
GUIDELINES FOR ANALYSING THE FINANCIAL STATEMENTS OF BULGARIAN PUBLICLY TRADED INSURANCE COMPANIES

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Abstract: Financial statements provide information necessary to analyse and assess the financial position of publicly traded companies. Information users include a wide range of entities, such as creditors, suppliers, customers, investors, external control bodies, etc. This paper promotes the thesis that the information disclosed in financial statements helps investors in their decision to invest in the shares of publicly traded companies. A precise analysis of financial statements may result in a decision to purchase, not to purchase, or to sell some of the stocks of the companies which are subject to analysis. The article focuses on publicly traded companies in the insurance sector.

Key words: publicly traded companies, assets, financial statements, stock exchange.

JEL: G21, G22

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The financial statements of publicly traded companies may be analysed in several aspects. Generally, the scope of financial analysis covers:¹

- Analysis of corporate earnings;
- Analysis of corporate liquidity;
- Analysis and assessment of corporate solvency;
- Analysis of restructuring corporate capital.

The capital structure of publicly traded companies may also be subject to analysis.²

¹ Zahariev, A. i kolektiv. *Finansov analiz*. V. Tarnovo, 2016.

In this article, financial statements analysis focuses on the financial results achieved by companies and the generated cash flows. The object of research is Bulgarian publicly traded companies operating in the insurance sector. The subject of research is the financial statements which these companies publish.

At the early stage of the development of Bulgarian insurance market, the premium generated by an insurance company was a major performance benchmark. It is a common practice in Bulgaria to rank companies by the "gross premium income" criterion. We should note, though, that some of the insurance companies are publicly traded nowadays. This means that the most significant value to investors is no longer that of the income, but of the final financial result and the return on equity of an insurance company. This article promotes the thesis that analysis of the financial statements of publicly traded insurance companies must focus on the dynamics of key financial indicators, such as return on equity, return on sales, and return on assets. These financial ratios best indicate the performance of an insurance company and help investors in their decision whether to invest in that company.

The aim of this research paper is to analyse the financial results and the profitability of insurance companies listed on the stock exchange. To accomplish this, our research deals with two main issues:

- Analysis of key indicators in the financial statements of publicly traded companies;
- Assessment of the current financial position of the companies which are subject to analysis.

The methods employed in our research are comparative analysis, graphical analysis and financial ratios analysis.

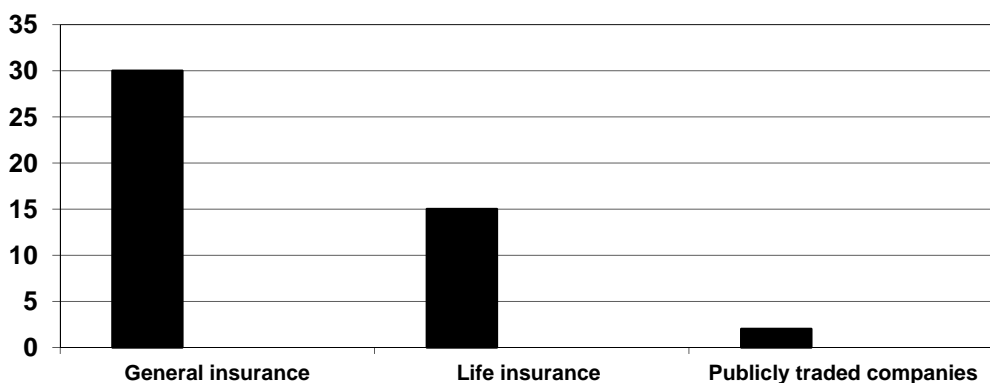
I.

In terms of the total number of all insurance companies, the number of those traded on the stock exchange remains relatively small. Currently, there are forty-five companies operating on the insurance market, thirty of them operating in the sphere of general insurance, and fifteen – in the life-insurance sector. Only two general insurance companies are listed on the stock exchange (see Figure 1). They belong to the sector of Financial and insurance

² See further: **Zahariev, A.** Tehnologiya za optimizatsia na kapitalovata struktura na firmata v Balgaria (2013) – po primera na "Sopharma" AD. Sbornik s nauchno-prilozhni izsledvaniya po upravlenie na kapitalite vav firmata – 2013 (Nauchna sesiya), Tom 3, Svishtov, 2013, p. 33-52.

activities, sub-sector of Insurance, reinsurance and supplementary pension security.

Figure 1. Number of insurance companies which operate in both sectors – general and life insurance as of April 2016



Source: Data provided by the Financial Supervision Commission and the Bulgarian Stock Exchange

Publicly traded insurance companies prepare their financial statements in compliance with International Accounting Standards (IAS). These are:

- The financial position statement (i.e. the balance sheet);
- The changes in equity statement;
- The comprehensive income statement;
- The cash flow statement.

