# RATING REPORT

# EFU General Insurance Limited

**REPORT DATE:**
September 11, 2020

**RATING ANALYSTS:**
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| RATING DETAILS | | |
|---|---|---|
| | **Latest Rating** | **Previous Rating** |
| **Rating Category** | **Long-term** | **Long-term** |
| **IFS** | AA+ | AA+ |
| ***Rating Date*** | *September 11, '20* | *July 30, '19* |
| **Rating Outlook** | Stable | Stable |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1932** | **External auditors:** KPMG Taseer Hadi & Co., Chartered Accountants |
| **Public Company** | **Chairman of the Board:** Mr. Saifuddin N. Zoomkawala |
| **Key Shareholder(s):** | **Chief Executive Officer:** Mr. Hasanali Abdullah |
| **Jahangir Siddiqui & Co. Ltd. – 21.10%** | |
| **Managing Committee of Ebrahim Alibhai Foundation – 12.02%** | |
| **Rafique R. Bhimjee – 8.29%** | |
| **Muneer R. Bhimjee – 7.98%** | |
| **Bano R. Bhimjee – 6.92%** | |
| **Energy Infrastructure Holding (Pvt.) Ltd. – 5.39%** | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| **VIS Entity Rating Criteria: General Insurance, March 2017** |
| **https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Meth-GenInsurance201702.pdf** |

# EFU General Insurance Limited

## Company Overview

*In 1932, EFU General Insurance Limited (EFU) was incorporated as a public limited company. EFU is engaged in provision of general insurance business and is listed on the Pakistan Stock Exchange.*

**Profile of Chairman:**

*Mr. Saifuddin N. Zoomkawala has been associated with EFU Group since 1964. He also worked as General Manager for Credit & Commerce Insurance Company at UAE, an insurance company of EFU group. He served as Managing Director of EFU General Insurance Limited from July 10, 1990 till July 2011 when he was elected Chairman of the Company. He is also the Chairman of Allianz EFU Health Insurance Limited and Director of EFU Life Assurance Limited, and EFU Services (Pvt.) Limited, all being EFU Group Companies.*

**Profile of CEO:**

*Mr. Hasanali Abdullah has been associated with EFU General Insurance Limited since 1979 and is Managing Director & Chief Executive of the Company from 2011. He is on the Boards of EFU Life Assurance Ltd., Allianz EFU Health Insurance Ltd., EFU Services (Private) Ltd., Tourism Promotion Services (Pakistan) Limited (owners of Serena Hotels), Honorary Treasurer of Aga Khan Hospital & Medical College Foundation, Member National Committee of Aga Khan University Foundation (Pakistan Branch) Geneva.*

## RATING RATIONALE

EFU General Insurance (EFU) is one of the oldest general insurance companies in Pakistan with an established franchise value and highest market share in the non-life segment. Market share of the company, inclusive of takaful contributions underwritten, was 23.3% (2018: 24.3%) in 2019. The company operates through a network of 54 (2018: 53) branches.

### Insurance Sector Update

**Table 1: Insurance Industry Financial Indicators (Source: IAP)**

| (Rs. in Billions) | 2018 | 2019 |
|---|---|---|
| Insurance Premium (Gross) | 77.0 | 83.7 |
| Takaful Contributions (Gross) | 8.6 | 11.0 |
| Industry Total (Gross) | 85.7 | 94.6 |
| Combined Ratio | 86.3% | 89.1% |
| - Net Claims Ratio | 50.5% | 51.7% |
| - Underwriting Expense Ratio | 35.8% | 37.4% |
| Net Operating Ratio | 71.6% | 72.5% |
| RoAA | 4.3% | 4.7% |
| RoAE | 9.8% | 10.5% |
| Operating Leverage | 50.7% | 49.6% |

