GCR RATINGS

Public credit rating report | South Africa Insurance | February 2023

Western National Insurance Company Limited

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Western National Insurance Company Limited	Financial strength	National	A+(ZA)	Stable Outlook

Strengths

- Sustained earnings strength supported by very competitive underwriting profitability.
- High risk adjusted capitalisation.
- Strong liquidity supported by operational cash flows and conservative investment strategy.

Weaknesses

- Low market shares in both South Africa and Namibia.
- Limited premium diversification and geographic spread.

Rating rationale

Western National Insurance Company Limited's ("Western National SA") rating reflects the very strong financial profile of Western Group Holdings Limited's ("WGHL" or "the group"), largely driven by Western National SA, which is the core operating entity. Furthermore, the rating considers the overall risk profile of the majority shareholder, PSG Konsult Limited ("PSGK"), which was upgraded in July 2022.

WGHL reflects strong earnings, supported by competitive claims and an efficient cost structure. The insurer benefitted from business interruption reserve releases in FY22, resulting in the net claims ratio lowering to 52% (FY21: 54%) and the combined ratio to 82% (FY21: 85%). Subsequently, the KwaZulu-Natal floods compressed underwriting profitability slightly, although margins remained strong, with the combined ratio registering at 89% versus a cross cycle average of approximately 95% for its peers. We expect the group to continue reflecting strong underwriting profitability, given its selective underwriting and competitive operating expense ratio, while net earnings stability is likely to be supported by consistent realised investment income.

Strong internal capital generation has supported risk adjusted capitalisation within a high range, with the GCR capital adequacy ratio ("CAR") being maintained at around 1.7x over the past two years and continuing into 1H F23. Similarly, Western National SA's Solvency Capital Requirement ("SCR") coverage ratio is very strong and has followed an increasing trend, registering at 2.7x at FY22 (FY21: 2x; FY20: 1.8x) after implementing a refinement of the calculation. Looking ahead, solvency is likely to be maintained at similar levels, although it could moderate if managed down towards the dividend threshold.

Liquidity is also positive for the rating. Growing operational cash flow generation has supported very strong liquidity metrics, with stressed coverage of expected liquidity requirements registering at a stable 2.7x after normalising for the claims reserve releases. Conservative investment allocations and continued positive operational cash flow generation are likely to maintain liquidity levels within a rating appropriate range over the outlook horizon, although also being sensitive to potential dividend distributions.

The above factors are partly offset by the group's limited competitive position, given low market shares in the South African and Namibian insurance sectors. Line of business diversification is viewed to be healthy but geographic diversification outside South Africa is limited. The assessment considered the group's success in executing its strategic plans, as evidenced by the growth achieved over the review period, which has coincided with a strengthening in underwriting profitability. This could contribute towards a more positive assessment of the business profile if sustained going forward.

Outlook statement

GCR expects earnings strength to continue over the Outlook horizon, with the combined ratio likely to be in the 85% to 89% range and return on revenue at around 16%. Solvency and liquidity are also expected to remain within rating appropriate bands in the absence of large dividend payments. The business profile is not expected to change materially over the near term, but we see potential for incremental increases in market share over the longer term as the group continues to execute its strategic plans.

Rating triggers

The rating could be upgraded if the financial profile of the group remains strong, but this would need to be accompanied by a strengthening in PSGK's credit profile. Downward rating action could follow a material reduction in capitalisation or liquidity if regulatory solvency is managed towards the dividend threshold.

Analytical contacts

Primary analyst	Susan Hawthorne	Deputy Sector Head: Insurance
Johannesburg, ZA	SusanH@GCRratings.com	+27 11 784 1771
Committee chair	Sylvia Mhlanga	Senior Analyst: Insurance
Johannesburg, ZA	SylviaM@GCRratings.com	+27 11 784 1771

Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
GCR Ratings Scales, Symbols & Definitions, May 2022
Criteria for Rating Insurance Companies, July 2022
GCR Country Risk Scores, February 2023
GCR Insurance Sector Risk Scores, February 2023

Ratings history

Western National Insurance Company Limited					
Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Claims paying ability	Initial	National	A-(ZA)	Stable Outlook	April 2015
Financial strength	Last	National	A+(ZA)	Stable Outlook	December 2021

Analytical entity: WGHL

Western National SA is 60% owned by Western National Insurance Company Ltd Namibia, which in turn is owned by WGHL, incorporated in Namibia. The remaining 40% is owned by Santam. The ultimate majority shareholder is PSG Konsult. Western National SA's financials are consolidated into WGHL, and the insurer is the core entity within the group, contributing c. 94% of GWP in FY22. As a result, the analysis was conducted on a group basis.

