NLG Insurance Company Limited: [ICRANP-IR] A- (assigned)

October 16, 2023

Summary of rating action

Facility/Instrument	Rated Amount (NPR Million)	Rating Action
Issuer Rating	NA	[ICRANP-IR] A- (assigned)

Rating action

ICRA Nepal has assigned issuer rating of [ICRANP-IR] A- (pronounced ICRA NP Issuer Rating A minus) to NLG Insurance Company Limited (NLG), indicating adequate degree of safety regarding timely servicing of financial obligations. Such issuers carry low credit risk. The sign of + (plus) or – (minus) appended to the rating symbol indicates the entity's relative position within the rating categories concerned. The rating is only an opinion on the general creditworthiness of the rated entity and is not specific to any debt instrument.

Rationale

The assigned ratings factor in NLG's long track record in the Nepalese industry, its good ownership profile (50% stake owned by National Life Insurance Company Limited, one of the old and large life insurance companies in Nepal) and experienced management team. The rating also takes comfort from steady business growth, good overall profitability, and comfortable solvency/liquidity profile, albeit on a moderate scale of operations considering the age. The rating also positively factors in adequate headroom for future business growth given the current low market penetration of general insurance sector in Nepal. The rating also takes note of the adequate reinsurance arrangements including catastrophic cover from strong counterparty reinsurers[1], which remains a comfort.

Nonetheless, the ratings remain constrained by fragmented industry and NLG's relatively moderate scale given its low premium retention ratio. Although NLG's market share in terms of gross premium written (GPW) stood at ~8% for FY2023 (marginally above industry average), its share in net premium written (NPW) was below-average at ~5% for the same year, on account of low premium retention ratio. NLG's premium retention (NPW/GPW) has been on a steady decline since 2020 when the regulator mandated all insurers to incrementally cede 20% of their business to domestic reinsurance companies; and stood at ~25% in FY2023 (vs. industry average of ~38%). NLG's low NPW levels has reduced its economies of scale which coupled with high claims ratio (despite improvement in FY2023) has dampened its underwriting profitability despite the good support from ceding commission income. Accordingly, NLG's combined ratio has generally remained high, although the improvement in the claims ratio for FY2023 (unaudited) has helped the company report low combined ratio and thus better underwriting surplus. Nonetheless, amid volatile underwriting surplus, NLG's overall profitability remains supported and stabilized by its adequate investment earnings.

Going forward, continuous decline in premium retention could subdue the company's market share and return indicators, considering the gradual uptick in industry-wide claims ratio affecting industry profitability and NLG's proposed equity raising plan. NLG's ability to compete with other players that have grown large organically/inorganically, its ability to scale up commensurate while maintaining the financial indicators and solvency profile will also remain among the key rating monitorable.

[1] *Hannover Re (Germany) is the lead reinsurer for NLG; rated at AA- during the latest exercise by S&P Global.*

Key rating drivers

Credit strengths

Strong parentage, long track record of operations and steady market position – NLG is a 50% subsidiary of National Life Insurance Company Limited (NLICL) which is one of the old and large private sector life insurance company in the country. NLG's board of directors and the management team comprises of representatives from NLICL as well as other individuals and professionals with adequate experience in the Nepalese business arena and general insurance industry, which remains a positive for the governance aspect. Linkages with strong institution also comforts the funding prospects as well as business growth aspects of NLG. All these are partly reflected in the company's steady performance and market share in the recent years despite the intense competition from newly licensed general insurers.

Good solvency, strong liquidity and adequate reinsurance arrangements – On the solvency front, NLG's solvency margin as of mid-July 2022, calculated as per the regulatory directive stood at ~3.73 times (vs. 4.45 times as of mid-July 2021), comfortably above the regulatory minimum of 1.5 times. The moderation in FY2022's solvency can be partly attributed to high claims ratio and build-up of reinsurers' receivables against the losses incurred towards the years end. Nonetheless, incremental solvency is expected to get strengthened after the proposed rights issue (assuming full subscription).

NLG has also been maintaining the mandatory technical reserves and restricted reserves[2] as prescribed by the regulatory authority (Nepal Insurance Authority). As at FY2022 end, the said reserves accounted for ~63% of its net worth (~65% as of FY2021 end). NLG also maintains adequate liquidity with cash and liquid assets accounting for ~5 times the technical reserve.

NLG has maintained adequate reinsurance arrangement including catastrophic coverage which is likely to support the company's solvency during catastrophic events. The credit profile of counterparty reinsurer also remains strong ('Hannover Re', Germany) which remains a comfort against reinsurer receivable risk.

