

Centriq Insurance Company Limited

South Africa Insurance Analysis

June 2011

Security class	Rating scale	Currency	Rating	Rating watch	Expiry date
Claims paying ability	National	Rand	A+	No	06/2012

Financial data:

(US\$m Comparative)

	31/12/09	31/12/10
R/US\$ (avg.)	8.44	7.34
R/US\$ (close)	7.42	6.65
Total assets	321.0	370.8
Total capital	24.7	16.3
Cash & equiv.	265.4	284.8
GWP	231.5	277.6
U/w result	1.2	1.9
NPAT	5.8	3.3
Op. cash flow	16.3	18.8

Market cap n.a.

Market share* 19.2%

* Based on FSB statistics relating to total cell captive NWP for the 2010 calendar year.

Fundamentals:

Centriq Insurance Company Limited ("Centriq") specialises in alternative risk financing and affinity solutions and the provision of underwriting facilities through a UMA partnership model. This is mostly achieved through contingency policies and cell captive facilities respectively. The insurer is a wholly owned subsidiary of Centriq Insurance Holdings Limited, which in turn is 100% owned by Santam.

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Rating rationale

The rating is based on the following key factors:

- Centriq is an established player in the cell captive and alternative risk transfer segment, with an estimated 19% market share. Furthermore, the reinsurance support provided by Santam positions the company for longer term strategic growth.
- The insurer has been consistently profitable at the promoter level, supported by relatively stable fee and investment income. Cognisance is, however, taken of the anticipated growth in risk assumption at the promoter level, which could increase earnings volatility going forward.
- Notwithstanding a substantial dividend payment, the insurer remained adequately capitalised at the promoter level in F10, with the solvency margin expected to remain relatively stable in the near term. Including a R20m draw down facility from Santam, total available capital covered the internally calculated requirement 1.1x at FYE10, which was in line with budget and GCR's minimum comfort level for the current rating.
- Centriq remains exposed to credit risk relating to the capital shortfall in certain cells. This increases capital risk and could limit capacity for longer term growth at the promoter level.
- The conservative investment mix and comfortable liquidity measures were favourably viewed.

Solvency & liquidity

Following a R111m dividend payment and increase in the cumulative solvency shortfall in the cells, shareholders funds covered the internally calculated promoter capital requirement 0.9x at FYE10 (FYE09: 1.9x). Including the R20m draw down facility from Santam, the capital coverage factor amounted to 1.1x at FYE10. The statutory solvency margin registered at 30% in F10 (FYE09: 33%) and remained above the minimum regulatory requirement. The adjusted claims cash coverage ratio amounted to 42 months in F10 (F09: 35 months), while total cash covered preference shareholders funds and net technical liabilities a stable 1x (FYE09: 1.1x). Excess of loss reinsurance reduces Centriq's exposure per risk and event to less than 2% of FYE10 shareholders funds.



Business mix

Centriq is a specialist insurer with an established presence in the cell captive and alternative risk transfer segment. The insurer's product offering includes contingency policies and a large book of insurance business that is managed on an outsourced administration basis. In terms of the latter, Centriq partners with UMAs and affinity partners, who perform the day-to-day administration, underwriting and distribution functions, while leveraging off Centriq's business resources, reinsurance access and technical expertise. Most UMA and all affinity business is currently conducted within a cell structure. However, the insurer has started to structure more UMA agreements outside a cell facility, when it is efficient to do so for higher volatility risk types. MiWay began to operate under its own licence from 2H F10. However, given that this book was previously 100% reinsured through Santam, the impact on NWP and profitability will be neutral.

