GCR affirms Uganda Reinsurance Company Limited's national scale financial strength rating of $A_{(UG)}$; maintains Positive Outlook

Rating action

Johannesburg, 25 June 2020 – GCR Ratings ("GCR") has affirmed Uganda Reinsurance Company Limited's ("Uganda Re") national scale financial strength rating of $A_{(UG)}$ and maintained the Positive Outlook.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook/Watch
Uganda Reinsurance Company Limited	Financial strength	National	$A_{(UG)}$	Positive Outlook

Rating rationale

Uganda Re's national scale financial strength rating has been maintained on Positive Outlook, reflecting an anticipated advancement in the capital base over the rating horizon, with slower internal capital generation and base case scenario COVID-19 pandemic stresses unlikely to detract from the trend. The Outlook accounts for conservative views on liquidity and earnings to cater for relatively higher uncertainty in the operating environment, while the business profile is expected to remain limited relative to regional peers.

The reinsurer has maintained steady capital base progression over the review period, while safeguarding solid capital adequacy through balancing strategy driven underwriting risk pressures with significantly lower market risk, alongside somewhat contained credit risk, exposures. In this respect, the reinsurer's capital base improved significantly to USD9.4m at FY19 (22% annual growth rate over the review period) and is expected to be sustained above USD10m over the outlook horizon, potentially resolving rating concerns over a limited capital base. The GCR capital adequacy ratio ("CAR") is expected to measure above 2x (FY19: 2.9x; FY18: 3.2x), catering for the envisaged strong uptake of insurance risk over the medium term. In this respect, the capitalisation assessment is expected to improve over the rating horizon, strengthening the overall credit profile.

Earnings capacity is expected to persist within an intermediate range, albeit under pressure, reflecting underwriting profit dilution from less profitable growth. Underwriting margin compression is largely expected from premium advancement in the medical line, which exhibits high loss volatility, offsetting a largely competitive loss ratio from the rest of the portfolio. While management has put in place measures to restructure loss making accounts, in collaboration with the major cedants, underwriting margins are expected to revert to the0-4% range (FY18: 16%) registered during start-up phases. Furthermore, investment income is expected to moderate, corresponding to a lower return on revenue range of 10-14% (prior 5-year average: 16%) over the medium term, factoring in a moderation in interest rates due to the COVID-19 pandemic and a possible continuation of dovish interest rate policies in line with the electoral cycle.

Liquidity stabilised within a moderately strong range supported by a combination of high growth and enhanced premium collection efforts. In this respect, cash generation from operations improved to a sizeable UGX10.4bn in FY19, compared to an operating cash outflow of UGX2.6bn in the prior year, while the reserving ratio moderated materially. As such, the liquidity ratio equated to 2.1x at FY19 (FY18: 2x) and could trend within a medium term range of 1.5x to 1.8x under a conservative view of cash generation and reserving. The rating factors in this forward looking view, with the downside limited by regulatory support of premium collection efforts.

Notwithstanding robust growth and strong market share of domestic industry cessions (supported by 15% legal cessions and strong growth in voluntary business), Uganda Re’s business profile remained limited relative to regional peers, constrained by comparatively low gross premium scale, tentative participation in external markets (2% of gross premiums) and a concentrated product mix. The reinsurer’s share of domestic cessions increased to 16% (FY18: 11%), with robust growth being registered in the medical line. In this regard, the line measured at material levels, together with the traditionally high exposure to fire, while potential diversifiers among ancillary lines lacked sufficient scale. The business profile is expected to be maintained within the same range over the medium term due to the reinsurance market’s limited size and increased competition in regional markets, albeit with significant premium development initiatives in oil and gas, as well as agriculture, underpinning the domestic market’s potential over the longer term.

Outlook statement

The Positive Outlook reflects expectations of stronger risk adjusted capitalisation underpinned by a material improvement in capital scale to above USD10m over the rating horizon. On the other hand, GCR has factored in likely stress in liquidity and earnings metrics over the next 12 to 24 months, due to uncertainty from the COVID-19 pandemic impact. The business profile largely reflects limitations from the size of the primary market and cautious reinsurance in external markets, which is expected to limit gross premium growth and market diversification over the medium term.

Rating triggers

The rating is likely to be upgraded if risk adjusted capitalisation, including capital scale, measures in line with expectations, while realising base case scenario impacts on earnings and liquidity. Conversely, downward rating action may follow a material reduction in the financial profile.

Analytical contacts

Primary analyst	Godfrey Chingono	Deputy Sector Head: Insurance
Johannesburg, ZA	GodfreyC@GCRratings.com	+27 11 784 1771
Committee chair	Matthew Pirnie	Group Head of Ratings
Johannesburg, ZA	MatthewP@GCRratings.com	+27 11 784 1771

Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Insurance Companies, May 2019
GCR Ratings Scales, Symbols & Definitions, May 2019
GCR Country Risk Scores, May 2020
GCR Insurance Sector Risk Scores, June 2020

Ratings history

Uganda Reinsurance Company Limited

Rating class	Review	Rating scale	Rating class	Outlook/Watch	Date
Claims paying ability	Initial	National	$A-_{(UG)}$	Stable Outlook	September 2018
Financial strength	Last	National	$A_{(UG)}$	Positive Outlook	October 2019

Risk score summary

Rating Components and Factors	Risk score
Operating environment	**7.00**
Country risk score	3.25
Sector risk score	3.75
Business profile	**(1.00)**
Competitive position	0.00

Premium diversification	(1.00)
Management and governance	0.00
Financial profile	**1.75**
Earnings	(0.25)
Capitalisation	1.50
Liquidity	0.50
Comparative profile	**0.00**
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	**7.75**

Glossary

Premium	The price of insurance protection for a specified risk for a specified period of time.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Rating Horizon	The rating outlook period
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Reinsurance	The practice whereby one party, called the Reinsurer, in consideration of a premium paid to him agrees to indemnify another party, called the Reinsured, for part or all of the liability assumed by the latter party under a policy or policies of insurance, which it has issued. The reinsured may be referred to as the Original or Primary Insurer, or Direct Writing Company, or the Ceding Company.
Retention	The net amount of risk the ceding company keeps for its own account.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Securities	Various instruments used in the capital market to raise funds.

Security	One of various instruments used in the capital market to raise funds.
Senior	A security that has a higher repayment priority than junior securities.
Short Term	Current; ordinarily less than one year.
Underwriting	The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.
Upgrade	The rating has been raised on its specific scale.

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the rating is based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such rating is an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit rating has been disclosed to the rated party. The rating was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating. The rated entity participated in the rating process via face-to-face management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The information received from the entities and other reliable third parties to accord the credit rating included:

- Audited financial results as at 31 December 2019;
- Four years of comparative audited financial statements to 31 December
- Full year budgeted financial statements for 2020;
- Unaudited interim results to 31 March 2020;
- Reinsurance cover notes for 2020; and
- Other relevant documents.