Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

ICICI Lombard General Insurance

Mixed bag, improved outlook

Insurance	Sharekhan code: ICICIGI
Reco/View: Buy ↔	CMP: Rs. 1,423
Price Target: Rs. 1,750 ↔	

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 21.86

Updated Jan 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

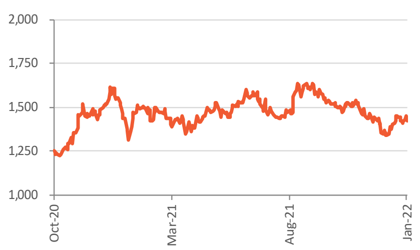
Company details

Market cap:	Rs. 69,966 cr
52-week high/low:	Rs. 1,674 / 1,295
NSE volume: (No of shares)	4.5 lakh
BSE code:	540716
NSE code:	ICICIGI
Free float: (No of shares)	25.5 cr

Shareholding (%)

Promoters	48.1
FII	28.1
DII	13.5
Others	10.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.3	-5.5	-7.8	-5.8
Relative to Sensex	-2.4	-4.1	-22.1	-27.4

Sharekhan Research, Bloomberg

Summary

- ICICI Lombard General Insurance Company's (ILGI) profitability missed our estimates, owing to an increase in underwriting loss. PAT came in at Rs. 318 crore versus our expectation of Rs. 442 crore and declined by ~29% q-o-q (up 1% y-o-y).
- We believe the company's focus on diversifying into tier-3 and 4 cities is positive and will help the company to ride on a diversifying product mix and multi-channel distribution network, backed by robust risk selection and strong investment returns.
- Merger with Bharti Axa is expected to bring in cost and operational efficiencies going ahead.
- We maintain our Buy rating on ILGI with a PT of Rs. 1,750.

ICICI Lombard General Insurance (ILGI) reported Gross Direct Premium Income (GDPI) of Rs. 4,699 crore, an increase of 16% y-o-y. Net premium earned stood at Rs. 3,312 crore, up 27% y-o-y and 2% q-o-q. The merger of Bharti Axa was effective as of September 8, 2021. PAT came in at Rs. 318 crore versus our expectation of Rs. 442 crore and declined by ~29% q-o-q (up 1% y-o-y). The sequential decline is on account of higher underwriting loss even as net premium earned witnessed an increase of 2% q-o-q. The retail health segment reported an operating loss of Rs. 20 crore versus Rs. 19 crore loss in Q2FY2022. While the group health and corporate segments reported operating profit of Rs. 57 crore and Rs. 47 crore, respectively, an increase of 15% y-o-y and 64% q-o-q. Operating profit of motor insurance stood at Rs. 29 crore versus Rs. 333 crore in Q2FY2022. Incurred claims ratio was steady at 69.6% versus 69.8% in Q2FY2022.

Key positives

- Claims ratio was steady at 69.6% in Q3FY2022.
- COVID-19 claims are on a declining trend and stood at Rs. 529 crore in 9MFY2022.

Key negatives

- Operating losses from the retail segment continued to be higher (Rs. 20 crore in Q3FY2022).
- Motor continued to report underwriting loss for the third quarter as well.

Management Commentary

- Management continues to focus on retail health policies and intends to grow the segment through building up network and technology.
- The company plans to harness its growth potential by expanding its network to increase in tier-3 and tier-4 cities.
- With the merger of Bharti Axa, management intends to see synergy benefits from H2FY2023.

Our Call

Valuation – We expect ILGI to deliver on profitability going ahead as the company is in a leadership position in gross written premium through focus on profitable product lines (retail health and motor insurance). Although the combined ratio is likely to stay high due to higher motor claims on account of increased mobility and increased non-COVID health claims in the near term. Further, a shortage of semiconductor chips and lower demand for two-wheelers are expected to impact the motor insurance segment's growth. However, the health segment is likely to report higher growth aided by awareness due to the pandemic and the base effect. We believe business momentum may pick-up in H2FY2022 for the consolidated entity as Bharti Axa's product profile would get aligned with ILGI, aided by improved operating efficiencies and as the industry's volumes pick up. At the current price, ILGI trades at 47.9x/32x its FY2022E/FY2023E EPS. We maintain our Buy rating on ILGI with a price target (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 (Standalone) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Gross premium	14,320	18,803	21,473	24,629
PAT	1,473	1,414	2,090	2,470
ROE (%)	21.7	16.9	20.8	20.8
EPS (Rs)	32.4	31.1	46.0	54.3
BVPS (Rs)	163.6	203.6	239.3	282.3
P/E (x)	45.9	47.9	32.4	27.4
P/BV (x)	9.1	7.3	6.2	5.3

Source: Company; Sharekhan estimates

Key result highlights from Concall

Operating performance:

The company's PAT came in at Rs. 318 crore versus our expectation of Rs. 442 crore and declined by ~29% q-o-q (up 1% y-o-y). The sequential decline is on account of higher underwriting loss even as net premium earned witnessed an increase of 2% q-o-q. It reported a combined ratio of 104.5% in Q3FY2022 owing to higher opex ratio. Expense ratio was up 210 bps y-o-y and 250 bps q-o-q at 31.5%. Investment yield was at 7.4% versus 8.4% in Q2FY2022 due to lower capital gains (booked Rs. 131 crore). Motor insurance reported an underwriting loss of Rs. 388 crore on account of broad-based industry under performance.

Results Rs cr

Particulars	Q3FY22	Q3FY21	Q2FY22	Y-o-Y %	Q-o-Q %
Gross written premium	**4,786**	**4,112**	**4,508**	**16.4**	**6.2**
Premium ceded	1,131	903	1,456	25.3	(22.3)
Net Premium	**3,655**	**3,209**	**3,053**	**13.9**	**19.7**
Change in unexpired risk reserve	343	597	(197)	(42.6)	(273.8)
Net earned premium	**3,312**	**2,611**	**3,250**	**26.8**	**1.9**
Net incurred claims	2,304	1,720	2,270	33.9	1.5
Net commission paid	203	224	144	(9.7)	41.2
Operating expenses related to insurance	**1,075**	**802**	**938**	**34.0**	**14.6**
Employees' remuneration and welfare expenses	239	167	246	43.3	(2.8)
Advertisement and publicity	126	77	133	63.5	(5.4)
Sales promotion	512	411	364	24.5	40.7
Other expenses	197	147	194	34.7	1.7
Underwriting Profit/ (Loss	**(269)**	**(135)**	**(101)**	**98.8**	**167.2**
Income from investments	**532**	**442**	**726**	**20.4**	**(26.7)**
Income from investments (net	532	442	552	20.4	(3.5)
Income from investments			174		
Other income	**10**	**68**	**6**		
Other expenses	17.26	27	32	(36.1)	(46.3)
Profit before tax	**421**	**418**	**594**		
Tax	103	105	147		
Profit after tax	**318**	**314**	**447**	**1.3**	**(28.9)**
Balance sheet (Rs cr)					
Investments	37,454	29,892	37,195		
Shareholders' Fund	8,634	7,220	8,600		
Policyholders' Fund	28,820	22,672	28,595		
Shareholder's equity	8,792	7,266	8,649		
Paid up equity capital	491	455	491		
Reserve & Surplus (Excluding Revaluation Reserve)	8,301	6,812	8,158		
Fair Value Change Account and Revaluation Reserve	637	607	908		
Key Ratios (%)					
Retention ratio	76.4	78.0	67.7	-890	1080
Net incurred claims ratio	69.6	65.9	69.8	260	-2220
Combined ratio	104.5	78.0	105.3	560	-2380
Solvency ratio	2.5	2.8	2.5	-25	-12
RoE	14.6	17.6	21.0		

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Long runway for growth, opportunity for strong players to gain

We believe the Indian insurance sector has a huge growth potential. 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 over the long term

ILGI's long-term business fundamentals have remained steady even during times of crisis. We believe the company is seeing higher demand for health products (due to increased fear factor because of the pandemic), which resulted in better recovery traction for the company. ILGI has also been able to maintain an attractive loss ratio with attractive metrics, which indicates its strong fundamentals. However, in the near term, ratios may not look attractive. 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 past 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 unchanged price target of Rs. 1750

We expect ILGI to deliver on profitability going ahead as the company is in a leadership position in gross written premium through focus on profitable product lines (retail health and motor insurance). Although the combined ratio is likely to stay high due to higher motor claims on account of increased mobility and increased non-COVID health claims in the near term. Further, a shortage of semiconductor chips and lower demand for two-wheelers are expected to impact the motor insurance segment's growth. However, the health segment is likely to report higher growth aided by awareness due to the pandemic and the base effect. We believe business momentum may pick-up in H2FY2022 for the consolidated entity as Bharti Axa's product profile would get aligned with ILGI, aided by improved operating efficiencies and as the industry's volumes pick up. At the current price, ILGI trades at 47.9x/32x its FY2022E/FY2023E EPS. We maintain our Buy rating on ILGI with a PT of Rs. 1,750.

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 maintained around 7% market share based on GDPI from FY2020 till now. The company has been able to maintain a strong growth trajectory, but it has also been successful in keeping costs under control, along with building reach via both physical and virtual channels. The 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 tide 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 Girish Nayak	Chief Customer Service, Technology & Operations
Mr Sanjay Datta	Chief Underwriting, Reinsurance & Claim

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Pvt Ltd	2.2
2	FIL Ltd	2
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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