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Talanx Primary Insurance Group

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Talanx Primary Insurance Group

Credit Highlights

Financial Strength Rating
Local Currency
A+/Stable/--

Overview

Strengths	Risks
Sound geographic and business-line diversification of premiums, complementing its domestic market position as one of the largest insurance groups in Germany.	Although business operations are diverse, they don't contribute equally to TPG's bottom-line results, which benefit from Hannover Re dividends.
Extremely strong capital adequacy, based on our internal risk-based capital model, supported by Hannover Re's earnings contribution.	Ongoing restructuring measures in the industrial lines segment is adversely influencing premiums and earnings, although this is improving.

S&P Global Ratings expects Talanx Primary Insurance Group (TPG) to maintain its position as one of the largest insurance groups in Germany. The Talanx group operates mainly across the following segments: industrial lines, German P/C retail, German life retail, international retail, P/C reinsurance and life and health reinsurance. TPG operates in the first four segments. Primary operations disclosed gross premiums of €15.3 billion in 2018. We expect premiums to increase by about 4% in 2019 and 2020, mainly driven by the international business and, in 2019, by the inclusion of the specialty operations within the industrial lines segment.

TPG's broad premium diversification has not yet translated into earnings diversity. The group is one of the leading providers in the industrial lines segment, mainly in Germany for historical reasons. Following large losses in 2017 and 2018, the group started a new profitability program called 20/20/20. We have seen some first positive signs in terms of performance, but long-term success still needs to be proven. In the retail business, Talanx profits from the strong footprint in its domestic market. Earnings volatility on interest rates and higher costs compared with peers have been addressed with a profitability program called KuRS, where we have seen a positive development in recent years. Retail international remains one of the main profit providers of the group's EBIT. However, TPG is also reliant on dividend payments from Hannover Re. Overall, TPG disclosed a combined ratio of 100% in 2018 compared with 101% in 2017, leading to a return on equity (ROE) of 6.6% and 6.9%, respectively. We estimate a gradual improvement in technical, as well as bottom-line performance with a combined ratio of about 97%-99% and a ROE of 6%-8% over the next two years, reflecting the positive impact of the ongoing profitability programs.

Capitalization is very strong, protected by sound risk controls. We assess TPG's capital adequacy at the 'AAA' level, based on our internal risk-based capital model. The group's regulatory solvency ratio was also sound at half-year 2019, at 203% excluding transitional measures. The group has a track record of solid and sustainable retained earnings that are gradually improving capital adequacy. We also think that the group's successful risk controls will potentially mitigate capital volatility. We believe that capitalization will remain at least in the 'AA' range despite the group's organic and nonorganic growth ambitions.

Outlook

The outlook is stable because we believe that the group will maintain its competitive strength, based on its strong business and regional diversification over our 2019-2021 forecast horizon. We also expect that TPG will maintain at least very strong capital and earnings without any major volatility.

Downside scenario

Although currently remote, we would consider taking a negative rating action on TPG over the next 24 months if its capital and earnings sustainably weakened to lower than very strong levels. This could occur if we observed an increase in capital needs that is higher than expected, or markedly lower earnings than we currently anticipate in our base-case scenario.

Upside scenario

We view a positive rating action as a remote possibility over the next 24 months. However, it could occur if TPG further significantly diversifies its earnings base by geography in its industrial and retail insurance business. This would also require a successful turnaround of its German retail and industrial lines.

Key Assumptions

- Historically low long-term interest rates at -0.4% in 2019 and -0.5% in 2020 for Germany, and 0.3% and 0%, respectively, in the eurozone.
- Stable real GDP growth of 1.2% in 2019 and 1.1% in 2020 for the EU, and at 0.5% in Germany over the same period.
- Decline in unemployment rate to 7.6% in 2019 and 7.5% in 2020 in the eurozone, after 8.2% in 2018. Similar trend in Germany, moving to 3.2% in 2019 and 3.5% in 2020 from 3.4% in 2018.

Key Metrics*

	2020f	2019f	2018	2017	2016	2015	2014
S&P Global Ratings capital adequacy	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong	Very Strong	Very Strong
Gross premium written (mil. €)	~16,500	~15,800	15,270	14,803	14,225	14,359	14,215
Net income (mil. €)	>770	>720	703	729	895	750	808
Return on shareholders' equity (%)	~6-8	~6-8	6.6	6.9	9.0	8.1	9.8
Financial leverage (%)	<40	<40	25.7	22.8	19.8	20.9	25.3
EBITDA Fixed charge coverage (x)	~6-8	~6-8	7.0	6.6	7.6	7.1	5.6
Financial Obligation / EBITDA	~2-3	~2-3	2.6	2.3	1.5	1.4	2.0
Net investment yield (%)	~3.0-3.2	~3.1-3.3	3.5	4.2	3.5	3.7	3.8
P/C net combined ratio (%)	~97-99	~97-99	100.0	101.0	97.7	97.6	100.9

Key Metrics* (cont.)

