

# RatingsDirect®

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## Santam Ltd.

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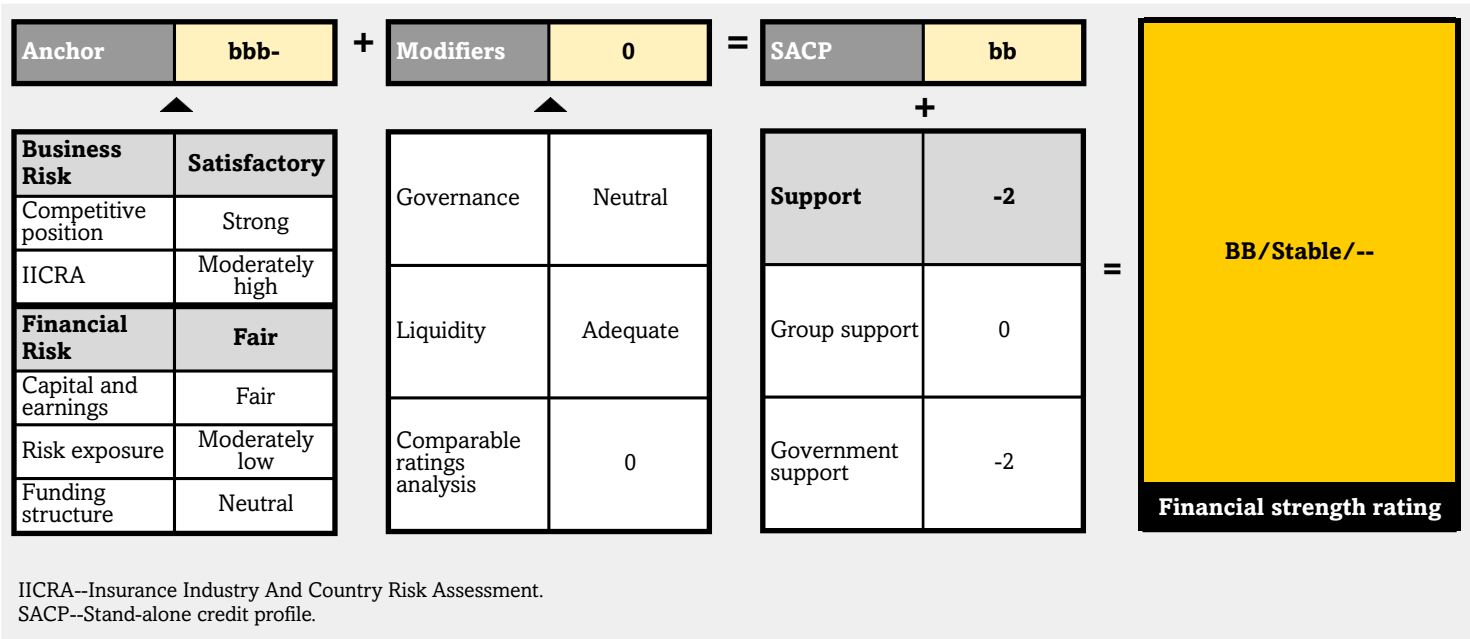
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# Santam Ltd.



## Credit Highlights

Overview	
Strengths	Risks
Leading position and prominent brand in South Africa's property/casualty (P/C) market, with robust operating performance.	Challenging economic conditions in South Africa that affects revenue, earnings, and asset quality, in common with local peers.
Diversified underwriting portfolio, with increasing international diversification.	Material exposure to business-interruption claims resulting from COVID-19.
	Strained capitalization, with risk-based capital at the bottom of the 'BBB' range.

**Santam continues to display a dominant competitive position in the domestic market.** S&P Global Ratings expects Santam to maintain its strong franchise value in South Africa, where it has a leading position in many business lines with a market share of close to 25% by premium income. Furthermore, Santam is increasing its presence in the rest of Sub-Saharan Africa and Morocco. We believe that Santam has strong risk-management practices that support its robust operating performance. Its strong risk-control framework limits underwriting and, in particular, investment risks, such that potential losses are within its risk appetite.

