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## Santam Ltd.

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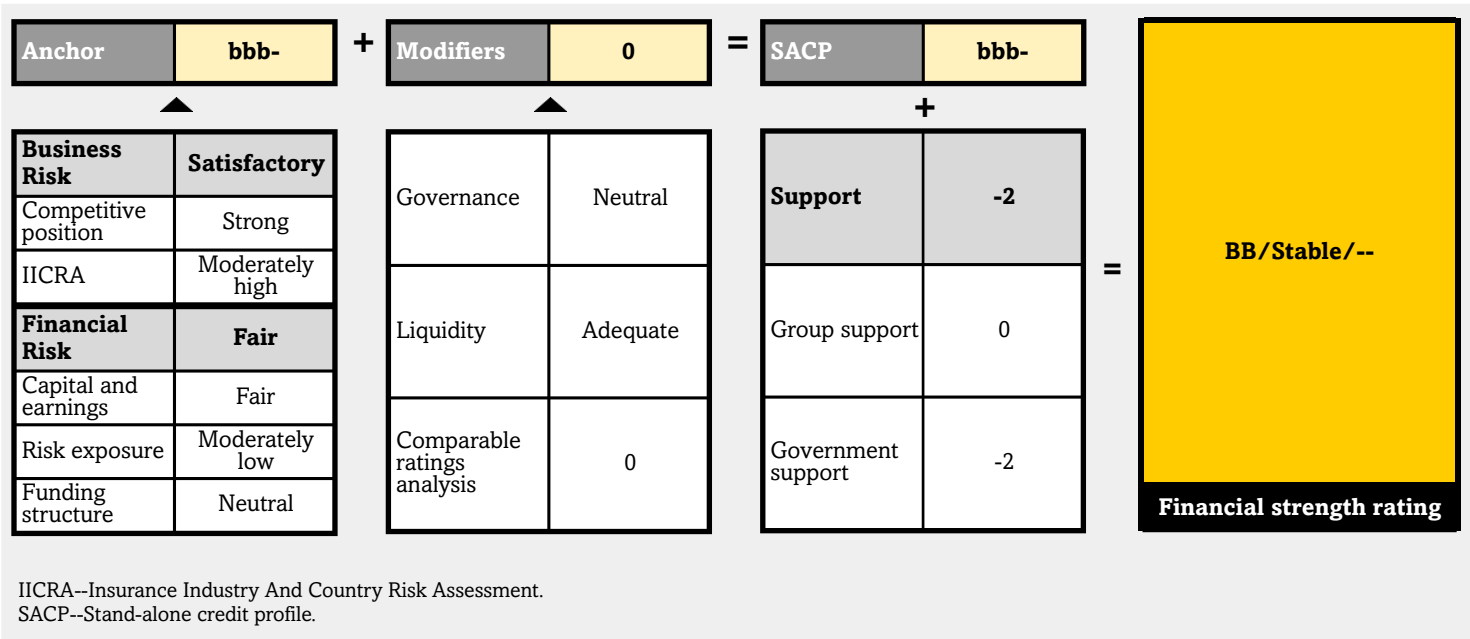
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# Santam Ltd.



## Credit Highlights

| Overview  |   |
|---|---|
| Key strengths   | Key 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 affect 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.** We expect 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 22% by premium income. Santam is increasing its presence in the rest of Sub-Saharan Africa and Morocco through Saham which was acquired by Santam's parent, Sanlam, in recent years. 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 is unlikely to place further pressure on earnings, bearing in mind the level of reserves already set aside.** Santam had made a provision of South African rand (ZAR)3 billion for the contingent business interruption (CBI) claims during 2020. Out of the ZAR3 billion, the company has settled ZAR1.7 billion claims--ZAR 1 billion in 2020 and ZAR700 million over January-August 2021. We don't expect material additions to reserves already set aside. 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 of around 97% for the year-end 2021, with net income close to ZAR1.4 billion, taking into account performance to the end of June 2021.

