

## **FITCH AFFIRMS ADRIATIC SLOVENICA AT IFS 'BBB-'; KD GROUP AT IDR 'BB'; OUTLOOKS STABLE**

Fitch Ratings-London-22 July 2016: Fitch Ratings has affirmed Slovenian composite insurer Adriatic Slovenica Zavarovalna družba d.d.'s (Adriatic Slovenica) 'BBB-' Insurer Financial Strength (IFS) Rating and its holding company, KD Group finančna družba, d.d.'s (KD Group) 'BB' Issuer Default Rating (IDR). The Outlooks on both ratings are Stable.

### **KEY RATING DRIVERS**

The ratings reflect KD Group's high financial leverage, historically weak profitability and fairly small size by global standards. However, KD Group has a strong market position in the Slovenian insurance and asset management market.

KD Group's high financial leverage remains a negative rating driver. Adriatic Slovenica issued EUR50m of subordinated Tier 2 notes in May 2016 and used EUR27.6m of the proceeds to repay existing bank debt on KD Group level. This caused KD Group's financial leverage to increase to 46% on a pro-forma basis from 40% at end-2015 (2014: 47%, 2013: 51%). However, the group plans to reduce leverage in the medium term, which Fitch views positively for the ratings.

Fitch views KD Group's capitalisation as "adequate" on a consolidated basis as measured by the agency's Prism factor-based capital model (Prism FBM). While Adriatic Slovenica reported a strong regulatory solvency ratio of 172% on a Solvency I basis and its Solvency Capital Requirement (SCR) ratio under Solvency II was 124% at end-2015, KD Group's consolidated Prism FBM score is negatively affected by a high amount of goodwill on the holding company's consolidated balance sheet, which Fitch does not give credit for in its capital assessment.

Fitch expects Adriatic Slovenica's Solvency II SCR ratio and KD Group's Prism FBM score to improve in 2016, benefiting from the subordinated notes issued in May 2016 and additional reinsurance cover.

KD Group's reported net income declined to EUR0.8m in 2015 from EUR4.7m in 2014 (2013: EUR6.6m). The reduction in 2015 was mostly driven by the gross written premiums (GWP) of the group's health business declining to EUR101m in 2015 (2014: EUR108m) and the segment's combined ratio worsening to 101.6% (2014: 97.8%). Adriatic Slovenica has been consistently profitable, reporting annual net income of over EUR10m for each of the past five years and an average return on equity of 18%.

KD Group's market position and scale are small, based on global benchmarks, with GWP of EUR298m in 2015 (2014: EUR302m), total assets of EUR0.8bn and shareholders' funds of EUR121m. Nevertheless, it is one of the largest financial service providers in the Balkan region, with Adriatic Slovenica being the second-largest insurer in Slovenia and the group's asset management operations being the third-largest in the Slovenian mutual fund market by assets under management. Fitch views this strong position in the local market as a rating-positive.

KD Group is in the process of divesting most non-core assets to focus on its core insurance and asset management businesses. Fitch expects this measure to improve the group's performance and generate extra cash flow over the next three years.

As around two thirds of the group's assets are held in Slovenian investments and 98% of the group's revenue is in Slovenia (BBB+/Positive), the group's performance is exposed to the

local economy. This exposure includes the risk of losses on its EUR324m of non-unit linked investments, as of end-2015, and the risk of lapses on its EUR260m of unit-linked liabilities. For example, write-downs on Slovenian banks led to investment losses of EUR16m in 2013, EUR2m in 2014 and EUR2m in 2015 for Adriatic Slovenica.

#### RATING SENSITIVITIES

KD Group's leverage improving to below 40%, in combination with stabilised profitability, could lead to an upgrade.

The ratings could be downgraded if the group's consolidated capital position weakens to a Prism FBM score of below "adequate" for a sustained period. Financial leverage in excess of 50% could also lead to a downgrade.

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Applicable Criteria

Insurance Rating Methodology (pub. 17 May 2016)

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