

Nepal Insurance Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed rights issue (equity shares) of Nepal Insurance Company Limited

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (NOVEMBER 2017)
Rights Issue (Equity shares)	NPR 301.98861 million	[ICRANP] IPO Grade 4+ (Assigned)

ICRA Nepal has assigned “[ICRANP] IPO Grade 4+”, indicating below average fundamentals to the proposed rights issue amounting to NPR 301.98861 million of Nepal Insurance Company Limited (NICL). 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.

NICL has proposed 1:1 rights issue of 3,019,886.1 units 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 insurers² as prescribed by the regulator (Insurance Board of Nepal).

The grading factors in NICL’s long operating track record (since 1947), strong ownership profile comprising of 15% stake from Government owned Nepal Bank Limited (class A Commercial Bank) along with recent introduction of new promoters related to IME group³ (~17% stake) and Vishal group⁴ (~14% stake). The grading also derives comfort from the introduction of experienced senior management team into the company. ICRA Nepal notes marginal improvement in the growth, underwriting performance and profitability of NICL during Q1FY2018, following the change in ownership and management which remains a comfort. However, sustainability of the same remains to be seen. The grading also takes into consideration, limited impact on claims paying ability and solvency position of the company in the aftermath of the April 2015 earthquake; despite considerable impact on underwriting performance and profitability in FY2015.

The grading remains constrained by weak market positioning of the company in recent years, characterized by steadily declining market share, weak underwriting performance and modest profitability despite small scale of operation. NICL’s growth fared weak vis-à-vis industry average during past 5 years (NICL’s GPW grew by ~7% vs. industry average of ~20%). Losses arising from earthquake and lukewarm marketing efforts hindered NICL’s growth, while industry peers grew in the aftermath of April 2015 earthquake. The grading also remains constrained by stiff competition from larger players in the industry which could affect the incremental growth plans for NICL.

Despite being the oldest player in the industry, NICL accounted for ~4% industry share⁵ in terms of GPW in FY2017. During past 5 years between FY2013-FY2017, NICL has lost around half of its market share as the company failed to keep pace with industry growth. NICL was a subsidiary of Nepal Bank Limited (government owned class A commercial bank) till FY2016. At the end of FY2016, NBL divested 36% stake in NICL (out of total 51% stake) through auction. Major portion of the auctioned shares were taken up by promoters related to IME Group and Vishal Group. New promoter groups have since then taken over the board⁶ and also brought in new senior management team at the end of FY2017. Although new promoters and management team have good standing and experience in the industry, their ability to turnaround the company remains to be seen.

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 Investors associated with Mr. Chandra Dhakal. IME group also has controlling interest in Global IME Bank (rated A- by ICRA Nepal).

⁴ Vishal group also has controlling interest in NIC Asia Bank (rated A- by ICRA Nepal)

⁵ Among the 17 players’ universe.

⁶ 5 out of current 7 board members are from new investor groups.

NICL has settled almost entire⁷ earthquake related claims arising from April 2015 earthquake. NICL was exposed to a total earthquake related claims of ~NPR 687 million of which loss amounting to NPR 235 million (34%) was retained in NICL's account and rest were recovered from reinsurers. Catastrophic cover for insured risks proved inadequate which has since been increased. Due to the earthquake impact, NICL registered underwriting deficit of NPR 162 million in FY2015 leading to reported net loss of NPR 21 million; despite sizeable investment earnings booked that year. High proportion of fixed property insurance⁸ and inadequate catastrophic cover exposed the company to relatively higher earthquake loss. Nonetheless, the impact was only on the short-term profitability and not on long term solvency of the company.

NICL's portfolio mix is dominated by the motor segment (50% of Net premium earned (NPE) in FY2017), followed by fire (38%) and miscellaneous⁹ (6%) with negligible contribution from other segments. Portfolio mix has changed in favour of fire segment during past 3 years with motor proportion declining from 63% of NPE in FY2015 to 50% of NPE in FY2017 pushing up the fire proportion from 32% to 38% and miscellaneous proportion from 2% to 6% over the same period. Source wise, business from agents accounted for ~84% of GPW during FY2017, most of them sourced through banks ((corporate agents). Similarly, during FY2017, more than 2/3rd of GPW was accounted for by institutional clients indicating weak retail presence of the company.

