

Wethaq Takaful Insurance Co. K.S.C.

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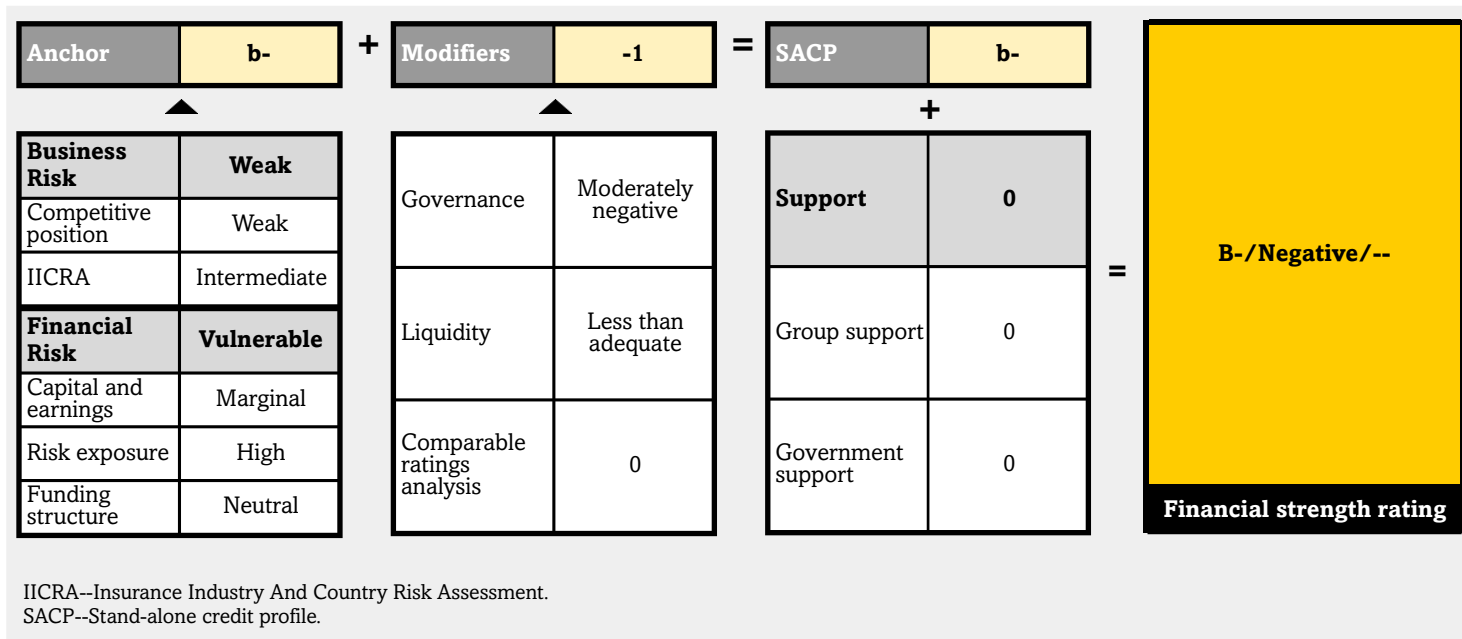
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Wethaq Takaful Insurance Co. K.S.C.



*Modifiers do not impact the rating since the anchor is at the lowest level under our Insurance Rating Methodology, namely 'b-'.

Credit Highlights

Overview	
Key strengths	Key risks
Business exposure limited to the Kuwait property and casualty (P/C) insurance market.	Liquidity is a key rating constraint.
Debt-free balance sheet.	Weakening competitive position, due to losses from both underwriting and investments, coupled with a small market share in Kuwait.
	Small and declining capital base and a qualified audit opinion on financial statements for more than three years weighs on our financial risk profile assessment.

Wethaq's top-line exposure remains limited to Kuwait, which is a rating strength, but our assessment is weakened by the company's small size and weak operating performance. Wethaq writes all its business in the Kuwait P/C and health insurance sector for which our industry risk assessment is comparable with the global average of our P/C and health insurance assessments. Kuwait's insurance industry risk is also at the same level as P/C insurance industry risk in the United Arab Emirates (UAE), Saudi Arabia, and Qatar.

Our view on Wethaq's capital adequacy is limited by its small capital base and unresolved audit qualifications.