Since the nature of the annual financial statements of publicly traded insurance companies is very specific, it is necessary to briefly analyse each type. Table 1 shows the comprehensive income statement of Euroins Insurance Group. The major elements of the comprehensive income statements of insurance companies differ substantially from the income statements of the companies operating in real economy. This is due to the fact that insurance companies take certain risks when signing insurance contracts, therefore they need to form technical reserves. Those reserves are deducted from the generated premium income. As evident from the financial statement given below, the change in the value of unearned premium reserve has a substantial impact on earned net premiums and the net income of the insurance company.

Another major factor which affects the premium income is the value of outward reinsurance premiums. When the managers of an insurance company take on especially high risks, they need to sign reinsurance contracts. The

value of outward reinsurance premiums affects net premiums while the reinsurance policy affects the financial result of the insurance company.³

Table 1. Comprehensive income statement of Euroins Insurance Group as of 31st December 2015

	(BGN thousand)	
	2015	2014
Subscribed gross premiums	118.387	82.886
Outward reinsurance premiums	(24.162)	(12.793)
Net premiums	94.225	70.093
Change in gross unearned premium reserve	(785)	7.233
Reinsurer's share in the change in unearned premium reserve	1.304	7.211
Net premiums earned	94.744	84.537
Fee and commission income	1.719	2.652
Financial income	1.474	1.425
Other operating income	709	252
Net income	98.646	88.866
Net losses incurred from reinsurance	(51.290)	(50.202)
Acquisition costs	(24.781)	(18.355)
Administrative costs	(9.960)	(9.270)
Financial expenses	(620)	(571)
Other operating expenses	(11.518)	(9.989)
Operating profit	477	479
Other income (costs)	(177)	(118)
Profit (loss) for the period	300	361
Tax expenses	(96)	(64)
Total comprehensive income for the reporting period	204	297

Source: The annual financial statement of Euroins Insurance group for the year 2015

The costs incurred by an insurance company generally differ from the costs incurred by publicly traded companies which operate in real economy, due to the operation of publicly traded insurance companies. They sell insurance products related to the coverage of specific risks. A major cost item in the income statements of insurance companies is the value of insurance benefits paid. At the same time, insurance companies incur significant costs related

³ See: **Krastev, L.** Prilozhenie na finansovite pokazатели pri analiz na obshtoto zastrahovane. // Biblioteka "Obrazovanie i nauka", No. 26, 2012, pp. 117-122.

to the sale of insurance products (expenses made on commissions and advertising), staff costs, and investment management costs. Receivables written off under insurance policies are another prime cost item for insurance companies. Thus, in addition to the costs related to the payment of insurance benefits, the value of the final financial result of the insurance company is also affected by acquisition, administrative, financial, and operational costs. The information provided by the comprehensive income statement of another publicly traded insurance company, Busltrad Vienna Insurance Group, is similar (Table 2).

Table 2. Comprehensive income statement of Busltrad Insurance Group as of 31st December 2015

BGN thousand	2015	2014
Subscribed gross premiums	185.340	171.485
Outward reinsurance premiums	(65.503)	(59.542)
Net premiums	119.837	111.943
Net change in unearned premium reserve	(1.179)	(1.615)
Net premiums earned	118.658	110.328
Reinsurance commissions	10.291	10.733
Income from investment	3.665	3.999
Other technical income	1.443	2.124
Other income	343	137
Total income	134.400	127.321
Net losses incurred from reinsurance	(74.776)	(67.942)
Acquisition costs	(36.826)	(34.682)
Net change in deferred acquisition costs	941	280
Administrative costs	(17.747)	(17.506)
Other technical expenses	(20.169)	(9.088)
Other non-technical expenses	(458)	(3.861)
Total costs	(149.035)	(132.799)
Loss from operations	(14.635)	(5.478)
Tax expenses	26	1
Annual loss	(14.609)	(5.477)

Source: Annual financial statement of Bulstrad Vienna Insurance Group for the year 2015

The information quoted above confirms the fact that the principle of calculating the financial result in insurance is totally different from the man-

ner in which financial result is calculated for companies operating in the other sectors of economy. Despite those major differences in calculating the financial result of different publicly traded companies, investors' assessment of their performance is based on comparable general financial indicators. Those could be earnings before interests and taxes and net earnings in the period. In economic literature, earnings before interests and taxes are a key indicator of a company's profitability.⁴ It shows the ability of a company to generate profit from its activity in general, without taking into account the value of tax liabilities and interest payments. In this statement, interest payments are reported as financial costs and calculated in the formation of operating profit. However, their share in the value of total financial costs is small. The financial costs of a company also include losses from impairment and sale of financial assets, investment management costs, and other financial costs.⁵ In this article, the analysis of the performance of publicly traded insurance companies will be based on the net earnings for the period, that is, the profit which remains at the disposal of the company after covering all costs and making all tax payments.

II.

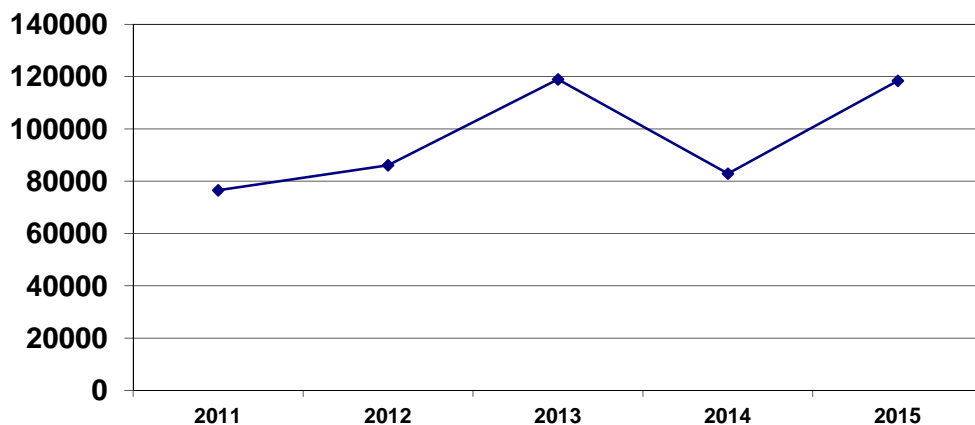
The financial statements of publicly traded insurance companies provide essential, though contradictory, information to investors. It is easy to note that despite the large amount of the premium income which Euroins Insurance Group reported, the value of earnings remained small.⁶ The premium income of the company increased by approximately 43 per cent while operating profit shrank by nearly 20 per cent in 2015. The dynamics of the premium income and the value of the net earnings of the company over the last five years provide a long-term idea about the financial position of Euroins Insurance Group (figures 2 and 3).

⁴ See: **Bodie, Z., Kane, A., Marcus, A.** Investitsii. Sofia, 2000, p. 469.

⁵ According to data provided in the explanatory notes to the financial statements of Euroins Insurance Group.

⁶ As evident from the income statement of Euroins Insurance Group, the premium income in 2015 was nearly BGN 118 million, and in 2014 it was nearly BGN 83 million. At the same time, the company reported earnings of BGN 207,000 in 2015 and BGN 361,000 in 2014.

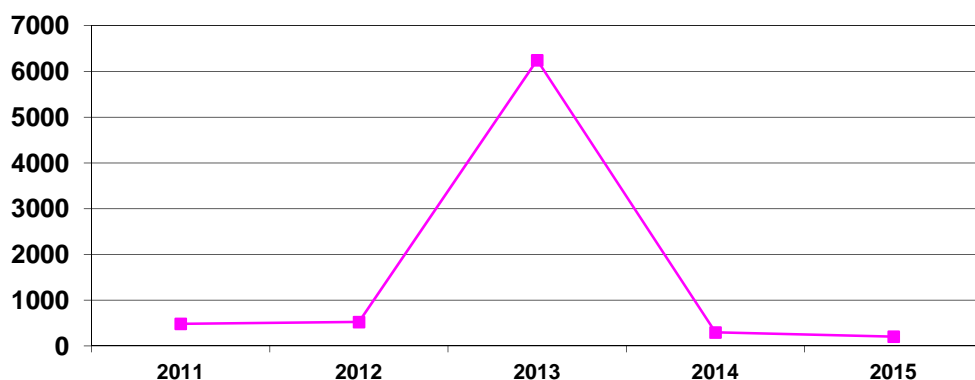
Figure 2. Dynamics of the premium income (gross premium income) of Euroins Insurance Group for the period from 2011 to 2015 in BGN thousand



Source: Data provided in the financial statements of Euroins Insurance Group for the period from 2011 to 2015.

The premium income (the gross premium income) of Euroins Insurance Group over the period indicated an upward trend. The company generated the highest premium income in 2013, nearly BGN 119 million, and in the year 2015 the value of the premium income was roughly the same. Despite the high values of reported premium income, the value of net earnings over the analysed period remained low, except for the year 2013.

Figure 3. Dynamics of the net earnings of Euroins Insurance Group in the period from 2011 to 2015 in BGN thousand.