Underwriting performance of the company has remained modest over past 5 years, due to weak motor performance. Motor, the largest segment of NICL, reported underwriting deficits in 3 out of past 5 years ending FY2017, a reflection on the underwriting quality of the company. NICL has reported underwriting deficit in 3 out of past 5 years, despite fire segment generating underwriting surplus in each of those period (except FY2015 because of earthquake induced losses). Combined ratio of NICL during past 5 years ending FY2017 stood at 101%. Weak underwriting performance has resulted from weak premium growth and high loss ratio on major segments. The company has recently changed its reinsurance arrangement for motor segment, lowering the retention on all motor losses (own damage and third party). As a result, NICL reported underwriting surplus in FY2017 for the first time in past 4 years, backed by improvement in motor claims ratio. Underwriting surplus is also supported by improvement in ceding commission ratio, mainly in the motor segment. Moreover, during Q1FY2018 underwriting performance has further improved (combined ratio of 66%), backed by moderation in claims ratio and improvement in ceding commission ratio. This remains positive from incremental return perspective.

During past 3-5 years, profitability of NICL has remained moderate and almost entirely supported by its investment income (average yield of ~5.50% during FY2017 on an investment portfolio of NPR 989 million in mid-July 2017 vs. yield of ~5% in FY2016). Investment portfolio of NICL is in compliance with the guidelines prescribed by the regulator, with a large concentration in government securities and Fixed Deposit Receipts (FDRs) with banks. Recent uptick in bank deposit rates has had a positive impact on the investment yield of NICL (investment yield improved to ~7% during Q1FY2018). Rising interest rate environment and proceeds collected from the proposed rights could boost NICL's investment income and prevent dilution of return for the shareholders to some extent.

NICL has been maintaining the mandatory technical reserves and restricted reserves¹⁰ as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-October 2017 the said reserves accounted for 124% of NICL's net worth. NICL's solvency margin on mid-Jul-17, calculated as per regulatory directive, stood at 2.50 times (1.75 times in FY2016) vis-a-vis a regulatory minimum of 1.5 times.

Company Profile

Nepal Insurance Company Ltd. is Nepal's oldest Insurance company, that operates in general insurance segment. It was established in 1947 under the leadership of Nepal Bank Ltd-NBL (First commercial bank of Nepal; majorly held by government). Starting from 1991, the company started providing service to general public and other entities, which before then was limited to Nepal Bank Ltd. & its clients only. NICL was the subsidiary of NBL for almost 70 years, until the latter divested ~71% of its holding to private investors in FY16 through auction.

⁷ ~95% of the total claims of NPR 687 million has been settled till date.

⁸ fire segment accounted for ~32% of Net premium earnings in mid-July 2015

⁹ Includes personal accidents, group medical policies, bankers' blanket indemnity, among others.

¹⁰ Technical reserve includes (reserve towards unpaid claims & unexpired risk); restricted reserves include Insurance reserve and Insurance fund appropriated from annual profits.

NICL's is a small player in the Nepalese general insurance industry with ~4% share in industry GPW and ~3% share in industry NPW in FY17. As on mid-July 2017, NICL is in operation with 20 branches (including head office) spread across the nation for procuring business and extending after sales services. The paid-up capital and the net worth of NICL as of mid-July 2017 stood at ~NPR 302 million and ~NPR 585 million respectively. As on mid-July 2017, NICL has 51:49 promoter-public shareholding ratios with major shareholding from Nepal Bank Limited (15% stake), United Distributors Nepal Pvt. Ltd. (~7%) and Worldwide Investment Private Limited, IME Limited & IME Investment Pvt. Ltd each holding 5.22%.

NICL reported profit after tax of ~NPR 116 million in FY 2017 (NPR 56 million in FY 2016) over an asset base of NPR 1,577 million as on FY2017 end (NPR 1,581 million on FY2016 end). During Q1FY2018, NICL reported profit after tax of ~NPR 27 million over an asset base of NPR 1,642 million on mid-October 2017. In terms of technology platform, NICL has implemented "Ensure" across all its branches.

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