Wethaq has a small capital base, with shareholders' equity (net of the deficit from policyholders' operations) of Kuwaiti dinar (KWD) 2.9 million (about \$9.5 million) as of Sept. 30 2020. On top of that, unresolved audit qualifications since 2017 weigh on our assessment of Wethaq's capital and earnings.

In 2020, we expect Wethaq's top line to contract significantly, but gradually improving operating performance. After reporting a big loss in 2019, Wethaq took corrective action by increasing prices and not renewing some loss-making accounts. Thanks to these actions, we expect profitability to improve in 2020 and 2021 compared with 2019 when Wethaq reported a policyholder fund deficit of KWD1.7 million. At the same time, the slower economic activity in Kuwait due to the COVID-19 pandemic, plus the corrective actions mentioned above, means Wethaq's top line will contract significantly in 2020.

Our rating on Wethaq is unaffected by the modifiers in the current situation. We apply our Insurance Rating Methodology (IRM) to arrive at the rating. Wethaq's anchor is at the lowest level in IRM ('b-') and hence the governance modifier is not applicable in this case, despite of our assessment being moderately negative.

Outlook: Negative

The negative outlook reflects the possibility of a downgrade over the next 12 months if the operating performance does not improve and there is further deterioration in capital adequacy or liquidity.

Downside scenario

We could lower our ratings over the next 12 months if:

- Wethaq's liquidity deteriorates further or if it becomes a severe risk to the company's ability to meet its financial obligations in a timely manner; or
- Wethaq is unable to resolve its accounting issues with auditors, which could lead to investment losses and further volatility in its capital adequacy and liquidity; or
- Operating performance does not materially improve in 2020.

Upside scenario

We could revise our outlook to stable in the next 12 months if:

- Wethaq is able to resolve its accounting issues, which could improve its liquidity, and capital and earnings;
- Wethaq demonstrates a sustainable trend of improving operating performance; and
- Wethaq manages to improve its liquidity.

Key Assumptions

- We project that Kuwait real GDP will contract by 6% in 2020, with both oil and non-oil sectors shrinking. We do not expect a rebound in 2021, with GDP growth to remain flat, due to the continuation of OPEC+ production volume cuts. However, the recovery should gather momentum from 2022, with average real GDP growth forecast at close to 7% over 2022-2023.
- We expect premiums in Kuwait P/C and health industry to increase at a slower pace than in previous years, namely up to 5% in 2020, due to the pandemic-related lockdown during the second quarter of this year, combined with low hydrocarbon prices. The government initiatives and infrastructure projects mentioned above should cause growth of

gross written premiums (GWP) to pick up from 2021, reaching 5%-10% per year. That said, uncertain economic conditions could mean that some initiatives or projects remain on hold, or are delayed for longer.

- For detailed macroeconomic forecasts, see "Insurance Industry And Country Risk Assessment: Kuwait Property/Casualty And Health," published Sept. 23, 2020, on RatingsDirect.

Wethaq Takaful Insurance Co. K.S.C.--Key Metrics

	--Year end Dec. 31--				
('000 KWD)	2021f	2020f	2019	2018	2017
S&P Global Ratings' capital adequacy	Marginal	Marginal	Satisfactory	Exxtremely Strong*	Moderately Strong*
Gross premium written	4,000-4,500	4,000-4,500	5,839	5,019	4,329
Net income	(100)-0	(400)-(600)	(1,701.0)	87.3	(847.1)
Return on shareholders' equity (%)	~0	~(15)	(39.4)	1.6	(14.8)
Net combined ratio (%)	100-110	110-120	169.0	102.8	124.9

KWD--Kuwaiti dinar. P/C--Property/casualty. f--Forecast. *The assessment reflects the rating scores under the previous insurance criteria framework.

