October 12, 2017

HDFC ERGO General Insurance Company Limited

Summary of rated instruments

Instrument*	Rated Amount (in Rs. crore)	Rating Action
Non-Convertible Debenture (Subordinated Debt)	350.00	[ICRA]AAA (stable); reaffirmed
Claims Paying Ability	-	iAAA; reaffirmed
Total	**350.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the rating of iAAA (pronounced i triple A) for the claims paying ability and the credit rating of [ICRA]AAA (stable) (pronounced ICRA triple A with a stable outlook) for the non-convertible debenture (subordinated debt) programme of HDFC ERGO General Insurance Company Limited (HDFC ERGO)[1].

Rationale

The ratings take into account the parentage of HDFC ERGO with a majority stake (50.80% as on June 30, 2017) being held by HDFC Limited (HDFC; rated [ICRA]AAA with a stable outlook and [ICRA]A1+) and ERGO International AG (ERGO, primary insurance entity of Munich Re, rated Aa3 by Moody's Investors Service) holding a 48.66% stake as on June 30, 2017. HDFC's majority shareholding, its representation on HDFC ERGO's Board of Directors and the presence of a shared brand name strengthens ICRA's belief that HDFC ERGO will receive capital support from the parent companies as and when the need arises. ICRA takes note of the company's current solvency indicators (1.65 as on June 30, 2017 compared to the regulatory minimum of 1.50), and its policy and track record of adhering to the same.

The credit rating also factors in the key features of the rated instrument in line with applicable guidelines for subordinated debt:

- Servicing of interest is contingent on the company maintaining a solvency ratio above the levels stipulated by the regulator
- In case the interest pay-outs were to lead to a net loss or an increase in net loss, prior approval of the regulator would be required to service the debt

Given the standing of HDFC in the Indian capital markets, ICRA believes that there is a strong onus on HDFC to ensure that HDFC ERGO meets all its regulatory requirements for timely and adequately servicing the rated subordinated debt. The company receives considerable support from HDFC and Munich Re (parent company of ERGO) including access to the large branch network of HDFC (and its group and associate companies) which enables it to reach lower tier cities at a low cost. Going forward, achieving scale and size without cost over-runs, maintaining the underwriting quality of its insurance book and achieving healthy claims settlement ratios will be critical in maintaining the rating profile of the company.

Key rating drivers

Credit strengths

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[1] For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications.

- **Strong parentage of HDFC and ERGO; experienced management team –** HDFC ERGO is owned by HDFC (rated [ICRA]AAA(stable)) and ERGO (primary insurance entity of Munich Re, rated Aa3 by Moody's Investors Service) in a 51:49 joint venture. The presence of a shared brand name strengthens ICRA's belief that HDFC ERGO will receive capital support from its parent companies as and when the need arises. The company receives considerable support from HDFC and Munich Re (parent company of ERGO). HDFC ERGO's operations are handled by a team of senior managers with considerable experience in the general insurance industry. Going forward, the continued importance of the company to the parents and the capital and operational support received would be a key rating sensitivity.

- **Well diversified distribution network with a strong bancassurance channel (excluding crop business) –** Bancassurance continues to be a significant distribution channel accounting for 20% of the gross written premium (GWP, 33% of the total business excluding the crop business) during FY2017. The company has a robust retail franchise with tie-ups with a number of banks and NBFCs including HDFC Bank, Deutsche Bank, SVC Co-operative Bank, and L&T Finance Ltd. The company has been increasing its focus on retail health, personal accident and small and medium enterprises (SME) pertinent insurance businesses. During FY2017, the share of direct business in the overall GWP grew considerably because of the significant increase in the share of crop business to 34% of the GWP from 8% in FY2016. The company has a long term objective to source higher business volumes through direct (including online) and agency channels while reducing its dependence on the bancassurance channel.

- **Revival of growth in FY2017; improvement in profitability with better underwriting and investment performance –** During FY2017, while the general insurance industry registered a GWP growth of 32% (a growth of 18% in non-crop GWP), HDFC ERGO's GWP grew at 72% (a growth of 24% in non-crop GWP) with most of the growth coming from the crop insurance business, both for the industry and the company. The company's growth was also supported by the motor and health insurance portfolios, which it realigned over the past two years to achieve a profitable business mix. HDFC ERGO's underwriting losses reduced to Rs. 88 crore during FY2017 from Rs. 151 crore during FY2016. Over the same period the combined ratio moderated to 101% from 105%, and compares favourably to most of its private sector peers. Further, given that performance of the investment book (both in the form of investment income and profit on sale of investments) also complemented the improved underwriting performance, the company was able to post a net profit of Rs. 277 crore during FY2017 (return on equity of 19.2%) as compared with a net profit of Rs. 151 crore during FY2016 (return on equity of 14.6%). During Q1FY2018, the company made a net profit of Rs. 76 crore as compared with Rs. 38 crore during Q1 FY2017.

- **Adequately capitalised for the current scale of operations; capital support available –** HDFC ERGO's capitalisation and solvency levels have so far been supported by timely capital infusion from the parents along with healthy internal accruals. HDFC and ERGO have together infused Rs. 650 crore in HDFC ERGO in the past five years. The parent companies infused Rs. 550 crore in FY2017 to support the acquisition of HDFC General Insurance Ltd. (erstwhile L&T General Insurance Company Ltd); both companies merged effective from August 16, 2017. As on June 30, 2017, the company's solvency ratio stood at 1.65 times compared to the regulatory requirement of 1.50 times. The company will continue to receive capital support from the parent entities as and when required to support the growth targets. Going forward, the company's ability to maintain its underwriting performance as it scales up operations would have a bearing on the solvency levels and would thus remain a key monitorable.

Credit weaknesses

- **Competitive pressures from public and private sector players –** The general insurance industry in India remains very competitive with price wars in various business segments which have resulted in high loss ratios. Most general insurance players have been reporting underwriting losses. Further, while the underwriting performance of the retail business segments is better than that of the corporate segments, acquiring new business in an increasingly competitive retail segment continues to be a challenge. Also, the motor TP segment, which forms considerable part of the industry gross written premium (GWP) remains tariffed with high loss ratios (greater than 100%). ICRA expects the operating environment to improve marginally with the introduction of the Motor Vehicle Amendment Act, 2016.

- **Significant increase in exposure to crop insurance business which is vulnerable to the vagaries of the weather –** HDFC ERGO has incrementally underwritten significant proportion of crop business. The GWP for the crop business grew from 8% of the overall GWP during FY2016 to 34% during FY2017. While HDFC ERGO has a decade of experience in this business and a significant portion of the business (80%) is reinsured, ICRA notes that the claims in the segment remain contingent on the climatic conditions which are unpredictable, thus posing a high risk.

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

Links to applicable criteria:
Methodology for claims paying ability ratings for General Insurance Companies

About the company
HDFC ERGO General Insurance Company Limited
HDFC ERGO General Insurance Company Limited (HDFC ERGO) is a joint venture between HDFC Limited, India's premier housing finance institution (rated [ICRA]AAA with stable outlook; holding 50.80% stake as on June 30, 2017) and ERGO International AG, the primary insurance entity of Munich Re group (holding 48.66% as on June 30, 2017 with balance being held by employees of HDFC ERGO). The company offers a complete range of general insurance products ranging from crop, motor, health, travel, home and personal accident in the retail space and customized products like property, marine and liability insurance in the corporate space. HDFC ERGO has a presence across the country with 108 branch offices as on June 30, 2017.

HDFC Limited
Housing Development Finance Corporation Limited (HDFC) is India's premier housing finance entity in existence for 40 years. With a presence in banking, insurance and asset management, the HDFC Group is an important part of the Indian financial services sector. During FY2017, HDFC reported a total income of Rs. 33,160 crore on an asset base of Rs. 336,358 crore as compared with a total income of Rs. 30,957 crore on an asset base of Rs. 288,877 crore in FY2016. The company's PAT stood at Rs. 7,443 crore during FY2017 as compared with Rs. 7,093 crore during FY2016. Further, during Q1FY2018, HDFC reported a PAT of Rs. 1,556 crore on a total income of Rs. 8,142 crore.

ERGO International AG
ERGO is a major insurance group in Germany and Europe. Worldwide, the group is present in over 30 countries and concentrates on Europe and Asia. ERGO offers a comprehensive spectrum of insurance, provision and services. In its home market of Germany, ERGO ranks among the leading providers across all segments.

Key Financial Indicators (Audited)

Parameters	FY2016	FY2017	Q1FY2017	Q1FY2018
Gross Direct Premium	3,379.5	5,840.2	882.7	1,696.8
Total Underwriting Surplus/(Shortfall)	(151.3)	(88.3)	(42.1)	(18.4)
Total Investment + Trading Income	360.3	526.9	96.7	142.1
PAT	151.4	277.2	38.0	76.3
Total Net worth	1,069.9	1,812.3	1,107.9	1,888.7
Total Technical Reserves	2,857.0	3,744.8	2,983.1	4,030.2
Total Investment Portfolio	4,113.1	6,825.0	4,370.6	8,363.3
Total Assets	4,891.4	8,622.4	5,080.1	9,218.9
Return on Equity	14.6%	19.2%	13.7%*	16.2%*
Gearing	0.0	0.2	0.0	0.2
Combined Ratio	105.3%	100.7%	107.0%	99.0%
Regulatory Solvency Ratio	1.67	1.71	1.87	1.65

Source: Company public disclosures; Amount in Rs. crore
*Annualised ratio

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:

Sr. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. crore)	Oct 2017	FY2017	FY2016	FY2015
					Oct 2016	Feb 2016	Mar 2015
1	Claims Paying Ability	Long Term	-	iAAA	iAAA	iAAA	iAAA
2	Non-Convertible Debenture (Subordinated Debt)	Long Term	350.00	[ICRA]AAA (Stable);	[ICRA]AAA (Stable);	-	-

Complexity level of the rated instrument:
ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Instrument Details

ISIN Number	Instrument	Date of Issuance	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
INE392I08011	Non-Convertible Debenture (Subordinated Debt)	09-Nov-2016	7.60%	09-Nov-2026[2]	350.00	[ICRA]AAA (Stable)

Source:Company

[2] Call option with 09-Nov-2021 as exercise date

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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