

Grading Rationale

United Insurance Company (Nepal) Limited

Grading

Facility	Amount (Rs. In Million)	Grading	Grading Action
Rights Share Issue	725.76	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 [IPO Grade Four]’ to the proposed Rights Share Issue of United Insurance Company (Nepal) Limited (UIC). ‘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. UIC proposes 240% rights share issue of 7.2576 million equity shares of face value of Rs.100 each at par aggregating Rs.725.76 million.

Detailed Rationale & Key Grading Drivers

The grading assigned to the rights share issue of UIC is constrained by action taken by Insurance Board of Nepal to halt the fire business of the company, volatile net underwriting profit & net profit over the period impacting Combined Ratio, substantial decline in Gross Premium Written (GPW), however, improvement in profit during 9MFY18 (refers as 9 months ended April 13, 2018) over 9MFY17, negative reserve and surplus at the end of the last two financial years ended July 15, 2017 (refers as FY17) as well as on April 13, 2018, although recovered substantially over the period, volatile investment income, concentration on motor segment and competition from other insurance companies & relatively small market share in the non-life insurance industry in Nepal. The grading, however, derives strength from long track record and strong promoter group, experienced Board and Management team, good assets quality of investment book and moderate solvency ratio.

Continued parentage and support, solvency position and ability of the company to grow and maintain the profitability after the latest decision by IB to halt the fire insurance business would be the key grading sensitivities.

Detailed Description of the Key Grading Drivers

Key Grading Weaknesses

Action taken by Insurance Board of Nepal to halt fire business of the company

Insurance Board has issued notice to UIC dated March 12, 2018 to halt Fire Insurance Business provided by UIC on back of excess claim paid to EOL Pvt. Ltd., CG Impex Pvt. Ltd. and CG Electronics P Ltd. The ban will discontinue if UIC will be able to convince Insurance Board that level of Corporate Governance is satisfactorily implemented within the company. Further as per the same notice UIC has to recover excess claim paid for an amount of Rs. 231 Million to above mentioned companies. The action taken by IB is expected to impact the reputation as well as future business of the insurance company in the industry.

Volatile net underwriting profit & net profit over the period impacting Combined Ratio

Net Underwriting Profit of UIC was volatile during the last 3 years from the loss of Rs. 66 Million during FY15 on back of high level of claims incurred due to earthquake, to loss of Rs. 295 Million during FY16 and the same was improved substantially to a profit of Rs. 224 Million during FY17.

The volatility in the net underwriting profit during FY16 and FY17 was mainly due to claim and settlement related with Engineering Insurance of C.G. Properties Pvt. Ltd. (CGP). UIC insured CGP's Cityscape Apartments (under construction) and due to the earthquake which occurred in April 2015, the apartments faced severe damages and the total claim for the insurance was Rs. 540 Million (direct claim liability of Rs.94 million on UIC). Out of the total liability of Rs.446 million of reinsurer, UIC received an amount of Rs. 244.72 million from reinsurer till December 6, 2017 for the above claim. UIC accounted only the amount received from reinsurer till August 11, 2017 and added remaining amount as Claim Outstanding while preparing Financial Statements for the FY16 leading to high loss on back of high claims outstanding and the same eventually became the income during FY17 due to substantial decline in claims outstanding on back of adjustment for the amount received from the reinsurer.

During FY17, the company's gross premium written (GPW) increased by 9.95% (from Rs. 563 Million in FY16 to Rs. 619 Million in FY17), however, the growth in GPW was lower than the industry growth of 27%. UIC reported net profit of Rs. 257 Million during FY17 which increased substantially over net loss of Rs. 259 Million during FY16 on back of increase in Net Premium Written (NPW) by ~32% over FY16 and the case related with claim & settlement of

CGP on Engineering Insurance as mentioned above. The net premium earned (NPE) showed substantial increase of 20.49% to Rs. 338 Million on back of increase in NPW. The increase in the NPW of UIC in FY17 to Rs. 376 Million was due to growth in GPW and increase in the retention ratio of the premium to ~61% during FY17 from ~51% during FY16; which was higher than the industry average of 48% during FY17.

The loss ratio (claim ratio) of UIC has substantially decreased to -0.46 % in FY17 from 188.35% in FY16 due to high net claim during FY16 (Rs. 528 Million) as compared to FY17 (Rs. -2 Million). Further, there has been decline in the commission ratio to 9.91% during FY17 as compared to 18.71% of FY16 resulting from decreased Reinsurance Commission Income (down by 23%) and increased Agency Commission Expenses (up by 39%) and Expense Ratio has been increased to 44.22% during FY17 from 35.59% during FY16. On the back of these combined ratio has been improved to 33.85% in FY17 as compared to high combined ratio of 205.22% during FY16. The reinsurance commission income decreased to Rs. 49.37 Million during FY17 from Rs. 64.02 Million during FY16 due to reduction in the reinsurance commission rates by the reinsurers and high premium retention during the year.

Substantial decline in Gross Premium Written (GPW), however, improvement in profit during 9MFY18 over 9MFY17

During 9MFY18, the GPW of UIC declined by 20% to Rs. 385 Million from Rs. 483 Million during 9MFY17. However, UIC registered growth in NPE and Net Underwriting Profit during 9MFY18. NPE grew by 9% to Rs. 234 Million due to 80% decrease in Unexpired Risk Reserve and Net Underwriting Profit increased by 130% to Rs. 88 Million. On back of these, UIC reported significant increase in PAT by 104% to Rs. 92 Million during 9MFY18.

