

Union Life Insurance Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed IPO of Union Life Insurance Company Limited

Instrument/Facility	Issue Size	Grading Action (November 2018)
IPO (Equity) grading	NPR 645 million	[ICRANP] IPO Grade 4+ (Assigned)

ICRA Nepal has assigned “**[ICRANP] IPO Grade 4+**” indicating below average fundamentals to the proposed initial public offering (IPO) issue amounting to NPR 645 million of Union Life Insurance Company Limited (ULICL). ICRA Nepal assigns IPO¹ grading on a scale of IPO Grade 1 to 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 indicates 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. ULICL is proposing to come out with an IPO of 6,450,000 equity shares of face value of NPR 100. The proposed issue is being launched to meet the minimum capital requirement for life insurers² rolled out by the regulator, Insurance Board of Nepal.

The assigned grading factors in ULICL’s good market position, as reflected by healthy business growth reported during the first 12 months of operation. Among the new licensed nine life insurance companies (LICs), ULICL’s market share in gross premium written (GPW) stood at ~28% while its share in the GPW of 18-players industry stood at ~2%. An experienced management team, strong franchise (103 branches till mid-October 2018) and an adequate agency force including bancassurance arrangement provide additional comfort for a continuation of growth. ULICL has derived a major portion of premium earnings from profitable traditional endowment products (~69% in FY2018), which indicates the sustainability of business volume. The grading also factors in the company’s ability to contain management expense within the regulatory ceiling, even during the initial years of operation. The grading also factors in the strong financial state of the promoter group and adequate reinsurance arrangement including the catastrophic provision. The grading also takes comfort from the current high interest regime, which remains a positive from the investment yield perspective. This is likely to have a positive impact on policyholders’ and shareholders’ return, going forward.

However, the grading remains constrained by the company’s limited track record. Although initial growth of ULICL remains good, the ability of the management to continue the same, in the face of tough competition from new and existing players, remains to be seen. In addition, the underwriting process of the company, remains to be tested as premiums were primarily underwritten in the last one year. Due to small asset base and life fund of ULICL at present, its ability to generate returns on sizeable equity base remains moderate. The return prospect is likely to dilute further after the proposed equity infusion. The grading is also constrained due to lack of strong institutional promoters and challenging operating environment for life insurers after the recent licensing (in mid-2017) of nine new LICs by the regulator. The grading is also constrained by low insurance penetration in the country which limits the prospect for fast growth and product innovation.

ULICL’s GPW stood at NPR 425 million during Q1 FY2019, registering an annualised growth of 100% (GPW of NPR 865 million during FY2018), albeit on a small base. The growth was backed by strong franchise network and agency force developed by the company within a limited time span of operation. Healthy portion of long-term endowment business (~69% during FY2018) in the overall premium earnings also remains positive from business growth prospects. Experienced management team, ULICL’s marketing efforts and geographical expansion helped the company bring in healthy first year premium (FYP) during Q1 FY2019, which was higher compared to some of the older and established players as well. Continuation of similar growth in FYP as well as policy continuation rate (renewal rate) will be critical in determining the incremental business outlook for ULICL. In terms of distribution channel, ULICL’s bancassurance arrangement has helped derive good business during Q1 FY2019, however, the business remains highly reliant on individual agents (~85% of GPW during Q1 FY2019).

ULICL’s premium mix is heavily comprised of endowment policies (and its variants) during FY2018, which

¹ Includes rights and further public issue of equity shares.

² Minimum paid up capital of NPR 2 billion to be maintained by all life insurers.

contributed ~69% to GPW during FY2018. Term insurance business, which made up for the remaining of GPW, was composed of entirely mandatory foreign employment (FE) insurance business. Incremental business growth is likely to be driven by endowment products given the relatively saturated and highly competitive FE business and lukewarm market for term insurance business so far. Although experienced senior management team of ULICL is likely to help the company in rolling out innovative endowment and term products, its marketability and business prospect remain to be seen.

The net investment income of ULICL for FY2018 stood at NPR 206 million corresponding to the average investment yield of ~11%. The current high interest rate regime across the banking sector remains conducive to the investment performance of LICs given high concentration of investment portfolio towards bank fixed deposit receipt (FDR). This is likely to reflect positively on the policyholders' and shareholders' returns, going forward. The investment portfolio of ULICL as of mid-July 2018 is compliant with regulatory guidelines, with ~90% of portfolio in Government securities, FDR and debentures of Banks and Financial Institutions (BFIs).

Return indicators of ULICL remains subdued given the initial stage of operation and high acquisition cost associated with insurance business in initial years. Moreover, due to sizeable endowment business, ULICL's profitability remains highly reliant on the transfer of surplus, upon actuarial evaluation of the adequacy of life fund. During Q1 FY2019, ULICL reported a net profit of ~NPR 37 million on a net premium of NPR 391 million (net profit of NPR 108 million³ on a net premium of NPR 765 million in FY2018) corresponding to return on net worth of ~9% before transfer of actuarial surplus from life fund to profit and loss account. Return indicators of ULICL were dragged by relatively high operating expense ratio on a small scale of operation. However, the company's ability to contain management expense within the regulatory ceiling provides comfort on the ability of ULICL to generate economies of scale in the near future, as business volume grows. Besides, healthy pace of premium growth, endowment product driven portfolio and growing life fund remain positive for the company's profitability. However, sustainability of business growth, amid increased competition in the industry, remains a challenge.

ULICL's solvency ratio remained 1.43 times in July 2018 (pending actuarial valuation⁴) vis-a-vis a regulatory minimum requirement of 1.5 times. Initial stage of operation, preliminary expenses and resulting low quantum of qualifying assets (for solvency margin calculation) resulted in moderate solvency ratio. However, the ratio is likely to improve as the company builds up its assets base with future business growth. Incremental capital infusion plan of the company is also likely to provide comfort to its solvency position to some extent⁵. ULICL has reinsurance agreement (including catastrophic reinsurance agreement) with Trust Re, Manama, Kingdom of Bahrain⁶ and with Nepal Re for foreign employment term policies since its inception.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below:

Links to applicable criteria:

[IPO Grading Methodology](#)

Company Profile

Union Life Insurance Company Limited (ULICL) is operating since July 2017. Its head office is located at New Baneshwor, Kathmandu. ULICL has been established with sole Nepalese capital, with major promoters' groups of Jagadamba, Golchha, Gadiya, Neupane, Rajesh Hardware & Tibrewala Group.

ULICL is a new player in the life insurance industry of Nepal. ULICL, along with eight other LICs were licensed by the Insurance Board in 2016-17, taking the total number of life insurers from earlier nine to 18. ULICL is the fastest-growing LIC among the new players in terms of business volume and branch network. As of mid-October 2018, it had 103 branches with around 8,140 agents including 3,125 active agents spread across the nation for procuring new business and extending after-sales services.

³ Pending actuarial valuation and transfer to life fund.

⁴ Transfer to life fund after actuarial valuation will have positive impact on current solvency margin

⁵ ICRA Nepal estimates the solvency ratio increase to 1.85 times after the equity infusion through IPO

⁶ Rated B++ (Good) by A.M. Best for financial strength rating



ULICL has a total paid-up capital of NPR 1,505 million as of mid-July 2018 and will reach NPR 2,150 million after the public issuance. Post IPO, the promoter: public shareholding ratio will be 70:30. ULICL has reported a profit after tax of ~NPR 108 million for FY2018 over total asset base of NPR 2,282 million compared to a profit after tax of NPR 12 million during FY2017 over total asset base of NPR 1,523 million.

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