



Fitch Affirms Adriatic Slovenica at IFS 'BBB-'; Outlook Stable

Fitch Ratings-London-5 March 2015: 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 strong market position in the Slovenian insurance and asset management market and its adequate capitalisation. However, the ratings are limited by the group's high financial leverage, its historically weak profitability and its fairly small size.

Fitch regards KD Group as having a small market position and size/scale, based on global benchmarks, with gross written premiums (GWP) of EUR302m in 2014 (2013: EUR316m), total assets of EUR0.8bn at end-9M14 and shareholders' funds of EUR130m at end-9M14. 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 having a market share of around 21% in the Slovenian mutual fund market. Fitch views this strong position in the local market as a rating positive.

KD Group's high financial leverage of 46% at end-9M14 (end-13: 51%) is a negative rating driver. However, Fitch views positively that the group has been reducing leverage since 2008.

KD Group entered into a long-term syndicated loan agreement with five Slovenian banks in February 2015. Fitch views this as neutral to KD Group's and Adriatic Slovenica's ratings as the loan proceeds of EUR67m are fully used to refinance KD Group's KDH1 and KDH2 bonds maturing in May and October 2015, respectively. However, the agency views positively that the loan agreement, which has a maturity of seven years, increases the group's financial flexibility by extending the duration of its financial liabilities and by removing the refinancing risk of the two maturing bonds.

Fitch views KD Group's capitalisation as "adequate" on a consolidated basis as measured by the agency's Prism factor-based capital model. While Adriatic Slovenica reported a strong regulatory solvency ratio of 175% at end-2013, KD Group's consolidated Prism score is negatively affected by a high amount of goodwill on its balance sheet, which Fitch does not give credit for in its capital assessment.

KD Group reported net income of EUR7.8m for 9M14 and EUR6.6m in 2013. This followed losses between 2009 and 2012 driven by its underperforming bank business (which was disposed of in 2012) and losses from other non-core corporate affiliates affected by the financial crisis. The insurance company, 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%. Fitch expects KD Group to have remained profitable in 2014.



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 to improve the group's performance and generate extra cash flow over the next three years.

As 74% of the group's assets were held in Slovenian investments and 94% of the group's revenue was in Slovenia (BBB+/Stable) in 2013, the group's performance is exposed to the local economy. This includes the risk of losses on its EUR353.7m of non-unit linked investments, as per end-9M14, and the risk of lapses on its EUR258.2m of unit-linked liabilities. For example, in 2013 write-downs on Slovenian banks led to investment losses of EUR16.3m for Adriatic Slovenica.

RATING SENSITIVITIES

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

The ratings could be downgraded if the group fails to build its cash balance at the holding company through retained earnings, or if the group's consolidated capital position declines to a Prism score of below "adequate" for a sustained period.

Contact:

Primary Analyst
Ralf Ehrhardt
Associate Director
+44 20 3530 1551
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Secondary Analyst
Clara Hughes
Senior Director
+44 20 3530 1249

Committee Chairperson
Harish Gohil
Managing Director
+44 20 3530 1257

Additional information is available on www.fitchratings.com

Applicable criteria 'Insurance Rating Methodology', dated 4 September 2014, are available at www.fitchratings.com.