GCR GLOBAL CREDIT RATING CO.
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Santam Limited

South Africa Insurance Analysis **August 2012**

Security class	Rating scale	Rating	Rating outlook	Review date
Claims paying ability	National	$AAA_{(ZA)}$	Stable	08/2013
Long term subordinated debt	National	$AA\text{-}_{(ZA)}$	Stable	08/2013

Financial data:

(US$'m Comparative)

	31/12/10	31/12/11
R/US$ (ave)	7.34	7.27
R/US$ (close)	6.65	8.14
Total assets	1,957.2	1,733.0
Total capital	753.8	723.1
Cash & equiv.	350.9	270.3
GWP	1,901.5	2,085.6
U/w result	131.2	137.0
NPAT	139.6	175.2
Op. cash flow	181.9	122.7
Market cap.*	US$2.48bn	
Market share**	22.3%	

*As at October 2012.

**Based on GCR's estimate for the sample group in 2011 and calculated in terms of total GWP.

Related methodologies:

GCR's Criteria for Rating Short Term Insurance and Reinsurance Companies, November 2011.

Santam Limited ("Santam") rating reports, 2009 - 2011

South Africa Short Term Insurance Industry Bulletin, 2003-2011.

Rating history:

Initial Rating (05/2009)

National CPA symbol: $AAA_{(ZA)}$

National CPA outlook: Stable

Subordinated debt symbol: $AA\text{-}_{(ZA)}$

Subordinated debt outlook: Stable

Last Rating (07/2011)

National CPA symbol: $AAA_{(ZA)}$

National CPA outlook: Stable

Subordinated debt symbol: $AA\text{-}_{(ZA)}$

Subordinated debt outlook: Stable

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Rating rationale

The rating is based on the following key factors:

- Santam is the short term insurance market leader, displaying a GWP market share of approximately 22%. Santam's formidable competitive position is underpinned by its very strong franchise value, superior diversification and market expertise, and an extensive distribution network within South Africa.
- This is supported by Santam's multifaceted operations, enabling the insurer to effectively compete in diversified market spaces. In light of this position, Santam is viewed as well placed to attract high quality business, while positively influencing terms, conditions and pricing.
- Capitalisation is viewed to be strong, underpinned by an internally developed, risk-based model that has become entrenched in operations and strategic decision making. This is complemented by a mature and embedded ERM framework, as well as adequate reserving levels. However, owing to the extensive scope of the business, the development of an enterprise-wide risk culture is viewed as a challenge.
- Santam's sizeable investment portfolio reflects adequate liquidity, and is supported by a large portion of readily redeemable instruments. Investment and capital risk was further mitigated by the equity sell-off in F12.
- Santam has achieved a high level of sustained underwriting profitability, underpinned by a well diversified portfolio, selective underwriting policies and pronounced scale economies.
- The funds from the debt issue are ring-fenced in a separate portfolio and invested in cash and fixed interest bearing investments, with a minimum benchmark return equivalent to Santam's bond performance. Debt serviceability measures remain sound.
- The evolving competitive environment continues to pressure market share, suppress rates and threaten quality blocks of risk. This is primarily attributable to the increasing prominence of direct players and more flexible companies that can adapt quickly to emerging market developments. This is exacerbated by the difficult economic conditions, particularly given Santam's lack of geographic representation.

What could trigger a rating action

Positive movement factors: The insurer's current CPA rating is at the rating scale ceiling. Upward movement on the debt rating or outlook could develop with a strengthening in gearing and interest coverage metrics.

Negative movement factors: A downgrade may arise if there is a material weakening in the insurer's financial or market profile. In this regard, significant and sustained movements in terms of market share reductions, a deterioration in underwriting performance, an erosion of solvency below requirements (as per GCR's solvency model, the insurer's internal economic capital model, and regulatory calculations), or a substantially weakened liquidity profile coupled with elevated investment risk exposure.

Competitive environment

Despite the stronger macro-economic fundamentals, industry GWP growth rose by a moderate 5.9% in 2011 (2010: 5%), with the competitive rates environment limiting growth. Amid more contained demand from the corporate sector, premium diversification efforts into higher margin specialist lines have increased rivalry for market share, inducing rates pressure. A favourable claims environment in motor and property classes supported underwriting profitability, with the earned loss ratio declining further to around 59% in 2011 (2010: 60%). Despite management cost pressures, the industry underwriting margin is anticipated to have amounted to a stable (and very high) 10% in 2011. However, it is GCR's view that over the medium term, the systemic challenges facing the motor industry (inclusive of the exposure to Rand volatility), combined with the competitive rate dynamics, will pressure the motor loss ratio despite improved risk segmentation. This, coupled with an anticipated normalisation in the property class loss ratio (given the atypically low claims experience), is likely to see the overall loss ratio trend higher. As such, GCR expects underwriting profitability to shift into single digit territory over the medium term.

