

Max Financial Services

28 May 2020

Reuters: MAXI.NS; Bloomberg: MAXF IN

Focus on maintaining absolute VNB in FY21 amid sales downturn

Max Life reported NBP of Rs18.9bn for the quarter (5% below our estimate), down 8.3% YoY. Understandably, new business generation was affected due to the lockdown in the latter half of Mar'20. We think that renewal growth was comparably better than ICICI Pru Life and HDFC Life at 15.1% YoY. However, there was some deterioration in persistency ratios in the ULIP segment on account of volatile capital markets. April'20 also saw some stress in terms of renewals collections on the back of grace period in light of the covid situation. Normalcy is expected to return by June'20. In the near-to-medium term, growth in the savings segment is expected to remain weak. Therefore, the management's focus would be on pushing more of protection and non-par savings products. Besides supporting growth, this strategy is expected to help improve margins from current levels. For FY20, the net VNB margin was 10bps lower at 21.6% compared to last year on account of acquisition cost overruns. Current view is that as the intensity of investments in building proprietary channel subsides, the reduction in cost overruns should aid net margins. On gross basis, the margin increased by 180bps YoY to 24.3% on the back of overall improvement in product mix (driven by increase in share of non-par). Management aspires to deliver at least the same level of absolute VNB in FY21 even as the topline may see a decline given the overall stressed economic scenario. This implies that the net VNB margin would need to improve from current levels. From a product mix standpoint, current expectation is that non-par would eventually form about 30-35% of the overall product mix. Company sounded positive on the longer duration guaranteed products, partly as rates have hardened. In line with our sector stance, we expect new business growth to be weak for Max Life. 30% acquisition by Axis Bank is a positive development from a long-term distribution strategy standpoint as it puts to rest the near-term uncertainty regarding distribution pact renewal. Response on applications filed with the RBI and IRDA is awaited. The stock currently trades at 1.2x FY22E EV. We think there is a potential for re-rating if the deal with Axis Bank goes through. However, the deal falling through would be a risk to our business growth and fair value estimates. We retain BUY on the stock with a target price of Rs515, based on 1.6x FY22E EV.

Balanced product mix: Share of ULIPs came down from 42% in FY19 to 38% in FY20 while that of overall protection increased from 10% last year to 13% in FY20. Going forward, protection remains a key focus area from growth standpoint as savings growth is expected to be weak. Non-par savings contribution increased from 9% last year to 18% in FY20. Within non-par savings, focus till now has mostly been on short-term endowment products. Going forward, the company would also be looking at selling income-oriented guaranteed products. In the protection segment, sales through tele-medicals have seen a sharp rise (from 15% earlier to 35-40% now) due to customers' reluctance for face-to-face sales. This trend has been observed for other players as well. From an ideal product mix perspective, the company would like to keep share of non-par savings at 20-25% and protection at 10% (total non-par at 35%).

Investments in proprietary channels paying off: Share of business through proprietary channels accounted for 31% of the total business compared to 29% last year. Note that the company has been investing heavily in building this channel. The company intends to increase the share of proprietary channel further to 35-40%. Banca channel accounted for 68% of the total business in FY20 compared to 70% last year. Within this, Axis Bank accounted for 57%, same as last year. A key positive development recently has been the announcement of 30% acquisition by Axis Bank which should put to rest the uncertainty around the Axis Bank distribution tie up.