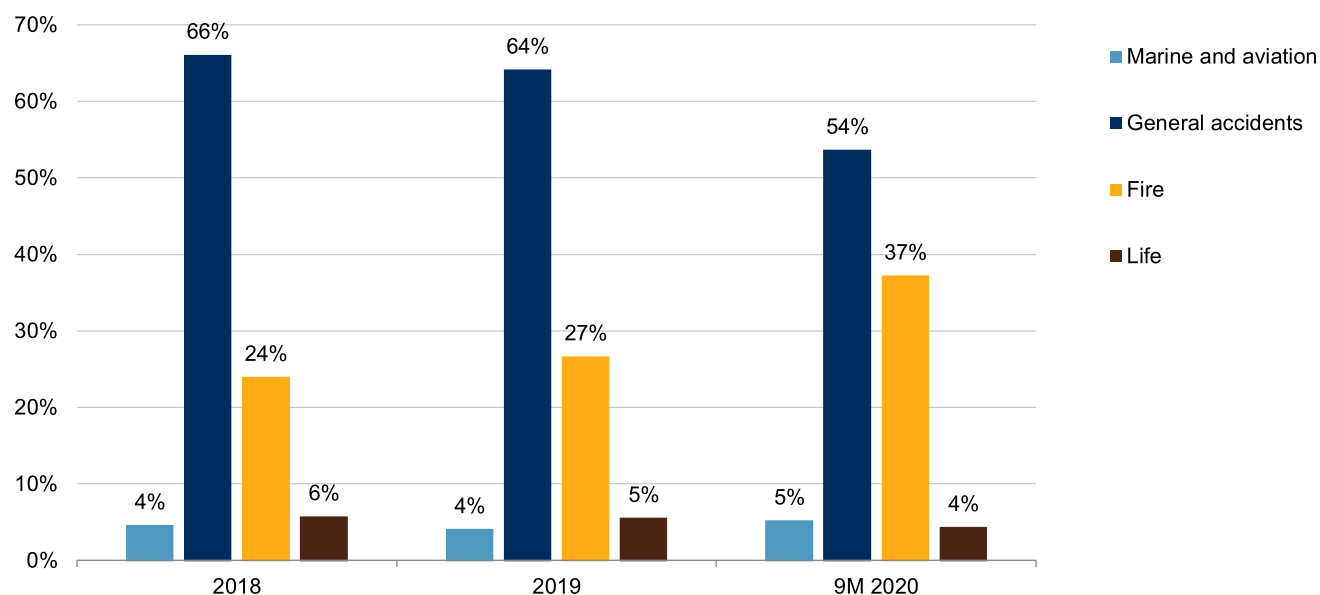
Business Risk Profile: Weak

Established in 2000, Wethaq is a Sharia-compliant (takaful) insurer, headquartered in Kuwait. Being a takaful player, Wethaq serves an important niche in the Kuwaiti insurance market. Wethaq's shares are listed on the Kuwait Stock Exchange, although majority of shares (69.4%) are owned by The Investment Dar Company (TID) (unrated), a Kuwaiti-based financial services group.

Wethaq derives its business solely from the Kuwait P/C insurance market. Based on its 2019 financial statements, Wethaq's underwriting operations are spread between general accidents, fire), marine and aviation, and life business. In first nine months 2020, due to the corrective action in the general accidents segment, the proportion has come down (refer to chart 1). Wethaq's high exposure to the motor business is a common phenomenon for the Kuwaiti insurance market where motor and medical business represent a dominant share of the total market. Due to its small size, Wethaq incurs relatively high costs in comparison with its scale of operations, similar to a number of other small takaful players in the Kuwaiti market.

