and iv) relatively lower loss ratio (mainly health and motor) in the coming years compared to the historical average due to structural changes (including changes in driving behaviour and the rising importance of health since COVID-19 outbreak). They have size advantages, and given the loyalty discounts and wide network, their customers are likely to be sticky. Further, the company has a well-diversified investment portfolio and has been generating a consistent investment income (~SAR200mn on average; 2020 was an exceptional year, in our view).

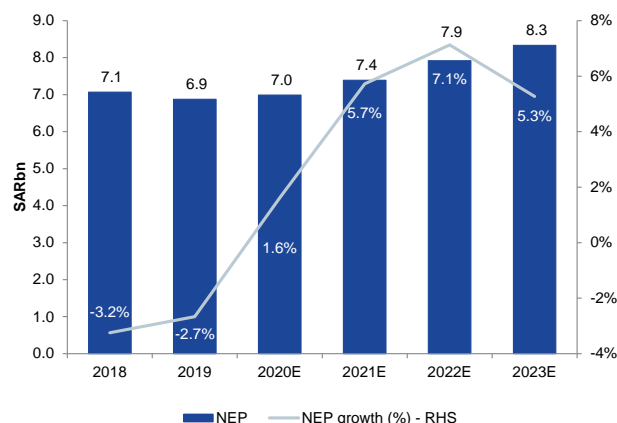
**GWP is expected to continuously improve**, albeit at a mid-single-digit, driven by healthy growth across the segments. The health segment, which remained almost flat over the past couple of years on non-renewals of loss-making accounts, is likely to grow at a low single-digit in the coming years (~3% CAGR over 2019-25E). As per our understanding, the company recently won a large contract from Bupa. Further, the high-margin Hajj and Umrah portfolio may increase at a CAGR of +15% over 2020-25E, accounting for ~6% of 2025E GWP. Further, as mentioned above, Tawuniya is one of the biggest beneficiaries of the recent enforcement on the motor segment. Overall, we expect the health segment (~67% of 2021E GWP) to continue to be the largest contributor to GWP, followed by the P&C segment (accounting for 21% of 2021E GWP).

**Figure 34 GWP to increase gradually**



Source: Company data, Al Rajhi Capital

**Figure 35 NEP broadly tracks the GWP trend**



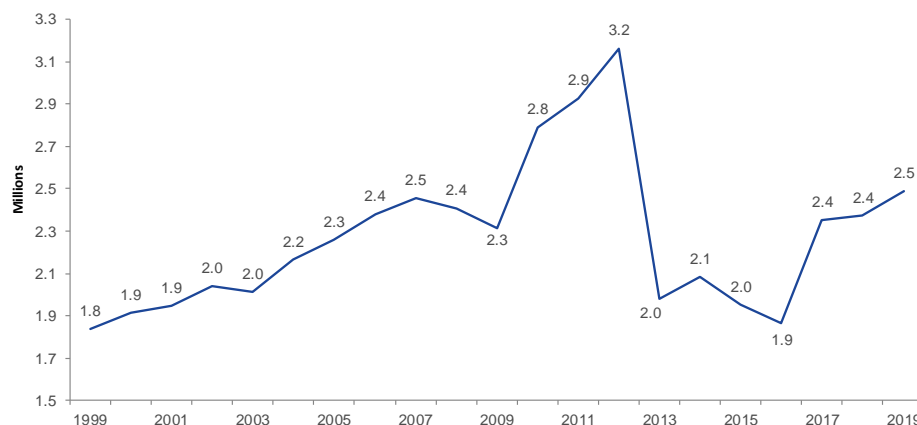
Source: Company data, Al Rajhi Capital

**Hajj & Umrah program and the government's push towards tourism** have started on Jan 1, 2020; however, the outbreak of coronavirus has impacted this segment's performance last year. Nonetheless, Hajj/Umrah visas have now resumed as part of a phased reopening (currently in Phase 3 @ 20k pilgrims, Phase 4 is full reopening which will be announced accordingly). As per Bupa, Umrah product is likely to add 10mn insurance policies annually by 2023 with GWP per life of SAR 100-200 (implying SAR1.5bn additional GWP potential at the mid-point). Consequently, Tawuniya, being a lead underwriter for this product, stands to benefit.





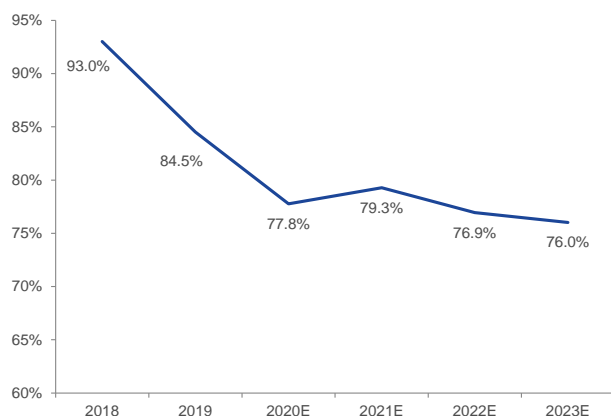
**Figure 36 Hajj pilgrims**



Source: Company data, Al Rajhi Capital

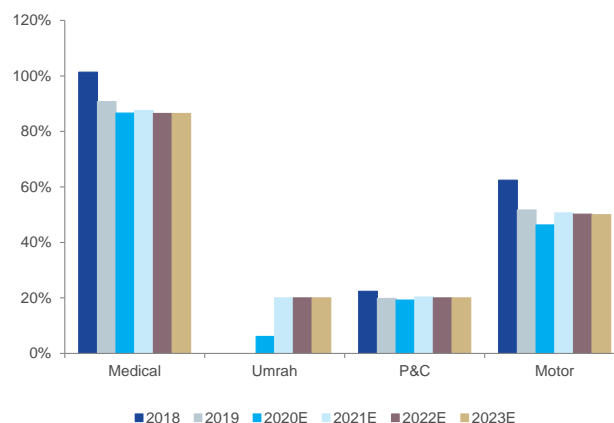
**Loss ratio.** We believe there could be a structural improvement in the health segment as we have witnessed in the past few years. Initiatives like the Tawuniya Vitality program (through which it can collect the health data of the customers as well as encourage them for healthy lifestyles) and the rising awareness about the healthy life (since the outbreak) may help in better management of medical claims. As for the motor loss ratio, post the COVID-19 pandemic, we see a lot of structural changes with the significant change in customer behaviour, driving & spending patterns. People now prefer digital shopping, while corporates are shifting from offline to online channels and have started offering work from home options to many employees. Further, most schools have now adopted online education as well. Consequently, we expect lower vehicles on road over the near to medium term, thereby leading to lower accidents amid ‘the new normal’ market conditions. In addition, the tougher motor regulations may reduce the number of fraud cases, leading to an improvement in the motor loss ratio (~50%) in the long-term. Moreover, we expect a stable loss ratio of ~20% (in-line with the historical trend) for the high-margin P&C segment and Umrah portfolio during our forecasted periods.

