ICICI Lombard General – BUY

22 July 2019

1QFY20 review

IIFL Institutional Equities

In-line quarter, on track for a solid 2H

ICICI Lombard (ILOM) reported in-line 1QFY20 results, with GDPI growth at 17.7% ex-crop, much higher than the industry at 13.6%, gaining share through motor and health segments. Combined ratios worsened by 80bps QoQ, due to continuing new business strain from long term TP business, resulting in 7% PAT growth, in line with our expectations. Motor grew 14% YoY, as TP segment continued its strong trajectory (17% YoY) despite no price hike in TP rates for the large part of the quarter. Changing regulations, improving competitive dynamics and conservative strategy favouring profitability over growth by avoiding businesses such as crop provide strong earnings visibility, in our view. Hence, we forecast GDPI/EPS Cagr of 12%/33% over FY19-21ii. We expect ~530bps improvement in its RoE, to 26.6% by FY21ii (6.8x P/B). Reiterate Buy.

Market share gains continue in major segment: ILOM's GDPI grew much better than the industry in 1QFY20, as it gained market share in motor and fire segments due to better positioning, with OEM dealers and increased exposure to PVs. Management reiterated its intention to tactically chase businesses where pricing improves such corporate health, CVs and crop. But it remains committed to maintain RoE above 20% and combined ratios lower than 100%.

GDPI motoring away; crop may cease to exist in FY20: Structural changes in motor TP regulations are resulting in high premium growth (14% YoY) despite declines in underlying autos sales in 1Q. While motor loss ratios increased due to pricing pressure in OD and lack of tariff hike in TP, it is being offset by higher float income and investment leverage (up 30bps YoY to 4.3X). ILOM remains cautious on crop which may result in no crop business in FY20.

Reiterate BUY: ILOM remains our top pick despite the 30% rally YTD, as we believe it is a good long-term compounding story and has upside risks to EPS and RoE from improving GDPI/combined ratios. Our 12-mth TP of Rs1,300 is pegged at 30x 2YF P/E. Key risk: Natural catastrophes.

CMP	Rs1092
12-mth TP (Rs)	1300 (19%)
Market cap (US$m)	7,195
Bloomberg	ICICIGI IN
Sector	General Insurance

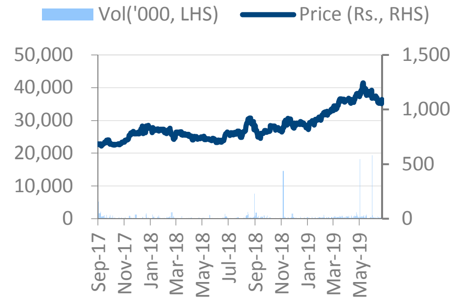
Price performance (%)

	1M	3M	1Y
Absolute (Rs)	-3.6	-0.3	45.5
Absolute (US$)	-2.6	0.3	44.8
Rel. to Sensex	-3.2	0.3	38.6
Cagr (%)		3 yrs	5 yrs
EPS		26.8	15.0

Shareholding pattern (%)

Promoter	55.9
Pledged (as % of promoter share)	0.0
FII	27.7
DII	8.6
52Wk High/Low (Rs)	1283/639
Shares o/s (m)	454
Daily volume (US$ m)	19.0
Dividend yield FY20ii (%)	0.7
Free float (%)	44.0

Stock performance



Financial summary (Rs m)

Y/e 31 Mar, Parent	FY18A	FY19A	FY20ii	FY21ii	FY22ii
GDPI	123,569	144,882	155,400	182,099	213,510
Underwriting Profit	(2,309)	(1,455)	(747)	574	1,276
Investment Income	15,687	18,512	23,245	29,249	36,239
Profit before tax	11,962	15,984	21,264	28,403	35,883
Profit after tax	8,618	10,493	13,822	18,462	23,324
Pre-exceptional EPS (Rs)	19.0	23.1	30.4	40.6	51.3
Growth (%)	22.0	21.7	31.7	33.6	26.3
PER (x)	57.5	47.3	35.9	26.9	21.3
BVPS (Rs)	100.0	117.1	132.7	161.2	197.1
PB (x)	10.9	9.3	8.2	6.8	5.5
Dividend payout (%)	25.3	31.2	30.0	30.0	30.0
ROE (%)	20.8	21.3	23.8	26.6	27.8
Solvency margin (%)	205	224	237	245	253

Source: Company, IIFL Research. Priced as on 18 July 2019

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Key conference call takeaways

- **Above-industry growth continues:** ICICI Lombard reported GDPI decline of 7.6% YoY in 1QFY20, on account of no kharif crop tenders being underwritten in 1QFY20. Ex-crop GDPI growth stood at a robust 17.7% YoY, higher than the industry growth (ex-crop) of 13.6% YoY. Net earned premium growth was also healthy, at 21.7% YoY. PAT growth stood at 7.1% YoY, in line with IIFL expectations.

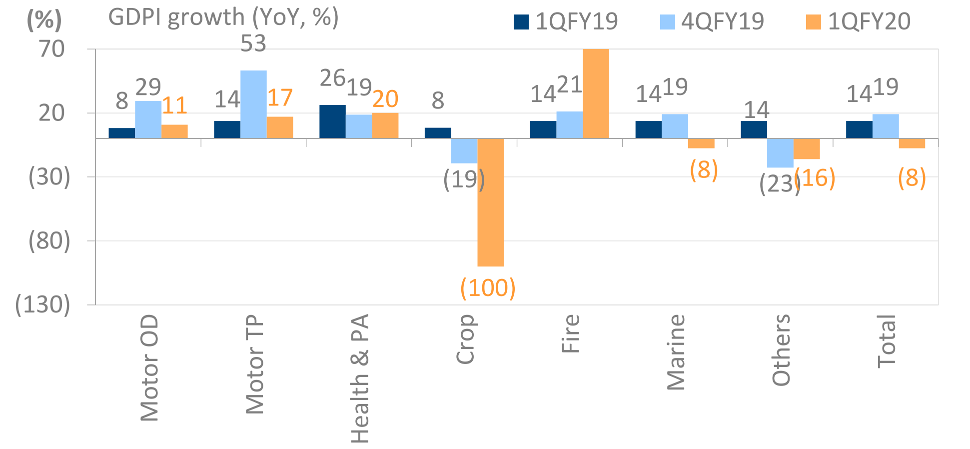
Figure 1: ILOM 1QFY20 results summary

ICICI Lombard (INR bn)	1QFY20	1QFY19	YoY (%)	1QFY20ii	Actual v. IIFL
GDPI	34.9	37.7	-7.6%	34.9	0.0%
Net Earned Premium	22.4	18.4	21.7%	23.3	-3.8%
Claims ratio (%)	75.5%	76.9%	-146 bps	74.0%	147 bps
Combined ratio (%)	102.0%	103.8%	-179 bps	101.8%	19 bps
PAT	3.1	2.9	7.1%	3.1	-0.3%

Note: Combined ratio calculated as % of NEP
Source: Company, IIFL Research

- Loss ratio improved by 146bps YoY to 75.5%, led by an improvement in the health and fire segment. However, it was a tad higher than IIFL expectations due to worsening of loss ratios in the Motor OD segment both sequentially and on a YoY basis.
- Combined ratio stood at 102.0%, in line with IIFL expectations. Combined ratio was impacted to the tune of ~70bps by cyclone Fani. Combined ratio worsened slightly on a sequential basis on account of long-term motor TP policies, wherein price hikes were effective only from mid-June.
- **Structural boost to fire segment's growth and profitability:** Fire segment grew strongly by 75% YoY, driven by improvement of occupancy rates across eight occupancies. ILOM elaborated upon this – in eight fire occupancies (segments) like power, rubber, steel, etc, GIC Re had asked primary insurance players to raise the premium prices charged to the customer, if they were to enter into a treaty with GIC Re. Since GIC Re is the dominant reinsurer in the Indian industry, this resulted in a structural boost for the industry; the fire segment, on aggregate, grew ~40% YoY for the industry.
- Management indicated that these segments formed ~30-35% of the fire business and the average price hike across the segments was nearly 3-4x. As the pricing has become more favourable, ILOM has also decided to retain 10% more fire business.
- **Market share gains in Motor continue:** Growth in the motor TP/OD business continued to be above industry, at 17% YoY/11% YoY, despite no price hike in TP rates for the large part of the quarter. ILOM continues to benefit from various regulatory tailwinds to the sector and to gain market share, driven by its investments in the agency channel.
- **Unbundling of Motor OD opens new possibilities:** With the regulator now allowing standalone OD policies to be sold for both new and old cars, ILOM commented that it could enhance focus on certain segments/geographies, where it deemed the OD loss ratio to be favourable, but the TP loss ratio to be high.

