

## Grading Rationale

### Everest Insurance Company Limited

#### Grading

Facility	Amount (Rs. In Million)	Grading	Grading Action
Rights Share Issue	962.28	CARE-NP IPO Grade 4 [IPO Grade Four]	Assigned

*The explanatory notes regarding the Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure 1*

CRNL has assigned grading of ‘CARE-NP IPO Grade 4’ to the proposed Rights Share Issue of Everest Insurance Company Limited (EIC). ‘CARE-NP IPO Grade 4’ indicates Below Average Fundamentals. CRNL assigns IPO grades on a scale of Grade 1 to Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. CRNL’s IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the ‘fundamentals’ of the issuer.

The proposed Rights share issue will be in two Phases; Phase I proposes 105% right shares issue of 1.403325 Million number of equity shares aggregating Rs.140.3325 million and Phase II proposes 300% right shares issue of 8.219475 Million number of equity shares aggregating Rs.821.9475 million.

#### Detailed Rationale & Key Grading Drivers

The grading assigned to the rights share issue of EIC is constrained by volatile net underwriting profit & net profit over the period impacting combined ratio, low retention ratio, investment is not made as directed by Insurance Board (IB) in the past, concentration on motor segment and competition from other insurance companies & relatively small market share in the non-life insurance industry. The grading, however, derives strength from long track record and strong shareholder group, experienced board and management team, improved overall performance during 9MFY18 (UA)(refers to period ending mid-April 2018), improvement in the investment income over the last 2 years albeit lower base and moderate solvency ratio.

Ability to the company to scale up the operations while maintaining the solvency position and limit the loss ratio would be the key grading sensitivities.

#### Detailed Description of the Key Grading Drivers

**Key Grading Weaknesses****Volatile net underwriting profit & net profit over the period impacting the combined ratio**

Net Underwriting Profit of EIC was volatile during the last 3 years with underwriting loss of Rs.97 Million during FY15 on back of high level of claims incurred due to earthquake. The same turned to profit of Rs. 39 Million during FY16 and loss of Rs. 27 Million during FY17. During FY17, the company's gross premium written (GPW) increased by 45% (from Rs.181 Million in FY16 to Rs. 264 Million in FY17). The operations of the company have grown at a substantial pace (albeit lower base) over the period, more than industry growth in GPW of 27% during FY17. Other income increased to Rs. 62 Million during FY17 as compared to Rs. 2 Million during FY16 which mainly include write-off of reinsurer liabilities which resulted in net profit of Rs. 47 Million during FY17. The net profit of the company declined in comparison to the net profit of Rs. 63 Million during FY16 on back of low retention ratio, high net claim incurred as compared to FY16 and high increase in the provision for income tax. The net premium earned (NPE) shows marginal decrease of 3.42% to Rs. 48 Million (FY16 Rs. 49 Million) on back of low retention ratio of ~17% during FY17 as compared to ~29% during FY16.

The loss ratio (claim ratio) of EIC has substantially increased to 100.03 % in FY17 from (67.47%) in FY16 due to high net claim incurred during FY17 as compared to FY16; further there has been increase in the commission ratio to 79.05% during FY17 as compared to 30.46% of FY16 resulting from increased Reinsurance Commission Income and decreased Reinsurance Commission Expenses and Expense Ratio has been increased to 136.18% during FY17 from 119.17% during FY16. On the back of these combined ratio has been deteriorated to 157.16% in FY17 as compared to low combined ratio of 21.24% during FY16. The reinsurance commission income increased to Rs. 47.12 Million during FY17 from Rs. 22.04 Million during FY16 due to high premium ceded to reinsurer.

The net premium written (NPW) of EIC has been decreased by 18.04% in FY17 (from Rs. 53 Million in FY16 to Rs. 44 Million in FY17) despite of 45.43% increase on GPW during FY17 over FY16 as a result of decline in retention ratio of the premium to ~17% during FY17 from ~29% during FY16; which is very low compared to the industry average of 48% during FY17.

