

October 2015

ZD „Bul Ins” AD

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| CLAIMS PAYING ABILITY RATING Long-term Rating: Outlook: | Initial Rating 12.2008 | Update 12.2009 | Update 23.12.2010 | Update 01.06.2011 |
| | iBBB | iBBB | iBBB | iBBB+ |
| | Stable | Stable | Positive | Positive |
| CLAIMS PAYING ABILITY RATING Long-term Rating: Outlook: | Update 22.06.2012 | Update 19.09.2013 | Update 20.10.2014 | Update 19.10.2015 |
| | iBBB+ | iBBB+ | iBBB+ | iBBB+ |
| | Stable | Stable | Stable | Stable |

BCRA – Credit Rating Agency (BCRA) is the third qualified rating agency in the EU, registered under Regulation (EC) No. 1060/2009 of the European Parliament and of the Council. The credit ratings, assigned by BCRA, are recognized throughout the EU and are entirely equal with the other ratings, recognized by European Securities and Markets Authority (ESMA), without any territorial or other limitations.

BCRA – CREDIT RATING AGENCY AD retains the long-term claims paying ability rating of ZD „Bul Ins” AD iBBB+, outlook „stable”. The officially adopted methodology by BCRA for assigning a claims paying ability rating is used: (http://www.bcra-bg.com/files/file_202.pdf).

The report has been prepared and the rating – assigned, based on information, made available by the rated insurance company, the Financial Supervision Commission, the National Statistical Institute, BCRA’s database, consultants and other sources of public information.

The political turmoil and destabilization of the banking system after the middle of the previous year (2014) reinforced the negative effects of weak demand and low economic activity over the remainder of 2014.

The economy of Bulgaria marked a significant growth in the first quarter of 2015, the main driver was exports, and (growth) continued in the second

quarter, but at a slightly slower pace. The business climate after August (over the next 3 months) for part of the sector is expected to be beneficial, while for others - the forecasts are more reserved. The increase in electricity prices rose to discontent among producers as possible consequences would lead to a reduction in economic growth and adverse changes in conditions of the labor market.

Bulgaria can be determined with a low economic activity for the previous year (2014) and recovery for the first half of 2015 which is expected to persist through the remainder of the year, but at a lower pace.

The banking system events in 2014 led to the emergence of a potential threat to banking institutions to deepen the banking crisis and the involvement of a larger number of participants in this sector. Despite the increased risk in the financial system caused by the removal of one of the main players and the risk of dropping the second, the banks in Bulgaria maintained its stability. For the first half of 2015, the banking environment can be described as stable, as evidenced by the high capital adequacy and liquidity of assets and growth in deposits. There was a reduction in the negative rate of change of loans, and the share of classified loans also marked a decrease, contributing to an improvement in the balance sheets of banks in the country.

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|  | CLAIMS PAYING ABILITY RATING ZD „Bul Ins” AD iBBB+ (<i>outlook: stable</i>) October 2015 |
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During the period 2012-2014, the general insurance sector operated in an unfavorable economic environment resulting from the effects of the global crisis on the economy of Bulgaria. There were reported weak signs of recovery - the downtrend was interrupted in Gross Premium Income in recent years and a slight revenue growth was reported. At the end of 2014, however, a negative result from an insurance activity was reported and minimum total profit for the sector; 10 companies reported a negative financial result for the year. Recovery was felt in the middle of this year but still weak.

The main factors hindering the development of general insurance companies remained still uncertain recovery of the Bulgarian economy from the crisis, and the weak economic activity and reduced domestic consumption. The sector maintained a high growth potential, given the low levels of insurance penetration and density. Despite the growing number of companies, market concentration maintained high. A main share in the aggregate portfolio of the insurance sector continued to be occupied by the motor insurances with a share of less than 70%.

A new Insurance Code is about to be adopted after a long preparation. One of the most important changes is related to the introduction of the EU Directive "Solvency II", that bring in new conditions – of the capital requirements, for determining the reserves, for determining the solvency margin, for the financial stability of the insurance and reinsurance companies. Many other changes are coming as a result from the implementation of the requirements of the European legislation related to improvement of the entire regulatory framework with the aim at providing a better protection of the interests of the users of insurance services. These changes will undoubtedly affect the environment in that the insurance companies operate and in the aspect of increased demands to them.