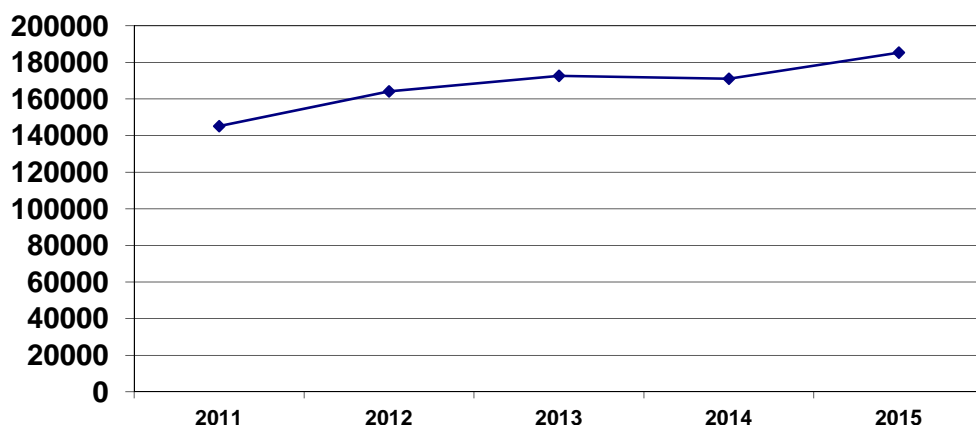


Source: Data provided in the annual financial statements of Euroins Insurance Group for the period from 2011 to 2015.

In each of the last five years, Euroins Insurance Group reported a positive financial result. Nevertheless, over the analysed period, the net earnings of the company, as a percentage of the gross premium income did not exceed one per cent, except in the year 2013. The company reported the highest financial result in 2013 when earnings exceeded BGN 6 million.

The dynamics in the value of gross premium income and net earnings also provide interesting information.

Figure 4. Dynamics in the premium income (gross premium income) of Bulstrad Vienna Insurance Group for the period from 2011 to 2015 in BGN thousand.



Source: Data provided in the annual financial statements of Bulstrad Vienna Insurance Group for the period from 2011 to 2015.

As for its gross premium income, Bulstrad Vienna Insurance Group reported an upward trend. The company expanded its market position and in 2015 it had 12 per cent of the total market share in the sphere of general insurance. According to the "gross premium income" criterion, the insurance company ranked second on the market for general insurance.⁷ Obviously, the strong market position and the sustainable growth of the premium income should indicate that 2015 was another successful year in the performance of Bulstrad Vienna Insurance Group on the general insurance market. Was it in fact? The final financial result gives a more realistic idea about the performance of the insurance company. Essential information is also provided by a number of general indicators such as return on sales, return on equity, and return on assets. The next figure illustrates the dynamics in the value of net earnings of Bulstrad Vienna Insurance Group over a five-year period.

⁷ Data provided by the Financial Supervision Commission for the year 2015.

Figure 5. Dynamics in the net earnings of Bulstrad Vienna Insurance Group for the period from 2011 to 2015 in BGN thousand.



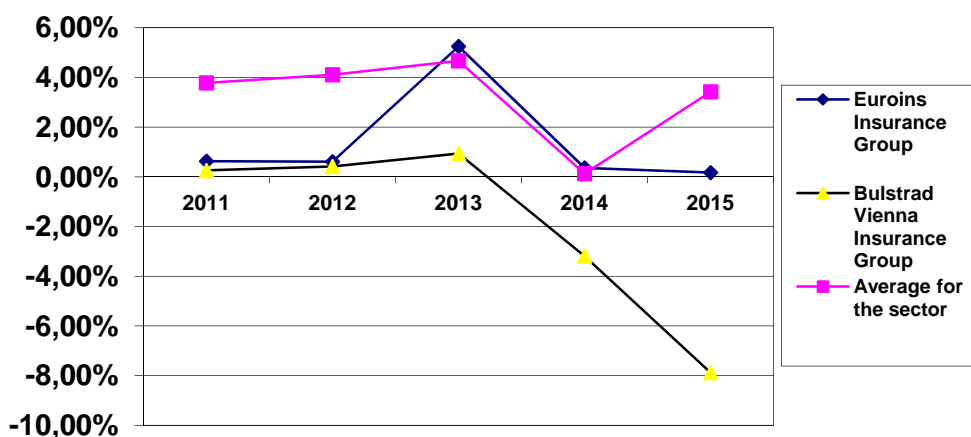
Source: Data provided in the annual financial statements of Bulstrad Vienna Insurance Group for the period from 2011 to 2015.

The company reported growth of net earnings, but only in the first three years of the analysed period. Despite the upward trend in the gross premium income, the company suffered substantial losses over the last two years of the analysed period. In 2015, the losses exceeded BGN 14 million. Such anomalies in the sphere of insurance are often explained with the fact that companies take a substantial risk when signing and executing insurance contracts. The final financial result is negatively affected mainly by the growth of insurance benefits paid under signed insurance contracts, high levels of acquisition and administrative management costs, and increased costs of written off insurance claims.

This issue brings the focus of attention to the profitability of a company performance on the insurance market. One of the indicators for assessing the efficiency of a company is return on sales. This indicator compares the value of net earnings to the value of premium income (gross premium income) generated by the insurance company. It shows the net earnings generated from one hundred levs of gross premium income. The figure below illustrates the return on premium income for analysed insurance companies, calculated by comparing the values of net earnings and gross premium income. Over the analysed period, the returns of both insurance companies tend to remain below the average for the sector of general insurance. The return on the premium income of Euroins Insurance Group in that period was below one per cent, except for the year 2013 when the return of the company exceeded five per cent. Return on the premium income of Bulstrad Vienna In-

insurance Group was below one per cent, too. What is more, in the last two years of the reviewed period, the value of return remained negative since the company made a loss.

