

### Research Update:

## Kuwait-Based First Takaful Insurance Co. Lowered To 'BB+' On Financial And Business Profile Concerns; Outlook Stable

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## Research Update:

# Kuwait-Based First Takaful Insurance Co. Lowered To 'BB+' On Financial And Business Profile Concerns; Outlook Stable

## Overview

- In our view, the difficult market environment in Kuwait is weighing on First Takaful Insurance Co.'s business profile.
- Unsatisfactory underwriting and investment results have weakened First Takaful's capitalization.
- We are lowering our ratings on First Takaful to 'BB+' from 'BBB-' and removing them from CreditWatch where they were placed with negative implications on May 12, 2010.
- The stable outlook reflects our expectation that the company will be able to prevent further weakening of its capitalization and operating performance.

## Rating Action

On Oct. 7, 2010, Standard & Poor's Ratings Services lowered its counterparty credit and insurer financial strength ratings on Kuwait-based First Takaful Insurance Co. to 'BB+' from 'BBB-'. At the same time, the ratings were removed from CreditWatch, where they were initially placed with negative implications on May 12, 2010. The outlook is stable.

## Rationale

The rating actions reflect our assessment that First Takaful's financial and business profile is weakening. Specifically, we have observed that continually deteriorating underwriting and investment results have weakened First Takaful's capitalization. Additionally, First Takaful is, in our view, at risk of its revenues falling below a level that we would regard as consistent with its book of business.

Although takaful insurance appears to represent a promising niche in the Kuwaiti market, competition seems to have become extremely fierce, especially owing to the large number of takaful participants in recent years. The risks of this scenario are intensified by what we see as reduced insurance opportunities. These developments became manifest in a decrease in gross premiums written of about 10% for the first six months of 2010, following a 20% drop in 2009. However, we view as positive that management is trying to change the company's business mix and has actively reduced the size of its still-dominant motor business to 49% as of June 2010 from 55% in 2009.

We consider First Takaful's operating performance to be marginal, owing to the company's underwriting performance. The net combined ratio for the first six months of 2010 was about 128%, after 113% for the full year 2009, mainly because of very disappointing results for motor. We are also concerned about the development of the administration expense ratio, which deteriorated to about 38% for first-half 2010 from 29% in 2009; this indicates to us that current business volumes do not allow First Takaful to generate sufficient economies of scale.

Our assessment also reflects the continually disappointing investment performance of the combined shareholders' and policyholders' accounts, which showed a loss of Kuwaiti dinar (KWD) 1.3 million (about €3.6 million) for the first six months of 2010, compared with a loss of KWD0.7 million in 2009. We understand that part of the loss comprised about KWD0.5 million related to First Takaful's stakes in associated companies, which are still in a start-up phase.

First Takaful's capital adequacy, which we assess using our risk-based capital model, is now marginal, in our view. The company's combined shareholders' and policyholders' capital as of June 30, 2010, has dropped further to KWD7.9 million from KWD9.9 million at year-end 2009. Heavy capital requirements for locally concentrated property and equity investments remain. In our view, the relatively small capital base in absolute terms makes First Takaful's capital adequacy vulnerable to asset volatility.

We consider First Takaful's liquidity to be good. The company generally covers its cash needs with premiums income. Cash and available-for-sale assets of the combined policyholders' and shareholders' accounts as of June 30, 2010, cover net claims reserves 3.9x, but this ratio reduces to 1.3x if we exclude unquoted equity securities.

## Outlook

The stable outlook reflects our belief that First Takaful will be able to prevent further weakening of its capitalization and operating performance. We expect underwriting results to recover to a level that translates into a combined ratio approaching 105% and the net takaful fund to achieve break-even trading within the next 12 months. The stable outlook also reflects our expectation that the shareholders' net income will return to at least breakeven within the same period. We do not expect the company's competitive position or size to deteriorate to a level that does not support the current ratings.

Renewed pressure on the ratings may occur if the company's performance appears insufficient to maintain earnings and capitalization at levels supportive of the current ratings. Conversely, we could see positive ratings momentum if the company is able to manage a return to a more robust financial and business profile over the next 12 months.

## Related Criteria And Research

- Interactive Ratings Methodology, April 22, 2009
- Group Methodology, April 22, 2009
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
First Takaful Insurance Co.		
Counterparty Credit Rating	BB+/Stable/--	BBB-/Watch Neg/--
Financial Strength Rating	BB+/Stable/--	BBB-/Watch Neg/--

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