

HDFC Life Insurance Company

24 July 2019

Reuters: HDFL.NS; Bloomberg: HDFCLIFE IN

Multi-pronged protection and multi-channel approach

HDFC Life Insurance Company (HLI) reported 1QFY20 results with the key pointers being (1) HLI continued to reinforce its position as the margin leader of the industry with a new business margin of 29.8% in 1QFY20 on the back of continued term protection and annuities traction (2) HLI underlined its diversified channel mix and its reduced dependence on HDFC Group, (the bank was an exclusive sourcer), now sourcing 28% of credit protect business (3) Persistency is on an improving trend with 13th month persistency for FY19 standing at a sound 89% and 61st month persistency inching up to 56%. Also, see comprehensive conference call takeaways on page 2 for significant incremental colour. Per se, on the key P&L items, HLI posted NBP growth of 47% YoY at Rs39,260mn, Surplus growth of 11% YoY at Rs3,765mn and PAT growth of 12% YoY at Rs4,246mn. We have revised our estimates for FY20/FY21 and have retained an Accumulate rating on HLI with a revised target price of Rs526 (from Rs510 earlier) and valuing the stock at 4.0x FY21E P/EV. Also, see our recent initiating coverage report on the life insurance sector: [A Very Attractive Way To Play Indian Financials](#). Our top pick in the life insurance sector is SBI Life.

HLI continued to reinforce its position as the margin leader of the industry with a new business margin of 29.8% in 1QFY20 on the back of continued term protection and annuities traction: Term protection APE has grown 63% YoY during the quarter. Further, Annuities APE has grown at 69% YoY. Consequently, new business margin has expanded to 29.8% in 1QFY20. HLI's pension fund business, India's largest private sector pension fund manager and the largest private player on the NPS platform, helps source annuity business for HLI. Government entity employees have been allowed to choose private sector pension fund managers on the NPS platform. Management see continued margin expansion in the realm of possibility.

HLI underlined its diversified channel mix and its reduced dependence on HDFC Group, (the bank was an exclusive sourcer), now sourcing 28% of credit protect business: Furthermore, direct channels sourced as much as 20% of individual new business APE and individual agents sourced a further 15% of individual new business APE, implying proprietary channels brought in 35% of new business during the quarter.

Persistency is on an improving trend with 13th month persistency for Q1FY20 standing at a sound 89% and 61st month persistency inching up to 56%: Persistency is on an improving trend for HLI, which augurs well for operating variance on embedded value assumptions. For the record, operating variances in FY19 across different parameters have all been small and on the positive side. Variance on the expense assumption has been positive for the last several years.

Valuation and outlook: We have revised our NBP estimates by 6.6%/8.3%, VNB estimates by 1.2%/3.3% and EV estimates by 0.9%/1.9% for FY20/FY21, respectively. We have retained Accumulate rating on HLI and revised our target price to Rs526 (from Rs510 earlier), valuing the stock at 4.0x FY21E P/EV.

ACCUMULATE

Sector: Insurance

CMP: Rs508

Target Price: Rs526

Upside: 4%

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Key Data

Current Shares O/S (mn)	2,017.5
Mkt Cap (Rsbn/US\$bn)	1,026/14.9
52 Wk H / L (Rs)	512/344
Daily Vol. (3M NSE Avg.)	2,538,645

Price Performance (%)

	1 M	6 M	1 Yr
HDFC Life	16.1	36.2	5.3
Nifty Index	(3.4)	4.6	2.2

Source: Bloomberg

Y/E March (Rsmn)	1QFY20	1QFY19	4QFY19	YoY (%)	QoQ (%)
NBP	39,260	26,776	50,318	46.6	(22.0)
Net premium	64,512	50,013	102,475	29.0	(37.0)
Investment & other income	20,836	18,562	41,271	12.3	(49.5)
Total income	85,348	68,575	143,746	24.5	(40.6)
Net commission	3,222	1,982	3,935	62.6	(18.1)
Opex	8,808	7,246	12,189	21.6	(27.7)
Total mgmt expenses	12,030	9,228	16,124	30.4	(25.4)
GST	849	789	933	7.6	(9.0)
Provision for taxes	48	235	1,897	(79.4)	(97.4)
Claims	36,618	29,425	46,899	24.4	(21.9)
Change in actuarial liability	31,197	25,409	71,763	22.8	(56.5)
Total cost	81,583	65,186	137,789	25.2	(40.8)
Surplus/(deficit)	3,765	3,389	5,956	11.1	(36.8)
T/f to s/hs' account	3,503	3,200	4,759	9.5	(26.4)
Investment & other income	988	881	1,846	12.1	(46.5)
Total income	4,491	4,081	6,605	10.0	(32.0)
Non-insurance expenses	122	28	171	342.4	(28.6)
T/f from p/hs' account	0	135	2,981	NA	NA
PBT	4,369	3,918	3,453	11.5	26.5
Taxes	123	116	(187)	5.3	(165.5)
PAT	4,246	3,802	3,640	11.7	16.7
AUM	1,295,815	1,096,337	1,255,517	18.2	3.2

Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

Comprehensive Conference Call Takeaways

VNB margins, EV and Profitability

- The company stated that it was able to achieve high VNB margins on account of favorable product profile and improving cost efficiency.
- In terms of margins, without quantifying or guiding to a particular number, the management stated China as an example where margins have continued to expand. The company stated it would continue to focus on morbidity, mortality and longevity along with other opportunities in order to drive margin expansion.
- In terms of hedging risk, the company stated it has moved away from individual product approach to portfolio approach. For this, the company runs comprehensive financial risk management. Hence, despite the change in product mix, it has been able to contain the VNB and EV sensitivity.
- Regarding the profitability of Sanchay Plus, the management stated it depends on which channel the product is being sold through. The management also stated that all the channel are double-digit margin profitable.
- The company stated that share of VIF in EV has come down since the company is writing a lot of non-par business and the rates have come down, which has cause VIF to fall while ANW has increased. However, on EV level, the impact is neutral.
- In the EV walk, the positive delta on account of operating leverage is based on actual experience in Q1FY20 while persistency and mortality are based on last year's assumptions. In case the product mix moves in favor of ULIPs in subsequent quarters, operating leverage could reduce and margins would get rationalized. Nonetheless, margins for the full year are expected to be robust.
- Margins on Sanchay Plus are wafer thin, as per the company.
- ROEV for Q1 is not comparable with Q4 since Q4 witnesses the maximum amount of business.

Business Growth and Product Mix

- The company continues to witness strong traction across protection products and retirement solutions. The annuity business continued to show robust growth during the quarter.
- Despite share of non-par increasing substantially during the quarter, the company expects share of other segment like par and ULIPs to catch up in ensuing quarters. As per the company, Q1 was a non-par heavy quarter. On full year basis, the company stated the product mix could see some rationalization.
- The company saw 21% yoy growth in credit protect NBP during the quarter despite the high base of last year as well as slowdown in the NBFC business.
- For non-par portfolio risk management, the company looks at the portfolio in terms of annuity and non-annuity. Further, the company stated it also follows a disciplined approach to reprice products as and when required.
- Renewal premium growth looks optically lower since Q1FY19 had a lot of policies which were coming up for maturities this year.
- The management stated that in case of pricing a product where they lack experience, the management usually takes conservative assumptions.
- The management stated it expects to see robust growth in APE over the next 9 months.
- The management stated that IRDA does not allow for repricing product weekly as there has to be a one-month cooling period. Given this, there are enough reserves to take care of any sharp movements in yields in any non-par product.
- 1/3rd of credit life business is from MFI and small finance banks.
- In terms of product mix, the bank expects share of non-par business to normalize during the year.

- The company stated that its agents understand the Sanchay Plus product very well and are able to sell it effectively without incurring any incidences of mis-selling.
- The company stated it would be rationalizing average ticket sizes going forward. Adjusting for the discontinued health business which was there last year, number of policies has grown by 13% during the quarter.
- As per the company, since insurance is fairly underpenetrated, there is still a lot of room for the industry to grow without displacing any other industry in the BFSI sector.

Distribution

- Banca channel witnessed strong growth in business with HDFC Bank growing 44% yoy. Part of the growth came on account of increase in branch activation.
- During the quarter, the company deepened relationship with Badhan Bank, Cholamandalam and Bajaj Finance.
- Business from overall HDFC Group was 28% of the banca business. Other marquee partner like Cholamandalam and Bajaj account for another 6-8% of the credit protect business.
- The bank expects the share of agency channel to go up to 25%, direct channel to go up to 25%, other channels including small corporate agents could become 5-10% and banca would be around 40%. This is expected to happen over the next 3-4 years.

Claims and Expenses

- The company stated that it has taken various initiatives to improve agent productivity and these measures have paid off. Further, operating leverage during the quarter came on account of strong growth, resulting in lower opex ratio.

Solvency

- Solvency for Q1 is usually higher than Q4 since the increase in PAT is higher than the required solvency margin.

Exhibit 1: Key Metrics

(Rsmn)	Q1FY20	Q1FY19	Q4FY19	YoY (%)	QoQ (%)
Commission ratio (%)	5.0	4.0	3.8	103bps	115bps
Opex ratio (%)	13.7	14.5	11.9	-83bps	176bps
Mgmt expense ratio (%)	18.6	18.5	15.7	20bps	291bps
Claims ratio (%)	56.8	57.7	45.8	-97bps	1099bps
Solvency ratio (%)	193.0	197.0	188.0	-400bps	500bps
Yield on s/hs' funds					
with unrealized gains (%)	2.8	(0.7)	2.8	350bps	0bps
without unrealized gains (%)	1.8	1.9	3.4	-10bps	-160bps
Persistence (%)					
13th month	88.8	85.0	87.1	380bps	170bps
37th month	71.4	71.2	71.2	20bps	20bps
61st month	55.5	49.5	53.7	600bps	180bps
Conservation ratio (%)	81.7	86.3	82.6	-458bps	-88bps

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: EV Table

(Rsmn)	Q1FY20	Q1FY19	FY19	YoY (%)	QoQ (%)
VNB	5,090	2,490	15,370	104.4	-
VNB margin (%)	29.8	24.2	24.6	560bps	520bps
EV	192,300	156,930	183,010	22.5	5.1

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Financial summary

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
NBP	86,964	113,496	149,715	199,803	264,005
PAT	8,921	11,090	12,768	15,951	19,351
P/E (x)	113.8	92.2	80.3	64.2	53.0
P/B (x)	26.7	21.7	18.1	15.3	12.8
P/EV (x)	8.1	6.7	5.6	4.7	3.9
RoE (%)	25.5	26.0	24.6	25.9	26.3
RoEV (%)	21.0	21.5	20.1	21.6	21.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Actual performance versus our estimates

(Rsmn)	1QFY20	1QFY19	4QFY19	YoY (%)	QoQ (%)	1QFY20E	Devi. (%)
NBP	39,260	26,777	50,318	46.6	(22.0)	40,604	(3.3)
Operating Surplus	71,627	58,456	126,516	22.5	(43.4)	116,648	(38.6)
PAT	4,246	3,802	3,640	11.7	16.7	3,876	9.6

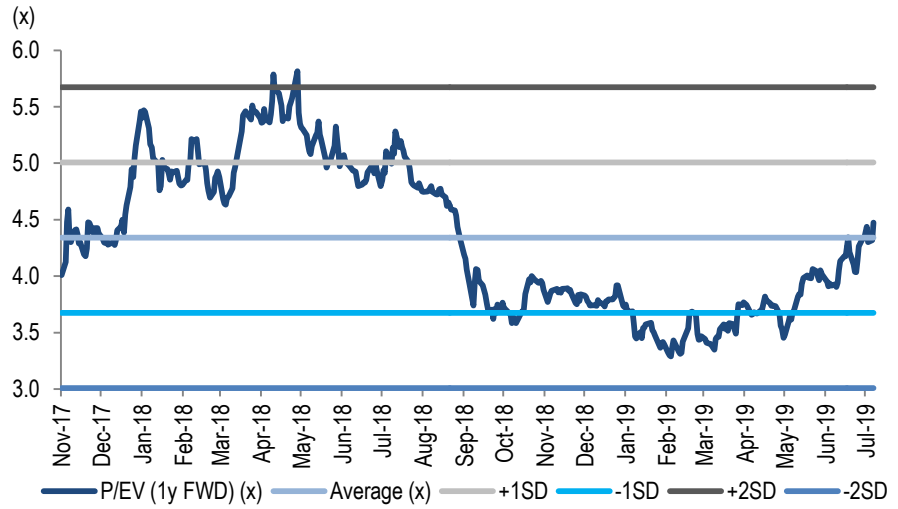
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Change in our estimates

(Rsmn)	Revised estimate		Earlier estimate		% Revision	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
NBP	199,803	264,005	187,440	243,755	6.6	8.3
VNB	19,401	24,193	19,177	23,418	1.2	3.3
VNB margin (%)	26.5	27.0	25.5	26.0	100 bps	100 bps
EV	218,703	262,213	216,685	257,394	0.9	1.9

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: One-year forward P/EV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 7: Revenue account

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E
FYP (first year premium)	47,385	50,581	59,145	70,226
SP (single premium)	66,112	99,133	140,658	193,780
NBP (new business premium)	113,496	149,715	199,803	264,005
RP (renewal premium)	122,148	142,146	164,342	191,346
Gross premium	235,644	291,860	364,145	455,351
(-) Reinsurance ceded	1,934	2,620	3,705	4,658
Net premiums	233,710	289,240	360,440	450,693
Income from investments & other income	88,631	95,115	112,784	135,501
Total income	322,341	384,355	473,224	586,194
- Commission expenses	10,749	11,177	12,874	16,029
- Operating expenses	31,593	38,136	47,195	59,431
- Provision for doubtful debts and taxes	2,960	4,304	3,851	4,555
Operating surplus	277,038	330,739	409,304	506,179
- Benefits paid (net)	128,949	134,146	162,338	196,542
- Interim & terminal bonuses paid	2,165	5,743	4,178	4,898
- Change in reserves	133,223	175,075	225,903	287,637
Pre-tax surplus / (deficit)	12,702	15,775	16,885	17,101
Provisions for tax	1,755	2,268	2,468	1,931
Post-tax surplus / (deficit)	10,946	13,507	14,416	15,170

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: P&L account

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E
T/f from technical a/c	10,022	12,069	14,216	16,346
Investment and other income	2,933	4,295	5,158	7,003
Total income	12,955	16,364	19,374	23,350
Total expenses	1,687	3,465	2,930	3,400
PBT	11,267	12,899	16,444	19,950
Provision for tax	177	131	493	598
PAT	11,090	12,768	15,951	19,351

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Balance Sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E
Source of Funds				
Shareholders' fund	47,492	56,557	66,800	80,399
Policy liabilities	1,001,267	1,181,243	1,408,986	1,698,858
Funds for future appropriations	9,592	11,030	11,230	10,054
Total	1,058,351	1,248,829	1,487,017	1,789,312
Application of Funds				
Shareholders' investments	40,703	50,498	64,132	76,959
Policyholders' investments	453,471	571,245	745,713	978,291
Asset held to cover linked liabilities	571,854	633,774	673,701	716,145
Net other and current assets	(7,678)	(6,688)	3,471	17,918
Total	1,058,350	1,248,829	1,487,017	1,789,312

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Embedded value table

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E
Opening EV	124,710	152,160	182,960	218,703
Unwind	10,440	13,000	15,552	18,590
VNB (or NBAP)	12,820	15,400	19,401	24,193
Operating variance	3,570	2,200	4,550	4,550
EV Operating Profit (EVOP)	26,830	30,600	39,502	47,333
Non-operating variance	2,590	3,600	2,000	2,000
EV Profit	29,420	34,200	41,502	49,333
Net capital injection	-1,960	-3,400	-5,760	-5,823
Closing EV	152,160	182,960	218,703	262,213

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Key ratios

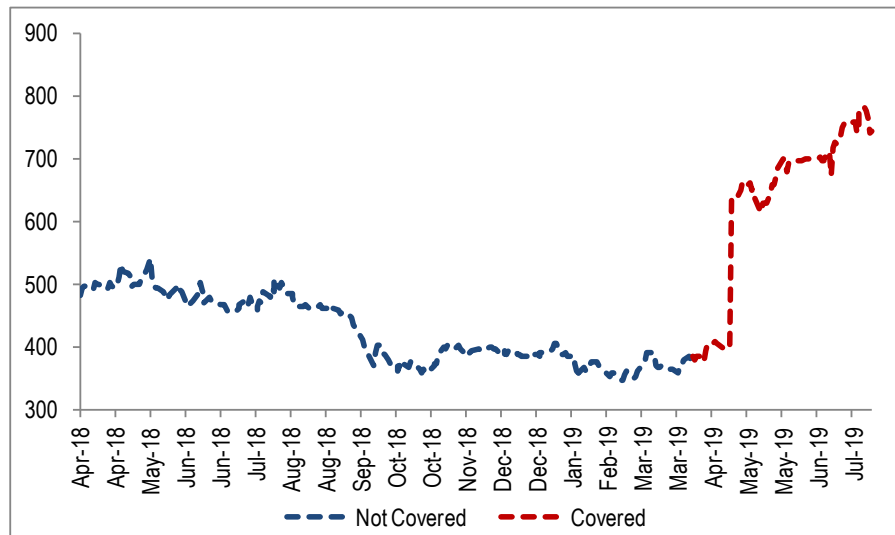
Y/E March	FY18	FY19	FY20E	FY21E
Growth (%)				
New business premium	30.5	31.9	33.5	32.1
Renewal premium	13.6	16.4	15.6	16.4
Net premium	21.3	23.8	24.6	25.0
PAT	24.3	15.1	24.9	21.3
Total AUM	16.2	17.8	18.2	19.4
Total Assets	15.9	18.0	19.1	20.3
Expense analysis (%)				
Commission ratio	4.6	3.8	3.5	3.5
Opex ratio	13.4	13.1	13.0	13.1
Claims ratio	54.7	46.0	44.6	43.2
P/hs' opex / Avg P/hs' AUM	3.3	3.4	3.6	3.8
Profitability analysis (%)				
RoA	1.1	1.1	1.2	1.2
RoE	26.0	24.6	25.9	26.3
RoEV	21.5	20.1	21.6	21.6
VNB margin	23.2	24.6	26.5	27.0
S/hs' AUM yield	8.0	9.4	9.0	9.0
P/hs' AUM yield	9.0	8.1	8.3	8.3
Balance sheet analysis				
P/hs' funds / P/hs' AUM (x)	1.0	1.0	1.0	1.0
NWP / Net worth (x)	5.0	5.1	5.4	5.6
Per share data (Rs)				
EPS	5.5	6.3	7.9	9.6
BVPS	23.5	28.0	33.1	39.8
EVPS	75.6	90.7	108.4	130.0
Valuation data (x)				
P/E	92.2	80.3	64.2	53.0
P/BV	21.7	18.1	15.3	12.8
P/EV	6.7	5.6	4.7	3.9

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
3 April 2019	Buy	385	450
30 April 2019	Buy	399	459
8 July 2019	Accumulate	474	510
24 July 2019	Accumulate	508	526

Rating track graph



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