Prudential Insurance Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed rights issue of Prudential Insurance Company Limited

Facility/Instrument	Issue Size	Rating Action (October 2017)
Rights Issue Grading	NPR 128.304 million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned **"[ICRANP] IPO Grade 3"**, indicating average fundamentals to the proposed rights issue amounting NPR 128.304 million of Prudential Insurance Company Limited (PICL). ICRA Nepal assigns IPO 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 position within the grading categories concerned. Thus, the grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4 respectively. PICL is proposing to come out with 30% rights issue of 1,283,040 numbers of equity shares of face value NPR 100/- each to be issued to its existing shareholders at par. The proposed capital injection is step towards ensuring regulatory minimum paid up capital of NPR 1,000 million for general insurance companies by mid-Jul-18.

The average fundamentals grading takes into account PICL's long track record (established in 2000), healthy business growth (GPW[1] grew by CAGR[2] 29% in past 3 years), strength of major promoter groups[3] along with experienced board and management team. The assigned grading also factors in the strengthening of reinsurance arrangements in recent past[4], moderate profitability profile backed by improvement in underwriting performance across major segments, moderate market share (around 7% in terms of GPW for FY17) and adequate branch network across Nepal (33 branches) for targeted business growth. The grading also takes into consideration, PICL's adequate reinsurance arrangements in the past, including catastrophic provisions, which helped PICL maintain its claims paying ability, adequate solvency position and profitability profile in the aftermath of the April 2015 earthquake.

However, the grading is constrained by significant decline in PICL's retention of premium during FY17 (from 57% to 29%) affecting overall underwriting performance. The grading is further constrained by high concentration towards motor segment (~73% in terms of GPW for FY17), increase in claims ratio in recent past, stiff competition from other large players in the general insurance industry and low general insurance industry penetration in Nepal offering limited scope for product innovation/diversification. The grading is also constrained by probable dilution of return indicators of PICL with significant capital increment requirements set by the regulator. While PICL's performance has improved over last few years supported by high business growth, sustainability of the same on enhanced scale of operations, given the inherent limitations in insurance industry in Nepal, remains to be seen.

PICL is among the medium sized players in the general insurance industry in terms of premium earnings with ~7% share in industry gross premium written (GPW) in FY17. PICL's growth in revenue from premium earnings however remained much lower to the industry average; with ~21% CAGR growth in NPE[5] over past three years compared to ~29% growth for industry primarily due to reduction in retention. Despite impressive overall premium growth, the growth in NPE over the past three years in the relatively more profitable segments has remained moderate with Fire (23% CAGR), Engineering (34% CAGR), Marine (10% CAGR) and Miscellaneous (17% CAGR). Growth in all the segments were overshadowed by growth in least profitable Motor segment (33% CAGR) and with such growth, this segment accounted for ~88% of NPE and ~93% of Net Claims of all segments for FY17. Higher growth in the motor segment, which remains relatively vulnerable to claims, has brought about increase in

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[1] Gross Premium Written

[2] Compounded Annual Growth Rate

[3] Promoted by Vishal Group, Triveni Group and Golyan Group

[4] Lead reinsurer from FY17 onwards is XL Bermuda Limited rated A2 by Moody's (Earlier GIC, India rated at A-) with ~80% of total risk ceded towards 'A' rated reinsurance companies compared to ~55% earlier.

[5] Net Premium Earning

claims ratio (from ~68% of NPE in FY15 to ~80% for FY17). Though motor portfolio has higher vulnerability as compared to other segments, the segment helps the company to maintain market share as well as manage cash flow and investments. Going forward, the management intends to restructure the portfolio mix by increasing the focus towards more profitable segments such as fire, marine etc to reduce its dependence on the motor segment. ICRA Nepal, however, expects the portfolio mix to remain nearly the same over the medium term.

PICL has settled almost entire earthquake related claims (~98%) arising from April 2015 earthquake. PICL was exposed to a total earthquake related claims of ~NPR 478 million. The earthquake claims were on lower side due to limited exposure of PICL towards fixed property insurance (fire and engineering segment). PICL retained a total net loss of NPR ~46 million towards the earthquake claims and rest were passed on to the reinsurers.