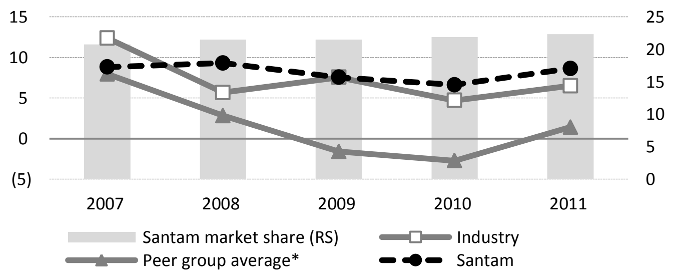
Table 1: South Africa short-term insurance key industry data

Regulatory authority			FSB
Min. capital requirement (non-life)			R10m
# of registered typical non-life insurers			30
# of registered niche non-life insurers			32
# of registered captive non-life insurers			10
# of registered cell captive non-life insurers			10
# of registered re-insurers			6
Cumm. market share of top 5 assurers			48%
Non-life industry GWP in 2011			R77bn
Non-life ins. penetration (% of GDP)			4.10%
Key ratios (%):	**5-yr avg.**	**2010**	**2011**
GWP growth	7.0	4.9	5.9
Retention	75.0	75.0	75.5
Earned loss	62.7	60.5	58.6
Management expense	18.7	20.1	22.2
U/w margin	8.2	10.4	10.2
Int. solvency	51.1	52.0	53.2
LOB % of GWP	Motor (43%)	Property (36%)	Accident (6%)

Competitive positioning

Santam Limited ("Santam") is listed on the JSE, with major shareholder Sanlam Limited (national long term rating AA-) holding a 56.8% stake, and a further 31.6% in free float. Sanlam had a market cap of R81bn as at October 2012 (Santam: R21.5bn; June 2011: R16.5bn).

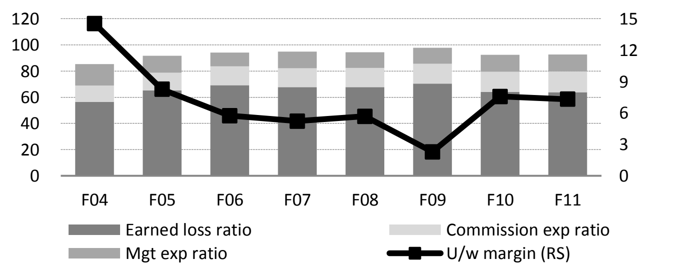
GWP growth (%)



*Peer group average excludes Santam.

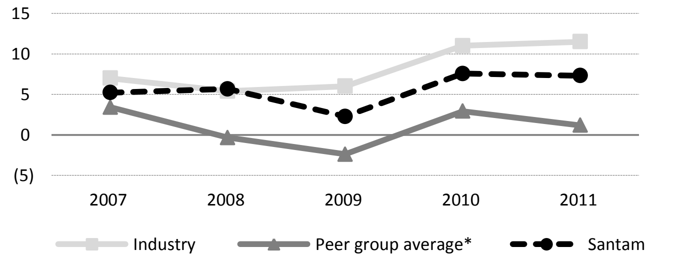
At an industry level, successful growth strategies have been demonstrated by players able to navigate both traditional markets and product types, while supplementing a commoditised portfolio with alternative and specialised products via effective, modern distribution channels. Santam has achieved a 4-year compound annual growth rate ("CAGR") of 8% over the review the period, exceeding the industry average of 6%, and contrasting the peer groups' flat premium development pattern. The insurer has utilised its market leading position to retain key portfolios, capture new blocks of revenue, and generate new business, with the growth trajectory exhibiting a relatively high degree of stability.

Net underwriting profit drivers (%)



Santam has recorded 17 consecutive underwriting surpluses. The strength of the insurer's long-term performance has been underpinned by robust underwriting cycle management, exhibiting a notably resilient level of performance through depressed market conditions, while capturing increased volumes during upturns. The wide spread of the insurer's operations have supported a comparably stable underwriting performance. Furthermore, diversification benefits can be priced into products, providing a competitive advantage over less diversified competitors. In addition to the quality of the insurer's underwriting techniques and systems and underlying portfolios, GCR views Santam's stringent enterprise risk management ("ERM") processes as having contributed to the fortified performance relative to peers, throughout the challenges of both the underwriting and broader economic cycles.

Net underwriting margins (%)



*Peer group average excludes Santam.

Table 2 compares the insurer's key performance and credit protection metrics with the top tier players in the South African market. Santam's scale allows the company to realise underwriting margins in excess of its peers, which is achieved through diversification and economies of scale. Specifically, Santam's delivery cost ratio (29%) continued to compare favourably to that of the peer group average (33%), supported by the containment of the loss ratio in recent years. International solvency is managed by a stringent and advanced risk-based policy. Liquidity is supported by near-cash holdings.

