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Renasa Insurance Company Limited

South Africa Insurance Analysis **October 2007**

Security class	Rating scale	Currency	Rating	Rating watch	Expiry date
Claims paying ability	National	Rand	BBB+	No	10/2008

Financial data:

(US$'m Comparative)

	30/06/06	30/06/07
R/US$ (avg)	6.42	7.21
R/US$ (close)	7.27	7.07
Total assets	5.8	7.8
Total capital	2.5	2.7
GPI	15.9	26.8
U/w result	(0.4)	(1.1)
NPAT	(0.2)	(0.9)
Market cap	n.a.	
Market share*	0.2%	

**Estimated market share based on GPI*

Fundamentals:

Renasa Insurance Company Limited ("Renasa") was established in 1998 as a subsidiary of the USA carrier Reliance National. Subsequent to Reliance National being placed into "run off" in the USA during 2000, Renasa came up for sale and was acquired by a consortium of local investors. Since this time, new management and other key personnel have been appointed and the company has undergone significant reconstruction.

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Rating rationale

The rating is based on the following key factors:

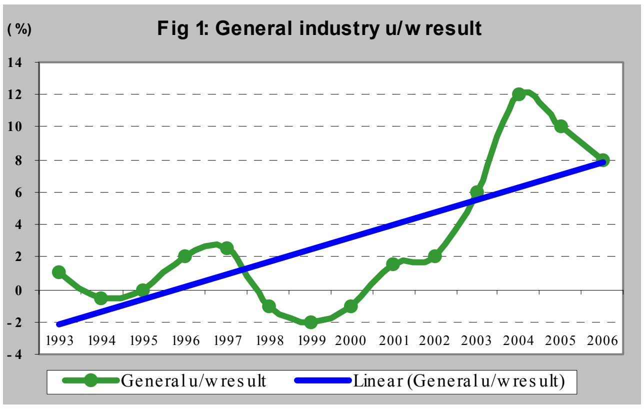
- The continued financial support provided by the insurer's sole shareholder, who has injected approximately R21m to date, lent support to the rating.
- Renasa's strong management team, which constitutes a healthy mix of experienced and innovative staff, was positively considered.
- The company's significantly improved operational infrastructure, and the successful introduction of portfolios and increased volumes of business. In this regard, Renasa has achieved growth six times that of its peers, and is closer to attaining critical mass.
- The insurer has secured three-year treaty arrangements with Munich Re, Africa Re and Swiss Re, underpinning the insurers ability to meet increased capital requirements associated with the growth risk and near term underwriting risk. This represents a first for the industry and attests to the soundness of Renasa's business model.
- Cognisance was taken of the company's heavy weighting in the motor class, which is evidencing the long term effects of economic growth. In this regard, the motor class market is currently undergoing severe rates pressure, with rates not commensurate with claiming patterns – no evident correction in the sector is anticipated in the short term.
- Accordingly, in order to compete profitably in this segment of the market whilst simultaneously achieving scale economies, Renasa restructured its business post F07, the long term success of which remains to be seen.

Solvency & liquidity

The company's primary shareholder continued to show its categorical support of the insurer by injecting a further R7m in capital prior to the insurer's year-end. Accordingly, both the international and statutory solvency margins remained unchanged at 53% and 43% respectively in F07. Liquidity levels have remained comfortable over the review period, and amounted to 13 months in F07, slightly down from 15 months in F06.

Operating environment

The overall underwriting return of the market indicates a buoyant trend. This is primarily underpinned by a record number of new policies issued on the back of new vehicle sales (and more recently commercial vehicles) and the continued upward revision of property values (reflective of current building cost inflation), albeit the rate of growth has slowed. The market, however, is in the throws of rate pressure stemming from the introduction of competition, both existing and new. However, the overall fall in underwriting performances are not expected to significantly unlock market shares for the top tier of the market, which have secured their distribution channels. Moreover, consolidation in the broker market as a consequence of the implementation of FAIS, will reinforce this trend.



Fundamentals

In 2001, a consortium of investors acquired Renasa (a subsidiary of Reliance National USA, then in run off) and from 2002 to 2004 the company faced the challenges of poor business, brought to book by uncontrolled growth. By mid 2004, the assumption of control by the current controlling shareholder was concluded and the reconstruction of the company commenced. This entailed the curtailment of business on the book with annualised premium falling to R102m in 2006.

The insurer writes a range of business classes and distributes its products through 3 distinct channels, namely:

- **Brokers** – Through this channel, the company has established relationships with brokers with regional concentrations.
- **Portfolio Managers/administrators** – these are system driven broker portfolio outsourcing companies. The company has made a commercial investment in such entities, in order to entice a larger share of broker participation and release pricing efficiencies.
- **UMAs** - This channel's underwritten risks currently consist mainly of construction performance guarantees; contractors all-risks business; and marine business. However, the company has resourced a division to secure more UMA mandated and/or equity participation.

Commercial business remains the core focus of Renasa's business, and accounted for 42% (F06: 46%) of gross premiums. However, in order for the company to achieve critical mass, and thereby reduce unit costs, growth has been targeted at the personal lines segment of the market (F07: 58%). Although sound progress has been made in this regard - evidenced in gross premium growth of 90% - growth has come at a cost to the company, given the uneconomical rates currently being offered in this segment (principally motor, which comprises 72% of the personal lines book). In this regard, the "cleansing" of the new business exerted considerable pressure on underwriting margins in F07.

Currently, the personal motor class for the industry has been significantly impacted by soft rates and adverse claims experience. The overall deterioration in the claims environment can be ascribed to the increased congestion on South African roads, as the rise in vehicle population is not met by a comparable improvement in road infrastructure. This has been compounded by an overall deterioration in the standard of driving, exacerbated by the number of unlicensed and inexperienced drivers on the road. Furthermore, the increase in severity can also be attributed to the technological advancements of vehicles leading to the repair cost of accidental damage to more modern vehicles amounting to a greater proportion of the sum insured than in the case of older vehicles. In light of the aforementioned, and in order to compete profitability in this segment of the market, Renasa have implemented the following initiatives:

- A business intelligence system has been established – this system consolidates the output of disparate lines of business operated by outsource partners that distribute Renasa products. The system permits keen analysis of the consolidated experience on the basis of reliable data flows and raises efficiency of corrective strategies. The company is confident that 60% of its book can be re-priced on a portfolio consistent basis, with re-pricing having already commenced. Moreover, implementation, which has been historically difficult, given the increasing "distance" between broker and client insured (through the growing role of the portfolio administrator), seems less problematic.
- A project has been instituted to achieve reductions in average claims costs. Incorporating an in-house

assessing and auditing resource, the renegotiation of procurement panels and the securing of towing services, to which end an intensive education initiative for the insureds to use the service has been implemented.

Competitive positioning

Primarily driven by the poor performance of the motor book, Renasa's earned loss ratio in F07 evidenced a substantial increase to 83% (F06: 65%), above the average of approximately 71% at 1H07 reported by industry leaders. Given that industry loss ratios in the motor class are not expected to improve materially in the short to medium term, Renasa has restructured the business to ensure achieving critical mass, but not at the expense of profitability. The restructuring should improve risk selection, enforce correct pricing, and manage claims costs (supported by a 100% audit of motor collision claims) going forward.