BUY

Sector: Insurance

CMP: Rs442

Target Price: Rs515

Upside: 16%

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Key Data

Current Shares O/S (mn)	269.6
Mkt Cap (Rsbn/US\$bn)	119.6/1.6
52 Wk H / L (Rs)	612/276
Daily Vol. (3M NSE Avg.)	2,669,982

Price Performance (%)

	1 M	6 M	1 Yr
MaxFinancial	(7.0)	(13.2)	3.5
Nifty Index	0.4	(23.0)	(21.9)

Source: Bloomberg

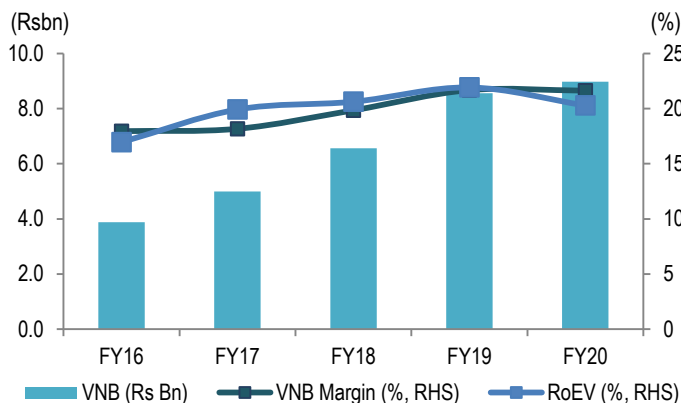
Y/E March (Rsmn)	4QFY20	4QFY19	3QFY20	YoY (%)	QoQ (%)
NBP	18,900	20,620	14,020	-8.3	34.8
Net premium	58,042	54,610	38,219	6.3	51.9
Investment & other income	-15,872	16,110	14,781	-198.5	-207.4
Total income	42,170	70,721	53,000	-40.4	-20.4
Net commission	3,652	3,925	2,498	-6.9	46.2
Opex	6,643	6,229	5,964	6.6	11.4
Total mgmt expenses	10,295	10,154	8,462	1.4	21.7
Claims	16,150	17,740	16,533	-9.0	-2.3
Change in actuarial liability	12,960	40,178	25,921	-67.7	-50.0
Total cost	40,176	68,688	51,528	-41.5	-22.0
PBT	2,420	2,473	1,833	-2.1	32.0
AUM	684,710	627,980	686,180	9.0	-0.2

Source: Company, Nirmal Bang Institutional Equities Research

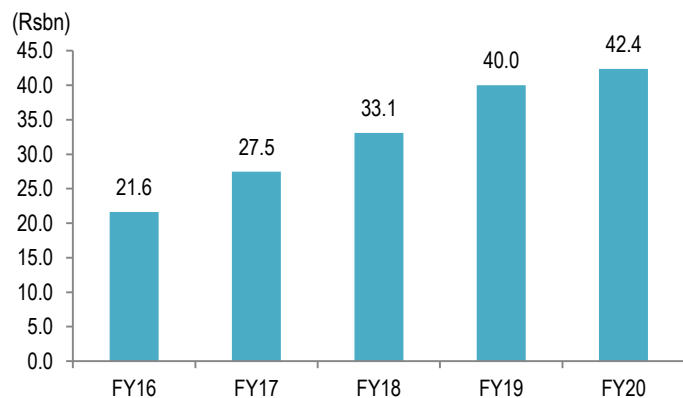
EV up 12% YoY: The company reported EV of Rs99.8bn, up 12% YoY. Absolute VNB for the year was Rs8.97bn, up 5% YoY. Negative economic variance was Rs3.2bn due to the turmoil in capital markets (equity impact was Rs2.7bn, debt impact was Rs1.9bn). Operating ROEV was 20.3%, mainly driven by new business growth and unwind.

