

1 January 2006



Recommendation

**Add\***

Upside/Downside

**5.2%**

Target Price

**SAR738.4**

Current Price

**SAR702.0**

Reuters Code

**8010.SE**

Market Cap

**SAR7,020.0 mil.**

Number of Shares Outstanding

**10.0 mil.**

Average Daily turnover

**SAR132.6 mil**

52-Week high/low

**SAR740.0/325.8** (Nov 19, 05/Feb 5, 05)

Absolute Performance

**0.4%/16.2%/91.3%** (1M/3M/YTD)

Performance Relative to TASI

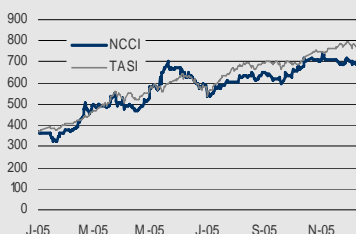
**-1.4%/3.7%/-17.9%** (1M/3M/YTD)

Shareholders' Structure

**70%** | **Free Float**

**15%** | **Gen. Org. for Social Insurance**

**15%** | **Public Pension Agency**



\* Refer to back cover for investment ratings

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# The Company for Cooperative Insurance

Insurance sector | Saudi Arabia

**"The First Mover"**

## National Insurer with an established network

The Company for Cooperative Insurance, NCCI, established in 1986 as a national insurer on the principles of cooperative insurance, is the largest insurance company in Saudi Arabia with a market share of 32%. NCCI's lines of business include motor vehicle, medical, fire and property, energy, engineering, marine, aviation, casualty insurance and Takaful insurance. Motor vehicle, medical, and fire & property insurance are the key lines of business and contributed 34%, 22%, and 19%, respectively, to the gross premiums written in 2004. NCCI is also the first licensed insurer in Saudi Arabia and has the largest insurance distribution network in the country. The company had also historically enjoyed exclusive rights for providing insurance to government sponsored projects and agencies, giving it a preferred status in compulsory insurance initiatives.

## Well positioned to capitalize on growth opportunities

Saudi Arabia's insurance penetration level as a percentage of Gross Domestic Product (GDP) in 2004 at 0.5%, is the lowest in the world. However, growing acceptance of the concept of insurance among Saudi nationals due to the regulated environment and the government's initiatives on compulsory healthcare and motor insurance are expected to propel the insurance market to SAR15.0 billion in 2009 from the current levels of around SAR4.5 billion. We believe that established infrastructure and a widely recognised brand give the company a significant edge in the medium term over its newly licensed competitors to consolidate its leadership position in the growing personal lines of business like motor and medical insurance. Driven by a 75.0% growth in motor insurance and a 40.0% growth in health insurance premiums, we expect gross premiums written (GPW) by NCCI to grow by 39.7% year-on-year to SAR1,773.8 in 2005. We forecast revenues to grow by 52.0% to SAR1,419.0, and EPS to increase by 81.6% to 34.1 in 2005.

## We value NCCI at SAR738.4/share, 5.2% above the current market price

We value NCCI at a 12-month fair value per share of SAR738.4, 5.2% above the current market price of SAR702.0 per share. We have arrived at the valuation using the DCF methodology and a comparison with international peers based on 2005E and 2006E P/E multiples. Our DCF valuation yielded a 12-month fair value of SAR778.9 per share, whereas the comparison-based valuation generated a fair value of SAR617.0 per share. To derive the fair value, we have taken a weighted average of the two fair values: 75% weight to DCF and 25% weight to comparative valuation. Accordingly, we initiate coverage of NCCI with a "Add" recommendation.

## Selected Indicators\*

	2003a	2004a	2005e	2006e	2007e	2008e	2009e
Revenues (SAR mil.)	904.5	934.0	1419.4	1766.9	2267.2	2664.0	3095.1
EBITDA (SAR mil.)	65.1	197.3	362.1	316.7	402.4	465.7	541.4
EBITDA margin	6.9%	20.5%	24.1%	16.9%	16.8%	16.5%	16.4%
Net income (SAR mil.)	44.9	187.7	341.0	297.8	382.8	444.2	517.2
EPS (SAR)	4.49	18.77	34.10	29.78	38.28	44.42	51.72
P/E (x)	156.4	37.4	20.6	23.6	18.3	15.8	13.6
P/BV (x)	16.4	9.0	7.4	6.4	5.4	4.6	3.9
P/FCF (x)	81.2	-	25.3	18.9	20.7	16.8	14.4
EV/EBITDA (x)	108.8	35.2	18.8	21.0	16.0	13.5	12.3
DPS (SAR)	1.25	3.13	17.0	14.8	19.1	22.2	25.9
Dividend yield	0.2%	0.4%	2.4%	2.1%	2.7%	3.1%	3.6%

Source: NCCI, BMG estimates. EPS for 2003 is adjusted to reflect the increase in the number of shares outstanding due to a 2:1 split NCCI share price as on 31 December 2005.

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## Executive Summary

The Saudi Arabian insurance market is poised for tremendous growth. The government's initiatives on compulsory healthcare and motor insurance are expected to propel the insurance market to SAR15 billion in 2009 from the current levels of around SAR4.5 billion, a CAGR of 27.2%. Saudi Arabia's insurance penetration level as a percentage of Gross Domestic Product (GDP) at 0.5% in 2004 is the lowest in the world. However, we believe that a regulated environment built around the concept of the Islamically acceptable principle of cooperative insurance could lead to increased awareness among the people of Saudi Arabia and convince them of the benefits of insuring risk.

In a positive atmosphere conducive for exponential growth, we feel that The Company for Cooperative Insurance (NCCI) with its first mover advantage in the Saudi Arabian insurance market is likely to benefit immensely. NCCI, established as a national insurer over 19 years ago, is the first licensed player in the Kingdom of Saudi Arabia (KSA), and has the largest insurance distribution network in the country. Historically, NCCI had enjoyed exclusive rights to provide insurance services to a number of government agencies and contractors. Although the monopoly position is likely to end with the registration of new insurance companies, we do not foresee a decline in governmental contracts in the near term due to the company's long-standing relationships with these agencies and contractors.

Another key positive for NCCI is the changing regulatory environment in favor of homegrown insurers. Historically, all of NCCI's competitors have been offshore companies (largely domiciled in Bahrain) primarily operating through agents. The insurance regulation introduced by the Saudi Arabian Monetary Agency (SAMA) allows only Saudi Arabia-domiciled insurers to accept local market primary risks. Although the foreign companies operating in Saudi Arabia have been given a grace period of three years to comply with the licensing and regulatory requirements, we believe that Saudi Arabian nationals would prefer to deal with NCCI, particularly when it comes to buying insurance that is mandatory under law, in order to avoid uncertainty over the validity of the same. Furthermore, we feel that the foreign companies operating through agents would require time to establish operations that are capable of handling the volume associated with insurance policies that are expected to be made mandatory.

NCCI, the largest insurer in Saudi Arabia with a 32% market share, is the leader in nearly all its lines of business (LoB), prominent among them being medical, motor vehicle, and fire & property. The company's established brand and strong retail presence are likely to enable NCCI to maintain its leadership position in the growing motor and medical insurance business. The medical insurance premiums are estimated to grow from approximately SAR1.0 billion in 2004 to SAR6.3 billion in 2008, a CAGR of 54.8%, while the motor insurance market is estimated to grow at a CAGR of 42.2% over the next four years to reach SAR5.0 billion in 2008. Driven by the medical and motor insurance LoB, we expect NCCI's gross premiums written (GPW) to grow 39.7% in 2005 to reach SAR1,773.8, and increase to SAR3,530.3 in 2008.