**Business interruption will hit 2020 earnings but we expect a recovery in 2021.** Following the Ma-Afrika judgement, Santam increased its provisions for business interruption (BI) claims during November 2020 by South African rand (ZAR) 1.7 billion (about \$117 million) in addition to the ZAR1.3 billion booked in June 2020. The total amount is equivalent to about 30% of Santam's shareholders' capital. We recognize that the potential conclusion of an appeal against the Ma-Afrika judgement, including other related court decisions on these and Santam's other policies, could materially increase or decrease Santam's actual exposure to BI claims. At this stage, our base-case scenario is that Santam will maintain its capital at the bottom end of the 'BBB' range under our capital model over 2020-2022. At the same time, we expect it to maintain its solvency ratio within its 150%-170% target over the same period. As of Oct. 31, 2020, the ratio was just above 150% including the above-mentioned ZAR3 billion BI claims. We expect Santam to take

necessary actions (dividend suspension, execution of hedging strategy, or additional reinsurance) to ensure its capital does not deteriorate materially from current levels. We forecast Santam is likely to report a combined (loss and expense) ratio close to 100% for year-end 2020, with net income close to ZAR200 million, taking into account performance to the end of October 2020. While COVID-19 claims are material, the group has benefitted from better performance of its motor portfolio due to less mileage on the road. For 2021, we expect the combined ratio to improve to pre-pandemic levels, likely close to 95%, with the return on equity (ROE) at 14%.

**Santam's liquidity and sufficient capital buffers allow it to pass our stress test under a hypothetical foreign currency sovereign default.** We limit our ratings on Santam, as we do for most local peers, to the level of the local currency ratings on South Africa (foreign currency BB-/stable/B; local currency BB/Stable/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.

## Outlook: Stable

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

### Downside scenario

We could lower the rating if:

- Santam failed our sovereign stress test and we saw signs that it is not executing its risk-mitigation plan; or
- Capital and earnings weaken below the current levels.

### Upside scenario

We could raise the ratings on Santam if we took a similar action on the local currency sovereign rating on South Africa.

## Key Assumptions

Table 1

South Africa Economic Forecast Summary					
	2021f	2020f	2019	2018	2017
Real GDP growth (%)	3.6	(7.3)	0.2	0.8	1.4
Inflation (annual average, %)	4.0	3.3	4.1	4.7	5.3
Unemployment rate (%)	30.9	30.0	28.7	27.1	27.5

Source: South Africa Long-Term Foreign And Local Currency Ratings Affirmed; Outlook Stable, Nov 21, 2020. f--S&P Global Ratings forecast.

**Table 2**

Key Metrics	--year ended Dec. 31--				
	2021f	2020f	2019	2018	2017
S&P Global Ratings capital adequacy	Fair	Fair	Fair	Fair	Lower Adequate*
Gross premiums written (mil. ZAR)	40,000	37,500	35,852	33,109	29,720
P/C: Net combined ratio (%)	95.0	~100.0	92.9	91.7	94.2
Net investment yield (%)	3.5	2.5	4.3	5.3	3.6
Net income (mil. ZAR)	~1,500	~200	2,321.0	2,529.0	1,807.0
Return on equity (%)	~14.0	~1	23.9	29.3	23.7
Financial leverage (%)	~23.0	~26.0	22.2	23.2	24.6
Fixed charge coverage(x)	~6.5	~1	10.7	11.8	9.0