Negative reserves and surplus at the end of the last 2 financial years as well as on April 13, 2018, although recovered substantially over the period

UIC had negative accumulated reserve and surplus of Rs. 163 Million at the end of FY16 mainly due to claim and settlement related with Engineering Insurance of CGP. The reserves and surplus position has improved substantially to negative Rs.50 Million at the end of FY17 and further improved to negative Rs.3 Million at the end of 9MFY18 as significant amount related with Engineering Insurance of CGP has been recovered from reinsurer during the said period.

Volatile Investment Income

The investment income of the company was volatile over the period. Investment income increased by 148% y-o-y during FY15 to Rs. 109 Million. The same declined substantially by 70% to Rs. 32 Million during FY16 majorly impacted by Rs. 74 Million dividend from Nepal Reinsurance Co. Ltd. during FY15 which was absent during FY16. Investment income of UIC increased by 25% to Rs.40 Million during FY17 over FY16 mainly due to ~40% increase in investment portfolio. Average yield on investments was 6.66% in FY17 which was relatively lower than industry yield of 8.31%. Investment income has further increased by 36% to Rs. 36 Million during 9MFY18 over 9MFY17.

Concentration in motor segment

UIC had 66.13% of GPW from motor insurance business during FY17 followed by fire insurance with 16.64% of total GPW. Further, the recent action taken by Insurance Board (IB) to halt fire insurance is expected to impact the total GPW of UIC. Also, during FY17, motor segment insurance contributed ~88% of Net Premium Earned (NPE) followed by fire (~7%) and other segments (~5%). Total NPE increased by 20% during FY17 to Rs. 338 Million on the back of 29% increase in motor segment and 18% increase in fire segment.

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. 10,601 Million of Gross Premium Written (GPW) as on January 14, 2018; where UIC shares only 2.54% of total GPW and ranks 16th reflecting very low market share in the industry. Further, due to increase in number of non-life insurance companies UIC is facing competition to tap the new customers. Along with this Insurance board has also reduced the insurance premium for private motor segment which has hampered the business of the company as a major portion of income of UIC is from Motor Segment.

Key Grading Strength

Long track record and strong promoter group

UIC has been providing its service in non-life insurance sector from around 24 years. As on July 15, 2017, 60% of shares are hold by promoter group and remaining 40% shares is hold by general public. The promoter group shares are mostly owned by Chaudhary Group and N.E. group. Chaudhary Group P Ltd is a part of CG Group which is a multi-national conglomerate headquartered in Nepal. It has diversified business interests including financial services, FMCG,

automobile dealerships, education, hospitality, energy, consumer electronics, real estate etc. Mr. Binod Chaudhary is the Chairman of CG Group, with networth of USD 1.52 Billion as per Forbes Magazine as on May 24, 2018. N.E. Group is an Industrial and Trading House with wide range of business activities.

Experienced Board and Management team

UIC has eight experienced members on its board lead by Mr. Uday Krishna Upadhyay, Chairman, appointed on January 14, 2018. Mr. Upadhyay has more than thirty years' of work experience in various Banks and Financial Institutions. The day to day operations of the company are headed by newly appointed Acting CEO Mr. Ramesh Kumar Bhattarai, who have overall work experience of around two decades in Insurance sector. Mr. Bhattarai holds Master in Business Administration degree. He is assisted by an experienced team across various functions.

Good assets quality of investment book

The company had an investment portfolio of around Rs. 456 Million in FY16 which was increased by 40% to Rs. 757 Million in FY17 and the same was declined by 11% in 9MFY18 to Rs. 677 Million, mainly due to withdrawal from Bank Deposits. UIC has complied with guidelines prescribed by regulator, out of the total investment portfolio, UIC has invested 77% in fixed and interest bearing deposit in different Bank and Financial Institutions as on April 13, 2018, which are readily marketable in nature which lends sufficient liquidity cushion to the company.

Moderate solvency ratio

UIC maintained moderate solvency ratio of 2.20 times as on July 15, 2017. However, the solvency ratio was low at 1.37 times as on July 15, 2016 against the minimum regulatory requirement of 1.50 times due to high provisions for outstanding claim related to CGP and others on back of the earthquake during April 2015.

About the Company

United Insurance Co. (Nepal) Limited (UIC) is an ISO 9001:2000 certified General (Non-life) insurance company. The company has started its operation from December 1, 1993. The company is promoted by leading industrialists and reputed trading and commercial houses of Nepal. 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, Agriculture and Aviation etc. UIC has branch network of 30 (including head office) and 65 insurance agents as on Mid-April 2018. UIC has assets base of Rs. 1,372 Million as on July 15, 2017 which has increased to Rs. 1,652 Million as on April 13, 2018.

UIC has achieved PAT of Rs.257 million on GPW of Rs.619 million as on July 15, 2017 as against loss of Rs. 259 million on GPW of Rs.563 million as on July 15, 2016. Further, UIC achieved PAT of Rs. 92 million during 9MFY18 (UA) against PAT of Rs.45 million during 9MFY18.

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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.