

Grading Rationale
AJOD Insurance Limited

Grading

Particulars	Amount (Rs. In Million)	Grading	Grading Action
Initial Public Offer	300.00	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 Initial Public Offer (IPO) of AJOD Insurance Limited (AIL). ‘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. AIL proposes to issue 3 Mn shares of face value of Rs. 100 each at par aggregating Rs. 300.00 Mn.

Detailed Rationale & Key Grading Drivers

The grading assigned to AIL is constrained by its moderate financial risk profile and high combined ratio, nascent stage of operation with relatively small market share in the non-life insurance industry and competition from other insurance companies. Further, the grading is constrained by AIL’s concentration in motor segment and insufficient solvency ratio. The grading, however, derives strength from strong promoter group, experienced board and management team, diversified investment book with fair return on investment.

Detailed Description of the Key Grading Drivers

Key Grading Weaknesses

Moderate financial risk profile with low solvency and high combined ratio

During FY19, the company earned gross premium written (GPW) of Rs.415 Mn during FY19 and stands 18th position in the industry (out of 20). The Net premium written (NPW) was Rs.155 Mn during FY19 with retention ratio of 37.39%. Further the GPW and NPW of AIL increased to Rs.201 Mn (Rs.43 Mn during Q1FY19) and Rs.80 Mn (Rs.9 Mn during Q1FY19) respectively during Q1FY20. AIL reported Net Underwriting Loss of Rs.123 Mn during FY19 owing to high operating expenses related to insurance business. AIL reported Rs.15 Mn net underwriting loss during Q1FY20. AIL reported net loss of Rs.31

Mn during FY19 against net profit of Rs.20 Mn during FY18. AIL reported net profit of Rs.7.80 Mn during Q1FY20 against net profit of Rs.5.87 Mn during Q1FY19.

The loss ratio (claim ratio) of AIL was 44.30%, while expenses ratio was high at 273.56% due to high operating expenses and commission ratio was moderate at 35.10% during FY19. Loss ratio further declined to 82.67% during Q1FY20, however, expense ratio and commission ratio improved to 151.23% and 81.90% during Q1FY20 which led to improvement in combined ratio to 151.99% during Q1FY20.

Nascent stage of operation, relatively small market share in the non-life insurance industry and competition from other insurance companies

AIL started its commercial operation from July 05, 2018 and operated only for 12 days during FY18. Currently there are 20 non-life insurance companies operating in Nepal sharing total Rs.25,375 Mn of Gross Premium Written (GPW) during FY19; where AIL shares only 1.64% of total GPW and ranks 18th position reflecting very low market share in a competitive industry. However, AIL has been able to increase its market share in terms of GPW to 2.73% during Q1FY20, out of industry total GPW of Rs.7,352 Mn over the same period and improves its position to 17th during Q1FY20. Further, due to competition among non-life insurance companies coupled with limited market, AIL is facing high competition to tap new and retain existing customer.

Insufficient solvency ratio

Being the initial years of operations, AIL has maintained 0.78x solvency margin (though improved from 0.73x during FY18) which is very low as compared to minimum required ratio of 1.50x. The company had low solvency margin mainly on account of high required solvency of Rs. 1,000 Mn, based on minimum capital requirement, as compared to low paid up capital of the company amounting Rs. 700 Mn in FY19. With the increased capital (after proposed IPO issue) and accretion of profits, the solvency ratio of the company is expected to improve.

Concentration in motor segment

Motor segment compromised 75.61% (37,732 policies) of total policies of 49,902 followed by fire segment 8.53% (4,255 policies) of total policies as on July 16, 2019. Motor segment has further concentrated to 76.41% (20,377 policies) out of total policies of 26,669 during Q1FY20; whereas the proportion of fire segment policies slightly decreased to 7.45% as on same date. In terms of Net Premium Earned (NPE), out of total NPE of Rs. 47.23 Mn, motor segment contributed ~89% during FY19.

Key Grading Strengths***Strong promoter group***

As on July 16, 2019, all the shares of AIL are held by promoter group. The promoter group shares are mostly owned by Bhat Bhateni Group and Century Commercial Bank Ltd. Bhat-Bhateni Group is the largest retail chain of supermarkets in Nepal, having 17 stores all over Nepal, and has been the largest tax payer in the retail sector for the last five consecutive years.

Experienced board and management team

AIL has four experienced members on its board led by Mr. Ajad Shrestha, who is chairperson of the company and has more than 2.5 decades of experience in manufacturing and real estate sectors. He was the Vice- President and Executive Member of Federation of Nepalese Chamber of Commerce and Industry (FNCCI) in the past. The day to day operations of the company is headed by Mr. Kumar Bahadur Khatri, Chief Executive Officer (CEO). Mr. Khatri has more than two decades of experience in insurance sector. Presently he is executive member of Nepal Insurers' Association (NIA). He is assisted by an experienced team across various functions.

Diversified investment book with fair return on investment

AIL had an investment portfolio of around Rs.899 Mn during FY19 which increased by ~26% over FY18, mainly due to additional investment in deposits in the form of fixed deposits at different Bank and Financial Institutions (BFIs), and the same has further increased by ~6% to Rs.949 Mn during Q1FY20 over FY19. AIL invested almost all the investments in the form of fixed and interest bearing deposit at different BFIs, which are readily marketable in nature which lends sufficient liquidity cushion to the company. As majority of the investments of AIL are in deposits at different BFIs, investment income of AIL comprises interest income from the deposits. Investment income has increased by ~132% during FY19 to Rs.78.54 Mn over FY18. AIL earned Rs.25.36 Mn investment income during Q1FY20 reporting ~44% growth over Q1FY19. Average yield on Investment of AIL was 9.75% during FY19.

About the Company

AJOD Insurance Limited (AIL) is a general (non-life) insurance company. The company started its operation from July 05, 2016. 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. AIL has network of 39 branches (including head office) supported by 215 employees and 355 insurance agents as on Mid-December 2019. AIL has assets base of Rs.1,145 Mn as on July 16, 2019 which witnessed 55.40% growth over FY18. The capital structure of the company comprises of an authorized capital of Rs. 1000 Mn out of which Rs. 700

Mn is paid up capital from the promoter group and the remaining is proposed to be issued to the public through IPO.

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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.