However, competition in the industry is likely to intensify in the coming years with 24 companies awaiting SAMA's approval and another 7 companies under review, which could result in pricing pressure and loss of market share for the incumbent. Although NCCI holds the competitive edge, its dominance could be threatened by some big players — notable among them being The Mediterranean & Gulf Insurance & Reinsurance Co. (MedGulf) and BUPA Arabia that have a capital of SAR600 million and SAR400 million, respectively. However, we do not see any significant market share decline in the short term, as these companies will need time to establish/expand their infrastructure. However, in the long term, we expect NCCI's market share to fall to 26.9% in 2009 from the current levels of 32.0% due to higher competition.

We value NCCI at a 12-month fair value per share of SAR738.4, 5.2% above the current market price of SAR702.0 per share. We have valued NCCI using the Discounted Cash Flow (DCF) methodology and a comparison-based valuation versus international peers based on 2005E and 2006E P/E multiples. The DCF valuation yielded a 12-month fair value of SAR778.9/share, whereas the comparative valuation generated a fair value of SAR617.0/share. To derive the fair value, we have taken a weighted average of the two fair values: 75% weight to DCF and 25% to comparative valuation. Accordingly, we initiate coverage of NCCI with an "Add" recommendation.

## Valuation

### Discounted Cash Flow Valuation

The company's Discounted Cash Flow (DCF) valuation has yielded a fair value of SAR778.9 per share, a 11.0% upside over the current price of SAR702.0. We base our valuation on the following assumptions:

**A cost of equity of 12.93%.** This is the sum of a risk free rate of 4.63% and a risk premium of 8.3%. We have arrived at the risk premium based on the company's risk profile and experienced management team.

**A perpetual growth rate of 3.0%.** We have used a detailed forecast for the 5-year period 2005-2009. Thereafter, we have assumed a gradual decline in growth rate in revenues (from 14.7% to 6.7%) until 2019. With 2020 as the continuing value year, we have arrived at a continuing value based on a perpetual growth rate of 3.0%.

Based on these assumptions, we arrived at an equity value of SAR7,789.0 million, which translates to a 12-month fair value per share of SAR778.9.

**Figure 1 | Value of Operations: DCF Approach (SAR million)**

Year	Free Cash Flows to Equity	Discount Factor	PV of FCF
2006	375.3	0.99	371.5
2007	342.6	0.88	300.3
2008	423.1	0.78	328.4
2009	494.0	0.69	339.5
2010	558.8	0.61	340.1
2011-2019	8712.7	0.54-0.20	2,824.6
Continuing Value	13,584.4	0.20	2,766.6
Operating Value			7,270.9
Minus: Outstanding debt			0.0
Add: Cash			518.1
Add: Financial Investments			0.0
Equity Value			7,789.0
Number of shares (million)			10.0
12-month Fair value per share (SAR)			778.9

Source: BMG

We have conducted a DCF sensitivity analysis based on the cost of equity and the terminal growth rate. The best-case scenario of a cost of equity of 11.93% and a terminal growth rate of 5.0% results in a 12-month target price of SAR953.0, an upside of 34.1% over the current price. In the worst case, using a cost of equity of 13.93% and terminal growth rate of 1.0%, we arrive at a 12-month target price of SAR676.4, translating into a 4.8% downside with respect to the current price.

**Figure 2 | DCF Sensitivity Analysis (Value per Share SAR)**

		Terminal Growth Rate				
		1.0%	2.0%	3.0%	4.0%	5.0%
<b>Cost of Equity</b>	11.93%	813.5	837.9	867.7	905.0	953.0
	12.43%	774.5	795.5	821.0	852.5	892.3
	12.93%	738.9	757.1	<b>778.9</b>	805.6	839.0
	13.43%	706.3	722.1	740.8	763.6	791.8
	13.93%	676.4	690.1	706.3	725.8	749.7

Source: BMG

### Comparative Valuation

For comparative valuation of NCCI, we have chosen insurance companies operating in the non-life business across both developed and developing economies.

NCCI trades at a P/E multiple of 37.40 based on 2004 earnings, while on a forward basis it trades at 20.59 and 23.57 times our estimated 2005 and 2006 earnings, respectively. Although on a P/E basis the stock trades at a premium to its international peers in the insurance industry, it trades at a significant discount to the stocks listed on the Saudi Arabian market that are trading at around 34 times their expected 2005 earnings. We value NCCI using the peer group average multiples, which have been adjusted upwards by 25% to reflect the higher return on equity for NCCI. Taking an average of the prices arrived based on the estimated P/E multiples for 2005 and 2006, we arrive at a fair value of SAR617.0 per share.

**Figure 3 | Comparative Valuation on Market Multiples**

Company	Market Capitalization (USD million)	ROE (2004)	P/E 2004	P/E 2005E	P/E 2006E
Aksigorta (Turkey)	1145.8	22.2	24.63	26.58	21.96
Porto Seguro SA (Brazil)	834.0	18.7	13.03	8.55	7.86
Bangkok Insurance Public Co Ltd (Thailand)	247.4	6.1	16.59	16.99	14.13
Kurnia Asia BHD (Malaysia)	492.0	12.8	4.59	10.33	9.54
Ohio Casualty Corp (U.S.)	1850.2	12.5	15.18	11.16	12.47
<b>Average</b>			<b>14.07</b>	<b>16.27</b>	<b>14.52</b>
NCCI	1894.2	27.7	37.85	20.84	23.86

Source: BMG and Reuters estimates

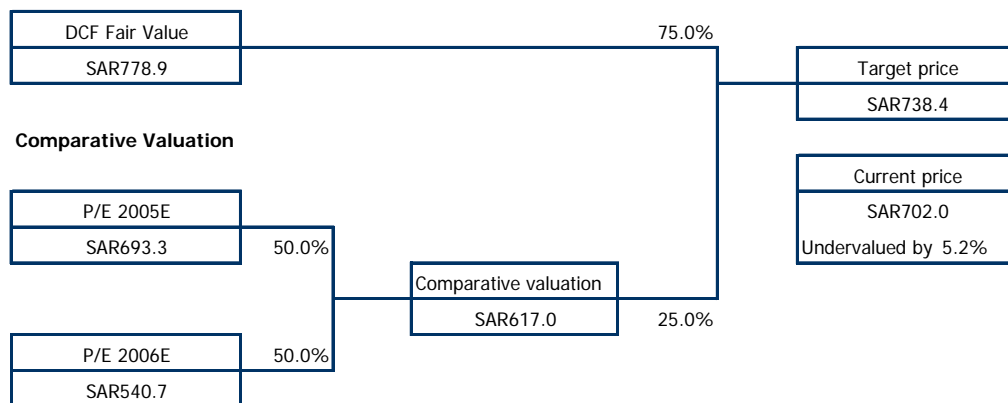
Note: Data as available on 27 December 2005; Financial year end June for Kurnia Asia

### Valuation Summary

We have calculated a weighted average of the two fair values arrived at using the above-mentioned two valuation methodologies. We assign a weight of 75% to the DCF methodology and 25% to the comparative valuation methodology. Consequently, we arrived at a fair value per share of SAR738.4, 5.2% above the current market price of SAR702.0/share.

**Figure 4 | Valuation Summary**

#### DCF Valuation



Source: BMG

# Insurance Industry in Saudi Arabia

## Historically, an unregulated market

The Saudi Arabian insurance market had historically operated in a completely unregulated environment. This resulted in the mushrooming of around 100 foreign-registered insurance companies that operated as intermediaries, international brokers, or agents for non-government related and personal insurance business. The companies preferred to get a registration in Bahrain, an insurance market regulated back in 2001. Furthermore, due to the lack of a regulatory framework in Saudi Arabia, the policyholders did not have any legal recourse or cover to protect them from unscrupulous operators. These factors paved the way for the much-awaited reforms required for the evolution of the Saudi Arabian insurance industry.

