

ICRA Lanka upgrades the Insurance Financial Strength rating of Softlogic Life Insurance PLC

May 24, 2019

Instrument	Rated Amount (LKR Mn)	Rating Action
Insurance Financial Strength rating	N/A	Revised to [SL]A (Stable) from [SL]A- (Stable)

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has revised the insurance financial strength rating of Softlogic Life Insurance (SLI or the Company) to [SL]A (pronounced SL A) from [SL]A- (pronounced SL A minus). The Stable outlook on the Company has been retained.

Rationale

The rating factors in the Company's position as the fifth largest life insurance company, a steady increase in its market share (to 12.5% in December 2018 from 10.5% and 8.8% in December 2017 and December 2016, respectively) and its healthy business performance indicators. The rating also factors in the expected operational, managerial and financial support from the Softlogic group (Softlogic Capital PLC, a subsidiary holding company of Softlogic Holdings PLC (SHP), has a 51.69% shareholding in SLI as on December 31, 2018; SHP is rated [SL]BBB+ with a stable outlook). The rating however takes note of the claims ratio¹, which grew to 13.5% in FY2018 from 6.6% in FY2017, following changes in the business mix and higher retention. SLI's capital adequacy ratio (CAR) of 199% as in December 2018 is above the regulatory requirement of 120%, however the same is moderate compared to similar-sized peers. The robust premium growth has led to a moderation in the CAR, with future growth expected to pressure the capitalization profile; ICRA Lanka however envisages the solvency to remain adequate in the near to medium term. The rating takes cognizance of the changes to the taxation regime (effective since April 2018), which may have an impact on the profitability of industry players, including SLI in the long term; any future unfavorable regulatory changes could adversely impact the financial and business risk of the Company.

ICRA Lanka also factors in the near term capital needs of the immediate parent entity, Softlogic Capital PLC (SCAP, not rated) as well as the large capital expenditure and high leverage of the Softlogic group, which limits SHP in extending any significant financial support to SLI in the near term. SLI however is expected to leverage on the operational synergies with the Softlogic group and, is envisaged to receive adequate financial support, if required, in the medium to long term.

¹ Claims ratio is calculated net of maturities and surrenders

Outlook: Stable

ICRA Lanka believes that SLI's current solvency and healthy business indicators support near to medium term growth. The outlook may be revised to 'Positive' in case of steady improvement in the capitalization and earnings of the Company. The outlook may be revised to 'Negative' in case of a deterioration in the Softlogic group's credit risk profile requiring higher dividends to be up streamed by SLI or a significant weakening in the solvency and profitability of SLI.

Key rating drivers

Credit strengths

Low life insurance penetration in Sri Lanka to support business growth: Life insurance industry in Sri Lanka is largely underpenetrated compared to regional peers. In CY²2017, penetration ratio of the life insurance business was recorded at 0.54% (CY2016: 0.53%). Positive growth outlook is expected over the medium-long term as the Sri Lankan life insurance industry would benefit from favourable macro factors such as increasing disposable income and increasing demand for private sector healthcare.

Steady increase in SLI's market share: SLI's gross written premium (GWP) grew at 33% YoY in FY2018 to LKR 10,006 Mn vis-à-vis a growth of 34% during FY2017 and 38% in FY2016. Overall market share stood at 12.5% in December 2018, an increase of about 200 bps from December 2017 (165 bps increase in market share during FY2017). SLI's growth has been above the industry average (12% and 13% in CY2018 and CY2017, respectively) and the same is because of the Company's business model which focuses on niche customer segments along with differentiated endowment/protection products. ICRA Lanka also notes that SLI's market share growth in FY2018 has come at the expense of larger peers, as the Company has been innovative to capture opportunities in the life insurance sector.

