

## Surya Life Insurance Company Limited

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

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (DECEMBER 2017)
Rights Issue (Equity)	NPR 288.75 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned “[ICRANP] IPO Grade 4” indicating below average fundamentals to the proposed rights issue amounting NPR 288.75 million of Surya Life Insurance Company Limited (SLICL). ICRA Nepal assigns IPO<sup>1</sup> 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. SLICL has proposed 40% rights issue of 2,887,500 number of equity shares each with face value of NPR 100/-, to be issued to the existing shareholders at par. The proposed issue is being made to comply with the revised capital requirement for life insurers<sup>2</sup> rolled out by the Insurance Board of Nepal (the regulator).

The grading factors in healthy premium growth of SLICL over past years (CAGR 53% over past 5 years ending FY2017, backed by healthy growth in new business premium (CAGR 58% over the same period)). Healthy growth in new business premium (albeit on a low base) indicates good market positioning of the company which is a positive from future growth perspective. The grading also considers adequate franchise network of the company (72 branches) across the country. The grading also factors in adequate reinsurance arrangements including catastrophic coverage provision. Grading also takes into account adequate solvency profile of the company (solvency ratio of 1.81 times in FY2016<sup>3</sup> vis-à-vis regulatory minimum of 1.50 times).

However, the grading remains constrained by small scale of operations of the company (smallest asset base in the industry comprising of 9 players as on mid-July 2017) vis-à-vis peers. It stems from limited operating track record (operating since 2008) and modest growth in early years of operation (first year premium growth of CAGR 7% between FY2010 and FY2013). Improvement in growth in recent years remains largely driven by foreign employment (FE) term policy. Sustainability of growth and profitability of FE segment remains to be seen, especially in view of declining number of migrant Nepalese workers and increasing risk cover. The grading also remains constrained by small life fund (~NPR 2.7 billion as on mid-Oct 2017) which limits the quantum of incremental returns to profit-sharing policyholders as well as shareholders of the company. The grading is also constrained by low policy renewal rate (70% in FY 2017) despite of improvement in recent period, absence of institutional promoters and challenging operating environment for life insurers after the recent licensing (in early FY2017) of 10 new life insurance companies (LICs) by the regulator.

SLICL’s GPW has grown at a CAGR of 53% during past 5 years (FY2012-FY2017), higher to the industry average of ~25%; albeit on a low base. SLICL had ventured into FE business from FY2014, which led to a high growth in premium earnings (between FY2014-FY2017, FE premium grew by CAGR 50%). Barring weak growth in FY2013 and FY2017 due to an unfavourable operating environment<sup>4</sup>, first year premium (FYP) growth also remained strong during past 5 years (CAGR growth of 37%). Renewal premium too has registered healthy growth (CAGR 48% during past 5 years), following improvement in policy renewal rates (70% in FY2017 vs ~55% in FY2016 and earlier). Policy renewal rate still remains lower than peers’ despite improvements in policy renewal rate in recent periods. In terms of distribution channel, SLICL relies heavily on individual agents (and corporate tie ups for FE business).

<sup>1</sup> Includes rights and further public issue of equity shares

<sup>2</sup> Minimum paid up capital of NPR 2 billion to be maintained by July 2018 by all life insurers

<sup>3</sup> Actuarial valuation of life fund as on FY2017 end is under progress currently

<sup>4</sup> agitation by insurance agents across the industry over compensation issues

Despite an increase in FE business since FY2014, SLICL's premium mix is dominated by endowment policies (and its variants). During FY2017, 75% of premium earnings was from endowment products (78% in FY2016) while rest was accounted by FE business. Apart from FE business, the company does not have any notable term business. A healthy growth in first year premium as well as single premium products, resulted in higher new business premium (first year premium *plus* single premium) stood at 51% in FY2017 (past 3 years average of 59%). Roughly 50% of new business premium is accounted for by single premium FE policies in past 2 years ending FY2017. Sustainability of growth and profitability of the FE segment remains to be seen. Nonetheless, improvement in policy renewal rate remains a positive from the sustainability of the premium earnings profile. ICRA Nepal takes note of a decline in first year premium of ~18% in FY2017 amid unfavourable business environment, competitive pressures on employees' retention created by licensing of new LICs, and local election during last quarter of FY2017.

Gross benefit paid by SLICL has grown at high pace albeit on a low base during past 3 years, pushing up the benefit payment ratio (from 3% in FY2014 to 9% in FY2017). Death claims accounted for the largest share in the benefit payment (81% in FY17, of which 87% was from FE segment). There has been sharp rise in FE death claims in recent years; coupled with a rising death cover under the FE policies poses a threat to the incremental profitability of the segment as well as overall business. At the same time, with the entry of new players, FE segment is likely to witness increase competition which is also likely to affect the incremental growth under this segment. Nonetheless, SLICL's claims paying ability remains comfortable despite some moderation in recent years (amount available for claims/ claims paid ratio of ~9 times in FY2017 (~13 times in FY2016).

Net investment income of SLICL for FY2017 stood at NPR 265 million corresponding to average yield on investment of ~9%<sup>5</sup>. The investment portfolio remains compliant with the regulatory guidelines, with 86% of portfolio, (comprising investments in Government securities, fixed deposits receipt (FDR) (with Commercial banks and Development Banks) and debentures of commercial banks) as on mid July 2017 compared to ~73% in mid-July-2016. During past year, banking interest rates have begun to harden, following a period of rising liquidity and softer rates (during FY2014-FY2016). Since, ~82% of the total investment of SLICL is concentrated in domestic financial institution FDRs, hardening of interest rates augurs well for the incremental earning profile of the company.

Due to a sizeable endowment business, SLICL's profitability depends upon transfer of the surplus after actuarial evaluation of the adequacy of life fund. During FY2017, SLICL reported net profit of ~NPR 104<sup>6</sup> million (before transfer of actuarial surplus from life fund) on a Net Premium of NPR 1,255 million as compared to a net profit of NPR 132 million on a net premium of NPR 1,010 million for FY2016 (corresponding to return on net worth of ~10% in FY2017, against 17% in FY2016). Although current profitability of the company remains adequate, the earnings sustainability will depend on the incremental performance of FE segment and SLICL's ability to maintain its market positioning in the face of increased competition. At the same time, a small life fund, relatively high operating expense ratio limits the profitability prospect of the company. Moreover, incremental return indicators are likely to remain diluted given sizeable equity injection plan of the management over next 6-8 months.

On the solvency front, SLICL remains solvency ratio of 1.81 times on July 2016<sup>7</sup> vis-a-vis a regulatory minimum requirement of 1.5 times. Incremental capital injection plan of the company is likely to comfort its solvency position to some extent. Similarly, life fund/total investment ratio stood comfortable at 76% on mid-July-2017 vs. 71% in mid-July-2016.

SLICL has reinsurance agreement (including catastrophic reinsurance agreement) with SCOR Global Life Re, Singapore<sup>8</sup> since inception (from FY2017 onwards FE policies are being reinsured with Nepal Reinsurance Company Limited).

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<sup>5</sup> Including capital gain, excluding capital gain, the yield stood at ~7%.

<sup>6</sup> Before transfer from life insurance fund due to pending actuary valuation

<sup>7</sup> Solvency ratio for July 2017 is yet to be determined pending actuarial evaluation

<sup>8</sup> Rated Aa3 (stable) by Moody's for financial strength rating.

### **Company Profile**

Surya Life Insurance Company Limited (SLICL) is the 7th life insurance company to be licensed by Insurance Board (insurance sector regulator in Nepal). SLICL started commercial operation after receiving the license in March 2008.

SLICL is amongst the smaller players in the industry with ~3.5% market share (8th rank among in the 9-players universe) in industry gross premium earnings during past 2 years ending FY2017. As of mid-July 2017, it is in operation with 72 branches and ~7,600 active agents spread across the nation for procuring new business and extending after sales services.

SLICL has 70:30 promoter-public shareholdings as on mid-July-2017. SLICL reported a profit after tax of NPR 104 million (before transfer from Life Insurance (LI) Fund) during FY2017 over total assets base of NPR 3,912 million on mid-Jul-2017 as compared to profit after tax of NPR 132 million during FY2016 over total assets base of NPR 2,792 million as of mid-Jul-2016. During Q1FY2018, the company has reported profit after tax of NPR 52 million. In terms of technology platform, SLICL has implemented “Siddhi Life” in its corporate office and all its branches.

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