## Regulations based on the principles of cooperative insurance in place

In 2003, the Saudi Council of Ministers approved the Law of Cooperative Insurance Supervision and appointed SAMA as the industry regulator. Subsequently, SAMA formulated the regulation to activate the Law on the Supervision of Cooperative Insurance Companies ('the law') that will govern the insurance business in Saudi Arabia. The Law requires insurance activities in the KSA to be carried out only by Saudi Arabia-domiciled licensed insurers operating on the principles of cooperative insurance.

Furthermore, the law states that an applicant Insurer/ Reinsurer must be a joint stock company, established primarily to engage in insurance and/or reinsurance activities with Direct Insurers having a minimum capital of SAR100 million (USD26.7million) and Reinsurers having a minimum capital of SAR200 million (USD53.4million). The gross premiums written should not exceed 10 times the paid up capital. The law also states that the direct insurers retain at least 30% of total gross written premium and reinsure a minimum of 30% of total gross written premium within the Kingdom of Saudi Arabia. The law also requires transfer of 90% of the net surplus from insurance operations to the shareholders' income statement and the balance of 10% to be distributed to the policyholders either directly or in the form of a future reduction in premiums (Al Mudharaba Model<sup>1</sup> of cooperative insurance). The licensing of new companies, other than NCCI, would strengthen the market and enhance its credibility as well as end illegal and unfair practices, in our view.

## SAMA goes tough on the foreign domiciled players ...

A 29 December 2004 deadline was set for submitting registration applications in order to obtain licenses, while 9 February 2005 was set as the date before which to complete all the required documentation for the insurance companies wishing to operate in Saudi Arabia. SAMA also made it clear that once the deadline expires, it will not accept license requests for the next five years. Additionally, SAMA ruled that all companies transacting insurance business without applying for licenses after the deadline expired would be considered to be operating unlawfully in the Saudi market. The new SAMA regulations created major financial and operational hurdles for the offshore companies operating in Saudi Arabia primarily through agents. Consequently, only 33 of the nearly 100 companies and agents operating in the KSA had applied for licenses. SAMA also stated that all companies not wishing to continue operations in Saudi Arabia must coordinate their exit from the market with the agency in accordance with the deadlines. Subsequently, SAMA has asked 26 firms to close their offices for failing to fulfill the conditions set for conducting business in the KSA.

## ... the royal decree however provides some respite

However, pursuant to a royal decree (M/3120) issued in April 2005, SAMA rescheduled the deadline for acceptance of the licensing applications to 31 December 2005. The foreign insurance companies currently operating in the Kingdom through Saudi agents have also been given a 3-year period to settle all regulatory issues and abide with the licensing requirements following the issuance. Though the foreign players can now breathe easy, the uncertainty on the regulatory front would work to NCCI's advantage, as customers are likely to prefer dealing with a licensed insurer particularly for the insurances that are mandatory under law.

<sup>1</sup> International Cooperative and Mutual Insurance Federation

### Well capitalized companies to result in intense competition

Following the deadline to apply for licenses, SAMA had reviewed 24 applications with seven more under consideration. Thirteen of the companies to be licensed to operate in Saudi Arabia have foreign ownership and a total capital of SAR2.5 billion. Notable amongst them are The Mediterranean & Gulf Insurance & Reinsurance Co. (MedGulf) with a capital of SAR600 million, BUPA Arabia (SAR400 million), Saudi United Cooperative Insurance Company, Al-Alamiya Insurance Co., United Cooperative Assurance Co., and Arabian Shield Insurance Co. (all with capital of SAR200 million). The licensing of companies with strong financial backing is likely to result in the incumbent experiencing market share erosion and pricing pressures once these companies establish their distribution network.

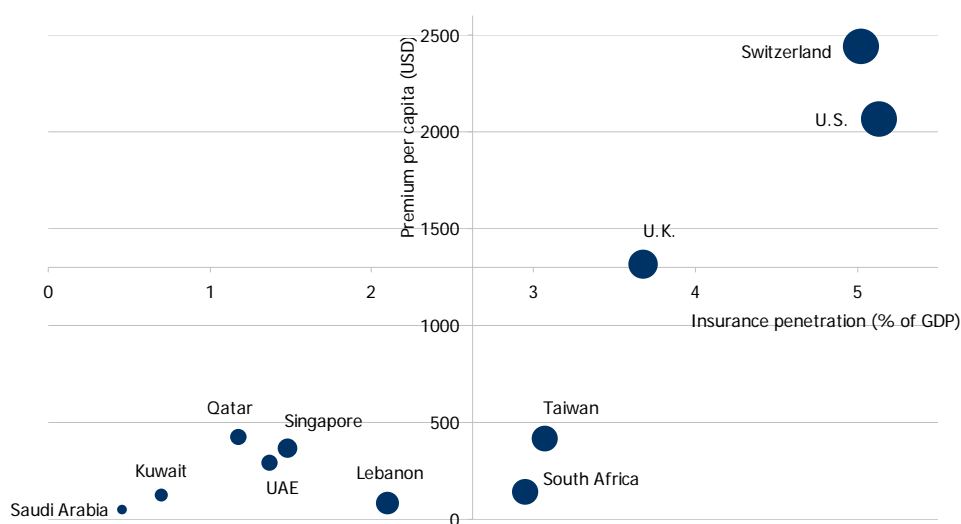
### Insurance market: Under-penetrated, poised for growth

Lack of proper regulations and enforcement, focus on insuring only high-risk oil and gas properties, low awareness among locals, and misconception/ misunderstanding of the insurance concept left the Saudi Arabian insurance market relatively underdeveloped. The insurance penetration (life and non-life) in Saudi Arabia as a percentage of Gross Domestic Product (GDP) in 2004 was 0.5%, whereas, The United Arab Emirates (UAE), Oman and the world averages are 1.6%, 1.3%, and 8.0%, respectively. Insurance premiums in Saudi Arabia averaged USD49.3 per person in 2004, compared to the average premium per person of USD290.6 in the UAE and USD122.2 in Kuwait. Furthermore, the premium per person in Saudi Arabia is a fraction of that paid by policyholders in economies like the US at USD2,062.6 and Switzerland at USD2,441.2.

Although Saudi Arabia is the largest non-life market in the Arab world, insurance penetration in this category was a mere 0.46% in 2004, well below Jordan, The UAE, and Oman that had averages of 2.36%, 1.37%, and 1.10%, respectively. Additionally, several properties and projects in the KSA are still uninsured against fire and property damage. Only 38% of business enterprises in the Kingdom of Saudi Arabia are insured<sup>2</sup>. Of the total non-insured businesses, 54% do not have any cover owing to the lack of awareness, while 46% see it as a needless expense since they have not suffered any losses arising from damages.

The KSA is all set to see a huge expansion in insurance premiums driven by regulation safeguarding public interest, the economic boom in the region, and greater awareness among its people. The total premium volume expanded 16.2% to SAR4.5 billion (USD1.20 billion) in 2004 from SAR3.87 billion (USD1.03 billion) in 2003. The gross premiums are estimated to cross SAR15.0 billion (USD4.0 billion) by end-2009, growing at a compounded annual growth rate (CAGR) of around 27%.

**Figure 5 | Non-life insurance market**



Source: Swiss Re Economic Research & Consulting, 2004

<sup>2</sup> Source: www.arabnews.com

### Compulsory health insurance, the key growth driver

The Kingdom of Saudi Arabia has made health insurance mandatory for expatriate workers. The law aimed to ease the financial burden on the Saudi government, which offers free medical services to over 22 million people. The new cooperative health insurance program to be implemented in three phases would cover about 6 million expatriates. The first phase, expected to begin in January 2006, requires companies with more than 500 expatriate workers to provide medical insurance cover for their employees, and would cover 450 companies employing over 500,000 expatriates. The second phase would cover companies with 100 to 500 expatriate workers while the companies with a non-Saudi work force of less than 100 will be covered in the third and final phase. Medical insurance is expected to be made compulsory for the Saudi nationals, eventually. The medical insurance premiums are estimated to grow from approximately SAR1.1 billion in 2004 to SAR6.3 billion in 2008, a CAGR of 54.8%.