In line with the trends in the industry, PICL's portfolio mix is dominated by the motor segment (73% of GPW for FY17), followed by Fire (14% of GPW for FY17), Miscellaneous (6% of GPW), Marine (4% of GPW) & Engineering (4% of GPW). The proportion of NPE from motor portfolio remains higher to industry average for PICL while that of fire and marine remain slightly lower than industry average. Since the motor segment is characterised by very low margins, in recent years, the higher segmental growth witnessed (when compared to Fire and Marine) has exerted pressure on the underwriting profitability metrics of the company. Despite accounting for ~88% of NPE, the motor segment contributed to only ~63% of total segmental underwriting surplus for FY17. However, the profitability indicator[6] for PICL's motor segment has been increasing in recent years (from 11% on FY15 to 33% for FY17) but still remains slightly lower to the industry average. All major segments of PICL has generated underwriting surplus during each of past four years ending FY17. The management intends to gradually shift its focus away from the motor segment in order to improve the company's profitability metrics.

For FY17, PICL reported Profit after Tax (PAT) of NPR 171 million over NPE of NPR 413 million corresponding to PAT/Net worth of ~19% and PAT/Total Asset base of 9.4%. The corresponding return indicators for FY16 were ~20% and 10.0% respectively. Decline in these profitability indicators was seen, despite growth in absolute profit amount, mainly due to increased capital base through rights and bonus issuance to meet the elevated capital requirements of NPR 1 billion to be met by Jul-18; earlier the requirement was NPR 250 million). Overall profitability for FY17 was boosted by the underwriting surplus of NPR 152 million (combined ratio ~63%) compared to NPR 109 million (Combined ratio ~78%) for FY16 and improved return on investment (~6% for FY17 vs. 4% for FY17; industry average of ~7% for FY17). However, the profitability remained constrained by increased management expense ratio (~40% of NPE for FY17 vs. ~24% for FY16; industry average ~31% for FY17) along with increase in claims ratio (from 65% to 80% during FY17. Increased commission income emanating from reduced retention supported the profitability to an extent by aiding the decline in combined ratio from ~78% for FY16 to ~63% for FY17.

Net investment income of PICL for FY17 stood at NPR 76 million (23% of net premium written in FY17 and corresponding to a yield of ~6%), which contributed ~30% to the overall operating income of PICL. Recent uptick in bank deposit rates has had a positive impact on the investment yield of PICL and the yields are expected to largely depend on interest rate movement across banking sector. The quality of investment portfolio of PICL remains healthy, with ~71% of the portfolio, as on mid-July-17, composed of Government securities & fixed deposits with Commercial banks and Development Banks against the minimum regulatory requirements of 65%. The investment portfolio remains by and large compliant to the investment guidelines prescribed by the regulator. PICL has been maintaining the mandatory technical reserves[7] as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-Jul-17, the said reserves accounted for ~37% of net worth of PICL (Regulatory requirement of minimum 50% of Net premium to Reserve for Unexpired risks and 115% of unpaid claims outstanding to Reserve for Unpaid claims).

[6] Underwriting surplus/Net premium earnings

[7] Reserves for Unexpired risks & Reserves for unpaid claims outstanding

Company Profile

Prudential Insurance Ltd (PICL), a public limited company established in November 2000, is the 13th private sector general insurer in Nepal. PICL is medium sized company with ~7% market share in terms of General Insurance Industry's Gross Premium Written in 2016-17. Currently, PICL is in operation with 33 branches (as of Jul 2017) spread across the nation for procuring business and extending after sales services.

PICL has 80:20 promoter-public shareholding ratios with major shareholding from Vishal Group, Triveni Group, Golyan Group and related companies. PICL reported a profit after tax of NPR 171 million during 2016-17 over assets base of NPR 1,819 million as of mid-Jul-17 compared to the profit after tax of NPR 154 million during 2015-16 over assets base of NPR 1,536 million as of mid-Jul-16. In terms of technology platform, PICL has implemented "Ensure" in its corporate office. The computerized information has been centralized across all the branches.

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