Credit Opinion: Al-Ain Ahlia Insurance Co.

Global Credit Research - 21 Nov 2011

Abu Dhabi, United Arab Emirates

Ratings

Category	Moody's Rating
Rating Outlook	STA
Insurance Financial Strength	A3

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Key Indicators

Al-Ain Ahlia Insurance Co.[1][2]

	2010	2009	2008	2007	2006
Total Assets (AED Mil.)	1,712	1,876	2,179	1,909	1,460
Equity (AED Mil.)	1,012	1,096	1,154	1,224	910
Net Income (AED Mil.)	62	75	144	208	183
Gross Premiums Written (AED Mil.)	594	605	696	635	548
Net Premiums Written (AED Mil.)	205	229	286	248	193
High Risk Assets % Shareholders' Equity	70.0%	66.0%	56.4%	65.2%	82.2%
Reinsurance Recoverables % Shareholders' Equity	41.8%	35.3%	53.8%	31.2%	31.7%
Goodwill + Other Intangibles % Shareholders' Equity	0.0%	0.0%	0.0%	0.0%	0.0%
Gross Underwriting Leverage	1.0x	0.9x	1.2x	0.8x	0.9x
Return on Capital (1 yr.)	5.9%	6.7%	12.1%	19.5%	17.7%
Sharpe Ratio of ROC (5 yr.)	198.9%	184.5%	259.6%	---	---
Adv/(Fav) Dev. % Beg. Reserves (1 yr.)	N/A	N/A	N/A	N/A	N/A
Adjusted Financial Leverage	0.0%	0.0%	0.0%	0.0%	0.0%
Total Leverage	0.0%	0.0%	0.0%	0.0%	0.0%

[1] Information based on IFRS financial statements [2] 1 US$ = 3.7 AED as at 31 Dec 2010

Opinion

SUMMARY RATING RATIONALE

Al Ain Ahlia Insurance Co. is an Abu-Dhabi based insurance company which provides all major lines of insurance, but with a focus on large commercial projects, particularly oil & gas related. It was established in 1975 and is currently 20% owned by the State of Abu Dhabi. The rating reflects Al Ain Ahlia's strong business position in the Abu Dhabi market as one of the principal state-owned insurance companies for large State commercial projects, its excellent capitalisation levels and robust reinsurance programme, somewhat offset by a higher risk investment strategy compared to typical Western insurers.

In accordance with Moody's rating methodology for GRIs, the rating of Al-Ain Ahlia reflects a combination of the following inputs: (i) a baseline credit assessment of 7 (on a scale of 1 to 21, where 1 represents the lowest credit risk); (ii) Very High (90%) dependence, reflecting the company's operating and financial proximity to the government of Abu Dhabi; and (iii) Low (0-30%) support, reflecting the importance of Al-Ain Ahlia in its capacity as an insurer of government projects offset by the limited state ownership of 19.7%.

Credit Strengths

Strong business position in Abu Dhabi, as a leading Government-owned insurer

Good technical proficiency, with long history of oil & gas underwriting and co-operation with major international reinsurers

Excellent capital position, with gross underwriting leverage at 1.0x

Consistent underwriting profitability

Credit Challenges

High risk investment strategy, with large investments in equities, and some land

Focus on Abu Dhabi, does create geographic concentration risk and reliance on the Abu Dhabi economic performance

Rating Outlook

The outlook is stable.

What Could Change the Rating - Up

Improvement in the asset quality, with a greater focus on high quality bond investments and deposits.

Wider geographic diversity, with a commanding position in the wider Emirates or elsewhere in the GCC.

What Could Change the Rating - Down

Weakened capital position with gross underwriting leverage increasing to 2.5x or lower quality reinsurance program.

Deterioration in the underwriting performance, with combined ratios above 100% for several years or increased volatility between business lines.

Increased exposure to risky asset classes, such as equities or property.

Recent Results

The 2010 net underwriting profit of AED 84.3 million was more than double the AED 31.1 million recorded in 2009. Total profit for the period of AED 61.7mn was lower than in 2009 reflecting weaker investment income, but gross premiums of AED 593.7mn were broadly stable. Total equity of AED 1,012mn was slightly lower than AED 1,096mn at YE 2009 reflecting a dividend payment.

As at Q3 2011, although gross written premiums declined 10% to AED 407m, both net underwriting profit and profit for the period increased vs. Q3 2010, with profit for the period increasing to AED 58.2m (Q3 2010: AED 32.1m). Shareholders' equity declined modestly to AED 980m (YE 2010: AED 1,012m) and we note in this regard that in May 2011, Al Ain Ahlia received permission from the Securities and Commodities Authority of the UAE to buy back up to 10% of its own shares.