	2020f	2019f	2018	2017	2016	2015	2014
Return on revenue (%)	N.A.	N.A.	5.7	5.9	4.6	5.1	1.9

*Ratios calculation according to our new methodology updated for all years. From 2015, all figures include HDI VaG. f--S&P Global Ratings forecast.M.A.--Not available.

Business Risk Profile

TPG is one of the leading insurance groups in Germany, with a broad business portfolio offering life and P/C insurance through its defined four segments. Although the group benefits from strong premium diversification across segments and geographies, this has not yet translated into a broad earnings' diversity.

The Retail Germany segment has a solid footprint in its domestic market. In recent years, the German operations suffered from low interest rates, especially in the life products, as well as a higher cost base than peers. In order to address those deficiencies, TPG started an efficiency program called KuRS. We believe that the implementation of the program is gradually improving TPG's operations in Germany, reducing its interest rate sensitivity and lowering its overall cost base. We see strong improvements in technical profitability, with a combined ratio of 99.3% in 2018 compared to 101.6% in 2017, and stable earnings. However, performance and premiums have been influenced by the ongoing restructuring measures.

In industrial lines, we believe that TPG has a leading market position, mainly with the German industrial sector for historical reasons. Operating performance deteriorated over the past two years, with a net combined (loss and expense) ratio of 109.1% in 2018, compared with 108.5% in the same period of 2017. The 2018 losses are highly influenced by a poor performance in its German fire book. To address this problem, the group replaced its former profitability program called Balanced Book with a program called 20/20/20. We understand that the new program has a broader scope, and a stringent underwriting approach. Despite this new restructuring program, we expect gross premiums to increase in 2019, reflecting the inclusion of the newly created joint venture called HDI Global Specialty SE. Based on half-year 2019 figures, gross premiums increased by about 20%, whereas technical profits remained unchanged with a combined ratio of 102.3%. We think that a successful implementation of the 20/20/20 strategy is key to be able to maintain its strong foothold in the industrial lines business.

We see the international retail operations as the group's main growth driver. Premiums increased in the first six months of 2019 by 6.5%, despite negative currency effects. Adjusted by these effects, premiums grew by 9.2%. The group has been able to expand its international business in a profitable way, indicated by a combined ratio of 95.2% over the same period.

Overall, we expect premium growth of about 4% over 2019 and 2020, mainly driven by expansion in the international retail business and a strong increase in industrial lines from the newly created joint venture. In terms of profits, we believe that 2019 group profits will enhance compared to previous years, demonstrating a positive development from the restructuring measures in retail Germany and industrial lines, leading to a combined ratio of about 97%-99% and net profit of more than €720 million. We also assume continued pressure on ordinary investment returns, reflecting the historically low interest rates over our forecast horizon.

Financial Risk Profile

Based on the analysis of our risk-based capital model, we assess TPG's capital adequacy firmly in the 'AAA' range in 2018, despite the costly catastrophe events and fire losses in the industrial business over the past two years. We assume capitalization will remain at least in the 'AA' range over 2019-2021 despite the group's organic and nonorganic growth ambitions. Equally, we expect regulatory capital to remain securely within the group target of 150%-200%. The regulatory solvency ratio was 209% in 2018 and 203% in first-half 2019 without inclusion of any transitional measures. The group has a track record of consistent and sustainable retained earnings that are gradually improving capital adequacy, mainly supported by sound dividends from Hannover Re.

Our prospective capital view is based on our expectation that TPG will generate net profits of more than €720 million in 2019 and more than €770 million in 2020 following a profit decline in 2018 and 2017 based on large losses in the industrial line operations. We believe that the restructuring measures in industrial lines and retail Germany will bear fruit in 2019 and the following years, improving net profits in the absence of major natural catastrophe events. Consequently, we expect the combined ratio to improve to about 97%-99% over the next two years. The challenging capital market environment might partly counterbalance the positive technical development, leading to a ROE of about 6%-8% over the same period compared with 6.6% in 2018. We assume the group will distribute up to 45% of earnings as dividends. However, we take into account that Talanx AG pays about 79% of the dividends to its mutual parent, increasing the capital strength of the wider HDI Group.

In our view, TPG's conservative investment strategy, broad geographic business diversification, and sound risk controls make the group relatively resilient against capital and earnings volatility. In our view, such potential volatility might result from large losses, such as natural catastrophe events, although the probability is in our view contained through sound reinsurance protection and conservative natural catastrophe and other large loss budgeting.

