

Grading Rationale

Surya Life Insurance Company Limited

Grading

Particulars	Amount (Rs. In Million)	Grading	Grading Action
Rights Share Issue	887.41	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 Surya Life Insurance Company Limited (SLICL). ‘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. SLICL proposes 70% rights share issue of 8.8741 Million equity shares of face value of Rs. 100 each at par aggregating Rs. 887.41 Million.

Detailed Rationale & Key Grading Drivers

The grading assigned to SLICL is constrained by its relatively small market share in the life insurance industry, inadequate solvency margin due to increase in new minimum capital requirements, concentration of premium mix primarily focused on endowment policies, high claims paid through Foreign Employment policies and surrender of policies. The grading is also constrained by competition from other insurance companies. The grading, however, derives strength from highly experienced board and management team, diversified and adequate geographical coverage through branches and agents, significant growth in Premium Income and Net Underwriting Profit over the period ended FY18 (refers to 12 months’ period ended mid-July 2018) and 9MFY19 (refers to 9 months’ period ended mid-April 2019) and good asset quality of investment book. The grading further takes into account healthy premium growth, comfortable Combined Ratio, increasing investment income, consistent growth of policyholder/ life insurance fund, return on shareholder funds and moderate lapse ratio.

Detailed Description of the Key Grading Drivers

Key Grading Weaknesses

Relatively small market shares in the life insurance industry and high competition from other insurance companies

Currently, there are 19 life insurance companies operating in Nepal. Gross Premium Written (GPW) of the industry was over Rs. 51,000 Million during FY18 where SLICL’s share was only ~3% of total GPW (ranking

8th Position). Also, total Policyholder's Fund in the industry was Rs. 174,960 Million as on July 16, 2018 where SLICL share was ~2% (ranking 9th position) reflecting low market share. Intense competition from other life insurance companies can make it challenging for the company to grow and maintain its profitability. With increase in number of life insurance companies, SLICL is exposed to high competition to tap the new customers.

Inadequate solvency margin due to increase in the new minimum capital requirements

SLICL has inadequate solvency ratio of 0.68 times as on July 16, 2018. The solvency ratio was at 1.81x and 2.17x during FY16 and FY17 respectively. The solvency ratio has declined substantially mainly due to regulatory requirement of maintaining minimum licensing capital of Rs. 2,000 Million as provisioned by 'Insurer Registration and Operation of Insurance Business Directive, 2073' issued by Insurance Board Nepal. The solvency margin calculated on the basis of paid up capital as on July 16, 2018 (i.e. Rs. 1,095 Million) stood at 1.24 times, which is still lower than stipulated minimum of 1.5 times. SLICL plans to improve its solvency margin ratio by increasing capital by issue of bonus shares and right shares.

Concentration of premium mix primarily focused on endowment policies

The premium mix of SLICL is primarily focused towards endowment segments and its variants. Premium income from endowment policies and its variants grew by CAGR of ~42% over four years ending FY18. During FY18, ~81% of premium earnings was from various endowment policies and the rest was contributed by Foreign Employment (FE) policies. FE segment of SLICL has led to high growth in premium earnings since FE premium grew by CAGR of ~49% over four years ending FY18. However, there was a decline in premium income from FE policies in FY18 by ~7% as compared to FY17 on account of decrease in number of FE policies by ~3% in FY18 over FY17 primarily due to unfavorable business environment and competitive pressures created by introduction of new life insurance companies in the industry.

High claim paid through Foreign Employment policies and surrender of policies

Death claim paid constituted ~70% of total claim paid during FY18 as compared to ~81% during FY17. There has been significant rise in death claim from FE policies over recent period. Share of death claim paid from FE policies was highest in comparison to other policies since FY15 which accounted for more than 80% of total death claim paid (~87% in FY17 and ~82% in FY18) and more than 50% of total claim paid (~70% in FY17 and ~58% in FY18).

During FY18, 690 policies were surrendered as compared to 440 policies during FY17 by SLICL's insured (an increment of ~57%). SLICL paid Rs. 50 Million during FY18 as compared to Rs. 17 Million during FY17 as part of claim settlement for the surrendered policies constituting ~22% in FY18 and ~11% in FY17 of the total claim paid.

Key Grading Strengths***Highly experienced board and management team***

SLICL has seven experienced members on its board. Mr. Keshab Prasad Bhattarai, chairman, has work experience under various positions in offices of Nepal Government and was Secretary of Nepal Government. The day to day operations of the company are headed by Mr. Shiva Nath Pandey, CEO, who has work experience as ex- executive director at Nepal Rastra Bank. He is assisted by an experienced team across various functions and departments.

Diversified and adequate geographical coverage through branches and agents

SLICL is present all over the country through its 85 branches (including Corporate Office) as on mid- April, 2019. The distribution channel of SLICL relies heavily on its agents, especially individual agents. Total number of agents of SLICL (both individual and corporate agents) are 13,304 as on mid- July 2018. SLICL has entered into bancassurance agreement with 31 banks and financial institutions of Nepal enabling the company to sell its products through their network.