Healthy business performance indicators: SLI's first year persistency rate was 84% in FY2018 and FY2017, which is higher than most peers; this is on account of its focused target marketing and product positioning, resulting in lower rate of lapses. The Company caters mainly to the premium segment of customers and, hence is characterized by above average ticket sizes; average premium per policy was LKR 128,887 in FY2018 (Industry average is between LKR 38,000 - 48,000). ICRA Lanka expects the Company's targeted customer selection approach to support its medium term growth plan of 30% YoY GWP growth. However, the ability to grow in view of an expected increase in competitive pressures and the consequent impact on performance indicators would be a key monitorable

Profitability supported by positive underwriting outlook: Company reported a profit before tax of LKR 1,095 Mn in FY2018 compared to LKR 1,905 Mn in FY2017; inclusive of deferred tax gains, Company reported a profit after tax of LKR 3,336 Mn and LKR 2,325 Mn, in the same periods, respectively. Moreover, the Company has recorded a RoE and RoA of 63.2% and 19.2% in FY2018, respectively (RoE and RoA of

² Calendar Year

79.5% and 18.6% in FY2017). The healthy profitability indicators and underwriting performance provide support for the Company's future growth through strong internal generations.

Operational, managerial and financial support from the Softlogic group: As part of the Softlogic group, the parent company, provides support from the group entities; and the ability to leverage synergies between different business units, including the healthcare segment comprising of the Asiri Hospital Chain. Support towards other entities in the group, limits SHP in extending any significant financial support in the near term. However, ICRA Lanka envisages SHP to adequately support, if required, in the long term.

Credit challenges

Solvency indicators moderate compared with similar-sized peers: Risk Based Capital adequacy ratio of the Company as in December 2018 was 199% which is above the regulatory minimum of 120%, although lower than peers; Risk Based CAR as in December 2017 and December 2016 was 208% and 195%, respectively. Dividend payouts by the Company over the past five years have been on average 33% which has negated the need for fresh equity. Despite the aggressive growth outlook of SLI, which may exert some pressure on its capitalization profile, ICRA Lanka expects the near to medium term solvency to remain adequate to support business growth.

Impact of tax liabilities: With the new Inland Revenue Act coming into effect in April 1, 2018, the total income of life insurance businesses would be liable to income taxes going forward. However, as in December 2018, Company has recognized deferred tax assets of LKR 2.8 Bn in respect of past accumulated tax losses which could be utilized to set off future income tax payable, for a period of six years. While the near term impact of changes in the tax regime is envisaged to be modest, being subject to higher taxes may impact the Company in the long term.

Increase in claims: SLI's claims ratio (as percentage of NPE) rose to 13.5% as of FY2018 vis-à-vis 6.6% in FY2017 (FY2016: 6.0%). A maturing product portfolio, changes in the business mix and higher retention has led to an increase in the claims ratio in FY2018; ICRA Lanka expects the claims ratio to remain at a similar level as the product portfolio seasons further.

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

Links to applicable criteria: [ICRA Lanka's Credit Rating Methodology for Insurance Companies](#)

About the Company:

Softlogic Life Insurance PLC, formally known as Asian Alliance Insurance PLC commenced operations in December 1999 and had evolved into a composite insurance solutions provider with a sizeable market share in the life insurance segment. The Company catered to a clientele that consisted of corporates and individuals both in Life and non-life businesses through an extensive network of regional distribution offices located throughout Sri Lanka. The Company was acquired by the diversified conglomerate, the Softlogic Group in 2011. Owing to a change in the regulations in 2014, the general insurance and the life insurance businesses were segregated with the former becoming a step-down subsidiary of the latter. In

October 2016, Company divested its entire stake in the general insurance business and the life insurance company was renamed as Softlogic Life Insurance PLC. As in 2018, two foreign institutional investors, DEG of Germany and Leapfrog (who have exposure to financial services and healthcare sectors) have invested in a significant minority (about 19% each) in the Company.

During the year ended December 31, 2018, SLI reported a net profit of LKR 3.3 Bn on a Gross Written Premium of LKR 10.0 Bn compared to a net profit of LKR 2.3 Bn on a Gross Written Premium of LKR 7.5 Bn for the corresponding period of the previous fiscal year.

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