Fellow subsidiaries include Hi-Five Corporate Finance (Namibia), Western Engineering Risk Specialists (SA) and Western Administration Services (SA).

Operating environment

The group primarily operates in South Africa, with a small premium contribution from Namibia weighing down the sector risk score slightly.

Country risk

The South African country risk score partially reflects the rebound in GDP per capita to USD6980 at 2022 from USD5620 at 2020 due to exchange rate improvements. However, weak macro-economic fundamentals are expected to continue to hamper growth prospects in the short to medium-term. The SARB is projecting GDP growth of 1.7% for 2022, followed by 1.9% for 2023 and 2024 respectively. Modest growth, alongside the persistent inflation pressures and high and rising unemployment (35.3% at Q4 2021) are the most significant pressure points for the South Africa country risk score and raise the risk of possible social unrest and industrial action going forward. Government debt levels remain high, projected at 73.4% for 2023 from 70.2% in 2022 and the risks are exacerbated by the vulnerable financial positions of State Owned Entities which will continue to require large amounts of capital. Positively, the mining boom has provided some relief for government revenues. The assessment is somewhat supported by stable institutional scores based on the World Bank Governance Indicators and World Economic Forum Global Competitiveness Index which are in the middle of the range, albeit better than regional peers. Details regarding GCR's country risk scores can be found here: https://gcrratings.com/wp-content/uploads/2023/02/20230215-Country-Risk-publication-1.pdf.

Sector risk

South Africa's non-life insurance sector risk score reflects its distinctive risk profile characterised by a different market structure from the life insurance industry. Core market factors remain stable reflecting a strong regulatory environment and a deep insurance market on a global scale. South Africa's regulatory environment is guided by risk-based supervision through the Solvency Assessment and Management ("SAM") model and a strong legal framework as well as healthy self-regulation, which supported markets during the COVID-19 pandemic, Insurance Sector Risk Scores: Updated 30 August 2022 averting reputational risks. In this respect, the nonlife insurance market managed to retain positive real gross premium growth potential, which we project within a 2% to 5% range over the medium term and capable of supporting insurance penetration of above 2.5%, given corresponding real GDP growth forecasts of below 2%. Market dynamics are considered healthy at an estimated HHI of below 1000, further supported by a proliferation of innovative product delivery models. Earnings risk is viewed to be relatively low, although has increased in the wake of increased frequency of catastrophe events and high value claims, mostly due to the effects of climate change, albeit with risk-based supervision somewhat mitigating these effects through better management of asset risk. Further information on GCR's insurance sector risk scores can be found here: https://gcrratings.com/wp-content/uploads/2023/02/Insurance-Sector-Risk-publication-20-February-2023.pdf

Competitive position

Limited market share but consistent growth has supported a gradual increase.

WGHL's traditional intermediated (direct) business has been growing at more than 10% over the past 18 months, although this has been diluted by fluctuations in demand for reinsurance inwards business, resulting in growth being somewhat dampened over the past two years. As a result, the group remains small in the South African and Namibian contexts, with respective market shares of around 1% and 3% in FY22. Looking ahead, growth is expected to pick up as investments in sales staff start to gain momentum, supported by a good franchise in the brokered commercial space. Although the more profitable reinsurance inward business is likely to be diluted on the back of this, the insurer aims to achieve enhanced cost efficiencies as volumes continue to increase. Premium scale is good with total GWP exceeding USD100m.

Table 1: Premium scale and growth

	FY21	FY22	6M F23
Gross written premium (USD'm)	108.6	109.9	110.7*
Gross written premium growth (NAD %)	5.5	4.3	10.5*
Market share (%)^	1.0	0.9	--
Premium retention (%)	67.8	65.0	62.9

*6M F23 figures are annualised.

^Market share relates to Western National SA only and is calculated using total gross written premiums for the short-term insurance industry with GCR estimates used where necessary.

Premium diversification

Intermediate diversification by line of business with geographic concentration to South Africa.

Table 2: Line of business summary (%)

	GWP		NWP		Retention	
	FY21	FY22	FY21	FY22	FY21	FY22
Fire/property	35.0	36.5	31.9	33.4	66.2	63.1
Transport	1.2	0.9	1.1	0.6	62.5	47.8
Motor	42.0	41.8	41.4	42.1	71.7	69.4
Accident & health	14.1	12.5	20.0	18.0	103.0	99.4
Guarantee	0.0	0.0	0.0	0.0	45.9	47.1
Liability	3.0	3.4	0.8	0.9	20.9	18.8
Engineering	1.7	2.0	0.9	1.3	40.6	45.0
Miscellaneous	2.8	2.3	3.7	3.2	90.8	89.3
Total	**100.0**	**100.0**	**100.0**	**100.0**	**69.0**	**64.3**

Source: Annual quantitative returns.