**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 |       |       |       |      |      |
|--|-------|-------|-------|------|------|
|  | 2022f | 2021f | 2020  | 2019 | 2018 |
| Real GDP growth (%)                    | 2.5   | 3.6   | (7.0) | 0.2  | 0.8  |
| Inflation (annual average, %)          | 4.4   | 4.2   | 3.3   | 4.1  | 4.7  |
| Unemployment rate (%)                  | 30.2  | 31.1  | 29.2  | 28.7 | 27.1 |

F--S&P Global Ratings forecast. Source: S&P research update--South Africa Ratings Affirmed At 'BB-/B' Foreign Currency And 'BB/B' Local Currency; Outlook Stable, May 22, 2021.

| Santam Ltd.--Key Metrics            |                        |        |        |         |         |
|-------------------------------------|------------------------|--------|--------|---------|---------|
|                                     | --Year ended Dec. 31-- |        |        |         |         |
|                                     | 2022f                  | 2021f  | 2020   | 2019    | 2018    |
| S&P Global Ratings capital adequacy | Fair                   | Fair   | Fair   | Fair    | Fair    |
| Gross premiums written (Mil. ZAR)   | 43,700                 | 40,900 | 38,273 | 35,852  | 33,109  |
| P/C: Net combined ratio (%)         | ~96                    | ~97    | 98.4   | 92.9    | 91.7    |
| Net investment yield (%)            | 3.0                    | 2.5    | 4.1    | 4.3     | 5.3     |
| Net income (Mil. ZAR)               | ~1,500                 | ~1400  | 855.0  | 2,321.0 | 2,529.0 |
| Return on equity (%)                | ~14.0                  | ~13.0  | 8.5    | 23.9    | 29.3    |

## Santam Ltd.--Key Metrics (cont.)

|                           | --Year ended Dec. 31-- |       |      |      |      |
|---------------------------|------------------------|-------|------|------|------|
|                           | 2022f                  | 2021f | 2020 | 2019 | 2018 |
| Financial leverage (%)    | ~23.0                  | ~24.0 | 28.2 | 22.2 | 23.2 |
| Fixed charge coverage(x)* | ~6.5                   | ~6.5  | 7.0  | 9.8  | 12.0 |

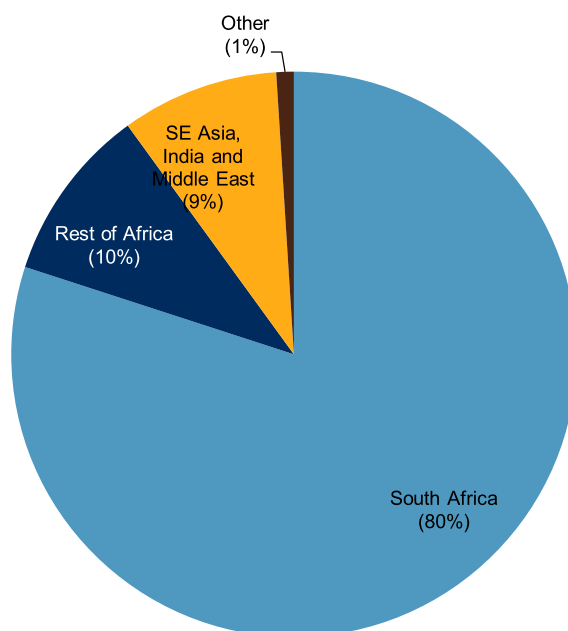
ZAR--South African rand. F--Forecast data reflects S&P Global Ratings' base-case assumption. P/C--Property and casualty. \*Excludes net realised and unrealised investment gains (losses) and net exchange gains(losses).

## Business Risk Profile: Satisfactory

Santam maintains its strong position in South Africa's P/C insurance market, with a market share of around 22%. In addition to the main South African P/C sector, Santam has exposure to other regions (chart 1). 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 (chart 2) and long-established market position help it navigate the challenging conditions in South Africa.

