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Santam Ltd.

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Santam Ltd.

Rationale

Operating Company Covered By This Report
Financial Strength Rating
Local Currency
BBB+/Stable/--

Business Risk Profile

- Strong competitive position, supported by a strong reputation, a dominant position in the South African market, and positive operating performance relative to peers.
- Intermediate country and industry risk, illustrating predominant South African business focus.
- Primarily brokered distribution.

Financial Risk Profile

- Lower adequate capital and earnings, reflecting tightly managed capital adequacy and strong earnings.
- Intermediate risk position due to highly leveraged but diversified investment portfolio.
- Strong and demonstrable financial flexibility combining access to a range of sources with favorable leverage and coverage ratios.

Other Factors

- Passes hypothetical foreign currency sovereign default stress test, owing to the execution of a credible risk-mitigation plan.
- Strong enterprise risk management, reflecting strong risk controls and positive strategic risk management.
- Insulation from its parent, Sanlam Ltd., due to an independent board of directors and sizable minority shareholders.

Outlook

The stable outlook on Santam mirrors that on the long-term local currency ratings on South Africa. This reflects our view that the ratings on Santam are constrained at the level of the long-term local currency rating on South Africa.

Downside scenario

We could lower the ratings on Santam if:

- Management actions increase Santam's exposure to sovereign risk. This could result from a weakening in capital, a greater weighting to longer-duration domestic fixed-income assets, or the company's failure to execute its investment policy amid rising sovereign risk.
- We consider that Santam's independence from its parent is compromised to such an extent that we no longer consider it an insulated subsidiary, according to our criteria.

Upside scenario

A positive rating action would most likely stem from a positive rating action on the sovereign.

Base-Case Scenario

Macroeconomic Assumptions

- Nominal GDP growth of 8%-9% in 2015-2017;
- Inflation at about 6% over the same period.
- A gradual depreciation of the South African rand (ZAR) against the U.S. dollar.

Company-Specific Assumptions

- Underwriting performance below 97% in 2015-2017, maintaining expense leadership relative to peers.
- Investment yield of at least 4% and operating profits of at least ZAR1.5 billion.

Key Metrics

Key Metrics

	--Year ended Dec. 31--				
(Mil. ZAR)	**2016f**	**2015f**	**2014**	**2013**	**2012**
Gross premiums written	>26400	>24,500	22,710	20,631	19,386
Net income	>1500	>1500	1,675	1,316	1,099
Return on shareholders' equity (reported) (%)	>18	>18	24.0	21.7	18.7
P/C net combined ratio (%)	<97%	<97%	91.9	97.4	96.5
Net investment yield (%)	>4%	>4%	4.6	4.7	6.1
S&P capital adequacy	Lower adequate	Lower adequate	Upper adequate	Lower adequate	Lower adequate

f--forecast. ZAR--South African rand. P/C--Property/casualty.

Company Description

The South African National Trust and Assurance Company Ltd. (Santam) was established in Cape Town in 1918 and is 59.3% owned by the South African Life Assurance Company Ltd. (Sanlam). The company has been listed on the Johannesburg Stock Exchange since 1964 and has a black ownership structure of 31%, making it a level 3 Broad-Based Black Economic Empowerment (B-BBEE) contributor. As of April 15, 2015, the company had a market capitalization of South African rand (ZAR) 26.5 billion ($2.2 billion).

The company writes a wide range of personal and commercial non-life business lines and is the South African market leader, with a market share of around 22%. It has held this position since 1999 following the merger with Guardian National Insurance Co. Ltd. In 2014, Santam's gross premiums written (GPW) amounted to ZAR22.7 billion ($1.84 billion), which was split roughly equally between personal and commercial business. Distribution is primarily through brokers, which accounts for 92% of premium. The primary lines of business are motor and property. In addition, the group is the technical and minority equity partner to its parent in international expansion in Africa, India, Southeast Asia, and China. This adds limited risk and diversity to Santam's profile.

Insurance industry and country risk: Intermediate

Overall, we consider that Santam faces intermediate industry and country risk, reflecting the sector dynamics in its core business in South Africa. We assess country risk as moderate, reflecting our view of South Africa as a middle income country with a diverse economy but wide income disparities. The economy continues to face fundamental supply shortages such as infrastructure bottlenecks, ongoing labor relations issues, and skills shortages, which constrain potential growth and consequently limit growth in insurable risk. Industry risk is intermediate, with good industry profitability and gradually increasing barriers to entry as a result of a new regulatory regime.

