Sharekhan by BNP PARIBAS

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Stock Update

ICICI Lombard General Insurance

A steady show

Banks & Finance	Sharekhan code: ICICIGI	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	+	↔	+
RQ	+	↔	+
RV	+	↓	=

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,509**	
Price Target: **Rs. 1,750**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

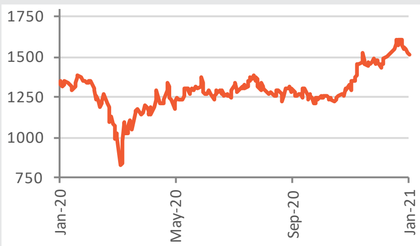
Company details

Market cap:	Rs. 68,609 cr
52-week high/low:	Rs. 1,625 / 805
NSE volume: (No of shares)	5.7 lakh
BSE code:	540716
NSE code:	ICICIGI
Free float: (No of shares)	20.1 cr

Shareholding (%)

Promoters	51.9
FII	27.4
DII	13.6
Others	7.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.4	21.1	14.2	11.4
Relative to Sensex	-3.1	-0.8	-17.8	-7.5

Sharekhan Research, Bloomberg

Summary

- Q3FY2021 results were steady; the company reported mixed operational numbers, helped by lower combined ratios. However, upfronting of acquisition costs, higher claims payout diluted the PAT performance compared to GDPI growth.
- Premium incomes, which normalised in 9MFY2021 (GDPI growth of 3.9% y-o-y for 9MFY2021); combined ratio was lower at 97.9% (versus 100.4% in FY2020).
- ILGI trades at 41x/33x its FY2022E/FY2023E EPS and valuations indicate its long-term business resilience even during challenging times.
- We recommend Buy on ILGI with a revised PT of Rs. 1,750.

ICICI Lombard General Insurance (ILGI) reported steady numbers for Q3FY2021. Operational performance was mixed, helped by lower combined ratios. However, upfronting of acquisition costs, higher claims payout offset the GDPI growth and impacted PAT performance. Premium incomes normalised in 9MFY2021 (GDPI growth stood at 3.9% y-o-y for the period). The insurer continued to see claims ratios decline. Performance was strong on the cost aspect, with a lower combined ratio of 97.9% (was 100.4% in FY2020). For Q3FY21, ROAE was 17.6% in Q3 FY2021 compared to 20.3% in Q3 FY2020 as this includes upfront expensing of acquisition cost relative to the growth of 9.2% in GDPI for Q3 FY2021, whereas the full benefit of earned premium will be realised over the policy period. The solvency ratio has improved further to 2.76x (from 2.74x in Q2FY2021). Overall loss ratios continued to decline to 67.5% (from 73.8% for 9MFY2020), which is a positive indicator. During the quarter, motor TP and Moor OD and Other segment saw y-o-y improvement in loss ratios. Management indicated that low claim ratios were more an exception, rather than a norm, and may revert to normalised levels in medium term. However, for the medium term ICICI Bank has chosen to focus on banking business, the management indicated that they were hopeful to regain traction from that segment and with the merger with Bharti AXA they may also have additional Bancassurance partners, which will aid business traction. Despite challenges, the insurance industry and players have responded with agility and speed with greater adoption of digital tools and operational tweaks, which is encouraging. We find the general insurance space attractive with strong growth potential. A positive regulatory environment, focus on higher-margin business, scale-driven operating cost benefit potential, and increasing retail focus (better pricing) make ILGI an attractive franchise for the long term. We recommend a Buy on ILGI with a revised price target (PT) of Rs. 1,750.

Key positives

- As a testimony of strong underwriting and well-developing business streams return on Average Equity (ROAE) was 22.4% in 9MFY2021 as compared to 21.8% in 9MFY2020.
- Healthy solvency ratio at 2.76x in Q3FY2021 was comfortably higher than the minimum regulatory requirement of 1.50x.

