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Gothaer Group

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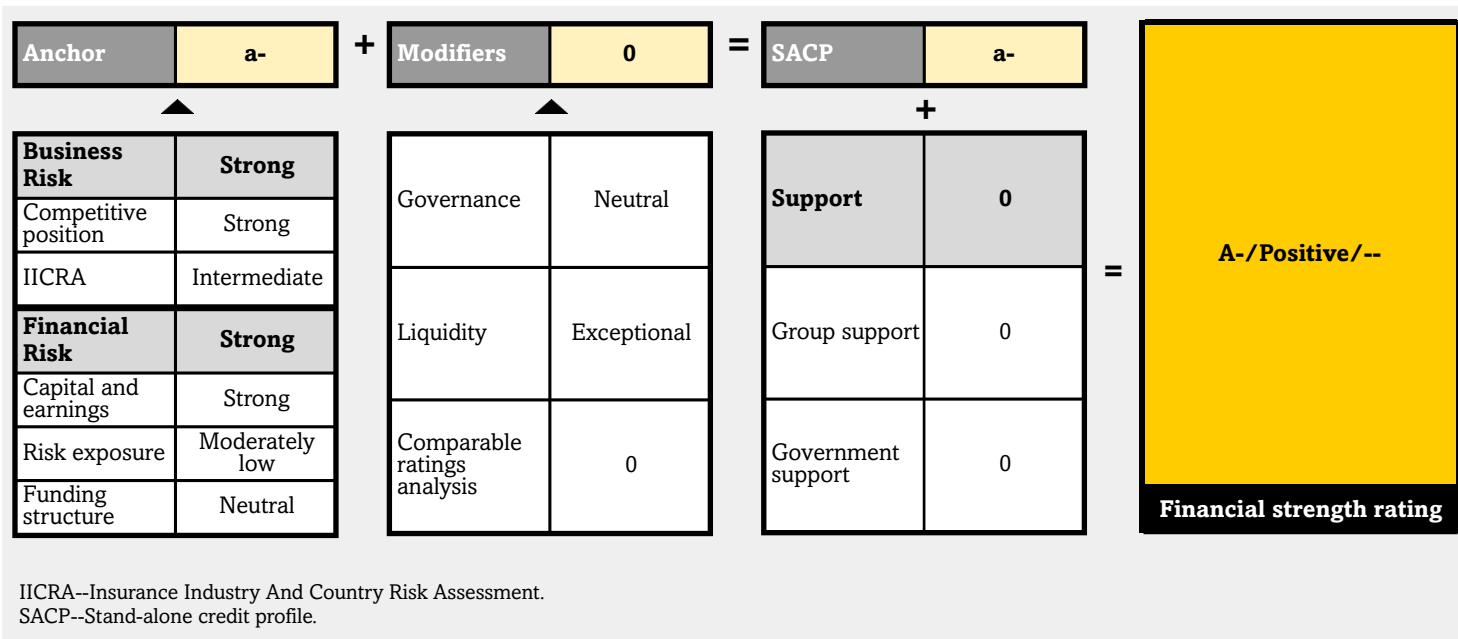
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Gothaer Group



Credit Highlights

Overview

Key strengths

Strong market credentials, supported by a well-diversified product portfolio and established distribution network.

Resilient capital base, complemented by stable underwriting discipline and sound earnings generation capabilities.

Key risks

Low interest rate environment and the COVID-19 pandemic will most likely weigh down on earnings.

Somewhat weaker nonlife profit metrics compared with those of higher-rated peers.

S&P Global Ratings believes Gothaer will maintain its established market position in Germany, backed by the group's broad product portfolio. Gothaer writes all three lines of business, namely property and casualty (P/C), life, and health. In our opinion, this makes Gothaer less susceptible to any adverse developments in a single business line. In addition, we believe the group will leverage its established distribution network to promote cross-selling opportunities, therefore enabling it to maintain its market standing in the mature German insurance market.

We expect Gothaer's profitability will remain resilient amid the turbulent market conditions, supported by the group's stable underwriting discipline. Gothaer has historically demonstrated underwriting discipline and we do not anticipate any major deviations going forward. Hence, we believe that the group's profitability will remain resilient to COVID-19-related pressure. Overall we assume Gothaer will post net income of €70 million-€90 million in 2020, followed by a modest recovery to about €100 million or more from 2021.