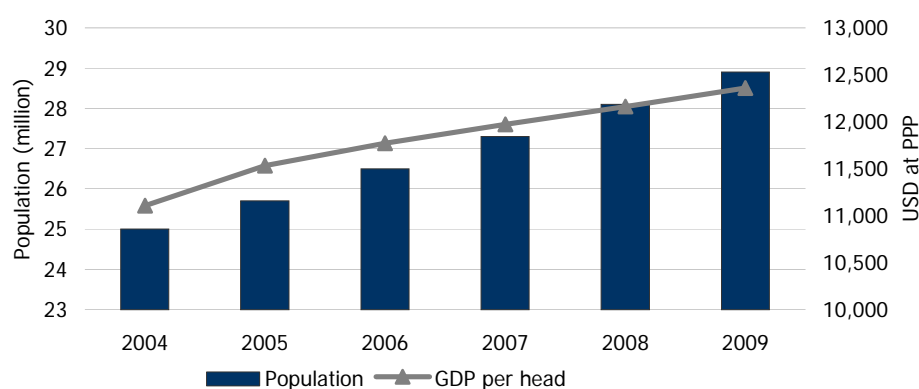
### Motor insurance to continue in top gear

In 2002, owing to the high rate of car accidents, Saudi Arabia made third-party liability motor vehicle insurance for in-country transit of foreign vehicles (nearly 1.2 million cars enter Saudi annually) along with drivers' license insurance (Rukhsa) compulsory for Saudi nationals and expatriates within the country. The compulsory insurance initiative coupled with a growth in the number of cars registered in the KSA has translated into a huge business opportunity for insurers. The number of cars registered in Saudi Arabia zoomed at a CAGR of 35.1% to about 10 million in 2004 from approximately 3 million in 2000. With the expected boom in the economy, we believe that the car market will continue to run in top gear. Furthermore, with the third-party liability motor insurance expected to be made mandatory for vehicles registered within Saudi Arabia, the car insurance market in the KSA is estimated to grow at a CAGR of 42.2% for the next four years to reach SAR5 billion in 2008 from SAR1.2 billion in 2004.

### Huge investments to result in increased need for risk cover

The increased economic activity in the region due to higher oil prices and the growing population are likely to see huge investments in virtually every sector, particularly construction and infrastructure. Saudi Arabia's GDP is likely to expand to 6.5% in 2005, reflecting more than 7% output growth in both the oil and private sectors. Furthermore, according to Economic Intelligence Unit's forecast, Saudi Arabia's GDP (in terms of USD billion at PPP) is likely to grow at a CAGR of 5.2% to reach USD357 billion in 2009 from USD277 billion in 2004. The GDP per capita at PPP is expected to rise at a CAGR of 2.2% to reach USD12,361 in 2009. The KSA's population is forecast to grow to 28.9 million in 2009, from 25 million in 2004. Saudi Arabia's investment projects for the next 15 years total SAR2.3 trillion (USD613 billion) and is open to local, regional and international investors. We see a significant growth opportunity for insurers as investments of such scale would require large insurance covers to hedge the basic construction and project risks.

**Figure 6 | Growing population and per capita GDP to boost insurance spending**



Source: Economic Intelligence Unit, 2005

## NCCI - An Overview

### NCCI in brief

The Company for Cooperative Insurance (formerly known as The National Company for Cooperative Insurance, NCCI) was established in 1986 as a national insurer in Saudi Arabia to conduct insurance business in accordance with the Islamically acceptable concept of cooperative insurance. Initially, the company issued a limited number of policies catering to aviation, fire & property and energy market needs. In 1989, the company emerged a leader in the Saudi Arabian insurance market with a 21% share. The company introduced the medical insurance scheme in 1991, motor insurance in 1995, and the Takaful (life) insurance products in 2000.

**Figure 7 | NCCI Timeline**

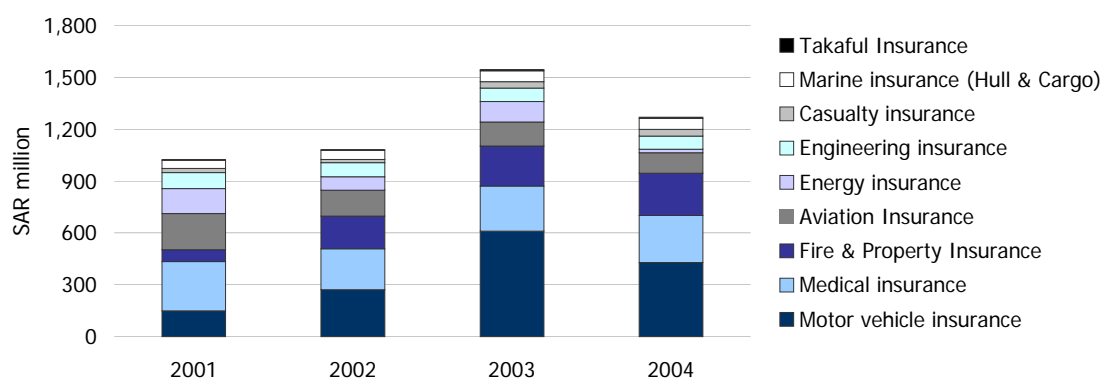


Source: NCCI

### NCCI's lines of business

NCCI's lines of business include motor vehicle, medical, fire and property, energy, engineering, marine, aviation, casualty insurance, and Takaful insurance. Motor vehicle, medical, and fire & property insurance are the major business lines, contributing around 34%, 22%, and 19%, respectively, to the company's total GPW in 2004. Motor insurance has, however, been driving the company's GPW. Since 2001, the company's motor vehicle insurance LoB grew at a CAGR of 42.4% to reach SAR427.6 million in 2004. Consequently, the motor insurance LoB's share of the total GPW increased from 14% in 2001 to 34% in 2004. Medical insurance has been relatively flat since 2001, whereas Fire & Property grew to SAR243.6 million, clocking a CAGR of 52.8%.

**Figure 8 | Motor insurance drives Gross Premiums Written**



Source: NCCI and BMG estimates for 2004

### Experienced and innovative management team

The company's top management has been with NCCI for over 10 years. The management leverages its extensive knowledge of local conditions to build on the concept of cooperative insurance by introducing innovative products. NCCI's new insurance product, Manasek, designed to provide emergency medical and personal accident insurance protection for Hajj pilgrims and performers of Umra during their stay in the KSA is one such example. By keeping the insurance premiums at reasonable levels, the company aims to reduce the financial burden on the 2 million Hajj pilgrims and 5 million performers of Umra that are susceptible to accidents, injuries, sickness, heat exhaustion and death during their visit to Saudi Arabia every year. We believe that such initiatives by the company will result in increasing acceptability of the concept of cooperative insurance.

