

Shikhar Insurance Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3+ to the proposed further public issue (equity shares) of Shikhar Insurance Company Limited

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (<i>SEPTEMBER 2015</i>)
Further Public Offer (Equity)	NPR 332.14 million	[ICRANP] IPO Grade 3+ (Assigned)

ICRA Nepal has assigned “[ICRANP] IPO Grade 3+”, indicating average fundamentals to the proposed further public issue (FPO) amounting to NPR 332.14 million of Shikhar Insurance Company Limited (SICL). 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. SICL is proposing to come out with an FPO of 510,988 numbers of equity shares of face value NRs 100/- each to be issued to the general public at a premium of NPR 550 per share (issue price NPR 650 per share).

The grading takes into account SICL’s moderate track record (operating since November 2004), good franchisee network (24 branches on mid-July-15), healthy growth in premium earnings (CAGR growth of 17% and 35% in GPW² and NPW³ respectively in the past 3 years), strong market positioning (share in industry’s GPW and NPW of ~12% and ~10% respectively in FY14), strong reinsurance arrangements incorporating adequate catastrophe coverage, experienced Board of Directors & management team and established underwriting norms. ICRA Nepal has noted that SICL’s claims paying ability, solvency position and profitability profile has not significantly deteriorated in the aftermath of April 2015 earthquake and its aftershocks, owing to adequate catastrophe reinsurance arrangement. ICRA Nepal takes comfort from the fact that the estimated losses⁴ towards earthquake-related claims lodged with SICL remains within the limits of the company’s catastrophe reinsurance arrangement. The grading also takes into consideration SICL’s healthy underwriting profitability aided by low claims ratio (past 3 years average of ~50% vs. industry’s ~55%); which has helped SICL maintain sound profitability indicators despite a decline in investment yield in recent times. Of late, the underwriting profitability has also improved in due to a gradual increase in premium retention⁵ (from 37% in FY13 to 49% in FY15) by SICL. However, the grading is constrained by the reduction in reinsurance commission from FY16, declining yield on investment portfolio, stiff competition from other large players in the general insurance industry and low general insurance industry penetration in Nepal offering limited scope for product innovation/diversification. Although SICL’s overall performance in recent years continues to improve with better underwriting practices, further improvement and sustainability of the same on enhanced scale of operations especially in the aftermath of recent earthquake remains to be seen.

SICL is the one of the largest players in the Nepalese general insurance industry in terms of GPW (aided by premium earnings from aviation segment) while it is among the larger players in terms of NPW. SICL’s growth in revenue from net premium written remained healthy with 35% CAGR growth over the past 3 years. SICL reported premium growth across all major business segments of motor, fire etc. Premium retention ratio of SICL (~46% in past 2 years ending FY15) has increased in recent years, following management’s decision based on independent actuarial evaluation. Coupled with improvement in claims

¹ Includes rights and further public issue of equity shares

² Gross Premium Written

³ Net premium written

⁴ SICL has received earthquake related claims of around NPR 1,300 million against catastrophe reinsurance coverage of up to NPR 2,000 million taken for FY 2014-15.

⁵ Net premium written/ Gross premium written



ratio, higher premium retention has helped boost the underwriting surplus position which has grown with CAGR 72% in past 3 years ending FY15.

In terms of portfolio mix, motor segment dominates the business profile of SICL; in line with the overall industry trend. Motor segment accounted for 73% of NPE in the last 2 years followed by the Fire (12%), Marine (4%) and Aviation (2%) segments. The proportion of the motor portfolio has been decreasing in recent years and remains subdued as compared to the industry average while that of fire remains comparable to industry average and that of marine and aviation remains higher (albeit on a low base). In the last 3 years, the proportion of fire, miscellaneous and marine segment (all with higher underwriting surplus per unit premium earnings) has improved at the expense of the motor segment. This improvement in mix has contributed to the growth in underwriting performance.

For FY15⁶, SICL reported Profit after Tax (PAT) of NPR 248 million over NPE of NPR 557 million against PAT NPR 131 million over NPE of NPR 388 million in FY14, corresponding to PAT/Net worth of 30.1% and PAT/ATA of 15.7% in FY15. The corresponding return indicators in FY14 were 22.4% and 9.5% respectively. The improvement in FY15 profitability was supported by receipt of dividend from Nepal-Reinsurance Company Limited⁷ (erstwhile Insurance Pool, Nepal) towards accumulated dividend on the equity investment⁸ made therein by SICL. Excluding the dividend, the return indicators for FY15 stood at 20.6% return on net worth and 10.8% return on assets; indicating low impact of 2015 earthquake. The profitability in FY15 was also supported by the improvement in the underwriting surplus (which rose to NPR 187 million from NPR 131 million). Marginal improvement in the combined ratio was, in turn, contributed by a decline in (management) expense ratio from 36.5% in FY14 to 32.1% in FY15; while it was offset by increase in claims ratio from 48.5% in FY14 to 50.3% in FY15, mainly due to earthquake related claims.

Net investment income of SICL for FY15 stood at NPR 139 million, including NPR 78 million of cash dividends from Nepal-Reinsurance Company. The investment income accounted for 21% of NPW in FY15 (9.2% excluding dividend income) corresponding to yield of 7.80%⁹, making a major contribution towards the overall profitability of SICL. However, the falling yield on investments (since ~75% of total investments were in domestic Bank FDRs) from declining bank interest rates remains a concern. The quality of investment portfolio of SICL remains healthy, with 78% of portfolio, as on mid-July-15, composed of investments in Government securities & fixed deposits with Commercial banks and Development Banks compared to ~84% in FY14. The investment portfolio remains by and large compliant with the investment guidelines prescribed by the regulator. SICL has been maintaining the mandatory technical reserves and restricted reserves¹⁰ as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-July-15 the said reserves accounted for 103% of net worth of SICL. SICL's solvency margin on mid-July-15, calculated as per regulatory directive, stood at ~3.20 times vis-a-vis a regulatory minimum of 1.0x times.

Company Profile

Established in March 2004, Shikhar Insurance Company Ltd (SICL) is among the younger players in the non-life insurance industry of Nepal (13th among the 16 non-life insurers). Despite small track record, SICL is among the larger players in the industry with ~12% of market share in terms of Gross Premium Written and ~9-10% in terms of net premium written in past 2 years. As of July-15, SICL has over 200 staffs posted over 24 branches spread across the nation for procuring business and extending after sales services.

⁶ As per unaudited quarterly report

⁷ First of its kind to be established in Nepal

⁸ NPR 77.74 million in cash dividend was received by SICL and other general insurers of Nepal from Nepal-Re.

⁹ Excluding accumulated dividend income from Nepal-Re

¹⁰ Technical reserve includes (reserve towards unpaid claims & unexpired risk); restricted reserves include Insurance reserve and Insurance fund maintained as per regulatory requirement.



SICL has 80:20 promoter-public shareholding ratios with major shareholding from Mr. Shashi Kant Agrawal Group and major groups in domestic aviation business like Buddha Air group, Yeti Airlines group and Fishtail Air Group. The promoter shareholding proportion is expected to come down to 70%, following the FPO (assuming full subscription). SICL reported a profit after tax of NPR 248 million during FY15¹¹ over assets base of NPR 1,576 million on July-15 as compared to NPR 131 million during FY14 over assets base of NPR 1,377 million as of mid-Jul-14. In terms of technology platform, SICL has implemented “Premia” in its corporate office. The computerized information has been centralized across all the branches.

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¹¹ Unaudited financial report