

FITCH MAINTAINS ADRIATIC SLOVENICA ON WATCH POSITIVE; REVISES KD GROUP TO WATCH NEGATIVE

Fitch Ratings-London-09 August 2018: Fitch Ratings has maintained Slovenian composite insurer Adriatic Slovenica d.d.'s 'BBB-' (Good) Insurer Financial Strength (IFS) on Rating on Rating Watch Positive (RWP) and has revised the Rating Watch on holding company, KD Group financna družba, d.d.'s (KD Group) 'BB' Issuer Default Rating (IDR) to Negative (RWN) from Evolving.

KEY RATING DRIVERS

The RWP on Adriatic Slovenica's IFS Rating reflects Fitch's view that the acquisition by Generali CEE Holding B.V., the intermediate holding company managing Assicurazioni Generali S.p.A.'s (IFS A-/Stable) operations in central and eastern Europe, will improve Adriatic Slovenica's credit profile. This is because Adriatic Slovenica has strong and stable net income and combined ratios, while at the consolidated KD Group level profitability has been weaker and more volatile. Financial leverage, which was 43% at end-2017 on a consolidated KD Group basis, is also lower for Adriatic Slovenica, at 34% at end-2017. Adriatic Slovenica's rating could also receive uplift from the standalone credit profile due to ownership support once it is part of the Generali group.

The revision of the RWE to RWN on KD Group's IDR reflects new information on KD Group's future strategy. KD Group will be a very small real estate investor, which Fitch regards as higher risk, instead of an insurance holding company after the sale of Adriatic Slovenica. Also, KD Group will no longer have access to Adriatic Slovenica's dividends.

The transaction is expected to close in 2H18 subject to regulatory approval.

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-2017 (end-2016: 43%) is a key negative rating driver. Financial leverage is high following the issuance of EUR50 million subordinated notes in May 2016 by Adriatic Slovenica. However, KD Group plans to use the proceeds from the sale of Adriatic Slovenica to repay all debt held at group level, and this will benefit KD Group's credit profile.

Fitch scores KD Group's consolidated capitalisation at end-2017 as "Very Strong", 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 159% at end-2017 (end-2016: 146%), without the use of any transitional measures.

However, Fitch views the quality of capital as weak because the subordinated notes represent a high share of KD Group's available capital. KD Group's available capital is also low due to Fitch not giving credit for goodwill, which totalled EUR50.2 million at end-2017.

KD Group reported positive but volatile net profits between 2013 and 2017, following losses in 2009-2012 from its underperforming bank business, which was sold in 2012, and losses stemming from other non-core corporate affiliates. KD Group's net profit improved to EUR2.6 million in 2017 from EUR2.3 million in 2016 (2015: EUR0.8 million) as lower operating expenses and changes in other insurance technical provisions more than compensated a higher loss ratio driven by weather related claims and higher expenses arising from deferred taxes.

Adriatic Slovenica has a stable earnings profile, reporting annual net income of over EUR10 million for each of the past five years and an average return on equity of 14%.

Fitch views KD Group's business profile as moderate. KD Group is of "small size/scale" compared with Fitch's global benchmarks, with total assets (excluding reinsurance assets) of EUR812 million and total equity of EUR124 million at end-2017. However, the group has a strong position in its domestic market, Slovenia. Adriatic Slovenica is the third-largest insurer in the country with a market share of 14%, and its asset management operations also rank third, with a market share of 20% in the Slovenian mutual fund market.

As around two thirds 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 domestic 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

Fitch will resolve the Rating Watches after the completion of the sale of Adriatic Slovenica to Generali and after completing its assessment of Adriatic Slovenica's and KD Group's standalone credit profiles as well as its assessment of Adriatic Slovenica's strategic importance to Generali.

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Applicable Criteria

Insurance Rating Criteria (pub. 30 Nov 2017)

<https://www.fitchratings.com/site/re/905036>

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