The business reflects a good mix between the predominant property and motor classes, while the accident and health class represents another material diversifier. The other classes of business are very small and not actively targeted by the group, given their higher exposure to volatility. Going forward, the business mix is likely to be similar given the consistent strategy. There is a 55%/45% split between direct business and reinsurance inwards sourced through PSG intermediaries, but this is likely to continue to reduce as emphasis is placed on growing through independent intermediaries. Premium retention has been declining given the higher weighting of direct business, which is more heavily reinsured, and this is likely to be further compressed by tougher reinsurance rates in South Africa.

Approximately 94% of business is sourced from South Africa and the balance from Namibia, with concentration to South Africa likely to continue going forward. There has, however, been a focus on expanding outside large metropolitan areas to enhance growth and diversification within the country.

Management and governance

GCR considers WGHL's management and governance to be neutral to the rating.

There is no real complexity in the group, transparency is good and both shareholders are associated with sound risk management and governance practices. Western National SA's board of directors consists of two executive and four non-executive members and committees are in place for the Audit, Risk and Investment functions. Deloitte was appointed as the auditor for FY22 in line with the group's audit rotation policy, and Western National SA and the group received clean audit opinions.

The group has delivered well on strategic objectives, having achieved a reasonable growth track record that has been accompanied by very competitive underwriting profitability. We expect risk selection and systems to continue to support underwriting profitability comfortably above peer averages over the short to medium term.

Financial profile

Earnings

Earnings are strong and expected to be sustained at competitive levels over the outlook horizon

Figure 1: Underwriting margin performance

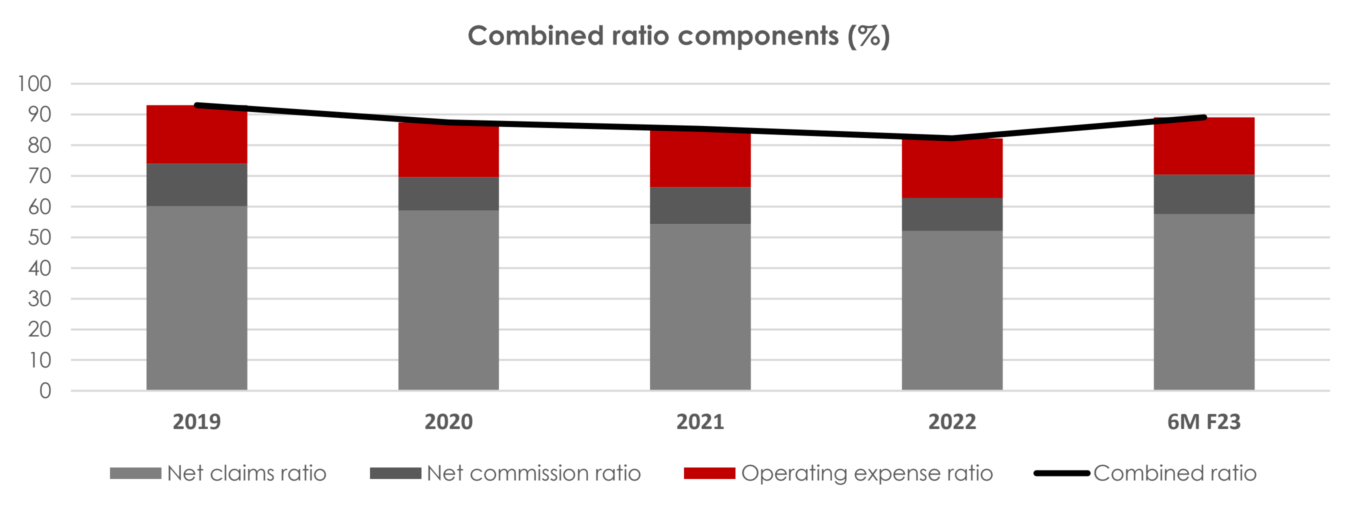

Table 3: Key performance metrics (%)

	FY21	FY22	6M F23
Net incurred loss ratio	54.2	52.1	57.5
Net claims ratio	12.1	10.7	12.9
Operating expense ratio	19.0	19.5	18.6
Combined ratio	85.3	82.2	89.1
Total investment yield	11.9	12.1	4.0
Realised investment yield	8.2	6.9	4.6
Return on revenue	15.8	19.1	11.8

