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 (JULY 2019)
Rights Issue (Equity shares)	NPR 176 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 176 million of Lumbini General Insurance Company Limited (LGIL). ICRA Nepal assigns IPO[1] 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+ is one notch higher than 2, 3, and 4, respectively. LGIL has proposed a 20% rights issue of 1,760,000 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 comply with the revised minimum paid up capital requirement for general insurers[2] as prescribed by the Insurance Board of Nepal.

The grading factors in LGIL's adequate track record in the industry and also takes into consideration LGIL's sufficiently tested underwriting norms, good underwriting performance and adequate profitability indicators. The grading also remains supported by LGIL's recent expansion of its branch network, which coupled with an experienced management team, augurs well for its incremental business growth. The grading further takes into consideration LGIL's adequate reinsurance arrangements, including catastrophic provisions, which provides comfort to its claims-paying ability and its quality of maintaining solvency in the event of catastrophic events like the April 2015 earthquake. ICRA Nepal notes the improved investment outlook for the company, given the hardening of the interest rate across the banking sector deposits, wherein a major portion of its investment portfolio is concentrated.

However, the grading remains constrained by limited portfolio diversification and LGIL's high concentration in the motor segment. This remains a concern, especially in the recent regime of increasing liability cover for the motor segment. The fire segment, along which LGIL has registered improved growth in recent years, could also come under pressure following the reduction in premium tariffs imposed by the regulator from H2 FY2018. Incremental growth and the return prospect of LGIL are likely to be determined by its ability to grow the customer base and diversify its revenue stream across different segments. While recent growth in its branch network is expected to support the endeavour, LGIL's ability to achieve the targeted growth and diversification in the highly fragmented and increasingly competitive domestic general insurance industry, remains to be seen. With sizeable equity injection proposed shortly and muted growth outlook, the return indicators are expected to remain supressed over the medium term; which has also been factored into the assigned grading.

LGIL is a medium-sized player in the Nepalese general insurance industry[3] in terms of premium earnings with ~6% share in the industry gross premium written (GPW). However, due to higher than industry average premium retention ratio, its share in the industry net premium written (NPW) for FY2018 stood marginally higher at ~7%. Between FY2015–FY2018, LGIL's GPW increased by a CAGR of 26%, at par with the industry average growth (LGIL's growth in NPW stood at 22% vs. the industry average growth of 21% over the same period). The average premium retention ratio of LGIL stood at ~62% during the last three years ending FY2018 (60% in FY2018), higher than the industry average of ~50%. LGIL's portfolio mix remains skewed towards the motor segment. During each of the last three years ending FY2018, over 60% of the GPW and over 85% of the NPW was driven by the motor segment. In FY2018, the motor segment made up ~85% of LGIL's NPW, followed by the fire segment (~9%) and miscellaneous segment

[1] *Includes rights and further public issue of equity shares*

[2] *Minimum paid up capital of NPR 1 billion to be maintained by mid-July 2019 for all general insurers*

[3] *Only the original 17 listed players included*

(~4%) with negligible contributions from other segments. The motor segment, a key driver of LGIL's revenue and profitability, has reported an underwriting surplus during each of the last five years ending FY2018, which remains a comfort. However, with the increase in third-party liability cover under this segment, the underwriting surplus from the segment could come under pressure. During FY2018, the claims ratio for the motor segment increased to 63% (from 55% in FY2017 and 47% in FY2016), which can be partly attributed to the increase in third-party liability cover from FY2017. Given the high reliance on the motor segment, deterioration of segment's underwriting performance could drag the overall company's performance.

Despite the increase in claims ratio, LGIL has been able to maintain a good underwriting performance so far. During the last three years ending FY2018, the company reported a combined ratio of 60-75% of net premium earned (NPE) backed by the claim's ratio of 45-60% of NPE. The company's claims ratio has generally remained at or below the industry average during the last four to five years, helping the company generate an underwriting surplus. The underwriting performance of the company also remains supported by the net ceding commission income from reinsurers, which stood at ~11% of the NPE during the last two years ending FY2018. Underwriting profitability also remains benefitted by low management expense ratio (26-28% of NPE during the last two years ending FY2018) of the company vis-à-vis similar aged industry peers. The underwriting surplus of LGIL stood at NPR 182 million in FY2018 (corresponding to a combined ratio of 76%), same as that in FY2017 (corresponding to a combined ratio of 70%). The underwriting surplus level was supported by the increase in net premium earned, despite an increase in the combined ratio. Increase in combined ratio in FY2018 was because of a higher claims ratio of 61% vs. 52% in FY2017. The incremental underwriting surplus of the company will depend on the performance of the motor segment, where the claims ratio could increase as a result of increased liability coverage for the segment. Furthermore, the fire portfolio (property insurance) could also witness an increased claims ratio after regulatory curtailment of the premium.

LGIL's profitability remains aided by good underwriting performance as well as improved returns on investment portfolio. About 81% of the company's investment portfolio as of mid-April 2019 was concentrated in fixed deposits with banks and financial institutions (BFIs). Therefore, the recent hardening of interest rates across banking sector deposits has benefitted institutional depositors like LGIL. For FY2018, the company's average investment yield stood at ~10% vs. ~6% in FY2017. The yield remains strong at ~9% during 9M FY2019 and is expected to remain healthy over the medium term. The company's investment portfolio follows the guidelines prescribed by the regulator, with major concentration in fixed deposits with BFIs. A high interest rate environment and proceeds collected from the proposed rights issue are factors which are likely to reduce the dilutive impact of the fresh equity injection proposed. LGIL has been maintaining the mandatory technical reserves and restricted reserves[4] as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-April 2019, the said reserves accounted for 68% of its net worth. Its solvency margin as of mid-July 2018, calculated as per regulatory directive, stood marginally below 1.5 times as the company is yet to raise the minimum paid-up capital required by the regulator.

Company Profile

Lumbini General Insurance Company Limited (LGIL), operating since July 2005, is among the younger players in Nepal's general insurance industry[5]. LGIL is a medium sized player with ~6% share in industry GPW and ~7% share in industry NPW in FY2018. As of mid-April 2019, the company was in operation with 42 branches across the country for procuring business and extending after-sales services.

The paid-up capital and net worth of the company as of mid-April 2019 was NPR 880 million and NPR 1,659 million, respectively. LGIL has 51:49 promoter-public shareholding ratios. Major shareholders as on mid-April 2019 included M/s. Lumbini Bikash Bank Limited (~10%), Mr. Manohar Das Mool

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

[5] *Industry comprises of 17 non-life insurers, including two Indian foreign branches, viz. Oriental Insurance and National Insurance, and one JV of Sagarmatha Insurance with Ceylinco Insurance PLC, Sri Lanka. Lumbini is the 15th player to be licensed by the Insurance Board of Nepal.*

(~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 233 million during FY2018 (NPR 179 million in FY2017) over an asset base of NPR 2,544 million as of mid-July 2018 (NPR 1,762 million in mid-July 2017). During 9M FY2019, the company reported PAT of NPR 149 million over an asset base of NPR 2,703 million on mid-April 2019.

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About ICRA Nepal Limited:
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