Capitalization will remain robust, supported by retained earnings and a conservative investment strategy. We believe that capital, although somewhat weakened due to financial market turmoil in first-half 2020, will remain securely above the 'AA' level over 2020-2022. Our assumptions are well-supported by the group's sound ability to generate earnings and low exposure to risky investments.

Outlook: Positive

The positive outlook indicates that we could upgrade Gothaer in the next 12-18 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 weakens below the 'AA' level for a prolonged period over the next 12-18 months because of rising capital requirements, significantly lower retained earnings, or a return to a more aggressive risk appetite. The same could apply the impact of COVID-19 results in significant underperformance compared with our base-case capital and earnings forecasts.

Key Assumptions

- We expect Germany's real GDP will decrease by about 5.0% this year, and rebound by 4.7% in 2021.
- Low inflation coupled with unemployment of 4%-5% through 2020-2023.
- Interest rate to remain negative over 2020-2023.

Key Metrics

	2022f	2021f	2020f	2019	2018	2017
Gross premium written (mil. €)	~4660	~4590	~4520	4524.6	4382.8	4290.7
Net premium written (mil. €)	~4300	~4230	~4160	4168.4	3991.5	3932.8
Net income (mil. €)	>100	~100	70-90	115.0	118.8	211.5
Return on shareholders' equity (%)	7-8	7-8	5-6	9.5	10.8	22.7
Net investment yield (%)	>2	>2	>2	2.6	2.8	3.2
P/C: Net combined ratio (%)	96-98	96-98	96-98	95.0	97.1	93.3
Life: Return on assets (%)	0.7-0.9	0.7-0.9	0.7-0.9	0.9	0.8	0.9
PC Return on revenue (%)	4-6	4-6	3-5	8.4	6.9	9.8
Financial leverage (%)	~17	~18	~19	18.7	21.8	27.3
EBITDA fixed-charge coverage (x)	>10	~9	~8	12.3	9.4	16.5

f--S&P Global Ratings forecast. P/C--Property and casualty.

Company Description

Gothaer is a mutual multiline insurer in the primary insurance market in Germany. Beside the Gothaer brand, the group operates through Janitos, and also has a small presence in Romania. The ultimate parent is the mutual company Gothaer Versicherungsbank VVaG (not rated).

Business Risk Profile: Strong

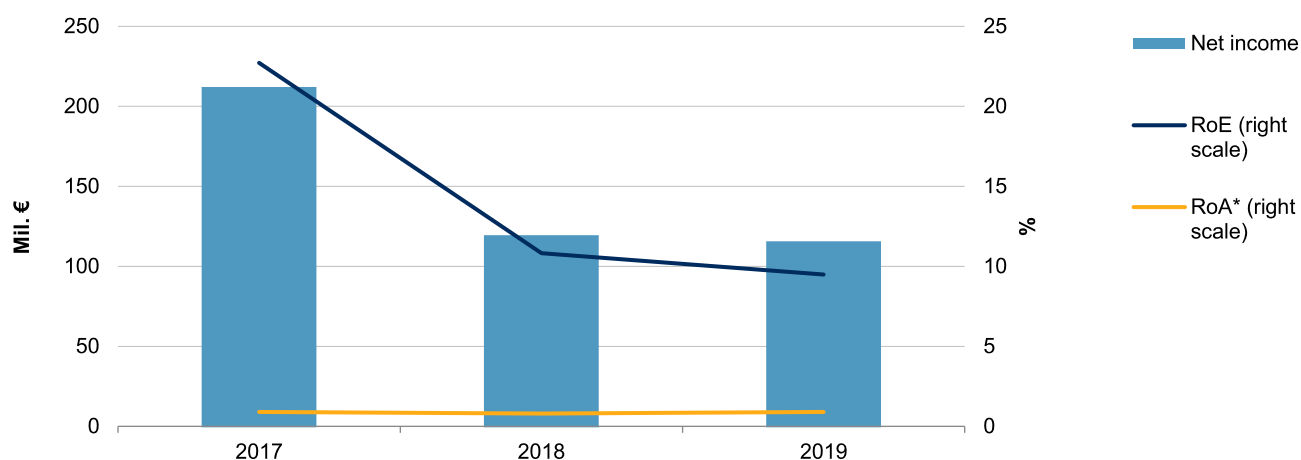
Gothaer has a prominent market standing in its domicile market of Germany, which is complemented by its diverse business lines. The group is also active in the small and midsize commercial business, where competition is high. In addition, Gothaer is actively undertaking measures to promote cross-selling, which in our opinion is vital when operating in a saturated market like Germany. The group's business across all three insurance segments makes it less vulnerable to adverse developments in a single product line, despite focusing on the mature German markets.