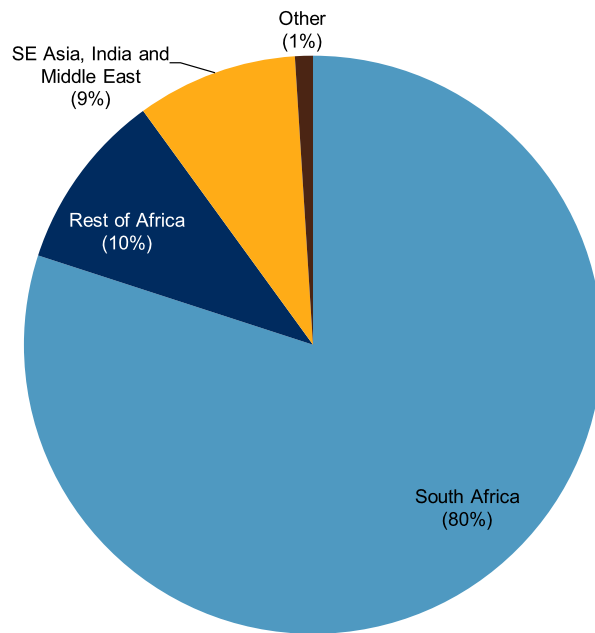
ZAR--South african rand. f--Forecast data reflects S&P Global Ratings' base-case assumption. \*The assessment reflects the rating scores under the previous insurance criteria framework.

## Business Risk Profile: Satisfactory

Santam maintains its strong position in South Africa's P/C insurance market, with a market share of around 25%. In addition to the main South African P/C sector, Santam has exposure to other regions (see chart 1). In particular, through its board representation at Sanlam Emerging Markets (SEM) and key subsidiaries, it provides strategic support and technical support when required by SEM. Since Santam writes the majority of its premium income in South Africa's P/C market, its revenue and earnings are affected by economic conditions, similar to local peers. However, the group's well-diversified product portfolio (see chart 2) and long-established market position help it navigate the challenging conditions in South Africa.

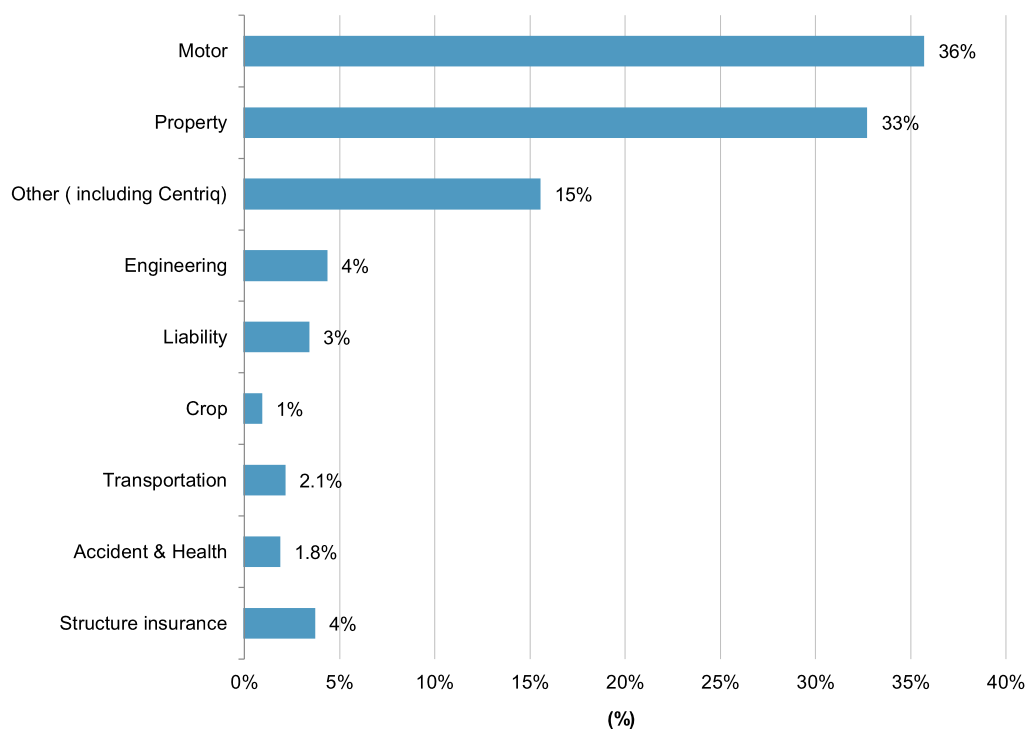
**Chart 1**

**Business Concentration In South Africa**



Source: Santam H1 2020 Presentation  
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**Chart 2**  
**Well Diversified By Product**