**Figure 37 Total loss ratio likely to improve**



Source: Company data, Al Rajhi Capital

**Figure 38 Loss ratio by the business segment**

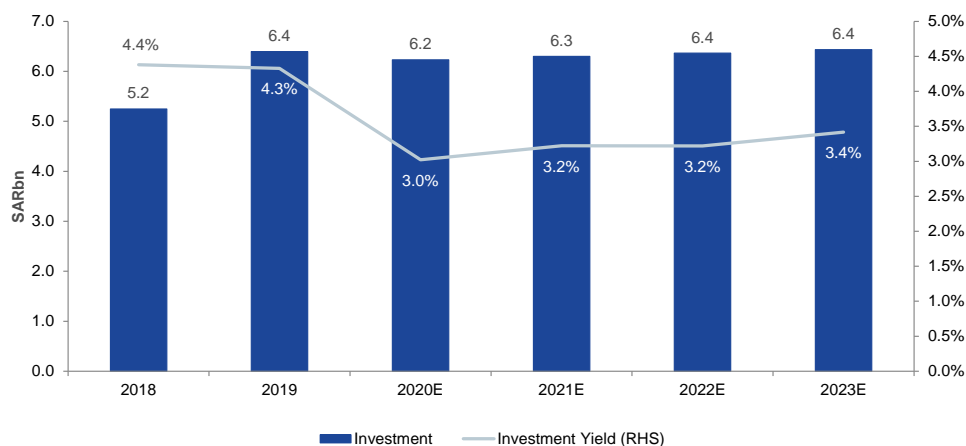


Source: Company data, Al Rajhi Capital

**Healthy investment income to remain.** Post availability of COVID-19 vaccines, the market sentiment has improved notably, leading to recovery across the asset classes. This will reduce unrealized losses (loss of SAR 154mn in 9M2020 vs. income of SAR 345mn in 9M2019) going forward.



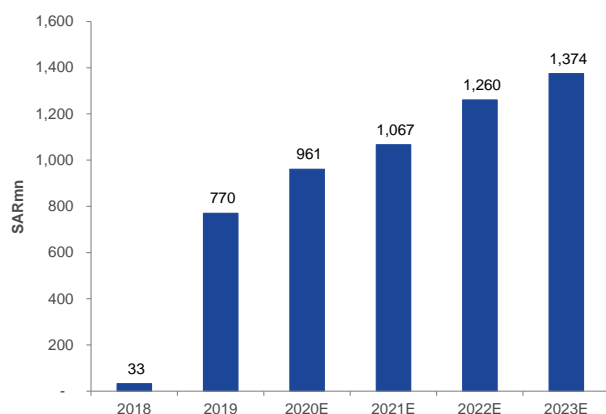
**Figure 39 Steady investment income to continue**



Source: Company data, Al Rajhi Capital

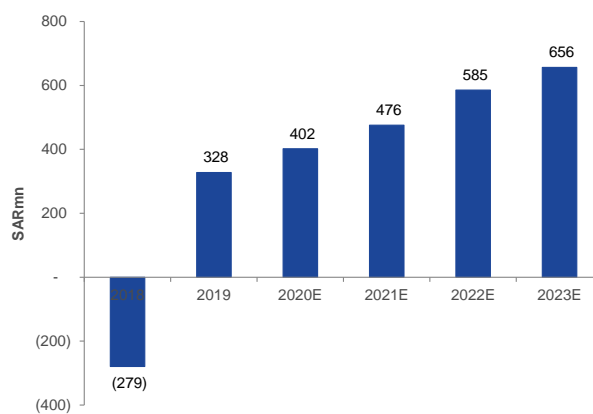
**Net income is expected to remain robust** in the coming years aided by healthy growth in top-line, improvement in loss ratio, and further supported by investment income and controlled operating costs. We expect the bottom-line to grow at a CAGR of ~15% over 2019-25E, aided by the addition of profitable clients and further supported by a high-margin Umrah and P&C portfolio. As per our calculations, a 1% change in loss ratio could translate into 14% incremental profit for the company in 2021E, due to operating leverage (Figure 10). Further, if the motor penetration rate increases to 100% on account of the compulsory motor insurance, then Tawuniya is well-positioned to grab the additional market shares, which may result in a 25% jump in EPS based on its 2019 retail motor market share (Figure 19).

**Figure 40 Increasing net underwriting income**



Source: Company data, Al Rajhi Capital

**Figure 41 Rising net profit after zakat**



Source: Company data, Al Rajhi Capital

**Healthy capital base:** As of Q3 2020, Tawuniya's shareholders' equity stood at SAR2.7bn, much higher than the current regulatory requirement. The company will remain well-capitalized even after adjusting for any possible upward revisions, thereby ensuring a stable solvency level in the current challenging market dynamics.

**Rising receivables, a short-term concern.** Though gross receivables went up sharply in Q2, mainly due to a slowdown in collection amid the lockdown and slowing economy, it has slightly reduced in Q3 (a major portion of this is from the government) but remains above the historical level.



**Valuation and risks.** Tawuniya is trading at an attractive valuation, trading at a P/B of 3.2x on our 2021E BVPS, below its 3-year average of 3.8x (Figure 42). We value the company using the P/E method (18x targeted multiple on our 2022E EPS) and the P/B method (3.5x targeted multiple on our 2022E BVPS, which is still lower than the historical average). This implies a weighted average TP of SAR94.0/sh., offering an upside potential of ~15% from the current levels.

