Prime Life Insurance Company Limited

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

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (JANUARY 2018)
Rights Issue (Equity)	~NPR 976.32 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 976.32 million of Prime Life Insurance Company Limited (PLIC). 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+ are one notch higher than 2, 3, and 4 respectively. PLIC has proposed 160% rights issue of 9,763,200 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[2] rolled out by the Insurance Board of Nepal (the regulator).

The grading factors in a strong policy renewal rate, and the recent improvement in new business premium which was backed by a strong growth in first year premium (FYP) (CAGR 47% between FY2014-FY2017). The rapid growth in FYP in recent years augurs well for incremental business growth. The grading also factors PLIC's strength in terms of franchise network (111 outlets across the country), institutional promoters (15% stake by Laxmi Bank Limited) and an experienced management team. The grading also factors an adequate reinsurance contracts including a catastrophic coverage provision. The grading incorporates the adequate solvency profile of the company (solvency ratio of 2.08 times in FY2016[3] vis-à-vis regulatory minimum of 1.50 times).

The grading remains constrained by a small scale of operations of the company (PLIC ranks 7th among the 9 players in terms of assets base). It stems from a limited operating track record (operating since 2008) and a slowdown in growth during FY2013 and FY2014. Business slowdown in those years was due to negative publicity generated after the regulator (Insurance Board) initiated action against PLIC amid allegations of excessive management expenditure. Sizeable portion (28% of gross premium in FY2017) of PLIC's business comprised of single premium foreign employment (FE) term business. Long term sustainability of growth and profitability of FE segment is to be tested, especially in view of a decline in migrant Nepalese workers and an increase in risk cover. The grading also remains constrained by a small life fund (~NPR 5.2 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 the challenging operating environment for life insurers after the recent licensing (in early FY2017) of 10 new life insurance companies (LICs) by the regulator.

PLIC was under scrutiny by the regulator in FY2013 for failure to contain the management expense ratio. Due to a high discretionary promotional expense, the regulator ordered a due diligence audit (DDA) of PLIC's expenses. The process of DDA and a resolution of its findings took about 2 years during which PLIC had a negative reputation in the industry. However, since the audit, PLIC has been reporting an improvement in business growth and in compliance with management expenses.

PLIC's GPW[4] has grown at a CAGR of 17% during past 5 years (FY2012-FY2017), which is lower to the industry average of ~25%. PLIC reported decline in first year premium (FYP) in FY2013 and FY2014 due to the unfavourable operating environment while single premium FE business reported a decline in FY2015 due to the April 2015 earthquake. The recent growth of PLIC remains encouraging (CAGR 19% growth in gross premium with 47% growth in FYP during FY2014-FY2017). Moreover, premium renewal

[1] Includes rights and further public issue of equity shares
[2] Minimum paid up capital of NPR 2 billion to be maintained by July 2018 by all life insurers
[3] Actuarial valuation of life fund as on FY2017 end is under progress currently
[4] Gross premium written

rate of PLIC has remained strong over the years (98% in FY2017 vs. past 5 years average of 88%), a reflection on the quality of policy underwritten over the period. In terms of distribution channel, PLIC still relies heavily on individual agents (and corporate tie ups for FE business). The management has introduced credit-linked products[5] in association with bank to boost the bancassurance business. However, its sustainability remains to be seen.

PLIC is one of the major player in FE business in the industry, accounting for ~1/3rd of industry FE business. However, the product mix of PLIC is still dominated by endowment policies (and its variants). During FY2017, 75% of the premium earnings was from endowment products (77% in FY2016) while remainder was accounted by FE business. Apart from FE product, the company does not have any notable term business. FE segment has shown signs of stagnation across the industry, given the decline in number of migrant workers going abroad. At the same time, FE segment is likely to witness increased competition after the licensing of new LICs. Therefore, incremental growth is likely to come from traditional business. Healthy growth in FYP and strong policy renewal rate, therefore, remains a comfort for the company's growth going forward. However, PLIC's ability to maintain its market positioning in the face of increased competition in the industry remains to be seen.

Benefit payment (net claims/net premium) ratio of PLIC has remained high, but fairly steady, ranging from 15-17% during past 3-4 years. Death claims accounted for the largest share in the benefit payment (58% during past 3 years, more than90% was from FE segment). There hasn't been any spike in death claims in recent years, despite PLIC having sizeable FE business. At the same time, proportion of policy surrender also remains low. Although the claims ratio could rise in future given the increased FE risk cover and increased competition (which could increase the policy surrender rate), nonetheless, the past track record of stable claims ratio remains a credit positive. Due to the benefit ratio remaining on higher side, claims paying ability ratio (amount available for claims/ net claims paid) remains relatively low at ~6 times in FY2017 (~5 times in FY2016).

Net investment income of PLIC for FY2017 was NPR 373 million corresponding to an average yield on investment of ~7%. The investment portfolio remains compliant with the regulatory guidelines, with 84% of the portfolio comprising investments in Government securities, FDR[6] with Commercial/Development Banks and debentures of Commercial Banks as on mid July 2017 (84% in mid-July 2016). During the past ~12 months, banking interest rates have begun to harden, following a period of rising liquidity and softer rates (during FY2014-FY2016). Since, ~81% of the total investment of PLIC 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, PLIC's profitability depends upon transfer of the surplus after actuarial evaluation of the adequacy of life fund. During FY2017, PLIC reported net profit of ~NPR 221[7] million on a Net Premium of NPR 1,917 million as compared to a net profit of NPR 209 million (including actuarial surplus of NPR 40 million) on a net premium of NPR 1,606 million for FY2016 (corresponding to return on net worth of ~14% in FY2017 vs. 16% in FY2016). Although current profitability of the company remains adequate, the earnings sustainability will depend on the incremental performance of FE segment and PLIC's ability to maintain its market positioning in the face of increased competition. At the same time, a small life fund and relatively high operating expense ratio (although within regulatory celling) 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, PLIC's solvency ratio of 2.08 times on mid-July 2016[8] remains adequate vis-a-vis regulatory minimum requirement of 1.5 times. Incremental capital injection plan of the company is likely to strengthen the solvency position further. Similarly, life fund/total investment ratio stood comfortable at 82% on mid-July-2017 vs. 79% in mid-July-2016.

---

[5] Endowment life policy tied up with home loan product of Sunrise Bank Limited (rated BBB by ICRA Nepal).

[6] Fixed Deposit Receipt

[7] Before transfer from life insurance fund due to pending actuary valuation

[8] Solvency ratio on mid-Jul-17 is yet to be finalized by insurance board

PLIC has a reinsurance agreement (including catastrophic reinsurance agreement) with Hannover Re. Malaysia[9] since FY2018[10].

Company Profile

Prime Life Insurance Company Limited (PLIC) is the 8th life insurance company to be licensed by Insurance Board of Nepal (insurance sector regulator). PLIC was incorporated in June 2007 and started commercial operation from June 2008. PLIC is among the smaller players in the industry with ~5% market share (7th rank among in the 9-players universe) in industry gross premium earnings during past 2 years. As of mid-Oct 2017, it is in operation with 5 regional offices, 28 branches and 82 sub-branches and ~5,300 active agents spread across the nation for procuring new business and extending after sales services.

PLIC has 70:30 promoter-public shareholdings as on mid-Oct-2017. The company has majority shareholding from individuals and institutions associated with Khetan Group, including 15% stake by Laxmi Bank Limited (class A commercial bank, rated BBB by ICRA Nepal).

PLIC reported a profit after tax of NPR 221 million during FY 2016-17 over total assets base of NPR 7,153 million on mid-Jul-2017 as compared to profit after tax of NPR 208 million during FY 2015-16 over total assets base of NPR 5.605 million as of mid-Jul-2016. During Q1FY2017-18, PLIC has reported net profit of NPR 63 million over asset base of NPR 7,579 million on mid-Oct 2017. In terms of technology platform, PLIC has implemented locally developed "CLAS" software in its corporate office and all its branches.

January 2018

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:

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

[9] Rated AA- with stable outlook by Standard & Poor's for financial strength rating.

[10] Reinsurance partner was SCOR Global Re till FY2017. Change in reinsurance partner was done after SCOR Re refused to reinsure increased risk cover (after government increased the death cover) under FE policies.