Source: Santam H1 2020 Presentation

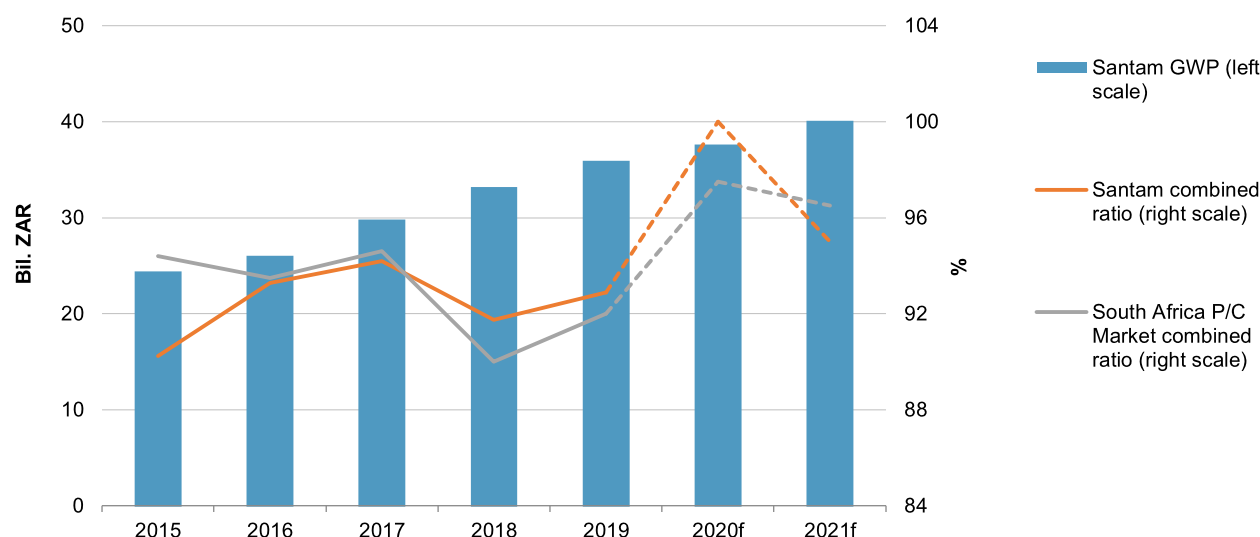
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Santam's operating performance in 2020 is likely to be hindered by BI claims, as will be the case for other insurers in South Africa. We expect Santam to report a premium growth rate of 5% for year-end 2020 taking into account 7% growth as of June 30, 2020, and the difficult economic conditions in South Africa. For 2021, we expect the growth rate to normalize at about 7% through pricing increases and better economic conditions relative to 2020.

Over the past five years (2015-2019), Santam's premium income increased at an average growth rate of 9.5%, reaching ZAR35.9 billion in 2019 with the average net combined ratio at around 92.5% (see chart 3). This is supported by Santam's business diversification within and outside South African markets and strong risk-management practices. In 2019, similar to other players in the market, Santam experienced catastrophe losses along with losses on crop insurance due to hail and frost damage, leading to weakening of the combined ratio. Overall, the company's underwriting performance is in line with the South African P/C market (see chart 3). However, its five-year average return on equity (ROE) is 25%, which is better than the South Africa P/C market average ROE of around 20%.

Chart 3

## Underwriting Performance In Line With South Africa P/C Market



f-- S&P Global Rating Forecast. ZAR--South african rand. Source: Audited financial statement, SARB Regulatory industry Data; S&P Global Ratings.

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## Financial Risk Profile: Fair

Santam's risk-based capital, measured using our capital model, is likely to remain at the lower end of 'BBB' level over 2020-2022, taking into account earnings projections and dividend expectation over this period. Santam's financial risk profile is constrained by its low asset quality ('BB' range). The majority of its assets in domestic banks are in money market funds and cash instruments, as well as local currency sovereign bonds (see chart 4).

