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Gothaer Insurance Group

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Credit Highlights

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Financial Strength Rating

Local Currency

A-/Positive/--

Overview

Strengths	Risks
Well-diversified product portfolio coupled with a strong distribution network.	Low interest rate environment constrains the group's life earnings.
Strong capital base complemented by underwriting discipline and solid bottom-line earnings.	Narrower geographic reach when compared to higher rated European peers.

We expect Gothaer will continue to prioritize earnings generation over growth and maintain its well-diversified product portfolio and distribution channels as a basis for its sound competitiveness. We anticipate the group's P/C business will drive overall premiums. In our opinion, Gothaer will leverage its established distribution network to promote cross selling and further establish its presence in the mature German insurance market. However, because of the focus on the domestic market we believe the group's business profile is somewhat narrower than higher rated European peers.

We expect Gothaer to maintain a stable and solid underwriting performance in light of its prominent position within the German insurance market. Gothaer has historically demonstrated sound underwriting performance in the P/C business and we do not foresee any material deviation. In the life business the ongoing strategic shift to less-capital-intensive products will stabilize earnings in the low-yield environment.

The group will further improve its capitalization backed by solid earnings and balance sheet de-risking. We believe Gothaer's capital position will consolidate at the 'AA' level, supported by the group's retained earnings. In our opinion, investment risks will further stabilize and compare well with the market average. However, the improvement to the 'AA' level is very recent and the group still lacks the track record of higher rated peers.

Outlook

The positive outlook indicates that we could upgrade Gothaer in the next 12-24 months if the group establishes a track record of firmly consolidating capital at very strong levels, while stabilizing investment risks at current levels.

Downside scenario

We could revise the outlook to stable if Gothaer's capital adequacy were to weaken below the 'AA' level for a prolonged period over the next 12-24 months because of rising capital requirements, significantly lower retained earnings, or a shift back toward a more aggressive risk appetite.

Key Assumptions

- Real GDP growth of 0.5%-1.0% over 2019-2021.
- Inflation remaining around 2% coupled with continuously low unemployment rates in Germany over 2019-2021.
- Negative 10-year average bond yields of -0.5% in 2020 only gradually increasing to -0.1% in 2022 in Germany.

Key Metrics

	2020F	2019F	2018	2017
Gross premium written (mil. €)	~4,520	~4,450	4,382.8	4,290.7
Net premiums (mil. €)	~4,100	~4,050	3,991.5	3,932.8
Net income (mil. €)	100-110	100-110	118.8	211.5
Return on shareholders' equity (%)	7-8	7-8	10.8	22.7
Net investment yield (%)	~2.5	~2.5	2.8	3.2
P/C: Net combined ratio (%)	94-96	94-96	97.1	93.3
Life: Return on assets (%)*	>0.5	>0.5	0.8	0.9
PC Return on revenue (%)	5-7	5-7	6.9	9.8
Financial leverage (%)	~20	~20	21.8	27.3
EBITDA fixed-charge coverage (x)	~9	~9	9.4	16.5

f--S&P Global Ratings forecast. All figures are based on German GAAP.

Gothaer is a mutual multiline insurer in the primary insurance market in Germany, writing life, P/C, and health business. Beside the Gothaer brand, the group operates through Janitos. Gothaer also has a small presence in Romania. It sold its presence in Poland, with effect from February 2019. The ultimate parent is a mutual company Gothaer Versicherungsbank VVaG (not rated).

Business Risk Profile

Gothaer has a prominent market standing in the German insurance market, which is complemented by its diverse business lines namely P/C (51% of total business written), life (30%), and health (19%). The group is also active in the small and midsize commercial sector where competition is high. However, in our opinion, Gothaer's strategy to focus mainly on the German insurance market constraints its business diversification compared to European peers.

Premium volumes grew across all business lines in 2018. We believe the increase in life premium volume indicates a successful portfolio shift toward unit-linked and biometrics products. In spite of top-line growth, Gothaer's bottom-line result dropped to €119 million in 2018 against €212 million in previous year, which was driven by extraordinary items. Gothaer has historically demonstrated solid underwriting discipline and we expect combined ratio of about 94%-96% and net income of €100 million-€110 million over 2019-2021. In our opinion, the continuing low-yield environment might weigh on Gothaer's investment returns in the near future.