**Figure 42 Tawuniya P/B trend vs. sector**



Source: Bloomberg, Al Rajhi Capital

**Figure 43 Tawuniya P/S trend vs. sector**



Source: Bloomberg, Al Rajhi Capital

**The key upside triggers** might be attributed to quicker-than-expected economic recovery, further enforcement on Saudis, and introduction of dividends while higher-than-expected loss ratio, non-renewal of major existing insurance contracts, pricing pressure amid the stiff competition may act as **the downside triggers**.

**Figure 44 Financial summary (SARmn)**

	2018A	2019A	2020E	2021E	2022E
<b>GWP</b>	<b>7,641</b>	<b>8,376</b>	<b>8,805</b>	<b>9,306</b>	<b>9,914</b>
NWP	6,527	6,712	7,052	7,467	7,998
NEP	7,066	6,877	6,989	7,389	7,915
NCI	(6,572)	(5,813)	(5,435)	(5,858)	(6,090)
Loss Ratio	93.0%	84.5%	77.8%	79.3%	76.9%
Policy acquisition costs	(391)	(360)	(382)	(322)	(345)
<b>Net Underwriting income</b>	<b>33</b>	<b>770</b>	<b>961</b>	<b>1,067</b>	<b>1,260</b>
G&A expenses	(498)	(577)	(565)	(580)	(630)
Investment income	217	221	175	191	193
Other income/expenses	35	23	(50)	(63)	(67)
Net profit before zakat	(213)	436	521	615	756
Zakat	(66)	(75)	(70)	(84)	(103)
<b>Net profit</b>	<b>(279)</b>	<b>328</b>	<b>402</b>	<b>476</b>	<b>585</b>
Net profit to NEP %	-4.0%	4.8%	5.8%	6.4%	7.4%
EPS (SAR)	(2.23)	2.62	3.22	3.81	4.68
BVPS (SAR)	14.47	20.00	22.05	25.85	29.55
P/E (curr.)	NM	31.6x	25.7x	21.7x	17.7x
P/E (target)	NM	35.9x	29.2x	24.7x	20.1x
P/B (curr.)	5.7x	4.1x	3.8x	3.2x	2.8x
P/B (target)	6.5x	4.7x	4.3x	3.6x	3.2x
ROAE	NM	15.2%	15.3%	15.9%	16.9%

Source: Company data, Al Rajhi Capital



## Tawuniya detailed financials

**Figure 45 Income statement (SARmn)**

	2018	2019	2020E	2021E	2022E	2023E
<b>Gross premium written</b>	<b>7,641</b>	<b>8,376</b>	<b>8,805</b>	<b>9,306</b>	<b>9,914</b>	<b>10,430</b>
Reinsurance premium ceded - local + international	(1,098)	(1,650)	(1,732)	(1,816)	(1,892)	(1,988)
Fee income from takaful	9	7	4	5	5	5
Excess of loss premiums	(25)	(20)	(26)	(27)	(29)	(31)
<b>Net premium written</b>	<b>6,527</b>	<b>6,712</b>	<b>7,052</b>	<b>7,467</b>	<b>7,998</b>	<b>8,417</b>
Changes in unearned premiums, net	539	165	(63)	(78)	(82)	(85)
<b>Net premium earned</b>	<b>7,066</b>	<b>6,877</b>	<b>6,989</b>	<b>7,389</b>	<b>7,915</b>	<b>8,333</b>
Reinsurance commissions	112	122	130	138	133	140
Other underwriting income	10	11	7	8	8	9
<b>Total revenues</b>	<b>7,188</b>	<b>7,010</b>	<b>7,127</b>	<b>7,535</b>	<b>8,057</b>	<b>8,482</b>
Net claims and other benefits incurred	6,572	5,813	5,435	5,858	6,090	6,335
Changes in reserves for takaful activities	(2)	(4)	(1)	(1)	(1)	(1)
Policy acquisition costs	391	360	382	322	345	363
Other underwriting expenses	138	14	188	148	158	167
Manafeth insurance share distribution	57	57	162	141	204	244
<b>Total underwriting costs and expenses</b>	<b>7,155</b>	<b>6,240</b>	<b>6,166</b>	<b>6,468</b>	<b>6,797</b>	<b>7,107</b>
	-	-	0	0	0	0
<b>Net underwriting income</b>	<b>33</b>	<b>770</b>	<b>961</b>	<b>1,067</b>	<b>1,260</b>	<b>1,374</b>
General and administrative expenses	(498)	(577)	(565)	(580)	(630)	(679)
(Allowance for) reversal of doubtful debts	(20)	(29)	(72)	(84)	(88)	(78)
Dividend and realized gain on investments, net	217	221	175	191	193	208
Share of profit from investments in associates, net	30	31	14	12	12	12
Other income, net	26	20	8	9	10	10
<b>Total other operating expenses</b>	<b>(246)</b>	<b>(334)</b>	<b>(440)</b>	<b>(452)</b>	<b>(504)</b>	<b>(526)</b>
<b>Net income / (loss) before attribution and zakat</b>	<b>(213)</b>	<b>436</b>	<b>521</b>	<b>615</b>	<b>756</b>	<b>848</b>
Net income attributed to the insurance operations	-	(34)	(49)	(55)	(68)	(76)
<b>Net income / (loss) before zakat</b>	<b>(213)</b>	<b>402</b>	<b>472</b>	<b>560</b>	<b>689</b>	<b>772</b>
Zakat	(66)	(75)	(70)	(84)	(103)	(116)
<b>Net income / (loss) after zakat</b>	<b>(279)</b>	<b>328</b>	<b>402</b>	<b>476</b>	<b>585</b>	<b>656</b>

Source: Company data, Al Rajhi Capital



**Figure 46 Balance sheet (SARmn)**

	2018	2019	2020E	2021E	2022E	2023E
<b>Assets</b>						
Statutory deposit	125	125	125	125	125	125
Accrued income on Statutory deposit	2	3	3	3	3	3
Property and equipment, net	266	260	248	224	203	185
Intangible assets	4	4	7	6	6	5
Investment property	10	10	10	10	10	10
Investment in associates	95	102	81	81	81	81
Available for sale investments	2,905	2,747	3,255	3,408	3,528	3,651
Murabaha deposits	2,239	3,539	2,887	2,803	2,747	2,692
Prepaid expenses and other assets	261	244	700	700	700	700
Deferred excess of loss premiums	9	8	11	11	11	11
Deferred policy acquisition costs	131	121	139	139	139	139
Reinsurers' share of gross outstanding claims	2,726	3,100	1,514	1,757	1,884	1,967
Reinsurers' share of incurred but not reported claims	192	328	274	243	227	211
Reinsurers' share of unearned premiums	545	716	814	859	907	960
Receivables, net	1,518	1,496	2,606	2,757	2,953	3,109
Accrued investment income	-	6	95	95	95	95
Cash and cash equivalents	1,600	1,307	1,052	1,533	1,983	2,441
<b>Total assets</b>	<b>12,628</b>	<b>14,114</b>	<b>13,821</b>	<b>14,754</b>	<b>15,601</b>	<b>16,383</b>
<b>Liabilities</b>						
Defined benefit obligations	133	129	138	148	158	170
Return payable on statutory deposit	2	3	3	3	3	3
Claims payable, accrued expenses and other liabilities	1,515	1,175	1,837	1,894	1,990	2,081
Short-term borrowings	-	-	400	400	400	400
Reserve for takaful activities	9	5	4	3	3	2
Gross outstanding claims	3,271	3,685	2,239	2,589	2,790	2,925
Incurred but not reported claim reserve	1,684	1,926	1,445	1,408	1,368	1,327
Premium deficiency reserve	7	3	153	116	96	79
Unearned commission income	39	43	36	29	36	44
Gross unearned premium	3,820	3,826	3,988	4,111	4,241	4,379
Reinsurers' balance payable	95	524	430	430	430	430
Surplus distribution payable	-	34	34	34	34	34
Dividend payable	6	6	6	6	6	6
Accumulated surplus	-	-	43	43	43	43
Zakat	237	256	308	308	308	308
<b>Total Liabilities</b>	<b>10,819</b>	<b>11,615</b>	<b>11,065</b>	<b>11,522</b>	<b>11,907</b>	<b>12,230</b>
<b>Equity</b>						
Share capital	1,250	1,250	1,250	1,250	1,250	1,250
Legal reserve	1,000	1,066	1,066	1,066	1,066	1,066
Fair value reserve for investments	(199)	167	22	22	22	22
Remeasurement of defined benefit obligation	(12)	(15)	(15)	(15)	(15)	(15)
Retained earnings	(231)	31	433	909	1,372	1,831
<b>Total Equity</b>	<b>1,808</b>	<b>2,500</b>	<b>2,756</b>	<b>3,232</b>	<b>3,694</b>	<b>4,154</b>
<b>Total Liabilities and equity</b>	<b>12,628</b>	<b>14,114</b>	<b>13,821</b>	<b>14,754</b>	<b>15,601</b>	<b>16,383</b>

Source: Company data, Al Rajhi Capital



**Figure 47 KPIs**

	2018	2019	2020E	2021E	2022E	2023E
<b>Growth (%)</b>						
GWP	-9.1%	9.6%	5.1%	5.7%	6.5%	5.2%
NWP	-10.3%	2.8%	5.1%	5.9%	7.1%	5.2%
NEP	-3.2%	-2.7%	1.6%	5.7%	7.1%	5.3%
NCI	-3.5%	-11.5%	-6.5%	7.8%	4.0%	4.0%
Net underwriting income	NM	NM	24.7%	11.1%	18.1%	9.0%
Net income	-90.6%	NM	22.7%	18.4%	23.0%	12.1%
<b>Per share (SAR)</b>						
EPS	(2.23)	2.62	3.22	3.81	4.68	5.25
DPS	-	-	-	-	1.0	1.6
BVPS	14.47	20.00	22.05	25.85	29.55	33.23
Tangible BVPS	14.44	19.97	21.99	25.80	29.51	33.19
<b>Performance metrics</b>						
Retention ratio	85.4%	80.1%	80.1%	80.2%	80.7%	80.7%
Loss ratio	93.0%	84.5%	77.8%	79.3%	76.9%	76.0%
Expense ratio	14.8%	14.2%	17.3%	15.3%	15.4%	15.4%
Combined Ratio	107.8%	98.8%	95.0%	94.6%	92.4%	91.5%
Underwriting income margin	0.5%	11.2%	13.7%	14.4%	15.9%	16.5%
Annual investment yield (%)	4.4%	4.3%	3.0%	3.2%	3.2%	3.4%
Net profit to NEP %	-4.0%	4.8%	5.8%	6.4%	7.4%	7.9%
GWP/Equity	4.2x	3.4x	3.2x	2.9x	2.7x	2.5x
NWP/Equity	3.6x	2.7x	2.6x	2.3x	2.2x	2.0x
Technical Reserves/Gross Premiums	1.1x	1.1x	0.9x	0.9x	0.8x	0.8x
Technical Reserves/Net Earned Premiums	1.2x	1.4x	1.1x	1.1x	1.1x	1.0x
Technical Reserves/Equity	4.9x	3.8x	2.8x	2.5x	2.3x	2.1x
<b>Valuation</b>						
P/E (curr.)	NM	31.6x	25.7x	21.7x	17.7x	15.8x
P/E (target)	NM	35.9x	29.2x	24.7x	20.1x	17.9x
P/B (curr.)	5.7x	4.1x	3.8x	3.2x	2.8x	2.5x
P/B (target)	6.5x	4.7x	4.3x	3.6x	3.2x	2.8x
Dividend payout	0.0%	0.0%	0.0%	0.0%	21.0%	30.0%
Dividend yield	0.0%	0.0%	0.0%	0.0%	1.2%	1.9%
ROA	-2.2%	2.4%	2.9%	3.3%	3.9%	4.1%
ROE	-14.2%	15.2%	15.3%	15.9%	16.9%	16.7%

Source: Company data, Al Rajhi Capital



## AXA

### Overweight rating with a TP of SAR43/sh.

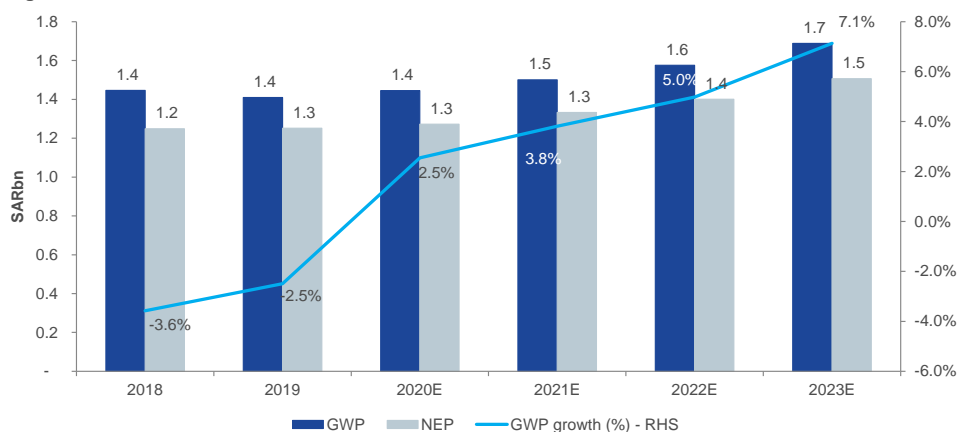
#### Earnings

Period End (SARmn)	2019A	2020E	2021E
<b>GWP</b>	<b>1,410</b>	<b>1,446</b>	<b>1,501</b>
Growth (%)	-2%	3%	4%
<b>NEP</b>	<b>1,252</b>	<b>1,272</b>	<b>1,333</b>
Growth (%)	0%	2%	5%
<b>NCI</b>	<b>(941)</b>	<b>(891)</b>	<b>(957)</b>
Loss Ratio	75.2%	70.0%	71.8%
<b>Net Underwriting income</b>	<b>231</b>	<b>291</b>	<b>280</b>
Growth (%)	14%	26%	-4%
<b>Net profit</b>	<b>87</b>	<b>145</b>	<b>137</b>
Growth (%)	47%	67%	-5%
<b>EPS (SAR)</b>	<b>1.7</b>	<b>2.9</b>	<b>2.7</b>
EPS Growth	47%	67%	-5%
P/E	22.1x	13.3x	14.0x
P/B	2.7x	2.2x	1.9x

Source: Company data, Al Rajhi Capital

**Motor business likely to grow on compulsory motor insurance.** AXA, being the second-largest motor insurers (in terms of market share) after Al Rajhi Takaful, is well placed to capture more motor business (accounting for ~57% of total GWP), following compulsory motor insurance introduced in July last year. Further, AXA's lower TPL premium will also attract more volume once the smaller players exit the market in the coming years. AXA is also expected to perform well in other business verticals (health and P&C). Accordingly, GWP is likely to reach ~SAR1.9bn by 2025 (CAGR of 4.8%) from SAR1.4bn in 2019. We expect GWP contribution from P&C to increase gradually in the coming years. Further, higher retention will help the company to ensure healthy growth in net earned premium as well.

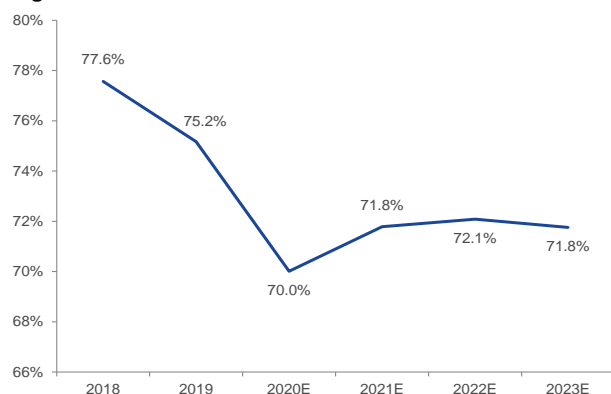
Figure 48 GWP and NWP continue to rise



Source: Company data, Al Rajhi Capital

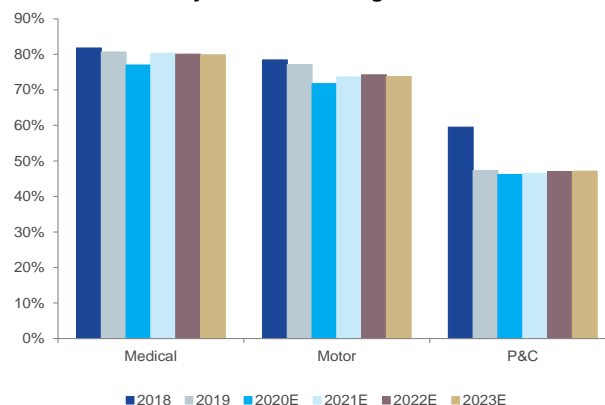
**Loss ratio to improve in the coming years.** Despite a likely increase in loss ratio in 2021, mainly due to deferred claims, we expect the total loss ratio to gradually improve to ~72% by 2025, compared to ~75% in 2019, primarily driven by likely improvement in motor loss ratio on structural and regulatory changes. With a gradual shift from offline to online channels (by customers, enterprises as well as schools), the number of vehicles on roads is likely to reduce in the near to medium term, thereby lowering the accidents amid 'the new normal' market conditions. Further, the tougher motor regulations may reduce the fraud cases, leading to a decline in the motor loss ratio (2025E: ~73% vs. ~77% in 2019) in the long-term. In addition, people are now more health-conscious since the outbreak, which may support the medical loss ratio (likely to remain below ~80% during most of our forecasted periods). For the P&C segment, we expect the claims ratio to remain at ~47% over 2019-25E.

Figure 49 Loss ratio to remain below the historical levels



Source: Company data, Al Rajhi Capital

Figure 50 Loss ratios by the business segment



Source: Company data, Al Rajhi Capital



**AXA Group signs a deal with GIG to sell its stake in AXA Cooperative.** In Nov 2020, the company announced that AXA Group has signed a deal with Gulf Insurance Group (GIG; backed by Kuwait-based KIPCO and Canada-based Fairfax Financial) to sell its Gulf insurance operations (including AXA Cooperative Insurance, AXA Gulf, and UAE-based AXA Green Crescent Insurance.). As a part of the deal, AXA Mediterranean Holding S.A. (AXA Med) will sell its 18% stake (9mn shares) in AXA Cooperative for SAR218.1mn (implied price: SAR 24.23/sh.). In addition, GIG will also acquire 100% of Bahrain-based AXA Insurance (Gulf), which holds a 32% stake (16mn shares) in Saudi-based AXA Cooperative Insurance Co., for SAR387.7mn (the equivalent price of SAR24.23/sh.). Upon the completion of the deal, which is likely in Q3 2021 (subject to regulatory approval), GIG will directly own an 18% stake in AXA Cooperative and an additional 32% indirect stake through AXA Insurance (Gulf).

**Figure 51 AXA-GIG deal details**

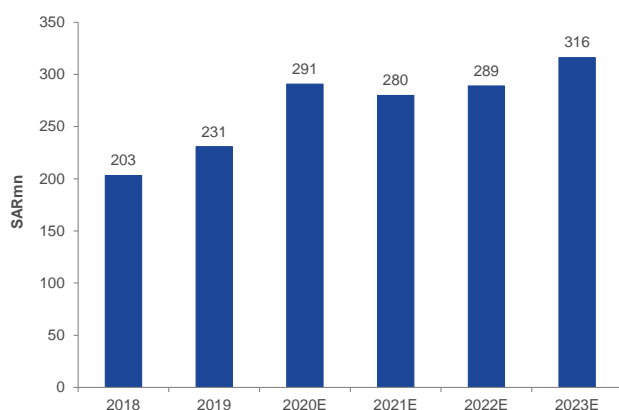
Shareholder	No. of shares (mn)	Ownership (%)	Implied Price (SAR)	Deal value (SARmn)
AXA Insurance (Gulf) - Bahrain	16	32%	24.23	387.7
AXA Mediterranean Holding Co.	9	18%	24.23	218.1

Source: Tadawul, Al Rajhi Capital

While this deal is not expected to impact the company's financial performance, AXA Cooperative is likely to be benefited through GIG's regional footprint and operational scale, and further supported by the international exposure and expertise of Fairfax (key stakeholder in GIG), which may deliver the growth with better customer services in the future.

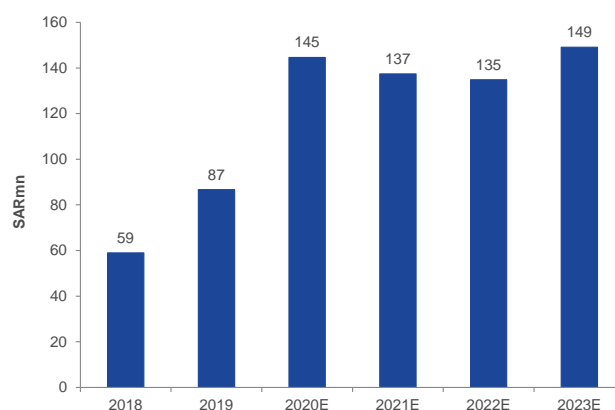
**Net profit likely to grow at a double-digit over 2019-25E.** Net underwriting income is likely to be driven by healthy GWP growth (driven by growth across the segments), coupled with improvement in loss ratio. This, along with improved operating efficiency and healthy non-operating income, will drive earnings by a double-digit over 2019-25E. In the case of a 1% improvement in loss ratio (vs. our estimate), AXA's 2021E earnings could increase further by 11% (Figure 10). In addition, AXA, being the second-largest motor insurers, has a huge EPS growth potential (~23% based on its 2019 retail motor market shares) in case of the motor penetration rate increases to 100% due to the mandatory motor insurance (Figure 19).

**Figure 52 Net underwriting income likely to drop in 2021 before improving from 2022**



Source: Company data, Al Rajhi Capital

**Figure 53 Net profit to continue to grow except for 2021**



Source: Company data, Al Rajhi Capital

**Capital base above the requirement.** We like AXA, given its healthy equity base of SAR828mn (as of 3Q20), above the current regulatory requirement (SAR100mn) and proposed capital requirement (likely SAR500mn), which could provide the stability in operations in addition to growth.





**Valuation and risks.** The stock trades at an attractive level, trading at a P/B of 1.9x on our 2021E BVPS, in-line its historical 3-year average but ~30% lower than the 3-year historical high of 2.7x and the sector's average (Figure 54). Based on the P/E method (15x targeted multiple on our 2022E EPS) and the P/B method (2.0x targeted multiple on our 2022E BVPS), we arrive with a weighted average TP of SAR43.0/sh., implying an upside potential of ~12% from the current level. While the fundamentals are likely to remain firm, our OW rating is mainly from the valuation perspective, given that it generates a better net margin (2020E: 11.4% vs. Tawuniya's 5.8%) than Tawuniya but trades lower in terms of multiple.

**Figure 54 AXA P/B trend vs. sector**



Source: Bloomberg, Al Rajhi Capital

**Figure 55 AXA P/S trend vs. sector**



Source: Bloomberg, Al Rajhi Capital

**The key upside risks** include better-than-expected economic recovery, quicker than expected improvement in loss ratio, further enforcement on Saudis, and introduction of dividends. **The key downside risks** include a higher-than-expected loss ratio, non-renewal of major existing insurance contracts, and pricing pressure amid the stiff competition.

**Figure 56 Detailed income statement (SARmn)**

	2018A	2019A	2020E	2021E	2022E
<b>GWP</b>	<b>1,446</b>	<b>1,410</b>	<b>1,446</b>	<b>1,501</b>	<b>1,576</b>
NWP	1,295	1,322	1,319	1,382	1,452
NEP	1,248	1,252	1,272	1,333	1,400
NCI	(968)	(941)	(891)	(957)	(1,010)
Loss Ratio	77.6%	75.2%	70.0%	71.8%	72.1%
Policy acquisition costs	(103)	(92)	(104)	(110)	(116)
<b>Net Underwriting income</b>	<b>203</b>	<b>231</b>	<b>291</b>	<b>280</b>	<b>289</b>
G&A expenses	(165)	(167)	(163)	(168)	(184)
Investment and other income	46	54	61	66	70
Net profit before zakat	76	108	173	162	159
Zakat	(17)	(22)	(28)	(25)	(24)
<b>Net profit</b>	<b>59</b>	<b>87</b>	<b>145</b>	<b>137</b>	<b>135</b>
Net profit to NEP %	4.7%	6.9%	11.4%	10.3%	9.6%
EPS (SAR)	1.18	1.73	2.89	2.75	2.70
BVPS (SAR)	11.80	14.20	17.34	20.09	22.79
P/E (curr.)	32.5x	22.1x	13.3x	14.0x	14.2x
P/E (target)	36.5x	24.8x	14.9x	15.7x	16.0x
P/B (curr.)	3.3x	2.7x	2.2x	1.9x	1.7x
P/B (target)	3.6x	3.0x	2.5x	2.1x	1.9x
ROAE	10.4%	13.3%	18.3%	14.7%	12.6%