Figure 6. Return on the premium income of Euroins Insurance Group and Bulstrad Vienna Insurance Group for the period from 2011 to 2015

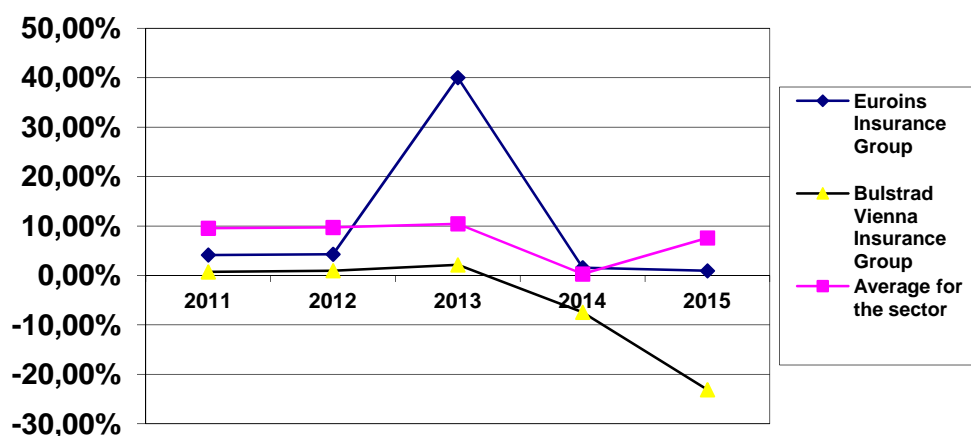


Source: Calculations of the author.

Another key indicator for investors is return on equity which compares the value of net earnings to the value of corporate equity⁸ and reveals the earnings made from BGN 100 of equity. This indicator must be approached in two aspects. First, it shows the dynamics in return on equity for the companies which are subject to our analysis. Second, the indicator makes it possible to compare the returns of reviewed companies and their performance to the average return in the insurance sector. Since both insurance companies are listed on the stock exchange and their financial indicators are closely monitored by investors, their return on equity will be expected to exceed the average for the sector. The dynamics in the indicator for Bulstrad Vienna Insurance Group and Euroins Insurance Group is illustrated in Figure 7.

⁸ When calculating the equity of a company, the average value is considered in comparison to the value of equity at the beginning and the end of a year.

Figure 7. Return on equity for Euroins Insurance Group and Bulstrad Vienna Insurance Group in the period from 2011 to 2015



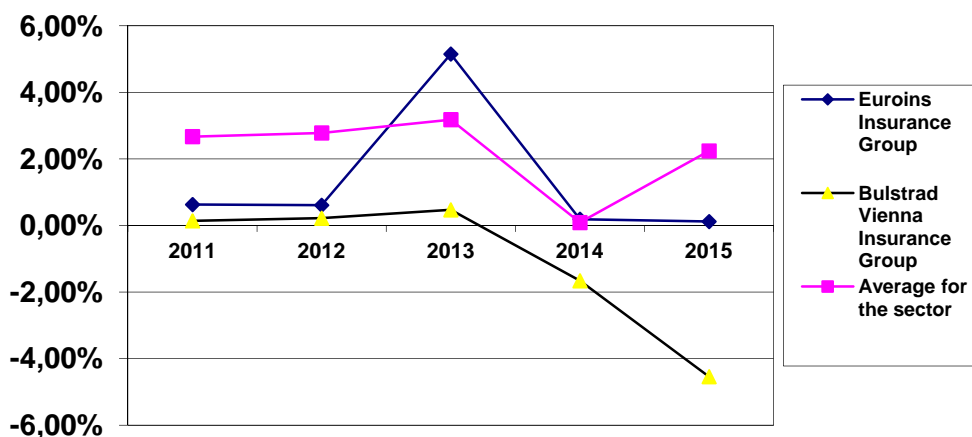
Source: Calculations of the author.

Return on equity for both companies was obviously below the average for the general insurance sector over the reviewed period. As a whole, the values reported by the sector for the indicator return on equity in that period were around 10 per cent, except for the year 2014. At the same time, Bulstrad Vienna Insurance Group reported minimum values of the indicator (between 1 and 2 per cent) in the first three years of the reviewed period, and negative return on equity in the last two years. In 2015, the return on equity reported by Bulstrad Vienna Insurance Group was roughly -23 per cent. The other insurance company, Euroins Insurance Group, reported positive values of the indicator. Nevertheless, return on equity was considerably below the average for the sector, except for the year 2013 when the company achieved a value of nearly 40 per cent for the indicator.

