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Ratings

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Santam Ltd.

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Table Of Contents

Santam Ltd.

Rationale

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

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.
- Moderate 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 reflecting greater sector concentrations but a lower proportion of high risk assets.
- 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.
- Strategic importance to and 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:

- Capital efficiency plans result in weaker-than-expected capital adequacy.

Upside scenario

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

Base-Case Scenario

Macroeconomic Assumptions

- Real GDP growth of 1.6%-2.5% in 2016-2018.
- Inflation at about 6% over the same period.

Company-Specific Assumptions

- Underwriting performance below 96% in 2016-2018, maintaining expense leadership relative to peers.
- Investment yield of at least 4% and operating profits of at least South African rand (ZAR) 1.4 billion.

Key Metrics

Key Metrics

	--Year ended Dec. 31--				
(Mil. ZAR)	**2017***	**2016***	**2015**	**2014**	**2013**
Gross premiums written	>27,800.0	>26,000.0	24,319.0	22,710.0	20,631.0
Net income	>1,000.0	>1,000.0	2,724.0	1,675.0	1,316.0
Return on shareholders' equity (reported) (%)	>20.0	>20.0	34.0	24.0	21.7
P/C net combined ratio(%)	<96.0	<96.0	90.9	91.9	97.4
Net investment yield(%)	>4.0	>4.0	4.9	4.6	4.7
S&P capital adequacy/redundancy	Lower Adequate	Lower Adequate	Strong	Upper Adequate	Lower Adequate

*Forecast data reflects S&P Global Ratings' base-case assumptions. 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 61% owned by the South African Life Assurance Company Ltd. (Sanlam). The company has been listed on the Johannesburg Stock Exchange since 1964 and is a level 3 Broad-Based Black Economic Empowerment (B-BBEE) contributor. As of May 3, 2016, the company had a market capitalization of ZAR26.5 billion ($1.85 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 24%. It has held this position since 1999 following the merger with Guardian National Insurance Co. Ltd. In 2015, Santam's gross premiums written (GPW) amounted to ZAR24.3 billion ($1.57 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: Moderate

Overall, we consider that Santam faces moderate industry and country risk. This assessment reflects a political impasse and heightened economic risk in South Africa, which has resulted in a marked weakening in GDP growth prospects. For 2016-2018, we expect real GDP growth to range from 1.6%-2.5%. This combines weak external demand, low commodity prices, and domestic constraints, including an inadequate electricity supply and overall weak business confidence that inhibits private-sector investment. We expect that the weak economic environment will dampen demand from consumers and business for both new insurance products and renewals of existing coverage.

This, in turn, has weighed on our expectations for real premium growth, which we have revised to negative from neutral. At the same time, we expect the already-strong competition to intensify with a greater focus on price.

Santam also writes business elsewhere in Africa and select international countries, but we expect this to remain a small part of the overall business for some time.

Industry And Country Risk

Insurance sector	Risk	Business mix
South Africa P/C	Moderate Risk	90.0%
Other P/C	High Risk	10.0%

P/C--Property/casualty.

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 24%. It remains the market leader and we believe Santam can draw on its positive brand differentiation relative to peers to help shape the South African market. 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.

Santam has sought to utilize its sophisticated risk management, segmenting customers by riskiness to achieve targeted rate increases. It has also sought to tighten its grip on the market, most recently achieved through the selective acquisition of books of business from its competitors. This, together with tight expense management, has helped the company develop an operating performance which serves as a competitive advantage over its peers. We expect a systems upgrade project, which is expected to conclude in 2017, to improve expenses by one percentage point.

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 is also developing an agency business with its parent Sanlam, however, its 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 7.5%-8.0% per year over 2016-2018.

Table 1

Competitive Position					
	--Fiscal year end Dec. 31--'				
(Mil. ZAR)	**2015**	**2014**	**2013**	**2012**	**2011**
Gross premiums written	24,319.0	22,710.0	20,631.0	19,386.0	17,707.0
Change in gross premiums written (%)	7.1	10.1	6.4	9.5	11.7
Net premiums written	18,884.0	17,635.0	16,900.0	15,822.0	14,674.0
Change in net premiums written (%)	7.1	4.3	6.8	7.8	8.5
Net premiums earned	18,523.0	17,222.0	16,751.0	15,626.0	14,652.0
P/C: reinsurance utilization - premiums written (%)	22.3	22.3	18.1	18.4	17.1

P/C--Property/casualty.