Competitive position: Strong

Santam has a strong competitive position, in our view, mainly stemming from its favorable brand and reputation, dominant position in the South African market, and an operating performance that we consider to be better than peers'. The company offers non-life insurance, primarily in South Africa, which is sold principally via intermediaries.

Santam holds a dominant position in the South African market where it has a market share of around 22%. It has been the market leader for over 13 years and we believe Santam can draw on its positive brand differentiation relative to peers to help shape the markets in which it operates. We note that few of Santam's subsidiaries share the same branding, although in the tightly-knit local market, we deem it highly likely that clients are fully aware of Santam's involvement in the subsidiary brands.

In the current soft market, Santam has sought to utilize its sophisticated risk management to achieve targeted rate increases. This, together with tight expense management, has helped the company develop an operating performance competitive advantage over its peers.

Santam's business is largely intermediated, although we note that the company has developed a longstanding and symbiotic relationship with its key brokers and has a well-established infrastructure to manage this channel. Santam also secures business through its network of underwriting managing agents and holds a controlling equity stake in many of the agencies. In doing so, it is able to exert appropriate control and oversight. Santam's principal direct offering is through MiWay Insurance Ltd., a 100% owned subsidiary that is branded separately to avoid conflict with its key brokers. For simple, commoditized business, the direct channel is a rapidly growing part of the South African market. We note that MiWay is a late entrant to this space and is not the market leader.

In our base-case scenario, we expect prospective top-line growth to be in line with nominal GDP growth. We expect this to be around 8%-9% per year over 2015-2017.

Table 1

Santam Ltd. Competitive Position					
	--Fiscal year end Dec. 31--				
(Mil. ZAR)	**2014**	**2013**	**2012**	**2011**	**2010**
Gross premiums written	22,710	20,631	19,386	17,707	15,855
Change in gross premiums written (%)	10.08	6.42	9.48	11.68	5.52
Net premiums written	17,635	16,900	15,822	14,674	13,519
Change in net premiums written (%)	4.35	6.81	7.82	8.54	4.85
Net premiums earned	17,222	16,751	15,626	14,652	13,550
P/C: reinsurance utilization--premiums written (%)	22.35	18.08	18.38	17.13	14.73

ZAR--South African rand.

Financial Risk Profile

We regard Santam's financial risk profile as upper adequate, as our criteria defines the term. This reflects lower adequate capital and earnings, an intermediate risk position, and strong financial flexibility.

Capital and earnings: Lower adequate

In our opinion, Santam has lower adequate capital and earnings, which we anticipate will continue in our base-case scenario. Our assessment balances strong earnings with correspondingly high dividend payments, and we expect capital adequacy to remain in the 'BBB' range according to our risk-based capital model. In evaluating capital adequacy, we give credit for Santam's ability to adjust premiums on a monthly basis. Although capital adequacy is a weakness for the overall rating and below that of similarly rated peers in equivalent markets, we note that Santam has the earnings capacity to substantially build capital through retentions.

There was a marked improvement in Santam's underwriting results in 2014 compared to 2013, with the loss ratio falling to 63% from 69%. This reflects a combination of targeted rate increases and a lower incidence of large claims and weather-related incidents. Santam's claims management also incorporates measures to offset the impact of a deteriorating exchange rate.

For 2015-2017, we forecast limited economic growth, relative currency weakness, and a potential easing of inflation as a result of lower oil prices. Consequently, we expect that a continued focus on efficiencies, supported by a gradual fall in the cost of efficiency and IT projects, will lead to a long-term expense ratio of around 27%.

Over the next two years, we assume a combined (loss and expense) ratio of 97% or less, resulting in operating profits of at least ZAR1.5 billion per year. This translates into a net income of at least ZAR1 billion, and compares to an average operating profit of ZAR2 billion and net income of ZAR1.4 billion over the past three years.

