

Siddhartha Insurance Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3+ to the proposed rights issue (equity shares) of Siddhartha Insurance Limited

| INSTRUMENT/FACILITY | ISSUE SIZE | RATING ACTION (APRIL 2018) |
|-----------------------|-----------------------|----------------------------------|
| Rights issue (Equity) | NPR 224.49735 million | [ICRANP] IPO Grade 3+ (Assigned) |

ICRA Nepal has assigned “**[ICRANP] IPO Grade 3+**”, indicating average fundamentals to the proposed rights issue (equity shares) amounting to NPR 224.49735 million of Siddhartha Insurance Limited (SIL). 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. SIL has proposed 35% rights issue of 2,244,973.5 numbers of equity shares of face value NPR 100 each, to be issued to the existing shareholders at par. The issue is being made in order to comply with revised paid up capital requirement² for general insurers, rolled out by the regulator (the Insurance Board of Nepal).

The grading considers SIL’s institutional promoter strength and existence of a shared brand name with Siddhartha Bank Limited³ (rated BBB+ by ICRA Nepal, which holds 15% stake in SIL). The grading also considers SIL’s good market share (~8% of gross premium written (GPW) in FY2017, ranking 2nd among the 17 players in the industry) and adequate franchisee network (53 branches as on mid-Jan 2018). The grading factors in SIL’s adequate reinsurance arrangements, experienced management team and sufficiently tested underwriting norms. ICRA Nepal also takes note that SIL’s claims paying ability, solvency position and profitability profile has not deteriorated in the aftermath of the April 2015 earthquake owing to sufficient catastrophic reinsurance arrangements. The grading also takes into consideration SIL’s healthy underwriting profitability aided by low claims ratio which has helped SIL maintain sound profitability indicators. Profitability is likely to improve further given the hardening of interest rates across banking industry and its favourable impact on the investment yield of SIL. However, the grading is constrained by the company’s moderate track record (operating since April 2006), high dependence on institutional customers (~75% of GPW in FY2017), high reliance on agency channels (>80% of GPW through individual and corporate agents in FY2017) and stiff competition from larger players with new licence in the Nepalese general insurance industry.

SIL is one of the large players in the Nepalese general insurance industry in terms of premium earnings, despite being the youngest among the 17 players in the industry. Over past 3 years ending FY2017, SIL’s growth in GPW and Net premium written (NPW) stood at CAGR 23% and 27% respectively, at par with industry average; enabling SIL to maintain its market share. Incremental growth is likely to remain supported by sharp growth in franchise achieved over past 18 months (number of branches grew from 21 in mid-July 2016 to 53 as of mid-Jan 2018). Increased footprint across the country is also likely to boost the retail business of SIL, curtailing its reliance on institutional clients (~75% of GPW in FY2017).

In terms of portfolio mix for FY2017, motor segment accounted for 47% of GPW, followed by fire segment at 26%, Miscellaneous segment⁴ at 13%, marine (cargo) segment at 7%; among others. Although motor remains the key segment for SIL, portfolio diversification of SIL remains aided by fire, miscellaneous and marine segment. This partly aids the resilience of premium earnings of SIL. Given high premium retention in motor segment and lower retention in other segment, motor portfolio accounted for 76% of NPW in FY2017 followed distantly by fire segment at 18%. Over next 2-3 years, motor and fire segments are likely to remain the key driver for premium growth of SIL. Premium growth of SIL could witness some moderation over next 6-12 months, given the slackness in banking sector credit growth, as SIL derives sizeable business from banking agents (~32% of GPW in FY2017).

¹ Includes rights and further public issue of equity shares

² NPR 1 billion paid up capital to be maintained by mid-July 2018.

³ Siddhartha Bank is a class A commercial bank rated BBB+ by ICRA Nepal.

