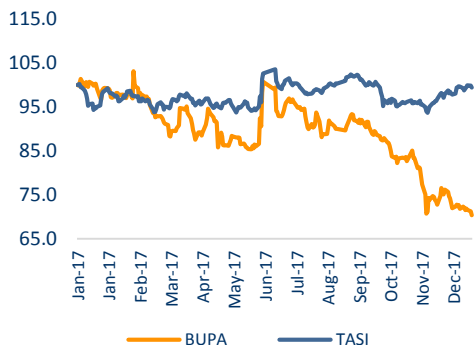


Initiation Coverage
January 4, 2017

Recommendation	Overweight
Current Price (SAR)	91.95
Target Price (SAR)	101.22
Upside/Downside (%)	10.1%

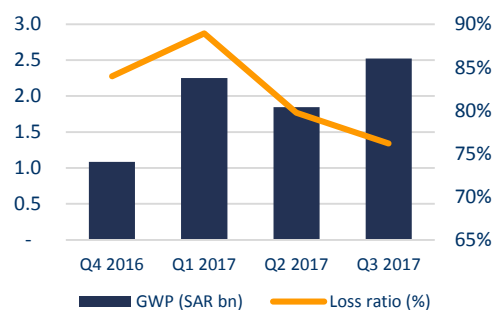
As of January 1, 2018
Key Data (Source: Bloomberg)

Market Cap (SAR bn)	7.4
52 Wk High (SAR)	138.5
52 Wk Low (SAR)	91.7
Total Outstanding Shares (in bn)	0.08
Free Float (%)	62.8%

BUPA vs. TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	-5.8	1.5
6m	-28.9	-3.9
12m	-29.6	-0.6

Major Shareholders (%)	%
BUPA Investments Overseas Co. Ltd	34.25%
Nazir Holding Group	9.00%
Computer Advanced Solutions	9.00%

GWP (SAR bn) and Loss ratio

Source: Bloomberg, Company Financials, FALCOM Research; Data as of January 1, 2018

Bupa's 3Q17 earnings missed consensus, with net profit before zakat and income tax declining to SAR 217.0mn (-17% YoY and -8% vs. consensus), although the results improved QoQ (+49%). The underlying performance can be mainly ascribed to a decrease in underwriting results, driven by higher net claims incurred and lower net earned premium compared to the year-ago period. However, better investment income and lower OpEx partially offset the decline.

Bupa is the largest healthcare provider in Saudi Arabia with market share of 23% as of 3Q17. Penetration of health insurance in the Kingdom is low, but is expected to gradually increase; supporting future top-line growth. The company continues to focus on optimizing costs and expects changes in regulations to decrease loss ratio in 2018. We have overweight rating on the stock, as the company's growth prospects outweigh risks arising from prevailing competitive and fiscal environment, and delays in enforcement of the Unified Health Insurance Policy.

Market share continues to improve

Bupa's market share expanded at a CAGR of 19.6% over 2013–16 to 21.5% from 12.6% in 2013. In 9M17, the company gained additional market share, reaching 23.0% by the end of 3Q17. With the expected increase in insurance penetration and market consolidation, we expect Bupa to benefit and achieve a market share of 24.2% by the end of 2018E. Towards this end, the company has recently signed a third party administration services agreement with Aramco.

Expense ratio declines, signals improvement in operational efficiency

Bupa rationalized its expense ratio to 11.9% in 2016 vis-à-vis 14.6% in 2013, showing signs of improvement in operational efficiency. This resulted in an overall improvement in the combined ratio to 92.5% in 2016 from 95.0% in 2013. The company intends to continue optimizing its costs.

Further delay in enforcement of one-contract health insurance could affect growth

The mandatory health insurance announced by the Council of Cooperative Health (CCHI) for all Saudi employees remains a key growth driver for the Saudi health insurance sector. However, the implementation of Unified Policy has been delayed, affecting Bupa's GWP growth in 2017. Any further delay in implementation would be a negative for the company.

GWP growth expected to remain in single digits

Amidst intense competition and slow pick-up in the insured population, we expect pricing pressure to continue, resulting in single-digit growth in the industry GWP. Emulating the industry, Bupa's GWP growth is expected to remain subdued. However, we expect the company's GWP to remain between 6.5% and 8.5% over 2018–20E, supported by better enforcement, policy changes and market normalization.