Key negatives

- Rise in operating expenses, due to higher sales promotion expenses and claims paid impacted PAT despite the robust GDPI

Our Call

Valuations - ILGI trades at 41x/33x its FY2022E/FY2023E EPS and valuations indicate its long-term business resilience even during challenging times. ILGI's strong execution capabilities, conservative underwriting, and healthy solvency should help sustain valuations. We believe the general insurance industry is an attractive space, which has a long runway for long-term growth. ILGI has demonstrated its strong underwriting, healthy solvency, and improving loss ratios, which should help it ride over medium-term challenges due to COVID-19 disruptions. We recommend a Buy on ILGI with a PT of Rs. 1,750.

Key Risks

Business disruptions and impact on GDPI growth due to COVID-19, adverse regulatory policies/guidelines, and aggressive risk pricing by peers may impact ILGI's profitability and growth.

Valuation Rs cr

Financial Summary	FY19	FY20	FY21E	FY22E	FY23E
Gross Direct Premium Income (GDPI)	14,488	13,313	13,846	15,922	17,674
Profit After tax	1049	1194	1477	1669	2071
ROE (%)	21.3	19.5	20.4	19.7	20.6
EPS (Rs)	23.1	26.3	32.5	36.7	45.6
BVPS (Rs)	117.1	135.0	159.3	186.8	220.9
P/E (x)	65.4	57.5	46.4	41.1	33.1
P/BV (x)	12.9	11.2	9.5	8.1	6.8

Source: Company; Sharekhan estimates

Business Update: The general insurance industry has performed well, with segments like motor insurance seeing strong traction. Pent-up demand for health insurance seen in H1 is now normalizing. Marine and engineering lines saw pickup in Q3 due to resumption of economic activity. Expect the growth momentum to be healthy going forward as well.

Industry combined ratio: Combined ratio for 105% for H1 FY2021 versus 115% for H1 FY2020, for the industry.

Regulatory changes: The IRDAI has introduced draft on withdrawal of existing long term credit-linked group insurance. The draft policy has not been converted into policy, and ILGI will review the declared norms once they are announced.

Normalization: Motor OD and health insurance claim levels have reached pre-COVID levels. New COVID claims in December are moderating.

Focus areas: Enhancing customer interaction, value-added products and continuing with conservative underwriting.

Business from ICICI Bank: A large part of health policies came from ICICI Bank and the bank had decided early in Q3 to reduce its health insurance distribution business to focus on core banking business. Owing to the bank's decisions, the "benefit" business has come down significantly, thus, dragging down aggregate health segment on a nine-month basis.

Loss ratio: The indemnity business however has growth smartly. The Indemnity loss ratio was 70% for 9MFY2020 against 83% for 9MFY2021. Benefit product loss ratio range stood at 35-40%. Combined ratio is likely to stabilise to 100% levels in the medium term.

Reserving approach continues: No change in reserving approach especially in terms of motors own damage (OD) and Motor Third paty (MTP) policy. However, some IBNR reserves created earlier have impacted the current quarter.

Claims outlook: COVID-19 claims are coming down, but surgery claims, etc picking up as normalization comes it.

Motor business: Due to pickup in motor sales, this segment's growth should be healthy.

Credit linked business, ICICI Bank gives a large part of business and while ILGI hopes the bank will review its stance the same trend continues. ILGI is adding bancassurance partners to broaden base.

Motor business: In terms of sourcing of Motor ODs, ILGI is back to pre-COVID levels, and now expects to see some possible pricing increase going forward. Incremental basis, the business is now discussing for price negotiations.

Demand scenario: Some pent-up demand is seen; retail indemnity seen in Q2 has reduced in Q3. ICICI Lombard is seeing trends in line with the industry and new indemnity growth is likely to normalise.

Property & commercial business' growth was good on industry levels, helped by Pricing rate changes (improvements) seen during FY2021.

Pricing outlook: ILGI expects renewals to happen in April quarter and expects Q4 growth to normalize on a higher base. Renewal discussions are on in Q4 and April would be an important month.

Road safety premium is a positive move and is likely to come in due course of time, but not in the near term.

Investment leverage: This indicator has come down in Q3. There were some older policies, which saw claims being paid which is why there was higher claims outgo. As the dividend payout was not there so impacted the Investment leverage. And there were some outflow from the crop business, which resulted in lower investment leverage.

Return on portfolio: ILGI had capital gains from debt paper and realized return on portfolio is at 7.9% on an annualised basis.

Health Loss ratio has increased y-o-y, but down q-o-q. Large part due to health, which in Q2 was higher compared to Q3.