During the period of updating, there were not significant changes in the shareholding structure of ZD "Bul Ins" AD. At the time of preparation of the rating, a procedure to increase capital was in progress. There were significant changes in the organizational structure of the company. Besides its headquarters in 2014, 28 general agencies continued to operate in the country and 7 general agencies in Sofia. The company's strategy is directed to increase of the share of the insurance "Third Motor Party Liability" (focusing on insuring vehicles) and diversification of the insurance portfolio by increasing revenues on less overlapped until now

insurances - property and other kind of insurances. During 2014, the strong presence of the company was retained at the market for aviation insurances.

During 2014, ZD „Bul Ins” AD marked a growth of 12.3% in Gross Premium Income, but as of the half of 2015, there was a decline of 8.6% year on year. The market share at the end of 2014 increased by 8.4% compared to 7.5% for 2013. The growth of GPP was mainly due to the insurance „Third Motor Party Liability“. With the other main insurance - „Autocasco” – a considerable decline was observed. As of the end of 2014 and the end of the first half of 2015, ZD "Bul Ins" AD retained its strong orientation to motor insurance, regardless of the internal restructuring of GPP between the two main types of car insurance. The total share of these insurances was 95.2%, exceeding significantly / more than 6% / the average for other leading companies in the sector.

During 2014, there was a decline in both gross and net claims ratio (where this reduction was significant). During the first half of 2015, the levels of the indicators, especially in gross claims ratio were higher compared to the first half of the previous year.

We should mention the fact that the decrease in net claims ratio for 2014 occurred in the background of increasing levels of this indicator for the other insurers of the leading group for comparison. 2014 was marked by several catastrophic events with an impact on the sector - floods, storms, landslides, hailstorms. Claims ratio has increased at most for car insurances, but the same was reported for property insurances.

The Company maintained a relatively constant level of net acquisition ratio, close and lower than the average for other leading companies. The value of the combined expense ratio continued to decrease and was significantly below 100% - 84.5% which indicated a positive result from insurance activity (16 953 thousand leva as of 31.12.2014 and 7235 thousand leva for the first half of this year).

During the reporting period, the company renewed the existing reinsurance contracts and concluded new ones with the aim to provide adequate reinsurance coverage for insurances related to vessels and aircraft, as well as a quota reinsurance contract on MTPL insurance. The retention remained at a very high level.

During the period of updating, ZD "Bul Ins" AD maintained a full coverage of its reserves. The portfolio covering the technical reserves of the company was structured according to the requirements of the Insurance Code.

During 2014, the size of the company's investment portfolio continued to decrease /also

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during the whole analyzed five-year period/, as the rate remained nearly the same compared to the previous year. In accordance with the adopted investment policy of the company, directed to formation of a low-risk, liquid portfolio, investments in equity securities were reduced more in the previous two years and in 2014 their relative share maintained its reduced level of the previous year. The total amount of highly liquid assets (government securities and bank deposits) decreased and in 2014 to 61.2% - with more 5.6% compared to 2013 and by nearly 25% compared to the high levels of 2012. This value was lower than the average for the group and the average for the adjusted sector, but at the end of the first half, the share of highly liquid assets rose to 68.7% and was higher than the average for other companies in the sector.

At the end of 2014, ZD "Bul Ins" AD reported a significant loss as a net financial result in the amount of BGN 8 336 thousand leva. This was mostly due to the loss from realization of the investments and the reported as a loss of the deposit in Corporate Commercial Bank AD. During the first half of the year, however, there was a partial refund on it under a cession contract.

The profitability of the investment portfolio at the end of 2014 and the first half of 2015 was strongly negative due to the realized loss. Over the last two years before 2014, the profitability of ZD "Bul Ins" AD reported significantly higher values than the average for the adjusted sector /despite the steady downtrend imposing for the other insurers as well/, at the end of the updating periods the loss of the rated company was significantly bigger.