Source: Company data, Al Rajhi Capital



## AXA detailed financials

**Figure 57 Income statement (SARmn)**

	2018	2019	2020E	2021E	2022E	2023E
<b>Gross premium written</b>	<b>1,446</b>	<b>1,410</b>	<b>1,446</b>	<b>1,501</b>	<b>1,576</b>	<b>1,688</b>
Reinsurance premium ceded - local + international	(150)	(88)	(127)	(119)	(124)	(129)
<b>Net premium written</b>	<b>1,295</b>	<b>1,322</b>	<b>1,319</b>	<b>1,382</b>	<b>1,452</b>	<b>1,559</b>
Changes in unearned premiums, net	(47)	(70)	(47)	(49)	(51)	(52)
<b>Net premium earned</b>	<b>1,248</b>	<b>1,252</b>	<b>1,272</b>	<b>1,333</b>	<b>1,400</b>	<b>1,507</b>
Reinsurance commissions	26	12	13	14	15	16
<b>Total revenues</b>	<b>1,274</b>	<b>1,264</b>	<b>1,285</b>	<b>1,347</b>	<b>1,415</b>	<b>1,523</b>
Net claims and other benefits incurred	968	941	891	957	1,010	1,081
Policy acquisition costs	103	92	104	110	116	125
<b>Total underwriting costs and expenses</b>	<b>1,071</b>	<b>1,033</b>	<b>995</b>	<b>1,067</b>	<b>1,126</b>	<b>1,206</b>
<b>Net underwriting income</b>	<b>203</b>	<b>231</b>	<b>291</b>	<b>280</b>	<b>289</b>	<b>316</b>
General and administrative expenses	(165)	(167)	(163)	(168)	(184)	(198)
Investment and other income	46	54	61	66	70	75
<b>Total other operating expenses</b>	<b>(119)</b>	<b>(113)</b>	<b>(101)</b>	<b>(102)</b>	<b>(114)</b>	<b>(123)</b>
<b>Net income / (loss) before attribution and zakat</b>	<b>84</b>	<b>118</b>	<b>189</b>	<b>178</b>	<b>175</b>	<b>193</b>
Net income attributed to the insurance operations	(7)	(10)	(17)	(16)	(16)	(17)
<b>Net income / (loss) before zakat</b>	<b>76</b>	<b>108</b>	<b>173</b>	<b>162</b>	<b>159</b>	<b>176</b>
Zakat	(17)	(22)	(28)	(25)	(24)	(27)
<b>Net income / (loss) after zakat</b>	<b>59</b>	<b>87</b>	<b>145</b>	<b>137</b>	<b>135</b>	<b>149</b>

Source: Company data, Al Rajhi Capital



**Figure 58 Balance sheet (SARmn)**

	2018	2019	2020E	2021E	2022E	2023E
<b>Assets</b>						
Statutory deposit	45	45	50	50	50	50
Accrued income on Statutory deposit	4	4	6	6	6	6
Property and equipment, net	6	11	23	24	25	25
Intangible assets	17	12	8	5	4	3
Available for sale investments	732	806	1,038	1,144	1,196	1,249
Deposits	854	849	686	747	777	808
Prepaid expenses and other assets	20	17	24	24	24	24
Right-of-use assets	-	26	23	22	21	20
Deferred policy acquisition costs	21	30	43	43	43	43
Reinsurers' share of gross outstanding claims	99	84	87	103	121	140
Reinsurers' share of incurred but not reported claims	46	51	66	81	95	110
Reinsurers' share of unearned premiums	18	19	30	40	52	66
Receivables, net	196	190	341	351	369	397
Due from insurance/shareholders' operations	53	87	101	101	101	101
Goodwill	50	50	50	50	50	50
Cash and cash equivalents	46	235	340	385	456	478
<b>Total assets</b>	<b>2,208</b>	<b>2,517</b>	<b>2,915</b>	<b>3,176</b>	<b>3,387</b>	<b>3,570</b>
<b>Liabilities</b>						
Claims payable, accrued expenses and other liabilities	114	113	134	140	148	159
Gross outstanding claims	278	260	287	322	322	322
Incurred but not reported claim reserve	616	701	799	806	813	820
Unearned reinsurance commission	4	4	4	5	5	6
Gross unearned premium	388	459	517	576	638	705
Reinsurers' balance payable	51	27	44	60	60	60
Surplus distribution payable	12	20	27	27	27	27
Due to shareholders/insurance operations	53	87	101	101	101	101
Advance premium	27	31	31	31	31	31
Lease liability	-	24	22	22	22	22
Employee benefit obligation	28	31	30	29	27	26
Due to related party	6	3	3	3	3	3
Accrued income payable to SAMA	4	4	6	6	6	6
Zakat	37	43	45	45	45	45
<b>Total Liabilities</b>	<b>1,618</b>	<b>1,807</b>	<b>2,048</b>	<b>2,171</b>	<b>2,248</b>	<b>2,332</b>
<b>Equity</b>						
Share capital	450	500	500	500	500	500
Statutory reserve	32	49	70	70	70	70
Fair value reserve for investments	(13)	20	32	32	32	32
Performance share reserves	1	1	2	2	2	2
Retained earnings	120	139	263	400	535	633
<b>Total Equity</b>	<b>590</b>	<b>710</b>	<b>867</b>	<b>1,005</b>	<b>1,139</b>	<b>1,238</b>
<b>Total Liabilities and equity</b>	<b>2,208</b>	<b>2,517</b>	<b>2,915</b>	<b>3,176</b>	<b>3,387</b>	<b>3,570</b>

