

ZAD „Armeets” AD

Vesela Velichkova, Lead Financial Analyst

v.velichkova@bcra-bg.com

Nikoleta Koleva, Financial Analyst

n.koleva@bcra-bg.com

CLAIMS PAYING ABILITY RATING *	Update 16.12.2016
Long-term rating:	BB+
Outlook:	stable
Long-term national-scale rating:	A- (BG)
Outlook:	stable

* To become familiar with the full rating history, please, see the chart at the end of the document.

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BCRA assigns to „ZAD Armeets“ AD the following ratings:

- **Long-term claims paying ability rating: BB+, outlook: „stable”;**
- **Long-term national-scale rating: A- (BG), outlook: „stable”.**

The methodology that BCRA has adopted officially is used for assigning ratings of the ability of insurance companies to pay claims (http://www.bcrabg.com/files/file_202.pdf).

To elaborate the credit report and to assign the credit rating, BCRA uses information from the rated insurance company, the FSC, the National Statistical Institute, its own database, consultants and other public information sources.

During 2015, the economy of the country reports a 3.0% real growth, as greatest contribution has the export of commodities and services sustained by an increase in the ultimate consumption. The reported GDI real growth is nearly twice higher than the achieved for the past two years (1.6% for 2014 and 1.3% for 2013). In the first half of 2016 there is an

increase in the importance of the internal consumption for economy growth.

The foreign investments flow reach 3.6% of GDP, after hesitations about 3.1-3.3% over the past 3 years. A considerable increase in the reinvested profit during the past year and an increase of the investments in the share capital is observed. The investors, however, remain on alert as the investment levels remain considerably lower than the years before the crisis. For the first half of 2016, the foreign investments reduce slightly compared to the same period of the past year – they declined to 2.0% of GDP (2.2% of GDP as of Q2 2015).

The favourable changes at the labour market remain – the unemployment ratio (as well as the continuous unemployment as a percent of active population) keep their downtrend after 2013. During 2015, the average unemployment rate amounts to 9.2% (11.5% for 2014).

Since early 2014, deflationary processes have been observed and they reach their peak at the beginning of 2015 and remain the same at the end of the year. According to the winter forecast of EC, the deflation will be maintained in 2016 as well, as the change expected in the price level is to be about -0.1% at the end of the year. EC foresees the factors acting in the direction of a reduction in the price level to be removed, and in 2017 the country to move to a situation of low inflation.

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

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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 2015 and the first half of 2016, the banking system is characterized by retention of the ascending trend of the generated profit, retention of the sustainable growth in attraction of deposits that together with the decline in lending determines accumulation of liquidity in the system. A favourable factor is the interruption of the uptrend of the classified loans that is partly connected with the preparation of the banks for implementation of assets review. The announced on 13.08.2016 results from the assets quality review and stress tests for stability of the banks in Bulgaria show that the banking sector is stable, well capitalized and a public support to the banks with resources financed by the state budget is not needed.

The general insurance market in Bulgaria during the period of updating is characterized by:

- Strengthening the uptrend in income on written gross premiums over the past three years;
- High level of market concentration - 73.7% of GPI in the sector (as of 06.2016) is formed by the seven biggest companies (71.5% for 2014);
- High share of the car insurance in the structure of the aggregate insurance portfolio (71.7% as of 06.2016).

The major factors hindering the development of the general insurance companies continue to be uncertain recovery of the Bulgaria's economy from the crisis and pursuing low economic activity, decreased domestic consumption and uncertainty concerning the future revenues of the households. The sector keeps high growth potential, having in mind the low levels of insurance density and penetration.

During the period of updating (06.2015-06.2016) there haven't been any changes in the registered share capital of ZAD "Armeets" and the capital remains in the size of EUR 33 019 thousand. Minor changes are observed in the shareholding structure as "CCB Group" JSC remains a majority shareholder.