**Figure 9 | NCCI management team**

Name	Title	Age	Length of Service
Ali Al Subaihin	CEO	52	11
Saad Al Marzoqi	Vice President-Technical	50	18
Saleh Al Subail	Manager-Major Accounts	48	14
Ali Al Ayed	CFO	47	11
Chaffai Tekfi	Manager-Information Systems	46	11
Hassan Al Akeel	Manager-Human Resources and Business Services	46	14
Ahmad A. Al-Shalan	Group Marketing Manager	40	7

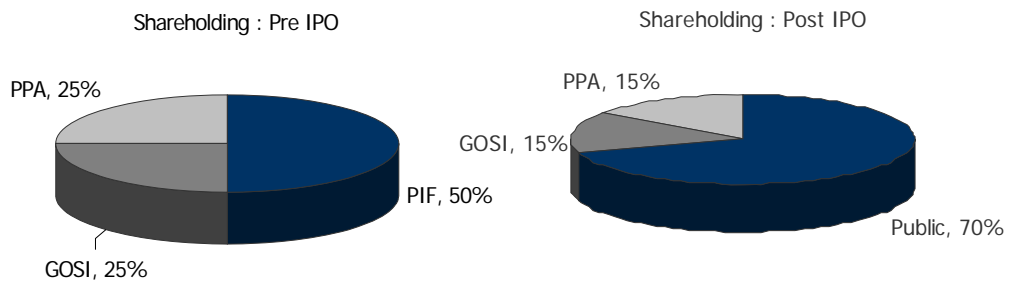
Source: NCCI

### Truly a 'National' company

The company invests heavily in training Saudi nationals for upgrading their technical skills and helping them attain specialized qualifications necessary for running the insurance business. The company through its Knowledge Development Centre has also devised a comprehensive development program to identify, develop and retain highly qualified staff. By providing opportunities to the young Saudi staff to occupy leading positions in the company, NCCI has been able to increase its Saudization rate (number of Saudi nationals in the total workforce) from 54% in 1998 to 72% in 2004. The Saudization rate at NCCI is one of the highest in the KSA and well above the mandatory requirement of 30%. With competition intensifying, the company's ability to attract and retain talent is however likely to be tested in the near future, as NCCI is the largest source of experienced insurance professionals in the KSA.

### Capital and shareholders' structure

NCCI was established as a closed joint stock company with the Public Investment Fund (PIF), the General Organization for Social Insurance (GOSI), and the Public Pension Agency (PPA) owning 50%, 25%, and 25% of the company's ordinary shares, respectively. The company was privatized through a resolution passed by the Saudi Council of Ministers by offering 70% of the shares to Saudi nationals. Prior to the Initial Public Offering (IPO), the company's paid up capital was raised to SAR500 million by transferring SAR100 million from the retained earnings to share capital and by payment of SAR150 million by PIF, GOSI and PPA towards the share capital. We believe that with the increased capital base NCCI is in a position to leverage the growth opportunities in the Saudi insurance market, considering that the SAMA regulations restrict the GPW to 10 times the paid up capital of the insurer. The offering, completed in January 2005, was a roaring success and was subscribed 11.5 times over with 800,000 applications after it received the backing of a fatwa that declared the offering Shariah-compliant. We believe that the fatwa and the subsequent success of the IPO have resulted in increasing the company's brand awareness. Post the IPO, the holdings of GOSI and PPA have come down to 15% each while PIF is no longer a shareholder in NCCI.

**Figure 10 | NCCI: Shareholding pattern**

Source: NCCI

## NCCI – The First Mover

### The largest insurance company is also the first off the blocks

NCCI is the largest insurance company in the Kingdom of Saudi Arabia with a total market share of 32%. The company is a market leader in a majority of its business lines including the high growth motor vehicle and medical insurance spaces. The company has a dominant position in the motor vehicle, energy and fire & property insurance lines of business.

SAMA granted NCCI an operating license on 1 December 2004, making it the first licensed insurance company in Saudi Arabia. We expect this head start to help NCCI capitalize on the growth opportunities in the sector while the smaller, undercapitalized operators grapple with uncertainties resulting from the changing regulatory environment and the newly licensed companies take time to establish their operations in Saudi Arabia. In May 2005, NCCI signed a one-year contract worth SAR65 million with the Saudi postal authority, Saudi Post, to provide health insurance to all the employees and their families. We believe that a key enabler for the contract is the fact that NCCI already had agreements in place with around 300 hospitals, clinics and medical centers throughout KSA.

**Figure 11 | Market leader in a majority of its business lines**

Line of Business	Number of Competitors	NCCI Market Share	Nearest competitor's market share	NCCI's Ranking
Motor Vehicle	29	35%	6%	1
Medical	27	25%	23%	1
Aviation	4	72%	15%	1
Energy	1	86%	14%	1
Engineering	26	36%	18%	1
Fire and Property	31	34%	10%	1
Marine hull	15	69%	-	1
Marine cargo	31	9%	-	2
Miscellaneous accidents	25	13%	19%	3
Takaful (Life)	13	1.4%	73%	10
<b>Overall</b>	<b>34</b>	<b>32%</b>	<b>7%</b>	<b>1</b>

Source: NCCI prospectus, Data available as on December 31, 2002

### Established distribution network: A competitive edge

NCCI has a network of regional offices, branches and sales offices around the country through which it conducts its cooperative insurance business. Over the years, NCCI has developed the largest insurance distribution network in the Kingdom of Saudi Arabia. As of July 2004, the Company had three regional offices, 20 branches and sales offices, 77 offices in traffic police departments, and 15 offices in driving schools, supported by a sales and operation staff of 473. In addition, NCCI distributes its products through tied agents, banks, and brokers. NCCI had contracts with 197 marketing representatives, 2 exclusive agents, 6 franchising offices and 22 brokerage firms. NCCI also has tie-ups with local banks namely Saudi Hollandi Bank, Riyadh Bank and Al-Rajhi Banking and Investment Corporation for insurance distribution. The established distribution network provides NCCI a clear advantage over the other soon to be licensed competitors, many of whom historically operated through agents in KSA. Although the royal decree allows foreign companies to continue operating through agents, we believe that the time taken by these companies to establish owned-operations in the country in order to handle the scale associated with motor and medical insurance will enable NCCI to consolidate its leadership position in these growing personal LoB.

### Strong government relationships

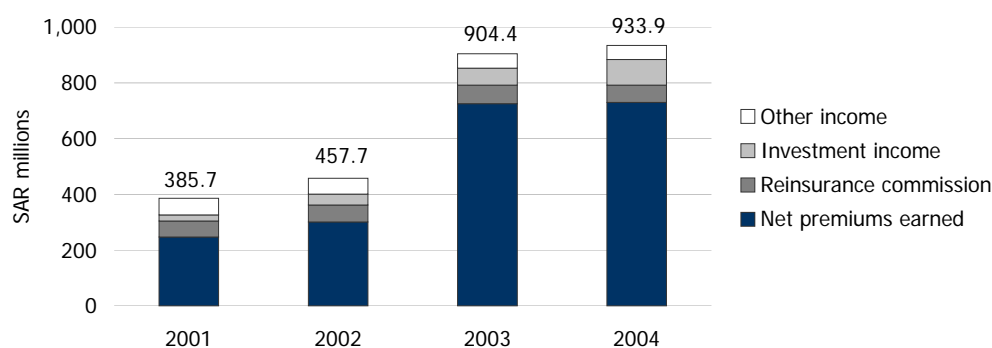
NCCI by virtue of being a government-owned company had enjoyed a virtual monopoly on government related business. The company had exclusive rights to provide insurance services to government agencies/contractors. By virtue of being established as a national insurer with government backing, NCCI was the automatic choice to provide cover to government-sponsored infrastructure projects. This also gave NCCI the preferred status in cases of compulsory insurance schemes. When Rukhsa (Driver's License) insurance became compulsory in 2002, the Government selected NCCI's Rukhsa policy as the

required method of compulsory motor insurance to protect affected third parties. The huge distribution network, public awareness programs, and advertisement campaigns helped the company register a 113% growth in its overall motor vehicle portfolio in 2003, and capture a 35% market share before other players gained entry. NCCI also gained ground in the area of providing compulsory motor vehicle third party insurance for foreign vehicles entering Saudi Arabia, which grew approximately 343% in 2003.