Comprehensive Conference Call Takeaways

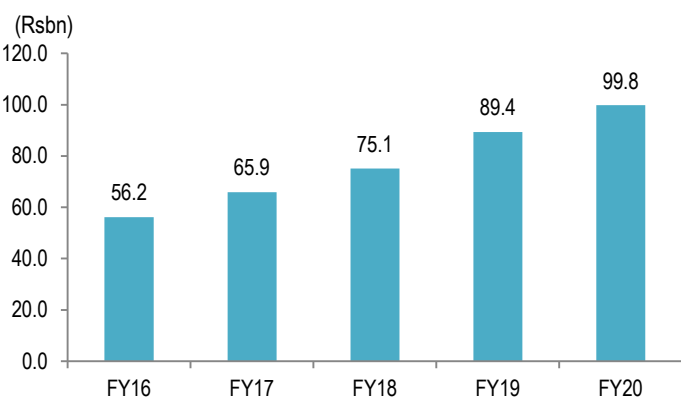
- Company witnessed moderation in persistency for 13th/61st month cohorts primarily in ULIP due to market volatility.
- Effective tax rate for Max Life stood at ~11.8%.
- A significant amount of business for company comes in 4Q due to bancassurance. As per company, higher sales through proprietary channel would help in adjustment of the same.
- There was some stress in renewals in April due to grace period on payments which has been corrected in May. Collections in April were 8% lower YoY while those in May are higher 13% YoY. Company expects to return to normal levels in June.
- As per the company, there are opportunities for cost reduction in expenses like people, recruitment, agency costs, rentals and contract with outsourced service providers, which is expected to yield ~10% cost savings in H1FY21.
- There has been an increase in underwriting of tele-medical protection policies. Compared to 15% earlier, company is doing 35-40% tele-medical policies.
- Due to expected stress on savings business this year, company would focus on improving margins through repricing and changing of product designs. Company aspires to maintain FY21 VNB similar to FY20 levels even as new business sales may decline.
- Increase in margins due to higher non-par and protection products has been negated by acquisition cost overruns.
- Break-up of negative economic variance worth Rs3.2bn is as follows:
 - Equity -Rs2.7bn
 - Debt -Rs1.9bn
 - CRNHR Rs1.33bn
- Company expects growth in long term non-par savings products to be healthy going forward. Protection and long term non-par savings are expected to drive growth in the near term.
- Over the last 2 years, company has made investments in banca and its own channels and a large part of processes have been digitized. Intention is to increase proprietary channel share to 35-40% and is working towards the same.
- Company expects non-par to form 30-35% of total premium. Rates on longer duration products have hardened and bank expects to be able to provide better guaranteed returns. Company uses FRAs for hedging liabilities. While banks will be focused more on selling non-par savings and protection, they would also sell reasonable amount of ULIPs.
- Under the new agreement with Axis Bank, it would own 30% which would be under a regulatory lock-in of 5 years. Axis Bank would be eligible to sell 2% shares every year in the market to non-competitors after the lock in period. Cash commission structure for Axis bank would be in line with IRDAI regulations.
- Acquisition cost over-run was due to strategy of investment in own channel. As business grows, the cost over-runs would be absorbed.
- As per management, capital isn't a constraint for growth. In 18 months, it may raise capital through debt or equity. After the Axis Bank transaction, company would have Rs8bn to fund business growth.
- In non-par, company intends to write both income and endowment, but currently it is writing more of endowment.

Exhibit 1: VNB, VNB Margin and RoEV


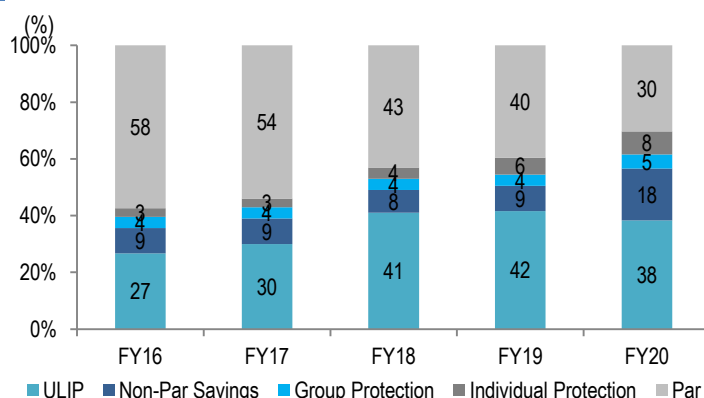
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: NBP – APE (Rs bn)