TPG has demonstrated its access to ample sources of external funding, including equity, reinsurance or debt markets, and we expect this to continue. At year-end 2018, Talanx Group's (including Hannover Re) financial leverage ratio (debt plus hybrids to shareholders equity) was 25.7%, compared with 22.8% in 2017, while fixed-charge coverage stood at 7.0x compared with 6.6x in 2017. Based on our capital and earnings forecast and assuming no major change in Talanx Group's capital management approach, we expect financial leverage to remain below 40%, with fixed-charge coverage ratios of about 6x-8x in 2019-2021.

Other Key Credit Considerations

Governance

We do not foresee any material governance issues that could affect the ratings.

Liquidity

We expect TPG's liquidity to remain exceptional over the next two years. The group has ample liquidity sources available, mainly premium income and a highly liquid asset portfolio. Moreover, there are no refinancing concerns, in our view.

Factors specific to the holding company

The ratings on Talanx AG, the group's operating holding company, are equalized with those of TPG's core entities, due to its role within the wider group as internal reinsurer, further enhancing the diversity of its future cash flows and its ability to honor its financial obligations. Furthermore, Talanx AG benefits from substantial levels of excess capital and a moderate level of financial leverage.

Group support

Our assessment of Hannover Re reflects the group's stand-alone characteristics. The group is 50.2%-owned by ultimate parent Talanx AG, while the remainder of its shares is widely held. We understand that Hannover Re's strategy, capital management, and cash flows are independent from Talanx AG. However, we believe that there is a strategic alignment between the two groups, evidenced by the joint venture in the primary industrial specialty business, where the nucleus was Inter Hannover, and HDI Global SE has taken control of the joint venture.

Accounting considerations

We mainly base our assessment of TPG on its annual financial statements, including the mutual parent HDI VaG, where we focus on the three primary insurance segments: German retail, international retail, and industrial lines, supplemented by nonpublic information on the life and P/C segments and a consolidated view on TPG. Our assessment of financial flexibility relies on consolidated HDI Group figures rather than on TPG data only. In our ratings on domestic and nondomestic subsidiaries of HDI Group, our analysis is based on annual reports under local generally accepted accounting practices and International Financial Reporting Standards.

Ratings Score Snapshot

Talanx Primary Insurance Group - Ratings Score Snapshot	
Business risk profile	Strong
Competitive position	Strong
IICRA	Intermediate risk
Financial risk profile	Very Strong
Capital and earnings	Very Strong
Risk exposure	Moderately low
Funding structure	Neutral
Anchor*	a+
Modifiers	
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Financial strength rating	A+

*The anchor is influenced by our view of TPG's capital levels and business diversification compared with its 'A+' rated peers.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, 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: A New Level Of Enterprise Risk Management Analysis: Methodology For Assessing Insurers' Economic Capital Models, Jan. 24, 2011
- 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

- Talanx Primary Group's Insurance Core Subsidiaries Affirmed At 'A+'; Outlook Stable, Aug. 28, 2019

Appendi

Talanx Primary Insurance Group--Credit Metrics History

Ratio/Metric	2018	2017
S&P Global Ratings capital adequacy	Extremely Strong	Extremely Strong
Total invested assets	89,739	88,923
Total shareholder equity	10,650	10,532
Gross premiums written	15,270	14,803
Net premiums written	12,662	12,182
Net premiums earned	12,317	11,843
Reinsurance utilization (%)	17.1	17.7
EBIT	902	929
Net income (attributable to all shareholders)	703	729
Return on revenue (%)	5.7	5.9
Return on assets (excluding investment gains/losses) (%)	0.9	1.0
Return on shareholders' equity (reported) (%)	6.6	6.9
P/C: net combined ratio (%)	100.0	101.0
P/C: net expense ratio (%)	27.6	28.5
P/C: return on revenue (%)	72.4	72.4
Net investment yield (%) - including all gains	3.5	4.2

Ratings Detail (As Of October 10, 2019)*	
Talanx AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	A+/Stable/--
Senior Unsecured	A+
Related Entities	
HDI Global Insurance Co.	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
HDI Global Network AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
HDI Global SE	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	A+/Stable/--
HDI Global Specialty SE	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
HDI Haftpflichtverband der Deutschen Industrie V.a.G.	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
HDI Lebensversicherung AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	A+/Stable/--
HDI Versicherung AG (Germany)	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
neue leben Lebensversicherung AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--

Ratings Detail (As Of October 10, 2019)*(cont.)	
PB Lebensversicherung AG	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
TARGO Lebensversicherung AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
Towarzystwo Ubezpieczen i Reasekuracji WARTA S.A.	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
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.