We have not yet observed any negative impact on the group's year-to-date business development from the COVID-19 pandemic. We assume overall flat growth in 2020, followed by gradual recovery in 2021, also based on our macroeconomic forecasts. For health insurance specifically, we expect modest cost and claims increases related to testing against the virus, and medical treatments. At the same time, these will likely be offset by cost savings following postponement or cancellation of medical treatments and increased hygiene measures that mitigate the risk for other diseases. For the P&C business, we anticipate business interruption will have the most significant impact on performance, but this should be offset by improving technical profitability in motor, household, and other business lines. In our view, the life business will suffer most from the market volatility and low interest rates, but Gothaer will mitigate this risk with the steady move toward less capital-intensive products.

Chart 1

Operating Performance

Gothaer's net income versus return on equity (RoE) and return on assets (RoA)



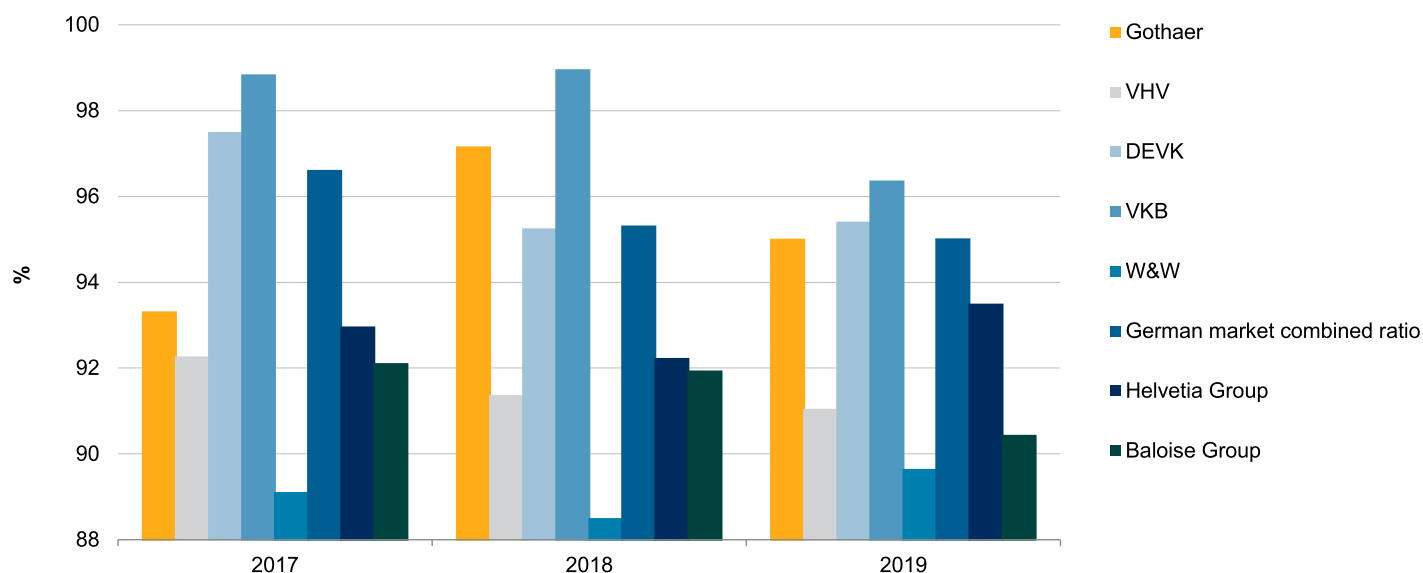
*Based on statutory accounts for Gothaer Lebensversicherung AG. Source: S&P Global Ratings. Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