WGHL's earnings strengthened consistently between FY19 and FY22 on the back of reducing claims and a competitive operating expense ratio. FY22 further benefitted from business interruption reserve releases, resulting in the net claims ratio lowering to 52% (FY21: 54%) and the combined ratio to 82% (FY21: 85%). There was a slight reversal in this trend in 6M F23, with the KZN floods adding about R11m to net claims for the period. However, margins remained strong with the combined ratio registering at 89% versus a cross cycle average of approximately 95% for its peers. Net earnings have followed the underwriting trend and were further bolstered by fair value gains in FY21 and FY22, resulting in return on revenue of 16% and 19% respectively (FY19: 13%). These gains were partially reversed in 6M F23 but net earnings remained sound, with return on revenue of 12% likely to continue outperforming peers. We expect the group to continue reflecting strong underwriting profitability, given its selective underwriting and efficient operating expense base, while net earnings stability is likely to be supported by consistent realised investment income.

Aside from FY21, which was impacted by business interruption claims recoveries, cumulative net reinsurance cessions have resulted in an average reinsurance technical margin of about 8%. Reinsurance is placed with counterparties of good credit quality (minimum national scale rating of A for treaty participants) and risk retention under the excess of loss treaty is below 1% of shareholders' funds.

Table 4: Reinsurance account (NAD'm)

	2019	2020	2021	2022	6M F23
Premium ceded	**(352.2)**	**(456.0)**	**(511.6)**	**(582.8)**	**(341.0)**
Claims recovered	221.8	280.0	390.1	281.2	197.4
Commission recovered	106.2	136.9	167.7	185.2	100.2
Reinsurers' technical result	**(24.3)**	**(39.1)**	**46.3**	**(116.4)**	**(43.4)**
Ratios (%)					
RI claims ratio	63.0	61.4	76.3	48.3	57.9
RI commission ratio	30.2	30.0	32.8	31.8	29.4
RI technical margin	6.9	8.6	(9.0)	20.0	12.7

Capitalisation

Strong risk adjusted capitalisation is supported by earnings generation.

Table 5: SAM calculation

	FY21	FY22	June 2023
Solvency capital requirement (R'm)	399.3	403.3	418.8
Own funds eligible to meet SCR (R'm)	810.5	1087.6	1116.9
SCR coverage (x)	**2.03**	**2.70**	**2.67**

Source: Annual and quarterly quantitative statutory returns.

WGHL has grown its capital base at a compound annual rate of 20% between FY19 and FY22, supported by high earnings and full profit retention. This has supported risk adjusted capitalisation within a high range, with the GCR capital adequacy ratio ("CAR") being maintained at around 1.7x over the past two years and continuing into 1H F23. Similarly, Western National SA's Solvency Capital Requirement ("SCR") coverage ratio is very strong and has followed an increasing trend, registering at 2.7x at FY22 (FY21: 2x; FY20: 1.8x) after implementing a refinement of the calculation. Looking ahead, solvency is likely to be maintained at similar levels, although it could moderate if managed down towards the dividend threshold of 1.8x.

Liquidity

Low risk investments and operational cash flow generation support sound liquidity

Strong net earnings have supported growth in operational cash flow generation, with cash available from operating activities registering at NAD157m in FY22 (FY21: NAD140m). This continued to support very strong liquidity metrics, with stressed coverage of expected liquidity requirements exceeding 3x at FY22 and registering at around 2.7x after normalising for the business interruption claims reserve releases. Conservative investment allocations and continued positive operational cash flow generation are likely to maintain liquidity levels within a rating appropriate range over the outlook horizon, although also being sensitive to potential dividend distributions.

Investment assets are predominantly placed in cash equivalents and unit trusts, with underlying assets in the unitised portfolio comprising domestic cash (75%) and bonds (18%), as well as a small component of offshore cash and equities (4% and 3% respectively). Exposure to aged premium receivables is well contained, with the majority aged within 30 days and the average collection period registering at around 21 months over the past two years.

Table 6: Investments

Investments	FY21 NAD'm	FY21 %	FY22 NAD'm	FY22 %
Cash on-hand	48.1	3.7	68.2	4.6
Money market assets	384.0	29.6	273.3	18.3
Cash and equivalents	**432.1**	**33.3**	**341.6**	**22.9**
Unit trusts / Collective investments	831.7	64.0	1,135.5	76.2
Loans / mortgages	9.8	0.8	11.3	0.8
Joint venture	1.0	0.1	1.1	0.1
Held for sale	24.6	1.9	0.0	0.0
Non-cash investments	**867.2**	**66.7**	**1,148.0**	**77.1**
Total investments	**1,299.3**	**100.0**	**1,489.6**	**100.0**

Comparative profile

Peer analysis

No peer adjustments have been factored into the rating.