Significant growth in Premium Income and Net Underwriting Profit over the period

The operations of the company have grown at a decent pace over the period. SLICL's GPW increased by ~31% from Rs. 1,338 Million in FY17 to Rs. 1,749 Million in FY18. Growth in GPW was less than the industry growth rate of ~38% in FY18 on account of new life insurance companies starting operations in FY18. GPW further increased by ~40% to Rs. 1,546 Million in 9MFY19 as compared to 9MFY18. Further, SLICL reported PAT of Rs. 187 Million during FY18 as compared to Rs. 136 Million during FY17 which further increased by ~40% to Rs. 137 Million in 9MFY19 as compared to 9MFY18.

Net Underwriting Profit increased by ~38% in FY18 compared to FY17 which was backed by growth in Net Premium Written (NPW). NPW of SLICL increased by ~33% in FY18 mainly due to ~31% increase in GPW and decline in Reinsurance premium ceded in FY18 over FY17. During 9MFY19, NPW of SLICL increased by ~44% and Net Underwriting Profit increased by ~39% as compared to 9MFY18.

Good assets quality of investment book and increasing investment income

Investment portfolio of SLICL increased by ~44% to Rs. 4,662 Million in FY18 from Rs. 3,244 Million in FY17. It further increased by ~44% to Rs. 5,856 Million in 9MFY19 compared to Rs. 4,077 Million in 9MFY18. Out of the total investment portfolio, SLICL has total investment of ~89% in fixed and interest-bearing deposits as on July 16, 2018, which are readily marketable in nature and provide sufficient liquidity cushion to the company. Investment income of SLICL is on increasing trend over the period which increased by ~56% to Rs. 392 Million during FY18 from Rs. 252 Million during FY17 mainly due to increase in investment portfolio during FY18. Average Yield on Investment increased to 9.91% in FY18 as compared to 9.05% in FY17.

Healthy Premium Growth

Around 50% of business income of SLICL was generated by renewal premium during FY18. First year premium and single premium accounted for remaining portion of the business income i.e. ~31% and ~19% respectively during FY18. First year premium increased by ~65% to Rs. 540 Million in FY18. Likewise, renewal premium increased by ~32% in FY18 to Rs. 872 Million as compared to Rs. 662 Million in FY17. However, single premium declined by ~3% in FY18 mainly due to decrease in premium from FE policy amid competitive pressures.

Comfortable Combined Ratio

Loss Ratio of SLICL increased to 11.39% in FY18 from 9.56% in FY17 on account of high Net Claim Incurred during FY18 as compared to FY17. There has been marginal decrease in the Commission Ratio from 12.46% in FY17 to 12.40% in FY18. Expense Ratio also showed marginal decrease to 19.49% in FY18 from 19.92% in FY17 on account of higher proportionate increase of Net Premium Earned compared to Operating Expenses. On back of these, Combined Ratio has increased to 43.29% in FY18 as compared to 41.95% during FY17.

Consistent growth of policyholder/ life insurance fund

Policyholder fund of SLICL experienced consistent growth over the period albeit on a low base. It increased by ~46% to Rs. 3,525 Million during FY18 from Rs. 2,417 Million during FY17 standing at 9th position in terms of fund volume. Further, SLICL's Policyholder Fund increased by ~44% during 9MFY19 as compared to 9MFY18.

Return on shareholders' fund

Return on net worth (RONW) of SLICL decreased to 16.76% in FY18 which was 17.05% in FY17 and 20.80% in FY16 mainly due to higher proportionate increase in Net Worth as a result of infusion of share capital in comparison to Net Profit. Similarly, return on total assets (ROTA) of SLICL decreased to 4.56% in FY18 which was 4.79% in FY17. Even though RONW and ROTA is in a decreasing trend, the ratios are still leading in the industry.

Moderate lapse ratio

Lapse ratio of SLICL was moderate over the years. It was 6.56% during FY18 which was slightly higher as compared to previous years where the ratio was 4.77% in FY17 and 4.68% in FY16. The ratio increased mainly due to increase in competition from additional life insurance players.

About the Company

SLICL is a mid-sized life insurance company which started its operation from April 23, 2008 after obtaining license from Insurance Board as on March 19, 2008. The company has been offering range of products in Foreign Employment Life Insurance, Endowment Plans and Term Insurance through its diversified sales network. Paid up capital of SLICL is Rs. 1,095 Million as on July 16, 2018. As on July 16, 2018, 70% of shares

are held by promoter group and remaining 30% shares are held by general public. In promoters' shareholders, 41% of total shares are held by corporates and rest by individuals. The promoters' group shares are mostly owned by Unitech Investment Pvt. Ltd. (10.28%), Prudential Capital Management Company Pvt. Ltd. (7.96%) and Usha Investment Pvt. Ltd. (6.68%).

SLICL's total asset base has increased to Rs. 5,462 Million during FY18 as compared to Rs. 3,783 Million during FY17. SLICL ranks 10th position with GPW of Rs. 1,546 Million and Life Insurance Fund of Rs. 4,648 Million during 9MFY19.

Declaration: Dr. Binod Atreya who is director in Surya Life Insurance Company Limited is also a non-executive non-independent Director on CARE Ratings Nepal limited. He is not part of the rating committee and did not have any role in assignment of Rights Issue grading to SLICL.

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Disclaimer

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ANNEXURE 1

CARE Ratings Nepal – IPO Grading Scale

CARE IPO grade	Definition
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.