Table 2: Peers F11 (R'm)	Santam	M&F	Hollard	Zurich SA	Peer avg.*
GWP	15,162.0	6,819.0	5,829.5	3,488.5	-
NWP	13,593.0	6,078.0	5,100.6	2,820.8	-
U/w result	996.0	47.0	148.7	(29.2)	-
NPAT	1,274.0	463.0	303.2	130.5	-
Capital	6,850.0	4,346.0	2,868.6	1,872.4	-
Assets	14,107.0	7,755.0	6,726.7	3,611.0	-
Operating ratios (%)					
GWP market share	22.3	10.0	8.6	5.1	11.5
NWP market share	27.4	12.8	10.2	8.3	14.7
GWP growth	8.6	4.8	12.2	(17.2)	4.8
Retention	89.7	89.1	87.5	80.9	88.2
Earned loss ratio	63.8	67.4	51.3	66.5	62.5
Comm ratio	16.0	14.4	13.9	15.3	15.2
Mgt exp ratio	12.9	17.4	32.0	19.2	18.2
Delivery cost ratio	28.9	31.8	45.9	34.5	33.3
U/w margin	7.3	0.8	2.8	(1.0)	4.2
Credit protection (%)					
Int. solvency	50.4	71.5	56.2	66.4	57.8
Stat. solvency	34.8	43.4	46.6	39.8	39.4
Cash / tech liabs (x)	0.4	2.0	0.8	0.9	0.9
Cash cover (mths)	3.0	12.5	8.1	6.4	6.4

*Excludes Santam.

Risk diversification

Santam's market segment focus has remained stable throughout the review period, with commercial and personal lines accounting for a fairly stable 51% and 44% of GWP in F11. Large corporate contracts, albeit still marginal relative to the remainder of the book (at 5% of GWP), have risen steadily over the past two years, reflecting the increased business derived following the on-take of Emerald Underwriting Management ("Emerald") in F10. Nevertheless, in light of the relatively limited corporate property portfolio, the book is well diversified in terms of client groupings.

Broker services includes both personal lines and commercial business that is sold through brokers, and is predominantly administered using Santam's in-house systems. GCR expects this division to remain a stable earnings contributor in the near term, as stringent underwriting policies remain intact, while the scale of the collective portfolio assists in diversifying the natural exposure to systemic industry factors. Entrenched broker relationships, enhanced by the introduction of strong pricing software, are also expected to assist in the insurer's ability to defend this portfolio from competitors, as well as the threat presented by the direct market. Given the generalised nature of this portfolio, and the resultant continued rate pressure in key lines, strict monitoring of performance and the application of effective underwriting measures are pivotal to sustaining earnings quality through underwriting cycles.

Portfolio management largely comprises personal lines business that is sourced through brokers who manage the portfolio of risks using their own administrators. Management has implemented the Fusion system, an integrated data management platform that enables rapid risk assessment and rate deployment, in order to support profitability in this division.

Niche business is derived from 16 UMAs, most of which are 100% owned by Santam via its wholly owned subsidiary, Swanvest 120 (Pty) Ltd. Santam's shareholding in these companies allows the insurer to align the interests of the UMA and insurer, participate in management decisions and provide technical support. A number of UMAs housed within this division are dominant underwriting entities in their respective fields (most notably SHA in the liability line, and Mirabilis in engineering). The long tail and specialised nature of these risks result in brokers being hesitant to move books of business, increasing retention rates. *Agriculture* is viewed within a similar context, given the specialised nature of this business, coupled with Santam's dominant market share (controlling half of the sub-segment's premium). The market remains very challenging, both in terms of managing the volatility of the 5-7 year cycle, as well as pricing difficulties (with rate discounting resulting from fierce competition by players vying for limited market share). Actuarial pricing is being progressively introduced as a corrective measure, with management noting the importance of geographic diversification to sustain profitability in this class. Claims in 2011 were impacted by heavy rainfall, (versus the more severe hail damage in 2010), although the book returned to underwriting profitability.

Santam Re largely relates to inter-company and internal reinsurance arrangements within the Santam group, with a large portion derived from the Miway book (which is 90% reinsured into the unit). The insurer is currently following a controlled growth strategy with regard to this division, with F11 activity focused on systems and capacity development. Going forward, however, Santam Re is viewed as a key growth driver, as well as an important geographic diversifier (targeting emerging markets). The *corporate* division continued to benefit from the revised approach to underwriting corporate property risk following the acquisition of Emerald.

Class analysis

The following commentary relates to the statutory returns submitted to the FSB, which differ from results reflected in the audited financial statements (and at the back of this report), due to the differing treatment of reserving as per statutory reporting methods.