Table 1: Competitor analysis (R'm)	Renasa JunF07	Constantia Aug F06	Compass Dec F06	New Nat. Dec F06
S/H Interest	18.9	85.3	56.9	59.8
GPI	193.5	1,351.8	501.6	408.1
NPI	35.6	295.0	167.4	141.7
U/W result	(8.2)	19.8	6.7	3.1
Ratios (%)				
Solvency*	53.0	28.9	34.0	42.2
GPI growth	89.6	25.1	23.3	32.8
NPI / GPI	18.5	21.8	33.4	34.7
Claims/EP	82.7	57.9	64.8	82.0
Mng. exp/EP	42.4	13.9	40.7	8.6
Comm/EP	(2.1)	21.6	(9.8)	7.1
U/W result /EP	(23.0)	6.6	4.3	2.3

*International solvency

As indicated in Table 1, based on a comparison of other insurers of similar business mix, Renasa compares unfavourably in some respects. This is primarily a function of the insurer's elevated expenses relative to premium earned, together with a comparatively high loss ratio, resulting in an impaired underwriting performance in F07. This notwithstanding, in terms of top line growth, Renasa's growth was 4 times that of the peer average. Considering this, and the corrective steps taken and to be taken on this book, the R6m cost to capital evidenced in F07 is deemed more palatable.

Risk diversification

As previously mentioned, Renasa secures business through 3 distinct channels, namely: brokers (25%), administrators (68%) and UMAs (7%), with the majority of premiums written emanating from the Gauteng region. As reflected below, the majority of net premium written comprises the motor class, with the balance derived largely from the property and miscellaneous classes respectively.

Table 2: Class analysis (%)	GPI		NPI		Retention ratio	
	F06	F07	F06	F07	F06	F07
Property	19.8	19.8	17.6	17.5	30.2	16.3
Motor	62.8	63.5	67.3	67.6	36.4	19.7
Guarantee	3.7	4.2	1.3	2.3	12.2	10.0
Liability	0.1	0.4	0.0	0.0	0.0	0.0
Miscellaneous	13.6	12.1	13.8	12.6	34.4	19.2
Total	**100.0**	**100.0**	**100.0**	**100.0**	**34.0**	**18.5**

The large losses reported in the motor book were partly offset by the solid profitability evidenced in the guarantee class.

Table 3: U/W result	F06		F07	
	R'm	% of E.P	R'm	% of E.P
Property	1.0	15.2	2.2	35.4
Motor	(9.0)	(39.6)	(13.8)	(56.8)
Guarantee	0.2	63.0	1.9	333.0
Liability	4.0	n.a.	0.7	n.a
Miscellaneous	1.3	31.1	0.8	17.3
Total	**(2.3)**	**(6.8)**	**(8.2)**	**(22.9)**

Reinsurance

During the year under review Renasa ceded 82% (F06: 66%) of gross premium income to reinsurers in terms of proportional arrangements. The increased cession assisted the insurer in meeting increased capital requirements associated with the robust growth evidenced in F07. With effect from 1 July 2007, the company secured three-year treaty arrangements with its lead reinsurers Munich Re, Africa Re and Swiss Re, thereby securing capacity to grow the book.

Table 4: Reinsurance result (R'm)	F06	F07
Premium ceded	(67.4)	(157.7)
Claims recovered	45.5	115.0
Commission recovered	13.2	29.0
Reinsurance (profit) / loss	**(8.7)**	**(13.7)**
Expenses recovered/paid	(0.7)	(2.0)
Net reinsurance profit	**(8.7)**	**(15.7)**

Renasa has established a technical partnership with Aon Re South Africa ("Aon Re"), under which Aon Re provides broad support to Renasa's processes. Consistent with its business model, the insurer has been able to secure lower commission rates from tied-in agents, in exchange for profit share on these activities.

Table 5: Reinsurance treaties		
Surplus treaties		
Class (lines)	**Net retention**	**Treaty limit**
Fire and Engineering	R5m	R25m
Quota share treaties		
Class	**Quota share**	**U/w limit**
Motor	(40:60)	R1m
Fire and Engineering	(40:60)	R5m
Marine	(75:25)	R10m
Bonds and Guarantees	(90:10)	R12m
Accident	(40:60)	R7.5m
Attritional net	(80:20)	R4.5m
Excess of loss treaties		
Class (layers)	**Net retention**	**Treaty limit**
General account XOL	R0.8m	R100m
Marine	R0.5m	R100m

Solvency

Ascribed to successive underwriting deficits recorded to date, the company's capital base has been significantly eroded. This notwithstanding, the company's primary shareholder continued to show its financial support of the insurer by injecting a further R7m prior to the insurer's year end, in addition to the cumulative R14m provided between F05 and F06. Accordingly, both the international and statutory solvency margins remained unchanged at 53% and 43% respectively.

