Company Analysis: IronRock Insurance Company Limited (ROC)

VMWM Research and Stockbroking | December 16, 2019

876-960-5000 | wealthinfo@myvmgroup.com | vmwealth.com | 53 Knutsford Boulevard, Kingston 5

- Recommendation: SELL
- Price Target: $2.20
- Current Price: $3.80 [1]

- Shares Outstanding: 214,000,000 units
- Market Value of Shares Outstanding: $813.2 million[1]
- Financial Year End: December 31

ABOUT THE COMPANY

IronRock Insurance Company Limited (ROC) was incorporated in June 2015 as a subsidiary of Granite Group Limited. It is primarily involved in the underwriting of general insurance. At the time, ROC was the first new insurer in the Jamaican market in 25 years. This company was launched to provide Jamaican customer with a more efficient general insurance service than was being provided by its competitors at the time.

CORPORATE STRATEGY

Ironrock was formed in order to provide a more efficient general insurance service in Jamaica by leveraging the benefits of technological advancement. Their ultimate objective is to enhance their reputation for quality customer service, ease of doing business and access to helpful technology for everyday life.

FINANCIAL PERFORMANCE

JMD '000	2016	2017	2018
Gross Written Premiums	127,346	424,462	571,838
Net Earned Premium	7,794	78,008	184,217
Underwriting Loss	-82,191	-101,382	-41,977
Investment Income	17,005	30,740	32,218
Net Profit	-50,319	-47,862	1,768

Outlook

As a relatively new company, IronRock has great potential to continue to grow revenue at a fairly accelerated pace if the company can differentiate itself through quality and efficiency of service and affordable pricing. However, it will likely face challenges in a highly competitive general insurance market.

Projections and Valuations

We used a discounted cash flow model with a cost of equity of 13.13% to establish a price target for ROC of $2.20 per share.

Risks to Price Target

The greatest risk to our price target is the potential for underwriting losses deteriorate further. Also, a material slowdown in growth or a decline in revenue, stemming from a loss in market share amidst heavy competition may contribute to the company overshooting our target to the downside.

[1] As at December 16,2019

FINANCIAL PERFORMANCE

($'000)	2016	2017	2018	2018 Q3	2019 Q3
Gross Written Premiums	127,346	424,462	571,838	381,513	474,610
Net Earned Premium	7,794	78,008	184,218	128,654	158,653
Underwriting Profit/(Loss)	(82,192)	(101,382)	(41,977)	(42,824)	(67,689)
Investment Income	16,946	30,736	31,281	24,249	28,157
Net Profit /(Loss)	(50,320)	(47,862)	2,772	(7,554)	(9,616)

FOR THE LAST THREE (3) YEARS:

ROC completed its first full year of operation in 2016. Within the past three years, the company has experienced a 349% increase in Gross Written Premiums from $127.3 million to $571.8 million. However, after accounting for premiums ceded to its reinsurance counterparts, Net Premium has increased from $46.5 million to $215 million. During these 3 years, the company has seen Underwriting Losses decline, falling from $82.2 million in 2016 to $42.0 million in 2018. The losses were due to a combination of high Claims and Operating Expenses. Claims increased from $4.0 million to $72.4 million, while operating expenses increased from $91.1 million to $160.1 million over the review period.

In addition to its Insurance Revenue, the company also earns Interest Income from its Investment Securities. The value of Investment Securities held by the company has increased from $466.5 million to $563.2 million which drove increased Investment Income from $16.9 million to $32.2 million or by 90.1%. The increase in Investment Income coupled with decreased Underwriting Losses has led to an overall increase in profitability, with the company turning a profit for the first time in 2018.

Total Assets for the company have increased by 48.9% to $1 billion in 2018. This follows the growth in business achieved by the company which coincided with a 201.7% increase in Insurance and Other Receivables, a 323.7% increase in Reinsurance Assets and a 54% increase in Investment Securities. The rise in the level of activity has also coincided with a 317.6% increase in Liabilities. The company solely has insurance linked liabilities, as opposed to debt instruments issued as the proceeds from the IPO have been sufficient to fund the business thus far. ROC has seen a notable increase in leverage over the review period, with Total Assets to Shareholders' Equity moving from 1.04x in 2016 to 2.06x in 2018 on the back of two years of losses from 2016 to 2017.

FOR THE FIRST NINE (9) MONTHS OF 2019:

IronRock is still a relatively new company and has experienced fairly strong revenue growth. In comparison to the first 3 quarters of 2018, the company earned an additional 24.4% in Gross Premium Revenue, increasing from $381.5 million to $474.6 million. However, a 70.1% increase in Claims from $61 million $103.8 million, led to an increase in the Underwriting Losses to $67.7 million, a 58.1% increase compared to the similar period last year. Most of these Claims came from the Motor Insurance business line. During this period, the company increased Investment Income by 16.1% as well as recognized a profit on the sale of Investment Securities of $24.9 million. This helped to reduce the impact of the increased Underwriting Loss and thus the Net Loss for the period only increased by 27.3% from $7.6 million to $9.6 million.

Within 9 months, ROC increased Total Assets by 10.2% due mainly to a 43.5% increase in investment securities coupled with a 63.1% decrease in Short-Term Investments. The low interest rate environment globally has caused ROC to increase their investment assets relative to cash to maintain or increase the Interest Income earned. The increase in Assets was coupled with a 15.7% increase in Total Liabilities and a 4.9% increase in Shareholders' Equity. The increase in Total Liabilities was attributable to a 20% increase in Insurance Contract Provisions to $432.3 million. The Net Losses this period would have decreased Retained Earnings and Equity, But this loss was completely offset by fair value gains on investments.

OUTLOOK:

IronRock began operating in 2015 making it the only new insurance company in Jamaica in 25 years at the time. Because it is a young and small company, it is likely to experience challenges in its profitability in the medium term as it builds out its business and seeks to achieve economies of scale.

Insurance Industry to be Boosted by Current Economic Activity

Insurance revenues are expected to be boosted by the positive economic environment being experienced by the country. Increasing car ownership, expansion in the real estate sector as well as overall business activities will lead to a major increase in the non-life insurance industry in which ROC operates. We expect some momentum from the tourism sector which is currently in a phase of rapid expansion. This sector requires insurance to mitigate against the risks to property investments and operation.

Increasing Investment Income Despite Low Interest Rate Environment

ROC is currently facing a low interest rate environment globally which has been causing a decline in investment income. The company is currently diversifying its portfolio to achieve a sufficient yield, but the trajectory of the yield on investment securities remains downward. The Financial Services Commission (FSC) is currently changing the investment framework for insurance companies. Currently, the majority of an insurance company's assets must be invested in government T-bills which have been yielding below 3%. Since the government of Jamaica is currently going through a process of deleveraging which will see less debt being issued, a new investment framework will be crucial. The updated guidelines should be launched before the end of 2020 and may allow the returns on investments for insurance companies to increase. However, at the current pace of growth in the business, ROC is likely to generate increased investment income in nominal terms.

Decrease in Underwriting Loss Subject to Claims Volatility

Based on the current trajectory of the company and the increases in premium income, it is expected that in the medium term the company will begin to experience an underwriting profit. However, Claims Expenses remain a highly volatile cost element for ROC.

Enhancing Reputation and Customer Service Quality Through the Use of Technology

IronRock has invested in technology to improve their service to clients. They have launched a mobile app and now offer account management capabilities through the client portal on their website. These developments will make it easier for customers to buy, renew and manage their policies. It is expected that by the end of 2019, it will be unnecessary for customers to go into a branch to conduct routine transactions. This development will not only appeal to current customers but will also attract new customers who desire this service. However, in such a competitive market, ROC's ability to offer attractive pricing will play a key role in its ability to grow and capture market share going forward.

INVESTMENTS POSITIVES:

- Has been able to increase investment income in a low interest rate environment.
- The company employs innovative tactics to expand customer base

INVESTMENT NEGATIVES

- Exposed to volatility in interest rates and premium rates.
- Unpredictability of claims expenses
- ROC is a young company and thus not as well-established as its peers
- Its cost of operation is relatively high due to its small scale
- High leverage
- May find it difficult to expand market share because of aggressive and more well established competition

CONCLUSION

ROC is a relatively new player in the general insurance space. It has sought to provide a value-added service by leveraging technology to provide a quality customer experience. However, competition remains strong, interest rates remain low, the cost structure of the business in quite volatile and the relatively small scale of the company will contribute to lower efficiency of operation than its larger peers.

We used a discounted cash flow model to determine a price target for the company. This valuation takes into consideration our expectation of the company's profitability and cash flow going forward along with the risks faced by ROC and a cost of equity of 13.13% to arrive at a target price of **$2.20** per share. This represents a 42.1% downside from the current price. As such, we recommend ROC as a **SELL**.

SOURCES

Bloomberg, The Jamaica Stock Exchange and IronRock Insurance Company Limited Jamaica Annual Reports, PwC, Loop Jamaica, Jamaica Gleaner

DISCLAIMER