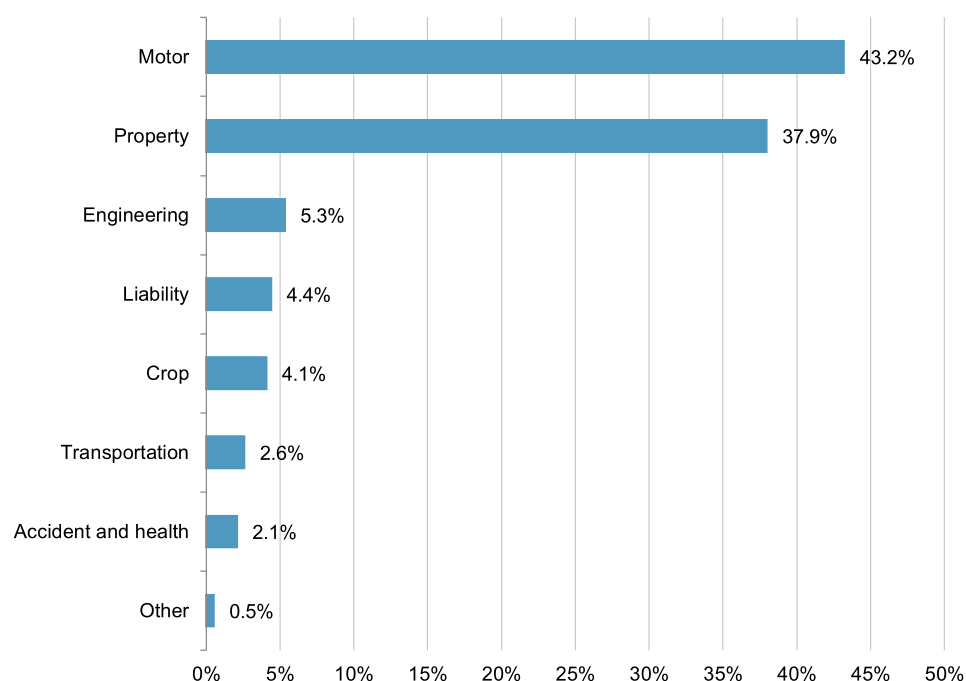
### Chart 1

#### Santam's Business Is Concentrated In South Africa



Source: Santam H1 2020 presentation.

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**Chart 2****Santam Is Well Diversified By Product**

Source: Santam YE 2020.

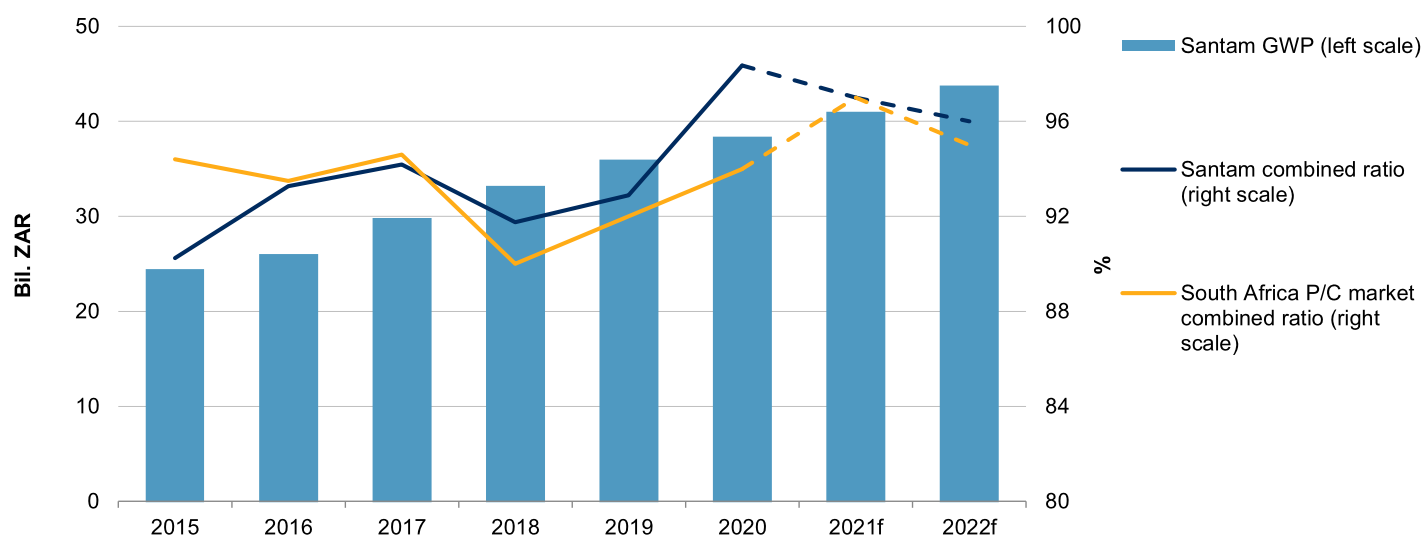
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Santam's operating performance in 2020 was hindered by the business interruption claims and economic slowdown, however the company is moving closer to pre-pandemic performance, with a 94% combined ratio as of June 30, 2021. We expect Santam will expand around 6%-7% in 2021-2023 as the economy recovers gradually.

Over the past five years (2016-2020), Santam's premium income increased at an average growth rate of 9.5%, reaching ZAR38.3 billion in 2020 with the average net combined ratio at around 94.1% (chart 3). This is supported by Santam's business diversification within and outside South African markets and strong risk-management practices. Overall, the company's underwriting performance is in line with the South African P/C market (chart 3). However, its five-year average return on equity (ROE) is 20.4%, which is better than the South Africa P/C market average ROE of around 18%.

Chart 3

## Santam's Underwriting Performance Is In Line With The South African P/C Market



f--S&P Global Ratings' forecast. P/C--Property and casualty. ZAR--South african rand. Source: Audit financial statements, 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 (chart 4).

