Sharekhan
by BNP PARIBAS

Max Financial Services

Notwithstanding headwinds, valuations are attractive

Sector: Banks & Finance
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 444**	
Price Target: **Rs. 570**	↓

↑ Upgrade ↔ No change ↓ Downgrade

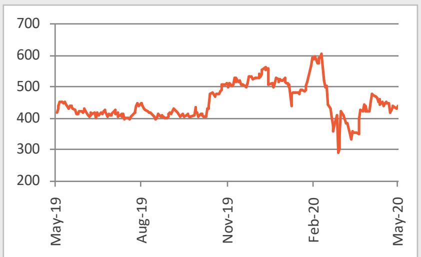
Company details

Market cap:	Rs. 11,963 cr
52-week high/low:	Rs. 611/280
NSE volume: (No of shares)	34.2 lakh
BSE code:	500271
NSE code:	MFSL
Sharekhan code:	MFSL
Free float: (No of shares)	19.3 cr

Shareholding (%)

Promoters	28.3
FII	30.6
DII	29.0
Others	12.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.3	-23.4	-16.5	3.2
Relative to Sensex	-5.7	-5.9	7.5	23.7

Sharekhan Research, Bloomberg

Max Financial Services (MFS) posted modest numbers for Q4FY2020,with below expectations operating performance, and posted slower business growth in Value of New Business (VNB) and Annualised Premium Equivalent (APE) due to impaired collections because of the lockdown. The life insurance business, Max Life Insurance (MLIC, MFS has 72.5% shareholding) saw gross written premium (GWP) rise by 6% y-o-y, despite the lockdown, which impacted the last part of March, which typically is a seasonally important period for life insurance players. The 13th-month persistency ratio (for 11 months FY2020) was stable at 83% as compared to FY2019 persistency, which indicates good customer retention and effective client communication. Individual APE for FY2020 increased at a slower pace of 5% y-o-y, while assets under management (AUM) grew by 9% y-o-y. VNB grew by 5% y-o-y, and FY2020 margins (actual) stood at ~21.6%, driven by change in business mix. Individual protection mix also grew by ~200 bps y-o-y to 8% for FY2020. MLIC has a strong bancassurance relationship with Axis Bank, which is now looking more stable due to the recent agreement between the two entities. Going forward, as operating leverage benefits kick in, and lesser pressure on investing in own channels will be positive support for margins, which will help at present times of impacted sales and volatile markets. Due to the lockdown, for the medium term, premium recovery and incremental sales growth may be impacted for insurance players, including MLIC. We believe the Indian insurance market has significant growth opportunities; and MLIC, with its strong brand image and riding on stable bancassurance partnership with a strong player such as Axis Bank, along with other partners, is well placed to ride over medium-term challenges. Despite uncertainties, we believe strong business fundamentals and current valuations (at a significant discount to peers) make risk-return favorable for MFS. Therefore, we maintain our Buy rating on the stock with a revised price target (PT) of Rs. 570.

Key positives

- Maintained private market share at 10% (increased by 4 bps y-o-y)
- New business margins (NBM) before cost overruns has increased by ~180 bps y-o-y to 24.3% for FY2020 on account of improved business mix (increased proportion of non-par business)

Key negatives

- Growth in APE as well as VNB slowed due to the lockdown impact.
- Solvency declined to 207% (from 242% in FY2019) but is still higher than regulatory minimum of 150%.

Our Call

Valuation for MFS appears attractive and is at a significant discount compared to some of the listed bank-owned insurance players. We find that there are significant long-term positives in the strong operational numbers for the company. While the share pledge is a niggle, we believe the deal with Axis Bank and the arrangement with MFS's partner in the insurance business are steps in the positive direction with long-term positives. We maintain our Buy rating with a revised PT of Rs. 570.

Key Risks

Adverse change in regulatory policies and a prolonged lockdown may impact MLI's profitability and growth.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E
Total Premium (Rs.cr)	14,575	16,183	18,523	21,270
New Business Premium (Rs.cr)	3,950	4,149	5,171	6,179
VNB Margin (%)	21.7	21.6	19.0	20.0
Embedded Value (Rs.cr)	9,257	9,977	11,550	13,317
EV / Share (Rs.)	248	267	311	358
P / EV (x)	1.8	1.6	1.4	1.2

Source: Company; Sharekhan estimates

Key Concall Highlights

MSI swap transaction: CCI and shareholders' approval have been received. IRDAI approval are in fairly advanced stage and expect to close the transaction within a month.

Status of Axis Bank deal: Application to IRDAI went 20 days back, and CCI approval is being sought. Postal ballot notice has been already issued and will take the voting shortly. Management hopes to close this transaction towards year end.

Tax Settlement: Company addressed the Contingent liability of past tax dues of telecom, which was settled. The company has deposited Rs. 124 crore and the matter now stands settled as per the company.

COVID-19 impact: Performance impacted by COVID-19 pandemic. March is always very busy seasonally, which was a washout this time. There was some MTM loss due to volatility in markets due to COVID-19. Bancassurance channel from a recently troubled private bank channel saw sales being down by 2%, however the same is now improving due to improved business because of capital infusion (in the bank).

Persistency: There was a marginal dip in the 13th month due to market volatility and problems in collections.

Tax rate for FY2020 for MLI: The effective tax rate (ETR) for MLI is11.8% from 11.5% earlier, and it is computed based on dividend being paid historically.

Steps to reduce seasonality: Sales activity is more active in the latter part of March months and may look to offset the trend by increasing own channel sales.

Digital: While in April, MLI wrote about 80% of sales of April 2019, the proportion of digital was much higher and the volume of policies underwritten was also higher. MLI was able to train ~25,000 sales people in few weeks and identified areas of cost reduction. Already the company has taken steps that will have 10-12% beneficial impact on cost in H1FY2021. Collection and persistency have almost normalised, but saw some impact in April.

Margins: Management plans to focus on maintaining its margin; but expects some stress on growth on the savings side of the business. Management may entail new products or change in pricing, re-insurers charges etc.

Tele-medicals: 35-40% of policies are going for telemedicine, which was earlier ~15%. The total number of policies pending medical checkup was ~10% and were not recorded as sales.

VNB margin change: There is higher non-par savings and protection (change in business mix), but it was offset by the interest rate curve to some extent.

Variance: Change in assumptions has been impact of Rs. 103 crore on EV. Operating variance breakup was a mark to market charge (MTM) on equity of Rs. 270 crore, for debt the impact was of Rs.190 crore and due to change in net effective tax rate of Rs. 30 crore etc. During the year, it did a re-adjustment on capital charge, which was around Rs. 133 crore.

Business mix: Strategy to drive protection and seeing tailwind of market demand (COVID-19 related etc). There is uncertainty on the financial sphere also, and non-PAR savings may also see improved demand.

Collections in April and May: IRDAI had given extension on premium collections, so collection numbers are not representative. In April, it was down 8% y-o-y because of extension of grace period, there was some delay in collections. In May, collections were up by 13% y-o-y, the flow is picking up. Hopefully by May end, it will normalise.

Investment book: Savings plan may be a challenge in the near term because of shorter term due to the fall in interest rates. However, going forward, with more consistency, it expects long-term business to continue.

Axis Bank: MFS does not have a buy back agreement with Axis Bank. New commission structure remains same as of now, but it may change if new products are launched and as per IRDAI norms.

Investment made in own proprietary channels: Large part of the investment has already been done and is expected to benefit from change in product mix. Management indicated the margin may go up higher than 21.6% in the medium term due to operating leverage and business mix and aspires for similar VNB as last year.

Bancassurance outlook: Banks will be focused on selling more of non-PAR savings and protection products. The share of Bancassurance from Axis Bank has been stable over the near term. Own channels will contribute 35-40% to sales in the next few years, and the rest is likely coming from Bancassurance channels. The share of ULIPs is expected to be tepid due to subdued market performance.

New products: The Company may come out with new products in the non-PAR segment. Currently, non-PAR is skewed more towards endowment products.

Post COVID-19: Company was doing around 500-550 medicals test per day, and are doing ~900 medicals per day now. Around 10% of the policies (by numbers) are pending due to pending medicals due to the lockdown etc.

VNB from segments: The Company does not share exact numbers but VNB are (in descending order) from protection, non-PAR, PAR plans, and lastly ULIPs.