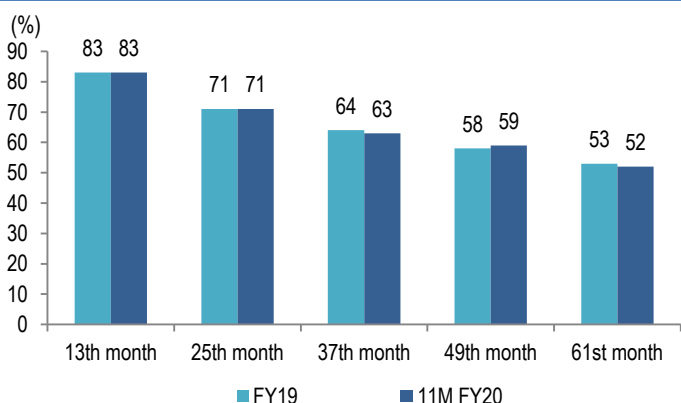
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Closing EV (Rs bn)


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: APE mix (%)


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Persistency Ratio (%)


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key Metrics

	Q4FY20	Q4FY19	Q3FY20	YoY (%)	QoQ (%)
Commission ratio (%)	6.3	7.2	6.5	-89bps	-24bps
Opex ratio (%)	11.4	11.3	15.8	15bps	-432bps
Mgmt expense ratio (%)	17.7	18.5	22.3	-75bps	-456bps
Claims ratio (%)	27.8	33.9	45.3	-607bps	-1745bps

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: EV Table

(Rsmn)	FY20	FY19	9MFY20	YoY (%)	QoQ (%)
VNB	8970	8560	5760	4.8	-
VNB margin (%)	21.6	21.7	21.0	-10bps	-
EV	99,770	89,380	100,770	11.6	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Financial summary

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
NBP	43,486	51,604	55,830	55,491	61,582
PAT	5,276	5,568	5,874	6,471	8,156
P/E (x)	31.4	29.7	28.2	25.6	20.3
P/B (x)	6.2	6.0	5.7	5.1	4.4
P/EV (x)	2.2	1.9	1.7	1.4	1.2
RoE (%)	20.3	20.4	20.7	20.9	23.2
RoEV (%)	20.6	21.9	20.3	18.9	18.5

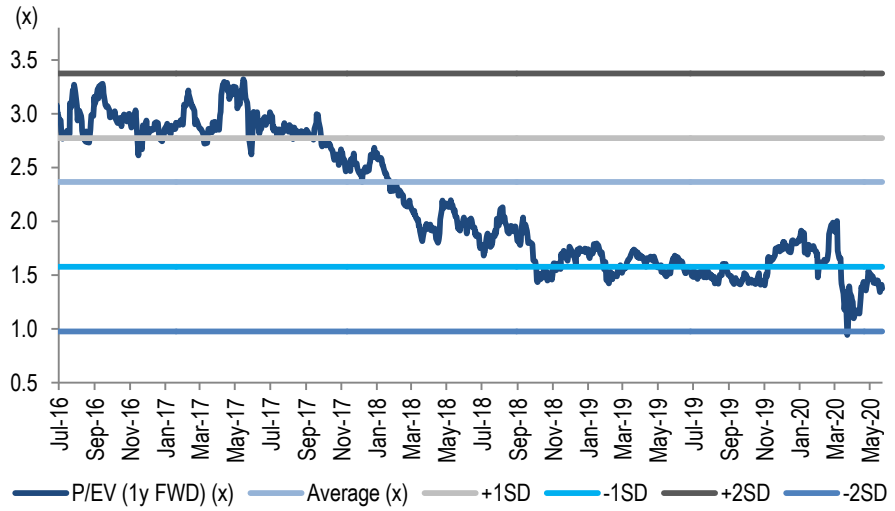
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Change in our estimates

