

Rating Rationale

Prabhu Insurance Limited

Rating/Grading

Facility/Instrument	Amount (Rs. In Million)	Rating/Grading	Rating Action
Rights Share Issue	316.6679	CARE-NP IPO Grade 3 [IPO Grade Three]	Assigned

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

CRNL has assigned grading of ‘CARE-NP IPO Grade 3’ to the proposed Rights Share Issue of Prabhu Insurance Limited (PIL). ‘CARE-NP IPO Grade 3’ indicates 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. PIL proposes 46% rights share issue of 3.166679 million equity shares of face value of Rs.100 each at par aggregating Rs.316.6679 million.

Detailed Rationale & Key Rating/Grading Drivers

The grading assigned to the right share issue of Prabhu Insurance Limited (PIL) derives strength from long track record and reputed brand name of Prabhu Group, experience of the directors and management team, growing operations and profitability over the period, good asset quality of investment book, strong combined ratio and healthy solvency ratio. The grading, however, remains constrained by relatively small market share of the company in non-life insurance industry, declining trend of investment income, concentration on motor segment and competition from other insurance companies.

Ability of the company to scale up the operations while maintaining the solvency ratio, investment quality and continued parentage and support would be the key rating sensitivities.

Detailed Description of the Key Rating/Grading Drivers

Key Rating Strengths

Long track record, experienced board & management team

PIL has been providing services in the non-life sector for more than two decades. Previously known as Alliance Insurance its name has been changed to Prabhu Insurance on April 9, 2015 with the acquisition of substantial promoter shares by Prabhu Group of Companies. PIL has seven experienced members on its board led by Ms. Kusum Lama who is the Chairperson of the company. Ms. Kusum Lama had also served as director in Prabhu Bank Limited and is director in Prabhu Money Transfer Private Limited, Prabhu Management Private Limited, Prabhu Investment Private Limited, and Prabhu Capital Limited. The day to day operations of the company are headed by Mr. Sanchit Bajracharya, CEO. Mr. Bajracharya holds a MBA degree.

He is involved with PIL since 2009, where he was appointed as finance and administrative head. He is assisted by an experienced team across various functions.

Growing operations & net profit over the period and strong Combined Ratio

During FY17 (refers to the 12-month period ending mid July 2017), the company's gross premium written (GPW) increased by 10% y-o-y to Rs.837 Million. The operations of the company are growing at a decent pace over the period, however, the growth in GPW is less than the industry growth of 27% during FY17. PIL reported net profit of Rs.165 Million in FY17 which increased by 10% over FY16 on the back of increase in total income by 15%. The net premium earned (NPE) increased by marginally 3% to Rs.413 Million (FY16 Rs. 400 Million). The loss ratio (claim ratio) of PIL decreased to 41% in FY17 from 44% in FY16 and there has been substantial increase in the commission ratio resulting in improvement in the combined ratio to 51% in FY17 from 60% in FY16. The reinsurance commission income increased to Rs.21.65 Million during FY17 from Rs.12.20 Million during FY16.

The net premium written (NPW) of PIL decreased by 10% in FY17 (from Rs.436 Million in FY16 to Rs.392 Million in FY17) on the back of increase in the reinsurance business. As a result, the retention ratio of the premium of PIL declined to 47% during FY17 from 57% during FY16. However, the same is in line with industry average of 48% during FY17.

Good solvency ratio

Solvency margin forms the basic foundation for meeting policyholder obligations. All insurance companies are required to comply with the solvency margin requirements of the regulator. Solvency Margin Directives, 2071, prescribes a way to calculate the solvency ratio and states the minimum solvency ratio to be maintained by the general insurance companies in Nepal which is 1.5 times. Solvency ratio of PIL for FY17 calculated as per directives is around ~5 times (FY16 ~3 times) the required margin, which reflects its long term operation and survival of business in the industry.

Good assets quality of investment book

The company had an investment portfolio of around Rs.499 Million in FY16 which increased by 83% to total portfolio of Rs.914 Million in FY17 which further increased by 48% in Q1FY18 to Rs.1352 Million. PIL has complied with guidelines prescribed by the regulator and out of the total investment portfolio, PIL has total investment of 77% in citizen investment trust, mutual funds and fixed deposit of commercial and development bank (including interest bearing deposit from commercial and development bank), which are readily marketable in nature lends sufficient liquidity cushion to the company.

Key Rating Weakness

Decreasing trend of Investment Income

Investment income of PIL shows a declining trend over the period. The investment income decreased from Rs.44 Million during FY16 to Rs.35 Million during FY17. Although in FY17, the investments have increased but the income from investments decreased by 20.51% contributing only 12.77% of total income. Average yield on Investment of PIL was 5.01% in FY17 (for FY16 average yield on investment was 8.56%) which is relatively lower than industry yield which is 8.31%. During FY17, the dividend income from the investment in the shares decreased by 88% from Rs. 12.37 Million in FY16 to Rs. 1.52 Million during FY17. However, the income from the investments other than dividend showed a growth of 5.41% during FY17 over FY16 in absolute terms.

Concentration in motor segment

PIL's portfolio mix is dominated by motor segment which contributes ~75% of Net Premium Earned (NPE) followed by fire 11% and other 14%. In comparison to other segment motor segment is least profitable segment and is highly vulnerable. PIL is taking steps to diversify its segment to more profitable segments, which shown the decline in concentration over motor segment from 79% of NPE during FY16 to 75% in FY17. Further, PIL's profit is mainly driven by motor segment contributing ~64% of total income and rest by the other segments.

Competition and relatively small market share in the non-life insurance industry

Currently there are 17 non-life insurance companies operating in Nepal with total GPW of Rs.18978 Million. PIL's share in this is only 4% and ranks 11th reflecting small market share in the industry. Further, due to increase in number of non-life insurance companies PIL is facing competition to tap new customers. Along with this, Insurance Board has also decreased the insurance premium for private motor vehicles which has hampered the premium income of the company as the major portion of income is from Motor Segment.

About the Company

Prabhu Insurance Limited (PIL) is a non-life insurance company incorporated in July 1995 as Alliance Insurance Company Ltd. (AICL) in Nepal. The Company obtained regulatory approval to undertake General (non-life) Insurance business on July 16, 1996 from the Insurance Board ('IB') of Nepal. The name of the company changed to Prabhu Insurance Limited w.e.f. April 09, 2015, following the acquisition of majority stake in AICL by Prabhu Group of Companies. Along with Prabhu Group, Karmachari Sanchaya Kosh (Employees Provident Fund; an enterprise of Government of Nepal) is also one of the major shareholders of the company with 15% shareholding. In PIL Promoter group holds 51% of the share capital and remaining 49% is held by general public. The company has been offering a range of general insurance covers for businesses and individuals and has a comprehensive range of general insurance products for Fire, Marine, Motor, Aviation, Accidental, Medical, Micro, Agriculture and cattle etc.

PIL has network of 19 branches as on July 15, 2017 and is in process of expanding the branches reaching total 26 including head office by end of FY18. Total number of agents has also increased to 90 in Q1FY18 from 65 earlier. PIL had reported PAT of Rs. 165 Million with GPW of Rs. 837 Million during FY17 and PAT of Rs. 24 Million with GPW of Rs.253 Million during Q1FY18.

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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.