Table 3: AFS vs. ST (R'm)	ST		AFS	
	F10	F11	F10	F11
NPE	12,709.2	13,541.6	12,712.0	13,615.0
Claims	(8,018.8)	(8,735.8)	(8,153.0)	(8,686.0)
Commission	(1,971.5)	(2,138.1)	(1,964.0)	(2,173.0)
Management expenses	(1,625.0)	(1,754.8)	(1,632.0)	(1,760.0)
U/w result	**1,093.9**	**912.9**	**963.0**	**996.0**
Selected ratios (%):				
Incurred loss ratio	63.1	64.5	64.1	63.8
Commission ratio	15.5	15.8	15.4	16.0
Mgmt expense ratio	12.8	13.0	12.8	12.9
Technical margin	21.4	19.7	20.4	20.2
U/w margin	8.6	6.7	7.6	7.3

GWP grew by 9% to R15.2b in F11 (F10: 7%), with all classes other than accident registering upward premium development. Growth was primarily a function of the motor book, following very strong uptake from both the broker and direct (via reinsurance) channels, which exceeded the industry growth. Accordingly, motor accounted for a higher 48% of GWP in F11 (F10: 46%), versus 43% in F07. Property and engineering also registered healthy (albeit slowing) growth (a combined premium increase of R374m), as the Mirabilis and Emerald portfolios continue to expand. On a risk basis, motor and property accounted for a combined 84% (F10: 83%) of total NWP, compared with the industry of 80% (F10: 79%).

Table 4: Class volumes (%)	GWP		NWP		Retention	
	F10	F11	F10	F11	F10	F11
Property	37.0	35.6	34.4	32.4	84.7	81.6
Transport	2.6	2.5	2.5	2.4	86.5	85.3
Motor	45.6	47.6	48.7	51.5	97.0	96.9
Accident	2.7	1.8	2.3	1.3	77.4	63.4
Guarantee	0.1	0.1	0.1	0.1	91.9	75.7
Liability	7.7	7.5	8.0	8.2	94.5	97.4
Engineering	4.1	4.7	3.8	4.3	85.2	82.0
Miscellaneous	0.1	0.1	0.2	(0.2)	99.2	(145.8)
Total	**100.0**	**100.0**	**100.0**	**100.0**	**91.0**	**89.7**

Motor continued to record a downward loss ratio trend in F11, as Rand-benefits and improved procurement functions took effect. However, management has noted a subsequent rise in motor losses owing to systemic issues such as increased loss frequency, rural road deterioration, and currency depreciation. The property book performed well due to limited impact from large industrial and fire-related claims on the insurer's net account. The liability loss ratio deteriorated by 11 percentage points to 57% (F10: 10%), following upward claims adjustments. The overall loss ratio rose to 65%, albeit remaining below the previous 4-year average of 68%. In conjunction with a slight uptick in the delivery cost ratio to 29%, the underwriting margin lowered to 7%.

Table 5: Class performance (%)	Net loss ratio		Deliv cost ratio		U/w margin	
	F10	F11	F10	F11	F10	F11
Property	63.4	65.0	31.4	31.7	5.2	3.3
Transport	39.2	43.3	28.9	28.2	31.9	28.5
Motor	69.4	68.6	25.1	25.9	5.5	5.5
Accident	64.3	32.2	35.6	34.1	0.1	33.7
Guarantee	0.9	15.3	34.7	42.1	64.4	42.5
Liability	46.2	57.3	29.0	30.0	24.8	12.7
Engineering	34.6	44.3	34.7	35.4	30.7	20.3
Miscellaneous	34.6	(20.8)	27.8	(22.5)	37.6	143.3
Total	**63.1**	**64.5**	**28.3**	**28.7**	**8.6**	**6.7**

Reinsurance

The reinsurance programme consists entirely of internationally secure rated entities (minimum requirement of A- international rating), led by Lloyds' and Munich Re, with other large participants including Gen Re and Swiss Re. Based on an analysis of Santam's exposure and global catastrophe purchasing practices, the insurer's retention level was increased from R50m to R100m in F12. Accordingly, unless specifically approved by the board, Santam does not accept any net risk greater than R50m, or any net exposure greater than R100m, before the cost of reinstatement premiums. Given this, maximum net retention per risk and event equates to a conservative 0.8% and 1.3% of FYE11 capital.

Table 6: Reinsurance account (R'm)	F07	F08	F09	F10	F11
Premium ceded	(1,041.1)	(1,031.7)	(1,116.2)	(1,260.6)	(1,509.7)
Commission recovered	197.8	248.6	184.4	259.3	358.9
Claims recovered	313.2	411.3	592.9	553.7	612.1
Earned profit/(loss)	**(530.1)**	**(371.7)**	**(338.9)**	**(447.6)**	**(538.8)**
Cash profit/(loss)	(223.6)	(239.0)	(255.0)	(205.0)	(600.4)
Earned result : Capital (%)	(12.2)	(8.7)	(7.3)	(8.9)	(9.2)

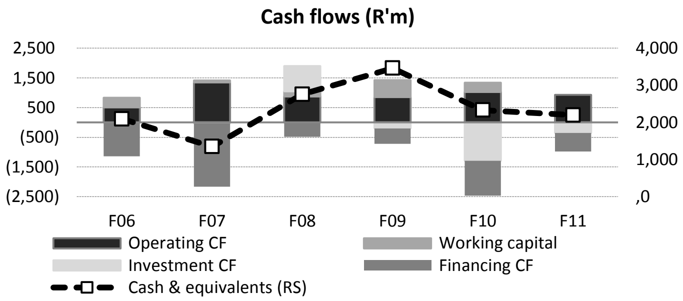
Santam's gross loss experience has evidenced the relative stability exhibited a net level. Accordingly, reinsurers have recorded net surpluses on the account throughout the review period, which cumulatively have amounted to R2.2bn.

Asset management

Santam outsources the investment management function to Sanlam Investment Management. The external fund managers are required to adhere to strict and specific mandates for each investment class. In addition, Santam manages credit risk by limiting exposure to various counterparties and specifying minimum credit ratings. The insurer's approach is to match insurance technical liabilities with liquid funds, while assets backing the subordinated bond (managed on a ring-fenced basis for asset-liability matching purposes) include cash and fixed interest bearing instruments. On a combined basis, these asset classes accounted for an unchanged 49% of the overall investment portfolio, and covered net technical liabilities 1.1x at FYE11.

Table 7: Investments	F10		F11	
	R'm	%	R'm	%
Cash & equiv.	***2,330.0***	***20.8***	***2,200.0***	***18.5***
Subsidiaries	1,843.0	16.4	1,927.0	16.2
Associates	133.0	1.2	133.0	1.1
Listed equity	3,166.0	28.2	3,285.0	27.7
Unlisted equity	12.0	0.1	14.0	0.1
Bonds & Money mkt	3,145.0	28.0	3,646.0	30.7
Pref. shares	670.0	6.0	664.0	5.6
Derivatives	(75.0)	(0.7)	(1.0)	0.0
Total	**11,224.0**	**100.0**	**11,868.0**	**100.0**

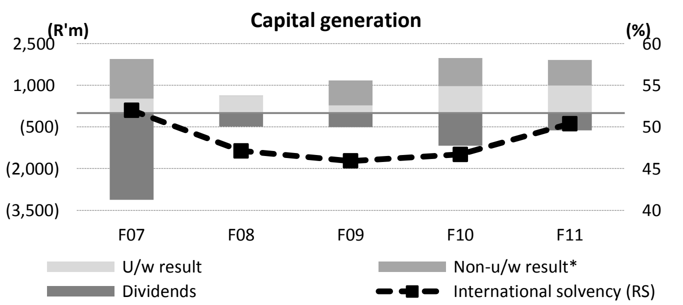
On the back of the large dividend payment and financial asset purchases, cash and equivalents declined to R2.2bn at FYE11, representing 19% of the investment portfolio (FYE10: 21%). As such, the claims cash coverage ratio reduced to 3 months (F10: 3.4 months), representing the lowest level since F07. Note is, however, taken of the increased allocation to bonds and money market instruments, which rose to 31% at FYE11 (FYE10: 28%), further supporting liquidity. Inclusive of these amounts, claims coverage held steady at a comfortable 8 months. Excluding ring-fenced cash, claims coverage was recorded at a relatively stable 2 months. GCR favourably views Santam's consistently positive operating cash flows, cumulatively amounting to R6.1bn over the review period.



Although the proportion of listed equities within the portfolio remained largely unchanged, at 28% at FYE11, relative to capital this reduced, to 48% from 53% at FYE10. In July and August F11, Santam closed out its derivative hedging arrangement, which protected R1bn and R0.75bn of listed equities respectively. In this regard, a R5m profit was realised over the term of the contracts. Post balance sheet date, the equity exposure has been reduced by R800m, for the purposes of funding the special dividend payment, lowering the equity capital exposure to 46%. Stress tests conducted on the equity exposure as at YTD F12, by assuming a 10% decline in equities, reveals that the net effect would be a R249m decrease in group profit before tax. This would lower the group's international solvency by roughly 2.5 percentage points.

Investments in subsidiaries constitute Santam's direct shareholdings in strategic and investment holding companies, as well as its interests in Centriq and Santam Namibia. During F11, Santam acquired 55% of the voting interest in Mirabilis Engineering Underwriting Managers, merging its construction and engineering business into Mirabilis. This led to a subsequent increase in subsidiary investments to R1.9bn.