There are significant changes in the composition of the Management Board. In November 2015, Rumen Georgiev, who was a Chairman and CEO of the company since 2002, left the company. During

the same month, Galin Gorchev is elected and approved as a member of the Board. In early September, as members of the Board in the Commercial Register entered Vasya Kokinova-Mollova, Miroljub Ivanov, Konstantin Velev and Diana Maneva. During the same month, another longtime member of the Board left - Tsvetanka Krumova. After these changes, at present, the Management Board consists of Alexander Kerezov, Miroljub Ivanov, Konstantin Velev, Diana Maneva, Vasya Kokinova-Mollova, Galin Gorchev and Valentin Dimov.

The composition of the Supervisory Board (the SB) has also changed. During August 2016, as a member of the SB is approved Ivanka Gaidardjieva who replaced Nansen Behar.

During 2015, Gross Premium Income of ZAD "Armeets" reports a 5.5% growth which lags behind the reported by the adjusted sector¹ that achieves 10.1%. This leads to a slight reduction in the market share of the company from 13.7% for 2014 to 13.2% for the last complete year, but although it is a market leader in general insurance market during this period. Besides that, we should note that in 2014 the company reports a growth of 11.0% compared to a 0.7% decline in the adjusted sector. The increase in premiums written of ZAD "Armeets" is mainly in line of the main insurance - "Autocasco" - on which GPI increases by 6.9%, but despite that the market share by this insurance decreases by 1.1 pp to 23.4%. At the same time, there is a fall in GPI of the second insurance by importance - "Motor third party liability" - 2.4%, where the market share of the company decrease from 10.9 percent to 10.0 percent.

In the first half of 2016, the total GPI of ZAD "Armeets" decreases by 11.2% yoy, while the adjusted sector grows by 6.9%. It determines the decrease in the company's market share by 2.1 p.p. to 11.7%. The company ranks third by GPI in the sector after "Bulstrad VIG" and IC "Lev Ins". During this period, a decrease is observed in both basic insurances - "Autocasco" (2.8%) and "Motor Third Party Liability" (25.6%), on which the market share decreases, respectively by 2.3 pp to 21.5% and by 3.0 p.p. to 7.0%.

ZAD "Armeets" performs active reinsurance. Gross premium income on which it reports a decrease of 18.8% yoy in 2015 and in the first half of 2016 the

¹ Adjusted with the data of the rated company.

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trend deepens with a fall of 69.4% compared to the corresponding period of the previous year.

Regarding the structure of the portfolio of the company (based on total premium income) the analysis shows that the uptrend in the share of "Autocasco" retains. It grows for the fifth consecutive year reaching 54.4% in 2015. The increase is on account of a decline in the share of „Motor Third Party Liability” for the last year - 2.3 pp to 28.3%. In the first half of 2016, the share of "Autocasco" continues to grow reaching 58.2% (53.2% a year earlier) and the weight of "Motor Third Party Liability” decreases by 4.6 pp to 23.7%. In a comparative aspect, the company continues to report a higher share of "Autocasco" compared to the average for other leading companies and lower of "Motor Third Party Liability" As a whole, the concentration in the portfolio of the company remains close to its competitive group.

In 2015, ZAD "Armeets" reports a decline in gross claims ratio by 8.8 p.p. to the level of 62.9%, while in the first half there is a growth yoy to 64.8% (50.6% for the first half of 2015.). Net claims ratio follows similar dynamics – it reduces from 59.5% for 2014 to 45.1% for 2015, and in the first half of 2016 they increase again to 55.2%. In a comparative aspect, compared to the average for other leading companies the indicator for ZAD "Armeets" is more favorable for 2015, but higher in the first half of 2016.

During the previous three years, the combined expense ratio of the company exceeds 100%. In 2015, it decreased to 94.3% which is an indicator for realization of an insurance profit. The improvement is achieved mainly through the reduced net claims ratio. By level of combined expense ratio, the company has a favourable position compared to the reference group which reports 96.3% for the period. In the first half of 2016, the value of the ratio of ZAD "Armeets" decreases by 1.3 p.p. compared to 2015, while average for the reference group it remains nearly unchanged.

ZAD "Armeets" has developed its reinsurance programme in order to both ensure the stability of the portfolio and meet the needs of all its customers in the event of adverse events. After the previous three years, the retention level remains between

91% and 92%, in 2015 there is a significant decrease of 13.2 p.p. to 78.3%. This trend continues in the first half of 2016, when the level of the indicator decreases to 68.8%, compared to 92.4% for the corresponding period of the previous year.