- The gross premiums/ takaful contributions underwritten by the industry grew by 10% in 2019. The non-life insurance penetration, at ~0.2%, continues to lag the regional counterparts.
- Amidst double digit inflation (CYTD Dec'19: 12.6%), the industry' underwriting expense ratio increased, while a slight uptick was also noted in net claims ratio.
- Nevertheless, the industry's investment income grew by almost a fifth, which supported the net operating ratio.
- The sector's operating leverage remains around ~50%, which is considered to be on the lower side.
- The impact of the outbreak of novel coronavirus on the insurance has been relatively measured so far. Nevertheless, given the overall pandemic-induced macroeconomic changes, the following pointers summarize the impact.
    - The premium from all lines of business is expected to be impacted for 2020.
        - The pandemic-related project delays are expected to impact premiums under fire & engineering segment, albeit this largely depends on the actual project delays.
        - The reduced international trade will affect premiums in the marine line of business.
        - As a result of the coronavirus public lock down in Q2'2020, the automobile sales have been notably impacted. These have started picking up in Q3'2020, albeit the reduced automobile sales will have an impact on motor premiums, as new car insurance policies would drop.
        - In view of the above factors, we expect full-year premium for 2020 to be affected. The impact will largely depend on how long the pandemic stretches.
    - Despite lower premiums, the profitability of the insurance industry is likely to improve
        - The reduced economic activity, due to Covid-19, is likely to have a positive impact on claims ratio. The recent rains would adversely impact motor claims ratios generally in Property and Motor portfolio.
        - However, the expenses base likely to remain sticky, which should

*Director of Institute of Financial Markets of Pakistan. He is ex – officio member of Executive Committee of Insurance Association of Pakistan. He has served on the Boards, Council and Committees of various Aga Khan Development Network institutions from 1976 to 2002. Mr. Hasanali Abdullah is Chartered Accountant and Certified Director from Pakistan Institute of Corporate Governance (PICG).*

resultantly increase underwriting expense ratio.

- Given the sizable reduction in interest rates, the investment income, specifically for companies holding fixed rate PIBs, are expected to increase on account of capital gains on PIBs. This should have a positive impact on the net operating ratio.

- Overall capitalization & liquidity buffers in place are considered to be adequate. Industry capitalization & liquidity are expected to persist.
- Going forward, there are plans to implement IFRS 17 across the industry, which will require additional provisioning. However, the industry-de IFRS 17 implementation is scheduled for January 1' 2022 and so far we have not received an estimation of the related provisioning charge.

## EFU General Insurance: Business Update

- **Business Mix**

**Table 2: Gross Premium (Segment-wise)**

| (Rs. in millions) | 2018 | 2019 |
|---|---|---|
| Fire | 59.9% | 61.3% |
| Marine | 12.9% | 12.9% |
| Motor | 18.6% | 17.5% |
| Miscellaneous | 8.5% | 8.3% |
| Gross Written Premiums | 18,780.2 | 19,774.2 |

- EFU offers insurance policies covering fire and property damage (including engineering), marine cargo hull and aviation, motor and other miscellaneous risks.
- Fire and property segment constitutes the largest proportion of overall business mix on gross basis. During 2019, EFU's gross underwriting (inclusive of takaful contributions) grew by 6%. In Q1'2020, the gross premium underwritten remained comparable to SPLY (+1.8%).
- As per management, so far the impact of the coronavirus has been measured on EFU, with gross premium not being significantly impacted by the business activity recession in Q2.
- In terms of line of business, premium from the motor segment is expected to be depressed in 2020, with new car purchases being significantly lower in Q2'2020, than SPLY. Furthermore, given trade slowdown, marine segment has also been affected.

**Table 3: Cession (Segment-wise)**

| (Rs. in millions) | 2018 | 2019 |
|---|---|---|
| Fire | 83.7% | 83.0% |
| Marine | 35.3% | 41.2% |
| Motor | 0.3% | 0.4% |
| Miscellaneous | 64.2% | 65.8% |
| Cession | 60.3% | 61.7% |
| Cession (excluding motor) | 74.0% | 74.7% |

- **Reinsurance Arrangements:** Cession ratio of the company was reported at 61.7% (2018: 60.3%) in 2019. EFU's cession stands the highest amongst peers.

  In 2020, there have been a few changes in reinsurance arrangements, which include a shift from proportional treaty to excess of loss treaty in the Fire & Engineering, and a similar change has been undertaken in the Miscellaneous segment. As per management, given these changes the cession will be lower going forward, vis-à-vis EFU's historical trend.