The major conclusion then is that both publicly traded insurance companies generally reported results below the average for the sector of general insurance. This was the trend for the analysed companies both in terms of return on premium income (gross premium income), and return on equity. What is more, the same trend was confirmed in terms of the indicator return on assets calculated as a comparison between the companies' net earnings and the value of their assets.⁹

⁹ When calculating the value of assets, only their average value is taken into consideration, compared to the value of the assets at the beginning and at the end of the year.

Figure 8. Return on assets for Euroins Insurance Group and Bulstrad Vienna Insurance Group for the period from 2011 to 2015



Source: Calculations of the author.

Return on assets in the sector of general insurance over the analysed period was between 2 and 3 per cent. The year 2014 was an exception, as the value of the indicator was below 0.5 per cent. In the first three years of the period, the value of the indicator for Bulstrad Vienna Insurance Group was under 0.5 per cent, and in the last two years the value was negative. Return on assets for Euroins Insurance Group ranged from 0.5 to 1 per cent, except for the year 2013 when the value of the indicator exceeded 5 per cent.

In addition to the financial ratios quoted above, investors also use the value of the income generated from a single stock and the price of that stock to analyse and assess the performance of Bulgarian publicly traded companies. Basically, a stock is attractive to investors when it can generate the income expected from it. Stocks can generate income in two manners –from the change in their price and as dividends. Decreasing prices of stocks lead to poor financial results, and the inability of stocks to generate profit, which puts off investors. Therefore the managers of Bulgarian insurance companies listed on the stock exchange must focus on raising the market value of equity.¹⁰ When the managers of an insurance company aim to increase the market value of the company on the equity market, they need to accomplish a number of goals. Those goals may be divided into two categories – technical-insurance goals and financial goals.¹¹ Technical-insurance goals relate to increased premium income and control on the value of incurred costs. Financial goals

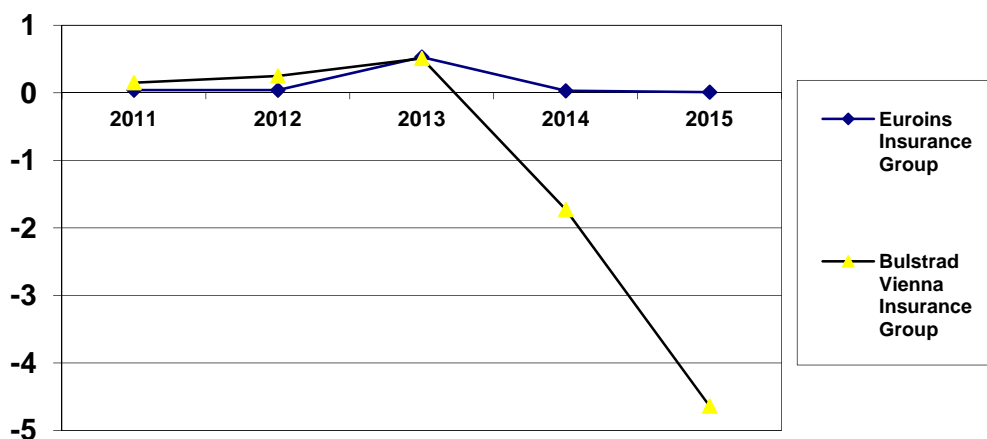
¹⁰ See: **Iliev, B.** Adaptiven menidzhmant v zastrahovaneto. Faber, 2010, p. 43-52.

¹¹ **Iliev, B.** Op. cit., p.45.

relate to increased return on the investment portfolio and the manner in which the company is funded.¹²

Figure 9 illustrates the revenue generated by a single stock of the companies which are subject to analysis in this paper.

Figure 9. Revenue (earnings) generated per stock in Euroins Insurance Group and Bulstrad Vienna Insurance Group in the period from 2011 to 2015



Source: The annual financial statements of Euroins Insurance Group and Bulstrad Vienna Insurance Group

Euroins Insurance Group maintained positive, although minimum, revenue from the ownership of a single stock. The income per share ranged between BGN 0.01 and BGN 0.04, except for the year 2013, when the income per share exceeded BGN 0.50. As for Bulstrad Vienna Insurance Group, the income per share ranged between BGN 0.15 and BGN 0.50, and in the last two years of the analysed period the company reported loss per its shares. In the year 2015, the loss per single share exceeded BGN 4.

III.