Gothaer's performance was largely in line with that of its peers in 2019. Premium volumes increased across the group's health and life business lines. We believe the increase in life premium volume indicates a successful portfolio shift toward unit-linked and biometrics products. The P/C business was impacted by a one-off event--Gothaer divested its Polish business. In spite of top-line growth and improved investment results, Gothaer's bottom-line result dropped to

€115 million in 2019 against €119 million in the previous year, due to special tax effects. Gothaer has historically demonstrated solid underwriting discipline, and we expect combined ratio of about 96%-98% over 2020-2022. However, in our view, the group still shows somewhat weaker nonlife profit metrics compared with those of higher-rated peers because, for example, of their product portfolio and conservative reserving approach. In addition, the continuing low-yield environment might weigh on Gothaer's investment returns in the near future.

Chart 2

Gothaer Combined Ratio Comparison With Peers



Source: S&P Global Ratings.

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We think that capital market volatility and the economic downturn following the outbreak of COVID-19 will put pressure on Gothaer's performance in 2020, as well as on that of its mutual peers. As for the sector as a whole, we believe equity price drops, widening spreads, and a further decline in interest rates will affect the insurer's investment performance and, coupled with uncertainties around COVID-19-related insurance claims, will likely negatively impact Gothaer's earnings in 2020.

In our base case, we assume Gothaer will post net income of €70 million-€90 million in 2020, improving to about €100 million or more from 2021.

Financial Risk Profile: Strong

Gothaer benefits from sound capital adequacy at the 'AA' level under our risk-based capital model, and we expect it will remain above this level through 2020-2022, despite unfavorable market conditions. Our assumption is mainly

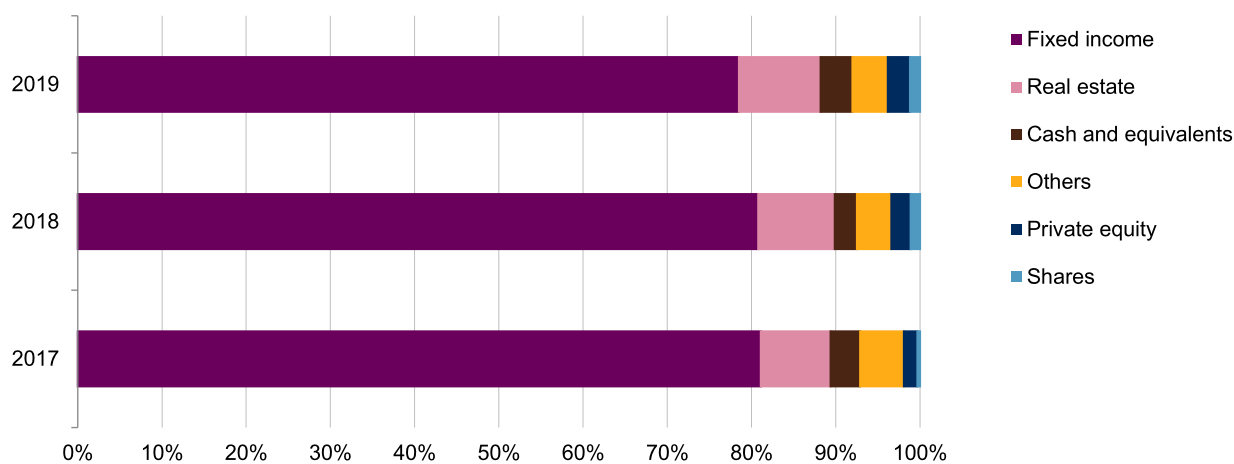
supported by favorable earnings generation mainly stemming from nonlife business and a portfolio shift to unit-linked and biometric life business, which are less capital intensive. Gothaer's strong solvency ratio, which stood at 276% (including transitionals) at year-end 2019, further backs our view.

