RATING REPORT

Security General Insurance Company Limited (SGICL)

REPORT DATE:
January 07, 2019

RATING ANALYSTS:

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RATING DETAILS

	Latest Rating	Previous Rating
Rating Category	**Long-term**	**Long-term**
IFS	AA	AA
Rating Date	*Dec 28,'18*	*Sep 14,'17*
Rating Outlook	Stable	Stable

COMPANY INFORMATION

Incorporated in 1996	**External Auditors:** A.F. Ferguson & Co, Chartered Accountants
Unquoted Public Limited Company	**Internal Auditors:** Ahsan & Ahsan Chartered Accountants
	Chairman: Mian Hassan Mansha
Key Shareholder(s):	**Chief Executive Officer:** Mr. Farrukh Aleem
Allied Bank Limited -18.22%	
Nishat Mills Limited - 15.02%	
Adamjee Insurance Co. Ltd – 14.22%	
Mian Hassan Mansha – 13.30%	
Mian Umer Mansha – 13.30%	
Mian Raza Mansha – 11.95%	
Mrs. Naz Mansha – 7.50%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: General Insurance March 2017 ***http://jcrvis.com.pk/kc-meth.aspx***

Security General Insurance Company Limited (SGICL)

OVERVIEW OF THE INSTITUTION

SGICL was incorporated as an unquoted public limited company in May 1996. Headquartered in Lahore, the company operates with a network of 8 branches providing insurance coverage against risks related to fire, marine, motor and other categories.

Profile of Chairman

Mian Hassan Mansha continues to Chair the Board. Mr. Hassan carries over 11 years of professional experience and is on the Board of various Nishat group companies.

Profile of CEO

Mr. Farrukh Aleem serves as Chief Executive Officer (CEO) of the company. Mr. Aleem carries 13 years of experience in the insurance industry and also holds a postgraduate degree in Business Administration.

Financial Snapshot

Net Equity: 9M18: Rs. 14.7b; FY17: Rs. 15.4b; FY16: Rs. 14.9b

Net Profit: 9M18: Rs. 630.4m; FY17: Rs. 824.7m; FY16: Rs. 799.6m

RATING RATIONALE

Ratings assigned to Security General Insurance Company Limited (SGICL) take into account its association with a large diversified conglomerate "Nishat Group" having business interests in banking, textile, cement, power generation, real estate and paper products. Ratings draw strength from growth in business volumes, improved underwriting results and conservative risk appetite leading to cautious business selection. The sound capitalization and leverage indicators exhibiting strong loss absorption capacity remain the key rating driver. Credit risk emanating from reinsurance panel selection remains sound with all reinsurers, except one, rated in category 'A' or higher. The ratings also incorporate sizeable recurring dividend income emanating from investment in blue chip companies.

Business Strategy

The company primarily offers insurance cover for fire and property damage, marine and transport, motor, crop and miscellaneous risks including burglary, loss of cash in safe and cash in transit, engineering losses, business interruption losses, accident and natural calamities. The business mix of the company remained dominated by fire segment followed by motor; meanwhile exposure in miscellaneous segments is limited owing to risk averse approach adopted by the management owing to higher incidence of claims in respect to premium earned. During the period under review, business volumes of the company increased to Rs. 2.3b (FY17: 2.0b; FY16: Rs. 2.1b) during 9M18 primarily on the back of new power projects underwritten in the fire segment. The company has surpassed the target of Rs. 2.3b for FY18 during 9M18. On the contrary, the company was unable to meet its growth target of Rs. 2.2b for FY17 owing to non-renewal of facultative business emanating from Neelum Jhelum Hydro Power Project amounting to around Rs. 300m during FY17. As per the management, the company has managed to fulfill the gap by smaller ticket business during the ongoing year. Overall cession reduced during 9M18; however the same did not reflect fully on net premium revenue on account of revenue recognition policy where the increase in retention has a staggered impact on twenty-four months, previously twelve months. Around one-third of premium growth emanated from related parties, constituting 36.8% (FY17: 41.3%; FY16: 35.4%) of gross premium. The snapshot of business mix is presented in the table below:

	FY15	FY16	FY17	9M18
Fire	77.5%	79.8%	72.1%	76.3%
Marine	6.2%	3.6%	3.9%	3.2%
Motor	12.0%	10.6%	13.4%	11.7%
Miscellaneous	4.3%	6.1%	10.6%	8.9%
Gross Premium (m)	1,850.6	2,087.1	2,000.3	2,249.8

The takaful operations were initiated during FY18 after the company received license from the regulator. The growth in takaful business is likely to be sluggish on account of limited capacity in the market, the company projects to achieve breakeven in takaful business during FY19. Going forward, the company plans to streamline the proportion of group related business by focusing on market based business, pursuing clients with strong track record and credit history.

During the ongoing year, the company purchased residential property in Karachi amounting to Rs.

459.0m with the long-term view of capital appreciation. As per the management, the acquired asset will also contribute rental income estimated around Rs.1.5m per month to the company's bottom line.

Reinsurance Arrangement

SGICL's risk profile is supported by strong capitalization indicators and adequate reinsurance coverage provided by diversified panel of reinsures. Risk profile of the reinsurance panel is considered sound as majority of the reinsurers are rated 'A-' or higher. For FY18, General Insurance Corporation of India (Dubai Branch) and Oman Reinsurance Company were added to the existing reinsurer panel of SGICL. Given the anticipated business in fire segment, the company arranged a special fire treaty with total treaty capacity of Rs. 750m for FY18. Other than the aforementioned change, the treaty capacities and retention limits remained unchanged. In order to maintain its business risk profile, SGICL ceded around half of its business to reinsurers. Size of maximum per risk claim remained unchanged which, on net account, is considered manageable in relation to the company's loss absorption capacity. As per the management, no major change in the re-insurance panel is expected for FY19 other than Antares (Lloyds Syndicate) leading the marine segment in place of Trust Reinsurance owing to rating downgrade of the latter. As per SGICL's internal policy, the company cannot cede more than 30% of the premium written to a reinsurance company with a rating below 'A-'.

Claims Experiences

The conservative stance to underwrite insurance policies, effective pre-screening of market-based clients for their past track record coupled with higher proportion of group related business resulted in improved claims performance of the company on a timeline basis. During 9M18, the highest net claims ratio emanated from the motor segment on account of higher retention on net account in line with procurement of excess of loss treaties. Further, increased incidence of claims under Rs. 0.6m sum insured led to SGICL covering the entire loss amount. The loss retention on company's books was recorded the lowest in fire segment followed by marine. The segment-wise net claims ratios are presented in the table below:

	FY15	FY16	FY17	9M18
Net Claims Ratio	**28.2%**	**16.8%**	**18.8%**	**14.4%**
Fire	20.3%	2.7%	9.9%	3.9%
Marine	44.8%	14.2%	23.7%	9.6%
Motor	35.0%	39.0%	35.2%	35.1%
Miscellaneous	75.2%	72.3%	40.9%	29.1%

Underwriting Performance:

Given lower incidence of claims, the company's underwriting results have continued to improve during FY17 and 9M18. Further, the management expenses were rationalized on a timeline basis in line with lower service charges by co-insures along with lower provisioning booked against doubtful receivables during the period under review. In addition, the net commission expense was also recoded lower at Rs. 16.0m (FY17: Rs. 18.7m; FY16: Rs. 25.5m) during 9M18 as a result of SGICL negotiating higher commission rates with re-insurers under marine cargo and bond segments. Subsequently, expense ratio improved resulting in a lower combined ratio. The combined ratio of the company continues to remain the lowest amongst the peer insurance companies. All segments reported profits during FY17 and 9M18; ability to maintain these performance metrics will remain a key rating factor: The snapshot of underwriting results is tabulated below:

Rs. in millions	FY15	FY16	FY17	9M18
Underwriting Profit	**78.6**	**150.5**	**186.1**	**199.7**
Fire	54.9	120.8	134.0	119.5
Marine	(1.8)	8.2	9.3	11.7
Motor	27.1	25.3	37.8	58.5
Miscellaneous	(1.60)	(3.8)	5.0	10.1

Investment income, around 99% of which pertained to dividend income, remained sizable and continued to support the bottom line of the company. Investment income was reported lower during the ongoing year owing to overall downturn in the stock market performance; Adamjee Insurance Company Limited (AICL), an associate concern, announced cash dividend of Rs. 1.0/share during 9M18 as compared to Rs. 2.5/share during FY17. The company reported a minimal loss of Rs. 2.2m on takaful operations during FY18. On the other hand, with improvement in underwriting performance, the company earned a higher net profit.

Investments

Investments are largely manifested in blue chip equities with strategic investment in group companies, namely MCB Bank Limited, AICL, DG Khan Cement Company Limited, Pakgen Power Limited, Lalpir Power Limited and Nishat Hotels and Properties Limited. SGICL increased its equity stake in AICL to 7.9% during FY17 as compared to 6.5% in the preceding year. The company has a long-term investment horizon for equities; therefore it is not actively involved in trading. Given the asset composition, investment portfolio is subject to considerable market risk. Moreover, in the backdrop of prevailing volatility pertaining in the capital market, market value of investment portfolio witnessed a decline by end-9MFY18. On the other hand, in line with investment in high dividend yielding stocks, investment portfolio translated into healthy dividend income thereby supporting core operations of the company. Going forward, the management plans to increase its shareholding in MCB Bank Limited.