Claims trend higher, loss ratio remains a concern

Claims for Bupa are among the highest in the insurance industry and increased sharply at a CAGR of 42.0% over 2013–16. This increased the loss ratio to 80.6% in 2016 (the ratio touched 88.9% in 1Q17). Thereafter, the loss ratio declined to 76.2% in the latest reported quarter. However, with rising medical inflation, we expect the loss ratio to remain high in the range of 79–80%.

Valuation: We valued Bupa using the residual income approach to arrive at a fair value of SAR 101.2 per share. We estimated WACC at 12.1% and considered a terminal growth rate of 2.0%.

	2016A	2017E	2018E	2019E
GWP (SAR bn)	7.9	8.6	9.3	10.0
NEP (SAR bn)	7.7	8.1	8.8	9.4
EPS (SAR)	7.9	9.3	10.5	11.8
RoE (%)	31.1%	28.4%	25.5%	23.3%
P/E (x)	16.7	9.9	8.7	7.0
Price/BV (x)	1.5	0.9	0.8	0.7
DPS (SAR)	1.5	1.5	1.5	1.5

Source: Company Financials, FALCOM Research

Initiation Coverage

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Valuation Summary

Explanation of valuation methodology and assumptions

We valued Bupa using the residual income approach to arrive at a fair value of SAR 101.2 per share. We estimated WACC at 12.1%, with a terminal growth rate of 2.0%.

In relative terms, Bupa is trading at a one-year forward P/BV of 0.9x, showing a discount of 50.0% to its sector peers and nearly 56.3% to the Tadawul All Share Index.

SAR Mn	FY 2016A	FY 2017E	FY 2018E	FY 2019E	FY 2020E
Net income	631	743	841	943	1,050
Beginning equity value	1,667	2,027	2,613	3,292	4,046
Equity value	201	244	315	397	488
Residual Income	430	499	526	546	562
Discount factor		1.0	0.9	0.8	0.8
PV of Residual Income		499	469	435	399
Net Present Value (A)					1,802
PV Terminal Value (B)					4,029
Assumed Terminal Growth Rate					2.0%
Discount Rate					12.1%
Enterprise Value (A+B)	5,830	WACC Assumptions			
Shareholder's equity	2,242				
Equity value in SAR mn	8,073				
Number of shares in mn	80	Risk-free rate			2.5%
Target price in SAR per share	101.2	Market returns			9.8%
CMP in SAR as on January 1, 2018	92.0	Beta			1.0x
Upside/(downside) to current market price	10.1%	Cost of equity			12.1%

Source: Company Financials, FALCOM Research Estimates

Risks

Upside risks:

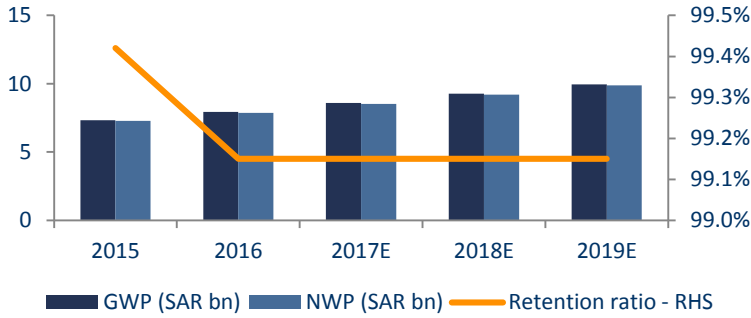
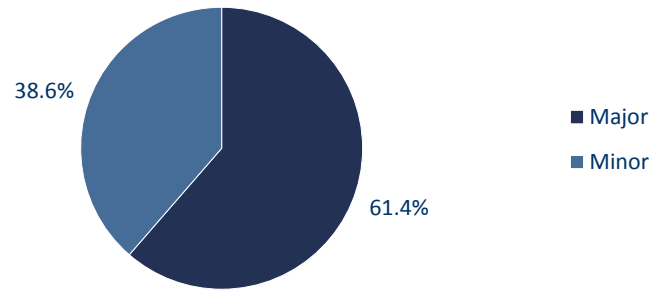
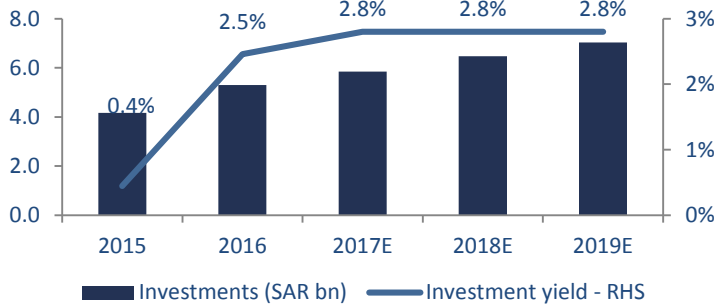
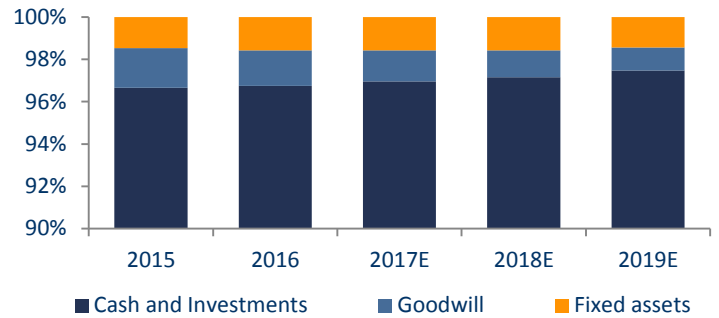
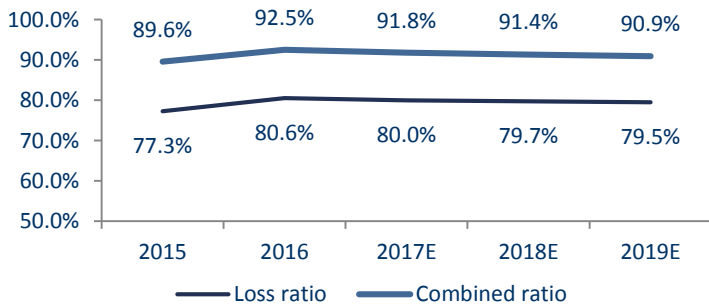
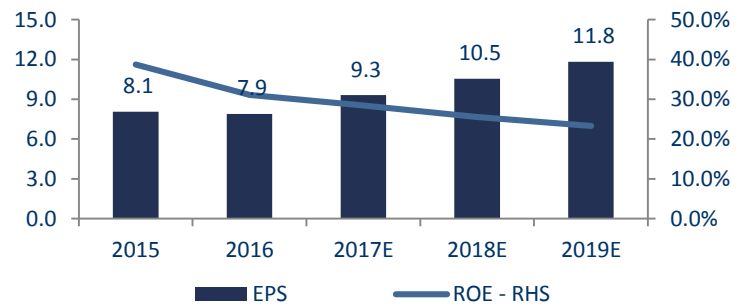
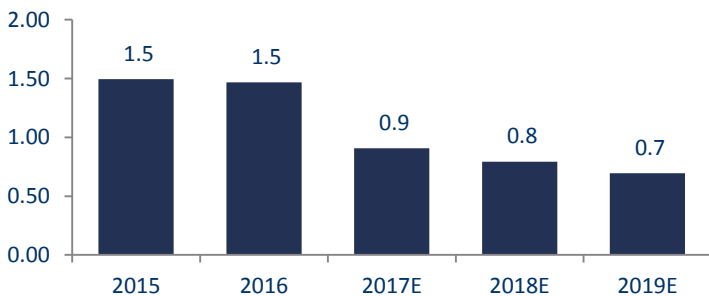
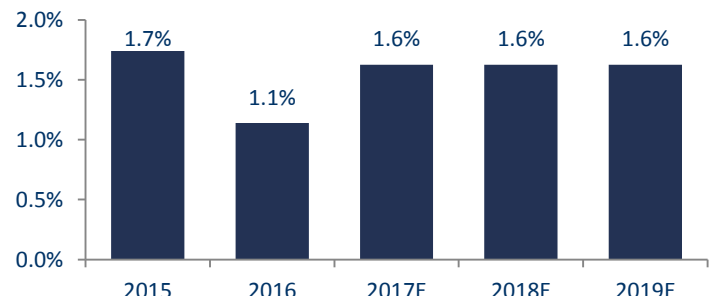
- An earlier-than-expected enforcement of SAMA's regulation, mandating medical and third-party liability insurance, could significantly improve business opportunities for Bupa Arabia.
- The Saudi insurance industry is likely to consolidate over the next few years, easing pressure on margins.
- Other regulatory reforms encouraging higher health insurance sales could support GWP growth.

Downside risks

- There is intense competition in the insurance market. Failure to compete with nimbler competitors could result in contraction in market share.
- Trend of higher/increasing claims may adversely impact the company's profitability outlook.
- Since the company's business primarily depends on sales to large corporations, any non-renewal would affect GWP growth and market share.

Initiation Coverage

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Key Charts
GWP vs NWP

GWP Split (9 months 2017)

Investments & Yield

Asset Breakup

Loss & Combined ratio (%)

EPS & ROE (%)

PB

Dividend Yield


Source: FALCOM Research Estimates

Initiation Coverage

January 4, 2017

Summary Financials

P&L (SAR mn)	2016	2017E	2018E	2019E
Gross written premium	7,939	8,588	9,274	9,961
Net written premium	7,871	8,515	9,195	9,876
Net earned premium	7,667	8,131	8,781	9,431
Net claims incurred	6,178	6,503	7,001	7,496
Surplus (Share.) from insurance Operations	589	695	788	887
Net income	631	743	841	943
EPS	7.9	9.3	10.5	11.8
DPS	1.5	1.5	1.5	1.5

BS (SAR mn)	2016	2017E	2018E	2019E
Investments	5,530	6,401	7,466	8,646
Insurance Operations assets	4,921	5,286	5,779	6,286
Shareholders' assets	2,234	2,826	3,511	4,287
Total assets	7,155	8,111	9,290	10,572
Insurance Operations Liabilities and surplus	9,673	10,283	11,133	11,992
Shareholders' liabilities	207	233	264	314
Shareholders Equities	2,027	2,613	3,292	4,046
Total Liabilities	7,155	8,111	9,290	10,572

CF (SAR mn)	2016	2017E	2018E	2019E
Cash Flow from Operating Activities	436	695	787	876
Capex	(28)	(35)	(42)	(34)
Cash Flow from Investing Activities	(807)	(293)	(233)	(217)
Dividends	(160)	(120)	(120)	(120)
Cash Flow from Financing Activities	(129)	(83)	(78)	(73)

Source: Bloomberg, Company Financials, FALCOM Research

* Peers selected for relative valuation are based on data availability for forward PB on Bloomberg

Growth	2016	2017E	2018E	2019E
Gross written Premium	8.3%	8.2%	8.0%	7.4%
Net earned Premium	13.8%	6.0%	8.0%	7.4%
EPS	-2.0%	17.9%	13.2%	12.1%
Total Investments	27.1%	10.4%	10.5%	8.7%

Ratios (%)	2016	2017E	2018E	2019E
Retention ratio	99.2%	99.2%	99.2%	99.2%
Loss ratio	80.6%	80.0%	79.7%	79.5%
Expense ratio	11.9%	11.8%	11.6%	11.4%
Combined ratio	92.5%	91.8%	91.4%	90.9%
Investment yield	2.5%	2.8%	2.8%	2.8%
Dividend payout ratio	19.0%	16.1%	14.2%	12.7%
ROE	31.1%	28.4%	25.5%	23.3%
ROA	2.4%	3.0%	3.6%	4.1%
Dividend Yield	1.1%	1.6%	1.6%	1.6%

Valuation	2016	2017E	2018E	2019E
PE	16.7	9.9	8.7	7.8
PB	1.5	0.9	0.8	0.7

Peer Valuations*	12M Fwd PE	12m Fwd PB
Tawuniya	14.3	3.3
Al Rajhi Takaful	16.2	3.2
Walaa Co-operative	9.5	1.8
Malath Insurance	17.4	1.5
Bupa Arabia	10.1	0.9
Sector Median	14.3	1.8
TASI	14.6	1.6

Initiation Coverage

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FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by $\geq 10\%$.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by $\geq 10\%$.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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FALCOM acquired the Saudi Capital Market Authority license number (37-06020) on 27/05/2006, and commenced providing its services to the investors in the Saudi Stock Exchange on 19/02/2007 with CR Number 1010226584 Issued on 04/12/1427H.