Figure 2: Overall Motor grew 14% YoY, as the TP segment continued its strong trajectory (17% YoY) despite no price hike in TP rates for the large part of the quarter



Source: Company, IIFL Research

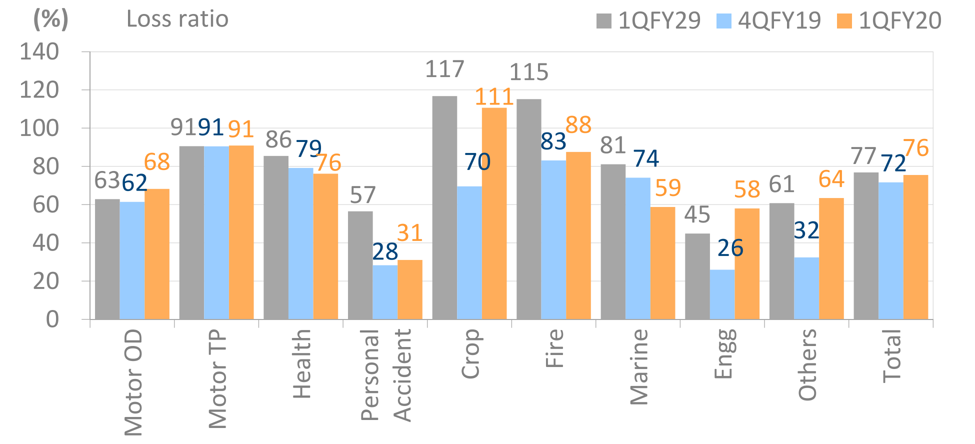
- **Possibility of competitive intensity increasing remains:** ILOM admitted that unbundling of OD policies could lead to increased pressure on pricing, as the players who were not able to build scale in TP could try and focus on OD via higher discounts. However, they indicated that motor OD loss ratios for the industry were much higher than theirs (mid-70s) and, hence, further price cuts could make the segment unviable.
- **Structural change in nature of motor business continues:** With more long-term OD policies being sold, ILOM indicated that savings from renewal and distribution costs would be passed on to the customer. Hence, loss ratios could inch upwards while expense ratios would decrease. ILOM indicated that its share of long-term OD policies stood at ~20%/9% for 2W/4Ws, with jump in share of 4Ws (~3% earlier) driven by Maruti, where long-term OD policies have gone up to ~40%.
- **Recalibrating mix of CVs in the motor business:** ILOM indicated that it was not seeing very favourable pricing in CVs and hence indicated increased caution on the CV book.
- **Robust growth in the health segment continues:** ILOM's health & PA segment grew at a robust 20% YoY, driven by the retail indemnity new business, which grew 49% YoY. While business sold by NBFCs was muted, banks saw benign growth.
- **Turning selective on group health:** ILOM had tactically increased exposure to its corporate health business in FY19, since pricing was quite favourable vs. FY18. ILOM is witnessing no further improvement in pricing and hence is turning selective, and reducing exposure in accounts with higher loss ratios.

Figure 3: Loss ratios worsened sequentially due to motor TP and cyclone Fani

Operating ratios (%)	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	% YoY
Loss ratio	76.9	80.4	72.4	71.7	75.5	-150 bps
Commission	2.2	1.2	4.4	2.9	2.4	20 bps
Expense ratio	24.6	19.4	24.6	26.6	24.1	-50 bps

Note: All ratios calculated as % of NEP Source: Company, IIFL Research

Figure 4: Loss ratios in motor OD segment continued to inch upwards due to increasing competitive intensity, higher share of retail business led to lower loss ratios in health



Source: Company, IIFL Research

Figure 5: ILOM remains our top pick despite 30% rally YTD as we believe it is a good long term compounding story; we forecast 12%/33% GDPI/EPS Cagr over FY19-21ii

