

Research Update:

Azerbaijan-Based PASHA Insurance OJSC Assigned 'BB+' Rating; Outlook Stable

April 6, 2020

Overview

- We consider that PASHA Insurance OJSC, the leading property and casualty (P/C) insurer in Azerbaijan, benefits from its well-established market position, and sound earnings and profitability.
- We assess insurance industry country risk in Azerbaijan as high, taking into account the pressured macroeconomic environment, low P/C insurance sector penetration, only moderate growth prospects, and still-developing sector regulations.
- We note that, while PASHA Insurance is well capitalized, it is significantly exposed to market and credit risks due to its investment portfolio's concentration in noninvestment grade instruments.
- We are assigning our 'BB+' financial strength and issuer credit ratings to PASHA Insurance.
- The stable outlook indicates our expectation that the company will remain the leading P/C insurer in Azerbaijan and maintain sound earnings and profitability over the next 12 months.

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Rating Action

On April 6, 2020, S&P Global Ratings assigned its 'BB+' long-term insurer financial strength and issuer credit ratings to Azerbaijan-based PASHA Insurance OJSC. The outlook is stable.

Rationale

The ratings reflect our view of the company's leading position in the property and casualty (P/C) insurance market of Azerbaijan and its solid underwriting performance compared with both local and global peers. At the same time, we note high industry and country risks in Azerbaijan's P/C insurance sector. Our ratings on PASHA Insurance are also constrained by the company's significant exposure to high-risk assets and concentration risk in the investment portfolio.

We assess the operating environment for Azerbaijan insurers as challenging, taking into account macroeconomic trends, a low insurance penetration rate, and only moderate growth prospects.

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Our assessment of insurance industry and country risk (IICRA) is high for property/casualty (P/C) insurance sector in Azerbaijan, reflecting these factors. We expect Azerbaijan's real GDP will contract by 0.7% in 2020, gradually rebounding in the next two years, reflecting weakness in external demand. This follows our downward revision of the expected average Brent oil price in 2020 to \$30 per barrel from \$60 previously (see "S&P Global Ratings Cuts WTI And Brent Crude Oil Price Assumptions Amid Continued Near-Term Pressure" published March 19, 2020), as well as our expectation for a global recession in 2020, with GDP rising by just 0.4% (see

The Escalating Coronavirus Shock Is Pushing 2020 Global Growth Toward Zero" published on March 30, 2020, on RatingsDirect). Therefore, we expect P/C insurance sector premium growth in Azerbaijan will not exceed 5% annually in the next two years, and that the sector will largely depend on regulatory measures to develop new lines of business and increase market transparency. Despite a number of new regulatory initiatives, we expect their implementation might take time and require additional effort from the regulator. Taking this into account, as well as declining business activity and GDP growth prospects, we believe insurance spending will remain at \$20-\$25 per capita, while insurance penetration will remain low and close to the five-year average of 0.5%.

These many factors also weigh on our assessment of PASHA Insurance's operating environment. PASHA Insurance is the clear market leader, benefiting from its expertise, brand awareness, and diversified business mix. With Azerbaijani manat 148 million (AZN) (approximately \$87 million) of gross written premium (GWP) in 2019, PASHA Insurance has a 36% share of the P/C insurance market in Azerbaijan, which we expect it will maintain over the next two years. While the local P/C insurance market is generally concentrated on motor insurance (about 35% of overall gross premiums in 2019), PASHA Insurance's business is well diversified across various business lines. The major lines are medical (40% of GPW in 2019), motor (20% of GPW in 2019) and property (18% of GPW in 2019). We expect these three business lines will account close to 80% of the business mix in 2020-2021. We note that a significant part of the company's premiums come from one medical contract representing about 28% of the company's total GPW in 2019.

We project the company will remain well capitalized in the next two years, with capital adequacy (based on our model) above 'A' benchmark level. In our base-case assumptions, we expect premiums will increase annually by about 5% on average during this period, in line with our expectations for the Azerbaijani P/C insurance market. We expect, however, that premium growth in 2020 may be constrained due to overall pressure on Azerbaijan's economic growth prospects as a result of the COVID-19 pandemic and oil price volatility. We expect market turbulence, in particular securities market volatility, could negatively affect investment income. As a result, we also incorporate potential negative revaluation of the company's bonds in our forecasts, although this could be somewhat offset by foreign exchange revaluation of the dollar-denominated instruments.

We believe PASHA Insurance will maintain favorable profitability metrics in the next two years. In our projections, the company's combined (loss and expense) ratio will likely remain below 85% due to strict underwriting standards, the company's pricing power as the market leader, and its operating efficiency. We note that the company's portfolio does not include protection against pandemic risks, or tourist operator liability risk. We also expect PASHA Insurance's dividends won't exceed 50% of net income in the next two years, in line with the company's plans. We believe that revaluation of noninvestment grade bonds, while material, will be absorbed by PASHA Insurance's capital buffers.

Our assessment of PASHA Insurance's financial risk profile is constrained by the average credit quality of its investments, which we consider in 'BB' range. This is relatively low compared with that of global peers. We note, however, that this is mostly explained by our sovereign rating on

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Azerbaijan (BB+/Stable/B) and limitations imposed on insurance companies by the local regulator (investments in foreign instruments are not recognized when calculating the regulatory capital adequacy ratio). We also note that the company's investment portfolio is highly concentrated in the local banking sector.

We consider that PASHA Insurance benefits from an experienced management team and established risk management practices relative to peers.

We assess that PASHA Insurance has sufficient liquidity to meet its obligations, with a liquidity ratio of 112% at the end of 2019 as per our calculations. We note, however, that this level of liquidity is lower than that of rated peers in the commonwealth of independent states region. We believe that PASHA has a sufficient liquidity cushion and will follow strict liquidity management in order to meet its obligations. However, if the company's liquidity position deteriorates, we would review its liquidity score.

Outlook

The stable outlook reflects our expectation that PASHA Insurance will maintain a strong operating performance in the next 12 months, supported by both favorable underwriting and investment results. This will allow the insurer to maintain its solid capitalization level and safeguard its leading positions in the P/C insurance segment in Azerbaijan.

Downside scenario

We could consider a negative rating action in 12 months if:

- We took a negative action on the Azerbaijan sovereign rating, which could put pressure on PASHA Insurance's investment credit quality and underwriting results in view of tightening operating conditions;
- The company's capitalization came under pressure as a result of higher-than-expected insurance portfolio growth, higher-than-expected dividends, or underwriting and investment losses that we do not anticipate in our base case;
- PASHA Insurance's investment strategy became more aggressive, with the weighted average credit quality of investments moving toward 'B' level; or
- If we saw significant pressure on the company's liquidity position.

Upside scenario

We view a positive rating action as remote in the next 12 months, taking into account the concentration of the company's insurance and investment activities in Azerbaijan and the sovereign long-term rating of 'BB+'.

Ratings Score Snapshot

Financial strength rating	BB+
Anchor*	bb+
Business risk	Fair

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IICRA	High
Competitive position	Strong
Financial risk	Fair
Capital and earnings	Strong
Risk exposure	High
Funding structure	Neutral
Modifiers	
Governance	Neutral
Liquidity	Adequate
Comparable ratings analysis	0
Support	0
Group support	0
Government support	0

*We choose a lower option for the anchor because we consider that high IICRA risks in Azerbaijan put pressure on the company's business risk profile compared with global peers.
IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

New Rating

PASHA Insurance OJSC

Issuer Credit Rating	BB+/Stable/--
Financial Strength Rating	BB+/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support

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