**Low premium retention ratio**

EIC is passing most of the risk insured to the reinsurer impacting the underwriting surplus of the company. During FY17, out of total GPW of Rs. 264 million, EIC retained premium of Rs. 44 Million only with retention ratio of only ~17%. Similarly, during 9MFY18, out of total GPW of Rs. 427 million, EIC has retained premium of Rs. 78 Million only with retention ratio of ~18%. Despite GPW increases by more than 126% during 9MFY18 over 9MFY17, NPW was decreased by 6.44% over the same period due to low retention. After the infusion of equity on the basis of the proposed Right share issue the retention ratio of EIC is expected to improve going forward leading to increase in the risk bearing capacity and the same is expected to improve the underwriting surplus.

### **Investment is not made as directed by Insurance Board in the past**

As per Insurance Board, for non-life insurance companies, minimum of 65% of their investment funds should be invested in combination of government securities, fixed deposits & short term investment of commercial banks and fixed deposits of development banks, and mutual fund/ Citizen Investment Trust Schemes. EIC had an investment portfolio of Rs. 473 Million in FY17 and the same was further increased by ~26% in 9MFY18 over FY17 to Rs. 597 Million. EIC has invested Rs. 290 Million as on July 15, 2017 in the prescribed investments; that accounts for only ~61% of total investments. However, the same has been reached to 67% of total investment with Rs.401 Million during 9MFY18.

### **Concentration in motor segment**

Motor segment comprise 57.24% (10,622 policies) of total policies of 18,558 followed by miscellaneous segment 12.71% (2,359 policies) & fire segment 12.44% (2,308 policies) of total policies as on July 15, 2017. Further 36.65% of total GPW accounts for motor insurance segment during FY17 which has marginally increased to 36.81% of total GPW during 9MFY18. Also due to high premium retention in the motor segment, the motor segment contributes ~71% of Net Premium Earned (NPE) followed by miscellaneous ~23%, marine ~ 14% and other segments contributes only ~13% of NPE earned by EIC during FY17.

### **Competition from other insurance companies and relatively small market share in the non-life insurance industry**

Currently there are 17 non-life insurance companies operating in Nepal sharing total Rs. 15,952 Million of Gross Premium Written (GPW) as on April 13, 2018; where EIC shares only 2.68% of total GPW and ranks 16th Position reflecting very low market share in the industry. Further, due

to high number of non-life insurance companies, EIC is facing competition to tap the new customer. The industry has witnessed price wars across business segments resulting in high loss ratios and underwriting losses for the smaller companies in the industry. Along with this Insurance board has also decreased the insurance premium for private motor which hamper the premium income of the company as the major portion of income is from Motor Segment.

### **Key Grading Strength**

#### **Long track record and strong shareholder group**

EIC has been providing its service in non-life insurance sector from more than 24 years. As on July 15, 2017, all the shares are held by general public. The shares are mostly owned by Laxmi Bank Limited with 14.79% of total paid up capital followed by individual investors. Laxmi Bank Limited is a “A” class commercial bank licensed by Nepal Rastra Bank.

#### **Experienced board and management team**

EIC has five experienced members on its board lead by Mr. Rajiv Sapkota, who is chairperson of the company. Mr. Sapkota has more than seventeen years of work experience in Banking sector and presently working as Chief–Institutional Banking and Business Development in Laxmi Bank Limited and also as CEO of Laxmi Capital Market Limited. The day to day operations of the company are headed by Mr. Kamal Gautam, CEO who have overall work experience of twenty-six years in banking sector and was appointed as CEO of EIC w.e.f. June 30, 2017. Mr. Gautam holds Master in Business Studies (MBS) degree and was also CEO of Infrastructure Development Bank Limited and Deputy General Manager at NCC Bank Limited. He is assisted by an experienced team across various functions.

#### **Improved overall performance during 9MFY18 (UA)**

During 9MFY18, the GPW of EIC achieved growth of 126.43% (albeit lower base) to Rs. 427 Million from Rs. 189 Million during 9MFY17 driven by motor, fire and engineering segment. The reopening of closed branches and addition of new branches during the last 9 months also lead to increase in business level and the same is likely to support the future growth. In 9MFY18, EIC’s NPW has decreased by 6.44% to Rs. 78 Million in comparison to Rs. 84 Million during 9MFY17 on back of low retention ratio leading to decline in NPE by ~12% over 9MFY17. Net Underwriting Profit achieved growth of 12% during 9MFY18 to Rs.7 Million over 9MFY17. Net claim incurred is increased by 48% from Rs.30 Million during 9MFY17 to Rs.45 Million during 9MFY18 due to high claim outstanding at the end of 9MFY18. Net investment income increases

from Rs.24 Million on 9MFY18 to Rs.37 Million on 9MFY18 lead by 38% increases in investment portfolio over the same period. On back of these EIC reported significant increase in PAT by 44% to Rs. 30 Million during 9MFY18 (PAT of Rs. 21 Million during 9MFY17).