Table 2

Santam Ltd. Capitalization Statistics					
	--Fiscal year end Dec. 31--				
	2014	**2013**	**2012**	**2011**	**2010**
Common shareholders' equity	7,440	6,532	5,617	6,141	5,219
Change in common shareholders' equity (%)	13.90	16.29	(8.53)	17.67	11.71
Total reported capital	8,463	7,553	6,675	7,129	6,168
Change in total capital (reported) (%)	12	13	(6)	16	11

Table 3

Santam Ltd. Earnings Statistics					
	--Fiscal year end Dec. 31--				
	2014	**2013**	**2012**	**2011**	**2010**
Total revenue	18,016	17,510	16,554	15,323	14,272
EBIT adjusted	2,071	1,194	1,358	1,864	1,791
EBITDA adjusted	2,201	1,308	1,474	1,932	1,834
Net income (attributable to all shareholders)	1,675	1,316	1,099	1,513	1,717
Return on revenue (%)	11.50	6.82	8.21	12.17	12.55
Return on shareholders' equity (reported) (%)	23.98	21.66	18.69	26.64	34.72
P/C: net expense ratio (%)	28.71	28.13	28.18	28.29	27.57
P/C: net loss ratio (%)	63.16	69.29	68.34	64.18	64.08
P/C: net combined ratio (%)	91.88	97.42	96.53	92.47	91.65

P/C--Property/casualty.

Table 4

South Africa--Selected Indicators					
	2016e	**2015e**	**2014e**	**2013**	**2012**
Real GDP growth (%)	2.9	2.5	1.4	2.2	2.2

Table 4

South Africa--Selected Indicators (cont.)					
CPI (%)	5.5	5.4	6.1	5.1	5.6

CPI--Consumer price index. f--Forecast. e--Estimate. The data and ratios above result from S&P's own calculations, drawing on national as well as international sources, reflecting S&P's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Risk position: Intermediate

In our view, Santam's risk position reflects intermediate risks. We view Santam's investment leverage as high, as 26% of the group's investment portfolio is invested in equities. The average asset quality of Santam's portfolio is 'BBB', reflecting the company's exposure to South African assets, in particular, highly systemically important domestic banks. We expect this to be maintained prospectively.

In recent years, Santam, like the rest of the South African market, has been exposed to an increased incidence from weather events--such as hail, floods, and drought--which have drawn significant claims. For Santam, these events have not caused significant capital or earnings volatility, in part reflecting appropriate reinsurance cover.

Foreign currency account balances, which are predominantly in U.S. dollars, are closely matched to net liabilities and capital funds. Foreign currency mismatch in relation to Santam's exposure to the cost of imported motor parts is harder to quantify. However, in the past few years, Santam has made a significant effort to reduce the effect of this exposure by using certified rather than manufacturer parts and settling claims in cash rather than offering repairs. This is also reflected in the company's underwriting results.

Table 5

Santam Ltd. Risk Position					
	--Fiscal year end Dec. 31--				
	2014	**2013**	**2012**	**2011**	**2010**
Total invested assets	16,551.0	15,417.0	14,183.0	13,705.0	13,131.0
Net investment income	736.0	691.0	845.0	586.0	653.0
Net investment yield (%)	4.6	4.7	6.1	4.4	5.1
Net investment yield including realized capital gains/(losses) (%)	7.5	6.4	8.8	6.7	5.7
Portfolio composition (% of general account invested assets)					
Cash and short-term investments (%)	26.9	24.4	23.9	24.6	36.8
Bonds (%)	45.4	45.5	47.1	40.4	27.2
Equity investments (%)	25.5	28.0	27.2	33.0	34.4
Investments in affiliates (%)	2.1	2.1	1.8	2.0	1.6
Other investments (%)	0.0	0.0	0.0	0.0	0.0

Financial flexibility: Strong

Santam has strong and demonstrable financial flexibility, in our view, thanks to its proven access to capital and reinsurance markets and comparably favorable leverage and coverage ratios.

In 2014, Santam implemented a credit wrap facility with Allianz Risk Transfer AG, which increased reinsurance utilization to 22% from 18%. This facility has enabled Santam to protect its international reinsurance portfolio, which is managed by the Santam Re division.

The financial leverage ratio (debt plus hybrids to economic capital) was 12% as of year-end 2014. Fixed-charged coverage improved to 24x, reflecting the improvement in earnings. We assume that the company's financial leverage and fixed-charge coverage will remain in line with the three-year averages of 14% and 15x, respectively.