Financial Risk Profile

Gothaer benefits from sound capital adequacy of about 'AA' under our risk-based capital model. We forecast this will consolidate at the 'AA' level mainly supported by favorable earnings and reduced dependence on capital-intensive products. In addition, we believe the change in the calculation of the additional reserving requirements (ZZR) in Germany will lead to some relief and reduce pressure on the group's earnings and capital requirements. However, the prevailing low-yield conditions will slightly out-weigh the favorable impact of these changes. The life back-book is still affected by traditional guarantees that weigh on interest rate risk, but we note that this pressure is declining. Management has also initiated steps to decrease asset liability mismatch, which has helped to reduce risks arising from prolonged low interest rates. The group is reducing its exposure to risky investments, and more than 90% of their investment portfolio comprises securities that are rated 'BBB' or higher. We regard Gothaer's investment portfolio as varied, with no substantial segment or single obligor concentration. Equity exposure remains low, accounting for approximately 5% (before hedging) of the portfolio. The weighted average credit quality has improved over the years and was in the upper 'A' level in 2018, helping to reduce credit risk.

Gothaer's leverage and coverage are within our acceptable thresholds and we do not foresee any material deviations. The group issued subordinated debt in 2015 that was used to refinance another maturing hybrid issuance, which was callable in 2016.

Other Key Credit Considerations

Governance

Gothaer has a risk-limit system in place with pre-defined risk tolerance at all entity levels. In our opinion, the ability to manage interest rate and ALM risks is crucial considering the long-term and guarantee features of Gothaer's life business. The group has managed these risks quite well. The group's management is value-oriented and its strategy fits well with the available financial resources. We understand that management currently faces the challenge of guiding Gothaer through the low-yield environment and pursuing sustained profitable growth. We currently do not see any governance deficiencies in our assessment.

Liquidity

The liquidity profile is sound thanks to the various liquid sources at Gothaer's disposal, such as premium income and a very liquid asset portfolio. We do not foresee any refinancing concerns.

Other considerations

The group is very focused on the saturated German insurance market, which somewhat constrains our view of Gothaer's competitiveness compared to higher rated European peers who are exposed to more than the domestic markets.

Group support

We consider Gothaer Lebensversicherung AG, Gothaer Allgemeine Versicherung AG, and Gothaer Krankenversicherung AG core operating entities of the group.

Accounting considerations

Gothaer switched to German generally accepted accounting principles (GAAP) from IFRS in 2018. However, 2017 figures in this report are based on local GAAP for comparability reasons.

Gothaer prepares traditional embedded value calculations for its life portfolio. In calculating the group's capital base, we recognize 50% of the value-in-force on the group's life portfolio, 50% of P/C reserve redundancy, off-balance-sheet unrealized gains other than life bonds, and eligible parts of life and health policyholder capital.

Table 2

Ratings Score Snapshot	
Business Risk Profile	Strong
Competitive position	Strong
IICRA	Intermediate
Financial Risk Profile	Strong
Capital and earnings	Strong
Risk exposure	Moderately Low
Funding structure	Neutral
Anchor*	a-
Modifiers	
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Financial Strength Rating	A-

*This is influenced by our view of the group's business profile, which is somewhat narrower than higher-rated European peers because of its focus on the German market.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Insurance | Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- German Insurance Group Gothaer Outlook Revised To Positive, Sept. 24, 2019

Ratings Detail (As Of October 11, 2019)***Operating Company Covered By This Report****Gothaer Allgemeine Versicherung AG**

Financial Strength Rating

Local Currency

A-/Positive/--

Issuer Credit Rating

Local Currency

A-/Positive/--

Junior Subordinated

BBB

Related Entities**Gothaer Krankenversicherung AG**

Financial Strength Rating

Local Currency

A-/Positive/--

Issuer Credit Rating

Local Currency

A-/Positive/--

Gothaer Lebensversicherung AG

Financial Strength Rating

Local Currency

A-/Positive/--

Issuer Credit Rating

Local Currency

A-/Positive/--

Domicile

Germany

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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