- **Investments**: There have been some change in the composition of the investment portfolio, most notably the reduction in proportion of investment in equities, which reduced from 19.5% as of Dec'18 to 9.2% as of Mar'20. In its place, the investment in debt securities has increased. Given the higher interest rate environment in 2019, the exposure towards PIB's increased from Rs. 1.3b to Rs. 6.1b (as a & of debt portfolio Dec'18: 16%, Dec'19: 62%), while T-Bill holdings reduced from Rs. 6.8b to Rs. 3.2b (as a & of debt portfolio Dec'18: 83%, Dec'19: 33%)

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**Table 4: Investment Portfolio**

| *Rs. in millions* | Dec'18 | | Dec'19 | | Mar'20 | |
|---|---|---|---|---|---|---|
| | Rs. | % | Rs. | % | Rs. | % |
| Subsidiary | 9,897.9 | 38.8% | 10,169.3 | 39.3% | 9,411.1 | 37.9% |
| Equities | 4,970.5 | 19.5% | 3,271.5 | 12.6% | 2,280.0 | 9.2% |
| Debt Securities | 8,228.8 | 32.3% | 9,654.5 | 37.3% | 10,395.5 | 41.9% |
| Term Deposits | 506.6 | 2.0% | 444.4 | 1.7% | 392.0 | 1.6% |
| Real Estate | 1,879.1 | 7.4% | 2,341.5 | 9.0% | 2,343.1 | 9.4% |
| Total | 25,482.9 | | 25,881.2 | | 24,821.7 | |

- **Profitability:** The net claims ratio, which increased to 40.8%, vis-à-vis average of 40% during 2017-18.

**Table 5: Gross Claims Ratio (Segment-wise)**

| | 2018 | 2019 |
|---|---|---|
| **Gross Claims Ratio** | **24.1%** | **31.6%** |
| **- Fire** | 12.7% | 21.3% |
| **- Marine** | 36.7% | 42.6% |
| **- Motor** | 49.8% | 51.6% |
| **- Miscellaneous** | 33.1% | 44.5% |
| **Net Claims Ratio** | **40.8%** | **47.6%** |
| **Underwriting Expense Ratio** | **42.5%** | **46.3%** |
| **Combined Ratio** | **83.4%** | **93.9%** |

Amidst high inflation, the underwriting expense ratio trended up. Included within the expense ratio, is the commission expense ratio, which remained at almost similar level (2019: 7.5%; 2018: 7.8%). On the other hand, management expense ratio increased from 34.8% to 38.9%. In absolute terms, management overheads grew by 10% during 2019, which is aligned with the double-digit inflation experienced during the period.

Given the uptick in both net claims and underwriting expense ratio, the company's underwriting profit for 2019 was notably lower. This was also reflected in the combined ratio, which increased from 83.4%, in 2018, to 93.9% in 2019.

**Table 6: Income Statement Extract**

| *Rs. in millions* | 2018 | 2019 | Q1'19 | Q1'20 |
|---|---|---|---|---|
| **Net Premium** | **7,562** | **7,460** | **1,825** | **2,179** |
| Claim & Acquisition Costs | (3,677) | (4,105) | (950) | (1,125) |
| Management Expenses | (2,629) | (2,900) | (693) | (729) |
| **Underwriting Results** | **1,257** | **454** | **182** | **326** |
| **Investment Income** | 1,612 | 2,262 | 214 | 646 |
| **Rental Income** | 104 | 112 | 29 | 32 |
| **Profit on WTO** | **117** | **214** | **53** | **59** |
| **Other (net)** | **172** | **784** | **49** | **55** |
| **Profit Before Tax** | **3,262** | **3,827** | **527** | **1,118** |
| **Taxation** | **(1,091)** | **(1,219)** | **(159)** | **(404)** |
| **Profit After Tax** | **2,171** | **2,609** | **368** | **714** |
| **Unrealized Loss on AFS Investments** | **(1,708)** | **(480)** | **(60)** | **(924)** |
| **Other Comprehensive Income** | **464** | **2,129** | **309** | **(210)** |

The investment income depicted notable improvement in 2019, growing from Rs. 1.6b to Rs. 2.3b. In line with the heightened in policy rate in 2019, yield recorded on debt portfolio increased by 400 bpts. However, it is pertinent to mention that there were unrealized outstanding losses on equities, which were taken through Other Comprehensive Income and charged directly to equity. Adjusting the same from the investment income, the net investment income for 2019 was notably higher at Rs. 1.8b, vis-à-vis investment loss of Rs. 96m in the preceding year.

The company reported profit after tax of Rs. 2.6b in 2019 (2018: Rs. 2.2b).

- **Liquidity:** EFU's insurance debt had grown by 32% as of Mar'20, vis-à-vis Dec'18. In absolute terms, the insurance debt grew from Rs. 3.6b, as of Dec'18, to Rs. 4.0b as of Dec'19. The aging of the insurance debt as of Dec'19, is presented in figure 1. With only about a tenth of the insurance debts outstanding for a period greater than 1 year, the aging profile of the insurance debt is considered sound. As per management, there hasn't been any notable change as of Jun'20.