⁴ Including agriculture and micro-insurance

Underwriting surplus of SIL grew by 22% from NPR 199 million in FY2016 to NPR 243 million in FY2017 (combined ratio stood at 62% in both the years). Steady combined ratio on increased premium base augurs well for incremental underwriting profit. Combined ratio in turn remains supported by relatively low claims ratio (57% in FY2017 vs. 52% in FY2016), low management expense ratio (29% in FY2017 and FY2016) and improvement in ceding commission ratio. All major segments of SIL has generated underwriting surplus in each of past 3 years, which remains a comfort. Premium retention of SIL (47% in FY2017 vs. 49% in FY2016) continues to remain marginally lower to industry average, due to lower reliance on motor segment⁵. Premium retention ratio of SIL is likely to increase going forward, with the increase in net worth (and risk bearing capacity). This could further support the underwriting surplus.

Profitability indicators of SIL has remained healthy over the years. However, with continuous capital injection and retention of accruals, return on net worth of SIL has witnessed marginal dilution in recent period. SIL reported return on net worth of 20% in FY2017 vs. 22% in FY2016, while return on average assets diluted to ~11% from ~12% over the same period. During H1FY2018, return on net worth and return on assets stood at 14% and 7%, due to seasonal nature of general insurance business and relatively higher unexpired risk reserve requirement during first half of financial year. However, the dilution in return is also aided by moderation in premium growth (annualized GPW growth of 16% during H1FY2018) caused by weakening of banking sector credit growth during past 6-12 months.

Profitability of SIL also supported by investment income of SIL (average yield of ~9% in H1FY2018 over an investment portfolio of NPR 1,670 million in mid-Jan 2018). As on mid-Jan 2018, >85% of Investment is concentrated in fixed deposits with banks and financial institutions (BFIs), in line with the regulatory requirement. Therefore, recent uptick in banking sector interest rates, has led to improvement in investment yield of SIL (average yield stood at ~6% in FY2017). Improved yield on investment is likely to aid the profitability profile and offset the dilution effect of increased capital base, to some extent. SIL has been maintaining the mandatory technical reserves and restricted reserves⁶ as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-Jan 2018, the said reserves accounted for 97% of net worth of SIL. SIL's solvency margin on mid-Jan-2018, calculated as per regulatory directive, stood at 4.68 times (4.30 times in mid-July-2017) vis-a-vis a regulatory minimum of 1.5 times.

Company Profile

Established in 2006, Siddhartha Insurance Company Ltd (SIL) is the youngest players in the nonlife insurance industry of Nepal. Despite short track record, SIL is among the larger players in the industry with ~8% share in industry GPW in FY2016 and FY2017. Among the 17 players in the general insurance segment, SIL ranked 2nd in terms of GPW and 6th in terms of NPW during FY2017. As of mid-Jan-2018, SIL has 53 branches spread across the country for procuring business and extending after sales services.

SIL has 51:49 promoter-public shareholding ratios with major shareholding from Siddhartha Bank Limited⁷ at 15%. SIL reported a profit after tax of NPR 224 million during FY2017 over an asset base of NPR 2,611 million as of mid-July 2017 as compared to NPR 186 million during FY2016 over assets base of NPR 1,857 million as of mid-July 2016. During H1FY2018, SIL reported profit after tax of NPR 88 million over an asset base of NPR 2,796 million as of mid-Jan 2018. In terms of technology platform, SIL has implemented "Insure" in its corporate office. The computerized information has been centralized across all the branches.

April 2018

For further details please contact:

Analyst Contacts:

⁵ Premium retention in motor segment remains high (>75%) due to excess of loss treaty for most of the industry players.

⁶ Technical reserve includes (reserve towards unpaid claims & unexpired risk); restricted reserves include Insurance reserve and Insurance fund appropriated from annual profits.

⁷ Siddhartha Bank is a class A commercial bank rated BBB+ by ICRA Nepal.



Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)
Kishor@icranepal.com

Mr. Sailesh Subedi (Tel No. +977-1-4419910/20)
sailesh@icranepal.com

Relationship Contacts:

Mr. Tulasi R. Gautam, (Tel. No. +977-1-4419910/20)
trgautam@icranepal.com

All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website (www.icranepal.com) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents