

## Prabhu Life Insurance Limited: [ICRANP-IR] BB+ (assigned)

September 28, 2020

Facility/Instrument	Rated Amount (NPR Million)	Rating Action (September 2020)
Issuer Rating	NA	[ICRANP-IR] BB+ (assigned)

### Rating action

ICRA Nepal has assigned the issuer rating of [ICRANP-IR] BB+ (pronounced ICRA NP Issuer Rating Double B plus) to Prabhu Life Insurance Limited (PLIL). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument. The sign of + (plus) or – (minus) appended to the rating symbols indicate their relative position within the rating categories concerned. Thus, the rating of BB+ is one notch higher than BB.

### Rationale

The rating factors in PLIL's good ownership profile and its established brand name in Nepal ('Prabhu'). Additionally, a high proportion of the endowment business in the overall premium earnings (~95% in FY2020), good quality investment and adequate reinsurance arrangements, including the catastrophic provision, also remain rating positives. Further, the rating considers an adequate franchise network (90 outlets across the country as of mid-July 2020), an experienced management team, a robust agency force, and the relatively unpenetrated insurance market, which offers adequate growth potential.

However, the rating remains constrained by PLIL's limited track record (operating since December 2017) and its small-scale operations (~4% share among 10 new players and less than 1% share in the industry in terms of premium earnings in H1 FY2020). Further, the management's ability to achieve sustainable growth amid intense competition remains to be seen. The rating is also constrained by PLIL's moderate policy continuation rate, despite the initial years of operations (~70%<sup>1</sup> renewal in FY2020 in terms of premium) and the modest solvency profile. The rating is also restricted by the fragmented industry, the increase in competition (19 LICs in Nepal) and the decline in yield on investment book. Business disruptions caused by the Covid-19 triggered lockdown and the expected impact of the pandemic on the Nepalese economy might impair the company's business in the medium term and increase claim demand, thereby raising rating concerns.

### Rating strengths

**Institutional ownership with brand sharing of 'Prabhu'** – The rating factors in the presence of BFIs in PLIL's ownership profile (~14% held by Prabhu Bank Limited (rated [ICRANP-IR] BBB), with representation of one director on the company's board and ~13% held by Shangri-La Development Bank, graded at [ICRANP] IPO Grade 3). Prabhu Group, along with its associates, holds majority stake in the company via institutional as well as individual promoters.

**High portion of long-term endowment business in overall premium earnings** – PLIL's portfolio remains dominated by endowment insurance products, in line with the broader industry trend. Endowment insurance products accounted for ~95% of the gross premium written (GPW) in FY2020, with the term insurance business mainly comprising the mandatory Foreign Employment Term Policies (FE) business, accounting for the rest. Though the high proportion of endowment business is a positive from business growth prospects, the sizeable share of single premium endowment policies (~40% of the overall premium earnings), might lead to revenue uncertainty to some extent. As it is in the early years of operations, the first-year premium (FYP, including single premium) accounted for the majority share in the company's total earnings (~76% in FY2020). Incremental business growth is likely to be driven by endowment products, given the fixed agreed percentage share in the FE business (1% in the industry) and the lukewarm market for term insurance business so far.

<sup>1</sup> Considering the renewal of the grace period, the same would be ~73% (one-month grace period is given to life insurance companies (LICs) for policy renewal)

**Adequate reinsurance support** – The company enjoys adequate reinsurance support from Hannover Reuck SE (for regular life policies and catastrophic reinsurance, CAT XL) and Nepal Re (compulsory direct cession). While Hannover Reuck SE is rated AA- by Standard & Poor's, Nepal Re is a Government of Nepal Undertaking (graded [ICRANP] IPO Grade 2 by ICRA Nepal).

**Satisfactory investment quality; declining interest rate could create pressure on profitability** – The company had total investment of NPR 2,286 million as of mid-July 2020, which was dominated by FDRs and debentures of class-A banks at ~64%, and the balance by the FDRs in class B banks (~13%), shares in the listed companies and call deposits in BFIs, each having 10% shares. PLIL's net investment income stood at ~NPR 194 million in FY2020 (~NPR 164 million in FY2019), corresponding to the average investment yield of ~9.5% (~10% in FY2019). The reduced yield is in line with the declining interest rate scenario in the Nepalese banking sector. Declining interest rate environment, post the Covid-19 pandemic, is likely to create pressure over the investment earning as most of the investments are short-term in nature.

## Rating challenges

**Limited track record with small market share** – Operating since December 2017, the company has a track record of less than three years with a small scale of operations (share of ~4% among 10 new players and less than 1% share in the industry in terms of net premium earnings in H1 FY2020). Despite the low market share, ICRA notes the consistent growth since the start of operations. PLIL's GPW stood at NPR 1,198 million in FY2020, registering ~1.5 times growth over FY2019, albeit on a small base. The growth was backed by the adequate franchise network (90 outlets as of mid-July 2020) and the agency force (~10,500 agents as of mid-July 2020) developed by the company within a limited time span. The continuation of similar growth in FYP as well as an improvement in the policy continuation rate (renewal rate) will be critical for determining the incremental business outlook for PLIL. However, promoter support and management ability remain a comfort. Mid-term growth may remain constrained by the economic impact of the Covid-19 pandemic.

**Modest policy continuation rate** – The policy continuation rate was moderate, at ~70% renewal, in FY2020. The premium is comparable to the new age peers while it is lower than some established peers. However, if the renewals during the grace period are considered, the rate would be ~73% (one-month grace period is given to LICs for policy renewals).

**Subdued return indicators with high cost of operations** – PLIL's return indicators remain subdued, given the initial stage of operations and the high acquisition cost associated with the insurance business in initial years. Moreover, due to the sizeable endowment business, PLIL's profitability remains highly reliant on the transfer of surplus on the actuarial evaluation of the adequacy of the life fund.

In FY2020, PLIL reported a net profit of ~NPR 45 million on a net premium of NPR 1,159 million (net profit of NPR 83 million after transfer from life fund of ~NPR 10 million on a net premium of NPR 456 million in FY2019), corresponding to a return on net worth of ~3% before the transfer of the actuarial surplus from the life fund to the profit and loss account. The company's return indicators were affected by a relatively high operating expense ratio (total management expense of ~32% of GPW in FY2020, against regulatory ceiling of 30%) on a small scale of operations. However, the same is likely to decline in the near future, with the achievement of economies of scale as the business volume grows. The company would require a healthy pace of premium growth, an endowment product driven portfolio, and a growing life fund to improve its profitability.

**Suboptimal solvency profile** – PLIL's solvency margin, as of mid-July 2019 stood at ~1.4 times (against the regulatory minimum of 1.5 times), calculated as per the regulatory directive considering regulatory capital requirement of NPR 2 billion. PLIL's incremental capital infusion plan is likely to provide comfort to its solvency position to some extent.

**Analytical approach:** For arriving at the rating, ICRA Nepal has applied its rating methodology as indicated below.

**Links to applicable criteria**

[Issuer Rating Methodology](#)

**About the company**

Prabhu Life Insurance Limited (PLIL) is a public limited life insurance company (LIC), operating since December 2017. Its head office is in Kamaladi, Kathmandu. PLIL was established with Nepalese capital and its promoters include Nepalese banks, merchant bankers, investment management companies, insurance company and high net-worth individuals. On an overall basis, institutions hold 60% share and individuals hold the rest. Prabhu Group holds the majority stake in the company (considering both, the institutions under the Group and the individuals).

PLIL is a new player in the life insurance industry of Nepal. Along with nine other LICs, PLIL was licensed by the Insurance Board in 2016/17, taking the total number of life insurers to 19 from nine. As of mid- July 2020, the company has been in operations with 90 outlets and 10,463 individual agents and 25 corporate agents spread across the nation for procuring new business and extending after-sales services.

PLIL's total paid-up capital was NPR 1,400 million as of mid-July 2020 and will reach NPR 2,000 million after the public issuance. Post the IPO, the promoter and the public shareholding will be in the 70:30 ratio. PLIL reported a profit after tax of ~NPR 45 million<sup>2</sup> in FY2020 on a total asset base of ~ NPR 2,958 million as of mid-July 2020, compared to the profit after tax of NPR 83 million in FY2019 on a total asset base of NPR 1,983 million.

**Key financial indicators:**

Amount in NPR million	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Provisional)
<b>Number of months in operation</b>	<b>7</b>	<b>12</b>	<b>12</b>
First year premium (FYP)	82	348	438
Renewal premium (RP)	-	58	283
Single premium (SP)	33	67	477
Total gross premium (TGP)	114	474	1,198
Net premium	112	456	1,159
Premium on endowment policies	114	447	1,135
% share of endowment in total premium	100%	94%	95%
Premium on term policies	-	27	63
% share in total premium	0.00%	5.71%	5.26%
Total management expenses	90	211	383
Management expenses as % of gross premium	79%	44%	32%
Total investment (including policy loans)	1,475	1,756	2,338
Yield on investment	15.35%	10.14%	9.46%
Profit after tax	43	83	45*
Return on equity	7.81%	5.59%	2.91%*
Solvency margin	1.01	1.40**	

\* Before actuarial valuation

\*\* As per the regulatory directive, the solvency ratio should be 1.5 times or above. The paid-up capital of PLIL is only NPR 1.4 billion as against minimum licensing capital of NPR 2 billion. At available capital of NPR 1.4 billion the solvency ratio comes out to be 1.99 times as of mid-July 2019.



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