Guidance: VNB will be flat, but margins would be better by better business mix, the driver for VNB will be non-PAR and protection.

Investment variance: There was some negative impact due to adverse movement in interest rates, since there was some movement in the shape of curve, hence that has resulted in negative investment variance.

Unwinding rate: Largely same and has not changed since September 2019.

Results Rs cr

Particulars	Q4FY20	Q4FY19	YoY %	Q3FY20	QoQ %
First year premium	1,391	1,631	-14.7	999	39.2
Renewal premium	3,983	3,459	15.1	2,477	60.8
Single premium	499	431	15.8	403	23.8
Gross Written Premium	5,873	5,521	6.4	3,781	55.3
Shareholders Profit (Pre Tax)	242	247	-2.0	183	32.2
Individual APE	1,398	1,634	-14.4	1,000	39.8
Conservation ratio (%)	86.4	86.6	-20 bps	88.2	-180 bps
Average case size (Rs.)	57,873	70,415	-17.8	62,272	-7.1
AUM	68,471	62,798	9.0	68,618	-0.2
13th Month Persistency Ratio (%)	83.0	83.0	0 bps	85	-200 bps

Source: Company; Sharekhan Research

Outlook

MFS is effectively building an attractive insurance franchise characterised by a multi-channel distribution network built upon a conservatively underwritten insurance business. We believe the strategy to achieve a balanced product mix and focus on non-par savings with the protection segment will be margin-accretive and is achievable. We view that cost management, re-balancing of product mix, and further diversification of distribution channels are key levers for profitability and will add to business sustainability. Going forward, as operating leverage benefits kicks in, due to lesser pressure on investing in own channels, there will be positive support for margins, which will help at present times of impacted sales and volatile markets. Due to the lockdown, for the medium term, premium recovery and incremental sales growth may be impacted for insurance players, including MLIC. However, we believe the Indian insurance market has significant growth opportunities; and MLIC, with its strong brand image and riding on stable bancassurance partnership with a strong player such as Axis Bank, along with other partners is well placed to ride over medium-term challenges.

Valuation

Valuation for MFS appears attractive and is at a significant discount compared to some of the listed bank-owned insurance players. We find that there are significant long-term positives in the strong operational numbers for the company. While the share pledge is a niggle, we believe the deal with Axis Bank and the arrangement with MFS's partner in the insurance business are steps in the positive direction with long-term positives. We maintain our Buy rating with a revised PT of Rs. 570.

About company

MFS is the holding company (holds ~72.5% share) of Max Life Insurance (MLI), a private life insurance company. MLI is a joint venture with a Japanese insurance partner, which holds 25.5% share of MLI, and is a global leader in life insurance. MLI offers comprehensive long-term savings, protection, and retirement solutions through its high-quality agency distribution and multichannel distribution partners. The company has a strong customer-centric approach focused on advice-based sales and quality service delivered through its superior human capital. It is the fourth largest private life insurance player in India with ~10% market share.

Investment theme

MFS holds MLI, which is among the leading private sector insurers. It has gained critical mass and enjoys strong operating parameters in the industry. MLI had delivered strong performance on both new and renewal business over the years. As the insurance sector is showing signs of sustained growth potential, the company's well-diversified product mix and a strong distribution channel augur well and will help sustain healthy growth in premiums and profits. Strong focus towards customer measures has helped to deliver superior performance across parameters and will continue to remain an important differentiator.

Key Risks

Adverse change in regulatory policies and a prolonged lockdown may impact MLI's profitability and growth.

Additional Data

Key management personnel

Mr. Mohit Talwar	Managing Director
Mr. V Krishnan	Company Secretary
Mr. Jatin Khanna	CFO
Mr. Aman Mehta	Independent Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Moneyline Port Inv Ltd	6.7
2	Jacksom National Asset	6.09
3	Mirae Asset Global Investments Co	5.42
4	HDFC Asset Management Co Ltd	4.81
5	Reliance Capital Trustee Co Ltd	3.68
6	Icici Prudential Asset Management	3.63
7	Baron Capital Inc	3.49
8	Kotak Mahindra Asset Management Co	2.94
9	New York Life Insurance Co	2.38
10	Government Pension Fund - Global	1.99

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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