

## Global Alliance Seguros

### Mozambique Insurance Analysis

April 2008

Security class	Rating scale	Currency	Rating	Rating watch	Expiry date
Claims paying ability	National	Metical	A	No	07/2009

#### Financial data:

(US\$'m Comparative)

	31/12/06	31/12/07
Mt/US\$ (avg)	26,100	25,750
Mt/US\$ (close)	25,250	23,750
Total assets	12.7	7.9
Total capital	2.8	3.7
Cash & equiv.	5.1	5.1
GPI	11.7	12.7
U/w result	0.3	1.8
NPAT	0.3	1.3
Op. cash flow	3.1	0.2
Market cap.		n.a.
Market share*		18%

\*Based on estimated GPI at 31 December 2007

#### Fundamentals:

Global Alliance Seguros (GA) was registered as an insurer in 1992. The company has a composite licence to transact both non-life and life insurance. GA is a 100% owned subsidiary of Global Alliance Holdings. Due to corporate restructuring, its non-life (over 95% of the business) is to be transferred to a new licence, separately capitalised with the existing licence utilised to write life insurance business only.

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#### Rating rationale

The rating is based on the following key factors:

- GA is one of the leading insurers in the Mozambican market, with a large percentage of contracts having been on the books for over 10 years.
- The IT systems infrastructure and high levels of service were favourably viewed.
- The reinsurance programme provides adequate protection, while counterparties are of a high credit quality.
- Liquidity measures were considered to be adequate, notwithstanding the decline from F06. However, cash coverage is expected to decline further in F08, to below 10 months.
- The company has been accepting lower rates on certain policies, which may affect loss and efficiency ratio performance going forward.
- Cognisance is taken of the exceptionally volatile profit trend over the review period, with unrealised exchange movements failing to smooth out earnings.
- Despite significant cash holdings, investment returns remain weak.

# All figures in this report relate to the Old Metical

#### Solvency and liquidity

GA's solvency margin increased to only 58% from 54% in 2006, notwithstanding the net profit posting of Mt31bn in 2007. This was due to the write off of long outstanding debtors, which was not taken through the income statement. Historically 63% of premiums were payable annually, although this reduced to 57% in 2007, with bi-annual and quarterly payment terms being the preferred methods of policy issuance. Accordingly the financial base ratio at 77% at year-end 2007 provides an additional buffer. Cash and cash equivalents were posted at a lower Mt120bn in 2007 (2006: Mt128bn). This coupled with the 41% rise in claims saw coverage decline from 25 months to 17 months. Cognisance is taken of the fact that the company is building a head office building valued at US\$2m in Maputo, which will significantly alter the balance sheet (currently invested exclusively in cash) and the company's liquidity profile.



## **Economic overview**

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Nominal GDP in Mozambique is estimated at US\$6.7bn for 2007, an increase of 6%. Annual average inflation has climbed to around 12% for 2007. The sensitivity of inflation to changes in the food price is substantial, due to food comprising the majority of the consumer mix of goods used in the CPI calculation. In addition, the imported inflation component will be adversely affected by increasing inflation in South Africa and food inflation the world over. Interest rates gradually declined from 18.5% in 2003 to 11.5% in January 2005, with substantial foreign debt write off and an improved inflationary outlook. This, however, is now under threat of reversing. In 2007, the exchange rate evidenced a steady appreciation from the Mt26,000/US\$ level to Mt25,000 /US\$.

Robust economic growth (averaging 7% since 2002) is dependent on the continued roll out of mega investment projects in the country. These projects are concentrated in the minerals sector (recently titanium and coal). With commodity prices at record levels, ongoing benefit is highly dependant on seamless commissioning of capacity. The mega Aluminium smelter Mozal continues to contribute a dominant share of export earnings, however, the dependency on uninterrupted power supply is significant, so much so that the margin of interruption of a few hours could render a significant aspect of the production process redundant. The country has a long term supply contract with South African utility Eskom, which is currently under severe reserve margin pressure, which is a concern. As a major contributor to the Sub-saharan electricity grid, its domestic absorption is weak given the dilapidated infrastructure (transmission lines), with power sold/routed to Eskom using DC and converted/purchased back at the more expensive AC current for consumption in Maputo. The country has purchased up to 80% of the Cohora Basa hydroelectric power facility for \$800m, from former colonial power Portugal. Funding was sourced through a consortium of local banks through their parent companies, and is not expected to increase foreign debt service in the medium term - after the foreign debt reduction programme (HIPC and MDRI) brought debt service to around 40% of GDP. Although local debt is increasing, government has expanded the tax net to collect tax revenue i.e. 20% withholding tax on goods imported and a withholding tax on coupons on government t-bills.

Whilst most of the banking infrastructure is geared to the capital of Maputo, a multinational bank has increased its branch network and budgeted for 25 more outlets in the regional areas (to follow the expected decentralisation of government service

delivery/departmental structures, particularly to the Renamo constituencies).

With the largest bank, namely Millenium Bim, said to have increased profitability by 30% in 2007, the broader financial services sector is expected to benefit as banks increase their own value proposition to wealthier clients. With the big two banks spending heavily on systems this capacity, when it does come on line, would facilitate a significant opportunity to introduce the bancassurance model.

A possible withholding tax levy on foreign reinsurance payments could prove difficult, and is likely to push up the cost of reinsurance or, as in the case of banks with t-bills (which inadvertently forced banks to switch assets into lending activity), the insurers would react with alternative (in this case) funding solutions.

## **Operating environment**

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The country experienced flooding in the North in February 2008, which in the year 2000 caused damage of US\$350m, the majority of which was uninsured. The recent flooding has not affected rates in the market (as would the more likely cyclone exposure), given that the flooding was mostly in the rural areas (uninsured), and accordingly the company advises that they have not been notified of any exposures.

GPI growth for the industry amounted to 34% in 2006 to total US\$64m (85% of which related to non-life). Around 43% of premiums are sourced from the motor book, which accounts for 73% of claims. Due to GA securing the larger well-established corporates as clients, the company faces the threat of losing these books of business, compounded by the broker market wanting to demonstrate goodwill with clients in negotiating better rates. Accordingly the company has been forced to defend its book. Competition from Hollard Seguros and MCS is expected to intensify, with the former trading off of its brand awareness (despite perceived higher rates charged in the corporate clientele arena) and the latter offering boutique style products (as well as leveraging off the acquisition of a large telecoms account).

The largest insurers (Empresa Mocambicana de Seguros (EMOSE) and Segurado Internacional De Mocambique (SIM)) have displayed high levels of prudent underwriting, allowing the other industry participants market access through lower rates. Growth opportunities should increase following the rehabilitation of the Maputo Port, which would effect increased demand for marine insurance, and more clarity on private property rights. This in turn should create a long term pricing mechanism to supply the

market with much needed underwriting capacity to match the large shortfall in corporate demand for insurance (which is currently placed offshore).

SIM remains the largest insurance company operating in Mozambique in terms of GPI, operating two brands namely Impar (corporate network) and Millenium Seguros (retail and bancassurance). During the course of 2006, BIM (Banco Internacional de Mocambique) increased its interest in the company from 22% to 90%. SIM had a market share of around 35% in 2007, slightly above EMOSE, and increased non-life premiums by a significant 32% and life premiums (mostly credit life and pensions) by 30%. Although life business represents only 26% of total premium income, it contributed 70% of the net technical margin. Non-life has a combined ratio of 88%, split between the administration cost ratio (43%) and the claims ratio (45%). SIM reported a 39% ROaE for the year.

### Re-organisation

The company has a composite licence to transact both non-life and life insurance. Due to corporate restructuring, its non-life (over 95% of the business) is to be transferred to a new licence, separately capitalized, with the existing licence utilised to write life insurance business only. All reinsurance treaties will be transferred to the new non-life company and new treaties will be put in place for the life company. There will be a fresh injection of capital into the life company with new shareholders and staff. As and when the policies come up for renewal they will be renewed onto the new company, all policies should be run off on the old company within a one-year period. The new company will charge an administration fee to the old company for the run off period.

### Risk diversification

The insurer sources the majority of its business from three multinational brokers (around 63%). Direct sales accounted for 8% of premiums, compared to 10% in 2006. With respect to personal lines, GA has not aggressively pursued this business due to the typically low penetration rates. This appears to be improving.

Currently 90% of business is sourced from corporate clients, paying between US\$10,000 and US\$150,000 of annual premium. The 5 largest clients accounted for 20% of total GPI in 2007. Analysis of the average duration of policies reflects below inflation increases for polices over 5 years old, with these policies being low claiming. With respect to 3rd party motor, a large fleet could fetch 1/5th of the tariffed rate.

Table 1: Class analysis	GPI (%)	NPI (%)	Net profit before tax ** Mtm
Aviation	2.3	0.0	181
Fire	30.1	7.8	(2,198)
Goods in transit	1.4	2.8	1,493
Marine	1.9	1.6	742
Other *	24.4	17.8	20,286
Personal liability	6.2	2.2	4,685
Personal Acc.	2.6	1.5	1,981
Motor	24.3	51.5	19,738
Workman Comp.	6.8	14.7	1,655
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>48,563</b>

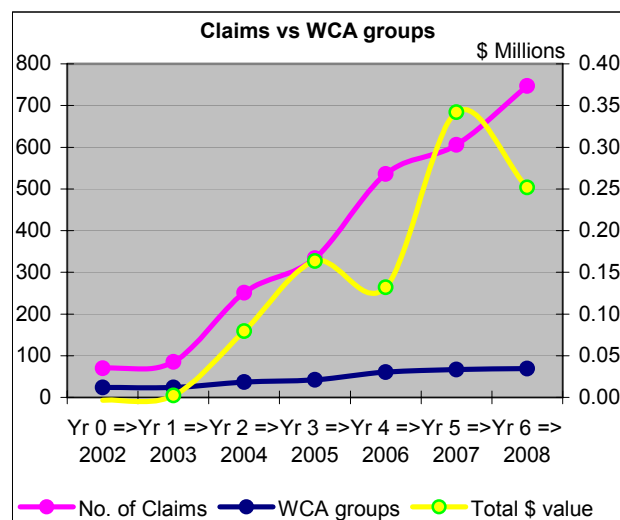
\* Includes engineering, Toursure and unallocated income.

\*\* Using average rate of exchange to effect translation.

The ability to price for risk by class has historically been high, as the motor book (typically prone to rates pressure) did not constitute the high 40-45% composition of typical insurance books. In 2007, however, due to shedding of policies, including motor, the motor class now represents 51.5% of net account risk.

The insurer's financial performance in the previous year (after admin fees) was largely driven by the underwriting profit in the fire, WCA and Toursure (tourist 3<sup>rd</sup> party motor) classes. By contrast, the motor account posted a large underwriting loss of Mt2.9bn during 2006. In 2007, engineering, Toursure, miscellaneous and motor (recovery following cancellation of business) were the best performers. The WCA class performed relatively poorly, although still profitable.

### WCA



Analysis of gross claims within the 6-year period reflects 2,629 claims raised totalling \$967,962. The largest claim was \$80,160. Low value claims (\$0 - \$100) represented 26% of the total, with high value claims (\$1,000-\$10,000) contributing 56% to the total claims value. The average growth rate in claims incurred over the period increased by a significant 48% per annum, with the number of claims per

insured group increasing from 3 claims to 11 claims per group by the end of the period.

### Motor

The company has contracted panel-beating companies (which are becoming more professional outfits), so as to ensure veracity of repair work and improve efficiencies in the sourcing of parts. Given that an analysis of claims reveals that motor claims (in the range of \$1,000 to \$10,000) have represented 50% of total claims by value since 2001, this area requires constant monitoring.

### Reinsurance

Reinsurance protection on both proportional and non-proportional treaties is lead by Munich Mauritius Re with 25% participation, and includes Africa Re (20%), Arig (10%), Scor (15%), Swiss Re (20%) and ZEP Re (10%). The company has replaced Everest Re with Arig and Scor. Historically, US\$1.2m was paid to group companies for financial risk reinsurance cover. In F07 this was discontinued.