### Financial highlights

NCCI registered a strong 43.0% rise in its gross premiums written in 2003, mainly benefiting from its monopolistic position resulting from the introduction of its Rukhsa policy product. However, intense competition with the General Traffic Authority allowing other companies to issue Rukhsa insurance certificates resulted in a 30% decline in motor insurance premiums in 2004. The GPW also took a SAR100 million hit as Energy insurance premiums decreased due to non-renewal by a major client. Overall, the GPW declined 17.8% to SAR1,270.0 million. However, a higher premium retention ratio of 55.6% in 2004 (53.6% in 2003) and a 51.9% jump in investment income helped NCCI register a modest 3.3% growth in total revenues to SAR934.0 million from SAR904.5 million in 2003.

Figure 12 | NCCI revenues



Source: NCCI

NCCI's gross claims paid increased by 86.8% to SAR1,276.0 million, primarily due to an increase in aviation claims to SAR565.5 million in 2004 from SAR8.5 million in 2003. However, as the company had reinsured 100% of the aviation claims, this did not contribute to an increase in the net claims incurred. The 9.2% increase in net claims incurred to SAR513.6 million was primarily due to underwriting losses in the motor vehicle LoB. Furthermore, greater control over selling & marketing expenses resulted in the company's total costs growing by only 4.6% to SAR758.9 million in 2004 from SAR725.6 million in 2003. Subsequently, NCCI's net surplus from insurance operations stood at SAR175.1 million in 2004. Additionally, as per the requirement of the executive regulations of the Cooperative Insurance Law, 90% of this surplus was transferred to the shareholders' operations, resulting in a 318.0% jump in the net income to SAR187.7 million in 2004 from SAR44.9 million in 2003. Consequently, the EPS rocketed to SAR18.77 in 2004 from SAR4.49 in 2003.

### Efficient underwriting results in an improved performance

NCCI's loss ratio, which is a measure of net claims incurred to net premiums earned, increased from 66.0% in 2003 to 70.7% in 2004, primarily due to a higher proportion of motor insurance claims as the compulsory insurance was linked to the driving license instead of the motor vehicle itself. In order to cover the losses, the company raised the annual insurance rate from SAR710 to SAR1,200 for those holding temporary permits (less than 18 years) and from SAR530 to SAR1,000 for drivers holding a private driving license (under 21 years). NCCI also managed to reduce its expense ratio from 35% in 2001, to 23% in 2003 due to increased operational efficiency.

In 2004, NCCI's combined ratio increased to 95.6% from 92.0% in 2003. The jump in the loss ratio in 2004 due to an increase in claims incurred relative to net premiums earned resulted in the higher combined ratio. However, the combined ratio has not exceeded 100% since 2001, showing NCCI's ability

to achieve an underwriting profit in the last couple of years. Consequently, the net surplus from insurance operations increased to SAR175.1 million in 2004 from SAR63.0 million in 2001.

The company's ROE jumped from 12.1% in 2003 to 27.7% in 2004, primarily due to the transfer of surplus from policyholders of SAR157.6 million to the shareholders' income statement as per the SAMA regulations.

**Figure 13 | Key performance ratios**

	2001	2002	2003	2004
Net Loss ratio	66.0%	81.0%	66.0%	70.7%
Net Expense ratio	35%	28%	23%	23.6%
Net Combined ratio	107.0%	121.0%	92.0%	95.6%
ROE	-0.9%	-2.6%	12.1%	27.7%

Source: NCCI

#### **Shareholders likely to benefit from distribution of surplus**

In line with the cooperative insurance principles, the law requires transfer of 90% of the net surplus from insurance operations to the shareholders' income statement. As of 31 December 2004, NCCI had an accumulated surplus of SAR548.9 million. SAMA had set a one-year deadline from the grant of the license for compliance with the law. Since the law is applicable with prospective effect, there is ambiguity on the disposition of the accumulated surplus from insurance operations. We expect the distribution to be in the same proportion as set out in the regulations resulting in SAR494.01 million, or SAR49.4 per share, to be transferred to the shareholders' income statement. The amount if distributed as dividend would translate into a yield of 7.0% (excluding the normal dividends) to the shareholders based on the current price of SAR702.0.

## Financial Analysis and Projections

In this section, we describe the financial projections for NCCI. We have used the Discounted Cash Flow (DCF) methodology to value the company.

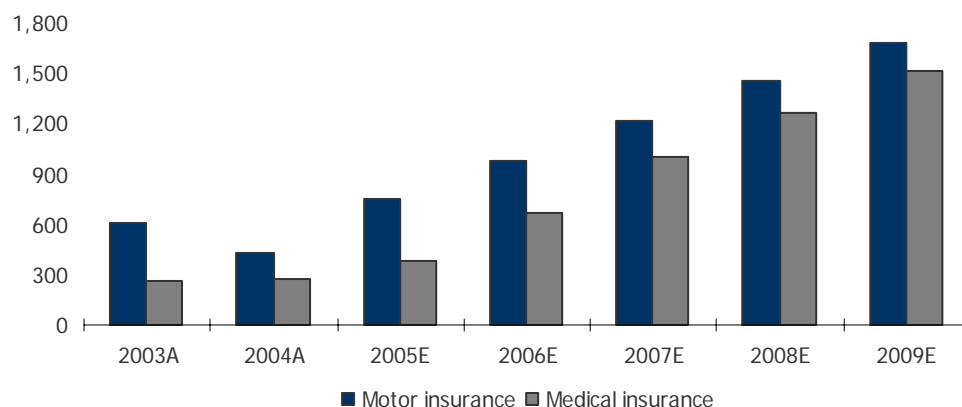
### The health booster

The health insurance market is poised for substantial growth boosted by the mandatory cover to be provided to expatriates. The health insurance market is expected to reach SAR6.3 billion by 2008, clocking a CAGR of over 54.8%. NCCI has the first mover advantage, as well as established operations and expertise required to provide health insurance cover. With the first phase of the compulsory medical insurance initiative commencing January 2006, and the 14 other companies having received only preliminary approval, we expect NCCI's health insurance premiums to grow by 75% in 2006. In 2007, we expect the growth rate to be 50%, as competition from the other insurers heats up. Another factor for the likely slowdown is the beginning of the third phase of the health insurance program involving smaller companies with less than 100 expatriate workers.

### Motor insurance: To go into overdrive

The GPW from the motor vehicle LoB for NCCI grew by 113% in 2003 after the introduction of the compulsory Rukhsa policy. Although the motor insurance LoB experienced a decline of 30% in 2004, we expect NCCI's vehicle insurance segment to grow at a rate of 75% in 2005 by capturing the business of the smaller companies that are facing regulatory uncertainties and introduction of third party insurance. However, 2006 onwards, we expect the growth rate to decline due to competition from the newly licensed foreign companies. Overall, we expect GPW of SAR1.4 billion in 2008, translating into a market share of 29.2% by end-2008, down from the current levels of 35%.

**Figure 14 | GPW from motor and medical insurance**

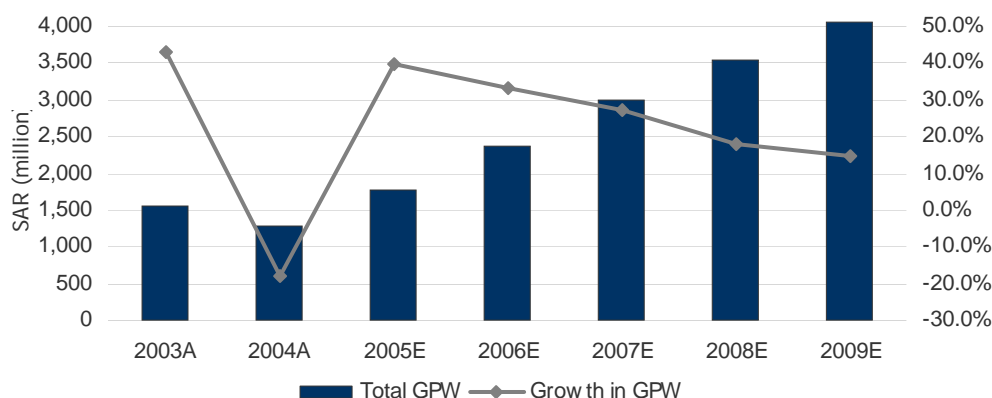


Source: NCCI and BMG

### NCCI likely to remain market leader

Driven by medical and motor insurance, we expect the GPW to grow by 39.7% to reach SAR1,773.8 million in the financial year 2005. Furthermore, we expect the GPW to increase at a CAGR of 26.1% over the next five years enabling NCCI to end the year 2009 with a GPW of SAR4,041.7 million, translating into a market share of 26.9%. Given the head start that NCCI enjoys and the existing dominant position in the key LoB, we believe that NCCI's aim of commanding at least a 10% higher market share than its nearest competitor is achievable.