### **Improvement in the investment income over the last 2 years albeit lower base**

The investment income of the company is on increasing trend over the last two years. Investment income increased by 184% during FY15 to Rs. 116 Million over FY14; and investment income has decreased substantially by 77% to Rs. 27 Million during FY16; majorly impacted by Rs. 74 Million dividends from Nepal Reinsurance Co. Ltd. and Rs. 13 million profit from the sale of investments during FY15. Investment income of EIC increased by 24% to Rs. 33 Million during FY17 over FY16 mainly due to increase on interest income from fixed deposits. Further, the investment portfolio is expected to grow post proposed rights issue and high interest rate prevailing in the banking sector likely to improve the investment yield and income for EIC. Average yield on Investment of EIC was 7.46% in FY17 (for FY16 average yield on investment was 6.89%) which was relatively lower than industry yield of 8.31%. Investment income has increased by 51.48% to Rs. 37 Million during 9MFY18 as against Rs. 24 Million during 9MFY17.

### **Moderate solvency ratio**

EIC maintained moderate solvency ratio of 1.72 times as on July 15, 2017. However, the solvency ratio was low at 1.32 times as on July 15, 2016 against the minimum regulatory requirement of 1.50 times because of also due to small assets size during FY16 of Rs. 672 Million compared to Rs.858 Million of FY17 on back of low capital base.

### **About the Company**

Everest Insurance Company Limited (EIC) is a general (non-life) insurance company incorporated as a public limited company as on Dec 3, 1991 and commence business from May 31, 1994. Presently, EIC has its total shareholding as General Public without any promoter shares. EIC is going to issue right share in the proportion of 1:1.05 as promotor shares to make promotor and public shareholding ratio of 51:49 through Phase I. After that EIC will issue right share in the proportion of 1:3 to meet regulatory requirement for paid up capital of Rs.1 Billion through Phase II. The company has been offering a range of general insurance covers for businesses & individuals and has a comprehensive range of general insurance products for Fire, Marine, Motor, Engineering, Miscellaneous, Agriculture and Aviation etc.

Insurance Board (IB) of Nepal has halted fire insurance business of EIC from August 2012 and took over BoD and management under its control from September 9, 2013, due to financial irregularities happened in EIC. These events resulted in closure of many branch offices, large scale turnover of staffs and loss of market share. IB has handed over the BoD and management to the newly elected BoD and also lifted the ban on fire insurance from February 17, 2014.

EIC has network of 23 branches (including head office) and 86 insurance agents as on Mid-April 2018. During 9MFY18, EIC has reopened three branches and opened 11 new branches. EIC have assets base of Rs.865 Million as on July 15, 2017 which has increased to Rs.1,039 Million as on April 13, 2018.

EIC has achieved PAT of Rs.47 million on GPW of Rs.264 million as on July 15, 2017 as against PAT of Rs.63 million on GPW of Rs.181 million as on July 15, 2016. Further, EIC achieved PAT of Rs.30 million during 9MFY18 (UA) against PAT of Rs.21 million during 9MFY18.

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**Annexure 1****CARE Ratings Nepal – IPO Grading Scale**

<b>CARE IPO grade</b>	<b>Definition</b>
CARE-NP IPO Grade 1	Strong fundamentals
CARE-NP IPO Grade 2	Above average fundamentals
CARE-NP IPO Grade 3	Average fundamentals
CARE-NP IPO Grade 4	Below average fundamentals
CARE-NP IPO Grade 5	Poor fundamentals

Note:

Modifiers {"+" (plus)} can be used with the grading symbols 2, 3 and 4. The modifiers reflect the comparative standing within the category.