Although the change in the calculation of the additional reserving requirements (ZZR) in Germany has led to reduced pressure on the group's earnings and capital requirements, we expect the prevailing low-yield conditions and COVID-19-related market turmoil will continue to weigh on this favorable impact. The life backbook is still affected by traditional guarantees, leading to somewhat higher 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. Equity investments are low, with less than 2% of total invested assets, which makes Gothaer less susceptible to equity price drops. The weighted average credit quality has improved over the years and was in the upper 'A' level in 2019, indicating a reduction in the group's credit risk. Furthermore, we regard Gothaer's investment portfolio as diverse, with no substantial segment or single obligor concentration.

Chart 3

Gothaer's Investment Portfolio



Source: S&P Global Ratings.
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Gothaer's leverage and coverage are within acceptable thresholds for the rating, 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 comprehensive risk management system in place with pre-defined risk tolerance at all entity levels. In our opinion, interest rate and asset liability mismatch risk management are crucial considering the long-term and guarantee features of Gothaer's life business. We believe the group has managed these risks quite well. Management is value-oriented, and we believe Gothaer's business strategy fits well with the financial resources at its disposal. Overall, we do not see any governance deficiencies in our assessment.

Liquidity

We do not foresee any liquidity or refinancing concerns owing to the strength of available liquidity sources, and we expect the group would withstand severe liquidity stresses in the case of a stress scenario.

Group support

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

Environmental, social, and governance

We believe Gothaer's exposure to environmental, social, and governance risks are in line with that of overall German insurance industry and its peers. Since life insurance constitutes close to 33% of the total business, the group is exposed to demographic trends relating to improved longevity or rising chronic diseases. These trends could increase its liabilities in Germany. That said, this is a common problem for life insurers. Environmental risks mainly stem from Gothaer's natural-catastrophe exposure, however, the majority of these exposures are reinsured. Governance factors, in our opinion, remain consistent with those we see across Germany.

Accounting considerations

Gothaer switched to German generally accepted accounting principles (GAAP) from International Financial Reporting Standards 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.

Ratings Score Snapshot	
Business Risk Profile	Strong
Competitive position	Strong
IICRA	Intermediate risk
Financial Risk Profile	Strong
Capital and earnings	Strong
Risk exposure	Moderately low
Funding structure	Neutral
Anchor*	a-

Ratings Score Snapshot (cont.)

Modifiers	
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Financial Strength Rating	A-/ Positive

*This is influenced by the group's still somewhat weaker nonlife profit metrics compared with those of higher rated peers.

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
- 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

Appendix**Gothaer Group--Credit Metrics History**

Ratio/Metric	2019	2018	2017
S&P Global Ratings capital adequacy*	Very strong	Very strong	Strong
Total invested assets	32095.0	30922.2	30657.5
Total shareholder equity	1263.7	1159.2	1035.5
Gross premiums written	4524.6	4382.8	4290.7
Net premiums written	4168.4	3991.5	3932.8
Net premiums earned	4164.5	3976.6	3919.2
Reinsurance utilization (%)	7.9	8.9	8.3
EBIT	217.1	165.0	390.9
Net income (attributable to all shareholders)	115.0	118.8	211.5
Return on revenue (%)	4.2	3.3	7.8
Return on shareholders' equity (reported) (%)	9.5	10.8	22.7
P/C: net combined ratio (%)	95.0	97.1	93.3
P/C: net expense ratio (%)	29.8	30.7	30.6
P/C: return on revenue (%)	8.4	6.9	9.8
Health: Medical loss ratio (%)	77.6	77.6	77.5
Health: Return on revenue (%)	13.8	14.5	14.8
EBITDA fixed-charge coverage (x)	12.3	9.4	16.5
EBIT fixed-charge coverage (x)	11.7	8.7	15.9
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	11.7	8.7	15.9

Gothaer Group--Credit Metrics History (cont.)

Ratio/Metric	2019	2018	2017
Financial obligations / EBITDA adjusted	1.3	1.8	1.0
Financial leverage including pension deficit as debt (%)	18.7	21.8	27.30
Net investment yield (%)	2.6	2.8	3.2
Net investment yield including investment gains/(losses) (%)	3.4	3.1	4.7

P/C--Property and casualty.

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bbb	bb-/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of October 16, 2020)***Operating Companies 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

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

Ratings Detail (As Of October 16, 2020)*(cont.)

debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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