Figure 15 | GPW forecast



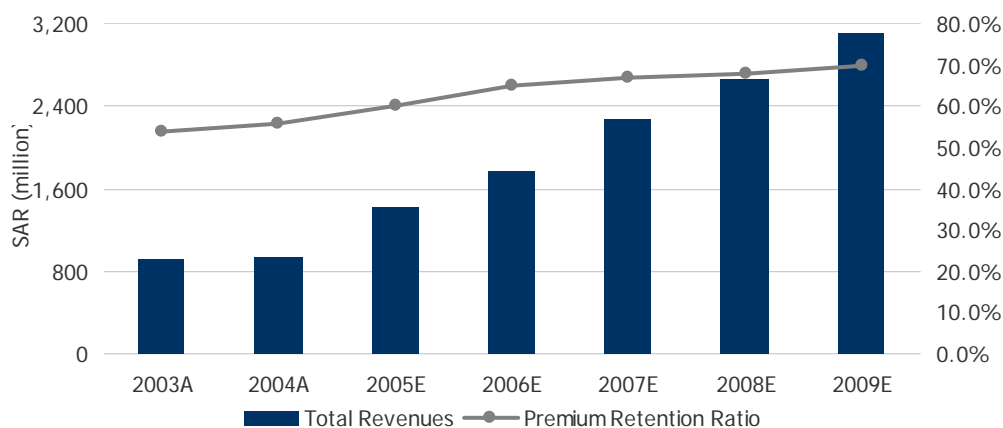
Source: NCCI and BMG

### Revenue and earnings projections for the period 2005-2009

The company retains nearly 100% of its motor insurance underwritten while it has increased its retention of medical premiums from 65% to 70%. With the proportion of motor and medical insurance GPW increasing from 55% in 2004 to 64% in 2005 and subsequently to 79% in 2009, we believe that the company will retain an increasingly higher proportion of its risks. Consequently, we have assumed the premium retention ratio to go up from the current level of 56% to 60% in 2005 and increasing to 70% by the end of 2009. The company has invested over 27.5% of its policyholders' assets in local and foreign equity, which has resulted in the investment income increasing to SAR188.1 million in 1H05 as compared to SAR92.4 million for the full year 2004. We project the investment income to grow 145% year-on-year to SAR226.9 million for the financial year 2005 driven by a 30% return on its equity investment portfolio given the buoyancy in the worldwide equity markets. However, 2006 and beyond, we expect the company to earn a 15% return on its equity investment portfolio. The growth in medical and motor insurance GPW along with the higher retention ratio and an increase in investment income is likely to result in revenues from the insurance operations increasing from SAR933.9 million in 2004 to SAR1,419.3 million in 2005. Overall, we project revenues to grow at a CAGR of 27.1% for the five-year period 2005-2009.

The loss ratio for NCCI had increased from 65% in 2003 to 71% in 2004 primarily due to higher motor insurance claims. With the proportion of motor and medical insurance in the total premiums written increasing, we expect the loss ratio to increase to 78% going forward. Based on our expectations of the loss ratio and an increase in investment income, we arrive at the net surplus from insurance operation of SAR294.9 million for 2005, up 68.5% from SAR175.06 in 2004. Overall, we expect the net surplus from the insurance operation to grow to SAR364.2 million by 2009, clocking a CAGR of 15.8%.

Figure 16 | Revenue forecast



Source: NCCI and BMG

We expect the return on invested capital to increase from 6.8% in 2004 to 12.1% in 2009 and the return on equity to be around 29.0%. However, the return ratios are likely to drop in 2006, primarily due to a decline in investment income. The earnings per share is expected to grow at a CAGR of 22.5% over the next five years, driven by investment income and as the company will transfer 90% of the net surplus from insurance operations to the shareholders' income statement. We expect NCCI to register an EPS of SAR34.1 in 2005, increasing to SAR51.7 in 2009.

**Figure 17 | Projected return ratios for NCCI**

	2004A	2005E	2006E	2007E	2008E	2009E
<b>ROIC</b>	6.84%	11.02%	9.17%	10.69%	11.38%	12.11%
<b>ROE</b>	27.70%	35.82%	27.05%	29.63%	29.34%	29.17%

Source: NCCI and BMG

#### **Dividend projections**

We forecast a dividend payout ratio of 50% of net income for the period 2005 and expect it to keep increasing in the coming years. The expected payout of SAR155.4 million in 2005 is over and above the payout, if any, from the distribution of accumulated surplus from insurance operations. This is in line with management guidance of maintaining healthy dividends for shareholders. We believe that the higher payout ratios are manageable, as the company will be generating substantial shareholder's profits resulting from transfer of surplus from the insurance operations to the shareholder's income statement. Furthermore, we believe that the company will not require substantial funds for any major acquisitions or capital expenditure.

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## Risks

### Increasing Competition

Absence of a regulatory framework had resulted in the fragmentation of the industry with smaller low capitalized companies providing insurance services. Consequently, NCCI had no serious competition in terms of reach and the ability to underwrite high-risk large policies. However, with SAMA likely to grant licenses to over 30 companies other than NCCI to conduct insurance operations in the KSA, the industry is likely to experience intense competition that could result in pricing pressure and erosion of market share for the company. We expect NCCI's market share to decline from the current levels of around 32.0% to 26.1% in 2009. However, given its established distribution network and brand, we do not see any immediate threat to NCCI's leadership position as these companies will require time to develop their own distribution networks.

### High Equity Exposure

NCCI's local and foreign equity investments constitute 46.4% of the total assets. The equity investments are on a higher side when compared to non-life insurers in France, the UK, and the US with equity exposures of around 18%, 14%, and 29%, respectively. Although the equity markets have done well in the recent past, particularly in the emerging economies like the KSA (the Tadawaul All Share Index or TASI spurted 102.9% during the period 31 December 2004 to 26 December 2005), resulting in increased investment income, the high equity investments expose NCCI to earnings volatility.

### Higher Geo-political Risk

The Middle East region has historically witnessed regular conflicts resulting in a higher geo-political risk. Untoward incidents could result in higher claims resulting in underwriting losses for the insurance companies operating in these regions. NCCI, however, has tried to hedge itself by reinsuring most of its high-risk contracts. Gross claims paid at the end of 30 September 2004, climbed to SAR1.1 billion, mainly due to significant aviation claims of SAR564 million. Approximately SAR525 million of total aviation claims related to one particular claim, of which NCCI had a 0% retention ratio (i.e., it was fully covered by reinsurance).