Chart 1

Wethaq's Business Composition

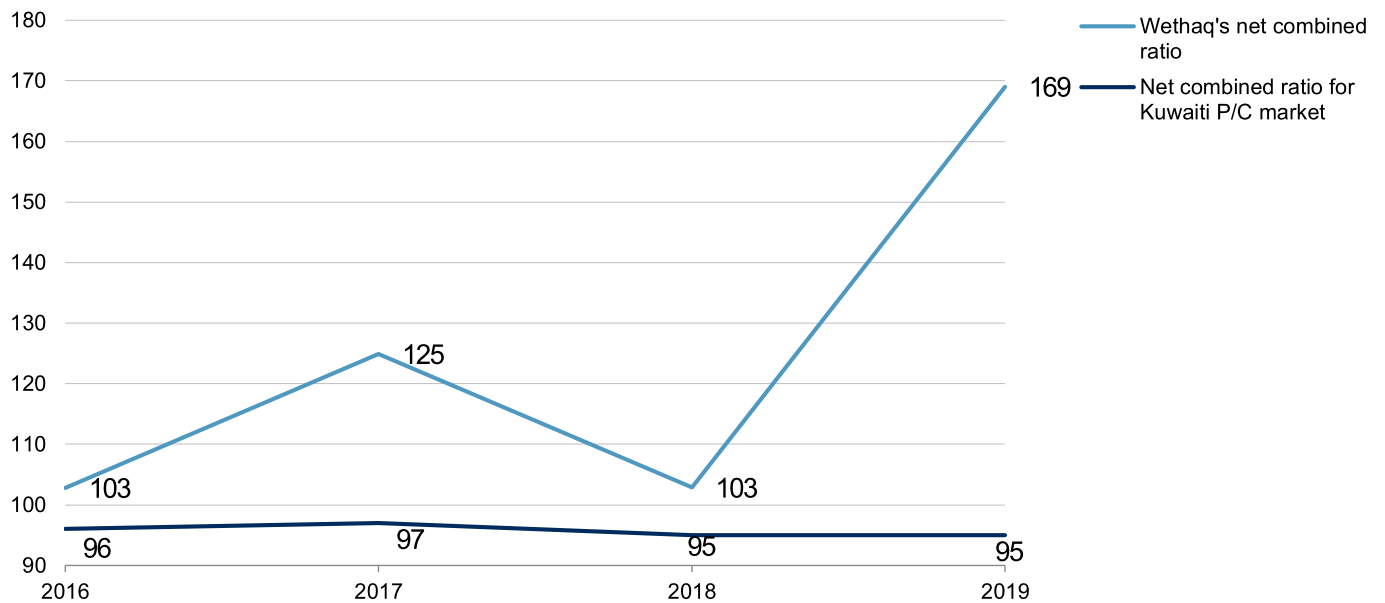


9M--First nine months. Source: S&P Global Ratings.

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Wethaq's competitive position reflects its small premium base and weak operating performance. Despite 16% GWP growth in 2018 and 2019, Wethaq remains a very small player in Kuwait with GPW of KWD5.8 million (\$18.6 million) in 2019 and a market share of 1.0%-1.5%. After reporting big loss in 2019, Wethaq increased the prices in its general accidents book, and did not renew some loss-making accounts. In addition, the pandemic has slowed economic activity in Kuwait. We expect Wethaq's top line will contract by about 30% in 2020, reflecting weaker economic conditions as well as the nonrenewal of some business. We expect normalized growth of 0%-5% in 2021-2022, in line with the Kuwaiti P/C insurance industry. In line with our expectations, for the first nine months of 2020, Wethaq registered a 30% decline in gross premiums to KWD3.5 million compared with KWD5 million for the same period in 2019.

Wethaq's underwriting performance has remained weak with consistent underwriting loss during the past five years, with a five-year average (2015-2019) combined ratio of 120%. Having said that, the five-year average is somewhat distorted by the significantly higher combined ratio of 169% in 2019 compared with 103% in 2018. In 2020, we expect Wethaq's underwriting performance to improve significantly compared with 2019, due to the corrective action in general accidents book. In the first nine months of 2020, Wethaq reported a net policyholder funds deficit of KWD0.73 million, compared with a deficit of KWD1.7 million in 2019.

Chart 2**Wethaq's Net Combined Ratio Is Weaker Than The Market Average**

Source: S&P Global Ratings. P/C--Property and casualty.

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Financial Risk Profile: Vulnerable

Our view of Wethaq's financial risk profile is informed by the small size of capital further limited by unresolved audit qualifications since 2017. In 2019, Wethaq registered significant underwriting losses that resulted in a policyholder fund deficit of KWD1.7 million. These losses further deteriorated Wethaq's already small capital base. Wethaq's shareholders' equity (net of the deficit from policyholders' operations) at Sept 30, 2020, stands at KWD2.9 million (about \$9.5 million).

In 2020, Wethaq changed its auditors to Bakertilly from Grant Thornton in line with the regulatory rotation requirement for listed companies in Kuwait to change their auditors every four years. The audit qualifications remain largely the same. Wethaq's financial report for the period ending Sept. 30, 2020, includes qualified opinions relating to an amount due to policyholders (including Qard Hassan) of KWD7.8 million, doubtful debts of KWD1.66 million without provisions, and investment property under its Egyptian subsidiary with no financial statement. We continue to write off the above qualified amount as provision for doubtful debts in our capital and earnings assessment.

