Neco Insurance Limited

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

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (OCTOBER 2017)
Rights Issue (Equity shares)	NPR 392.0925 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 392.0925 million of Neco Insurance Limited (NIL). 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. NIL has proposed 50% rights issue of 3,920,925 equity shares of a face value of NPR 100 each, to be issued to the existing shareholders at par. The proposed rights issue is being made to comply with the revised minimum paid up capital requirement for general insurers[2] as prescribed by the Insurance Board of Nepal.

The grading factors in NIL's long operating track record, adequate franchise network and improvement in market positioning in past 2 years. The grading also factors in strong ownership profile comprising of 20% stake from government owned commercial bank. The grading also factors in healthy underwriting performance of the company during past 2 years, backed by premium growth, moderation in claims and expense ratio. The grading also takes into consideration, NIL's adequate reinsurance arrangements, including catastrophic provisions, which helped the company maintain its claims paying ability and solvency position in the aftermath of the April 2015 earthquake.

However, the grading remains constrained by growing dependence on motor segment (~65% of Net premium earned (NPE) in FY2017). Incremental underwriting performance of NIL over medium term will depend on the performance of motor segment. The ability of NIL to maintain the underwriting performance, given the sharp increase in scale of operation during past 2 years remains to be seen. Return on net worth of NIL is expected to decrease over the medium term with proposed capital injection. However, return dilution is likely to be offset to some extent by high growth in premium earnings (64% CAGR growth in net premium earned during past 2 years ending FY2017) and increased investment income (yield on investment of ~7% during FY2017 vs ~5.5% in FY2016). The grading also remains limited by high management expenses, lack of expertise manpower in insurance industry and stiff competition from other players in the general insurance industry of Nepal.

Despite being one of the older players in the industry, NIL industry share remained low (in the range of ~4-5%) till FY2015. Post FY2015, the company has been following aggressive growth strategy after the entry of promoters from Mahato groupFY2015. During past 2 years ending FY2017, NIL has reported 61% CAGR growth in GPW [80% in Net premium written (NPW)]; backed by strong growth along motor segment whose GPW grew by CAGR 95% (108% in NPW). As a result, NIL's market share in industry GPW improved from 5% in FY2015 to 7% in FY2017. Future growth is likely to remain high supported by the geographical expansion plan of the management.

NIL has settled almost entire[3] earthquake related claims arising from April 2015 earthquake. NIL was exposed to a total earthquake related claims of ~NPR 512 million of which loss amounting to NPR 262 million was retained in NIL's account and rest were recovered from reinsurers. A high proportion of fixed property insurance[4] exposed the company to relatively higher earthquake loss. Nonetheless, due to adequate catastrophic coverage the company's claims paying ability and solvency position was not affected. However, the company reported underwriting loss in FY2015 mainly due to earthquake related claims.

NIL's portfolio mix is dominated by the motor segment (65% of Net premium earned (NPE) in FY2017), followed by fire (25%), miscellaneous[5] (4%) and engineering (4%) with negligible contribution from other

[1] Includes rights and further public issue of equity shares
[2] Minimum paid up capital of NPR 1 billion to be maintained by July 2018 by all general insurers.
[3] NPR 29 million remains to be settled, NIL's net retention shall be limited to NPR 14 million.
[4] fire segment accounted for ~40% of Net premium earnings in mid-July 2015
[5] Includes All Risk policies, personal accidents, group medical policies, bankers' blanket indemnity, among others.

segments. Portfolio mix has changed sharply in favour of motor segment during past 2 years with motor proportion rising from 55% of NPE in FY2015 to 65% of NPE in FY2017 (on much larger base) at the expense of fire segment whose proportion declined from 39% of NPE in FY2015 to 25% of NPE in FY2017. Source wise, business from agents accounted for 60% of GPW during FY2017, the proportion is declining since FY2015, after premium discount was introduced to direct customers and agency commission slashed by the insurance board. Similarly, during FY2017, ~63% of GPW was accounted for by institutional clients. ~50% of motor GPW during FY2017 came from commercial vehicles including syndicated transport business.

Despite the decline in business mix proportion, fire segment is a major contributor to NIL's underwriting surplus, which along with motor segment contribute more than 90% of underwriting surplus. Underwriting surplus of NIL has shot up during past 2 years because high premium growth, increase in the ceding of commission ratio, decline in expense and loss ratio. Backed by an improvement in underwriting performance, combined ratio of NIL stood at 61% in FY2017 (improving from more than 100% in FY2015), return on net worth of NIL in FY2017 stood at 17% vs. 20% in FY2016, despite sharp growth in capital fund.

Profitability of NIL remains supported by its investment income (average yield of ~7% during FY2017 on an investment portfolio of NPR 1,645 million in mid-July 2017). Investment portfolio of NIL is by and large in compliance with the guidelines prescribed by the regulator, with major concentration in Government securities and Banks fixed deposits. Recent uptick in bank deposit rates has had a positive impact on the investment yield of NIL (investment yield was ~5.5% in FY2016). Rising interest rate environment and proceeds collected from the proposed rights could boost NIL's investment income and prevent dilution of return for the shareholders to some extent. However, it will depend on the sustainability of the increased interest rates.

NIL has been maintaining the mandatory technical reserves and restricted reserves[6] as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-July-17 the said reserves accounted for 70% of NIL's net worth. NIL's solvency margin on mid-Jul-17, calculated as per regulatory directive, stood at ~6 times (~3.2 times in FY2016) vis-a-vis a regulatory minimum of 1.5 times.

Company Profile

Established in December 1994, Neco Insurance Ltd (NIL) is the 9th Non-Life Insurance Company of Nepal. NIL is 4th largest player (among 17 players) in Nepalese General Insurance Industry with ~7% market share in terms of industry's Gross Premium Written in 2016-17. Currently, NIL is in operation with 29 branches across the nation for procuring business and extending after sales services. Mr. Bishwa Ram Timila is the current chief executive officer of NIL.

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 holding of around 20%. NIL reported a profit after tax of NPR 208.5 million during 2016-17 over assets base of NPR 2,350 million as of mid-Jul-17 compared to the profit after tax of NPR 122 million during 2015-16 over assets base of NPR 1,329 million as of mid-Jul-16. In terms of technology platform, NIL has implemented locally designed oracle based software in its corporate office. The information has been centralized across all the branches.

October 2017

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. Deepak Raj Kafle, (Tel. No. +977-1-4419910/20)
drkafle@icranepal.com

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