	Revised estimate		Earlier estimate		% Revision	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
NBP	55,491	61,582	62,827	70,616	(11.7)	(12.8)
VNB	9,311	10,415	10,860	12,333	(14.3)	(15.5)
VNB margin (%)	21.8	21.8	21.8	21.8	0.0	0.0
EV	115,941	133,966	122,432	143,104	(5.3)	(6.4)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: One-year forward P/EV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 11: Revenue account

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
FYP (first year premium)	31,915	38,731	40,880	41,289	46,243
SP (single premium)	11,571	12,873	14,950	14,203	15,339
NBP (new business premium)	43,486	51,604	55,830	55,491	61,582
RP (renewal premium)	81,523	94,148	106,000	117,504	130,210
Gross premium	125,009	145,752	161,830	172,995	191,792
(-) Reinsurance ceded	1,213	1,569	1,578	1,884	2,274
Net premiums	123,795	144,184	160,252	171,111	189,519
Income from investments & other income	37,917	49,083	50,195	59,517	70,398
Total income	161,712	193,267	213,448	243,827	280,783
- Commission expenses	8,929	9,888	10,605	11,878	13,432
- Operating expenses	16,099	19,274	23,304	25,276	27,489
- Provision for doubtful debts and taxes	1,096	1,317	1,689	1,974	2,329
Operating surplus	135,588	162,788	177,850	204,698	237,533
- Benefits paid (net)	49,456	57,165	68,759	77,670	90,113
- Interim & terminal bonuses paid	10	14	12	13	14
- Change in reserves	79,043	97,365	100,327	117,675	136,346
Pre-tax surplus / (deficit)	7,079	8,244	8,752	9,340	11,060
Provisions for tax	0	0	0	0	0
Post-tax surplus / (deficit)	7,079	8,244	8,752	9,340	11,060

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: P&L account

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
T/f from technical a/c	3,992	4,402	4,871	5,415	7,102
Investment and other income	2,184	2,202	2,525	2,727	3,004
Total income	6,175	6,604	7,396	8,141	10,106
Total expenses	24	377	550	600	600
PBT	6,152	6,230	6,846	7,541	9,506
Provision for tax	875	662	972	1,071	1,350
PAT	5,276	5,568	5,874	6,471	8,156

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Balance Sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Source of Funds					
Shareholders' fund	26,989	27,609	29,052	32,801	37,525
Policy liabilities	486,144	585,765	686,959	805,693	943,324
Funds for future appropriations	18,655	22,498	26,388	30,313	34,271
Total	531,788	635,872	742,399	868,807	1,015,121
Application of Funds					
Shareholders' investments	32,146	35,187	36,946	38,793	41,315
Policyholders' investments	319,238	394,173	483,599	587,858	709,984
Asset held to cover linked liabilities	170,981	198,619	214,509	233,385	254,974
Net other and current assets	9,422	7,893	7,345	8,770	8,848
Total	531,788	635,872	742,399	868,807	1,015,121

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Embedded value table

Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
Opening EV	65,900	75,090	89,380	99,780	115,941
Unwind	6,410	6,970	8,130	9,076	10,546
VNB	6,560	8,230	8,970	9,311	10,415
Operating variance	620	1,260	1,030	500	500
EV Operating Profit (EVOP)	13,590	16,460	18,130	18,887	21,461
Non-operating variance	(470)	3,840	(3,170)	0	0
EV Profit	13,120	20,300	14,960	18,887	21,461
Net capital injection	(3,930)	(6,010)	(4,560)	(2,726)	(3,436)
Closing EV	75,090	89,380	99,780	115,941	133,966

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Key ratios

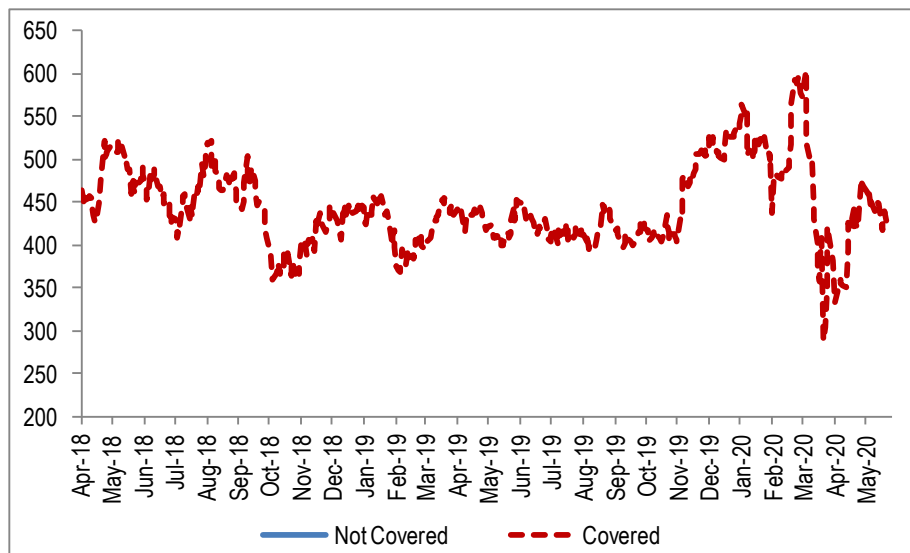
Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Growth (%)					
New business premium	18.6	18.7	8.2	-0.6	11.0
Renewal premium	14.6	15.5	12.6	10.9	10.8
Net premium	15.9	16.5	11.1	6.8	10.8
PAT	-20.0	5.5	5.5	10.2	26.1
Total AUM	17.7	20.2	17.1	17.0	17.0
Total Assets	18.9	19.6	16.8	17.0	16.8
Expense analysis (%)					
Commission ratio	7.1	6.8	6.6	6.9	7.0
Opex ratio	12.9	13.2	14.4	14.6	14.3
Claims ratio	39.9	39.6	42.9	45.4	47.5
P/hs'opex / Avg P/hs' AUM	3.6	3.6	3.6	3.3	3.1
Profitability analysis (%)					
RoA	1.1	1.0	0.9	0.8	0.9
RoE	20.3	20.4	20.7	20.9	23.2
RoEV	20.6	21.9	20.3	18.9	18.5
VNB margin	19.8	21.7	21.6	21.8	21.8
S/hs' AUM yield	6.8	6.5	7.0	7.2	7.5
P/hs' AUM yield	8.3	9.0	7.7	7.8	7.8
Balance sheet analysis					
P/hs' funds / P/hs' AUM (x)	1.0	1.0	1.0	1.0	1.0
NWP / Net worth (x)	4.6	5.2	5.5	5.2	5.1
Per share data (Rs)					
EPS	2.7	2.9	3.1	3.4	4.3
BVPS	14.0	14.4	15.1	17.1	19.5
EVPS	39.1	46.6	52.0	60.4	69.8
Valuation data (x)					
P/E	31.4	29.7	28.2	25.6	20.3
P/BV	6.2	6.0	5.7	5.1	4.4
P/EV	2.2	1.9	1.7	1.4	1.2

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
3 April 2019	Buy	436	535
8 April 2019	Buy	439	535
30 May 2019	Buy	440	549
8 July 2019	Buy	416	553
7 August 2019	Buy	413	538
23 September 2019	Buy	399	572
7 October 2019	Buy	405	557
7 November 2019	Buy	438	560
8 January 2020	Buy	559	653
6 February 2020	Buy	484	653
6 March 2020	Buy	518	599
27 March 2020	Buy	406	525
9 April 2020	Buy	355	525
29 April 2020	Buy	472	550
28 May 2020	Buy	442	515

Rating track graph



DISCLOSURES

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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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