

Nepal Life Insurance Company Limited

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

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (OCTOBER 2016)
Further Public Offer (Equity)	NPR 4,412.41 million	[ICRANP] IPO Grade 3+ (Assigned)

ICRA Nepal has assigned “[ICRANP] IPO Grade 3+” to the proposed further public issue (FPO) amounting to NPR 4,412.41 million of Nepal Life Insurance Company Limited (NLIC). The grading, at the current level, indicates average fundamentals to the proposed FPO of the company. 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. NLIC is proposing to come out with an FPO of 3,096,429 equity shares each with face value of NPR 100/- to be issued to the public at NPR 1,425 each including premium of NPR 1,325 per share.

The grading considers NLIC’s established track record (operating since May 2001), healthy market share (largest insurer in terms of premium earnings and assets base over past 5 years) and a deep franchisee network (more than a hundred offices² as on date). The grading also takes into consideration NLIC’s healthy return indicators, both to the policyholders as well as to shareholders (average return on net worth of ~39% in FY13-15). The grading also factors in diverse and large reinsurance arrangements incorporating adequate catastrophe coverage, experienced senior management team and conservative underwriting norms. ICRA Nepal also takes note of the negligible impact of the April 2015 earthquake on NLIC’s solvency, claims paying ability and profitability profile.

However, the grading is constrained by the absence of institutional promoters, limited diversity in product offerings, and declining investment earnings (on the back of a softening interest rate environment). The ability of the company to set up controls and risk mitigation measures as it grows its business volumes, will also have a bearing on its financial profile going forward.

Over the past 5 years ending FY16, NLIC’s gross premium earnings have grown at a CAGR³ of 35% enabling its market share to improve from ~25% to ~32% of industry’s gross premium earnings. A large part of the growth can be attributed to NLIC’s increased emphasis on marketing campaigns during FY13-15; that led to expansion of franchise network, geographical coverage, human resources and agency base.

NLIC’s premium mix is dominated by endowment policies (and its variants) contributing nearly 90% of annual premium earnings in the last 5 years. The recent growth strategy adopted by management has led to a higher growth in the endowment segment (which contributed 95% of gross premium during FY16). New business premium (*first year premium+single premium*) reported a marginal de-growth in FY16 and accounted for ~37% of gross premium earnings vis-a-vis 48% in FY14 and FY15. Nonetheless, gross premium earnings remained supported by strong renewal premium (92% renewal rate in FY16). As per the management, the lack of growth in new business premium earnings can be attributed to unfavourable business environment during FY16.

Due to considerable track record of NLIC, scheduled benefit payment and maturity payment accounted for 48% of total benefits in FY16 (past 3 years’ average of ~40%), followed by death benefits (claim) 27% in FY16 (past 3 years’ average of 31%) and policy surrender 25% of total benefits in FY16 (past 3 years’ average of 30%). Despite CAGR of 35% growth in gross claims paid (over the past 3 years), claims ratio (net claims paid/ net premium) remained low at 13% during FY16 (past 3 years’ average of 13%) due to faster growth in premium earnings. At the same time, NLIC’s claims paying ability remains healthy (amount available for claims/ claims paid ratio of ~8 times in FY16), albeit on a relatively fresh portfolio.

¹ Includes rights and further public issue of equity shares

² Including branches, sub-branches and regional centres

³ Compounded Annual Growth Rate



Net investment income of NLIC for FY16 stood at NPR 2,504 million corresponding to average yield on investment of ~8.50%⁴. The investment portfolio remains compliant with the regulatory guidelines, with 90% of portfolio, as on mid-July-16, comprising investments in Government securities, fixed deposits (with Commercial banks and Development Banks) and debentures of commercial banks compared to ~87% in mid-July-15. However, falling yield on investments (since ~83% of total investments were in domestic financial institutions FDRs) in softening interest rate environment continues to pose a risk to the company's earnings profile.

During FY 2015-16⁵, NLIC reported Net Profit of ~NPR 240⁶ million on a Net Premium of NPR 10,134 million (corresponding to return on net worth of ~9.28%) as compared to Net profit of NPR 523 million on a net premium of NPR 7,974 million for FY14 (corresponding to return on net worth of ~22.48%). Considering recent growth in premium earnings and relatively higher acquisition cost of business in the earlier years, profitability in later years is likely to improve. However, declining interest rate environment poses challenges to incremental yield on investment and therefore profitability. The return on equity (RoE) for NLIC is also likely to remain under pressure over next few years due to sharp growth expected in its net worth (due to fresh capital injection).

On the solvency front, NLIC remains comfortable with solvency ratio of 3.17x times on July 2015⁷ vis-a-vis a regulatory minimum requirement of 1.0x times. Similarly, life fund/total investment ratio stood comfortable at 95% on July-16 and July-15. NLIC has reinsurance agreement (including catastrophic reinsurance agreement) with Hannover Re Malaysia⁸ since inception.

Company Profile

Incorporated in 2001, Nepal Life Insurance Company Limited (NLIC) started its operations from its head office is located at Heritage Plaza, Kamaladi, Kathmandu. Promoted by individual local business people, NLIC is the largest player (market share of ~32% in terms of gross premium earned and ~41% in terms of new business premium¹) in Nepalese life insurance sector. As of mid-Jul-16, it is in operation with 104 branches (including region, branch, sub-branch and contact offices) and 73,592 agents spread across the nation for procuring new business and extending after sales services.

NLIC has 80:20 promoter-public shareholdings as on mid-July 2016; which is likely to change to 70:30 post proposed FPO. NLIC reported a profit after tax of NPR 240 million (before transfer from LI Fund) during FY 2015-16 over total assets base of NPR 36,283 million on mid-July 2016 as compared to profit after tax of NPR 528 million during FY 2014-15 over total assets base of NPR 27,081 million as of mid-July 2015. In terms of technology platform, NLIC has implemented NLIC Dams (Developed internally by NLIC) in its corporate office and all its branches.

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⁴ Including capital gain, excluding capital gain, the yield stood at ~7%.

⁵ As per unaudited financials, pending actuarial evaluation of policyholder liabilities

⁶ Before transfer from life insurance fund due to pending actuary valuation

⁷ Solvency ratio for July 2016 is yet to be determined pending actuarial evaluation

⁸ Rated AA- with stable outlook by Standard & Poors in June 2016



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