Asset management

As a consequence of the historic poor underwriting result, together with successive years of recapitalisation, the necessity to manage a liquid and conservative investment mix is recognised, and duly noted. In this regard, liquidity levels have remained comfortable over the review period. This notwithstanding, cognisance was taken of the decline in claims cash coverage from 15 months to 13 months in F07, which can be attributed to the 31% jump in claims (itself attributable to book building), which outpaced the 18% growth evidenced in liquid assets.

Table 6: Asset composition	F06		F07	
	R'm	%	R'm	%
Call deposits	20.9	49.5	30.2	55.1
Cash at bank	7.0	16.5	2.6	4.7
Cash & cash equivalents	**27.9**	**66.0**	**32.8**	**59.8**
Fixed assets	0.4	0.9	0.7	1.3
Other current assets	14	33.1	21.3	38.9
Total assets	**42.3**	**100.0**	**54.8**	**100.0**

Given that the majority of the company's asset mix comprises cash and call deposits, investment returns are subject to the fluctuation of interest rates. Accordingly, in light of the climbing interest rate environment experienced over the past year, the insurer reported an increased cash investment yield of 6.2% from the 3.4% previously.

Financial performance

A five-year financial synopsis of the company's results is reflected at the end of this report and brief commentary follows hereafter.

Table 7: Underwriting performance (R'm)	Actual F07	Variance	Budget F07
GPI	**193.5**	**(11.0)**	**217.3**
NPI	35.7	(12.1)	40.6
NPE	**35.6**	**(12.3)**	**40.6**
Net claims	(29.4)	(3.9)	(30.6)
Net commission	0.7	(89.6)	6.7
Mngt. Expenses	(15.1)	30.2	(11.6)
U/W profit/loss	**(8.2)**	**n.a**	**5.1**
Ratios (%)			
GPI growth	89.6	-	113.0
Retention ratio	18.5	-	18.7
Earned loss ratio	82.7	-	75.3
Commission ratio	(2.1)	-	(16.6)
Expense ratio	42.4	-	28.7
U/W margin	(23.0)	-	12.7

Despite slightly under performing initial premium projections, Renasa reported robust growth of 90%, (F06: 27% decrease) amounting to R194m in F07. The strong growth can primarily be attributed to an expanded marketing campaign, the use of additional administrators and brokers, as well as the establishment of additional UMA lines. However, following considerably lower retention of 18.5% (F06: 34%), NPI evidenced far less pronounced growth of 3%, to amount to R36m.

Net claims incurred increased in F07, rising by 31% (F05: 19% decline) to R29m (F06: R22m), which was chiefly attributed to book building. The aforementioned was exacerbated by the adverse claims environment experienced within the motor class, resulting in the earned loss ratio evidencing a notable increase from 65% to 83% in F07. Management expenses rose by R2.7m to R15.1m, which resulted in the expense ratio increasing to 42% (F06: 36%). This notwithstanding, when management expenses are evaluated against total premium written, the ratio improved to 8% (F06: 12%), which was reflective of greater economies of scale achieved in F07. Furthermore, total commissions recorded a net inflow of R0.7m, which when combined with management expenses of R15.1m, facilitated in the delivery cost ratio slightly improving to 40% (F06: 42%).

Despite the effects of corrective action taken on the motor book throughout the year (in addressing average claims cost), which led to a significant improvement in the underwriting performance for the months March to June 2007, the overall underwriting result was negative. Accordingly, the deficit widened by a further R5.9m to amount to R8.2m, resulting in the underwriting loss as a percentage of earned premiums increasing to 23% from the 7% previously recorded. Cognisance is taken of the fact that on a gross basis (before reinsurance), the company reported an underwriting profit of R1.9m (versus a reinsurance profit of R10.1m). After accounting for the two fold increase in interest income to R1.9m, the shortfall widened by 320% to report a R6.3m loss.