Source: Company, IIFL Research, Bloomberg

Figure 6: ICICI Lombard 1QFY20 review

ICICI Lombard (Rs m)	1QFY19	4QFY19	1QFY20	% YoY	% QoQ
Policyholders' Account					
Gross premium written	38,557	35,279	35,607	(8)	1
Net premium written	22,677	24,610	23,850	5	(3)
Premium Earned (Net)	**18,449**	**21,975**	**22,449**	**22**	**2**
Income from investments (net)	3,837	3,130	4,098	7	31
Other income	158	93	94	(40)	2
Total income	**22,444**	**25,197**	**26,642**	**19**	**6**
Commission	413	632	547	33	(13)
Operating expenses	4,544	5,852	5,410	19	(8)
a) Staff expenses	1,481	1,313	1,744	18	33
b) Other operating expenses	3,063	4,539	3,666	20	(19)
Premium deficiency	-	-	-	NA	NA
Incurred claims	14,191	15,747	16,941	19	8
Total expenses	**19,148**	**22,230**	**22,898**	**20**	**3**
Underwriting profit/ (loss)	**(699)**	**(255)**	**(449)**	**(36)**	**76**
Provision for doubtful debts	-	-	-	NA	NA
Provision for fall in inv. value	-	-	-	NA	NA
Operating profit/ (loss)	**3,296**	**2,967**	**3,743**	**14**	**26**
Shareholders' Account					
Income in shareholder's account	**4,633**	**4,106**	**5,013**	**(19)**	**(9)**
a) Transf frm Policyholders' Fund	3,296	2,967	3,743	NA	NA
b) Income from investments	1,337	1,107	1,269	(5)	15
a) Other income	0	32	1	150	(98)
Total Expenses	**201**	**651**	**260**	**29**	**(60)**
Profit before taxes	**4,432**	**3,455**	**4,753**	**7**	**38**
Provision for taxes	1,539	1,178	1,655	7	41
Profit after tax	**2,893**	**2,277**	**3,098**	**7**	**36**

Source: Company, IIFL Research

Figure 7: ICICI Lombard 1QFY20 review

Analytical ratios (reported)	1QFY19	4QFY19	1QFY20	% YoY	% QoQ
GDPI Mix %					
Motor OD	20	27	24	400 bps	-320 bps
Motor TP	15	27	19	400 bps	-830 bps
Health & Personal Accident	20	22	26	600 bps	380 bps
Crop	21	11	-	-2100 bps	-1070 bps
Fire	9	4	17	800 bps	1320 bps
Marine	4	3	4	0 bps	100 bps
Others	11	6	10	-100 bps	420 bps
Total	**100**	**100**	**100**	**0 bps**	**0 bps**
Loss Ratio (%) (reported)					
Motor OD	62.9	61.5	68.2	530 bps	670 bps
Motor TP	90.6	90.5	90.9	30 bps	40 bps
Health	85.5	79.2	76.2	-930 bps	-300 bps
Personal Accident	56.5	28.3	31.1	-2540 bps	280 bps
Crop	116.8	69.6	110.7	-610 bps	4110 bps
Fire	115.2	83.1	87.6	-2760 bps	450 bps
Marine	81.1	74.1	58.8	-2230 bps	-1530 bps
Engineering	44.9	26.0	58.0	1310 bps	3200 bps
Others	60.8	32.4	63.5	270 bps	3110 bps
Total	**76.9**	**71.7**	**75.5**	**-140 bps**	**380 bps**
Ratios (as % of NEP)					
Claims ratio	76.9	71.7	75.5	-150 bps	380 bps
Commission ratio	2.2	2.9	2.4	20 bps	-40 bps
Expense ratio	24.6	26.6	24.1	-50 bps	-250 bps
Combined ratio	103.8	101.2	102.0	-180 bps	80 bps