Group support

The rating is limited by the overall credit profile of the majority shareholder, PSG Konsult Limited ("PSGK"), which was reviewed and affirmed in July 2022 with a risk score of 14.75.

Rating adjustment factors

Structural adjustments

No rating adjustment factors have been factored into the rating.

Instrument ratings

No adjustments for instrument ratings are applicable.

Risk score summary

Rating Components and Factors	Risk scores
Operating environment	**14.50**
Country risk score	7.00
Sector risk score	7.50
Business profile	**(2.75)**
Competitive position	(2.75)
Management and governance	0.00
Financial profile	**3.75**
Earnings	1.00
Capitalisation	1.25
Liquidity	1.50
Comparative profile	**0.00**
Group cap	(0.75)
Government support	0.00
Peer analysis	0.00
Total Score	**14.75**

Glossary

Assets	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Bond	A long term debt instrument issued by either a company, institution or the government to raise funds.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Capital Base	The issued capital of a company, plus reserves and retained profits.
Cash Equivalent	An asset that is easily and quickly convertible to cash such that holding it is equivalent to holding cash. A Treasury Bill is considered cash equivalent.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cede	To transfer all or part of a risk written by an insurer (the cedant or primary company) to a reinsurer.
Combined Ratio	Measures the ability to conserve profits through the expense line.
Commission	A certain percentage of premiums produced that is received or paid out as compensation by an insurer.
Country Risk	The range of risks emerging from the political, legal, economic and social conditions of a country that have adverse consequences affecting investors and creditors with exposure to the country, and may also include negative effects on financial institutions and borrowers in the country.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Dividend	The portion of a company's after-tax earnings that is distributed to shareholders.
Fair Value	The fair value of a security, an asset or a company is the rational view of its worth. It may be different from cost or market value.
Gross Written Premium Growth	Measures the growth in total premiums written and assumed by an insurer before deductions for reinsurance and ceding commissions.
Incurred Loss	The total amount of paid claims and loss reserves associated with a particular time period, usually a policy year.
Investment Income	The income generated by a company's portfolio of investments.
Investment Yield	Measures the investment return achieved relative to funds invested in financial instruments, excluding unrealised gains/losses.
Liability	All financial claims, debts or potential losses incurred by an individual or an organisation.

Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
National Scale Rating	National scale ratings measure creditworthiness relative to issuers and issues within one country.
Net Incurred Loss	The total amount of paid claims and loss reserves associated with a particular time period, less the reinsurance portion.
Operating Expense Ratio	Measures the proportion of operating expenses in net premiums earned.
Premium	The price of insurance protection for a specified risk for a specified period of time.
Property	Movable or immovable asset.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Receivables	Any outstanding debts, current or not, due to be paid to a company in cash.
Reinsurance	The practice whereby one party, called the Reinsurer, in consideration of a premium paid to him agrees to indemnify another party, called the Reinsured, for part or all of the liability assumed by the latter party under a policy or policies of insurance, which it has issued. The reinsured may be referred to as the Original or Primary Insurer, or Direct Writing Company, or the Ceding Company.
Reserve	(1) An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders. (2) An amount allocated for a special purpose. Note that a reserve is usually a liability and not an extra fund. On occasion a reserve may be an asset, such as a reserve for taxes not yet due.
Retention	The net amount of risk the ceding company keeps for its own account.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Short Term	Current; ordinarily less than one year.
Solvency	With regard to insurers, having sufficient assets (capital, surplus, reserves) and being able to satisfy financial requirements (investments, annual reports, examinations) to be eligible to transact insurance business and meet liabilities.
Statutory	Required by or having to do with law or statute.
Technical Result	Net premiums earned less net claims incurred and net commission expenses.
Underwriting Margin	Measures efficiency of underwriting and expense management processes.
Underwriting	The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.

For a detailed glossary of terms please click here

SALIENT POINTS OF ACCORDED RATINGS

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The credit rating has been disclosed to the rated entity. The rating above was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating. The rated entity participated in the rating process via virtual management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The information received from the rated entity and other reliable third parties to accord the credit rating included:

- Draft audited financial statements to 28 February 2022;
- Four years of comparative audited financial statements to end February;
- Full year budgeted financial statements to 28 February 2023;
- Unaudited management accounts to 31 August 2022; and
- Other relevant documents

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