Source: Company data, Al Rajhi Capital



**Figure 59 KPIs**

	2018	2019	2020E	2021E	2022E	2023E
<b>Growth (%)</b>						
GWP	-3.6%	-2.5%	2.5%	3.8%	5.0%	7.1%
NWP	-0.3%	2.0%	-0.2%	4.7%	5.1%	7.4%
NEP	0.8%	0.3%	1.6%	4.8%	5.1%	7.6%
NCI	-2.6%	-2.8%	-5.3%	7.4%	5.5%	7.1%
Net underwriting income	22.4%	13.6%	26.0%	-3.7%	3.3%	9.4%
Net income	30.9%	46.9%	66.8%	-5.0%	-1.9%	10.6%
<b>Per share (SAR)</b>						
EPS	1.18	1.73	2.89	2.75	2.70	2.98
DPS	-	-	-	-	-	1.0
BVPS	11.80	14.20	17.34	20.09	22.79	24.75
Tangible BVPS	11.47	13.95	17.19	19.98	22.71	24.69
<b>Performance metrics</b>						
Retention ratio	89.6%	93.8%	91.2%	92.1%	92.1%	92.4%
Loss ratio	77.6%	75.2%	70.0%	71.8%	72.1%	71.8%
Expense ratio	21.5%	20.7%	21.0%	20.9%	21.5%	21.4%
Combined Ratio	99.0%	95.9%	91.0%	92.7%	93.5%	93.2%
Underwriting income margin	16.3%	18.4%	22.9%	21.0%	20.6%	21.0%
Annual investment yield (%)	2.9%	3.3%	3.6%	3.5%	3.5%	3.6%
Net Margin	4.7%	6.9%	11.4%	10.3%	9.6%	9.9%
GWP/Equity	2.5x	2.0x	1.7x	1.5x	1.4x	1.4x
NWP/Equity	2.2x	1.9x	1.5x	1.4x	1.3x	1.3x
Technical Reserves/Gross Premiums	0.9x	1.0x	1.1x	1.1x	1.1x	1.1x
Technical Reserves/Net Earned Premiums	1.0x	1.1x	1.3x	1.3x	1.3x	1.2x
Technical Reserves/Equity	2.2x	2.0x	1.8x	1.7x	1.6x	1.5x
<b>Valuation</b>						
P/E (curr.)	32.5x	22.1x	13.3x	14.0x	14.2x	12.9x
P/E (target)	36.5x	24.8x	14.9x	15.7x	16.0x	14.4x
P/B (curr.)	3.3x	2.7x	2.2x	1.9x	1.7x	1.5x
P/B (target)	3.6x	3.0x	2.5x	2.1x	1.9x	1.7x
Dividend payout	0.0%	0.0%	0.0%	0.0%	0.0%	34.0%
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	2.6%
ROA	2.8%	3.7%	5.3%	4.5%	4.1%	4.3%
ROE	10.4%	13.3%	18.3%	14.7%	12.6%	12.5%

Source: Company data, Al Rajhi Capital



## Appendix

Figure 60 Sector consolidated data

Company	GWPs (SARmn)		NWP (SARmn)		NEP (SARmn)		NCI (SARmn)		Loss ratio		Net profit (SARmn)		Equity (SARmn)	
	2019	9M20	2019	9M20	2019	9M20	2019	9M20	2019	9M20	2019	9M20	2019	9M20
Bupa Arabia	10,411	8,789	10,305	8,753	9,371	8,069	7,749	6,299	82.7%	78.1%	594	627	3,032	3,782
Tawuniya	8,376	6,362	6,712	5,284	6,877	5,254	5,813	3,984	84.5%	75.8%	328	350	2,500	2,703
Al Rajhi Takaful	2,570	2,160	2,436	1,826	2,639	1,768	2,208	1,244	83.7%	70.4%	86	177	876	1,062
MedGulf	2,421	1,934	1,737	1,080	1,997	1,129	1,685	837	84.4%	74.1%	3	31	711	761
Axa Cooperative	1,410	1,201	1,322	1,087	1,252	944	941	660	75.2%	70.0%	87	105	710	828
Walaa	1,215	1,045	736	614	713	587	561	394	78.7%	67.1%	21	27	669	884
Allianz SF	1,012	532	700	318	685	401	549	311	80.0%	77.4%	32	(19)	327	712
Al Etihad	862	510	780	464	794	554	612	361	77.1%	65.1%	50	72	480	551
Malath Insurance	835	617	765	558	682	548	507	429	74.3%	78.3%	5	1	455	460
SAICO	834	666	573	422	628	391	492	250	78.2%	63.9%	(11)	33	311	344
Saudi Re	793	858	647	740	643	473	417	285	64.9%	60.1%	45	25	877	902
Wataniya	735	642	416	356	410	307	316	191	77.1%	62.3%	18	(4)	258	253
Gulf Union National	559	383	424	306	327	309	294	244	89.8%	78.9%	(29)	(8)	145	137
Arabian Shield	544	427	358	244	415	265	384	183	92.5%	68.8%	7	24	438	457
ACIG	529	376	471	323	467	335	361	247	77.3%	73.6%	2	5	144	153
Salama	504	340	438	287	504	277	432	193	85.6%	69.8%	(60)	5	203	208
Al Sagr	456	302	386	249	341	290	324	311	95.2%	107.3%	(48)	(81)	395	316
UCA	420	518	54	172	76	83	34	44	44.6%	53.4%	8	(24)	377	355
Solidarity	391	281	364	266	282	296	242	231	85.7%	78.0%	(43)	(22)	210	189
AICC	332	283	217	205	223	181	171	100	77.1%	55.4%	(42)	5	216	221
Alinma Tokio	331	266	169	106	162	104	118	47	72.9%	45.4%	(38)	1	207	208
Buruj	306	179	247	147	270	144	193	94	71.4%	65.1%	4	(10)	438	426
Gulf General	280	241	185	160	158	164	122	103	77.2%	62.9%	(1)	12	158	171
Amana Insurance	248	273	232	240	184	171	151	148	82.1%	86.1%	(37)	(25)	157	134
Alahli Takaful	239	188	47	43	47	43	19	12	39.4%	29.3%	7	2	242	245
Al Alamiya	219	136	102	38	126	57	62	18	49.5%	31.9%	15	4	408	413
SABB Takaful	171	150	113	92	115	93	91	64	79.0%	68.5%	(25)	(21)	322	301
Enaya	154	133	154	133	98	132	119	113	121.0%	85.6%	(106)	(24)	149	125
Aljazira Takaful	130	147	109	136	101	157	2	2	2.4%	1.5%	37	34	435	469

Source: Company data, Al Rajhi Capital



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