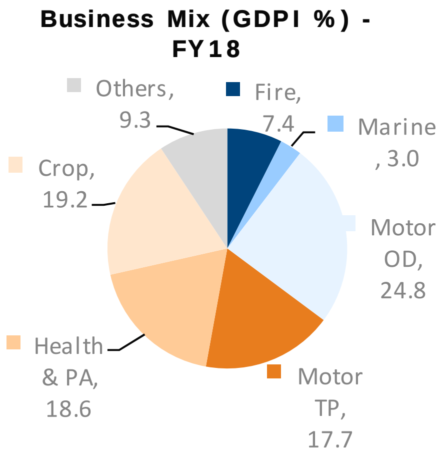
Source: Company, IIFL Research

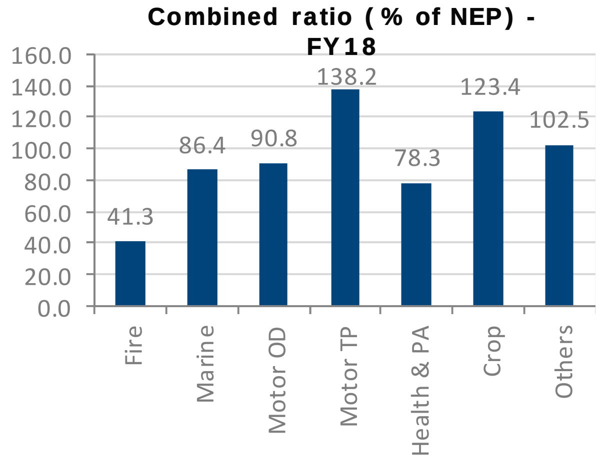
Background: ILOM was incorporated on 30-October-2000 as a joint venture between ICICIB and Fairfax Financial Holdings. The company commenced operations in FY02 and has built a large franchise by delivering diverse sets of products in the corporate and retail segments. ILOM registered GDPI of Rs144.9bn in FY19. The company's market share on GDPI basis stood at 8.5% among all non-life insurance insurers and 15.5% among private sector non-life insurers, in FY19. ILOM has maintained market leadership through various cycles of industry evolution since FY04. It became the first private sector non-life insurer in India to reach Rs100bn in GDPI in fiscal 2017.

Management

Name	Designation
Bhargav Dasgupta	MD & CEO
Gopal Balachandran	CFO

Source: Company

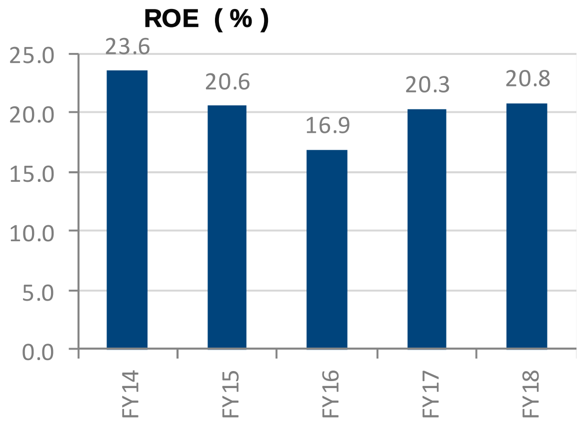


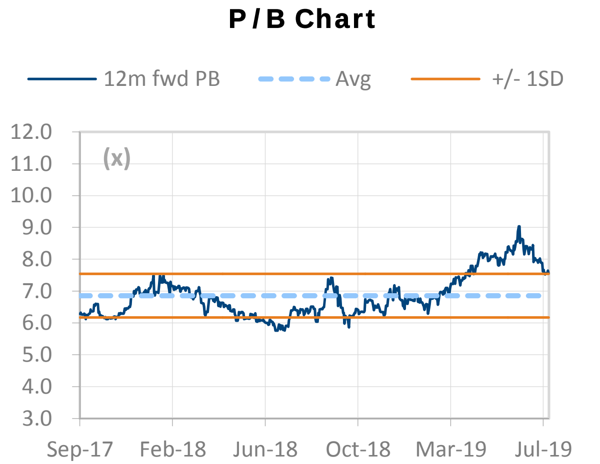


Key earnings drivers

Y/e 31 Mar, Parent (%)	FY18A	FY19A	FY20ii	FY21ii	FY22ii
GDPI growth	15.2	17.2	7.3	17.2	17.2
Retention Rate	62.3	64.5	60.2	62.3	64.5
Claims/ NEP ratio	76.9	75.3	75.1	74.3	73.9
Commission/ NEP ratio	(4.1)	2.7	3.3	3.3	3.2
Opex/ NEP ratio	30.6	23.8	22.3	21.9	22.0
Combined ratio	103.3	101.7	100.8	99.5	99.1
Tax rate	28.0	34.4	35.0	35.0	35.0
Inv Yield w unrealised gains	9.4	9.1	9.2	9.2	9.4
Inv Yield w/o unrealised gains	6.4	6.9	8.8	8.8	9.0