Adequate profitability profile – NLG's profit after tax (PAT) has remained progressive in recent years despite volatile underwriting performance. The underwriting performance for FY2022 and FY2023 were a marginal improvement over FY2021, backed by decline in claims ratio. Despite the decline in NLG's underwriting profitability (along with other industry players) because of falling premium retention and rising claims ratio, its overall profitability remains well supported by the investment income. Investment income to underwriting surplus has remained at 7.1x, 3.2x and 1.4x for FY2021, FY2022 and FY2023. NLG's concentration of investment in the fixed deposits of BFIs and recent hardening of banking sector interest rates augurs well for the investment earnings prospects over the near to medium term.

Credit challenges

Moderate scale: low premium retention affecting scale as well as underwriting profitability – Despite being one of the oldest players in the industry, NLG's scale of operations remains moderate. This can be partly attributed to conservative growth approach of the company and partly to the intensified competition in the industry following the licensing of new players few years ago. In the recent years, the scale growth has also been affected by steady decline in premium retention ratio translating into low net premium earnings for the company. Amid industrywide rise in claims ratio, the low scale of operations remains a concern to the company's ability to generate internal capital through future profits sustainably.

High sectoral concentration in motor segment – The motor segment accounted for 43% of GPW and 73% of NPW in FY2023, making it the largest business segment for the company, in line with the industry trend. Although the motor portfolio is highly granular, which minimises the chances of any large loss from the motor segment, this exposes the company to sectoral-concentration risk. Any regulation changes affecting the motor portfolio profitability has a correspondingly high impact on the overall business of NLG.

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

Regulatory changes affecting operating environment as well as industry fragmentation – The players in the general insurance industry have been facing frequent changes in regulatory environment affecting tariff, risk cover, capitalization/solvency as well as competitive landscape. For examples- increase in third-party motor insurance cover in FY2017 led to an industry-wide rise in motor claims, new 'property insurance directive' introduced in FY2019 required insurers to provide comprehensive risk coverage at relatively lower premium tariff, the waiver of premium related to Covid-19 lockdown period affected profit margins for players and limiting the number of offices of Department of Transportation that can be catered to by a single player affected the growth prospects of individual players. The licensing of large number of general insurers in FY2018 changed the competitive landscape of the industry and increased industry fragmentation. The most recent revision in minimum paid up capital norms has again affected the operating environment for many companies whereby few companies have undergone mergers, and few are in the process of fresh equity infusion. While all these changes are likely to increase the insurance sector penetration, strengthen institutions and eventually aid in industry growth, these could impact the current operating environment and affect short-term profitability over the short to medium term.

Company Profile

Established in 2005, NLG Insurance Company Limited (NLG) is among the older players in the general insurance industry of Nepal. It was created to take over the general insurance business of erstwhile National Life & General Insurance Company Limited which was in operation since 1988. As of mid-July 2023, NLG operates with 82 branches across the country and has a market share of 6-8% of industry GPW in the past few years.

NLG has 51:49 promoter-public shareholding ratio. As of mid-July 2023, NLG's major promoters include National Life Insurance Company Limited (50%), Rastriya Banijya Bank Limited (2%), Mr. Rana Bahadur Shah (2%), Mr. Siddheswor Kumar Singh (1%), Ms. Tejeshwi Rajeshwori Rana (~1%) among others.

NLG's paid-up capital and the net worth as of mid-July 2023 (unaudited) was NPR 1,459 million and NPR 3,057 million respectively (vis-a-vis NPR 1,327 million and NPR 2,827 million, respectively for FY2022). For FY2022 (latest audited period) and FY2023 (unaudited) NLG reported a profit after tax of ~NPR 239 million and ~NPR 241 million, respectively over an asset base of ~NPR 3,984 million and ~NPR 4,170 million for FY2022 and FY2023.

Key Financial Indicators

Amount in NPR million	Audited FY2019	Audited FY2020	Audited FY2021	Audited FY2022	Unaudited FY2023
Gross premium written (GPW)	1,666	1,801	2,120	2,361	2,532
Net premium written (NPW)	702	646	688	670	632
Net premium earned (NPE)	700	675	668	669	658
Premium retention (NPW/GPW)	42%	36%	32%	28%	25%
Claims ratio (Net claims incurred/NPE)- A	78%	63%	82%	79%	65%
Management expense ratio (Management expense/NPE)-B	43%	44%	48%	57%	62%
Commission expense ratio (Commission expense/NPE)-C	-29%	-32%	-36%	-46%	-51%
Combined ratio (A+B+C)	92%	75%	95%	90%	76%
Underwriting surplus	58	169	36	67	158
Investment earnings	202	219	259	212	220
Average yield on investments	8.6%	8.7%	9.5%	7.9%	8.5%
Profit after tax (PAT)	203	263	206	239	241
Return on equity	12%	11%	8%	8%	8%
Return on assets	7%	8%	5%	6%	6%

Source: Company Data

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About ICRA Nepal Limited:

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