Wethaq's investment portfolio is heavily leveraged toward high-risk assets, which brings an increased likelihood of earnings volatility. In 2019, Wethaq's portfolio was comprised of real estate (50%), equity investments (28%) (including

private equity), and cash and bank deposits (22%). Any material reduction to the value of Wethaq's equity portfolio due to market movement, similar to the fall witnessed during the first quarter of 2020, could place further pressure on the company's capital adequacy and liquidity.

Wethaq has made some progress in developing its controls and practices by engaging an external consultant. While this is a positive initiative, we believe the development of an adequate risk-control framework is still in its initial stages, and it will take time for Wethaq to embed it in its day-to-day operations.

Other Key Credit Considerations

Governance

We consider Wethaq's governance as a weakness to the overall rating, particularly owing to its appetite for high-risk assets under its investment strategy. Furthermore, the company's inability to resolve its financial reporting issues with its external auditors could place additional strains on its creditworthiness. Any further audit qualification or unexpected reclassifications may indicate severe governance deficiencies.

Wethaq has a basic strategic planning process, which includes a very simplified business plan highlighting specific targets by line of business. This is offset, however, by a long-serving management team that demonstrates a clear understanding of local market conditions.

Liquidity

In 2019, Wethaq's cash and bank deposits significantly decreased to KWD1.4 million from KWD2.3 million in 2018. This led to a further drop in the already unfavorable liquidity ratio of less than 1x. Although the company's liquidity ratio improved marginally in the first nine months of 2020, owing to a slightly higher cash position and lower business volumes, we continue to view it as a major rating constraint.

Group Support

Wethaq is 69.4%-owned by TID, a Kuwait-based financial services group conducting activities such as consumer and commercial financing, investment management, and real estate development. We believe that TID has no long-term or strategic interest in Wethaq, and hence our assessment of Wethaq's group credit profile excludes explicit consideration of TID's financial strength.

Environmental, social, and governance

We generally view corporate governance practices in Kuwait as satisfactory. However, in Wethaq's case, we note some governance deficiencies in relation to financial reporting standards. These weighed on our assessment of Wethaq's financial risk profile and governance assessment. Wethaq has more exposure to governance risk factors than is typical for Kuwait. It has become more common to see audit qualifications in the Gulf Cooperation Council region in recent years, and Wethaq's annual reports for 2017, 2018, 2019, and the first nine months of 2020 were qualified, first in relation to policyholder payables and doubtful debts without provisions and then also for Wethaq's investment property under its Egyptian subsidiary, for which there are no financial statements. We continue to write off the policyholder payables and doubtful debts without provisions from our capital analysis.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Kuwait-Based Wethaq Takaful Insurance Co. K.S.C. Downgraded To 'B-' On Weaker Capital Adequacy; Outlook Negative, April 30, 2020
- Insurance industry and Country Risk Assessment: Kuwait Property/Casualty and Health, Sept. 23, 2020

Appendix

Wethaq Takaful Insurance Co. K.S.C.--Credit Metrics History		
('000 KWD)	2019	2018
S&P Global Ratings capital adequacy*	Satisfactory	Extremely Strong*
Total shareholder equity	3,807.1	5,282.4
Gross premiums written	5,838.9	5,019.5
Net premiums written	2,955.3	2,752.8
Net premiums earned	2,656.6	3,608.6
Reinsurance utilization (%)	49.4	45.2
EBIT	(1,788.8)	90.4
Net income (attributable to all shareholders)	(1,788.8)	87.3
Return on revenue (%)	(58.1)	0.4
Return on shareholders' equity (reported) (%)	(39.4)	1.6
P/C: net combined ratio (%)	169.3	102.8
P/C: net expense ratio (%)	69.2	44.1
Net investment yield (%)	1.7	1.6

P/C--Property/casualty. KWD--Kuwaiti dinar.

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of December 7, 2020)***Operating Company Covered By This Report****Wethaq Takaful Insurance Co. K.S.C.**

Financial Strength Rating

Local Currency

B-/Negative/--

Issuer Credit Rating

Local Currency

B-/Negative/--

Domicile

Kuwait

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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