Retention ratio outlook: We expect that there will be higher retention going forward. ILGI plans to have high retention in its Retail indemnity business where it may retain 95% of the business. Retail benefit is segment where company is seeing challenges.

Results Rs cr

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Gross Direct Premium Income (GDPI)	**4034.0**	**3693.0**	**9.2**	**3096.8**	**30.3**
Gross premium written	4111.7	3769.5	9.1	3254.5	26.3
Premium earned (Net)	**2611.4**	**2456.2**	**6.3**	**2462.5**	**6.0**
Income in shareholders account	452.1	436.7	3.5	541.2	-16.5
Total Expenses	33.8	46.8	-27.7	-13.4	-352.8
PBT	**418.2**	**389.9**	**7.3**	**554.6**	**-24.6**
Taxes	104.7	95.8	9.3	138.8	-24.6
PAT	**313.5**	**294.1**	**6.6**	**415.7**	**-24.6**
Solvency ratio (x)	2.76	2.18	0.58	2.18	0.58
Combined ratio (%)	97.9	98.7	-0.80	98.7	-0.80

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Long runway for growth, opportunity for strong players to gain

We believe that the insurance sector has a huge growth potential in India. Significant under-penetration, formalisation of the economy, rising awareness for financial protection (accelerated by the pandemic), large protection gap, and expanding per capita income, among others, are key long-term growth drivers for the sector. In this backdrop, we believe strong players such as ILGI, armed with the right mix of products, services, and distribution network, are likely to gain disproportionally from the opportunity.

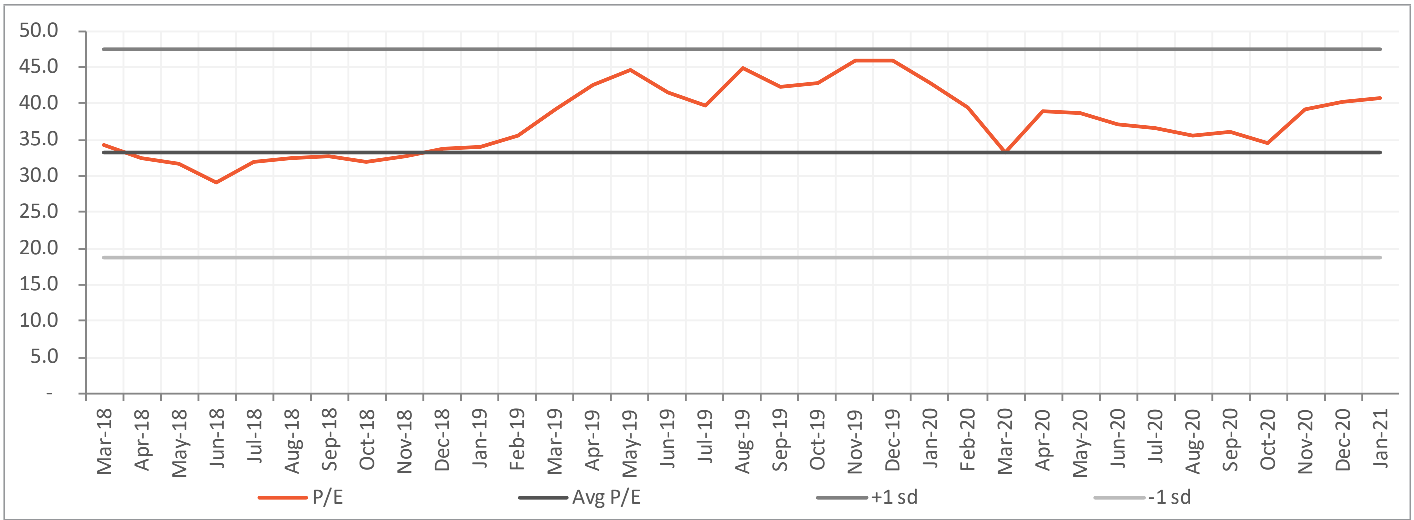
■ Company outlook - Strong fundamentals, attractive for the long term

