CREDIT RATING ANNOUNCEMENT

GCR affirms Lombard's national scale financial strength rating of A+$_{(ZA)}$ and long term issuer rating of A$_{(ZA)}$; both ratings maintained on Stable Outlook

Rating action

Johannesburg, 31 October 2023 – 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 rating of A$_{(ZA)}$; with the Outlook maintained on Stable.

Rated entity	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

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 sound liquidity and a strengthening capitalisation trend on the back of successfully executed corporate initiatives. These factors are counterbalanced by a moderation in earnings and the insurer's small market share. 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.

Risk adjusted capitalisation is rating positive, with the profit on sale of associates contributing towards strong capital build in 2023, as well as a reduction in associated market risk. This supported an increase in the group's GCR capital adequacy ratio (CAR) to about 1.3x at 30 June 2023 from close to 1x previously. Similarly, the group's Solvency Capital Requirement (SCR) coverage increased to above 1.3x from about 1.2x in the prior year. After post year-end settlement of related party loans and sale of another strategic investment, balance sheet risk is likely to decrease further over the near term, resulting in increased capital buffers. However, this is expected to be partly diluted by dividend distributions, given the management of group SCR cover at a target of around 1.25x – 1.3x.

Lombard's market share has increased gradually on the back of the ongoing diversification strategy, although remains low at around 2%. We view this to be somewhat offset by the insurer's positioning and brand in the guarantee segment and growing presence in other specialist lines. Diversification by line of business is very healthy, supported by a multi-channel distribution network and ongoing expansion in the Partnership business. As a result, four classes contribute materially to revenue, while there is high policyholder granularity and good diversification between product sub-segments. However, the insurer remains concentrated to South Africa.

Lombard's underwriting profitability has moderated slightly over the past two years and remains susceptible to volatility given the high operating expense base, partly driven by costs associated with the Partnership distribution model. During 2023, the insurer was impacted by expansionary cost increases and a weaker than expected performance by the comparatively new commercial property book, resulting in the insurer posting a small underwriting loss for the year. As a result, the combined ratio remained pressured at just over 100% for the year, against a prior cross cycle average of about 98%, despite continued competitiveness in the overall claims ratio. Group earnings increased significantly on the back of realised gains on the sale of an associate investment, which formed part of the insurer's balance sheet de-risking exercise. As a result, the five-year average return on revenue registered at a higher 17% (2022: 7%), although it is expected to normalise to between 8% and 12% over the outlook horizon. Looking ahead, we see potential for the earnings profile to strengthen over the medium term as the benefits of corrective underwriting actions unfold.

Positive cash generation supported slightly higher liquidity, with stressed financial assets coverage of expected liquidity requirements registering at 1.4x at fiscal 2023 (2022: 1.3x). This is expected to remain at similar levels as cash flows are anticipated to be positive in 2024 and the portfolio is conservatively invested. However, the metric is susceptible to potential dividend distributions.

Outlook statement

The Stable Outlook factors in the finalisation of corporate transactions that are likely to support strengthened risk adjusted capitalisation and adequate liquidity. In this regard, the liquidity ratio is expected to be maintained at around 1.3x to 1.4x and GCR CAR is expected to be closer to 1.5x over the next 12 to 18 months. We expect the business profile to be stable over the near term, although there is potential for a more positive assessment beyond the outlook horizon as the insurer delivers on its growth strategy.

Rating triggers

The ratings could be upgraded if GCR CAR strengthens above 1.5x on a sustainable basis. Furthermore, an improvement in earnings (combined ratio in the 90% to 95% range) that feeds into strengthened liquidity could be positive for the ratings. Downward rating action could follow if underwriting profitability remains comparatively suppressed, resulting in compression in the liquidity ratio.

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Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Insurance Companies, July 2022
GCR Ratings Scales, Symbols & Definitions, May 2023
GCR Country Risk Scores, August 2023
GCR Insurance Sector Risk Scores, February 2023

Ratings history

Lombard Insurance Company Limited					
Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Financial strength*	Initial	National	A(ZA)	Stable Outlook	March 2004
	Last	National	A+(ZA)	Stable Outlook	October 2022
Long term issuer	Initial	National	A(ZA)	Stable Outlook	October 2019
	Last	National	A(ZA)	Stable Outlook	October 2022

*Formerly claims paying ability.

Risk score summary

Rating components & factors	Score
Operating environment	**14.50**
Country risk score	7.00
Sector risk score	7.50
Business profile	**(0.75)**
Competitive position	(0.75)
Management and governance	0.00
Financial profile	**1.00**
Earnings	0.00
Capitalisation	0.25
Liquidity	0.75
Comparative profile	**0.00**
Group support	0.00
Peer comparison	0.00
Total risk score	**14.75**

Glossary

Agency	An insurance sales office which is directed by an agent, manager, independent agent, or company manager.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Capital	The sum of money that is invested to generate proceeds.

Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Catastrophe	An event, which causes a loss of extraordinary magnitude.
Compound Annual Growth Rate	The year on year percentage growth rate of an investment over a given period of time. It is found by calculating:
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. 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.
Premium	The price of insurance protection for a specified risk for a specified period of time.
Retention	The net amount of risk the ceding company keeps for its own account.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
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.
Undercapitalised	Term used when a business is not supplied with enough funds by its owners to support its activities and provide for any needed expansion.
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.
Upgrade	The rating has been raised on its specific scale.

SALIENT POINTS OF ACCORDED RATINGS

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 were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were 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 ratings above were 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 face to face management meetings, as well as 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:

- Draft company and group audited financial statements to 30 June 2023;
- Four years of comparative audited financial statements to 30 June;

- Full year budgeted financial statements to 30 June 2028;
- Other relevant documents.

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