# Financial Statements

## Balance Sheet

As on Dec 31

All figures in SAR million unless stated otherwise	2003a	2004a	2005e	2006e	2007e	2008e	2009e
Cash and cash equivalents	457.7	581.6	752.9	1,009.8	1,204.8	1,440.6	1,713.8
Accounts receivable, net	525.0	576.3	754.1	650.7	782.8	863.5	949.7
Other current assets	10.5	8.5	14.7	18.3	23.5	27.6	32.1
<b>Total current assets</b>	<b>993.2</b>	<b>1,166.3</b>	<b>1,521.7</b>	<b>1,678.8</b>	<b>2,011.1</b>	<b>2,331.7</b>	<b>2,695.6</b>
Property, plant and equipment, net	21.6	36.8	28.6	25.6	26.6	29.2	32.9
Other operating assets	1,182.1	1,543.0	1,543.0	1,543.0	1,543.0	1,543.0	1,543.0
<b>Total non-current assets</b>	<b>1,203.8</b>	<b>1,579.8</b>	<b>1,571.6</b>	<b>1,568.6</b>	<b>1,569.6</b>	<b>1,572.2</b>	<b>1,575.9</b>
<b>Total assets</b>	<b>2,197.0</b>	<b>2,746.1</b>	<b>3,093.3</b>	<b>3,247.4</b>	<b>3,580.7</b>	<b>3,903.8</b>	<b>4,271.5</b>
Accounts payable	267.0	260.4	360.6	311.1	374.3	412.9	454.1
Other current liabilities	142.4	146.9	223.3	278.0	356.7	419.2	487.0
<b>Total current liabilities</b>	<b>409.4</b>	<b>407.2</b>	<b>583.9</b>	<b>589.1</b>	<b>731.1</b>	<b>832.1</b>	<b>941.1</b>
Other Operating Liabilities	1,359.5	1,557.5	1,557.5	1,557.5	1,557.5	1,557.5	1,557.5
<b>Total non-current liabilities</b>	<b>1,359.5</b>	<b>1,557.5</b>	<b>1,557.5</b>	<b>1,557.5</b>	<b>1,557.5</b>	<b>1,557.5</b>	<b>1,557.5</b>
<b>Total shareholders' equity</b>	<b>428.1</b>	<b>781.3</b>	<b>951.8</b>	<b>1,100.7</b>	<b>1,292.1</b>	<b>1,514.2</b>	<b>1,772.8</b>
<b>Total liabilities and shareholders' equity</b>	<b>2,197.0</b>	<b>2,746.1</b>	<b>3,093.3</b>	<b>3,247.4</b>	<b>3,580.7</b>	<b>3,903.8</b>	<b>4,271.5</b>

Source: NCCI and BMG

## Income Statement

Year ended Dec 31

All figures in SAR million unless stated otherwise	2003a	2004a	2005e	2006e	2007e	2008e	2009e
Revenues	904.5	934.0	1419.4	1766.9	2267.2	2664.0	3095.1
Other revenues	45.2	30.3	82.5	109.1	132.5	162.2	196.6
<b>Total revenues</b>	<b>949.7</b>	<b>964.2</b>	<b>1501.9</b>	<b>1876.0</b>	<b>2399.7</b>	<b>2826.3</b>	<b>3291.8</b>
Cost of Goods Sold	551.4	598.1	948.5	1360.6	1778.3	2124.8	2502.1
Selling, Gen & Admin Expenses	333.2	168.8	191.4	198.8	219.0	235.8	248.3
Depreciation Expense	10.1	9.6	21.1	18.9	19.6	21.5	24.3
<b>Total operating expenses</b>	<b>894.8</b>	<b>776.5</b>	<b>1160.9</b>	<b>1578.2</b>	<b>2016.9</b>	<b>2382.0</b>	<b>2774.6</b>
Operating income	54.9	187.7	341.0	297.8	382.8	444.2	517.2
<b>EBITDA</b>	<b>65.1</b>	<b>197.3</b>	<b>362.1</b>	<b>316.7</b>	<b>402.4</b>	<b>465.7</b>	<b>541.4</b>
EBITDA margin	6.9%	20.5%	24.1%	16.9%	16.8%	16.5%	16.4%
<b>Net Income</b>	<b>44.9</b>	<b>187.7</b>	<b>341.0</b>	<b>297.8</b>	<b>382.8</b>	<b>444.2</b>	<b>517.2</b>
Common dividends	12.5	31.3	170.5	148.9	191.4	222.1	258.6
<b>Retained Income</b>	<b>32.4</b>	<b>156.5</b>	<b>170.5</b>	<b>148.9</b>	<b>191.4</b>	<b>222.1</b>	<b>258.6</b>

Source: NCCI and BMG

## Cash Flow Statement

Year ended December 31

All figures in SAR million unless stated otherwise	2003a	2004a	2005e	2006e	2007e	2008e	2009e
Net income	44.9	187.7	341.0	297.8	382.8	444.2	517.2
Adj. to reconcile to net cash from operating activity	83.4	6.3	13.7	123.9	24.2	37.7	42.7
Changes in assets and liabilities	-38.8	-187.7	-12.8	-16.0	-20.5	-24.1	-28.0
Net cash flow from operating activities	89.4	6.3	341.8	405.8	386.5	457.9	531.8
Net cash flow from investing activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net cash flow from financing activities	-12.5	117.5	-170.5	-148.9	-191.4	-222.1	-258.6
<b>Net change in cash &amp; cash equivalents</b>	<b>76.9</b>	<b>123.8</b>	<b>171.4</b>	<b>256.9</b>	<b>195.1</b>	<b>235.8</b>	<b>273.2</b>
BOP cash and cash equivalents	380.8	457.7	581.6	752.9	1009.8	1204.8	1440.6
<b>EOP cash and cash equivalents</b>	<b>457.7</b>	<b>581.6</b>	<b>752.9</b>	<b>1,009.8</b>	<b>1,204.8</b>	<b>1,440.6</b>	<b>1,713.8</b>

Source: NCCI and BMG

## Financial Ratios

	2003a	2004a	2005e	2006e	2007e	2008e	2009e
<b>Growth</b>							
Revenues	97.60%	1.54%	55.76%	24.91%	27.91%	17.78%	16.47%
Operating profit	309.14%	241.89%	81.64%	-12.67%	28.55%	16.05%	16.42%
EBITDA	224.50%	203.33%	83.48%	-12.53%	27.06%	15.74%	16.25%
Net profit	140.40%	318.03%	81.64%	-12.67%	28.55%	16.05%	16.42%
<b>Profitability</b>							
EBITDA margin	6.85%	20.46%	24.11%	16.88%	16.77%	16.48%	16.45%
Operating profit margin	5.78%	19.47%	22.70%	15.87%	15.95%	15.72%	15.71%
Net profit margin	4.73%	19.47%	22.70%	15.87%	15.95%	15.72%	15.71%
EPS (SAR)	4.5	18.8	34.1	29.8	38.3	44.4	51.7
RoIC	2.50%	6.84%	11.02%	9.17%	10.69%	11.38%	12.11%
RoE	10.49%	27.70%	35.82%	27.05%	29.63%	29.34%	29.17%

Source: NCCI and BMG

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## Glossary

**Al Mudharaba Model:** The surplus is shared between the policyholders and the Takaful operator. The sharing of the profit (surplus) may be in a ratio of 5:5, 6:4, 7:3, etc., as mutually agreed between the contracting parties. Generally, these arrangements allow the Takaful operator to share in the underwriting results from the operations as well as the favorable performance returns on invested premiums.

**Expense Ratio:** Total expense to net premiums written.

**Gross Premium Written (GPW):** Gross Premium Written, which is total premium whether or not earned) for insurance contracts written or assumed during a specified period, without deduction for premium ceded.

**Loss Ratio:** The ratio of incurred claims and claims expenses to net earned premium.

**Net Combined Ratio:** The ratio of net claims incurred, loss expenses, policy acquisition costs and general and administrative expense to net premiums earned.

**Net Premium Written:** Gross Premium Written for a given period less premiums ceded to reinsurance companies during such period.

**Retention Amount:** The amount of insurance coverage that the primary insurer assumes for its own account, exclusive of any amount ceded to its reinsurers.

**Rukhsa:** Driving license.

**Saudization rate:** The Proportion of Saudi nationals in the total work force

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