From a regulatory perspective, Santam reported a group economic capital coverage ratio of 160% in June 2021 (161% at year-end 2020), after considering the redemption of ZAR500 million in April 2021. We expect Santam's solvency ratio to remain at 100%, taking into account the 18-month indemnity period by the court (as per the Ma-Afrika case) instead of three months, and the potential refusal of reinsurers to cover Santam's business interruption claims, although such a scenario is very remote, in our view.

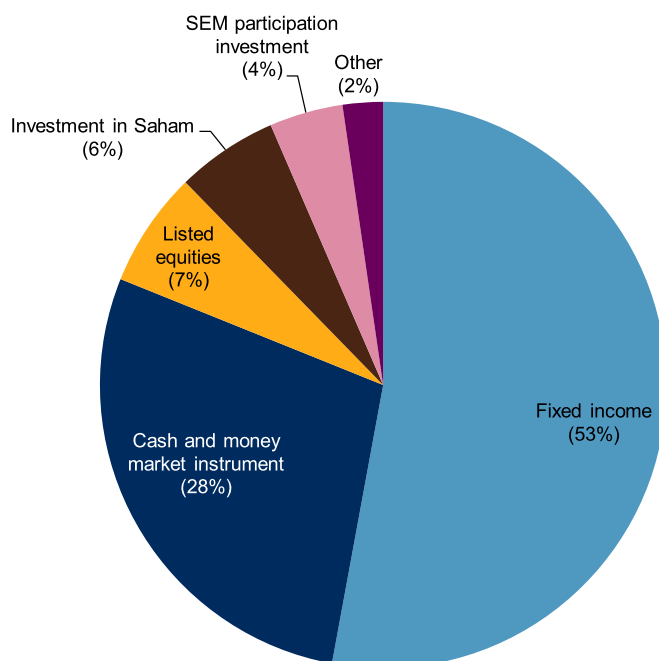
Overall, we expect the solvency ratio to sit comfortably within its target range (150%-170%) during 2021-2023. We recognize that Santam's regulatory ratio is resilient to various stress scenarios based on its modelled exposures, notably market shock (equities declining by 45%, bonds 25%, and preference shares 25%) and failure of the largest reinsurance counterparty after a severe catastrophe event costing about ZAR9.8 billion. In the event of such shocks, we expect Santam's solvency ratio would remain above 120% and we would expect the group to take necessary actions to return to levels within its 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

#### Santam's Low Asset Quality Reflects Exposure To The Domestic Market



Santam: Santam H1 2020 presentation.

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We view Santam's access to external funds 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 2021-2023 and the fixed-charge coverage to be around 6x-7x in 2021-2023.

## 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 business interruption 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.

### **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 Dec. 31, 2020, liquid assets (including fixed-income securities, equities, cash, and short-term investment) covered total net technical liabilities (after reinsurance) by more than 1.69x.

### **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 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 holding company**

Sanlam Ltd. holds the majority of 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**

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Insurance | General: Insurers 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. 20, 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

## Appendix

| Santam Ltd.--Credit Metric History                           |                       |        |
|--|-----------------------|--------|
| (Mil. ZAR)   | --Year ended Dec.31-- |        |
| Particular   | 2020                  | 2019   |
| S&P Global Ratings capital adequacy                          | Fair                  | Fair   |
| Total invested assets  | 37,534                | 33,179 |
| Total shareholder equity                                     | 10,092                | 10,063 |
| Gross premium written  | 38,273                | 35,852 |
| Net premium written  | 25,517                | 25,132 |
| Net premium earned   | 24,661                | 24,226 |
| Reinsurance utilization (%)                                  | 33.3                  | 29.9   |
| EBIT   | 1,973                 | 3,843  |
| Net income (attributable to all shareholders)                | 855                   | 2,321  |
| Return on revenue (%)  | 8.5                   | 13.8   |
| Return on shareholders' equity (%)                           | 8.5                   | 23.9   |
| P/C: Net combined ratio (%)                                  | 98.4                  | 92.9   |
| P/C: Net expense ratio (%)                                   | 30.4                  | 30.6   |
| Net investment yield (%)                                     | 4.1                   | 4.3    |
| Net investment yield including investment gains/(losses) (%) | 3.6                   | 5.3    |
| Financial leverage (%)                                       | 28.2                  | 22.2   |
| EBITDA fixed-charge coverage (x)                             | 7.0                   | 9.8    |
| Financial obligations / EBITDA (x)                           | 1.9                   | 0.7    |

P/C--Property/Casualty. ZAR--South African rand. EBITDA excludes net realised and unrealised investment gains (losses) and net exchange gains(losses).

## 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 October 15, 2021)\*

### 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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