**Table 7: Liquidity Indicators**

| | Dec'18 | Dec'19 | Mar'20 |
|---|---|---|---|
| Liquid Assets/ Net Technical Reserves | 2.73x | 2.42x | 1.96x |
| Insurance Debt to Gross Premium | 19.0% | 20.3% | 21.1%* |
| Operating CF to Net Premium | 23.6% | 38.5% | 74.1%* |

*Annualized

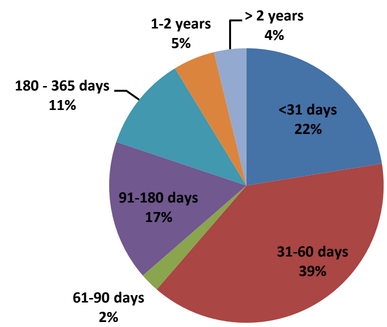


Figure 1: Aging of Insurance Debt (Dec'19)

The company' operating cash flow posted notable improvement in 2019, being reported at Rs. 864m (2018: Rs. 20m). Inclusive of recurring investment income, the operating cash flow for 2019 amounted to Rs. 2.9b (2018: Rs. 1.8b).

EFU's liquid asset holdings stood at Rs. 14.4b as of Mar'20 (Dec'19: Rs. 14.6b Dec'18: Rs. 15.0b). Given an increase in net technical reserves, the liquid asset coverage has trended down on a timeline.

- **Capitalization:** Given mild growth in business base, the operating leverage has not depicted any notable change as of Dec'19. However, Leverage did depict an adverse trend in Q1'20, partly on account of the drop in equity base.

The company's equity base did not depict any notable change in 2019.

**Table 9: Capitalization (Figures in PKR' Millions, unless stated otherwise)**

| | Dec'18 | Dec'19 | Mar'20 |
|---|---|---|---|
| Net Equity | 19,298 | 19,296 | 17,986 |
| - Paid-up Capital | 2,000 | 2,000 | 2,000 |
| - Reserves | 14,523 | 15,766 | 15,242 |
| - Unappropriated Profit | 2,775 | 1,530 | 744 |
| Surplus on Revaluation of PPE | 859 | 1,000 | 1,000 |
| Adjusted Profit | 464 | 2,129 | (210) |
| - Profit | 2,171 | 2,609 | 714 |
| - Unrealized Losses | (1,708) | (480) | (924) |
| Dividends Paid | 2,000 | 2,000 | NA |
| Dividend Payout Ratio | 92.1% | 76.7% | NA |
| Dividend Payout Ratio (Adjusted) | 431.3% | 94.0% | NA |
| Operating Leverage | 39.2% | 38.7% | 48.5%* |
| Financial Leverage | 45.9% | 52.3% | 61.7%* |
| Solvency (Excess Net Admissible Assets ) | 6,348 | 6,385 | NA |

**Key Rating Rationale**

**… Sizable market share and strong outreach**

The IFS ratings assigned to EFU are supported by the company's strong market positioning. Despite slight attrition in market share in 2019, with a market share of 23.3% (2018: 24.3%), EFU remains the industry leader in the non-life insurance domain.

**… Measured impact of novel coronavirus outbreak on the insurance industry**

The novel coronavirus outbreak has had an impact on a wide variety of sectors, which will in variably weigh down on the insurance industry. However, with insurance penetration to GDP already being too low and bulk of the policies representing repeat policy issuances, the impact on Property and Miscellaneous Business is expected to be limited, but the Marine and Motor Business is likely to show downward trend for reasons mentioned above in this report.

**… Sound Reinsurance Panel**

The IFS rating is also supported by the sound reinsurance arrangements in place. The company has a diversified panel of reinsurers providing lead share in different business segments. Reinsurance panel of EFU depicts sound credit quality with majority of business lines reinsured by companies with ratings in the 'A' band.

**… Financial indicators are aligned with the peer median**

Despite the uptick in combined ratio, it is aligned with the peer median. Even though, overall profitability of the company has depicted some volatility, this was akin to the industry and mainly a result of the adverse equity market performance. With equity exposures having been significantly reduced and increase in exposures to fixed income instruments, portfolio market risk is much lower.

In Q1'20, we have noted the increase in both operating and financial leverage. However, these remain aligned with peers. Nevertheless, VIS will continue to closely monitor leverage indicators on quarterly basis.

## EFU General Insurance Limited — Appendix I

| FINANCIAL SUMMARY | | | | *(amounts in PKR millions)* |
|---|---|---|---|---|
| **BALANCE SHEET** | **Dec 31, 2017** | **Dec 31, 2018** | **Dec 31, 2019** | **Mar 31, 2020** |
| **Cash and Bank Deposits** | 1,164 | 1,267 | 1,192 | 1,303 |
| **Investments** | 15,377 | 13,706 | 13,370 | 13,067 |
| **Investment Property** | 1,847 | 1,879 | 2,341 | 2,343 |
| **Insurance Debt** | 2,819 | 3,577 | 4,013 | 4,722 |
| **Total Assets** | 43,654 | 42,869 | 45,699 | 44,785 |
| **Paid-up Capital** | 2,000 | 2,000 | 2,000 | 2,000 |
| **Total Equity** | 20,841 | 19,298 | 19,296 | 17,986 |
| **Total Liabilities** | 22,563 | 22,304 | 25,009 | 25,392 |

| **INCOME STATEMENT** | **2017** | **2018** | **2019** | **Q1'19** | **Q1'20** |
|---|---|---|---|---|---|
| **Net Premium Revenue** | 7,615 | 7,562 | 7,460 | 1,825 | 2,179 |
| **Net Claims** | 2,975 | 3,089 | 3,549 | 779 | 906 |
| **Underwriting Profit** | 1,589 | 1,257 | 454 | 182 | 326 |
| **Net Investment Income** | 1,512 | 1,612 | 2,262 | 214 | 646 |
| **Profit Before Tax** | 3,662 | 3,262 | 3,827 | 527 | 1,118 |
| **Profit After Tax** | 2,500 | 2,171 | 2,609 | 368 | 714 |

| **RATIO ANALYSIS** | **Dec 31, 2017** | **Dec 31, 2018** | **Dec 31, 2019** | **Mar 31, 2020** |
|---|---|---|---|---|
| **Market Share (Gross Premium) (%)** | 26.8% | 24.3% | 23.3% | NA |
| **Cession Ratio (%)** | 58.8% | 60.3% | 61.7% | 44.8% |
| **Gross Claims Ratio (%)** | 29.5% | 24.1% | 31.5% | 23.3% |
| **Net Claims Ratio (%)** | 39.1% | 40.8% | 47.6% | 41.6% |
| **Underwriting Expense Ratio (%)** | 40.1% | 42.5% | 46.3% | 43.5% |
| **Combined Ratio (%)** | 79.1% | 83.4% | 93.9% | 85.1% |
| **Net Operating Ratio (%)** | 58.8% | 62.3% | 67.9% | 45.3% |
| **Insurance Debt to Gross Premium (%)** | 15.0% | 19.0% | 20.3% | 21.1%* |
| **Operating Leverage (%)** | 36.5% | 39.2% | 38.7% | 48.5%* |
| **Financial Leverage (%)** | 45.2% | 45.9% | 52.3% | 61.7%* |
| **Liquid Assets to Total Liabilities (%)** | 73.3% | 67.1% | 58.2% | 56.6% |

***Annualized**

## ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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:** 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.vis.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.vis.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.vis.com.pk/images/policy_ratings.pdf

## REGULATORY DISCLOSURES — Appendix III

| | |
|---|---|
| **Name of Rated Entity** | EFU General Insurance Limited |
| **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** | | | |
| 9/11/2020 | AA+ | Stable | Reaffirmed |
| 7/30/2019 | AA+ | Stable | Reaffirmed |
| 6/29/2018 | AA+ | Stable | Reaffirmed |
| 8/25/2017 | AA+ | Stable | Reaffirmed |
| 7/11/2016 | AA+ | Stable | Reaffirmed |
| 6/24/2015 | AA+ | Stable | Reaffirmed |
| 11/25/2014 | AA+ | Stable | Reaffirmed |

| | |
|---|---|
| **Instrument Structure** | N/A |
| **Statement by the Rating Team** | 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 financial strength only and is not a recommendation to buy or sell any securities. |
| **Probability of Default** | N/A |
| **Disclaimer** | Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Copyright 2020 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS. |
| **Due Diligence Meetings Conducted** | |

| Name | Designation | Date |
|---|---|---|
| **Altaf Gokal** | CFO | 23rd July 2020 |