From a regulatory perspective, Santam reported a group economic capital coverage ratio of just above 150% as on Oct. 31, 2020, down from 160% at year-end 2019), after taking a provision of ZAR3 billion in respect of BI claims. We expect Santam's solvency ratio to remain above 100%, taking into account the 18-month indemnity period by the court (as per Ma-Afrika case) instead of three months, and the potential refusal of reinsurers to cover Santam's BI claims albeit such a scenario is very remote, in our view.

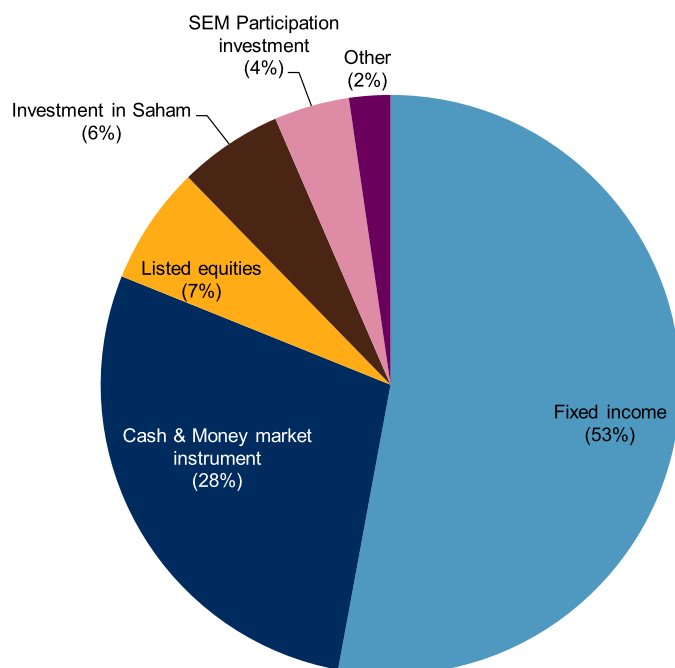
Overall, we expect the ratio to sit comfortably within its target range (150%-170%) during 2020-2022. We recognize that Santam's regulatory ratio is resilient to various stress scenarios based on its modelled exposures, notably market shock (equities declining by 45%, bonds 25%, and preference shares 25%) and failure of the largest reinsurance counterparty after a severe catastrophe event costing about ZAR9.8 billion. Following such shocks, we expect Santam's solvency ratio to remain above 120% and we would expect the group to take necessary actions to recover to levels within its aforementioned target. Such actions could include dividend suspension, execution of hedging strategy,

or higher reinsurance coverage.

Santam's investment portfolio is concentrated in South Africa, which is common to other local peers. It has exposure to unlisted equities, which we consider a high-risk asset, along with exposure to speculative-grade bonds and bank deposits. However, in our view, Santam's execution of its credible and board-approved risk mitigation plan help it keep capital and earnings volatility within the internally set target.

#### Chart 4

##### Low Asset Quality Reflecting Exposure To Domestic Market



Source: Santam H1 2020 Presentation.

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We view Santam's access to external fund as good, particularly because it is an active player in the domestic debt market. Including recently issued unsecured subordinate notes, we estimate Santam's average financial leverage at 20%-25% over 2020-2022. We expect fixed-charge coverage to drop close to 1x in 2020, mainly due to lower earnings resulting from COVID-19-related BI claims and reduced investment income. We forecast coverage will rise to 6x-7x over 2021-2022 since we expect earnings to improve over this period.

## Other Key Credit Considerations



## **Governance**

Santam benefits from an experienced team with a clear strategy focused on extending the group's leadership position in South Africa and building a pan-African position through SEM. Furthermore, the group's goal is to effectively manage the impact of COVID-19 and particularly the potential impact to its brand and reputation. Following pandemic-related losses, the group has adjusted the terms and conditions of its property book on renewals to exclude BI coverage caused by nonphysical damage. COVID-19-related losses may still affect 2021 results, particularly because some policies written before the pandemic will remain on risk into 2021.

From a risk-management perspective, Santam has a clear risk appetite framework including tolerances for investment and underwriting risks. In particular, the group runs various stress analyses to prepare itself for severe events including shocks to financial markets (such as, a 45% reduction in equity values or 25% drop in bond markets) and very large losses on the liability side, including failure of its largest reinsurance counterparty after a ZAR9.8 billion catastrophe event. While such shocks can reduce Santam's solvency ratio by up to about 30 percentage points, we expect the group will take necessary actions (including asset derisking, suspension of dividends, and a capital increase) to ensure it restores its capital ratio to the targeted 150%-170%.

## **Liquidity**

We view Santam as having a diverse array of available liquidity sources and a highly liquid asset portfolio, which is well managed. This is balanced by the concentration of investments in South Africa that back a significant portion of its technical liabilities. As of June 30, 2020, liquid assets (including fixed-income securities, equities, cash, and short-term investment) covered total net technical liabilities (after reinsurance) by more than 1.5x.

## **Ratings above the sovereign**

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 our foreign currency sovereign rating on South Africa. However, we 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 in local investment assets.

## **Factors specific to the subsidiaries**

Sanlam Ltd. holds the majority of stakes in Santam (around 59.2%) and we assess Santam as strategically important to it. At the same time, we consider it is insulated from the parent due to an independent board of directors and sizable minority shareholders. Furthermore, we assess Santam SI Investments Group (Santam SI) as a highly strategically important subgroup for Santam, and therefore our ratings on Santam SI are one notch below Santam's group credit profile. This is due to Santam's senior management's strong support and involvement in operational and financial decision-making at Santam SI, since 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. and Santam Structured Reinsurance Ltd. PCC, are equalized with our group credit profile on the subgroup.

## Accounting considerations

Santam's 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: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Insurance | Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

## Related Research

- South Africa Long-Term Foreign And Local Currency Ratings Affirmed; Outlook Stable, Nov. 21, 2020
- Santam's Proposed Unsecured Subordinated Notes Rated 'zaA+', Nov. 17, 2020
- Insurance Industry And Country Risk Assessment: South Africa Property/Casualty, Nov. 4, 2020

## Appendix

<b>Credit Metric History</b>		
	<b>--Year ended 31 December--</b>	
<b>(Mil. ZAR)</b>	<b>2019</b>	<b>2018</b>
S&P Global Ratings capital adequacy	Fair	Fair
Total invested assets	33,179.0	30,310.0
Total shareholder equity	10,063.0	9,365.0
Gross premium written	35,852.0	33,109.0
Net premium written	25,132.0	24,068.0
Net premium earned	24,226.0	22,812.0
Reinsurance utilization (%)	29.9	27.3
EBIT	3,843.0	3,850.0
Net income (attributable to all shareholders)	2,321.0	2,529.0
Return on revenue (%)	13.8	15.7

## Credit Metric History (cont.)

	--Year ended 31 December--	
(Mil. ZAR)	2019	2018
Return on shareholders' equity (%)	23.9	29.3
P/C: Net combined ratio (%)	92.9	91.7
P/C: Net expense ratio (%)	30.6	31.1
Net investment yield (%)	4.3	5.3
Net investment yield including investment gains/(losses) (%)	5.3	5.1
Financial leverage (%)	22.2	23.2
EBITDA fixed-charge coverage (x)	10.7	11.8
Financial obligations / EBITDA (x)	0.8	0.7

P/C--Property/Casualty; ZAR--South african rand.

## 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
<b>Satisfactory</b>	a	a/a-	a-/bbb+	bbb+/bbb	<b>bbb/bbb-</b>	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 11, 2020)\*

## Operating Company Covered By This Report

## Santam Ltd.

## Financial Strength Rating

Local Currency

BB/Stable/--

## Issuer Credit Rating

Local Currency

BB/Stable/--

South Africa National Scale

zaAAA/--/--

## Subordinated

South Africa National Scale

zaA+

## 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.

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