### Proportional treaties

Table 2: Reinsurance (US\$)	Net retention	Limit	Natural perils event limit
Fire first surplus*	500,000	5.5m	30m
Fire second surplus*	500,000	5.5m	30m
Eng. first surplus (material damage)	500,000	5.5m	30m
Eng. second surplus (material damage)	500,000	5.5m	30m
Eng. surplus (liability)	500,000	5.5m	n.a.
Gen. acc. & liability surplus	200,000	600,000	n.a.
Personal acc. & stated benefits (any one life)	200,000	600,000	n.a.
Personal acc. & stated benefits (any one accumulation)	600,000	1.8m	n.a.
Liability	500,000	1.5m	n.a.

Note: A loss occurrence in respect of natural perils relates to individual losses arising out of and directly as a result of one and the same event.

\*Subject to a minimum PML factor of 50% and inward facultative acceptances of 50% of capacity.

The excess of loss treaty covers losses between US\$100,000 and US\$10m and is subject to the specified maximum net retentions by class (applicable to per risk and accumulation of risk) with 2 reinstatements. In this regard, GA has increased its net retentions from US\$200,000 to US\$500,000 on miscellaneous accident and motor own damage, personal accident, WCA, and GIT. Also the marine surplus has been cancelled.

Table 3: Reinsurance trade off (Mtm)	F05	F06	F07
Premium ceded	166,741	204,910	175,751
Commissions received	(29,868)	(28,992)	(30,182)
Claims recovered	(20,795)	(34,578)	(126,971)
<b>Net result</b>	<b>116,078</b>	<b>141,340</b>	<b>18,598</b>

A marked decrease in reinsurance portfolio transfers was posted in F07, due to significant reinsurance recoverables from the large cyclone exposure.

### Asset management

The company benefited from a reinsurance recovery to the value of US\$2m, with US\$1.5m put on fixed deposit and US\$500,000 invested in property. The company has increased its property portfolio by Mt7.6bn (new corporate head office – land only). The total cost for the new head office is expected to be US\$2m (approximately Mt50bn at an exchange rate of Mt25,000:US\$), and will be commissioned in June 2008.

Table 4: Investment portfolio	F06		F07	
	Mtm	%	Mtm	%
<b>Cash &amp; cash equivalents</b>	<b>127,928</b>	<b>94.3</b>	<b>120,089</b>	<b>86.4</b>
Listed equities	673	0.5	713	0.6
Bonds	130	0.1	97	0.0
Offshore investment	8	0.0	0	0.0
Investment property	6,889	5.1	17,996	13.0
<b>Other investments</b>	<b>7,700</b>	<b>5.7</b>	<b>18,806</b>	<b>13.6</b>
<b>Total investments</b>	<b>135,628</b>	<b>100.0</b>	<b>138,895</b>	<b>100.0</b>

Cash holdings have reduced to 86% of total investments from 94% in 2006. The overwhelming majority of cash holdings are held in US\$, held with Barclays and Standard Bank in Mozambique. This translated into a claims cash coverage ratio of 17 months, down from 25 months in F06. This is expected to decline further in F08, given the cost of the head office, to around 9 months. Furthermore, cognisance is taken of the poor investment returns on the significant cash holdings. Management confirmed that inter-company funding does not take place and the poor rate of return is due to exceptionally low interest rates earned on these cash resources.

### Solvency and reserving

The solvency margin increased to 58%, from 54% in 2006. Cognisance is taken of the fact that shareholders interest increased by only Mt15bn, notwithstanding significant profits generated for the year of Mt31bn. This was due to third party balances (essentially with reinsurance intermediates) that were written off. These write offs were not taken through the income statement.

The company continues to price annually although this has reduced to 57% in 2007, with bi-annual and quarterly the preferred methods of policy issuance. Accordingly, the financial base ratio, at 77% at year-end 2007, provides an additional buffer.

## Financial performance

A 5-year financial synopsis is reflected at the back of this report and brief comment follows hereafter. It is noted that auditors BDO Binder & Co qualified the 2007 audited financial statements. Share capital increased by Mt56.9bn although the public deed had not been done in 2007. Management confirms that this will be resolved by mid-2008.

The table below compares actual results with the budget for 2007. GPI fell well short of budget, even with the strengthening currency, representing 94% of budget. This was largely due to the shedding of business and more specifically the lower rate acceptances. This, compounded by the softening admin fee margin (13% compared to budget of 16%) and higher than expected losses, saw the company report an underwriting profit that equated to 72% of full year budget.

	Budget	Actual
Gross premium income	346,730	326,920
Reinsurance	(174,350)	(175,751)
<b>Net premium income</b>	<b>172,380</b>	<b>151,169</b>
<b>Earned premium</b>	<b>169,688</b>	<b>147,898</b>
Net claims	(67,361)	(86,426)
Net commission	(24,618)	(13,362)
Management expenses	(71,138)	(44,089)
Admin fee income	56,444	41,614
<b>Operating result</b>	<b>63,015</b>	<b>45,635</b>

Note: Admin fees shown on a like for like basis

Gross premium income increased only 7% in F07, compared to growth of 31% in F06 (F05: 24%). Retention rates increased in F07, from 44% to 46%, which supported growth of 12% in earned premiums, to Mt148bn.

Gross loss experience worsened from 28% in 2006 to 60%, as a tropical cyclone struck central Mozambique during February 2007, damaging several tourist lodges and homes in the area. Notwithstanding significant reinsurance recoveries, the company reported a higher earned loss ratio of 58% in 2007, from 46.5% in 2006. This was also impacted by a spate of vehicle hijackings and theft, which is retained to net account. While net commissions remained largely in line with the previous year, management costs improved, which together with higher retentions, saw the cost ratio decline from 37% to 30%. This was insufficient to offset the rise in claims experience, and accordingly the company reported a marked reduction in its underwriting margin, from 6.8% to 2.7%.

Other income of Mt42bn, including admin fee income, supported the significant rise in after tax profits, from Mt7.7bn to Mt32bn.

Exchange movements are treated as unrealised profits/losses by GCR. These arise from the fact that premiums are received in Rands and Dollars. These are held in hard currency until payment is made to reinsurers (ie. facultative business) - usually 45 days between receipt and payments, with the resulting gain/loss put to the income statement. In terms of foreign currency received at a certain rate that must be paid out at a fixed rate in future (ie quarterly treaty business); the gain/loss is recorded as an unrealised gain/loss to the income statement.

Overall, cognisance is taken of the exceptionally volatile profit trend over the review period.

## Future prospects

	Actual F07	Budget F08
Gross premium income	326,920	365,000
Net premium income	151,169	185,000
<b>Earned premium</b>	<b>147,898</b>	<b>167,500</b>
Net claims	(86,426)	(90,000)
Net commission	(13,362)	(15,000)
<b>Technical result</b>	<b>48,110</b>	<b>62,500</b>
Management expenses	(44,089)	(64,670)
Admin fee income	41,614	49,714
<b>Operating profit</b>	<b>45,635</b>	<b>47,544</b>

### Ratios (%)

GPI growth	7.2	11.6
Retention ratio	46.2	50.7
Earned loss ratio	58.4	53.7
Management cost ratio	29.8	38.6
Net commission ratio	9.0	9.0
Admin fee margin	12.7	13.6
Operating margin	30.9	28.4
Solvency	57.7	75.0

Note: Budget translated using an exchange rate of Mt25,000:US\$

The company is budgeting a 6% increase in premiums to US\$14.6m in 2008 (or 12% if translated using an exchange rate of Mt25,000). A further reduction in reinsurance cessions will see earned premium increase by 13%. This, coupled with a relatively lower increase in claims will drive the 30% rise in the technical result. However, given significantly higher forecast management costs, the operating surplus is budgeted to increase by only 4%, despite a higher forecast admin fee margin of 14%. Given the increase in profitability, the solvency margin is expected to increase to 75% (assuming shareholders interest increases to Mt138bn).

# Global Alliance Seguros

(Old Meticaïs in millions except as noted)

Year ended : 31 December	2003	2004	2005	2006	2007*
<b>Income Statement</b>					
Gross premium income (GPI)	171,757	188,717	233,437	305,103	326,920
Reinsurance premiums	(79,330)	(81,358)	(131,060)	(170,935)	(175,751)
<b>Net Premium income (NPI)</b>	<b>92,427</b>	<b>107,359</b>	<b>102,377</b>	<b>134,168</b>	<b>151,169</b>
(Increase) / Decrease in insurance funds	(9,839)	(904)	(7,131)	(2,001)	(3,270)
<b>Net premiums earned</b>	<b>82,588</b>	<b>106,455</b>	<b>95,246</b>	<b>132,166</b>	<b>147,898</b>
Claims incurred	(28,258)	(48,446)	(38,205)	(61,497)	(86,426)
Commission	(5,404)	(2,209)	(6,730)	(13,081)	(13,362)
Management expenses	(34,186)	(34,619)	(50,334)	(48,580)	(44,089)
<b>Underwriting profit / (loss)</b>	<b>14,740</b>	<b>21,181</b>	<b>(23)</b>	<b>9,007</b>	<b>4,021</b>
Investment income	4,489	902	83	389	840
Other income / (expenses)	482	0	751	706	41,894
Taxation	0	0	(2,098)	(2,420)	(14,497)
<b>Net income after tax</b>	<b>19,712</b>	<b>22,083</b>	<b>(1,287)</b>	<b>7,682</b>	<b>32,257</b>
Unrealised gains / (losses)	219	(15,614)	5,746	(2,540)	(1,451)

## Balance Sheet

<b>Shareholders interest</b>					
Insurance funds	17,948	15,458	22,589	27,508	29,861
Other liabilities	111,479	103,753	136,662	220,956	69,530
<b>Total capital &amp; liabilities</b>	<b>185,427</b>	<b>181,681</b>	<b>226,180</b>	<b>320,276</b>	<b>186,543</b>
Fixed assets	4,284	4,322	3,881	4,210	4,400
Investments	190	673	4,774	7,700	18,805
Cash and short term deposits	57,127	80,366	51,512	127,928	120,090
Other current assets	123,827	96,320	166,014	180,438	43,248
<b>Total assets</b>	<b>185,427</b>	<b>181,681</b>	<b>226,180</b>	<b>320,276</b>	<b>186,543</b>

## Key Ratios

### Solvency / Liquidity

Shareholders funds / NPI	%	60.6	58.2	65.4	53.5	57.7
Financial base	%	80.0	72.6	87.4	74.0	77.4
Claims cash coverage	months	24.3	19.9	16.2	25.0	16.7
IBNR / EPI	%	2.5	4.2	5.1	5.7	6.6
Net outstanding claims / NPI	%	26.0	30.8	40.8	21.0	13.1
Insurance funds / NPI	%	19.4	14.4	22.1	20.5	19.8

### Profitability

ROaE (before foreign exchange gains / losses)	%	42.8	37.3	(2.0)	11.1	40.6
ROaE	%	43.3	10.9	6.9	7.4	38.8
Investment yield (including unrealised gains / losses)	%	8.7	(21.3)	8.5	(2.2)	(0.4)
Cash investment yield (average)	%	8.3	1.3	0.1	0.4	0.6

### Efficiency / Growth

GPI Growth	%	18.2	9.9	23.7	30.7	7.2
Premiums reinsured / GPI	%	46.2	43.1	56.1	56.0	53.8
Earned loss ratio	%	34.2	45.5	40.1	46.5	58.4
Commissions / Earned premiums	%	6.5	2.1	7.1	9.9	9.0
Management expenses / Earned premiums	%	41.4	32.5	52.8	36.8	29.8
Underwriting result / Earned premiums	%	17.8	19.9	(0.0)	6.8	2.7
Trade ratio	%	82.2	80.1	100.0	93.2	97.3

### Operating

Effective tax rate	%	0.0	0.0	258.7	24.0	31.0
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\* Admin fee income reflected in "other income/(expenses)"