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

Fitch Ratings-London/Frankfurt-06 October 2015: Fitch Ratings has affirmed Slovenian composite insurer Adriatic Slovenica Zavarovalna druzba d.d.'s (Adriatic Slovenica) 'BBB-' Insurer Financial Strength (IFS) rating and its holding company, KD Group financna druzba, 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: EUR311m), total assets of EUR0.8bn and shareholders' funds of EUR126m at end-2014. 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 number three 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's high financial leverage of 42% at end-1H15 (2014: 47%; 2013: 51%) remains a negative rating driver. However, Fitch views positively for the rating that the group has been reducing leverage since 2008.

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 176% on a Solvency I basis at end-2014, KD Group's consolidated Prism FBM 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. Fitch expects Adriatic Slovenica's Solvency II coverage to be lower than its Solvency I coverage.

KD Group reported net income of EUR4.7m in 2014 and EUR6.6m in 2013. This result 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. 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 be profitable in 2015, after reporting net income of EUR2m in 1H15 (1H14: EUR4.2m).

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

KD Group entered into a long-term syndicated loan agreement with five Slovenian banks in February 2015. Fitch views this agreement 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 for the rating 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.

As around three quarters of the group's assets are held in Slovenian investments and 94% of the group's revenue is in Slovenia (BBB+/Stable), the group's performance is exposed to the local economy. This exposure includes the risk of losses on its EUR347m of non-unit linked investments, as of end-2014, and the risk of lapses on its EUR257m of unit-linked liabilities. For example, write-downs on Slovenian banks led to investment losses of EUR16m in 2013 and EUR2m in 2014 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.

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

Secondary Analyst
Dr Christoph Schmitt
Director
+49 69 768 076 121

Committee Chairperson
Harish Gohil
Managing Director
+44 20 3530 1257

Media Relations: Elaine Bailey, London, Tel: +44 203 530 1153, Email: elaine.bailey@fitchratings.com.

Additional information is available on www.fitchratings.com.

Applicable Criteria
Insurance Rating Methodology (pub. 16 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=871172