The main features of the financial condition of ZD "Bul Ins" AD during the period of updating:

- during the first half of 2015, Gross premium income, generated by the company, amounted to 60 174 thousand leva, as an annual decline of 8.6% was reported registering growth in the sector (8.2%).
- over the past six months since the beginning of this year Net earned income decreased by 12.3% compared to the first half of 2014, mainly due to a considerable decline in Net premium income /by 48% /due to premiums ceded to reinsurers /27 072 thousand leva compared to 2269 thousand leva a year earlier/.
- during the first six months of 2015, there was a slight increase in the result from insurance activity by 1.8% annually compared to the same period of 2014,

but in absolute values it was significant - 7235 thousand leva compared to 7110 thousand leva a year earlier;

- During the update there was a strong increase in gross claims ratio to 112.5% due to the increase in the reserve for upcoming claims for the current year and payments on claims paid during the past year. The average level for the sector for this period amounted to 63.4%, and for the reference group - 60.4%.

- there was a relative slight increase in Net claims ratio - to 43.0%, but with these low values, they remained below the levels of the sector (54.2%) and the reference group (58.4%);

- the return on equity rose to 7.8% that was a very good performance as compared to the levels of the indicator of the company since the beginning of the analysis to 2014, also in comparison with the negative values reported on average for the adjusted sector and the reference group of leading insurers.

During the period of updating, ZD "Bul Ins" AD retains a stable financial condition realizing a positive net financial result and a very strong positive result from insurance activity. With these values the company ranks among the few insurers generated a profit for the financial year of 2014. In total, for the adjusted sector /excl. data for the rated company/, the result is a loss.

The indicators for insurance activity have significantly better levels than those of the direct competitors and the sector. The actual solvency of the company is good and increased for the period. There is a slight increase in the concentration of insurance portfolio in vehicle insurances. Its diversification, together with possible improvement of the shareholding structure, are factors that could have a positive impact on the level of the company's rating. The continuing decline in the value of the investment portfolio and large losses from it reported during the period of updating are a potential factor for increasing the risk level of this activity and with influence on the future condition of the company and its rating.

A negative impact on the rating assigned to the company also could have a continuing decrease in the values of the indicators for liquidity of technical reserves and of the reserve for impending payments.

Main Financial Indicators:

| <u>Indicator / Year:</u> | 06.2015 | 06.2014 | 2014 | 2013 | 2012 | 2011 |
|--|----------------|----------------|----------------|----------------|----------------|----------------|
| Gross Premium Income (thousand leva): | 60 174 | 65 867 | 119 814 | 106 662 | 104 026 | 138 566 |
| <i>Change on a yearly basis %</i> | -8.6% | -45.0% | 12.33% | 2.5% | -24.9% | 2.0% |
| Net Earned Income (thousand leva): | 48 353 | 55 115 | 109 588 | 108 871 | 110 543 | 138 885 |
| <i>Change on a yearly basis %</i> | -12.3% | -49.7% | 0.7% | -1.5% | -20.4% | 5.4% |
| Net profit (thousand leva) | 2 853 | 1 746 | 2 377 | 1 374 | 962 | 1 827 |
| Result from insurance activity | 7 235 | 7 110 | 16 953 | 3 376 | 7 260 | 840 |
| Gross Claims Ratio | 112.5% | 39.1% | 51.8% | 57.2% | 51.2% | 48.31% |
| Net Claims Ratio | 43.0% | 39.6% | 39.4% | 58.3% | 46.1% | 49.20% |
| Expense Ratio | 37.0% | 26.0% | 23.5% | 16.8% | 24.9% | 27.63% |
| Acquisition Ratio | 5.0% | 21.5% | 21.6% | 21.8% | 22.4% | 22.56% |
| Combined Ratio | 85.0% | 87.1% | 84.5% | 96.9% | 93.4% | 99.40% |
| Operating Leverage | 112% | 139% | 271% | 286% | 302% | 453% |
| Financial Leverage | 145% | 178% | 175% | 167% | 195% | 329% |
| Liquidity Ratio | 4.2% | 7.6% | 3.5% | 4.9% | 3.3% | 1.96% |
| Return on equity | 7.8% | -0.4% | 5.9% | 3.6% | 2.8% | 5.8% |