The volume of investment portfolio of "ZAD Armeets" in 2015 decrease by 0.7% after a significant increase of 17.3% during the previous year. In its structure there haven't been any significant changes. The shares and participations in investment funds remain leading, despite reduction of their size by 5.1% which reflects in a fall of their share in the portfolio by 1.8 p.p. to 38.7%. In the first half of 2016, there is a noticeable increase in shares and participations in investment funds - their volume increases by 31.1% compared to the end of 2015, and their share - by 6.8 p.p. to 45.5%.

During 2015, ZAD „Armeets“ increases the share of highly liquid assets in its portfolio, but despite this it remains considerably lower compared the adjusted sector. The position of the company remains unfavourable in the first half of 2016, when the share of the highly liquid assets of the company decrease by 5.9 p.p. compared to the end of 2015.

During 2015, the company reports negative profitability from its investment portfolio and due to this it takes an unfavourable position in a comparative aspect compared to the adjusted sector. For the first half of 2016, the investment profitability of the company is positive but minimum, and takes an unfavorable position in a comparative aspect.

The net earned income of the company is characterized by a decline for 2015 (2.0 percent) and for the first half of 2016 yoy (15.2%) which is largely due to a significant part of the premiums transferred to reinsurers. Unlike the previous three years in 2015, the company generates a positive result from insurance activities (9 850 thousand), as this trend continues in the first half of 2016 when the result from insurance activity amounts to 5700 thousand leva. The net financial result is also positive for 2015 (9 990 thousand leva), also for the first half of 2016 (5 700 thousand leva).

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Main Financial Indicators

	June 16	June 15	2015	2014	2013
Gross Premium Income (thousand leva)	94 044	105 871	207 791	196 896	177 412
Change on a yearly basis (%)	-11.2%	-49.0%	5.5%	11.0%	3.8%
Net Premium Income (thousand leva)	64 669	97 794	162 778	180 234	162 710
Net Earned Income (thousand leva)	81 366	95 960	172 120	175 698	147 066
Net Financial Result (thousand leva)	4 770	-2 456	9 990	-10 879	443
Retention	68.8%	92.4%	78.3%	91.5%	91.7%
Net Claims Ratio	55.2%	51.5%	45.1%	59.5%	53.2%
Expense Ratio	24.2%	27.8%	27.1%	26.5%	26.7%
Acquisition Ratio	13.6%	21.2%	22.0%	23.0%	23.8%
Combined Expense Ratio	93.0%	100.5%	94.3%	109.0%	103.7%
Equity (thousand leva)	64 355	47 321	59 693	50 097	60 658
Technical Reserves (thousand leva)	175 285	217 125	185 327	219 185	180 580
Operating Leverage	n/a	n/a	288%	351%	242%
Financial Leverage	n/a	n/a	310%	438%	298%
Liquidity ratio of technical reserves	36.4%	26.9%	33.5%	27.3%	28.4%
Liquidity ratio of the reserve for upcoming payments	63.8%	51.1%	66.4%	50.7%	60.9%
Return on equity	29.0%	-10.7%	18.7%	-19.8%	0.8%

*Rating History:

The ratings displayed in the chart are assigned under the previous Methodology for rating of the ability of insurance companies to pay claims, respectively with the applied rating scale and are not directly comparable with the ratings assigned after the entry into force of the current methodology on 04.07.2016.

CLAIMS PAYING ABILITY RATING	Initial Rating 6.2006	Update 11.2007	Update 12.2008	Update 10.2009	Update 30.08.2010	Update 10.08.2011
Long-term Rating:	BB+	iBBB-	iBBB-	iBBB	iBBB	iBBB
Outlook:	<i>stable</i>	<i>stable</i>	<i>stable</i>	<i>stable</i>	<i>stable</i>	<i>stable</i>
	Update 10.08.2012	Update 14.10.2013	Update 07.11.2014	Update 06.11.2015	Monitoring 05.07.2016	
Long-term Rating:	iBBB	iBBB	iBBB	iBBB-	iBBB- (under review)	
Outlook:	<i>stable</i>	<i>stable</i>	<i>stable</i>	<i>stable</i>		