Future prospects

Table 8: Budget (R'm)	F07 Actual	F08 Budget	Growth (%)
Gross premium	**193.5**	**320.0**	**65.4**
Net premium income	35.7	37.1	3.9
Net earned premium	**35.6**	**37.1**	**4.2**
Net claims	(29.4)	(28.0)	-4.8
Net commission	0.7	17.0	n.a
Management expenses	(15.1)	(17.0)	12.6
U/W profit / (loss)	**(8.2)**	**9.1**	**n.a**
Key ratios (%)			
GPI growth	89.6	65.0	--
Retention ratio	18.5	11.6	--
Earned loss ratio	82.7	75.5	--
Commissions ratio	(2.1)	(45.8)	--
Management expenses ratio	42.4	45.8	--
U/W result / earned premium	(23.0)	24.3	--

Renasa is anticipating premium growth of 65% (which includes a risk consistent portfolio-wide increase on 1 November 2007) to R320m. Cession is anticipated to further increase to 88%, in order to enable Renasa to cope with the capital requirements associated with the growth trajectory. On the back of the significant increase in net commissions received to R17m (partly reflective of rate uplift); management are forecasting a significant turn around in underwriting profitability, reporting a profit margin of 24% (F06: -23%), a first in the review period.

The company has expanded its organisational infrastructure (at a measured cost) to meet capacity demand. To this end the insurer has resourced suitable candidates and 'in sourced' significant external skills in motor pricing and general data profiling. In view of winning over broker support, the company continues to build on its insurance management software tools and resources allocation advancement in the delivery channel.

Going forward, Renasa will look to derive a large portion of its premium income from the commercial and industrial and specialist classes. However, to achieve economies of scale and increase market penetration, the company remains committed to writing business derived from the unprofitable personal lines. Although this will provide scale, given the current soft market, the effectiveness of management's ability to 'cleanse' the book will be tested. The company has participatory arrangements with distribution partners and reinsurers alike.

The following risks have been identified:

- To reinforce control over outsource relationships using participatory arrangements and term deals with incentive and penalty provisions (and where appropriate acquiring ownership interests in these partners). However, the ability of the insurer to appraise the risk of the book and react accordingly is significantly impaired by the current soft rate cycle. Notwithstanding this, the new business structure should mitigate this.
- The intensification of competition within the short term market.
- The general deterioration in the performance of the industry motor book, with no immediate correction anticipated in the short term.

Renasa Insurance Company Limited

(R in millions except as noted)