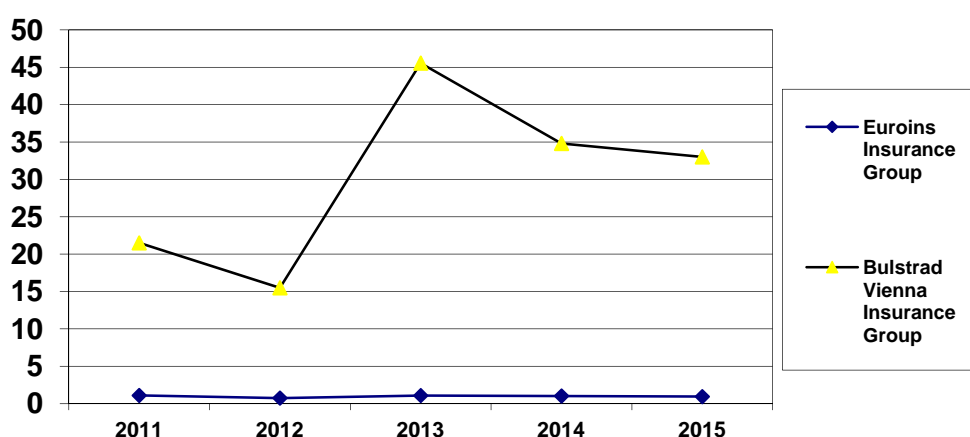
The way the market reacts to the financial results disclosed in the financial statements of public insurance companies is also worth analysing. In specialised literature, three major factors are considered to affect the market price of publicly traded companies. Those are the cash flows of companies, **long-term forecasts about the development of cash flows**, and the cost of

¹² Ibid., pp. 45-47.

equity, or the discount rate which reveals the risk related to receiving future cash flows.¹³ The financial results disclosed in the quarterly and annual financial statements of publicly traded companies gives investors an insight into the development of estimated cash flows, though. Hence, the reported revenue per share will affect the market value of a publicly traded company. Poor financial results may make investors adjust the forecast value of future cash flows, which will inevitably affect the price of shares.¹⁴

Figure 10 presents the dynamics in the price of shares of the two analysed publicly traded insurance companies.¹⁵

Figure 10. Price per share of Euroins Insurance Group and Bulstrad Vienna Insurance Group for the period from 2011 to 2015



Source: Data provided by the Bulgarian Stock Exchange.

Over the analysed period, Euroins Insurance Group maintained a steady price level for its shares, with prices ranging from BNG 0.95 to BGN 1.10 per share. The price of the shares of Bulstrad Vienna Insurance Group was characterised by greater dynamics, the price reaching the highest value in the year the company reported its highest financial result (2013). It fell dramatically in the last two years of the period when the company reported negative financial results.

It would be interesting to compare the prices of shares and the earnings (income) per share which the insurance companies report. In financial theory, this is known as the price-earnings ratio (P/E).

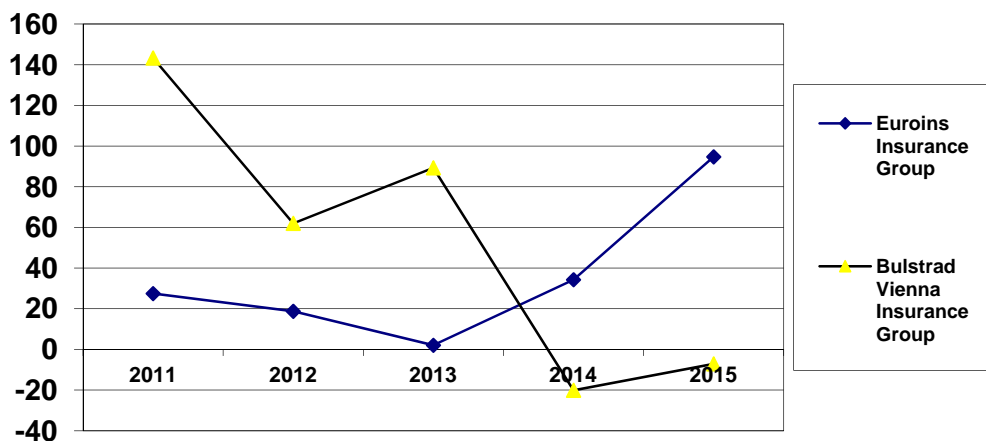
¹³ **Rappaport, A.** Creating Shareholder Value. A Guide for Managers and Investors. New York, 1998, p. 70.

¹⁴ **Rappaport, A.** Op. cit., p.71.

¹⁵ These are the prices of the shares at the end of the reporting year.

Figure 11 presents the price-earnings ratio of the analysed insurance companies.

Figure 11. Price-earnings ratio of Euroins Insurance Group and Bulstrad Vienna Insurance Group for the period from 2011 to 2015



Source: Calculations of the author.

Over the reviewed period, the price-earnings ratio for the shares of Bulstrad Vienna Insurance Group decreased substantially. At the beginning of the period (in 2011), this ratio was nearly 140, while it dropped to negative values at the end. The dramatic drop in the price-earnings ratio indicates that investors monitored the formally disclosed financial results of the company. The negative result reported in the last two years of the analysed period and deteriorating return affected investors' behaviour. At the beginning of the analysed period, the price-earnings ratio of Euroins Insurance Group was much lower than that of Bulstrad Vienna Insurance Group. The value of the ratio was the lowest in 2013, since the company reported the highest financial result, and hence income per share, and then it gradually started to increase.