ILGI's long-term business fundamentals have remained steady even during times of a crisis. We believe the company is seeing benefits of improved traction with the auto segment's OEMs (improved volumes) as well as higher demand for health products (due to increased fear factor because of the pandemic) resulted in better recovery traction for the company. Lower-than-normal claims in motor, with lower incidence of surgeries etc., are expected to normalise in the medium-term outlook, but operational improvements/business traction are positive for core profitability. ILGI has also been able to maintain an attractive loss ratio with attractive metrics, which indicates its strong fundamentals. ILGI's strategy to forego the crop business and instead focus on strong growth in preferred segments (fire, retail health, motor OD, etc.) indicate its emphasis on a profitable growth strategy (crop business had less visibility and low profitability). ILGI's business reach (by virtue of a multichannel distribution network, including branches of promoter bank) adds to its competitive advantage. Moreover, the company's conservative underwriting (a key differentiator in the insurance business) is displayed from its referencing triangle, which has been showing lesser incurred losses consistently since the last several years and its loss ratio has been consistently trending downwards, which is also a significant positive. Positive regulatory environment, focus on higher-margin business, scale-driven operating cost benefit potential, and increasing retail focus (better pricing) make ILGI an attractive franchise for the long term.

■ Valuation - Maintain Buy with a revised PT of Rs. 1,750

ILGI trades at 41x/33x its FY2022E/FY2023E EPS and valuations indicate its long-term business resilience even during challenging times. ILGI's strong execution capabilities, conservative underwriting, and healthy solvency should help sustain valuations. We believe the general insurance industry is an attractive space, which has a long runway for long-term growth. ILGI has demonstrated its strong underwriting, healthy solvency, and improving loss ratios, which should help it ride over medium-term challenges due to COVID-19 disruptions. We recommend a Buy on ILGI with a PT of Rs. 1,750.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY21	FY22E	FY21	FY22E	FY21	FY22E	FY21	FY22E
ICICI Lombard GI	1,509	9.5	8.1	46.4	41.1	3.6	3.7	19.6	19.7
New India Assurance Company Ltd	134	1.2	1.1	18.2	11.0	1.5	2.2	6.7	10.4
General Insurance Corporation of India	140	0.9	0.8	22.5	12.1	0.9	1.8	6.5	9.5

Source: Company, Sharekhan research

About company

ILGI is the fourth largest non-life insurer and the largest private-sector non-life insurer in India. The company offers customers a comprehensive and well-diversified range of products, including motor, crop, health, fire, personal accident, marine, engineering, and liability insurance. ILGI has 250+ offices and 35,000+ individual agents (including POS) and ~840 virtual offices. The company's key distribution channels are direct sales, individual agents, corporate agents - banks, other corporate agents, brokers, MISPs and digital, through which it serves individual, corporate, and government customers.

Investment theme

ILGI had ~7% market share based on GDPI in FY2020. The company has been able to maintain a strong growth trajectory, but it has also been successful in keeping its costs under control, along with building reach via both physical and virtual channels. Insurance business's profitability and returns are strongly dependent on underwriting skills of the insurer, which is, hence, the key. ILGI's long-term business fundamentals remained unchanged even in times of crisis. We believe the general insurance industry is an attractive space, which has a long runway for long-term growth. ILGI has demonstrated its strong underwriting, healthy solvency, and improving loss ratios, which should help it ride over medium-term challenges.

Key Risks

Business disruptions and impact on GDPI growth due to COVID-19, adverse regulatory policies/guidelines, and aggressive risk pricing by peers may impact ILGI's profitability and growth.

Additional Data

Key management personnel

Mr Bhargav Dasgupta	Managing Director & CEO
Mr Gopal Balachandran	Chief Financial Officer & Chief Risk Officer
Mr Lokanath Kar	Principal Compliance Officer
Mr Vinod Mahajan	Chief Investment Officer
Mr Alok Kumar Agarwal	Executive Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Pvt Ltd	2.2
2	FIL Ltd	2.0
3	Aditya Birla Sun Life Asset Manage	1.6
4	Vanguard Group Inc/The	1.6
5	Kotak Mahindra Asset Management Co	1.4
6	Kotak	1.4
7	BlackRock Inc	1.3
8	Governmnet Pension Fund	1.1
9	Nomura Holdings Inc	1.1
10	St James Place PLC	0.7

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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