Financial Risk Profile

We regard Santam's financial risk profile as upper adequate, reflecting the combination of lower adequate capital and earnings, an intermediate risk position, and strong financial flexibility.

Capital and earnings: Lower adequate

Our base-case scenario anticipates lower adequate capital and earnings.

At year-end 2015 better than average underwriting performance and investment returns, and a decision to retain capital within the business, resulted in a very strong level of capital adequacy. Santam has stated it is reviewing its capital management philosophy but we continue to expect capital and earnings in line with our current expectations and capital adequacy to remain in the 'BBB' range. The revised philosophy is influenced by the introduction of a risk-based regulatory regime and our expectation of the likely implementation of an approved internal capital model.

We view capital adequacy as a weakness for the overall rating and below that of similarly rated peers in equivalent markets, however, we note that Santam has the earnings capacity to substantially build capital through retentions.

For 2016-2018, we forecast flat real premium growth and continued underwriting outperformance relative to the market, although losses rise relative to 2015 and are expected to range between 65%-68%. Expenses are expected to remain stable at around 27%-28%, leading to a net combined ratio of 96% or better.

We expect stable investment income which combines dividend income from Santam's indirect holding in Saham Finances and interest income from cash holdings.

Over the next two years, we assume a combined (loss and expense) ratio of 96% or less, resulting in operating profits of at least ZAR1.4 billion per year. This translates into a net income of at least ZAR1.0 billion, and compares to an average operating profit of ZAR2.4 billion and net income of ZAR1.8 billion over the past three years.

Table 2

Capitalization Statistics

	--Fiscal year end Dec. 31--				
	2015	**2014**	**2013**	**2012**	**2011**
Common shareholders' equity	8,547.0	7,440.0	6,532.0	5,617.0	6,141.0
Change in common shareholders' equity (%)	14.9	13.9	16.3	(8.5)	17.7
Total reported capital	9,545.0	8,463.0	7,553.0	6,675.0	7,129.0
Change in total capital (reported) (%)	12.8	12.0	13.2	(6)	15.6

Table 3

Earnings Statistics

	--Fiscal year end Dec. 31--				
	2015	**2014**	**2013**	**2012**	**2011**
Total revenue	19,424.0	18,016.0	17,510.0	16,554.0	15,323.0
EBIT adjusted	3,151.0	2,071.0	1,194.0	1,358.3	1,864.3
EBITDA adjusted	3,268.0	2,201.0	1,308.0	1,474.3	1,932.3
Net income (attributable to all shareholders)	2,724.0	1,675.0	1,316.0	1,099.0	1,513.0
Return on revenue (%)	16.2	11.5	6.8	8.2	12.2
Return on shareholders' equity (reported) (%)	34.1	24.0	21.7	18.7	26.6
P/C: net expense ratio (%)	28.8	28.7	28.1	28.2	28.3
P/C: net loss ratio (%)	62.1	63.2	69.3	68.3	64.2
P/C: net combined ratio (%)	90.9	91.9	97.4	96.5	92.5

P/C--Property/casualty.

Table 4

South Africa--Selected Indicators					
	2017f	**2016f**	**2015e**	**2014**	**2013**
Real GDP growth (%)	2.1	1.6	1.4	1.5	2.2
CPI (%)	5.6	5.9	4.6	6.1	5.7

CPI--Consumer price index. f--Forecast. e--Estimate.

Risk position: Intermediate

We continue to view Santam's risk position as intermediate, although we note an improvement in investment leverage. At the same time, our revised view of government support toward South African banks has led to a downward revision of investment diversification.

We expect Santam's investment leverage--measured by exposure to high risk assets relative to total adjusted capital (TAC)--to rise from the levels seen at year-end 2015, but to be sustained well below the 100% threshold. The increase is attributed to the lower level of TAC following the completion of the acquisition of a stake in Saham which is held through Santam's 25% stake in Sanlam Emerging Markets. We give no credit to this holding in our assessment of TAC.

Our view of investment portfolio diversification has deteriorated due to our revised view of government support toward highly systemically important banks in South Africa. We now view government support as uncertain and therefore incorporate exposures to such institutions in our assessment of sector and obligor exposure.

We do not believe Santam is exposed to additional capital or earnings volatility beyond that already captured in our assessment. 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. Furthermore, exposure to foreign currency exposures--particularly as a result of the increasing cost of imported motor spares--has been closely managed through matching liabilities and assets, using certified parts and paying down claims.

Table 5

Risk Position					
	--Fiscal year end Dec. 31--				
	2015	**2014**	**2013**	**2012**	**2011**
Total invested assets	18,340.0	16,551.0	15,417.0	14,183.0	13,705.0
Net investment income	848.0	736.0	691.0	845.0	586.0
Net investment yield (%)	4.9	4.6	4.7	6.1	4.4
Net investment yield including realized capital gains/(losses) (%)	13.0	7.5	6.4	8.8	6.7
Portfolio composition (% of general account invested assets)					
Cash and short-term investments (%)	30.7	26.9	24.4	23.9	24.6
Bonds (%)	51.2	45.4	45.5	47.1	40.4
Equity investments (%)	16.8	25.5	28.0	27.2	33.0
Real estate (%)	0.0	0.0	N/A	0.0	0.0
Investments in affiliates (%)	1.4	2.1	2.1	1.8	2.0

N/A--Not applicable.

Financial flexibility

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.

Santam has a capital markets track record and issued ZAR1 billion unsecured subordinated notes in April 2016. Santam also continues to maintain a credit wrap facility with Allianz Risk Transfer AG which was first implemented in 2014.

In 2015, coverage and leverage levels improved, although we expect these to fall back, in part reflecting the increased level of debt within Santam's financial risk profile. Over the next three years, we expect financial leverage to be maintained below 20% and fixed charge coverage of at least 17x.

Table 6

Financial Flexibility					
	--Fiscal year-end Dec. 31--				
	2015	**2014**	**2013**	**2012**	**2011**
EBITDA interest coverage (x)	28.2	23.7	11.1	11.4	13.4
EBITDA fixed-charge coverage (x)	28.2	23.7	11.1	11.4	13.4
Debt leverage including pension deficit as debt (%)	10.8	12.1	13.4	14.7	22.2
Financial leverage including pension deficit as debt (%)	10.8	12.1	13.3	14.7	22.2

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 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 assess 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 ZAR18 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%. This is further supported by a credible risk-mitigation plan which we believe Santam will execute. 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 a strategically important subsidiary of the Sanlam group. This reflects our view of Santam's financial and operational independence from its majority owner, its role in group strategy, and contribution to group profits. We also view Santam as insulated from its parent due to 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.

We can assign up to three notches of support to such a subsidiary. We do not include any additional notches of support in the ratings on Santam as they are capped by the local currency sovereign rating.

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+/Negative
Indicative SACP	a-
SACP	bbb+

Table 7

Rating Score Snapshot (cont.)	
Anchor	bbb+
Business Risk Profile	Satisfactory
IICRA	Moderate 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
Liquidity	Strong
Sovereign Risk	-1
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

- Standard & Poor's National And Regional Scale Mapping Tables, Sept. 30, 2014
- 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

Related Research

- Various Rating Actions Taken On Insurers And Reinsurers With Exposure To South Africa Due To Diminished Growth Prospects, Dec. 9, 2015
- South Africa Property/Casualty Insurance Sector Carries An Intermediate Industry And Country Risk Assessment, Nov. 13, 2014

Ratings Detail (As Of May 3, 2016)	
Operating Company Covered By This Report	
Santam Ltd.	
Financial Strength Rating	
Local Currency	BBB+/Negative/--

Ratings Detail (As Of May 3, 2016) (cont.)	
Counterparty Credit Rating	
Local Currency	BBB+/Negative/--
South Africa National Scale	zaAAA/--/--
Subordinated	
South Africa National Scale	zaAA+
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.