Business mix	F08		F09		F10	
	R'm	%	R'm	%	R'm	%
UMA	964.5	52.3	970.0	44.1	1,062.0	44.7
Affinity	617.1	33.5	504.1	22.9	661.6	27.8
Conting.	187.7	10.2	485.2	22.1	362.6	15.3
MiWay	74.1	4.0	238.3	10.8	290.9	12.2
Total	1,843.4	100.0	2,197.6	100.0	2,377.1	100.0

Premiums derived from the UMA channel increased by 14% to account for a slightly higher 45% of statutory gross premiums in F10, mainly on the back of one new UMA arrangement (contributing R40m in GWP for the half year). Centriq had 20 active UMA arrangements in F10, with the largest two UMA's representing 15% and 6% of statutory GWP respectively. The UMA segment registered a stable earned loss ratio of 52% in F10 (F09: 53%), which was facilitated by reserve releases relating to discontinued cells as well as a marked improvement in the loss ratio for the largest agency. Given that this business line relates mainly to more conventional insurance types, some of the cells reinsure a relatively large portion of their books under proportional treaties, with the average retention ratio registering at 25% in F10 (F09: 27%). Accordingly, this division benefits from large commission inflows, which bolster technical profitability. The technical margin registering at a very high 72% in F10 (F09: 67%). In some cases, Centriq participates in the proportional reinsurance programmes of these cells, which exposes the company to underwriting risk. Centriq had around 18 of these arrangements in F10, with reinsurance inwards premiums totalling R164m for the year (F09: R118m).

Technical profitability	Earned loss (%)		Tech result (R'm)	
	F09	F10	F09	F10
UMA	52.7	52.4	177.9	189.4
Affinity	55.2	60.3	190.9	183.8
Total*	54.3	57.6	368.7	373.2

*Excluding MiWay and contingency policies.

In terms of the affinity channel, cell structures are used to facilitate the client's access to economic benefits from the sale of insurance policies. In most cases, Centriq is not directly exposed to underwriting risk under these arrangements. This business line reported robust GWP growth of 31% in F10, supported by an increase in volumes in three key clients' portfolios. Centriq had arrangements with 14 affinity clients in F10, with the largest contributing 13% of total statutory GWP. The next largest clients accounted for between 3% and 7% of gross premiums, indicating a reasonable degree of diversification. The earned loss ratio increased to 60% from 55% in F09, mainly as a result of reserving strain relating to top line growth in one cell. This was the only continuing client to register a technical loss for the year, with the balance of the book reflecting a combined technical margin of 43% in F10, which was in line with the prior year.

Solvency

The statutory solvency margin provides an indication of average solvency across all business lines, and includes the preference shareholders funds (net of associated liabilities) and the full statutory NWP base. The ratio amounted to 30% in F10 (F09: 33%) and remained above the minimum regulatory requirement. However, this measure has the theoretical assumption that there is cross-subsidisation between the various cells, including the promoter cell. Given that the cell owners' capital is not intended to be used to back insurance activities outside the cell, it is important to consider the solvency position of each facility on a standalone basis. In this regard, Centriq uses a benchmark ratio of 25% of NWP, and allocates a portion of promoter capital to the cells that fall short of this solvency level.

The cumulative capital shortfall of the undercapitalised cells amounted to R76m at FYE10 (FYE09: R69m), 69% of which related to two cells, where the shortfall mainly arose from reserving strain relating to growth in premium volumes. Centriq is discussing implementing plans to restructure these programmes to reduce the impact of reserving strain. Including security pledged by certain cells, the cumulative solvency shortfall amounted to approximately R62m at FYE10 (FYE09: R40m). All of the undercapitalised cells are being charged an appropriate solvency fee on the capital allocated from Centriq's promoter funds.

	F09	F10
Contingency policies (5% NWP)	19.7	9.8
Risk assumption (30% NWP)	36.7	51.7
Promoter requirement	56.5	61.5
Cells shortfall*	40.0	62.3
Total capital requirement	96.4	123.8
S/h funds	183.4	108.4
Capital cover (x)	1.9	0.9

*Net of security.

