OPERATING AND FINANCIAL REVIEW

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"Good spread within our portfolio continues to be one of our top priorities in managing risk and returns in a highly challenging market place."

Yassir Albaharna

Chief Executive Officer

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REINSURANCE

In 2013, the convergence of reinsurance with capital markets became a global reality. Institutional investors flocked to the catastrophe bond and Insurance Linked Security (ILS) markets, as they became increasingly attracted by the excellent returns on catastrophe linked derivatives. The combined capital available through these channels was estimated to have reached US$ 45 billion at the end of the third quarter last year[1] , which represents a noteworthy 9% of the invested funds supporting the reinsurance industry. Together with a general decline in insurance demand, this resulted in a reduction in catastrophe rates. Price pressure is expected to persist, as catastrophe bond coupons remain attractive relative to other credit spreads, even as the difference in pricing between alternative and traditional catastrophe markets may erode.

The struggle for top line growth has not been exclusive to natural catastrophe reinsurers. Even in emerging markets, Arig's premier operating territories, our clients have come under pressure as sluggish economies, low investment returns and competitive pricing forced some companies to revisit their business plans. We have seen limited operational response from regional insurers thus far - markets that tend to rely on proportional cessions. In fact, there is little surprise as companies in developing markets continue to view generous reinsurance commissions as an indispensable part of their underwriting income.

Only two volume segments seem to challenge that comfortable equation. Next to Motor, Medical insurance is quickly becoming a mainstay as additional compulsory schemes are being launched by governments aiming to push medical expenses into the private sector. In the Middle East, Qatar and Dubai have recently announced the impending introduction of mandatory Medical insurance. However, in the absence of viable market statistics, pricing Medical policies has proven to be a Black Box for many. Volume portfolios can quickly turn toxic, and even compromise capital, when future cost is underestimated. As a consequence, the Saudi Arabian regulatory authority has introduced stringent pricing and reserving rules, which are sending waves through a stressed market.

2013 has generally turned out to be a benign loss year for most. The few major natural catastrophe events - tornadoes and floods in North America, or hail storms in Europe and Australia - did not radiate beyond these markets. Rather than through catastrophes, it was the practice of coinsurance or inward facultative acceptances that made some underwriters grief: in China and Korea, the S.K. Hynix account produced a noticeable loss of US$ 900 million to the industry that turned a great number of reinsurance programs negative. In Saudi Arabia, a number of mid-size risk losses were amplified throughout the market's net retentions. Yet, on average, most reinsurers were able to capitalize on underwriting results that were better than expected along with reserve releases from prior years, which further boosted bottom lines.

Struggling for premium and armed with good results, even retro markets turned soft at the end of the year, often presenting a chance to 'buy more [protection] for less'. This was welcome relief for reinsurers whose margins are being squeezed.

BUSINESS REVIEW

Portfolio development

With a reduction in Gross Written Premiums by 5%, Arig's revenue streams largely replicated last year's. There have been two major shifts within the underlying portfolio during the reporting period:

1. Subsequent to an amendment in the International Financial Reporting Standards, Arig needed to consolidate the Participants' Fund of its subsidiary Takaful Re into the parent's annual accounts. In 2013, Takaful Re's share in the Group's revenue represented 8%, or US$ 21.5 million, out of the Group's total gross written premium income.

   Takaful Re is a company with a separate balance sheet and corporate profile. We are working to create viable future options for the Group, to capitalize on its independent Re-Takaful operator.

2. Arig's business partner at Lloyd's, Hardy Underwriting Ltd., was bought over by the CNA Financial Group, USA, and subsequently terminated its quota share cessions to Arig. For 2013, the need arose to replace US$ 59 million of premium, while making Arig less dependent on a single partner.

We are pleased to report that Arig managed to acquire a new Lloyd's portfolio that created over US$ 60 million in new premiums from four individual syndicates with significant future growth potential. Our new partners were selected by underwriting criteria that went well beyond the reputed Lloyd's franchise benefits. It was essential that their books should complement our own portfolio, rather than cumulating risks; and that they would fit in with our corporate risk appetite. For example: even though our premium written from Property classes has subsequently increased, growth was created from Direct & Facultative lines and mostly non-catastrophe areas that previously had not been part of Arig's accounts. All major risk exposures were thoroughly tested with our modeling tools before decisions were taken. We are reasonably comfortable that the quality of our portfolio would have further improved with the new structure.

In 2013, 23% of the Group's total gross written premiums were written through Lloyd's.

1 Aon Benfield: Reinsurance Market Outlook, January 2014

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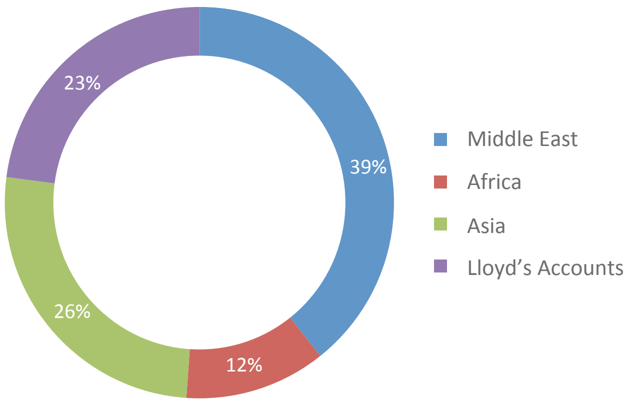
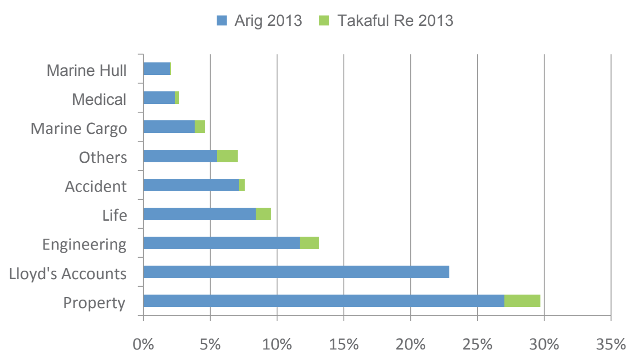
Territorial split by premium income



Regional premium distribution remained broadly the same; however there was a further reduction in the share coming from the Middle East by 6%, and that of Africa by 1%, which is mostly a reflection of the ongoing price competition in these markets. On the other hand, our income from Asia, including Turkey, and Lloyd's accounts grew by 5% and 2% respectively.

Individual line contributions to Group's premium income

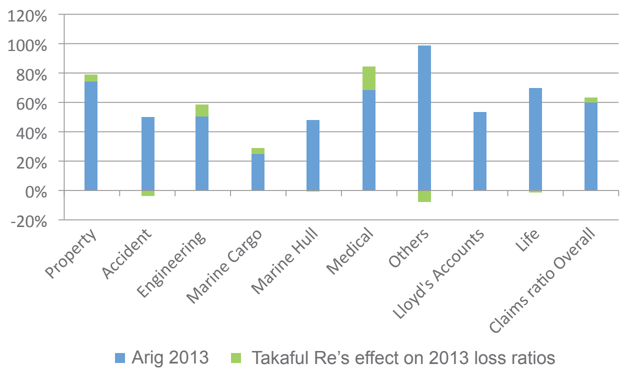


Despite the expansion in our largest line, Property, diversification throughout the Group's portfolio has increased as the growing Lloyd's book is composed of a diverse range of business lines and subclasses with very low or no correlation to Arig's own accounts. Good spread within our portfolio continues to be one of our top priorities in managing risk and returns in a highly challenging market place. In addition, Arig is determined to maintain a high degree of flexibility in its business, which would allow us to respond if market fortunes should change. In 2009, for example, our Medical book represented a sizeable share of 18% of total premiums. But when key markets chose to embark on a price war and we foresaw a downturn in future performance, Arig decided to reduce its exposure. Today, Medical reinsurance represents just 2.6% of the Group's premium income - and has remained profitable against the prevailing industry trend. We are now starting to see future opportunities again as our clients are returning to risk commensurate pricing levels or non-proportional forms of coverage, where we are able to support them with the assistance of our actuarial pricing tools.

Performance

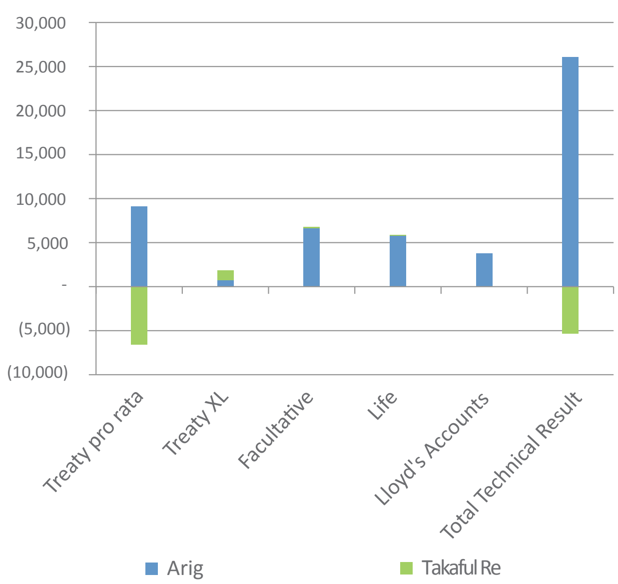
In 2013, after consolidation of Takaful Re's Participants' Fund under Arig's accounts, the Group's overall loss ratio slid by 2.9% to 63.1% against the previous year (2012: 60.2%). Arig alone showed limited movement as its loss ratio marginally rose from 59.4% in 2012 to 59.9% for the reporting period. The following graphic displays the effect of Takaful Re's book on the Group's loss ratios by lines of business.

Effect of Re-Takaful consolidation on loss ratios



While there has been a general increase in the loss load, the overall effect remained small due to the limited size of our subsidiary's portfolio. Overall technical results were largely influenced by Takaful Re's higher loss ratios in Property and Medical (Medical and short-term Life contracts are mostly written net of commissions, therefore target loss ratios tend to be higher than for other classes). Regional pro rata treaty business displayed mixed fortunes, in view of the ongoing battle between conventional insurers and Takaful operators over market shares. Profitability of treaties was mostly driven by volume rather than margin returns, whereas our facultative accounts and Life contracts contributed over-proportionally to the bottom line of our Group.

Technical Result by source (in US$ million)



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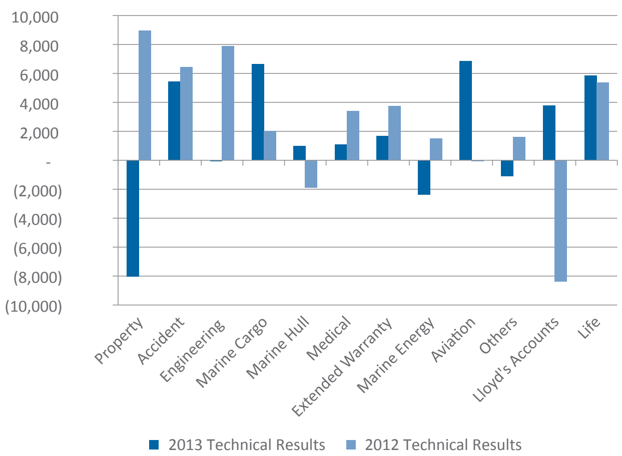
Including the consolidated Participants' results of Takaful Re, the Group managed to produce a solid underwriting result even though the tuning of the conventional and Re-Takaful books will need to continue. Property and Takaful Re's Medical line results, in particular, remain challenging. In emerging markets, Property treaties are commonly placed as part of a pro rata treaty bouquet. For Arig, the technical loss originating from the Property treaties was turned into an overall profit by the results from the associated other proportional treaty lines; for Takaful Re this was not the case. We are rather pleased with our Lloyd's business, which generated healthy turn-around performance after its restructuring and despite the conservative first-year reserve loadings commonly applied by the syndicates (please note below that the profit shown for the aviation line is due to a change in allocation in our run-off portfolio).

Group Technical Result by line (in US$ million)



Following a shift to predominantly short-term Life portfolio, profits have increased further over and above the high level achieved in 2012. This comes on the heels of an earlier investment made into our actuarial resources and subsequent in-depth analysis, which we can now place at the disposal of our regional clients.

Risk Capital position

The Economic Capital position for the Group was recalculated[2] for the 2014 business year. As before, our independent external actuaries provided us an estimate for the amount of capital needed to cater for risk events throughout the Group's operations at a 1:200 level, or with a 0.5% probability. Our Economic Capital requirement compares very favorably against the Group's shareholders equity, which stood at US$ 249.2 million at the end of 2013, demonstrating that Arig is offering substantial financial security to its customers in a stressed model scenario.

The consolidation of Takaful Re under Arig's risk pool has added a manageable amount to the required risk capital for the Group. The increase was moderated by the fact that Takaful Re does not share accounts in Arig's peak risk territories where natural catastrophes tend to drive capital requirements. Correlation is therefore limited and mostly expected to occur within the Medical portfolios and selected regional Property markets.

Arig's book, which represents 92% of the Group's, has seen limited changes over the position one year ago. Following a thorough review by our independent external actuaries, reserve risk has seen a notable reduction (partly helped by an increase in the number of modeled classes, among other factors) while market risk increased moderately. All movements combined resulted in a marginal decrease in the parent's Economic Capital position.

Key drivers for the Group's risk capital are underwriting risk, and to a lesser extent reserve risk, followed by market risk and operational risks.

As it was endorsed through our actuarial analyses, we are comfortable that the diversity and the quality of the Group's portfolio provide solid protection to Arig's reinsured clients and shareholders' capital alike. The Group is conscious of the fact that resources remain limited and that we need to use them efficiently, prudently and profitably.

Outlook

Following a disastrous 2011 business year, the global reinsurance industry was spoilt by the benign loss experience in 2012 and 2013, which has attracted additional capital into the markets. It appears to be general consensus that by and large, underwriters will struggle to grow, or even maintain their top lines beyond the current levels as most markets soften and prices remain under pressure. In several areas, risk rates have fallen below technical levels and it may be only a matter of time until results become tainted by increasing loss ratios. This is not unusual at all, and reinsurers have had ample opportunities to adjust to the regular cycles in our markets. In fact, it is fair to say that the swings in the industry's capital performance have actually reduced over the years - despite the ever increasing insured values and less predictable global weather patterns. This all is a sign of the growing use of modern risk management tools in minimizing risk exposure to corporate capital.

The same may not necessarily apply to the way some companies handle investments, especially when under pressure by shareholders' potentially unrealistic return expectations. The old correlation between risk and return still applies today even, as the memories of the 2008 Financial Crisis are starting to fade. A significant correction in global interest rates, major adjustment in the equity markets or a collapse of real estate bubbles in key locations could trigger losses that can wreak havoc on a risky investment portfolio. Just like in insurance, financial markets move in cycles but different to reinsurance, the financial impact of their swings appears to have grown in recent years.

The Arig Group has set itself prudent targets for the current business year. Bottom line profitability and protection of our shareholders' capital continue to enjoy top priority. As measures responding to the soft side of the market cycle, we will be reasonably 'technical' in our underwriting and conscious of the terms under which we accept business. Top line growth, although important over time, will not be our first order even though we will continue to target niche segments for viable opportunities. While willing

2 The Group's capital model was built and is run regularly with the support of independent actuaries and the model complies with actuarial best practices (e.g. FRC's TAS D, TAS R, TAS M etc.).

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to invest into our future, the Group continues to look for ways to reduce its internal and external expenses, without compromising its professional standards. Bringing the performance of our Re-Takaful portfolio in line with the remainder of the Group is a top target, even if it means that we need to stem the tide of the Takaful market trends. If it requires a smaller pool of contributions to be profitable, we are ready to accept it.

INVESTMENTS

2013 was a decisive year for the advanced economies. Accommodative monetary policies pursued by the Federal Reserve, the European Central Bank and other central banks resulted in better than expected economic performance. Encouragingly, countries at the heart of the Euro crisis also showed signs of improvement. Growth in emerging economies on the other hand, which accounted for the bulk of global growth in recent years, registered a slowing trend. Inflation in these economies was well in excess of expectations. The International Monetary Fund reckons that the global economy grew by 2.9% in 2013 (3.2% in 2012).

There was a broad based rally in global equities, reflecting the optimistic outlook and easy availability of credit. US equity indices scaled all-time highs. Japanese and European stock markets were buoyant. GCC equity markets also participated in this global rally, with the Dubai market as a stand-out. Government bond yields rose reflecting the better conditions. Yields on the bench mark U.S. 10-Year Treasury note climbed in excess of 125 basis points to close above 3%. European government bond yields displayed a similar trend. Demand for commodities, however, was muted as growth slowed in emerging markets.

In line with the risk tolerance of the Group, our investment strategy remained unaltered. The increase in global equity markets notwithstanding, we continued to be defensive in our allocation. Most of the investment portfolio was deployed in less risky assets. At the year-end, the Group's investments stood at US $ 642.2 million (2012: US $ 667.6 million) with 88% allocated to cash, deposits and bonds. Income generated in 2013 was US $ 20.4 million (US $ 21.6 million in 2012).

Looking ahead, issues remain. The global economy and financial markets need to adjust as the quantitative easing program of the Federal Reserve draws to a close. Careful implementation and clear communication on the part of the agency is important. The fragmented financial system in the Euro zone and continuing high levels of public debt in the Organization for Economic Co-operation and Development economies remain as issues that could trigger new crises. Fresh bouts of volatility in asset prices continue to be a possibility, especially as rising interest rates could trigger global shifts in asset allocation. For now, the prevailing low rates of interest continue to challenge predominantly short duration investors like Arig.

We will continue to manage a diversified low-risk portfolio within the Company's affirmed investment risk appetite, carefully balancing market opportunities against our standing obligation to policyholders and shareholders. We are still at a low point in the investment cycle, especially in terms of interest rates. Preservation and safety of capital at this stage is paramount to our ability of exploiting opportunities later.

SUBSIDIARIES

Takaful Re Limited (TRL)

The Group's Takaful reinsurance subsidiary reported a net loss of US$ 8.1 million (2012: net loss of US$ 2.0 million) for the year, mostly the result of major claims and adverse claim developments during the year. Arig's share in the loss was US$ 4.4 million (2012: loss of US$ 1.1 million). Gross underwriting contributions reduced by 43% to US$ 21.5 million (2012: US$ 37.9 million) as Takaful Re discontinued writing facultative business and reduced its exposure to under-performing accounts primarily in the Medical line, where contributions reduced to US$ 0.7 million (2012: US$ 11.2 million). Property was the largest class with contributions of US$ 7 million (2012: US$ 9.8 million), representing 33% of total income. Other important classes were Engineering and Auto, representing 17% (2012: 15%) and 17% (2012: 8%) of total contributions respectively. With a new management team on board, the company has engaged in re-underwriting its portfolio and every effort is being made to improve its underwriting performance.

Takaful Re's investments yielded an average return of 1.8% with investment earnings of US$ 2.1 million (2012: US$ 2.3 million). About 66% of the US$ 118.2 million (2012: US$ 116.6 million) of invested assets were held in cash and short-term Islamic deposits while the company maintained a conservative investment strategy with a high degree of liquidity.

Gulf Warranties W.L.L. (GW)

Gulf Warranties was reorganized during the year and showed significantly improved performance with net losses reducing to a nominal US$ 0.2 million (2012: net loss US$ 2.8 million). Motor warranty revenues grew by 50% to US$ 1.5 million (2012: US$ 1.0 million) as vehicle sales picked up while non-warranty income increased marginally to US$ 0.5 million (2012: US$ 0.4 million) for the year.

Arima Insurance Software W.L.L. (ARIMA)

ARIMA offers a scalable suite of software solutions for insurers and reinsurers (including Takaful operators), covering General, Life, Medical insurance as well as Bancassurance and Reinsurance. ARIMA reported revenues of US$ 2.4 million (2012: US$ 2.6 million) and a net profit of US$ 27 thousand (2012: US$ 0.4 million). During the year, Arig negotiated potential sale of 51% of its equity stake in ARIMA.

Arig Capital Limited (ACL)

ACL is a registered and fully owned corporate member at Lloyd's of London, which allows Arig to share in business written by Lloyd's syndicates. In 2013, ACL wrote business through four syndicates and generated a gross written premium of US$ 47.1 million (2012: US$ 48.1 million) to Arig. ACL retains limited risk for its net account and cedes most of its business to Arig. In the absence of any major claims, ACL recorded a small profit of US$ 0.2 million for the year (2012: net loss US$ 0.4 million).