NLG Insurance Company Limited

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

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (JUNE 2019)
Rights Issue (Equity shares)	NPR 384.20 million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned **[ICRANP] IPO Grade 3**, indicating average fundamentals to the proposed rights issue amounting to NPR 384.20 million of NLG Insurance Company Limited (NLG). ICRA Nepal assigns IPO[1] 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+ is one notch higher than 2, 3, and 4 respectively. NLG has proposed a 60% rights issue of 3,842,000 numbers 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 insurers[2] as prescribed by the Insurance Board of Nepal.

The grading factors in NLG's long track record in the industry and institutional ownership (with 50% stake from National Life Insurance Company Limited) and also takes into consideration NLG's sufficiently tested underwriting norms, good underwriting performance and adequate profitability indicators. The grading also remains supported by NLG's recent expansion in branch network which, coupled with an experienced management team, augurs well for its incremental business growth. The grading also takes into consideration, NLG's adequate reinsurance arrangements, including catastrophic provisions and strong profile of the lead reinsurer, which provides comfort to NLG's claims-paying ability and its quality of maintaining solvency in the event of catastrophic events like the April 2015 earthquake. The grading action also factors in the improved investment outlook for NLG, given the hardening of the interest rate across the banking sector deposits, wherein a major portion of its investment portfolio is concentrated.

However, the grading remains constrained by NLG's declining market share and its high concentration in the motor segment. NLG's premium growth rate has lagged behind the industry average for the last two to three years, affecting its scale of operations vis-à-vis the industry peers. This remains a concern, especially in the recent regime of declining premium tariffs and increasing liability cover for the major segments like fire and motor. Incremental growth and the return prospect of NLG are likely to be determined by its ability to grow the customer base and diversify its revenue stream across different segments. While recent growth in its branch network is expected to support the endeavour, NLG's ability to achieve the targeted growth and diversification in the highly fragmented and competitive domestic general insurance industry, remains to be seen. With sizeable equity injection proposed shortly and expectations of increased operating expense commensurate with the recent branch expansion, the return indicators are expected to remain muted over the medium term; which has also been factored into the grading assigned.

NLG is among the medium-sized players in the Nepalese general insurance industry[3] in terms of premium earnings with ~6.5% share in the industry premium (both gross and net premium) for FY2018. Between FY2015-2018, NLG's gross premium written (GPW) increased by the CAGR of 15% vs. an industry average growth of 26% (NLG's growth in net premium written (NPW) stood at 13% vs. industry average growth of 21% over the same period). The average premium retention ratio of NLG stood at ~50% during the last three years ending FY2018, at par with the industry average. NLG's portfolio mix remains skewed towards the motor segment. During each of the last three years ending FY2018, over 50% of the GPW and 80% of the NPW was accounted for by the motor segment. In FY2018, the motor

[1] Includes rights and further public issue of equity shares
[2] Minimum paid up capital of NPR 1 billion to be maintained by mid-July 2019 for all general insurers.
[3] Only the original 17 listed players included

segment made up ~84% of NLG's NPW, followed by the miscellaneous segment[4] (~10%) and the fire segment (~4%) with almost negligible contributions from other segments. The motor segment, a key driver to NLG's revenue and profitability, has reported an underwriting surplus during each of the last five years ending FY2018, which remains a comfort. However, with the increase in third party liability cover under this segment, the underwriting surplus from the segment could come under pressure. During FY2018, the claims ratio for the motor segment increased to 59% (from 35% in FY2017 and 45% in FY2016), which can be partly attributed to the increase in third party liability cover from FY2017. Given the high reliance on the motor segment, deterioration of underwriting performance of the segment could drag the overall company's performance.

Despite moderate growth, NLG has been able to maintain a good underwriting performance backed by a low claims ratio. During the last three years ending FY2018, NLG reported a combined ratio of 58-72% of net premium earned (NPE) backed by the claim's ratio of 45-62% of NPE. The claims ratio of NLG has generally remained at or below the industry average during the last four to five years, helping the company generate an underwriting surplus. The underwriting performance of the company also remains supported by the net ceding commission income from reinsurers, which stood at ~20% of the NPE. during the last 2 years ending FY2018. However, relatively small scale of operation and resulting higher operating expense ratio remains a drag to profitability. With the management looking to further increase the branch network, operating expenses are likely to increase over the near term, impacting the short-term profit levels. The underwriting surplus of NLG stood at NPR 192 million (corresponding to a combined ratio of 72%) declining from ~NPR 262 million (corresponding to a combined ratio of 60%); the decline in the surplus caused by a higher claim ratio in FY2018. The incremental underwriting surplus of NLG will depend on the performance of the motor segment, where the claims ratio could increase as a result of increased liability coverage for the segment. Furthermore, the fire portfolio (property insurance) could also witness an increased claims ratio after regulatory curtailment of the premium.

NLG's profitability remains aided by good underwriting performance as well as improved returns on investment portfolio. ~80% of the investment portfolio of NLG as of mid-April 2019 has been concentrated in the fixed deposits with banks and financial institutions (BFIs). Therefore, the recent hardening of interest rates across banking sector deposits has benefitted institutional depositors like NLG. For FY2018, NLG's average investment yield stood at ~8% vs. ~5% in FY2017. The yield has further increased to ~8.25% during 9M FY2019 and is expected to remain healthy over the medium term. The company's investment portfolio follows the guidelines prescribed by the regulator, with major concentration in fixed deposits with BFIs. A high interest rate environment and proceeds collected from the proposed rights issue are factors which are likely to reduce the dilutive impact of the fresh equity injection proposed. NLG has been maintaining the mandatory technical reserves and restricted reserves[5] as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-April 2019, the said reserves accounted for 85% of NLG's net worth. Its solvency margin as of mid-July 2018, calculated as per regulatory directive, stood marginally below 1.5 times as the company is yet to raise the minimum paid-up capital required by the regulator.

Company Profile

NLG Insurance Company Ltd. (NLG) was incorporated as the National Life & General Insurance (NLGI) in 1988 as an entity licensed to carry out both life and general insurance businesses. In 2005, NLG was spun off as a separate general insurer, following the change in regulation, requiring life insurers and general insurers to be separate entities.

NLG is a medium-sized player in the Nepalese general insurance industry with ~6.5% share in the industry GPW and NPW in FY2018. As on mid-April 2019, NLG has been in operation with 66 branches (including head office) across the nation extending after sales services.

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[4] Including cattle, agriculture and microinsurance products.

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

The paid-up capital and the net worth of NLG as of mid-April 2019 stood at ~NPR 640 million and ~NPR 1,678 million respectively. National life Insurance (a life insurer promoted by same investor group) holds 50% stake in NLG with the rest being held in a small proportion by individuals and institutions (including ~3% stake from two class A commercial banks viz. Rastriya Banijya Bank & Prime Commercial Bank).

During FY2018, NLG reported a profit after tax of ~NPR 253 million (NPR 231 million in FY2017) over an asset base of NPR 2,704 million as of mid-July 2018 (NPR 2,307 million as of mid-July 2017). During 9M FY2019, NLG reported a profit after tax of ~NPR 153 million.

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For further details please contact:

Analyst Contacts:
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:
Ms. Barsha Shrestha, (Tel. No. +977-1-4419910/20)
barsha@icranepal.com

About ICRA Nepal Limited:

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For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu-33, Nepal.
Phone: +977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com