Cash flows and Liquidity Profile

Liquidity profile is considered sound reflected by sizeable liquid assets maintained in relation to borrowings and technical reserves. However, insurance debt in relation to gross premium increased and is significantly higher than the rating benchmark. Premium due but unpaid from related parties represented 83.2% (FY17: 75.1%; FY16: 79.1%) of total premium due but unpaid from clients at end-9M18. According to the management, the increase was a function of higher new insurance policies with related companies during Aug-Sep'18. Further, overdue amounts from reinsurers also witnessed an upward trend mainly owing to delay from the local reinsurance company; the trend is similar in the insurance sector. On the contrary, adjusting for reinsurance payables, insurance debt in terms of gross written premium was recorded at 61.6% (FY17: 27.2%; FY16: 27.7%) at end-9M18.

The cash flow from operations witnessed a declining trend on a timeline basis in line with higher receivables and was recorded at Rs. 281.8m (FY17: Rs. 977.9m; FY16: Rs. 1.2b) during 9M18. In line with regulatory requirement, SGICL has a paid up capital above Rs. 500m, at end-9M18. The exponential growth in equity base in FY17 was a function of calculation of investments on market value as compared to cost price in preceding years. Given enhancement in overall business volumes and higher retention on net account, operating leverage of the company improved, while financial leverage remained largely stable during the period under review. Both operating and financial leverage are the lowest amongst the peer insurance companies and well below the rating benchmarks for the assigned rating. The company has enough room to optimize its leverage indicators by expanding its business further.

Security General Insurance Company Limited (Rs. in millions)			Appendix I
BALANCE SHEET	**DEC 31, 2016**	**DEC 31, 2017**	**SEP 30, 2018**
Cash and Bank Accounts	386.2	644.2	524.9
Deposits Maturing Within 12 Months	50.4	50.4	0.4
Investments	9,126.9	17,043.5	15,620.9
Insurance Debt	1,332.2	1,546.0	2,532.7
Total Assets	12,588.1	21,241.8	21,578.0
Net Worth	9,563.2	15,394.3	14,737.6
Borrowings	100.0	-	210.9
Total Liabilities	3,024.9	5,847.5	6,837.7
INCOME STATEMENT	**DEC 31, 2016**	**DEC 31, 2017**	**SEP 30, 2018**
Net Premium Revenue	445.7	502.5	432.6
Net Claims	74.7	94.4	62.4
Underwriting Profit/(Loss)	150.3	186.1	199.7
Investment Income	1,016.5	1,082.6	734.4
Other Income	4.2	0.3	12.8
Profit Before Tax	1,186.3	1,278.1	931.9
Profit After Tax	799.6	824.7	630.4
RATIO ANALYSIS	**DEC 31, 2016**	**DEC 31, 2017**	**SEP 30, 2018**
Cession Ratio (%)	76.0	74.0	53.0
Gross Claims Ratio (%)	112.3	32.8	15.5
Net Claims Ratio (%)	16.8	18.8	14.4
Underwriting Expense Ratio (%)	49.5	44.2	39.4
Combined Ratio (%)	66.3	63.0	53.8
Insurance Debt to Gross Premium (%)	66.6	80.6	116.9
Operating Leverage (%)	2.6	3.3	3.9
Financial Leverage (%)	6.8	9.4	10.7
Adjusted Liquid Assets to Technical Reserves & Borrowing (%)	46.6	60.6	39.8

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

JCR-VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: INSURER FINANCIAL STRENGTH

AAA
Highest capacity to meet policyholder and contract obligations; Risk factors are negligible.

AA+, AA, AA-
Very high capacity to meet policyholder and contract obligations; However, risk is modest, but may vary slightly over time due to business/economic conditions.

A+, A, A-
High capacity to meet policyholder and contract obligations; Risk factors may vary over time due to business/economic conditions.

BBB+, BBB, BBB-
Adequate capacity to meet policyholder and contract obligations; Risk factors are considered variable over time due to business/economic conditions.

BB+, BB, BB-
Marginal capacity to meet policyholder and contract obligations; Risk factors may vary widely with changes in business/economic conditions.

B+, B, B-
Low capacity to meet policyholder and contract obligations; Risk factors are capable of fluctuating widely with changes in business/economic conditions.

CCC
Very low capacity to meet policyholder and contract obligations; Risk may be substantial.

CC
Weak capacity to meet policyholder and contract obligations; Risk may be high.

C
Very weak capacity to meet policyholder and contract obligations; Risk may be very high

D
Extremely weak capacity to meet policyholder and contract obligations; Risk is extremely high.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Security General Insurance Company Limited (SGICL)
Sector	Insurance
Type of Relationship	Solicited
Purpose of Rating	Insurer Financial Strength (IFS) Rating

Rating History

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: IFS			
28/12/2018	AA	Stable	Reaffirmed
09/14/2017	AA	Stable	Upgrade
06/16/2016	AA-	Stable	Reaffirmed
09/23/2015	AA-	Stable	Reaffirmed
04/22/2015	AA-	Stable	Reaffirmed
02/04/2014	AA-	Stable	Upgrade
12/26/2012	A+	Stable	Reaffirmed

Instrument Structure	N/A
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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