

Lumbini General Insurance Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed rights issue (equity shares) of Lumbini General Insurance Company Limited

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (MAY 2017)
Rights Issue (Equity shares)	NPR 390 million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned “**[ICRANP] IPO Grade 3**”, indicating average fundamentals to the proposed rights issue amounting to NPR 390 million of Lumbini General Insurance Company Limited (LGIL). ICRA Nepal assigns IPO¹ grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative positioning within the grading categories concerned. Thus, the grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4 respectively. LGIL has proposed 1:1 rights issue of 3,900,000 numbers of equity shares of face value NPR 100 each, to be issued to the existing shareholders at par. The proposed rights issue is being made to increase its capital base in line with the revised minimum paid up capital requirement for general insurers² as prescribed by the Insurance Board of Nepal.

The grading factors in LGIL’s adequate track record, adequate franchise network, tested underwriting norms, adequate underwriting and overall profitability and experienced management team. LGIL has healthy premium retention ratio, backed by sizeable motor segment proportion, which has supported the underwriting performance so far. The grading also takes into consideration, LGIL’s adequate reinsurance arrangements, including catastrophic provisions, which helped LGIL maintain its claims paying ability, solvency position and profitability profile in the aftermath of the April 2015 earthquake.

However, the grading remains constrained by low business growth vis-à-vis industry average³ and limited diversification of business with high dependence on motor segment (~70% of gross premium written (GPW) during past 3 years). Incremental underwriting performance of LGIL over medium term will depend on the performance of motor segment. The grading is also constrained by probable dilution of return indicators of LGIL with proposed capital injection. However, return dilution is likely to be offset to some extent by recent growth in premium earnings (55% annualized growth during H1FY17) and increased investment income (yield on investment of ~9% during H1FY17 vs ~5% in FY16). The grading also remains limited by stiff competition from other players in the general insurance industry of Nepal.

LGIL is among the medium sized players in the general insurance industry in terms of premium earnings with ~5% share in industry gross premium written (GPW) in FY16. During FY12-FY16, average premium retention ratio for LGIL stood at ~64%, much higher than industry average of ~51% leading to ~6% share in industry NPW in FY16. During FY12-FY16, LGIL’s premium growth rate has lagged the industry average eroding the market share of the company, albeit marginally. Incremental premium growth is likely to remain supported by geographical expansion planned by the management. LGIL is also likely to increase the premium retention level commensurate with increase in net worth after proposed rights issue.

LGIL has settled the entire earthquake related claims arising from April 2015 earthquake. LGIL was exposed to a total earthquake related claims of ~NPR 255 million. The earthquake claims were on lower side due to limited exposure of LGIL towards fixed property insurance (fire and engineering segment). LGIL retained a total net loss of NPR ~22 million towards the earthquake claims and rest were passed on to the reinsurers.

LGIL’s portfolio mix is dominated by the motor segment (91% of Net premium earned (NPE) during FY12-FY16), followed by fire segment (6%) and miscellaneous⁴ (2%) with negligible contribution from other segments. All major segments of LGIL has generated underwriting surplus during each of past 5 years ending FY16 except for nominal underwriting deficit in fire segment in FY15 due to earthquake. Overall underwriting surplus of LGIL has grown by 60% during FY12-FY16, backed by decline in claims ratio (from 76% of NPE in FY12 to 44% in FY16) & commission expense ratio⁵ and low management expense ratio

¹ Includes rights and further public issue of equity shares

² Minimum paid up capital of NPR 1 billion to be maintained by July 2018 by all general insurers.

³ CAGR growth of 18% in GPW and 15% in NPW vs industry average of 21% and 19% respectively (during FY12-16)

⁴ Includes All Risk policies, personal accidents, group medical policies, bankers’ blanket indemnity, among others.

⁵ Agency commission was capped by the Insurance Board at 5% of GPW by the Insurance Board from April 2015.

(past 5 years' average of 25% of NPE). Source wise, business from agents accounted for 80-90% of GPW during FY14-FY16, indicating a strong agency channel. Similarly, during FY14-FY16, ~75% of GPW was accounted for by institutional clients. ~2/3rd of motor GPW during FY14-FY16 came from syndicated transport business and institutional clients.

Underwriting surplus of LGIL in FY16 has reported healthy growth (NPR 173 million in FY16 vs 35 million in FY15). Combined ratio of the company in FY16 stood at 61%, improving from 91% in FY15, backed by moderation in claims ratio & commission expense ratio and supported by low management expense ratio. Premium retention ratio in FY16 (61%) despite moderating vis-à-vis FY15 (65%), remains healthy benefitting the underwriting performance. Backed by improvement in underwriting performance, return on net worth of LGIL in FY16 stood at ~22% vis-a-vis ~24%⁶ in FY15.

Profitability of LGIL remains supported by its investment income (average yield of ~9% during H1FY17 on a portfolio of NPR 1,143 million in mid-January 2017). Investment portfolio of LGIL is by and large in compliance with the guidelines prescribed by the regulator, with major concentration in Government securities and Banks fixed deposits. Recent uptick in bank deposit rates has had a positive impact on the investment yield of LGIL (investment yield was ~5% in FY16). Rising interest rate environment and proceeds collected from the proposed IPO could boost LGIL's investment income and prevent dilution of return for the shareholders to some extent. However, it will depend on the sustainability of the increased interest rates. LGIL has been maintaining the mandatory technical reserves and restricted reserves⁷ as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-Jan-17 the said reserves accounted for 117% of LGIL's net worth. LGIL's solvency margin on mid-Jul-16, calculated as per regulatory directive, stood at ~2.6 times vis-a-vis a regulatory minimum of 1.

Company Profile

Lumbini General Insurance Company Limited (LGIL), operating since July 2005 is the among the younger players in general insurance industry⁸ of Nepal. LGIL is a medium sized player with ~5% share in industry gross premium written (GPW) and ~6% share in industry net premium written (NPW) in FY16. As of mid-Jan-2017, the company is in operation with 23 branches and 154 staffs spread across 20 districts of the country for procuring business and extending after sales services.

The paid-up capital and the net worth of the company as of mid-Jan 2017 is NPR 390 million and NPR 816 million respectively. LGIL has 51:49 promoter-public shareholding ratios. Major shareholders as on mid-Jan 2017 includes M/s. Lumbini Finance & Leasing Company Ltd. (~10%), Mr. Manohar Das Mool (~10%), M/s. Nepal Himalayan Trade Company Pvt. Ltd (~6%), Mr. Shankar Ghimire (~4%) and Mr. Suraj Vaidhya (~4%).

LGIL reported a profit after tax of NPR 152 million during FY16 (NPR 125 million in FY15) over an asset base of NPR 1,438 million as of mid-July 2016 (NPR 1,302 million in mid-July 2015). During H1FY17, the company reported PAT of NPR 77 million over an asset base of NPR 1,791 million on mid-Jan 2017. In terms of technology platform, LGIL has implemented "Gaps Go" in its corporate office. The computerized information has been centralized across all the branches.

May 2017

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⁶ Includes one-off dividend from Nepal Reinsurance Company, excluding which return on net worth comes to ~10%.

⁷ Technical reserve includes (reserve towards unpaid claims & unexpired risk); restricted reserves include Insurance reserve and Insurance fund appropriated from annual profits.

⁸ Comprising of 17 players. LGIL was 15th player to be licensed by the Insurance Board as general insurance company.



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