With regard to promoter solvency, Centriq allocates capital to each business line based on the underlying risk characteristics. In terms of contingency policies, the contracts relate to first party risks and underwriting risk is considered remote. Accordingly, Centriq is mainly exposed to operational risk on these policies, and considers a solvency margin of 5% of NWP to be adequate. For risk assumption (direct and participation in the cells' reinsurance programmes), the company allocates capital at 30% of NWP, which is viewed as an adequate economic level for the current business mix. The reduction in contingency policy premiums and higher reinsurance cession saw the internal capital requirement for contingency policies reduce to R10m at FYE10. This was offset by an increase in risk assumption NWP, with the promoter capital requirement amounting to a stable R62m at FYE10. The ratio of shareholders funds to promoter NWP equated to 30% in F10 (F09: 36%), which was comfortably above management's target band of between 15% and 20%.

During F10, the company undertook a review of capital efficiency, and paid a large dividend of R111m. Accordingly, shareholders funds declined by 41% to a review period low of R108m at FYE10. If promoter funds were allocated to cover the full cumulative capital shortfall in the cells, the total capital requirement would amount to R129m at FYE10 (FYE09: R106m), with shareholders funds covering this 0.9x. Including a R20m draw down facility from Santam, the total capital requirement was covered 1.1x at FYE10 (budget: 1.1x), which is in line with GCR's minimum comfort level for the current rating. The insurer does not plan to pay another special dividend in F11, with promoter capital budgeted to end the year at R105m. The coverage factor is not expected to decline significantly in the near term, although capacity for risk assumption activity could be limited in the absence of an improvement in the cell owners' solvency levels.

Asset management

The preference shareholders' funds are largely invested in cash and short term money market instruments. This asset mix limits counterparty and market risk and ensures that funds are readily

available in the event that the preference shareholders cancel their arrangement and withdraw the surplus funds from their cells. The promoter investment portfolio included R97m in fixed income investments in F10, with the underlying assets split between bonds and money market instruments. At FYE10, more than 90% of the combined investment counterparties had ratings of A- or better. Excluding liquid assets backing preference shareholders funds, the adjusted cash coverage ratio amounted to 42 months in F10 (F09: 35 months). On a combined basis, cash and equivalents covered preference shareholders funds and net technical liabilities 1x at FYE10 (FYE09: 1.1x).

Reinsurance

The extent to which Centriq participates on the cells' reinsurance programmes depends on the size and nature of the risk types. Currently, promoter exposures are limited to between R1m and R13m per risk, and the insurer purchases XoL cover to further reduce exposure to its net account. Accordingly, the highest net retention amounts to R1.5m per risk and R2m per event (2% of FYE10 capital). The insurer places reinsurance with Santam and with external counterparties (or groups) that have a minimum international rating of A- or above.

Financial performance

A 5 year synopsis of Centriq's financial performance (IFRS format) is reflected at the back of this report. Table 6 summarises the insurer's performance in the promoter format (excluding notional reinsurance transactions relating to the cells), and brief comment follows below.

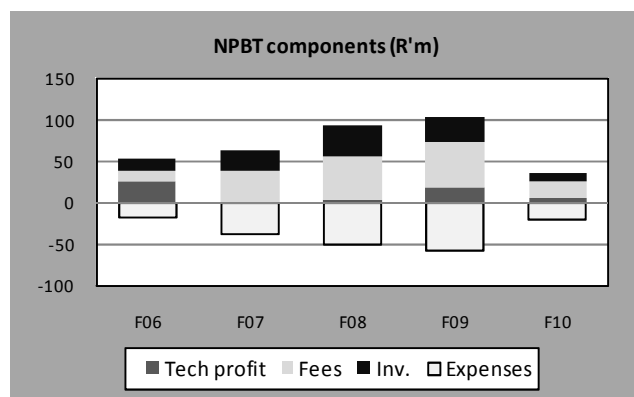
	F09	F10		
	Actual	Actual	Budget	% of budget
GWP - statutory	2,197.6	2,377.2	2,472.5	96.1
Technical result	18.7	22.2	13.3	167.1
Fee income	52.8	65.3	66.8	97.7
Inv. Income*	31.5	34.6	19.7	175.5
Total income	103.0	122.1	99.8	122.3
Expenses	(57.5)	(75.4)	(67.0)	112.6
Tax	(11.9)	(11.2)	(10.6)	105.9
NPAT	33.5	35.4	22.2	159.5

*Including unrealised investment movements.

Statutory gross premiums advanced by 8% to R2.4bn in F10, on the back of strong growth in cell business volumes. An increase in risk assumption and strengthening in underlying underwriting profitability supported a rise in the technical profit, to R22m in F10 (F09: R19m). Furthermore, investment income accruing to the promoter noticeably exceeded budget. This was mainly attributed to a lower than anticipated investment allocation to cells, as the budgeted distributions were based on a higher portfolio return assumption and did not make provision for re-

negotiation of variable fees. Fee income lagged budget slightly, as a result of lower than expected margin fees. Overall, total income increased by 19% to R122m in F10, and was 22% ahead of budget. Notwithstanding an R8m expense overrun (mainly driven by staff incentives), NPAT increased by 6% to R35m in F10, and was well above budget.

Centriq had achieved 44% of its annual profit target in the four months to April F11, supported by solid investment income and well contained management expenses.



Centriq is focusing on gradually increasing its risk participation in the cells, and is also considering several new direct business opportunities. Accordingly, the relatively stable fee and investment income components are expected to be complemented by a greater contribution of technical profits going forward. Cognisance is, however, taken of the higher degree of volatility associated with underwriting activities. In view of the large solvency shortfalls in some of the cells, capacity for growth into this type of business may be limited in the near term.

Future prospects

Table 5: Promoter (R'm)	Actual 4 mnths to April F11	Budget F11	Actual YTD as % of budget
<i>GWP – statutory</i>	<i>649.8</i>	<i>2,106.4</i>	<i>30.8</i>
Technical result	4.5	21.8	20.6
Fee income	21.0	60.4	34.8
Inv income*	8.9	23.1	38.7
Total income	34.4	105.2	32.7
Expenses	(20.4)	(73.4)	27.8
Tax	(4.0)	(8.9)	45.3
NPAT	10.0	22.9	43.5

*Including unrealised investment movements.

On a like for like basis (excluding MiWay), statutory GWP is expected to remain relatively flat at R2.1bn in F11. Following the reduction in assets backing shareholders funds at FYE10, investment income on promoter funds is budgeted to decline by 33% to R23m for the year. Accordingly, NPAT is forecast at a 35% lower R23m in F11. Note is, however, taken of Centriq's historically conservative budgeting approach, with actual performance exceeding expectations by more than 30% over the past three years.

Centriq Insurance Company Limited

(R in Millions except as noted)

