

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 (January 2019)
Rights Issue (Equity shares)	NPR 401.46515823 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 401.46515823 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 65% rights issue of 4,014,651.5823 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 the improvement seen in past 12-18 months in NICL’s premium growth rate and underwriting performance, following ownership and management change in FY2017. The rating also factors in NICL’s good ownership profile comprising of 15% stake from Government owned Nepal Bank Limited (class A Commercial Bank), promoters related to IME group³ (~17% stake) and Vishal group⁴ (~14% stake). The grading also derives comfort from the experienced senior management team of the company. NICL’s recent addition to the branch network and further geographical expansion plans is also likely to improve the market positioning of the company, which has been factored into the grading. ICRA Nepal also takes note of NICL’s new relations with reputed reinsurers like Hannover Re & Swiss Re, which is likely to aid to the company’s profile. Furthermore, the grading also considers adequate reinsurance arrangement including catastrophic coverage⁵ which is likely to enhance the claims paying ability of the company. Solvency profile of NICL has improved following 100% rights issuance in FY2018, which remains a comfort. It is likely to improve further after proposed equity injection plan. The recent hardening of interest rates across banking industry also augurs well for incremental investment income of NICL, which is expected to support the profitability profile of the company to some extent.

However, the grading remains constrained by small scale of operation of NICL and consequently lower economies of scale. NICL’s market share weakened over the years until FY2016, because of weak premium growth and modest profitability. Despite recent turnaround in performance and financial indicators, gaining market share in an increasingly competitive industry will remain a challenge. Grading concerns also emanates from modest underwriting performance in motor segment (largest segment of NICL) in FY2018. Incremental profitability of NICL will depend on the incremental performance of motor segment. Coupled with the proposed equity injection plans of NICL, incremental returns to equity holders over next 1-2 years could remain moderate, which has been factored into the assigned grading.

Despite being the oldest player in the industry, NICL accounted for ~4% industry share⁶ in terms of industry’s gross premium written (GPW) as well as net premium written (NPW) in FY2018 (~4% and ~3% respectively in FY2017). During past 5 years between FY2013-FY2017, NICL lost around half of its market share as the company failed to keep pace with industry growth. During FY2018, the company was able to register industry average GPW growth, maintaining its market share. In terms of portfolio mix, ~75% of NICL’s GPW in FY2018 was accounted for by motor portfolio (38%) and fire portfolio (36%); followed by miscellaneous⁷ (11%), marine (8%) and engineering (6%). While fire and motor segments continue to remain key drivers of premium, there has been a marginal increase in the proportion of other segments as well, which could help diversify the business profile going forward.

¹ includes rights and further public issue of equity shares

² minimum paid up capital of NPR 1 billion to be maintained by July 2019 by all general insurers.

³ IME group 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 which has been increased significantly from the coverage taken in FY2015, at the time of earthquake.

⁶ among the 17 players’ universe.

⁷ Includes personal accidents, group medical policies, bankers’ indemnity, among others. Also includes micro insurance.

NICL has reported underwriting surplus in both FY2017 and FY2018 (NPR 94 million and NPR 78 million respectively), following continuous underwriting deficits in previous three years. Underwriting surpluses in FY2017 and FY2018 were heavily supported by fire segment with negligible contribution⁸ from motor segment (the largest segment) in both these years. Motor performance of NICL in FY2017 and FY2018 is an improvement over earlier years, when the segment used to generate high underwriting deficits (because of higher loss retention provided in reinsurance agreement, which has since been lowered). Nonetheless, incremental underwriting performance of NICL's motor segment will be important to the company's ability to deliver return on increased equity base (following proposed equity injection). Average combined ratio of NICL stood at ~76% for FY2017 and FY2018 vs. average of 119% in previous two years. Improvement in combined ratio is mainly on account of low claims ratio (53% in both FY2017 and FY2018) and resulting improvement in ceding commission rate from reinsurers⁹.

During FY2018, NICL reported return on assets (RoA) of ~7% in FY2018 (similar to FY2017) while return on net worth (RoNW) diluted to ~12% in FY2018 from ~20% in FY2017 (after capitalization of 100% rights share). Profitability of NICL remains supported by increased investment earnings in recent period. As on mid-Oct 2018, NICL's investment portfolio stood at NPR 1,720 million, ~72% comprised of fixed deposits with banks and financial institutions. Hardening of interest rates across banking sector deposit products have led to improvement in investment yield for NICL (~10% in Q1FY2019 vs ~7% in FY2018 and ~5.5% in FY2017). Given the tight liquidity scenario in banking sector, high interest rate environment could prevail over short to medium term, benefitting the insurance companies like NICL.

NICL has been maintaining the mandatory technical reserves and restricted reserves¹⁰ as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-Oct 2018, the said reserves accounted for 83% of NICL's net worth (81% in mid-July 2018). NICL's solvency margin on mid-July 2018, calculated as per regulatory directive¹¹, stood at ~5.4 times (2.5 times in FY2017) vis-a-vis a regulatory minimum of 1.5 times. NICL's liquidity position remains comfortable as all fixed deposit investment are for less than two-year period, as per the regulation. As on mid-Oct 2018, NICL's liquidity buffer¹² stood at NPR 1,109 million, 101% of net worth (vs. 105% of net worth as on mid-July 2018).

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

Nepal Insurance Company Ltd., operating since 1947, is the first Insurance Company of Nepal. It was established as a subsidiary of Nepal Bank Limited (first commercial bank of Nepal, with majority stake from government of Nepal). NICL is a small player in the Nepalese general insurance industry with ~4% share in industry GPW and NPW in FY18. As on mid-Oct 2018, NICL is in operation with 35 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-Oct 2018 stood at ~NPR 617 million and ~NPR 1,091 million respectively. 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 was subsidiary of state-owned Nepal Bank Limited until June 2016 when NBL divested 36% (out of 51% stake in NICL) to private bidders.

⁸ Nil and underwriting deficit of NPR 2 million in FY2017 and FY2018 respectively

⁹ Ceding commission from reinsurers is based on sliding scale of claims ratio. Higher the claims ratio lower is the ceding commission and vice versa.

¹⁰ Technical reserve include reserve towards unpaid claims & unexpired risk; restricted reserves include statutory reserves appropriated out of annual profits (viz. insurance fund & insurance reserve)

¹¹ Assuming licensing capital of NPR 250 million.

¹² Total investments minus technical reserves



NICL reported profit after tax of ~NPR 132 million in FY2018 (NPR 113 million in FY2017) over an asset base of NPR 2,326 million as of mid-July 2018 (NPR 1,577 million as of mid-July 2017). During Q1FY2019, NICL has reported profit after tax of ~NPR 40 million. In terms of technology platform, NICL has implemented “Ensure” across all its branches.

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About ICRA Nepal Limited:

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