PRESS RELEASE

Prabhu Insurance Limited

July 2024

Rating

Instruments/ Facilities	Amount (NPR. Mn)	Rating	Rating Action
Issuer Rating	NA	IRN BBB+ (Is)	Assigned

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has assigned the issuer rating of IRN BBB+ (Is) [Triple B Plus Issuer]. Issuers with this rating are considered to have the moderate degree of safety regarding timely servicing of financial obligations. Such issuers carry moderate credit risk.

Detailed Rationale

The rating assigned to Prabhu Insurance Limited (PRIN) derives comfort from its long track record of operations, strong promoter profile with major shareholder being government owned pension fund-Employee Provident Fund and Prabhu Bank Limited (an A-class commercial bank of Nepal). The rating also factors in low claim ratio attributable to PRIN's risk management committee's stringent selection policies favoring safe investments and diverse policy portfolio with at least one policies issued under each segment. The rating also factors in PRIN's diverse investment across various instruments with increasing investment yield and investment income/NPW[1] ratio. Ratings also takes into consideration PRIN's adequate reinsurance arrangements including catastrophic provisions.

However, these rating strengths are partially offset by the company's moderate scale of operations, fluctuating financial profile with ebbs and flows in operating profit i.e. underwriting surplus across the review period. The rating is also constrained by its moderate level of retention ratio in par with industry average coupled with moderate solvency margins (Solvency Margin of 1.94x as of FY23 as against regulatory requirement of 1.5x). The increase in regulatory capital requirement of non-life insurances is likely to increase challenge of maintaining adequate solvency margins. The rating concerns also arise from intense competition within the industry and uncertainties surrounding changes in insurance laws and regulations mandated by the Nepal Insurance Authority (NIA), which could impact profitability. The rating also considers the low growth in GPW[2] and NPW in comparison to industry average growth across the same period. Going forward, the company's capability to upscale proportionally while upholding financial metrics and solvency standards will remain key rating sensitivities.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Long track record of operation and strong promoter profile with well-seasoned management team

Incorporated in 1995 AD, PRIN boasts around three decades of operational history, making it the oldest insurance company in Nepal. Over its long tenure, PRIN has navigated and adeptly responded to numerous shifts in the environmental, industrial, and political landscapes. Similarly, PRIN have strong promoter profile with Employee Provident Fund and Prabhu Bank Limited being top promoters of the company. Employee Provident Fund, a government sponsored pension fund brings large volume of experience with it and alongside other institutional and natural promoters provide strong backing in operations of PRIN. Alongside strong promoter group, PRIN have well- seasoned and experienced management team led by its board of directors. BOD is chaired by Mr. Rajendra Malla, who brings in decades' worth of experience in banking and insurance sectors. He is well supported

[1] Net Premium Written
[2] Gross Premium Written

by other directors and management personnel. The management team is led by Mr. Sanchit Bajracharya, CEO having more than 29 years of experience in insurance sectors and Mr. Samir Tamang, Assistant General Manager, having more than 27 years of professional experience in banking and insurance sectors. He is further supported by group of well experienced and qualified personnel.

Investment across diverse instruments with increasing investment yield and investment income/NPW ratio

The investment portfolio of PRIN is well-diverse across various sectors, with a significant focus on long-term investments. The portfolio has demonstrated robust growth, achieving a CAGR of ~19% from FY21 to Q3FY24. Likewise, the yield has continuously increased from 5.27% to 6.96% on account of heavier investment in FD of commercial banks. The resulting increase have resulted in Investment income ratio to moderate to 17% from 16% after a significant dip in FY22 on account of high liquidity and low interest rate during the same period. Ability to utilize the funds to generate healthy profits from investment is a rating strength.

Lower claim ratio below industry average

PRIN have lower claim ratio at around 40-45% in comparison to industry average of >60%. This is attributable to the selection policy adopted by risk management committee of PRIN as PRIN prefers only safe investors as reflected by slow growth in GPW. The resulting lower claim ratio is favorable in supporting underwriting surplus which ultimately ramps up the profitability of PRIN. These practices reflect PRIN's strategic approach to maintaining financial stability and maximizing profitability within the general insurance market through prudent underwriting and risk management strategies.

Diversified portfolio

PRIN's insurance portfolio exhibits significant diversification, with no single segment contributing more than 39% of Gross Premium Written (GPW). The motor segment, the largest by GPW at 39%, achieves a notable contribution to Net Premium Written (NPW) due to a high retention ratio, surpassing half of the total NPW independently. The Engineering segment follows with approximately 22% of GPW; however, its low retention ratio of around 7% limits its contribution to just 4% of total NPW. Another top contributor Miscellaneous segment brings in 16% of GPW and 19% of total NPW. Furthermore, PRIN offers a comprehensive range of 65 distinct policies distributed across all segments, ensuring representation in each segment of their portfolio, underscoring deliberate efforts to broaden its portfolio diversification. The resulting portfolio diversification helps in mitigating the risk and is a rating positive.

Key Rating Weaknesses

Moderate solvency margins and moderate retention ratio in par with industry average

As of mid-July 2023, PRIN's solvency margin, based on the Actuary Report and in accordance with regulatory guidelines, stood at approximately 1.94 times, surpassing the minimum requirement of 1.5 times set by regulations. This marks an improvement from approximately 1.73 times recorded in mid-July 2022. However, the increase in regulatory capital requirement of non-life insurances to NPR 2.5 Bn is likely to increase the challenge of maintaining adequate solvency margins in near future and remains a key rating sensitivity. Likewise, PRIN’s retention ratio of ~40% as on Mid-July 2023 is in par with industry average during the review period.

Fluctuating financial profile characterized by underwriting surplus

PRIN's financial profile has exhibited significant volatility characterized by fluctuations in underwriting surplus over the review period. Specifically, the underwriting surplus decreased from NPR 262 million in FY20 to NPR 209 million in FY21 and further to NPR 136 million in FY22, before rebounding to NPR 202 million in FY23. These variations can be attributed to changes in the retention ratio resulting from varied terms and conditions of reinsurance agreements with different reinsurers. The retention ratio fluctuated from 49% in FY20 to 31% in FY21, and subsequently rose to 40% in FY23. These

fluctuations in the retention ratio have had chain effects on both the claim ratio and commission ratio, as is typical in the general insurance industry. The claim ratio notably varied, decreasing to 35% in FY23 from 48% in FY22. Similarly, commission income experienced a decline in FY21 and FY22 (21-22% compared to 40% in FY20), followed by a recovery to 32% in FY23. The latest provisional data for Q3FY24 reflects a continuation of this fluctuating trend, with the retention ratio increasing to 51% (up from 40% in FY23), the claim ratio rising to 48% (up from 35% in FY23), and commission income ratio declining to 18% (down from 32% in FY23). Consequently, the underwriting surplus for Q3FY24 decreased to NPR 43 million from NPR 202 million in FY23. These fluctuations indicate the inherent volatility in PRIN's financial profile. Ability of management to improve its financial profile alongside is scale of operations by neutralizing volatility is key monitorable.

Impact of regulatory changes on industry structure and operating environment

In recent years, the insurance industry has encountered a series of regulatory adjustments, significantly impacting its operational landscape. These changes include alterations in tariffs, risk coverage, capital requirements, and competitive dynamics. The licensing of numerous general insurers in FY2018 reshaped the industry's competitive landscape. The recent revision in minimum paid-up capital requirements has further impacted the operating environment, leading to mergers among some companies and others seeking fresh equity infusion. Although regulatory changes aim to enhance insurance sector penetration and industry growth, they concurrently pose challenges for players, including PRIN. Navigating these changes demands strategic agility and adaptability to sustain profitability and ensure long-term viability in the dynamic insurance landscape.

Fragmented market with intense competition

In Nepal's non-life insurance sector, the competitive landscape presents significant challenges for companies, particularly in retaining customers and ensuring profitability. The market is crowded with numerous insurance companies with growth opportunities being limited, leading to intense competition. Companies are aggressively striving to retain their existing customer base, resulting in pricing pressures and difficulties in distinguishing their products. Moreover, since the motor segment serves as a primary revenue source for non-life insurers in Nepal, any slowdown in the automobile industry or changes in vehicle financing regulations could hinder growth prospects. Currently, there are 14 insurance companies in Nepal, down from 20. These companies collectively generated a Gross Premium Written (GPW) of ~NPR 3,300 million during FY23, with PRIN holding ~5% of the total GPW, indicative of a stable position in the industry.

Analytical Approach: Standalone

Applicable Criteria:

Issuer Rating Methodology

About the Company:

Established in 1995 AD, Prabhu Insurance Limited (PRIN) is one of the oldest general insurer in Nepal. PRIN is a medium-sized company with ~5% of the market share in terms of the general insurance industry's gross premium written in FY20-FY23. As of mid-July 2023, the company is in operation with 57 branches spread across the nation for procuring business and extending after-sales services. The paid-up capital and the net worth of the company as of mid-April 2024 is ~NPR 1,376 Mn and NPR 3,092 Mn respectively. PRIN has a 51:49 promoter–public shareholding ratio. The major shareholders as on mid-April 2024 include Employee Provident Fund (15.04%), Prabhu Bank Limited (14.97%) and Devi Prakash Bhattacharan (6.97%) among others.

Financial Indicators (Standalone)

Amount in NPR million	FY20	FY21	FY22	FY23	Q3FY24
	Audited				Unaudited
Gross Premium Written (GPW)	1,555	1,406	1,429	1,659	1,327
Net Premium Written (NPW)	758	433	531	661	672
Retention	49%	31%	37%	40%	51%
Net Premium Earned (NPE)	485	509	517	571	464
Underwriting Surplus	262	209	136	202	43
Net Claims Incurred / NPE (Claims Ratio)	44%	42%	48%	35%	48%
Management Expenses / NPE (Expense Ratio)	42%	39%	46%	62%	61%
Net Commission Expenses / NPE	-40%	-22%	-21%	-32%	-18%
Combined Ratio (A)	46%	59%	74%	65%	91%
Investment Income / NPW	10%	16%	13%	16%	17%
PAT/ Total Asset Base	9%	8%	6%	6%	12%
PAT/ Reported Net Worth	13%	10%	8%	8%	17%
Profit After Tax	258	224	186	225	391

Analyst Contacts

Mr. Raunak Mulmi
Tel No.+977-1-4583304/4585906
raunak.mulmi@infomericsnepal.com

Mr. Atish Ratna Shakya
Tel No.+977-1-4583304/4585906
atish.shakya@infomericsnepal.com

Relationship Contact

Mr. Rabin Pudasaini
Tel No.+977-1-4583304/4585906
rabin.pudasaini@infomericsnepal.com

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Infomerics Credit Rating Nepal Limited
Tanka Prasad Marga, Baneshwor Height, Kathmandu
Phone: +977-1-4583304/4585906
Email: info@infomericsnepal.com
Web: www.infomericsnepal.com

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