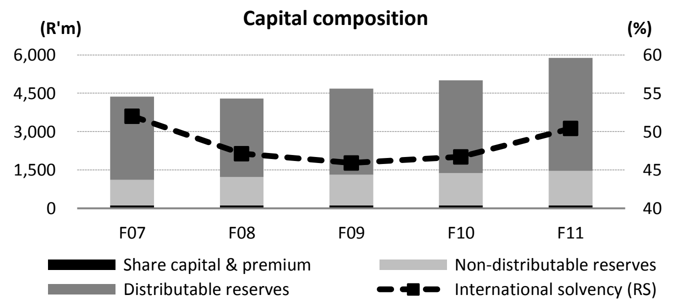
Solvency and reserving



*Investment & other income; inclusive of fair value movements.

Santam has generated cumulative retained surpluses of R4.4bn over the past four years, of which 64% have been distributed via dividends (average capital reinvestment rate of 36%). Robust profitability saw total capital increase by 18% to R6.9bn at FYE11. Accordingly, the international solvency margin strengthened by 3 percentage points to 50% in F11 (in line with the budget for the year), measuring above the 48% averaged over the previous 4 years, and is supportive of the insurer's current rating as per GCR's solvency framework. Similarly, based on the former regulatory solvency margin calculation, statutory solvency rose to 35% (F10: 30%). However, after accounting for the special dividend declared in February F12 (with total dividends in respect of F11 exceeding R1.4bn), the adjusted international solvency margin equated to 43% (albeit still adequate for the current rating).

Santam integrated a risk based capital model into the strategic level of operations in 2007, as a means of quantifying risk, and the deployment of capital per unit of risk, concurrent with strategic planning and forecasting. The model is aligned with the assessment of the five broad risk categories of underwriting risk, market risk, credit risk, operational risk, and reserving risk. On this basis, Santam's internal capital model indicates that the insurer needs to hold capital equivalent to 23.9% of F12 net earned premiums (FYE11: 21.2%). Based on an analysis of its risk profile, Santam has set a minimum international solvency margin of 35% to 45%. The excess allows for (1) a buffer over regulatory capacity requirements; (2) funding of new business; (3) credit rating maintenance; and (4) possible corporate action. Furthermore, the capital required for underwriting risk is substantially lower for the internal model than it is for the statutory bases, as the model makes allowance for the capital reducing effects of Santam's non-proportional reinsurance programme, whereas the statutory bases do not.



Santam's capital requirements have been aligned with its three year business planning horizon. The model exhibits that there is a 99.8% probability that the capital base (inclusive of subordinated debt) will exceed the statutory capital requirement. Santam's capital quality compares well with that of peers and the industry, with balance sheet strength supporting the capital intensity and cyclicality of risks accepted.

Santam has formulated a risk appetite policy that aims to quantify the amount of capital the company is willing to put at risk in pursuit of creating shareholder value. The populated risk universe assists with the aggregation and reporting of risks across business units and subsidiaries, while monitoring and aligning risk objectives and strategies across operational units. Key profitability metrics have been defined in order to test for risk adjusted capital efficiency within the scope of the various lines and units. GCR views Santam's ERM framework as strong, with embedded strategic risk management policies enabling the insurer to optimise risk adjusted returns.

Santam holds its technical reserves at a minimum of the 75th percentile level of sufficiency, in accordance with regulatory guidelines and global best practice. An additional capital amount is held to bring the reserve sufficiency up to the 99.5th percentile at a company level.

Debt rating factors

Santam issued R600m in subordinated callable notes in May 2007, at an effective fixed interest rate of 8.6%, and a further R400m in November 2007, at an interest rate of 9.6%. At FYE11, the gross gearing ratio amounted to 16.4% (FYE10: 18.5%). The funds from the debt issue are ring-fenced in a separate portfolio and invested in cash and fixed interest bearing investments, with a minimum benchmark return equivalent to Santam's bond performance. Interest rate swaps are used to hedge interest rate risk. The interest charge remained unchanged at R83m in F11, and was covered 15x by realised after tax profits and 10x by pre-dividend operating cash flows (F10: 12x and 16x respectively).