Year ended : 31 December

	2006	2007	2008	2009	2010	
Income Statement						
Gross written premium (GWP)	937.7	1,312.4	1,788.7	1,953.7	2,038.4	
Reinsurance premiums	(492.8)	(838.3)	(1,364.7)	(1,465.3)	(1,657.3)	
Net written premium (NWP)	444.9	474.2	424.0	488.3	381.1	
(Increase) / Decrease in insurance funds	(158.5)	68.0	62.2	(2.5)	13.2	
Net premiums earned	286.4	542.2	486.2	485.8	394.3	
Claims incurred	(190.2)	(441.9)	(412.4)	(384.8)	(268.0)	
Commission	(15.5)	(18.7)	(34.6)	(42.1)	(45.6)	
Management expenses	(73.7)	(82.4)	(52.4)	(48.8)	(66.6)	
Underwriting profit / (loss)	7.0	(0.9)	(13.2)	10.1	14.1	
Policyholder bonus	(72.8)	(86.9)	(110.3)	(37.8)	(61.3)	
Investment income*	111.6	144.1	226.5	145.1	132.6	
Fair value adjustment - preference share capital	n.a.	0.0	(61.2)	(56.7)	(50.3)	
Fee income	11.7	3.1	0.6	0.0	0.0	
Taxation	(8.3)	(6.3)	(11.1)	(12.0)	(11.2)	
Net income after tax	49.2	53.1	31.3	48.7	23.9	
Dividend paid	0.0	(16.0)	0.0	(25.0)	(111.0)	
Fair value adjustments - investments	(9.4)	(4.3)	(1.7)	(15.2)	11.5	
Cash Flow Statement						
Cash generated by operations	100.3	(117.0)	(131.6)	(133.4)	(101.2)	
Cash flow from investment income	36.2	152.4	173.4	180.8	150.2	
Working capital decrease / (increase)	326.2	121.8	142.2	58.4	193.1	
Tax paid	(16.4)	(24.7)	(24.7)	31.9	(56.3)	
Cash available from operating activities	446.3	132.5	159.3	137.7	185.7	
Dividends paid	309.8	(16.0)	0.0	(25.0)	(111.0)	
Cash flow from operating activities	756.0	116.5	159.3	112.7	74.7	
Cash flow from investing activities	124.2	23.8	52.0	63.9	(99.0)	
Cash flow from financing activities	0.0	63.9	(99.5)	(43.0)	(50.9)	
Net cash inflow / (outflow)	880.2	204.1	111.8	133.6	(75.2)	
Balance Sheet						
Shareholders interest	143.7	146.0	175.0	183.4	108.4	
Preference shares/cell owners' capital	271.4	504.6	770.6	860.9	966.3	
Holding company loans	31.1	0.0	0.0	0.0	0.0	
Net outstanding claims reserve	(3.4)	63.5	71.6	75.1	80.4	
Net unearned premium reserve	1,056.6	986.6	928.1	930.6	917.4	
Other liabilities	238.4	501.6	438.0	330.9	392.4	
Total capital & liabilities	1,737.7	2,202.3	2,383.3	2,380.9	2,464.9	
Fixed assets	0.0	0.2	1.2	1.8	2.0	
Investments	151.7	121.7	69.1	0.0	97.2	
Cash and short term deposits	1,518.3	1,722.5	1,834.7	1,968.3	1,893.1	
Other assets	67.7	357.9	478.3	410.7	472.6	
Total assets	1,737.7	2,202.3	2,383.3	2,380.9	2,464.9	
Key Ratios						
Solvency / Liquidity						
Statutory solvency ratio	%	25.7	28.7	23.3	32.9	30.0
Total capital / NWP	%	93.3	137.2	223.0	213.8	282.0
Shareholders funds / NWP	%	32.3	30.8	41.3	37.5	28.4
Cash claims coverage**	mth	78.7	33.1	31.0	34.5	41.5
Avg premium debtors days	days	n.a.	57.2	44.1	55.2	49.1
Cash & equivalents : Net tech liabilities	X	1.4	1.6	1.8	2.0	1.9
Cash & equiv : Pref s/holders funds and net tech. liabilities	X	1.1	1.1	1.0	1.1	1.0
Profitability						
ROaE (before unrealised gains / losses)	%	28.8	72.7	19.5	27.2	16.4
ROaE (after unrealised gains / losses)	%	21.5	66.8	18.5	18.7	24.3
Investment yield (including unrealised gains / losses)	%	n.a.	15.6	12.1	7.5	6.7
Efficiency / Growth						
GWP Growth	%	n.a.	40.0	36.3	9.2	4.3
Premiums reinsured / GWP	%	52.6	63.9	76.3	75.0	81.3
Earned loss ratio	%	66.4	81.5	84.8	79.2	68.0
Commissions / Earned premiums	%	5.4	3.5	7.1	8.7	11.6
Management expenses / Earned premiums	%	25.7	15.2	10.8	10.1	16.9
Underwriting result / Earned premium	%	2.4	(0.2)	(2.7)	2.1	3.6
Trade ratio	%	97.6	100.2	102.7	97.9	96.4

*Including foreign exchange movements.

**Excluding preference share capital.