

## **FITCH AFFIRMS ADRIATIC SLOVENICA & KD GROUP; OUTLOOKS STABLE**

Fitch Ratings-London-01 September 2017: Fitch Ratings has affirmed Slovenian composite insurer Adriatic Slovenica d.d.'s 'BBB-' (Good) Insurer Financial Strength (IFS) Rating and holding company, KD Group financna druzba, d.d.'s (KD Group) 'BB' Issuer Default Rating (IDR). The Outlooks are Stable.

### **KEY RATING DRIVERS**

The ratings reflect KD Group's high financial leverage, low profitability and moderate business profile.

KD Group's high financial leverage of 43% at end-2016 (end-2015: 40%) is a key negative rating driver. Financial leverage increased in 2016 following the issuance of EUR50 million subordinated notes in May 2016 by Adriatic Slovenica. Fitch views positively that the group plans to reduce leverage in the medium term.

Fitch views KD Group's consolidated capitalisation at end-2016 as "Very Strong" (end-2015: "Adequate"), based on the agency's Prism factor-based capital model (Prism FBM). Adriatic Slovenica's regulatory solvency coverage is also strong, with Solvency II solvency capital requirement (SCR) coverage of 146% at end-2016 (end-2015: 124%) without using any transitional measures. The group's Prism FBM assessment and its SCR coverage benefited from the issuance of subordinated Tier 2 notes in May 2016.

However, Fitch views the quality of capital as relatively weak because the subordinated notes now represent a high share of KD Group's available capital. KD Group's core capital is relatively low due to Fitch not giving credit for goodwill, which totalled EUR50.1 million at end-2016, when assessing available capital.

KD Group reported positive but volatile net profits between 2013 and 2016, following losses in 2009-2012 from its underperforming bank business, which was sold in 2012, and losses at other non-core corporate affiliates affected by the financial crisis. In 2016 KD Group's net profit improved to EUR2.3 million (2015: EUR0.8 million) due to lower revaluation expenses and a release of deferred tax. Adriatic Slovenica has been consistently profitable, reporting annual net income of over EUR10 million for each of the past five years and an average return on equity of 15%.

Fitch considers KD Group to have a moderate business profile. KD Group is of "Small Size/Scale", according to Fitch's global benchmarks, with total assets (excluding reinsurance assets) of EUR788 million and total equity of EUR122 million at end-2016. However, the group has a strong position in its main market, Slovenia. Adriatic Slovenica is the third-largest insurer in the country, and the asset management operations are second, with a market share of 23% in the Slovenian mutual fund market. Fitch views this strong position in the local market as 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 to improve the group's performance and generate extra cash flow over the coming years.

As around 60% of the group's invested assets are held in Slovenian investments and 98% of the group's revenue is in Slovenia (A-/Stable), the group's financial performance is exposed to the

health of the local economy. In particular, KD Group is exposed to the risk of losses on non-unit-linked investments and the risk of lapses on unit-linked liabilities.

## 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 for a sustained period. Financial leverage in excess of 50% could also lead to a downgrade.

### Contact:

Primary Analyst

Ralf Ehrhardt

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

Federico Faccio

Senior Director

+44 20 3530 1394

Media Relations: Athos Larkou, London, Tel: +44 203 530 1549, Email: [athos.larkou@fitchratings.com](mailto:athos.larkou@fitchratings.com).

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

### Applicable Criteria

Insurance Rating Methodology (pub. 26 Apr 2017)

<https://www.fitchratings.com/site/re/897260>

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