Prudential Insurance Company Limited

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

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (MARCH 2015)
Rights Issue Grading	NPR 54 million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned **"[ICRANP] IPO Grade 3"**, indicating average fundamentals to the proposed rights issue amounting NPR 54 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 20% rights issue of 540,000 numbers of equity shares of face value NPR 100/- each to be issued to its existing shareholders at par.

The grading takes into account PICL's long track record (established in 2000), healthy business growth (GPW[1] grew by CAGR[2] 40% in past 3 years), strength of major promoter groups[3], experienced BOD & management team, moderate profitability profile backed by improvement in underwriting performance across major segments, moderate market share (around 6% in terms of GPW as on FY 2014), adequate branch network across Nepal (with 22 branches), adequate solvency levels and good claims paying ability. However, the grading is constrained by PICL's high concentration towards motor segment (~66% in terms of GPW for FY14), increase in claims ratio in recent past, significant dependence on corporate clients (~85% in terms of GPW for FY14), stiff competition from other large players in the general insurance industry, low retention of premium affecting underwriting performance and low general insurance industry penetration in Nepal offering limited scope for product innovation/diversification. Viewed overall, PICL's performance has improved over the last few years supported by high business growth and improved underwriting performance across major segments. However, sustainability of the same on enhanced scale of operations, given the inherent limitations in insurance industry in Nepal, remains to be seen.

PICL's growth in revenue from premium earnings exceeded the industry average; with 44% CAGR growth in NPE[4] over past 4 years. Despite impressive overall premium growth, the growth in NPE along relatively more profitable segments in past 4 years has remained moderate with Fire (32% CAGR), Engineering (24% CAGR), Marine (8% CAGR) and Miscellaneous (42% CAGR). Growth in all the segments were overshadowed by growth in least profitable Motor segment (48% CAGR) and with such growth, this segment accounted for ~85% of NPE and ~93% of Net Claims of all segments as of mid-Jan 2015. Higher growth in the motor segment, which remains relatively vulnerable to claims, has brought about increase in claims ratio (from 54% of NPE in mid-Jul 2010 to 58% as of mid-Jan 2015, though there were rise and fall in claims ratio in between).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 least profitable motor segment. ICRA Nepal, however, expects the portfolio mix to remain nearly the same over the medium term.

In line with the trends in the industry, PICL's portfolio mix is dominated by the motor segment followed by Fire (14% of GPW as of Jan-15), Miscellaneous (13% of GPW as of Jan-15), Marine (6% of GPW as of Jan-15) & Engineering (2% of GPW as of Jan-15). The proportion of the motor portfolio remains

Note: Data for FY 2013-14 and Jan-2015 are unaudited and based on data submitted by Management of PICL.

[1] Gross Premium Written

[2] Compounded Annual Growth Rate

[3] Promoted by Vishal Group, Triveni Group and Golyan Group with aggregate shareholding around 45%

[4] Net Premium Earning

comparable to industry average while that of fire and Marine remain slightly higher 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 ~85% of NPE, the motor segment contributed to only ~32% of underwriting surplus as of mid-Jan-15 (47% average for last three years). However, profitability indicator[5] for PICL's motor segment remains largely comparable with the industry average of the past 2 years. The management intends to shift its focus away from the motor segment in order to improve the company's profitability metrics.

For FY14, PICL reported Profit after Tax (PAT) of NPR 62 million over NPE of NPR 232 million corresponding to PAT/Net worth of 15.1% and PAT/Total Asset base of 7.0%. The corresponding return indicators in FY13 were 18.5% and 8.2% respectively. As of H1 FY15, these ratios have come down to 12.4% and 5.0% respectively. Decline in these profitability indicators was seen, despite growth in absolute profit amount, mainly due to increased capital base post 1:1 rights which was capitalised in FY14. Overall profitability in FY14 was boosted by the underwriting surplus of NPR 46.2 million (combined ratio 80.1%) compared to NPR 25.7 million (Combined ratio 77.2%) in FY13, moderated management expense ratio (30.2% of NPE in FY14) compared to industry average (~35%) and fair return on investment (8.82% for FY14 compared to industry average of ~8%). However, the profitability remained constrained as of H1 FY 15, mainly due to increase in claims ratio (thereby pushing combined ratio from 80% in Jul-14 to 87% in Jan-15) and declining yield in investments as a result of systemic excess liquidity (5.34% as of Jan-15).

Net investment income of PICL for FY14 stood at NPR 48.6 million (14% of net premium written in FY14 and corresponding to a yield of 8.82%), which contributed ~50% to the overall profitability of PICL. The quality of investment portfolio of PICL remains healthy, with ~75% of the portfolio, as on mid-July-14, 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[6] as prescribed by the regulatory authority (Insurance Board of Nepal).

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 ~6% of market share in terms of General Insurance Industry's Gross Premium Written in 2013-14. Currently, PICL is in operation with 22 branches (as of Jan 2015) 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 and related companies, Triveni Group and Golyan Group (~45% combined holdings). PICL reported a profit after tax of NPR 62 million during 2013-14 over assets base of NPR 895 million as of mid-Jul-14 compared to the profit after tax of NPR 42 million during 2012-13 over assets base of NPR 510 million as of mid-Jul-13. As of Q2 FY 15, PICL has reported a profit after tax of NPR 27 million over assets base of NPR 1,081 million. 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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[5] Underwriting surplus/Net premium earnings

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

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