



Credit Rating Announcement

GCR affirms Lombard's national scale financial strength and long term issuer ratings of A^{+(ZA)} and A_(ZA) respectively; Stable outlook

Rating action

Johannesburg, 29 October 2021 - GCR Ratings ("GCR") has affirmed Lombard Insurance Company Limited's ("Lombard") national scale financial strength rating of A^{+(ZA)} with a Stable Outlook. At the same time, GCR has affirmed Lombard's national scale long term issuer and issue ratings (the latter on notes LOM02, LOM03 and LOM04) of A_(ZA) and BBB^{+(ZA)} respectively; with the long term issuer rating on Stable Outlook. Subsequently, GCR has withdrawn the ratings on the notes due to business reasons. GCR will no longer provide public coverage on the ratings on the notes.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook/Watch
Lombard Insurance Company Limited	Financial strength	National	A ^{+(ZA)}	Stable Outlook
	Long term issuer	National	A _(ZA)	Stable Outlook
LOM02	Long term subordinated notes issue	National	WD	--
LOM03		National	WD	--
LOM04		National	WD	--

Rating rationale

The ratings on Lombard consider its position as the core operating entity within Lomhold Proprietary Limited ("Lomhold" or "the group") and reflect the group's strong liquidity and intermediate earnings. These factors are counterbalanced by low capitalisation at group level and the insurer's limited business profile. The national scale long-term issuer credit rating is one notch lower than the financial strength rating, because GCR views policyholder obligations to be senior to those of senior unsecured creditors.

Lombard's business profile is viewed to be moderate, with the limited (albeit gradually increasing) share of total industry gross premiums somewhat offset by the insurer's strong position and brand in the construction guarantee sub-segment. Diversification by line of business is healthy, supported by the insurer's ongoing expansion in the specialist partnership business. As a result, four to five classes contribute materially to revenue, while there is high policyholder granularity and good diversification between risk exposures and sub-segments. However, the negative assessment for premium diversification stems from concentration to South Africa, which accounts for more than 90% of GWP.

Lombard has reflected positive cross cycle earnings, although underwriting profitability has been volatile given the linkage of the guarantee book's performance with the credit cycle. In this regard, large guarantee claims recoveries and favourable reserving development in the trade credit book supported a turnaround in operating profitability in FY21. Lombard's underwriting margin registered at 2% versus -4.5% in FY20, while the group's operating margin strengthened to 13% versus an historical average of c. 7% (FY20: 6%). Furthermore, improved performance in other group operating entities supported a strengthening in Lomhold's net earnings, with return on revenue registering at a high 20% (FY20: 5%) versus low to negative margins in FY18 and FY19. Going forward, we expect earnings to continue to be positive at operational and net level, although a comparatively high operating expense base means that performance will be sensitive to a potential normalisation in guarantee claims and higher recent claims experience in Brightrock.

The group continued to reflect capital limitations, reporting Solvency Capital Requirement ("SCR") coverage of just under 1x at FY21 and estimated to have improved to above 1x at 1Q F22. In this regard, we note plans for investment restructuring which along with positive earnings should help to improve group solvency levels over the next 12 to 18 months, with management targeting SCR coverage of at least 1.25x at both a company and group level. Lombard's risk adjusted capitalisation was sustained at an intermediate level, supported by higher net earnings, with the SCR coverage ratio equating to 1.35x at FY21 and increasing to 1.42x at 1Q F22 (FY20: 1.32x). The assessment considered relatively high (although improved) leverage, with non-core capital equating to 45% of shareholders' funds at FY21 (FY20: 55%).

Strong operational cash flows continued to drive strengthened liquidity at FY21, with the group's stressed coverage of net technical liabilities registering at around 2.5x and coverage of operational expenses above 15 months. We expect conservative asset allocation and positive cash flow generation to maintain liquidity at strong levels over the outlook horizon.