Financial performance

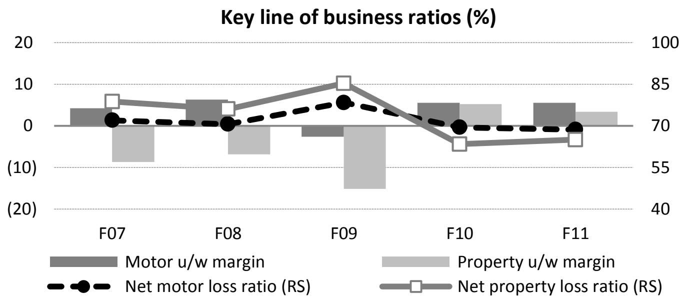
Table 8: Income statement (R'm)	Actual		% change
	F10	F11	
GWP	13,957.0	15,162.0	8.6
NWP	12,696.0	13,593.0	7.1
NPE	**12,712.0**	**13,615.0**	**7.1**
Claims	(8,153.0)	(8,686.0)	6.5
Commission	(1,964.0)	(2,173.0)	10.6
Mgmt expenses	(1,632.0)	(1,760.0)	7.8
U/w result	**963.0**	**996.0**	**3.4**
Key ratios (%)			
GWP growth	6.6	8.6	-
Retention	91.0	89.7	-
Earned loss ratio	64.1	63.8	-
Commission ratio	15.4	16.0	-
Mgmt expense ratio	12.8	12.9	-
U/w margin	7.6	7.3	-
Op. margin	12.3	12.7	-
International solvency	46.7	50.4	-

*Excludes unrealised movements.

A 5-year financial synopsis is reflected at the back of this report, and brief commentary follows. Top line growth improved to 9% in F11 (F10: 7%).

Santam's earned loss ratio held steady at 64% in F11, remaining below the review period average of 67%. This was partially offset by the higher management expense ratio of 13%, which followed IT platform cost overruns, the expansion of the contact centre and the provision for the phantom share scheme cost. As such, following the uptick in the delivery cost ratio to 29%, the underwriting margin narrowed slightly to 7% (F10: 8%), albeit remaining healthy, and above the previous underwriting margin target band of 4% to 6% (since revised to 5% to 7% for the next three years).

Strong profitability in the two core classes (significantly contrasting the first three years of the review period) bodes well for performance going forward. the review period average underwriting margin of 6% points to strong underlying earnings capacity.



Realised investment income strengthened by 22% to R738m, producing an investment yield of 6%. Dividend income was 27% higher than for F10, while interest income was negatively affected by the lower interest rate environment. Investment income benefited from the fence structures, which generated a credit of R80m for the year. Soft markets also resulted in significantly lower income from fair value movements in F11 (R180m), compared with F10 (R418m), with the total investment yield lowering by a percentage point to 8%.

Future prospects

Santam's growth strategy going forward centres on capturing market share utilising multi-channelling techniques. The insurer is looking to achieve aggressive annual growth, with increased market share penetration prioritised as the dominant strategic objective. In this regard, GCR expects the insurer to maintain its leadership credentials going forward, sustained by selective expansion feeding through to profitable growth. Improvements by way of increasingly integrated systems (most notably Fusion and STRIDE, addressing the interface with brokers) and stronger rate management and deployment should support initiatives, although continuing and pervasive rate pressures introduce a degree of execution risk. Santam Re is also a primary focus, although operations outside of South Africa are presently quite limited, restricting current growth potential. Santam has acquired Regent's aviation book to add to its niche division.

Claims controls are expected to sustain the low loss ratio posted in F11, with the completion of the ISTP system consolidating the procurement processes for increasing efficiency. Management also expects the benefits of this programme to allow for increased competitiveness in terms of rates. The next phase of claims control upgrades focuses on streamlining contact centres, thereby reducing costs while increasing controls. In addition, policy administration is expected to be strengthened by the inception of the Ignite system (albeit a 3-year programme).

Half year numbers display premium growth of 10% relative to the first six months of the previous year. The underwriting margin (6%) remains within the insurer's target band (5% to 7%), albeit impacted by a higher loss ratio, in turn a factor of a deterioration in motor claims, as well as reduced profitability in the property book.

Santam Limited

(R in millions except as noted)

