

Neco Insurance Limited

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

Facility/Instrument	Issue Size	Grading Action (October 2016)
Rights Share Issue	NPR 324.04 million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned “[ICRANP] IPO Grade 3”, indicating average fundamentals to the proposed rights issue amounting to NPR 324.04 million of Neco Insurance Limited (NIL). 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. NIL is proposing to come out with 1:1 rights issue of 3,240,436.32 numbers of equity shares of face value NPR 100/- each to be issued to its existing shareholders at par.

The grading considers NIL’s long track record, strength of its major promoter (20% stake of Rastriya Banijya Bank), sound profitability indicators and robust underwriting standards across major segments. NIL’s experienced Board of Directors & management team along with its diversified network of 23 branches across the country is expected to provide adequate growth opportunities over the medium term. ICRA Nepal has also taken note of the limited impact of the April 2015 earthquake on NIL’s financial profile owing to its exhaustive reinsurance arrangements. Nonetheless, the grading is constrained by small market share of NIL (~6% in terms of GPW for FY16), stiff competition from other large players in the general insurance industry, high operating costs and low retention ratios. Declining yield on investment in the falling interest rate regime also remains a concern to incremental profitability and has been factored into the grading assigned. The ability of the company to upgrade risk management systems/processes commensurate with the growth in business volumes will be a key rating sensitivity.

NIL’s portfolio is dominated by the motor segment (57% of NPE in FY16) followed by Fire (35% of NPE in FY16), Miscellaneous (5% of NPE in FY16) and Engineering (3% of NPE in FY16). The proportion of the motor portfolio remains subdued as compared to the industry average while that of fire remains higher than industry average. In last three years, motor segment has been one of the fastest growing business (CAGR of ~28% in FY14-16). Going forward, management intends to restructure the portfolio mix by focusing more on other profitable segments (such as fire) and consequently bring down the company’s dependence on the motor business.

Till FY15 NIL’s business growth mirrored the growth seen in the overall industry as it grew its premium at a CAGR of 17% during FY12-FY15. In FY16, premium growth spiked up to 73% mainly on account of high growth in motor segment, further aided by increase in franchise (6 branches added during the year) and increased focus towards institutional clients. Consequently, NIL’s market share improved to 6.0% in FY16 from 4.5% in FY15. The segments that grew the fastest during FY16 were Engineering (228%), Motor (101%) and Fire (42%). Premium retention ratio of NIL (~46% in past 2 years ending FY16) has slightly increased in recent years. Despite higher growth in motor segment, NIL was able to bring down the claims ratio in the segment from 89% in FY14 to 60% in FY16 causing the overall claims ratio also to fall (from 62% of NPE in FY14 to 36% in FY16).

On account of improved claims ratio, the underwriting surplus of NIL has grown at a CAGR of 89% in FY14-16. The overall profitability in FY16 was boosted by the underwriting surplus of NPR 167 million (combined ratio 59%) compared to NPR 8 million (Combined ratio 105%; on account of earthquake related claims leading to spike in claims ratio to 75%) in FY15. Net investment income of NIL for FY16 stood at NPR 45 million (~11% of NPW corresponding to a moderate yield of ~5.2%). For FY16¹, NIL reported Profit after Tax (PAT) of NPR 127 million over NPE of NPR 330 million corresponding to RoNW of ~20% and RoA of ~11%. The corresponding return indicators for FY15 were ~19% and ~11% respectively. However, the profitability of NIL remains constrained by high management expense ratio

¹ Based on unaudited financials provided by management

(~41% of NPE in last two years) compared to industry average (~32%) and lower yield on investment (~5% for FY16 compared to ~6% for industry).

Net investment income of NIL for FY16 stood at NPR 45 million (~11% of NPW corresponding to a moderate yield of ~5.2%). For FY15, NIL earned NPR 110 million in investment income (including NPR 78 million accumulated dividends from Nepal-Reinsurance Company, erstwhile Reinsurance Pool) which supported the overall profitability of NIL despite earthquake impacted underwriting performance. The quality of investment portfolio of NIL remains adequate, with 74% of portfolio as on mid-July-16 composed of investments in Government securities & fixed deposits with Commercial banks and Development Banks compared to 72% as of mid-Jul-15. However, the falling yield on investments from declining bank interest rates remains a concern. NIL has been maintaining the mandatory technical reserves² as prescribed by the regulator (Insurance Board of Nepal). As on mid-July-16 the said reserves accounted for ~59% of net worth of NIL. NIL's solvency margin on mid-July-16, calculated as per regulatory directive, stood at 3.22 times vis-a-vis a regulatory minimum of 1.0x times.

Company Profile

Established in December 1994, Neco Insurance Ltd (NIL) is the 9th Non-Life Insurance Company of Nepal. NIL ranks 7th among 17 players in Nepalese General Insurance Industry with ~6% market share in terms of industry's Gross Premium Written in 2015-16. Currently, NIL is operating through 23 branches across the nation for procuring business and extending after sales services.

NIL has 60:40 promoter-public shareholding ratios with Rastriya Banijya Bank (State owned largest Class A Commercial Bank of Nepal) as a major shareholder with 20% holding. NIL reported profit after tax of NPR 127 million during 2015-16 over assets base of NPR 1,311 million as of mid-Jul-16 compared to the profit after tax of NPR 92 million during 2014-15 over assets base of NPR 1,003 million as of mid-Jul-15. In terms of technology platform, NIL has implemented locally designed oracle based software in its corporate office. The computerized information has been centralized across all the branches.

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² Reserves for Unexpired risks & Reserves for unpaid claims outstanding