Outlook statement

The Stable Outlook considers expectations that earnings will remain sound and supportive of capital growth, which along with investment restructuring is likely to improve risk adjusted capitalisation. Furthermore, we believe liquidity will be maintained at strengthened levels (technical reserve coverage comfortably above 2x). We expect the business profile to be fairly stable over the near term, although there is potential for a more positive assessment beyond the outlook horizon as the insurer delivers on its diversification strategy.

Rating triggers

We could raise the ratings over the longer term if capitalisation strengthens sustainably and liquidity is maintained at strong levels, with coverage ratios above 2.5x and 1.3x respectively. Conversely, we could lower the ratings if plans to improve capitalisation towards the targeted level do not materialise within the next 12 months, especially if SCR cover is below 1x over successive reporting periods.

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Insurance Companies, May 2019
GCR Ratings Scales, Symbols & Definitions, May 2019
GCR Country Risk Scores, October 2021
GCR Insurance Sector Risk Scores, September 2021

Ratings history

Lombard Insurance Company Limited

Rated Entity / Issue	Rating class	Review	Rating	Rating	Outlook/Watch	Date
Lombard Insurance Company Limited	Financial strength*	Initial	National	A _(ZA)	Stable Outlook	March 2004
		Last	National	A _{+(ZA)}	Stable Outlook	October 2020
	Long term issuer	Initial	National	A _(ZA)	Stable Outlook	October 2019
		Last	National	A _(ZA)	Stable Outlook	October 2020
LOM02	Long term issue	Initial	National	BBB _{+(ZA)}	Stable Outlook	November 2018
		Last	National	BBB _{+(ZA)}	Stable Outlook	October 2020
LOM03	Long term issue	Initial	National	BBB _{+(ZA)}	Stable Outlook	December 2019
		Last	National	BBB _{+(ZA)}	Stable Outlook	October 2020
LOM04	Long term issue	Initial	National	BBB _{+(ZA)}	Stable Outlook	December 2019
		Last	National	BBB _{+(ZA)}	Stable Outlook	October 2020

*Formerly claims paying ability.

Risk score summary

Rating components & factors	Risk scores
Operating environment	15.00
Country risk score	7.00
Sector risk score	8.00
Business profile	(1.00)
Competitive position	(0.75)
Premium diversification	(0.25)
Management and governance	0.00
Financial profile	0.00
Earnings	0.25
Capitalisation	(1.00)
Liquidity	0.75
Comparative profile	0.00
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total score	14.00

Glossary

Capitalisation	The provision of capital for a company, or the conversion of income or assets into capital.
Cash	Funds that can be readily spent or used to meet current obligations.
Claim	A request for payment of a loss, which may come under the terms of an insurance contract.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Liquidity	The speed at which assets can be converted to cash. The ability of an insurer to convert its assets into cash to pay claims if necessary. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
National Scale Rating ("NSR")	National Scale credit ratings express risk in relative rank order, which is to say they are ordinal measures of credit risk and are not predictive of a specific frequency of default or loss.
Premium	The price of insurance protection for a specified risk for a specified period of time.
Rating Horizon	The rating outlook period
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Reserve	An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders.
Senior	A security that has a higher repayment priority than junior securities.
Solvency	With regard to insurers, having sufficient assets (capital, surplus, reserves) and being able to satisfy financial requirements (investments, annual reports, examinations) to be eligible to transact insurance business and meet liabilities.
Underwriting	The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.
Underwriting Margin	Measures efficiency of underwriting and expense management processes.

SALIENT POINTS OF ACCORDED RATING

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings are based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings are an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to the rated entity. The rating was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings. The rated entity participated in the rating process via virtual management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The information received from the rated entity and other reliable third parties to accord the credit ratings included:

- Audited annual financial statements for Lombard and Lomhold to 30 June 2021;
- Four years of comparative audited financial statements to 30 June;
- Lombard budgeted financial accounts to 30 June 2026;
- Other relevant documents

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