ICRA NEPAL

Shikhar Insurance Company Limited: Ratings reaffirmed

May 20, 2024

Facility/Instrument	Rated Amount (NPR Million)	Rating Action
Issuer Rating	NA	[ICRANP-IR] A+; reaffirmed

Rating action

ICRA Nepal has reaffirmed the issuer rating of Shikhar Insurance Company Limited (SICL) at [ICRANP-IR] A+ (pronounced ICRA NP Issuer Rating A plus). Issuers with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such issuers carry low credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument. The sign of + (plus) or – (minus) appended to the rating symbols indicate their relative position within the rating categories concerned.

Rationale

The rating reaffirmation continues to take comfort from the company's strong competitive positioning as reflected in the highest gross premium earnings (GPE) in the industry, its wide network of branches, seasoned management team, strong risk management policy, strong reinsurance arrangement with catastrophic provision and good financial profile of the lead reinsurer (Hannover Re[1], Germany); which is likely to support its future growth and solvency aspects. The rating also takes note of adequate profitability of SICL so far, despite the dilution in the last few years. Although the company's return indicators[2] have moderated marginally on account of an increased asset base/net worth and low premium retention, the company continues to maintain a strong solvency profile. ICRA Nepal also positively factors in the growth prospects of the company given the low penetration of insurance business in Nepal.

However, the rating remains constrained on account of steady uptick in the combined ratio and pressure on underwriting surplus of the company stemming from low net premium levels and uptick in claims and expense ratio as the company increased its footprint across the country in recent years. Although the H1FY2024 numbers have reported improvement in the areas of underwriting surplus, driven by the decline in claims, its sustainability will remain a key monitorable and rating sensitivity. Along with the pressure on underwriting surplus in the recent years, the softening of interest rates is also likely to dampen the investment income which could pressurise the profitability profile of the company over the near term. The impact on SICL's market leader positioning from large sized competitors formed through merger/acquisition of erstwhile players will also remain a monitorable. Although SICL remains adequately solvent and liquid despite the tax paid on premium collected on further public offering (FPO) of equity shares in the past, the recent buildup of receivables (including government subsidy receivable) and its future trend will also remain a monitorable.

Key rating drivers

Credit strengths

Long track record, strong market position and seasoned management team – Operating since 2004, SICL has a long track record of operations in the Nepalese general insurance industry and stands as the largest player in terms of asset base, net worth and gross premium earnings (notwithstanding the moderation in net premium earnings because of the decline in premium retention from FY2019 onwards). The company's market position remains stable and strong, supported by one of the largest branch network in the country, which is likely to help in the long-term growth and diversification of business. Its management team comprises of seasoned professionals with long industry experience, which is a positive factor incorporated in the rating.

[1] *Hannover Re's issuer credit rating has been affirmed at AA during the latest exercise by AM Best. (Published December 2023)*
[2] *Return indicators for FY2023 affected by tax related to prior period item (premium on equity raised through FPO)*

Strong reinsurance arrangements – SICL's lead reinsurer –'Hannover Re'[3], Germany (for FY2024) has a strong credit profile which comforts the claims paying ability of the company. SICL's reinsurance arrangement has remained among the strongest in the industry and continues to remain so. SICL's adequate catastrophic reinsurance arrangement at the time of the April 2015 earthquake not only supported its claims-paying ability but also helped its branding, enabling it to become the largest player in the years following. The company continues to maintain adequate reinsurance arrangements, including a strong catastrophic risk coverage for FY2024, which is likely to support the company's solvency during similar catastrophic events.

Strong solvency and liquidity profile – On the solvency front, SICL's solvency margin as of mid-July 2023 (Actuarial Valuation based), calculated as per the regulatory directive, stood at ~3.33 times against ~3.41 times as of mid-July 2022, versus a regulatory minimum of 1.3 times. The company continues to remain adequately liquid despite the pressure on cashflows during FY2021-FY2023 because of elevated claims, higher management expense ratio and tax liabilities towards share premium. SICL's liquidity position remains adequate as reflected in liquid assets to net insurance contract liabilities *(gross contract insurance liabilities less reinsurance assets)* ratio of 3.81 times as at mid-July 2023 vs. 3.76 times as at mid-July 2022. However, the gradual buildup in receivables (including subsidy receivables from government) in the recent years could pressurize the liquidity profile to some extent.

Adequate profitability profile – SICL's profitability remains adequate despite the pressure on underwriting surplus as reflected in elevated combined ratio between FY2021-FY2023. Despite the pressure on underwriting surplus, SICL's profitability remains supported by investment income given the healthy yield (9.5% for FY2023). The profit level in FY2023 was also affected by higher tax provision for the year (due on prior period items related to tax on share premium). However, the return indicators remain on a moderating trend due to larger base effect of rising assets/net worth. Although H1FY2024 profitability has remained improved, its sustainability remains to be seen. Over the near term, low net premium levels and recent softening of banking sector deposit rates could dampen the profitability profile.

