OPERATING AND FINANCIAL REVIEW

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Acting Chief Executive Officer

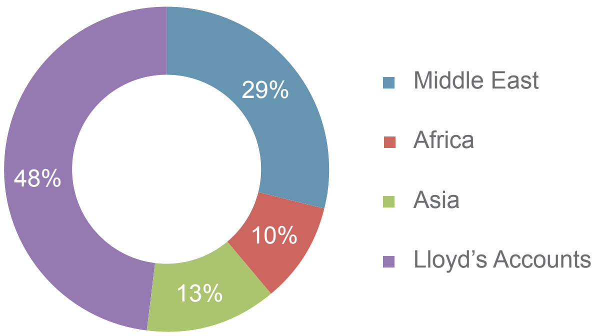
BUSINESS REVIEW

Portfolio Development

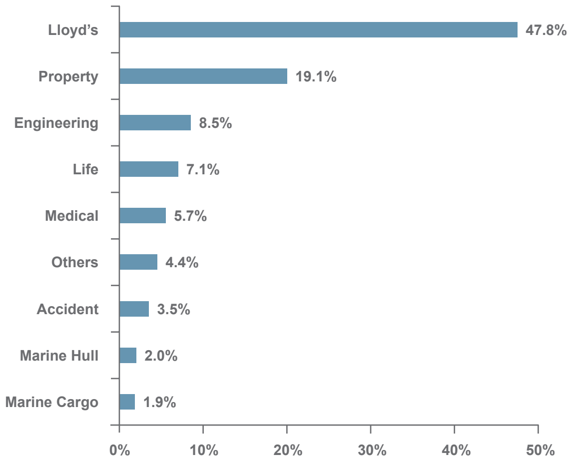
The Company's gross premiums written in 2018 reached US$ 262.8 million (2017: US$ 225.6 million) representing an increase of 16.5%. The growth was mainly due to participation at Lloyd's. In line with the Group's strategy, the non-Lloyd's facultative portfolio increased in 2018 by 9.0% from US$ 32.4 million to US$ 35.3 million. However, the rating downgrade in September 2018 limited its development. The non-Lloyd's treaty book remained stagnant mainly due to the impact of weakening of the Turkish Lira against the US dollar.

Overall, the property business accounted for 42.4% of the total non-life non-Lloyd's book of business followed by engineering and medical respectively with 18.8% and 12.6%. The Life portfolio meanwhile, experienced a 12.3% drop in 2018 reducing to US$ 18.6 million from US$ 21.2 million.

Territorial split of Gross Written premium income



Individual line contributions to Group's Gross Written premium income



Performance

The overall technical result for the Group was negative at US$ 19.4 million (2017: profit US$ 5.5 million). Our Lloyd's book reported a loss of US$ 28.3 million (2017: loss of US$ 19.6 million) mainly due to significant losses for underwriting years 2016, 2017 and 2018. The major impact was attributable to natural catastrophe losses in the US. The Company has reviewed its Lloyd's portfolio during 2019 renewal and reduced its exposure to this market.

The Non-Lloyd's book also contributed to the loss mainly driven by our facultative business which generated a technical loss of US$ 11.2 million (2017: profit of US$ 21.2 million).

Property business reported a technical loss of US$ 10.9 million mainly on account of major fire losses in the GCC.

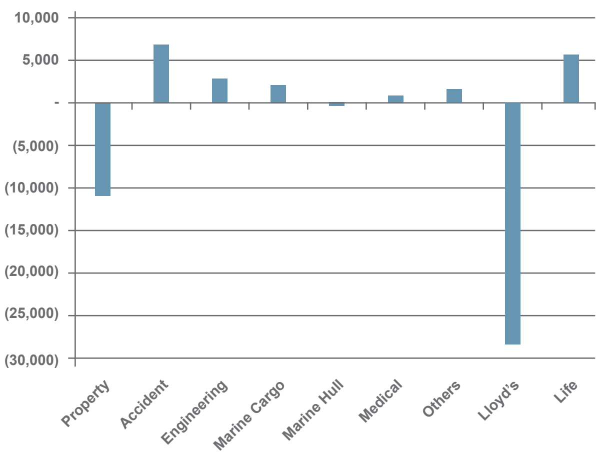
The Overall non-life treaties excluding Lloyd's business produced a profit of US$ 14.5 million for the year (2017: US$ 2.8 million) with Accident and Engineering lines contributing a technical profit of US$ 7.0 million and US$ 3.0 million respectively.

The life business performed well, compared to the previous year, contributing technical profit of US$ 5.7 million (2017: US$ 1.1 million).

Run-off of our subsidiary Takaful Re's portfolio which ceased operations in 2015 was in line with our exit strategy and contributed US$ 3.6 million to the Group's results (2017: US$ 1.2 million).

Group Technical Result by source (in US$ 000)

Group Technical Result by line (in US$ 000)



Risk Capital Position

As has been the Company's practice, we commissioned independent external actuaries to provide an updated estimate of the amount of capital required to cater for risk events throughout the Group's operations at a 1:200 probability, or 99.5th percentile. Arig's Economic Capital shows redundancy against the Company's shareholders equity at this confidence level.

This demonstrates that the Group is offering substantial financial security to its clients, even in a stressed model scenario. Arig's reinsurance book has seen limited changes over the position one year ago. Key drivers for the Group's risk capital are underwriting risk and reserve risk, followed by market risk, operational risk and credit risk. During 2018, market risk and reserve risk decreased moderately, while underwriting risk and credit risk increased slightly. The combined movements resulted in a moderate decrease in the Group's Economic Capital requirement.

As endorsed by actuarial analysis, we remain highly confident that the diversity and the quality of the Group's portfolio provides solid protection to Arig's reinsured clients and shareholders' capital alike.

Outlook

The Group has reevaluated its participation in the Lloyd's syndicates and introduced corrective measures to limit our exposure going forward. In view of the challenges posed in developing new markets following the rating downgrade last September, the Company will enhance efforts in its core markets leveraging on its strong relationship base, years of experience and technical knowhow. The Company is also reviewing its underwriting approach with greater emphasis on returns being commensurate with the risks, given that premium rates below technical levels. Return on investment and protection of Shareholder's funds remains the utmost priority along with continuing efforts to balance costs and operational efficiencies.

INVESTMENT

The year 2018 was a challenging year in the financial markets. An ongoing trade dispute between the USA and China, concerns on the extent of interest rate tightening in the US and geopolitical issues in various parts of the world, affected sentiment. Global equities corrected substantially in the fourth quarter of the year. There was a flight to safety out of riskier assets and into US Treasuries. A measure of market volatility, the VIX Index, which was range bound in 2016 and 2017, spiked substantially.

The Federal Reserve continued its policy of monetary tightening. The benchmark Fed Funds Target rate was increased four times in the year. Consequently, short term interest rates rose in the USA. Three-month US$ LIBOR closed at a multi-year high.

The monetary policies of other Central Banks continued to diverge with US monetary policy. The ECB kept key interest rates unchanged. The Bank of England raised its Official Bank Rate once while the Bank of Japan maintained its Short-term Rate target at minus 0.1%. The interest rate differential between the major currencies buoyed the US Dollar. The DXY Index gained 4.4%.

The actions of the Central banks influenced yield levels on government bonds. The benchmark ten-year US Treasury Note closed up twenty-seven basis points in yield at 2.68%. European government bonds with a tenor of seven years or less recorded negative yields. The Bank of Japan maintained a target yield of 0% for ten year Japanese Government Bonds.

A stronger dollar impacted emerging markets. There was an outflow both out of emerging market stocks and bonds. The JP Morgan Emerging Markets Bond Index lost 4.61%. Crude Oil (Brent) had a roller coaster year. After strengthening 23.7% in the first nine months of 2018, the commodity closed downward by 19.5% for the year. Gold the traditional haven, underperformed. In summary, it was a negative year for most asset classes. We continue to be conservative in our allocation. In line with the risk tolerance of the Group, our investment strategy remained unaltered. In this extreme year, our strategy enabled us to minimize losses. The Group's investments stood at US$ 613.9 million (2017: US$ 665.1 million) with 86% allocated to cash, short-term securities, and bonds. The Group generated an income of US$ 10 million in 2018. (2017: US$ 22.5 million).

At the time of this report, equity markets have recovered from the sell-off of the fourth quarter. The dollar has weakened slightly, and riskier assets such as emerging markets are attracting sizeable inflows. The level of returns on investment grade, short duration fixed income securities continues to be low by historical standards. This phenomenon continues to challenge fixed income investors like Arig.

We will continue to manage a diversified low-risk portfolio within the Company's avowed investment risk appetite, carefully balancing market opportunities against our standing obligation to policyholders and shareholders. We are probably at an inflection point in the global economic cycle. Risks are significant to the downside. We will continue to be cautious and will focus on safety and preservation of capital.

SUBSIDIARIES

Takaful Re Limited (TRL)

The Group's Islamic reinsurance subsidiary, TRL, which was placed in run-off in April 2016 reported a net profit of US$ 6.7 million (2017: US$ 2.3 million) for the year. Arig's share in the profit was US$ 3.6 million (2017: US$ 1.2 million).

TRL's investments yielded an average return of 1.4% (2017: 1.5%) with investment earnings of US$ 0.9 million (2017: US$ 1.3 million). The Company investments assets were almost entirely held in cash and short-term Islamic deposits.

Gulf Warranties (GW)

Gulf Warranties, the Group's subsidiary involved in administration of extended warranty insurance, contributed a loss of US$ 23.7 million to the Group's results for the year (2017: loss US$ 0.1 million) as a result of fraud committed by employees of the subsidiary. Based on management's assessments, the entire probable loss estimates of US$ 21.5 million have been provided for in the books of the subsidiary and consequently in the consolidated financial statements of the Group. This does not constitute admission of any liability beyond the share capital of Gulf Warranties W.L.L. On 15 November 2018, the Board of Directors of the Company decided not to write any further business and recommended the liquidation of the Company.

Arig Capital Limited (ACL)

ACL is a registered and fully owned corporate member at Lloyd's of London that allows Arig to share in business written by Lloyd's syndicates. In the year 2018 ACL wrote business through four syndicates namely 1969, 1200, 1910 and 2014 as well as two SPA's 6118 and 6133, generating gross written premiums of US$ 125.5 million (2017: US$ 88.6 million). ACL retains limited risk for its net account and cedes most of its business to the parent company. ACL recorded a loss of US$ 1.3 million for the year (2017: net loss US$ 2.7 million) mainly impacted by losses attributable to prior underwriting years 2016 and 2017.

Arig Insurance Management (DIFC) Limited

The Group's Insurance Management subsidiary, Arig Insurance Management (DIFC), incorporated in Dubai International Financial Center has been placed under voluntary liquidation.