Year ended : 30 June		2002	2003	2005*	2006	2007
Income Statement						
Gross premium income (GPI)		4.5	100.7	210.3	102.0	193.5
Reinsurance premiums		(2.2)	(74.1)	(155.7)	(67.4)	(157.7)
Net Premium income (NPI)		2.2	26.6	54.6	34.6	35.7
(Increase) / Decrease in insurance funds		(1.6)	(0.4)	(0.1)	(0.4)	(0.1)
Net premiums earned		**0.6**	**26.2**	**54.5**	**34.3**	**35.6**
Claims incurred		(0.6)	(25.2)	(41.6)	(22.4)	(29.4)
Commission		(0.1)	(2.2)	(2.5)	(1.8)	0.7
Management expenses		(5.4)	(5.4)	(25.1)	(12.4)	(15.1)
Underwriting profit / (loss)		**(5.4)**	**(6.7)**	**(14.7)**	**(2.3)**	**(8.2)**
Investment income (incl. realised gains)		3.6	4.4	2.2	0.9	1.9
Other income / (expenses)		(5.1)	0.8	0.0	0.0	0.0
Taxation		0.0	0.0	0.0	0.0	0.0
Net income after tax		**(7.0)**	**(1.5)**	**(12.5)**	**(1.5)**	**(6.3)**
Unrealised gains / (losses)		0.0	0.0	0.0	0.0	0.0
Cash Flow Statement						
Cash generated by operations		(2.9)	(4.8)	(13.2)	(1.4)	(7.8)
Cash flow from investment income		(1.6)	4.4	2.2	0.9	1.9
Working capital decrease / (increase)		(4.7)	7.3	(16.4)	(2.0)	4.4
Cash available from operating activities		(9.2)	6.9	(27.5)	(2.5)	(1.6)
Tax paid		0.0	0.0	0.0	0.0	0.0
Dividends paid		0.0	0.0	0.0	0.0	0.0
Cash flow from operating activities		**(9.2)**	**6.9**	**(27.5)**	**(2.5)**	**(1.6)**
Purchases of investments		(1.8)	(0.4)	(0.7)	(0.2)	(0.5)
Proceeds on disposal of investments		0.0	0.0	0.0	0.0	0.0
Other investing activities		0.0	0.0	0.0	0.0	0.0
Cash flow from investing activities		**(1.8)**	**(0.4)**	**(0.7)**	**(0.2)**	**(0.5)**
Cash flow from financing activities		**0.0**	**0.0**	**5.5**	**8.0**	**7.0**
Net cash inflow / (outflow)		**(11.0)**	**6.6**	**(22.6)**	**5.4**	**4.9**
Balance Sheet						
Shareholders interest		**20.3**	**18.8**	**11.7**	**18.3**	**18.9**
Insurance funds		1.6	2.1	0.4	0.8	0.9
Other liabilities		20.1	47.7	22.9	23.3	35.0
Total capital & liabilities		**42.0**	**68.5**	**35.1**	**42.3**	**54.9**
Fixed assets		1.6	1.2	0.5	0.4	0.7
Investments		0.0	0.0	0.0	0.0	0.0
Cash and short term deposits		38.6	45.2	22.5	27.9	32.8
Other current assets		1.8	22.1	12.1	14.0	21.3
Total assets		**42.0**	**68.5**	**35.1**	**42.3**	**54.9**
Key Ratios						
Solvency / Liquidity						
Shareholders funds / NPI	%	908.6	70.5	32.3	52.7	53.0
Solvency margin (Act)	%	122.3	(11.9)	19.8	42.7	43.0
Financial base	%	981.6	78.3	33.4	55.0	55.6
Outstanding claims / NPI	%	755.3	91.0	39.9	47.3	40.4
Insurance funds / NPI	%	73.0	7.7	1.2	2.3	2.6
Claims cash coverage	mth	817.1	21.5	9.8	15.0	13.4
Profitability						
ROaE (before unrealised gains / losses)	%	(29.4)	(7.8)	(54.7)	(9.9)	(33.9)
ROaE (after unrealised gains / losses)	%	(29.4)	(7.8)	(54.7)	(9.9)	(33.9)
Investment yield (including unrealised gains / losses)	%	8.1	10.5	4.4	3.4	6.2
Cash investment yield (average)	%	8.1	10.5	4.4	3.4	6.2
Efficiency / Growth						
GPI Growth	%	917.0	2,156.6	39.3	(27.0)	89.6
Premiums reinsured / GPI	%	50.0	73.6	74.0	66.0	81.5
Earned loss ratio	%	94.0	96.4	76.3	65.3	82.7
Commissions / Earned premiums	%	13.4	8.4	4.6	5.3	(2.1)
Management expenses / Earned premiums	%	891.5	20.7	46.1	36.3	42.4
Underwriting result / Earned premium	%	(899.0)	(25.5)	(27.0)	(6.8)	(23.0)
Trade Ratio	%	999.0	125.5	127.0	106.8	123.0
Operating						
Effective tax rate	%	0.0	0.0	0.0	0.0	0.0
Dividend cover	X	n.a.	n.a.	n.a.	n.a.	n.a.

* 18 months ended 30 June, prior to which 31 December year end - relevant ratios annualised.