

# Dagong Europe Affirms 'AA-' Long-Term Credit Rating on Euler Hermes SA, Outlook Stable

## Rating Action Report

Milan, 24 July 2017

Dagong Europe has affirmed its Long-Term Credit Rating of 'AA-' and equivalent Short-Term Credit Rating of 'A-1' on Euler Hermes SA (EH), Belgium based core operating subsidiary of the Euler Hermes Group SA. The outlook is 'Stable'.

### RATING RATIONALE

The assigned Long-Term Credit Rating of 'AA-' combines an Individual Financial Strength Assessment (IFSA) of 'a+' and External Support Assessment (ESA) of 'High', resulting in a one-notch uplift, based on the support from its parent and major stakeholder Allianz Group, via its operating holding entity Allianz SE (Allianz). The IFSA reflects the Very Strong and resilient financial profile of EH, its prudent risk management practices and large capital base. The rating is also supported by EH's leading competitive position in the credit insurance industry, coherent development strategy and its strong execution. These strengths are partially constrained by EH's mono-line business model (trade credit insurance), the potentially high product risk and sensitivity to economic cyclicality. The main considerations for the IFSA are:

- **Satisfactory operating environment:** Being a very international company, EH is exposed to increased geopolitical risks, currency fluctuations, volatile economic growth and increasingly frequent changes in international and domestic trade regulations. We see the industry development potential for Credit Insurance as 'Satisfactory' since it is negatively affected by increasing competition in the sector, weakening profitability and high cost of operations in smaller and developing markets. The current low interest rate environment also adds pressure on industry's profitability. These negative aspects are partially offset by Strong and well-established insurance regulatory and legal frameworks in the core European countries and improving economic outlook.
- **Successful strategy and Very Strong competitive position:** In our view, EH can count on a very experienced management team and a long-standing track record of successful execution of strategies and achieved goals. It is the leading player in the global credit insurance sector with a market share of above 30% and Strong geographical diversification. For 2017-18 we expect a low level of growth in premiums at about 1%-2% due to volatile economic environment, increasing risks and the company's strategic focus on protecting profitability.
- **Very Strong risk management:** Our view is based on very well developed risk management framework, supported by prudent underwriting policies. The implemented sophisticated risk management tools help EH to mitigate high tail risks and reduce volatility of earnings and capital. EH has a proven ability to identify and react to early signs of deterioration in the country, sector or buyers' risk profile and reduce its exposures to prevent large losses.
- **Very Strong financial performance, supported by Very Strong profitability but exposed to earnings volatility:** EH continues to show a solid track record of high, although slowly reducing profitability, due to lower investment returns, with a three-year average return on

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assets at 5.1%<sup>1</sup> and return on equity of 11.2%. EH's technical performance is stable and robust, considering its exposure to high severity risks and sensitivity to the macroeconomic environment. The net combined ratio was stable and stood at 80.3% by YE16 with a three-year average at 79.1%.

- **Excellent level of capital:** EH maintains a large, stable and high-quality capital base, consisting primarily of shareholder equity. It stands at 45.7% relative to its total assets adjusted<sup>2</sup>. The capital is managed at group level for economic and risk management purposes. By YE16, the Solvency II ratio at the EH group level stood at 166%, slightly above the target of 160%. Due to the volatile nature of the credit insurance business, we believe the main risks to EH's capital could come from a significant deterioration in the credit risk of buyers, and severe losses outside of the current reinsurance protection structure.

We regard the potential external support from Allianz, Euler Hermes' major stakeholder, as 'High'. In our view, EH is a strategically important and a highly integrated member of the Allianz Group. It provides high returns, diversification and growth opportunities for the parent. In addition, with its specialised niche products, EH supplements Allianz's value proposition and enables full product range proposition for its corporate client segment, from retail to risk management solutions.

## RATING OUTLOOK AND POSSIBLE EVOLUTION

### Outlook - Stable

The stable outlook reflects our expectations that EH will maintain and strengthen its competitive position, prudently manage increasing risks and growth in emerging markets, and at the same time maintain a large capital base and Very Strong profitability over the cycle. We anticipate return on equity to be around 11% and a net combined ratio within 75%-85% range in 2017-18.

### Upside - Downside Potential for the Rating

We consider a positive rating action unlikely. On a stand-alone basis the company already benefits from the parent support and improvements in its financial profile would not automatically lead to a rating upgrade. However, a material improvement in our opinion on the parent's financial strength or increased level of support could lead to a rating upgrade.

We would consider lifting the IFSA if EH successfully strengthens its sustainability and competitive position by increasing product diversification and growing its global market share outside Europe, while maintaining its Very Strong financial profile. We would also consider lifting the IFSA if we have evidence of an improvement of the operational environment, due to better industry development prospects.

A deterioration of the IFSA would unlikely result in a downgrade of the long-term credit rating due to the high level of support from the Allianz Group. However, we would consider lowering the ratings if we see a weakening of the Allianz Group's ability to provide support to EH. On the other hand, we would consider lowering the IFSA if we observe weakened risk management practices or a significant reduction in EH's capital levels, which could derive from a high and persistent earnings deterioration due to greater than expected losses.

<sup>1</sup> All ratios in this document are based on Dagong Europe calculations, unless stated differently. The financial data is taken from Euler Hermes Group SA financial statements and presentations.

<sup>2</sup> Total assets adjusted exclude Reinsurance assets from Total assets.

## EULER HERMES BUSINESS PROFILE

EH is a global leader and specialist in the niche credit insurance market with over 30% market share and also provides bonding, guarantees and collection services.

With over 100 year's history the group has evolved and grown significantly boosted by M&A's and JV's. EH is present in more than 50 countries and has exposure in most of the countries in the world with the majority of premiums coming from Europe, the largest trade credit insurance market, and represented over 70% of groups turnover in 2016.

Its organizational structure has been significantly streamlined in 2010-2014, while the optimisation process is ongoing. During this process, the group became highly centralised and has largely the same processes, risk management, IT, underwriting across all of its operations.

In addition, it leverages on its global trade market knowledge by providing important business information to companies and helping them to manage their trade receivables through payments monitoring and collection services.

## FULL LIST OF SOLICITED RATINGS ASSIGNED

### Euler Hermes SA

Long-Term Credit Rating (FC&LC)	AA-
Outlook	Stable
Short-Term Credit Rating (FC&LC)	A-1
IFSA	a+
ESA	High, Group Support

FC & LC: Foreign Currency and Local Currency

## RATING HISTORY

### Ratings affirmed on 26 July 2016:

Euler Hermes SA AA-/A-1/Stable

### Ratings affirmed on 20 January 2016:

Euler Hermes SA AA-/A-1/Stable

### Ratings affirmed on 20 January 2015:

Euler Hermes SA AA-/A-1/Stable

### Ratings affirmed on 6 November 2014:

Euler Hermes SA AA-/A-1/Stable

### Ratings withdrawn on 6 November 2014:

Euler Hermes France SA WR  
Euler Hermes Deutschland AG WR

### Ratings assigned on 20 January 2014:

Euler Hermes SA AA-/A-1/Stable  
Euler Hermes France SA AA-/A-1/Stable  
Euler Hermes Deutschland AG AA-/A-1/Stable

## CRITERIA APPLIED

- [Dagong Europe Criteria for Rating Insurance Companies, updated on 10 July 2017](#)
- [Dagong Europe Ratings Definitions, published on 16 March 2016](#)

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## OTHER REGULATORY DISCLOSURES

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