Credit challenges

Underwriting surplus under pressure from elevated claims and expense ratio – SICL's claims ratio has remained generally elevated since FY2021. At the same time, the management expense ratio has also increased as a result of increased overhead to support network expansion, which is expected to bring in business growth with a lag. As such, the underwriting surplus has remained subdued in the last 2-3 years, despite the support from ceding commission from reinsurers. Although the company has reported an improved underwriting performance in H1FY2024 backed by a decline in claims ratio, its sustainability remains to be seen.

Competitive landscape and industry fragmentation – The competition in the already crowded general insurance industry had further increased since FY2018, following the licensing of new players. The recent mergers between industry players have resulted in larger players which could affect the industry dynamics and challenge the market leader position of SICL. While the low penetration of insurance industry in Nepalese market offers growth potential for all players, the recent economic slowdown and slow growth in banking sector credit could intensify the competition among the industry players.

Changes in operating environment because of new regulations – The players in the general insurance industry have been facing frequent changes in regulatory environment, especially those related to tariff and risk cover. Additionally, the other provisions like mandatory cession, licensing of new players, etc also affects the operating environment. While the regulatory changes are likely to eventually result in the strengthening of overall sector over the long-term, these regulatory changes could potentially impact the financial profile of all players over short to medium term.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:

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[3] *Rated "Superior" by AM Best in terms of its Financial Strength Rating and Issuer Credit Rating.*

[Issuer Rating Methodology]

Links to previous detailed rating rationale:
[Issuer Rationale Shikhar Insurance Company Limited-December 2022]

Company Profile

Established in March 2004, Shikhar Insurance Company Limited (SICL) is the 13th private sector general insurer in Nepal. SICL is a large-sized company with ~13-16% of the market share in terms of the general insurance industry's gross premium written in FY2020-FY2023. As of mid-July 2023, the company is in operation with 113 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-July 2023 is ~NPR 2,655 million and NPR 4,887 million, respectively. SICL has a 51:49 promoter–public shareholding ratio. The major shareholders as on mid-July 2023 include Mr. Gaurav Agarwal (12%), Mrs. Chanda Sherpa (6%), Buddha Air Pvt. Ltd. (6%), Mr. Shashikant Agrawal (4%), Mr. Kailash Prasad Sirohiya (4%), Mr. Rajendra Prasad Shrestha, and Mr. Bikas J.B. Rana (4%), among others.

SICL reported a PAT of NPR ~226 million in FY2023 (NPR 273 million in FY2022) over an asset base of NPR 11,044 million as of mid-July 2023 (NPR 11,264 million in mid-July 2022).

May 2024

Key Financial Indicators

Amount in NPR Million	FY2019	FY2020	FY2021	FY2022	FY2023	H1FY24
	Audited-NAS			Audited-NFRS		Unaudited
Gross premium written (GPW)	3,434.9	3,385.4	3,921.2	4,392.6	5,296.2	1,941.9
Net premium written (NPW)	1,286.2	1,143.6	1,173.8	1,234.5	1,377.8	551.4
Net premium earned (NPE)	1,456.7	1,207.7	1,155.3	1,234.5	1,377.8	551.4
Premium retention (NPW/GPW)	37.4%	33.8%	29.9%	28.1%	26.0%	28.4%
Claims ratio (Net claims incurred/NPE)- A	76.7%	66.1%	78.7%	86.7%	76.4%	59.0%
Management expense ratio (Management expense/NPE)-B	39.5%	50.7%	52.8%	57.1%	58.2%	65.3%
Commission expense ratio (Commission expense/NPE)-C	-35.5%	-42.1%	-44.6%	-51.8%	-44.8%	-53.9%
Combined ratio (A+B+C)	80.7%	74.7%	87.0%	92.0%	89.9%	70.5%
Underwriting surplus	282	305	151	99	140	163
Investment earnings	288.9	279.7	333.2	260.7	375.4	202.8
Average yield on investments	9.2%	8.0%	9.3%	7.3%	9.5%	9.4%
Profit after tax (PAT)	401.4	407.6	311.4	273.2	226.1	251.1
Return on equity	15.6%	12.9%	8.4%	5.8%	4.6%	9.5%
Return on assets	9.4%	8.7%	6.2%	5.2%	3.8%	7.9%

Source: Company data

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About ICRA Nepal Limited:

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Our parent company, ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

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