Table 6

Santam Ltd. Financial Flexibility					
	--Fiscal year end Dec. 31--				
	2014	**2013**	**2012**	**2011**	**2010**
EBITDA interest coverage (x)	23.7	11.1	11.4	13.4	10.6
EBITDA fixed-charge coverage (x)	23.7	11.1	11.4	13.4	10.6
Debt leverage including pension deficit as debt (%)	12.1	13.3	14.7	22.2	25.2
Financial leverage including pension deficit as debt (%)	12.1	13.3	14.7	22.2	25.2

Other Assessments

Enterprise risk management: Strong

We consider enterprise risk management (ERM) at Santam to be strong. ERM is of high importance to the rating, reflecting its role in how Santam is managed, high exposure to asset risk, a wide product range, and considerable exposure to catastrophe risks.

Our ERM assessment is driven by our view of Santam's strategic risk management, reflecting the role that risk return considerations plays in Santam's strategic decision-making. In particular, these considerations include managing business profitability, capital management, reinsurance program design, and strategic asset allocation. These processes are supported by Santam's extensive risk appetite framework, which includes capital, earnings, investment, insurance, strategic, liquidity, and operational risk metrics. Managing its risk profile within its risk appetite is a major objective and/or constraint for Santam in the planning process and when taking strategic decisions.

In our opinion, the key risks facing Santam are underwriting and investment risks. For all of these risks, the company has risk controls, which we asses as positive. We view Santam's risk culture as positive as the company has fully embedded it across the business, supported by an extensive risk appetite framework and effective risk governance following a three-lines-of-defense model.

Management and governance: Satisfactory

Santam's management and governance is satisfactory, in our opinion. This reflects the company's detailed approach to--and successful execution of--its strategy. This is supported by experienced senior and middle management teams and a comprehensive approach to financial management, although we note some risk tolerances are more aggressive than those of international peers.

Liquidity: Strong

We regard Santam's liquidity as strong, with policyholder liabilities backed by bonds and total liquid assets in excess of ZAR16 billion. We understand that the company has no refinancing concerns and has sufficient cash and appropriate cash-call facilities in its reinsurance arrangement to meet attritional losses and large unexpected claims.

Sovereign risk

Under a hypothetical foreign currency sovereign stress scenario, we believe that Santam would likely retain positive regulatory capital and a liquidity ratio in excess of 100% owing to the execution of a credible risk-mitigation plan. This indicates that the insurer is unlikely to default on its insurance liabilities under the scenario and therefore passes the sovereign foreign currency stress test. Santam does not pass the more severe local currency stress scenario and the ratings are therefore limited by the South African local currency sovereign ratings.

Support

Group support

We view Santam as insulated from its parent, Sanlam Ltd. This reflects Santam's financial independence from its majority owner, as well as the benefits that stem from the oversight of the South African regulatory framework, Santam's independent board of directors, and its sizable minority shareholders who maintain an active economic interest.

Accounting Considerations

Accounting practices do not raise any analytical issues. Santam prepares its accounts in accordance with International Financial Reporting Standards, as required by the Companies Act of South Africa. Its accounts comply with the listing requirements of the Johannesburg Stock Exchange. Santam engages PricewaterhouseCoopers as its auditors. We have not made any significant adjustments to the reported figures.

Ratings Score Snapshot

Table 7

Rating Score Snapshot	
Financial Strength Rating	BBB+/Stable
Indicative SACP	a
SACP	bbb+
Anchor	a-
Business Risk Profile	Strong
IICRA	Intermediate risk
Competitive Position	Strong
Financial Risk Profile	Upper adequate
Capital & Earnings	Lower adequate
Risk Position	Intermediate risk
Financial Flexibility	Strong
Modifiers	+1
ERM and Management	+1
Enterprise Risk Management	Strong
Management & Governance	Satisfactory
Holistic Analysis	0

Table 7

Rating Score Snapshot (cont.)	
Liquidity	Strong
Sovereign Risk	-2
Support	0
Group Support	0
Government Support	0

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

Related Criteria And Research

Related criteria

- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Standard & Poor's National And Regional Scale Mapping Tables, Sept. 30, 2014

Related Research

- South Africa Property/Casualty Insurance Sector Carries An Intermediate Industry And Country Risk Assessment, Nov. 13, 2014

Ratings Detail (As Of April 16, 2015)	
Operating Company Covered By This Report	
Santam Ltd.	
Financial Strength Rating	
Local Currency	BBB+/Stable/--
Counterparty Credit Rating	
Local Currency	BBB+/Stable/--
South Africa National Scale	zaAAA/--/--
Domicile	South Africa

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's 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.

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