Source: Company, IIFL Research





Financial summary

Policyholders' Account (Rs m)

Y/e 31 Mar, Parent	FY18A	FY19A	FY20ii	FY21ii	FY22ii
GDPI	123,569	144,882	155,400	182,099	213,510
Premium on Reinsurance Accepted	2,432	3,010	3,830	4,508	5,308
Premium on Reinsurance Ceded	47,553	52,507	47,739	54,840	63,040
Net Premium	78,448	95,386	111,491	131,766	155,778
Change in the Unexpired Risk Reserve	9,330	11,632	14,060	17,137	20,845
Premium earned - Net	69,117	83,753	97,430	114,630	134,933
Income other than premiums	11,546	13,769	17,925	22,961	28,659
Total A	**80,663**	**97,522**	**115,355**	**137,590**	**163,591**
Net claims paid	34,690	58,450	67,824	78,949	92,341
Change in Claims Outstanding	18,458	4,631	5,374	6,255	7,316
Total Claims Incurred (Net)	53,147	63,081	73,198	85,205	99,658
Net Commission	(2,840)	2,229	3,227	3,748	4,345
Opex related to insurance business	21,119	19,898	21,754	25,104	29,654
Total Expenses	**71,426**	**85,208**	**98,178**	**114,056**	**133,657**
Operating profit/(Loss)	**9,237**	**12,314**	**17,178**	**23,535**	**29,935**
Transfer to Shareholders' Account	9,237	12,314	17,178	23,535	29,935

Note – summation may not equal to the surplus/(deficit) as all P&L items are not shown in the above statement

Shareholders' Account (Rs m)

Y/e 31 Mar, Parent	FY18A	FY19A	FY20ii	FY21ii	FY22ii
Operating profit/(Loss)	9,237	12,314	17,178	23,535	29,935
- Fire Insurance business	1,328	567	1,218	1,455	1,721
- Marine Insurance business	469	(363)	(219)	(214)	(210)
- Misc. Insurance business	7,440	12,110	16,178	22,293	28,424
Income from Investments	4,059	4,600	5,320	6,288	7,580
Other income	82	143	0	0	0
Total Income	**13,378**	**17,057**	**22,498**	**29,822**	**37,515**
Total Expenses	1,415	1,073	1,234	1,419	1,632
Profit Before Tax	**11,962**	**15,984**	**21,264**	**28,403**	**35,883**
Tax	3,345	5,492	7,442	9,941	12,559
Profit After Tax	**8,618**	**10,493**	**13,822**	**18,462**	**23,324**

Source: Company, IIFL Research

Balance Sheet (Rs m)

Y/e 31 Mar, Parent	FY18A	FY19A	FY20ii	FY21ii	FY22ii
Shareholders' Funds	**52,750**	**56,589**	**66,264**	**79,187**	**95,514**
Share capital	4,539	4,543	4,543	4,543	4,543
Reserves and surplus	48,211	52,046	61,721	74,644	90,971
Borrowings	4,850	4,850	4,850	4,850	4,850
Sources of Funds	**57,600**	**61,439**	**71,114**	**84,037**	**100,364**
Investments - Shareholders'	47,284	53,431	64,117	76,940	92,328
Investments - Policyholders'	134,643	168,877	219,541	274,426	329,311
Loans	0	0	0	0	0
Fixed assets	4,060	4,652	4,885	5,129	5,386
Deferred tax asset	2,114	3,013	3,013	3,013	3,013
Net current assets	**(130,500)**	**(168,534)**	**(220,441)**	**(275,470)**	**(329,673)**
Others	0	0	0	0	0
Application of Funds	**57,600**	**61,439**	**71,114**	**84,037**	**100,364**

Ratio analysis (%)

Y/e 31 Mar, Parent	FY18A	FY19A	FY20ii	FY21ii	FY22ii
Growth ratios (%)					
GDPI	15.2	17.2	7.3	17.2	17.2
Net Premium Income	12.1	21.2	16.3	17.7	17.7
Operating Expenses	9.8	19.3	15.2	16.2	17.2
NPAT	22.8	21.8	31.7	33.6	26.3
EPS	22.0	21.7	31.7	33.6	26.3
Profitability Ratios (%)					
Retention Rate	62.3	64.5	60.2	62.3	64.5
Commission To NEP	(4.1)	2.7	3.3	3.3	3.2
Opex to NEP	30.6	23.8	22.3	21.9	22.0
Combined Ratio	103.3	101.7	100.8	99.5	99.1
Underwriting profit/(loss) % of NEP	(3.3)	(1.7)	(0.8)	0.5	0.9
Operating profit/(loss) % of NEP	13.4	14.7	17.6	20.5	22.2
Return ratios (%)					
ROE	20.8	21.3	23.8	26.6	27.8
Solvency margin	205.0	224.0	236.9	245.2	253.0
Investment Leverage	3.9	4.1	4.4	4.6	4.5

Source: Company, IIFL Research

Disclosure: Published in 2019, © IIFL Securities Limited (Formerly 'India Infoline Limited') 2019

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A graph of daily closing prices of securities is available at http://www.nseindia.com/ChartApp/install/charts/mainpage.jsp, www.bseindia.com and http://economictimes.indiatimes.com/markets/stocks/stock-quotes. (Choose a company from the list on the browser and select the "three years" period in the price chart).

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Key to our recommendation structure

BUY - Stock expected to give a return 10%+ more than average return on a debt instrument over a 1-year horizon.

SELL - Stock expected to give a return 10%+ below the average return on a debt instrument over a 1-year horizon.

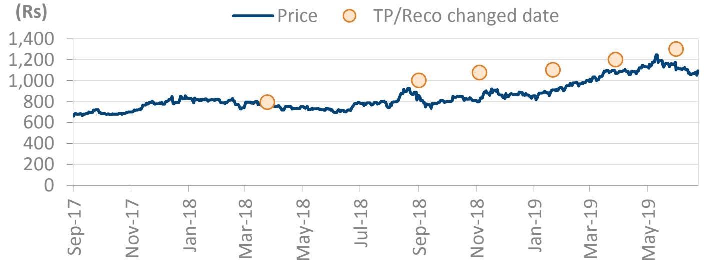
Add - Stock expected to give a return 0-10% over the average return on a debt instrument over a 1-year horizon.

Reduce - Stock expected to give a return 0-10% below the average return on a debt instrument over a 1-year horizon.

Distribution of Ratings: Out of 223 stocks rated in the IIFL coverage universe, 111 have BUY ratings, 7 have SELL ratings, 70 have ADD ratings and 34 have REDUCE ratings

Price Target: Unless otherwise stated in the text of this report, target prices in this report are based on either a discounted cash flow valuation or comparison of valuation ratios with companies seen by the analyst as comparable or a combination of the two methods. The result of this fundamental valuation is adjusted to reflect the analyst's views on the likely course of investor sentiment. Whichever valuation method is used there is a significant risk that the target price will not be achieved within the expected timeframe. Risk factors include unforeseen changes in competitive pressures or in the level of demand for the company's products. Such demand variations may result from changes in technology, in the overall level of economic activity or, in some cases, in fashion. Valuations may also be affected by changes in taxation, in exchange rates and, in certain industries, in regulations. Investment in overseas markets and instruments such as ADRs can result in increased risk from factors such as exchange rates, exchange controls, taxation, and political and social conditions. This discussion of valuation methods and risk factors is not comprehensive – further information is available upon request.

ICICI Lombard: 3 year price and rating history



Date	Close price (Rs)	Target price (Rs)	Rating
19 Apr 2018	766	792	ADD
26 Sep 2018	814	1000	BUY
29 Nov 2018	795	1075	BUY
15 Feb 2019	910	1100	BUY
22 Apr 2019	1095	1200	BUY
25 Jun 2019	1156	1300	BUY