In addition to the financial ratios analysed so far, investors are also interested in the price-to-book ratio (P/BV) which is the ratio between the market value and the book value of a share.¹⁶

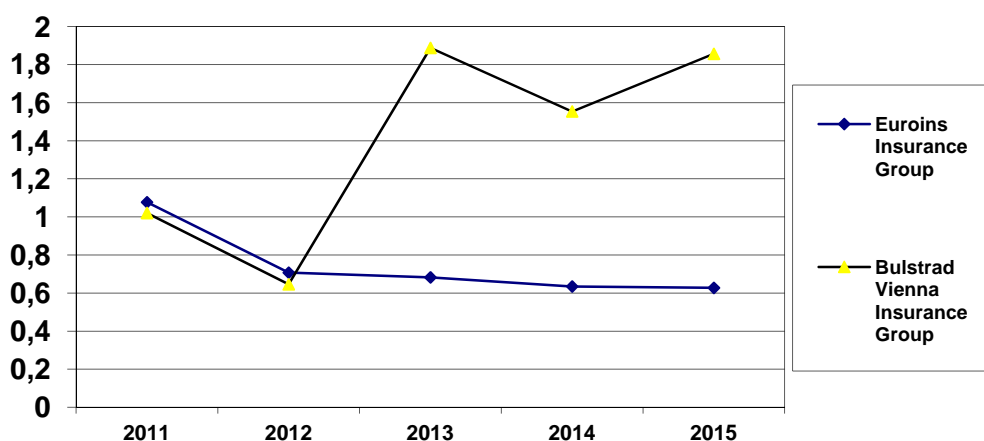
Shares with low price-to-book ratio are considered to be a safer investment, since the price of shares is not very likely to drop below their book

¹⁶ The book value of a share is calculated by dividing the equity of a company into the number of shares it has issued.

value.¹⁷ High price-to-book value, on the other hand, may indicate that investors are confident in the potential of a company to develop.¹⁸

Figure 12 shows the values of the price-to-book ratios of the analysed publicly traded insurance companies.

Figure 12. Price-to-book ratio of Euroins Insurance Group and Bulstrad Vienna Insurance Group for the period from 2011 to 2015



Source: Calculations of the author.

The value of the price-to-book ratio of Euroins Insurance Group tended to decrease. In the last four years of the analysed period, from 2012 to 2015, the value of the price-to-book ratio was below 1, i.e. the price of a single share was lower than its book value. Those low values of the price-to-book ratio (including values below 1) indicated that the shares of Euroins Insurance Group were not valued very highly on the market. One of the reasons behind this was the lower financial results which the company reported, as well as the low return on its performance. The value of the price-to-book ratio of Bulstrad Vienna Insurance Group varied widely. Thus in 2012 the value of the ratio was below 1, while in 2013, it nearly reached 2. Those fluctuations in the value of the ratio were due both to the change in the price of shares, and the dynamics in the value of the company equity. It is therefore difficult to identify a clear trend in the value of the ratio for Bulstrad Vienna Insurance Group.

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¹⁷ Bodie, Z., Kane, A., Marcus, A. Op. cit., p. 481.

¹⁸ Bodie, Z., Kane, A., Marcus, A. Op. cit., p. 481.

In terms of the findings and trends we have identified in this article, we could make four major conclusions about the performance of publicly traded insurance companies over the analysed five-year period.

First, Bulgarian publicly traded insurance companies reported an increase in their gross premium income. At the same time, those companies reported poor financial results, including losses, as a whole. Hence, premium income cannot be approached as the only criterion for assessing a company's performance on the insurance market.

Second, a major criterion for assessing the performance of insurance companies on the insurance market should be their returns. The returns of both insurance companies which were analysed in this article were generally below the average return in the general insurance sector. At the same time, the financial results of Bulgarian publicly traded insurance companies are monitored by investors and should achieve returns exceeding the average for the insurance sector. This finding also holds true for major financial indicators such as return on premium income (gross premium income), return on equity, and return on assets.

Third, the market gives clear indications in terms of the results disclosed in the financial statements of publicly traded companies. Those signals may be interpreted both through analysis of the dynamics in the prices of their shares, and through analysis of major market ratios. Those include the price-earnings ratio and the price-to-book ratio. The shares of Bulstrad Vienna Insurance Group clearly indicated a downward trend in terms of the value of the price-earnings ratio over the five-year period. As for Euroins Insurance Group, the values of the price-to-book ratio tended to decrease. What is more, in the last four years of the analysed period, the market value of their shares was below their book value.

Fourth, investors monitor closely the financial results disclosed by publicly traded insurance companies. A growth in premium income and an expanding market share should not be the primary objective of insurance companies' managers. Rather, their major objective should be the growth in the market value of equity. This goal is to be accomplished through increasing premium income; control on the value of incurred costs, including the insurance benefits paid; management of the investment portfolio and the technique of funding the companies.

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