

Neco Insurance Limited

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

	ISSUE SIZE	RATING ACTION
Rights Issue Grading	NPR 114.78 million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned “[ICRANP] IPO Grade 3”, indicating average fundamentals to the proposed rights issue amounting NPR 114.78 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 84.88% rights issue of 1,147,784 numbers of equity shares of face value NRs 100/- each to be issued to its existing shareholders at par.

The grading takes into account NIL’s long track record, competitive business growth (GPW¹ grew by CAGR² around 17% in last three years), strength of major promoter groups (Rastriya Banijya Bank, Machhapuchchhre Bank and others including Mahato Group), strong BoD & experienced management team, fair profitability profile backed by improvement in underwriting performance across major segments (except motor segment) and good claims paying ability. The grading also factors in NIL’s adequate solvency backup, largest market coverage in the most profitable fire insurance segment and improvement in the underwriting norms of motor insurance which expected to reduce loss on motor segment going forward. However, the grading is constrained by small market share of NIL, stiff competition from other large players in the general insurance industry, significant dependence on retail clients requiring higher operating costs, low retention of premium affecting underwriting performance and low general insurance industry penetration in Nepal offering limited scope for product innovation/diversification. Viewed overall, NIL’s performance in recent years has marginally declined despite modest business growth, mainly due to lower investment yields as a result of systemic excess liquidity in recent past. Going forward, management team expects improvement in performance indicators mainly due to greater focus towards better underwriting practices and diversification of investment portfolio to attain optimum yield. However, sustainability of the same on enhanced scale of operations, given the inherent limitations in insurance industry in Nepal, remains to be seen.

NIL’s growth in revenue from premium earnings exceeded the industry average despite lower growth in recent past; with 20% CAGR growth in Net premium earnings over past 3 years. The growth rate in recent year suffered from merger drive of the top management which ultimately could not be materialised. Despite impressive overall premium growth, the growth in net premium earnings (NPE) along profitable segments in past 3 years has remained moderate with Fire (17% CAGR), Miscellaneous (-15% CAGR) and Marine (4% CAGR). Over the same period, net premium earnings in motor portfolio saw growth by 27% CAGR. Higher growth in loss making motor segment brought about increase in claims ratio (from 55% of NPE³ in FY12 to 62% in FY14). As for future outlook, management looks forward to restructure the portfolio mix and strengthen underwriting norms; including increasing business along profitable segments like fire and miscellaneous thereby bringing down the dependence on non-profitable motor segment.

In terms of portfolio mix, motor segment dominates the business profile of NIL; in line with the overall industry trend. Motor segment accounted for 53% of NPE in past 4 years followed by Fire (38%), Miscellaneous (7%) & Engineering (2%). The proportion of motor portfolio remains subdued as compared to industry average while that of fire remains higher than industry average. In recent years,

¹ Gross Premium Written

² Compounded Annual Growth Rate

³ Net Premium Earning

motor segment has grown at the expense of Miscellaneous and other segments (49% of NPE in FY11 to 58% in FY14), thereby affecting the insurance profitability. Motor segment, the largest segment of NIL, has been generating underwriting losses over the years; mostly due to increase in claims ratio for the segment (from 72% of NPE in FY 12 to 89% in FY14). Profitability indicator⁴ for NIL's motor segment remains lower than the industry average in past 2 years. To this end, management has started following cautious growth approach in motor segment while increasing share of other segments for better profitability. There has been adoption of some stringent underwriting measures in recent period which is expected to be reflected in underwriting surplus by reducing claim ratio going forward.

For FY14, NIL reported Profit after Tax (PAT) of NPR 39 million over NPE of NPR 192 million corresponding to PAT/Net worth of 14% and PAT/ATA of 4.9%. The corresponding return indicators in FY13 were 15.5% and 6.0% respectively. The overall profitability in FY14 was boosted by the underwriting surplus of NPR 18.5 million (combined ratio 90%) compared to NPR 13 million (Combined ratio 92%) in FY13. However, the profitability of NIL remains constrained by high management expense ratio (37% of NPE in FY14) compared to industry average (~35%) and lower yield on investment (6.58% for FY14 compared to industry average of ~8%).

Net investment income of NIL for FY14 stood at NPR 36 million (18% of net premium written in FY14 and corresponding to a moderate yield of 6.58%), which however contributed largely to the overall profitability of NIL. The quality of investment portfolio of NIL remains fair, with 81% of portfolio as on mid-July-14 composed of investments in Government securities & fixed deposits with Commercial banks and Development Banks compared to 84% in FY13. The investment portfolio remains by and large compliant to the investment guidelines prescribed by the regulator. NIL has been maintaining the mandatory technical reserves⁵ as prescribed by the regulatory authority (Insurance Board of Nepal). As on mid-July-14 the said reserves accounted for 74% of net worth of NIL.

Company Profile

Neco Insurance Ltd (NIL), a public limited company established in December 1994, is the 9th private sector general insurer in Nepal. NIL is relatively small company with ~5% of market share in terms of General Insurance Industry's Gross Premium Written in 2013-14. Currently, NIL is in operation with 15 branches (as of July 2014) across the nation for procuring business and extending after sales services.

NIL has 60:40 promoter-public shareholding ratio as on mid-July-14. The major promoters of NIL includes Rastriya Banijya Bank (State owned largest Class A Commercial Bank of Nepal) with 20% holding and Machhapuchchhre Bank (Another Class A Commercial Bank of Nepal where reputed Mahato group has prominent shareholding) with 8.39% holding. NIL reported a profit after tax of NPR 39 million during 2013-14 over an asset base of NPR 783 million as of mid-Jul-14 compared to the profit after tax of NPR 37 million during 2012-13 over an asset base of NPR 621 million as of mid-Jul-13. 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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⁴ Underwriting surplus/Net premium earnings

⁵ Reserves for Unexpired risks & Reserves for unpaid claims outstanding



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