Year ended : 31 December		2007	2008	2009	2010	2011
Income Statement						
Gross written premium (GWP)		11,135.0	12,172.0	13,091.0	13,957.0	15,162.0
Reinsurance premiums		(1,019.0)	(1,036.0)	(1,085.0)	(1,261.0)	(1,569.0)
Net written premium (NWP)		**10,116.0**	**11,136.0**	**12,006.0**	**12,696.0**	**13,593.0**
(Increase) / Decrease in insurance funds		(253.0)	(236.0)	0.0	16.0	22.0
Net premiums earned		**9,863.0**	**10,900.0**	**12,006.0**	**12,712.0**	**13,615.0**
Claims incurred		(6,672.0)	(7,386.0)	(8,468.0)	(8,153.0)	(8,686.0)
Commission		(1,435.0)	(1,598.0)	(1,821.0)	(1,964.0)	(2,173.0)
Management expenses		(1,242.0)	(1,297.0)	(1,443.0)	(1,632.0)	(1,760.0)
Underwriting profit / (loss)		**514.0**	**619.0**	**274.0**	**963.0**	**996.0**
Investment income (incl. realised gains)		2,698.0	795.0	622.0	603.0	738.0
Other income / (expenses)		0.0	0.0	0.0	0.0	0.0
Taxation		(479.0)	22.0	(319.0)	(541.0)	(460.0)
Net income after tax		**2,733.0**	**1,436.0**	**577.0**	**1,025.0**	**1,274.0**
Unrealised gains / (losses)		(1,269.0)	(786.0)	277.0	418.0	180.0
Retained surplus / (deficit)		**1,464.0**	**650.0**	**854.0**	**1,443.0**	**1,454.0**
Dividends paid		(3,129.0)	(489.0)	(513.0)	(1,176.0)	(627.0)
Balance Sheet						
Shareholders interest*		**4,352.0**	**4,276.0**	**4,673.0**	**5,005.0**	**5,886.0**
Admissible tier II debt		908.0	972.0	839.0	925.0	964.0
Total capital		**5,260.0**	**5,248.0**	**5,512.0**	**5,930.0**	**6,850.0**
Net UPR		1,114.0	1,351.0	1,350.0	1,334.0	1,312.0
Net OCR & IBNR		3,017.0	3,278.0	3,557.0	3,511.0	3,891.0
Other liabilities		2,300.0	1,831.0	2,249.0	2,221.0	2,054.0
Total capital & liabilities		**11,691.0**	**11,708.0**	**12,668.0**	**12,996.0**	**14,107.0**
Fixed assets		31.0	36.0	39.0	40.0	29.0
Investments		8,362.0	6,734.0	7,126.0	8,894.0	9,669.0
Cash and equivalents		1,347.0	2,759.0	3,460.0	2,330.0	2,200.0
Other current assets		1,951.0	2,179.0	2,043.0	1,732.0	2,209.0
Total assets		**11,691.0**	**11,708.0**	**12,668.0**	**12,996.0**	**14,107.0**
Cash Flow Statement						
Cash generated by operations		632.0	679.0	352.0	1,048.0	1,006.0
Cash flow from investment income		918.0	791.0	568.0	599.0	658.0
Working capital decrease / (increase)		63.0	174.0	564.0	304.0	(35.0)
Tax paid		(200.0)	(593.0)	(63.0)	(616.0)	(737.0)
Cash available from operating activities		**1,413.0**	**1,051.0**	**1,421.0**	**1,335.0**	**892.0**
Dividends paid		(3,129.0)	(489.0)	(513.0)	(1,176.0)	(627.0)
Cash flow from operating activities		**(1,716.0)**	**562.0**	**908.0**	**159.0**	**265.0**
Cash flow from investing activities		**(29.0)**	**847.0**	**(207.0)**	**(1,289.0)**	**(319.0)**
Cash flow from financing activities		**998.0**	**2.0**	**0.0**	**0.0**	**0.0**
Net cash inflow / (outflow)		**(747.0)**	**1,411.0**	**701.0**	**(1,130.0)**	**(54.0)**
Key Ratios						
Solvency / Liquidity						
Total capital / NWP	%	52.0	47.1	45.9	46.7	50.4
Statutory solvency margin (Act)	%	39.4	35.3	33.2	30.2	34.8
Net UPR / NWP	%	11.0	12.1	11.2	10.5	9.7
Net OCR & IBNR / NWP	%	29.8	29.4	29.6	27.7	28.6
Financial base (IFRS) / NWP	%	83.9	80.0	79.8	77.6	81.6
Claims cash coverage	mth	2.4	4.5	4.9	3.4	3.0
Cash / Technical liabilities	x	0.3	0.6	0.7	0.5	0.4
Efficiency / Growth						
GWP growth	%	8.8	9.3	7.6	6.6	8.6
Retention rate	%	90.8	91.5	91.7	91.0	89.7
Earned loss ratio	%	67.6	67.8	70.5	64.1	63.8
Commissions / Earned premiums	%	14.5	14.7	15.2	15.4	16.0
Management expenses / Earned premiums	%	12.6	11.9	12.0	12.8	12.9
Underwriting result / Earned premium	%	5.2	5.7	2.3	7.6	7.3
Trade ratio	%	94.8	94.3	97.7	92.4	92.7
Operating margin	%	32.6	13.0	7.5	12.3	12.7
Profitability						
Investment yield (excluding unrealised gains / losses)	%	27.3	8.3	6.2	5.5	6.4
Investment yield (including unrealised gains / losses)	%	14.4	0.1	9.0	9.4	8.0
ROaE (excluding unrealised gains / losses)	%	52.9	33.3	12.9	21.2	23.4
ROaE (including unrealised gains / losses)	%	28.3	15.1	19.1	29.8	26.7
Operating						
Effective tax rate	%	14.9	(1.6)	35.6	34.5	26.5
Dividend cover	x	0.9	2.9	1.1	0.9	2.0

*Excluding intangible assets.