DETAILED RATING CONSIDERATIONS

Factor 1 - Market Position, Brand and Distribution: A

Al Ain Ahlia is a primary insurance company based in Abu Dhabi. It was established in 1975 as one of two Government-owned insurers. Al Ain Ahlia concentrates primarily on construction and energy risks where they have considerable past experience and a very strong market presence.

Al Ain Ahlia scores highly on technical quotations because of its technical expertise through its co-operation with recognised leaders in the reinsurance markets, its history of oil and engineering insurance in the region, its strong reinsurance program, and its State ownership. On pricing, Al Ain Ahlia is not the most competitive, instead focusing on servicing levels.

Al Ain Ahlia's government ownership and its history of Oil and Engineering expertise are regarded as its primary competitive advantages. It enjoys privileged access to Abu Dhabi Government business and with the international reinsurers who need relationships with local insurers to be able to access the State business. There is very low turnover of business and many clients have relationships with Al Ain Ahlia from the 1970s.

Al Ain Ahlia targets 15% premium growth per annum, but growth is somewhat dependent on the timing of major projects. There are significant numbers of large projects scheduled to be developed in the next 2-5 years, with ADNOC alone planning to award numerous multibillion dollar projects. The fall in premium during the last two years somewhat reflects the slowdown in the number of contracts awarded by the major State organisations. 2010 was expected to have shown an improvement back to 2008 levels, however, premium levels have remained fairly static. Distribution is primarily through direct relationships, particularly for the government contracts, through the main office and a small network of branches in Abu Dhabi, Dubai, Al Ain and Sharjah for personal lines business. Some major commercial contracts are acquired via brokers.

Moody's regards the market position as in line with an `A' range insurer.

Factor 2 - Product Risk and Diversification : Baa

Geographic diversification is considered to be weak, given the focus on Abu Dhabi. Al Ain Ahlia does write some inwards reinsurance from the rest of the Gulf region, but it is low in comparison to Abu Dhabi and UAE premium levels. Nevertheless, Abu Dhabi is a strong economy within the Gulf region, with significant hydrocarbon resources and has been relatively immune from the recent financial crisis.

Main lines of business include motor, property oil & gas, and group medical, with smaller positions in engineering, MAT, other small commercial lines and life. The motor exposure has reduced during 2010 following Al Ain Ahlia's decision to exit several unprofitable motor policies during 2009.

Factor 3 - Asset Quality : Baa

Al Ain Ahlia invests in cash, equities and investment real estate. As of December 2010 high risk assets (equities and real estate) were equal to 70% of shareholders funds representing a strong level of investment leverage and it should be noted there are concentration risks as the equities are primarily invested in UAE stocks, mostly in Abu Dhabi. The real estate has largely retained its value during 2010.

With the exception of the real estate, the portfolio is highly liquid, with most equities being listed. The company has no goodwill on balance sheet. Reinsurance recoverables, at 42% of equity at YE 2010 demonstrate some exposure to reinsurance partners.

Overall, asset quality is considered to be in line with a Baa rating.

Factor 4 - Capital Adequacy : A

With a Gross Underwriting Leverage of 1.0x, Al Ain Ahlia enjoys `Aaa' levels of capital on a raw score basis. However, a considerable amount of the assets are deemed to be high risk. The Gross Underwriting Leverage with 100% of high risk assets deducted from Shareholders Funds is 3.0x which is still in the `A' range.

Al Ain Ahlia places significant emphasis on its reinsurance program. Indeed strong retrocession is often an important factor when the Government awards insurance contracts. Al Ain Ahlia has strong long-term relationships with most key global reinsurers. Net retentions on any single loss are limited to a maximum of US$ 250,000 for Aviation liability, with retentions significantly lower on all other lines of business, which is small in comparison to total equity of US$276mn Nevertheless we regard capital adequacy to be in line with that of an `A' company.

Factor 5 - Profitability : A

With a 5 year return on capital of 12.4% and a Sharpe ratio of 199%, Al Ain Ahlia is highly profitable under the base metrics. Stripping out investment income, return on equity is a more modest 2.7% over the past 5 years, but fairly stable. Historically, underwriting results have been satisfactory, although the combined ratio improved to 81% in 2010 (2009: 112%, both on a Moody's basis) following a restructuring of the motor account. Underwriting results will be reasonably volatile due to the lumpy nature of the portfolio. Underwriting profitability improved markedly in 2010, with the 2010 net underwriting profit more than double at AED 84mn compared to AED 31mn in 2009.

Moody's considers the profitability to be in line with an `A' rated company.

Factor 6 - Reserve Adequacy : A

Reserving is regarded as fairly low risk. The average tail is 4 months and Al Ain Ahlia appoints independent loss adjusters for all claims above AED 50,000. There is no discounting in the reserves. Reserves are typically covered with cash, and coverage level is very high at 1.2x on a gross basis and 8.8x on a net basis. IBNRs are set in line with Abu Dhabi regulatory requirements, but tend to overstate losses given the nature of the portfolio.

Reserve adequacy is viewed to be in line with an `A' rated company.

Factor 7 - Financial Flexibility : Baa

Al Ain Ahlia is currently un-levered, and consequently the EBIT coverage ratios and debt leverage metrics are extremely strong and in line with a `Aaa' rating. Nevertheless, Moody's regards Al Ain Ahlia's ability to access capital as being more constrained. Al Ain Ahlia is listed on the Abu Dhabi stock exchange, and would be able to source additional funds through this, although Moody's regards the depth of the market to be fairly limited. We consider the financial flexibility based on limited needs to be in line with a `Baa' rating.

Factor 8 - Operating Environment : Baa

Al Ain Ahlia operates almost exclusively in Abu Dhabi which Moody's views as a medium level risk for insurance operating environment. The insurance market is still in a development stage, with growth potentially volatile and with some large risk concentrations. Offsetting this is the economic stability of Abu Dhabi, which is rated Aa2 with a stable outlook reflecting its status as the richest of the emirates with high hydrocarbon wealth and the stability of the domestic political environment.

Other Considerations

Management, Governance and Risk Management

Moody's considers Al Ain Ahlia's risk management to be somewhat more sophisticated than peers in the region. Through its co-operations with its insurance partners Al Ain Ahlia has, in Moody's opinion, a fairly strong understanding of underwriting and reserving risks in the lines of business it writes. Al Ain Ahlia's extensive history of oil and gas insurance in the region also supports the selected underwriting. Investment risks are high, but will be closely monitored due to the limited depth of the local investment markets.

Accounting and Disclosure

Al Ain Ahlia reports under IFRS. Although disclosure is limited in comparison to Western peers, it is in line with local insurers. Disclosure by line of business could be improved.

Ownership

Al Ain Ahlia is 20% owned by the State, through the Abu Dhabi Investment Council. The Abu Dhabi Sovereign Wealth funds are approximately US$875bn in value. Further Royal family ownership is through the private investments of members of the Royal family.

Rating Factors

Al-Ain Ahlia Insurance Co.[1]

Financial Strength Rating Scorecard	Aaa	Aa	A	Baa	Ba	B	Caa	Score	[2]Adjusted Score
Business Profile								**A**	**A**
Market Position, Brand and Distribution (23%)								**A**	**A**
Relative Market Share Ratio			**X**						
Underwriting Expense Ratio % Net Premiums Written	**X**								
Product Risk and Diversification (9%)								**Baa**	**Baa**
Product Risk			**X**						
P&C Insurance Product Diversification			**X**						
Geographic Diversification						**X**			
Financial Profile								**Aa**	**A**
Asset Quality (9%)								**Aa**	**Baa**
High Risk Assets % Shareholders' Equity			**70.0%**						
Reinsurance Recoverables % Shareholders' Equity		**41.8%**							
Goodwill + Other Intangibles % Shareholders' Equity	**0.0%**								
Capital Adequacy (14%)								**Aaa**	**A**
Gross Underwriting Leverage	**1.0x**								
Profitability (14%)								**Aa**	**A**
Return on Capital (5 yr. avg)	**12.4%**								
Sharpe Ratio of ROC (5 yr. avg)				**198.9%**					
Reserve Adequacy (9%)								**A**	**A**
Adv./(Fav.) Loss Dev. % Beg. Reserves (5 yr. avg.)			**X**						
Financial Flexibility (14%)								**Aa**	**Baa**
Adjusted Financial Leverage	**0.0%**								
Total Leverage	**0.0%**								
Earnings Coverage (5 yr. avg.)	**X**								
Cashflow Coverage (5 yr. avg.)									
Operating Environment (10%)								**Baa**	**Baa**
Aggregate Profile								**A1**	**A3**

[1] Information based on IFRS financial statements [2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis