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Santam Ltd.

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Anchor	bbb

Business Risk	Satisfactory
Competitive position	Strong
IICRA	Moderately high
Financial Risk	**Fair**
Capital and earnings	Fair
Risk exposure	Moderately low
Funding structure	Neutral

+

Modifiers	0
Governance	Neutral
Liquidity	Adequate
Comparable ratings analysis	0

=

SACP	bb+

+

Support	0
Group support	0
Government support	0

=

BB+/Negative/--

Financial strength rating

IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

Credit Highlights

Overview

Strengths	Risks
A market leading position and prominent brand in South Africa's property/casualty (P/C) insurance industry, and robust operating performance relative to peers'.	Heightened economic risk in South Africa, which affects Santam's revenue and earnings, given still-high domestic concentration, in common with local peers.
Diversified underwriting risk exposure and rising international diversification.	Strained capital, reflecting tightly managed capital adequacy and the nature of risks underwritten.
A stronger stand-alone credit assessment relative to the ratings, before the consideration of sovereign risk, due to a profitable position and the company's strong risk control framework that limits the underwriting, and particularly investment, risk exposure to outsized losses.	Economic conditions in South Africa, which have led to weaker asset quality on Santam's balance sheet, in common with local peers.

Santam continues to display a dominant competitive position in the domestic market. We consider South African insurer Santam to have strong business franchise value within the local market, where it has a leading position in many business lines. It is increasingly a leader in markets outside its South African stronghold, in the rest of Sub-Saharan Africa. We believe that Santam has strong risk management practices that support robust operating performance on an absolute and peer basis. Santam has a strong risk control framework that limits underwriting, and particularly investment, risk exposure to outsized losses. This supports our higher anchor choice of 'bbb', influenced by the strong risk framework and innovation.

Santam's liquidity and sufficient capital buffers allow it to pass our stress test under a hypothetical foreign currency sovereign default. We cap our ratings on Santam, as we do for local peers, at the level of the local currency ratings on South Africa (foreign currency BB/Negative/B; local currency BB+/Negative/B). This is because Santam's asset and liability concentration in the domestic economy makes it susceptible to the financial and macroeconomic stresses associated with a local currency sovereign default, in our view.

We regard Santam as strategically important to its parent, Sanlam Ltd. At the same time, we consider it insulated from the parent due to an independent board of directors and sizable minority shareholders.

Outlook: Negative

The negative outlook on Santam mirrors the negative outlook on the sovereign. Over the next 12 months, the most likely trigger for a further rating action, positive or negative, would be a similar action on the sovereign.

Downside scenario

We could also lower the rating if Santam were to fail our sovereign stress test and we see signs that it is not executing its risk-mitigation plan, or if the insurer's capital and earnings were to weaken below the current levels.

Upside scenario

We would raise the outlook to stable on Santam only if we took a similar action on the local currency sovereign rating on South Africa.

Key Assumptions

- South African real GDP growth will be 0.6% in 2019, then 1.9% in 2022.
- Inflation will remain within 4%-5% through 2022.
- Unemployment, which stood at 27.1% at end-2018, will increase modestly over the forecast period to 28.1%.

Table 1

Economic Forecast Summary--South Africa

	2015	2016	2017	2018	2019f	2020f	2021f	2022f
Key Indicators (%)								
GDP (real, YOY)	1.2	0.4	1.4	0.8	0.6	1.6	1.9	1.9
CPI (Avg, YOY)	4.5	6.3	5.3	4.7	4.3	4.9	4.7	4.7
CPI (Q4 Avg, YOY	4.9	6.6	4.7	4.9	4.3	4.7	4.7	4.7
Unemployment	25.4	26.7	27.5	27.1	28.4	28.5	28.4	28.2

f--Forecast. YOY--Year on year. CPI--Consumer price index. Source: S&P Global Economics, S&P Global Ratings, Oxford Economics.

Table 2

Key Metrics

(Mil. ZAR)	2017	2018	2019*	2019f	2020f
Gross premiums earned	29,720	33,109	17,018	>35000	>35000
Profit before tax	2,296	3,519	1,576	>2000	>2000
Net income	1,544	2,551	1,047	>1500	>2000
Total equity	7,924	9,365	9,648	>9,750	>9,750

Table 2

Key Metrics (cont.)					
(Mil. ZAR)	**2017**	**2018**	**2019***	**2019f**	**2020f**
Total assets	39,259	45,098	45,640	>47,000	>47,000
S&P Global Ratings capital adequacy	-	-	Fair	Fair	Fair
EBITDA fixed charge coverage (x)	7.1	14.5	N.M.	>8	>8
Financial leverage (%)	24.6	23.2	N.M.	>20	>20

ZAR--South African rand. f--Forecast data reflects S&P Global Ratings' base-case assumption. N.A.--Not applicable. *At end-June 2019.

Business Risk Profile: Satisfactory

Santam commands a leading position in South Africa's P/C insurance market. It reported gross premiums earned of South African rand (ZAR) 31 billion (about $2 billion) and ZAR45 billion of assets at year-end 2018. The group commands a market share exceeding 25%, writing a wide range of personal and commercial P/C business lines. Santam also has increased its diversification outside South Africa, which remains a supporting factor for its business position.

In addition to the main South African P/C sector, Santam group also owns a number of African insurance operations within the Southern African Development Community (SADC) region. The group also manages and provides technical expertise to several operations across sub-Saharan Africa under the Sanlam Emerging Markets Joint Venture with parent company Sanlam.

A significant proportion of Santam's business is still exposed to South Africa. However, the group's high diversification of business lines and long-established market position help insulate it from the competitive forces and exposure risks on particular lines. Nevertheless, given South Africa's economic challenges, we anticipate premium growth of between 5% and 8% in each of the next two years.

The high diversification of Santam's domestic P/C insurance franchise supports its profits. After elevated catastrophe losses in first-half 2019, we anticipate improvement in the underlying business lines and ultimately at the group level. We expect Santam will post a combined (loss and expense) ratio of below 95%, supported by its diversified portfolio. We anticipate that annual operating profits will be at least ZAR1.5 billion in 2019.

Financial Risk Profile: Fair

Santam's balance sheet resilience is supported by the group's capital funds, which are fully fungible through the group and could be used in the event of capital stress. We believe the insurer would be able to withstand the stress associated with a South African default on its foreign currency obligations, based on Santam's asset and regulatory capital base. We continue to rate Santam above the level of our foreign currency sovereign rating on South Africa. Our view is supported by Santam's execution of its credible and board-approved risk mitigation plan.

Santam's capital adequacy is constrained by its low asset quality. The average credit quality of Santam's asset portfolio is within the 'BB' range because the significant majority of its assets are exposed to domestic banks in money market funds and cash instruments, as well as local currency sovereign bonds. Santam also maintains exposure to unlisted equities. Although we note the capital buffer this provides within a weaker rand environment, given the nature of the unlisted equity exposure, we consider these assets to be higher risk.

In addition, we continue to view Santam's risk-based capital levels, as measured by our model, as a weakness to the overall rating. Capital sufficiency remains at the lower end of the 'BBB' level due to balance sheet expansion through acquisition and investment activity.

On a regulatory basis, on June 30, 2019, Santam reported a group economic capital coverage ratio of 160% (2018: 159%). Santam Ltd. has received approval from the Prudential Authority to use its partial internal model for determining regulatory capital. A condition attached to the approval is that Santam will, initially, be required to hold a capital add-on equal to 20% of the benefit obtained from using the partial internal model instead of the standard formula. Santam will be able to reduce the capital add-on over time by complying with the requirements of the Prudential Authority.

Santam therefore sits comfortably within its revised target range of 150% and 170%. Thus, we do not expect further significant capital repatriations within the next two years.

Other Key Credit Considerations

Governance

Overall, we consider governance to be neutral for the rating. This is due to the sizable minority interest and accompanying minority laws, as well as the strong board and independent governance.

Liquidity

We view Santam to have a diverse array of available liquidity sources and a highly liquid asset portfolio, which is well managed. This is balanced by the asset concentration on South African investments that are backing a significant portion of the technical liabilities.

Ratings above the sovereign

We continue to limit the ratings on Santam at the level of our local currency sovereign credit rating on South Africa. We believe the insurer remains susceptible to the incremental adverse effect that a default of the sovereign's local currency securities would have on its liquidity and investment position, given its asset concentration on local investment assets.

Factors specific to the subsidiaries

We assess Santam SI Investments Group (Santam SI) as a highly strategically important subgroup for Santam. This is due to Santam's senior management's strong support and involvement in operational and financial decision-making at Santam SI as it is integrated into the wider group. This is further reinforced by the role Santam SI plays within Santam's broader group strategy, its contribution toward the diversified revenue streams, and shared branding. The ratings on Santam SI's core operating subsidiaries, Santam Structured Insurance Ltd., Santam Structured Reinsurance Ltd. PCC, and Santam Structured Reinsurance dac, are equalized with our group credit profile on the sub-group. The rating on Santam SI is one notch below Santam's group credit profile of 'bb+'.

Accounting considerations

Santam's 2018 annual financial statements have been prepared in accordance with, and contain information required by, International Financial Reporting Standards.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Various Negative Rating Actions Taken On South Africa-Based Insurers Following The Negative Outlook On South Africa, Nov. 26, 2019
- Santam Ltd. 'BB+' Ratings Affirmed; Outlook Stable, Aug. 27, 2019
- Santam Ltd. 'BB+' Ratings Affirmed; Outlook Stable; Group Status On Santam SI Revised To Highly Strategically Important, April 26, 2019

Regulatory Disclosures

Regulatory disclosures applicable to the most recent credit rating action can be found at: Various Negative Rating Actions Taken On South Africa-Based Insurers Following The Negative Outlook On South Africa, Nov. 26, 2019.

Glossary

- Anchor: The starting point for rating an insurer, based on S&P Global Ratings' assessments of the business and financial risk profiles.
- Business risk profile (BRP: Assesses the risk inherent in the insurer's operations and therefore the potential sustainable return to be derived from those operations.
- Capital and earnings: Measure of an insurer's ability to absorb losses.

- Combined ratio: The ratio of the sum of loss expense, loss adjustment expense, and operating expenses divided by premiums earned. All elements are net of ceded reinsurance. We may use net premiums written (NPW) in the denominator where net premiums earned is not available or where expenses are not deferred in the accounting system the insurer uses (e.g., U.S. statutory accounting).
- Competitive position: An assessment based on an insurer's market or niche position, scale or efficiency of operations, brand name recognition or reputation, and strength of distribution.
- Date initial rating assigned: The date S&P Global Rating's assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Rating's last reviewed the credit rating on the entity.
- Earnings before interest (other than interest on nonrecourse or operational leverage) and taxes. We may apply analytical adjustments for items such as nonrecurring events; realized investment gains/losses; or impairments to goodwill.
- Earnings before interest (other than interest on nonrecourse or operational leverage), taxes, depreciation, and amortization. We may apply analytical adjustments for items such as nonrecurring events, realized investment gains/losses, impairments to goodwill, or other non-cash items. Where we believe depreciation and amortization is immaterial, we may use EBIT in the relevant ratios.
- Financial leverage. Financial obligations/(reported equity + financial obligations). We deduct from reported equity any off-balance-sheet pension deficit, net of tax, and any financial obligations included in reported equity, such as preferred stock. We typically include noncontrolling interests as part of reported equity. We may use net assets rather than reported equity, for example in the case of mutual insurers.
- Financial obligations/EBITDA. Determines the number of years of normalized earnings required to pay back debt and is another measure of the sustainability of the level of debt taken on by an insurer.
- Financial risk profile (FRP): The consequence of decisions that management makes in the context of its business risk profile and its risk tolerances.
- Financial strength rating (FSR): A forward-looking opinion about the financial security characteristics of an insurer with respect to its ability to pay under its insurance policies and contracts, in accordance with their terms.
- Fixed-charge coverage. EBITDA/fixed charges. Fixed-charge coverage represents an insurer's ability to service interest on financial obligations out of EBITDA. Fixed charges include total interest expense including interest expense reported as investment expense, lease expense, and preferred stock dividends (tax-adjusted), minus any interest expense on debt that we consider to be nonrecourse or operational leverage.
- High-risk assets: Volatile or illiquid assets.
- Insurance Industry And Country Risk Assessment (IICRA): Addresses the risks typically faced by insurers operating in specific industries and countries, and is generally determined at a country or regional level.
- Intangibles: The sum of goodwill, intangible assets, deferred acquisition costs (DAC), value of in-force, value of business acquired, and deferred tax assets.
- Issuer credit rating (ICR): A forward-looking opinion about an obligor's overall creditworthiness, focusing on its capacity and willingness to meet its financial obligations in full and as they come due.
- Prebonus pretax earnings are the sum of EBITDA and policyholder dividends.

- Return on assets (ROA): Indicates to us how efficiently management uses its assets to generate earnings by comparing EBIT to the two-year average of total assets adjusted. Total assets adjusted is total assets minus reinsurance assets.
- Return on revenue (ROR): EBIT divided by total revenue. Total revenue is the sum of net premiums earned (or net written premium if net earned premium is not available), net investment income, and other income. We remove the effects of realized and unrealized gains or losses from investments and derivatives to provide a more complete picture of an insurer's revenue-generating abilities.
- Risk exposure: Assesses material risks that the capital and earnings analysis does not incorporate and specific risks that it captures but that could make an insurer's capital and earnings significantly more or less volatile.
- Return on equity (ROE): Reported net income divided by the average of opening and closing reported equity for the year. Reported net income is before remuneration of preferred stock and non-controlling interests. Reported equity includes non-controlling interests and preferred stock.
- Stand-alone credit profile (SACP): S&P Global Ratings' opinion of an insurer's creditworthiness, in the absence of extraordinary intervention from its parent, affiliate, or related government.
- Total adjusted capital (TAC): S&P Global Ratings' measure of the capital an insurer has available to meet capital requirements.
- Total assets are the average of opening and closing total assets (less reinsurance assets) for the year.

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	**Fair**	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	**bbb/bbb-**	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of December 5, 2019)*

Operating Companies Covered By This Report	
Santam Ltd.	
Financial Strength Rating	
Local Currency	BB+/Negative/--
Issuer Credit Rating	
Local Currency	BB+/Negative/--
South Africa National Scale	zaAAA/--/--

Ratings Detail (As Of December 5, 2019)*(cont.)	
Subordinated	
South Africa National Scale	zaA+
Santam Structured Insurance Ltd.	
Financial Strength Rating	
Local Currency	BB/Negative/--
South Africa National Scale	zaAA/--/--
Issuer Credit Rating	
Local Currency	BB/Negative/--
Santam Structured Reinsurance DAC	
Financial Strength Rating	
Local Currency	BB/Negative/--
Issuer Credit Rating	
Local Currency	BB/Negative/--
Santam Structured Reinsurance Ltd. PCC	
Financial Strength Rating	
Local Currency	BB/Negative/--
Issuer Credit Rating	
Local Currency	BB/Negative/--
Domicile	South Africa

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.