Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

HDFC Life Insurance

Structural strengths make it attractive for the long term

Banks & Finance | Sharekhan code: HDFCLIFE | Results Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 574**	
Price Target: **671**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

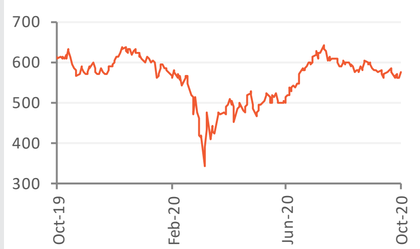
Company details

Market cap:	Rs. 115,241 cr
52-week high/low:	Rs. 648/339
NSE volume: (No of shares)	40.6 lakh
BSE code:	540777
NSE code:	HDFCLIFE
Free float: (No of shares)	79.9 cr

Shareholding (%)

Promoters	60.4
FII	23.8
DII	7.3
Others	8.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.9	-7.0	12.9	-6.1
Relative to Sensex	-6.0	-15.0	-14.8	-9.9

Sharekhan Research, Bloomberg

Summary

- We recommend Buy on HDFC Life Insurance (HLIC) with price target of Rs. 671; we expect HLIC to deliver ~24% VNB margins over the next 2-3 years (on a normalised basis).
- HLIC's results came largely in line with expectations for Q2FY2021, indicating steady recovery from the impact of COVID-19.
- The insurance sector's growth potential is huge in India; factors like large protection gap, retiral needs, expanding per capita income etc are key long-term growth drivers. We believe strong players such as HLIC are likely to gain disproportionally from the opportunity.
- The stock is at a valuation of 4.1x/3.4x its FY2022E/FY2023E EVPS. Well-diversified product bouquet (no segment contributing more than 30% of the APE), strong brand image and strong metrics make HLIC attractive.

For Q2FY2021, HDFC Life Insurance's (HLIC) results came largely in line with expectations, indicating steady recovery from the impact of COVID-19. Operational figures and business metrics showed improvement on a sequential basis. Better premium recovery m-o-m helped HLIC post market share gain in H1FY2021 to 17.5%, up 230 bps y-o-y. We believe change in customer preference for protection and annuity business, benefits HLIC. Total annualised premium equivalent (APE) is showing smart recovery and was only down 4% y-o-y for H1FY2021 to Rs. 3,334 crore. However, individual protection and PAR reflected strong traction. New business increased by 7 % y-o-y to Rs. 8,496 crore for H1FY2021, and the value of new business (VNB) was also down by 12% y-o-y (compared to 53% y-o-y decline in Q1FY2021) because of lower mix of non-PAR savings. New business margins improved to 25.1% for H1FY2021 (stood at 24.3% in Q1FY2021) as against 27.5% a year ago. Better cost control resulted in better opex ratio due to stringent cost-control initiatives, deferral of discretionary expenses, lower business volumes, and pause in business expansion. Moreover, rise in contribution from bancassurance/own channels (that are lower cost for the company) also helped. Management indicated that business is showing traction on m-o-m basis, especially in the individual protection business. As the situation begins to normalise, we expect protection and savings products to be the key growth drivers and help the company attract a higher quantum of inflows from Indian households. Given strong structural fundamentals of HLIC (a robust balance sheet and strong brand image) and high long-term growth potential for the Indian insurance industry in general and HLIC in particular, we see attractive potential for long-term investors. We have a Buy rating on the stock with an unchanged price target (PT) of Rs. 671.

Key positives

- HLIC posted Individual WRP growth of 22% YoY in Q2 helped neutralise the Q1 decline. HLIC saw 2% y-o-y growth in H1FY2021 versus private industry decline of 11%.
- HLIC reported solvency ratio of 203% (was 190% in Q1FY2021) helped by strong PAT accretion, and a sub-debt raise of Rs. 600 crore during the quarter.

Key negatives

- Persistency across middle cohorts declined on a y-o-y basis mainly due to the pandemic, adverse market conditions, and weak customer sentiment in ULIPs etc. categories.

Our Call

Valuation - The stock is at a valuation of 4.1x/3.4x its FY2022E/FY2023E EVPS. HLIC has a better diversified product bouquet (no segment contributing to more than 30% of the APE) as compared to other players, best-in-class branding, and strong metrics, which make us believe that the company is well-placed to deliver strong and sustainable long-term APE growth. Aided by strong fundamentals (robust balance sheet and consistent profitability) and high long-term growth potential for the Indian insurance industry in general and HLIC, in particular, we find HLIC an attractive long-term bet. We recommend Buy with a PT of Rs. 671.

Key risk

A slowdown in business operations and higher slippages/bond downgrades due to economic weakness may impact earnings outlook.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
EV	18,301	20,650	23,748	28,260	33,629
New Business Margins (%)	24.6	25.9	23.0	24.0	24.0
Networth	5,660	6,992	7,981	9,129	10,335
PAT	1,278	1,295	1,373	1,594	1,676
P/BV (x)	20.4	16.5	14.4	12.6	11.1
P/EPS (x)	90.2	89.0	83.9	72.3	68.7
P/EV (x)	6.3	5.6	4.9	4.1	3.4
ROE (%)	22.6	18.5	17.2	17.5	16.2
ROA (%)	1.0	1.0	0.9	0.9	0.8

Source: Company; Sharekhan estimates

Note: We now convert HDFC Life Insurance into a Stock update; it was earlier a 'Viewpoint' under our coverage.

Key Concall Notes

- **Business Performance:** Market share in individual APE has improved to 17.5% (235 bps) y-o-y. The share of protection in individual APE improved to 9% versus 6% last year. New business margins improved because of product mix change, better business trends, and cost-control metrics. Annuity business continues to gain traction. There is strong structural demand for this product.
- **COVID-19 Claims:** Total COVID-19 claims were 418 (nos) claims in the individual business while 50 (nos) in the group business. Credit life business continues to witness pressure currently.
- **Digital Channel:** There is 88% of premium that has come from digital channels. There was increasing trend in digital payments, with 95% policies payments made through the online channel mode.
- **Persistency performance:** Persistency in performance mostly due to delayed unwinding of products. Persistency assumptions looked once a year during March 2020. Overall, fair amount of recovery in ULIP persistency in comparison to pre-COVID levels.
- **Sanchay update:** Sanchay Par is doing very well due to its unique features and helped by improving traction from the Banca partners. Since in PAR products, both the upside and downside risk is shared with the unit holder, hence there is low risk for shareholders.
- **Persistency stable:** Persistency is holding up well, and even there is some improvement. This is due to close interaction with customers; the company is reaching out to customers and stressing the need to continue payment. Diversification also helped, with different profile of customers, which provided cushion for the company. The company was unable to collect premiums in April and May months which impacted Persistency. Persistency in the non-PAR segment has also improved.
- **Interest Rate Sensitivity:** Limited pay Products have higher interest rate sensitivity compared to regular pay. Using various hedging strategies helped in maintaining interest rate sensitivity.
- **Need to raise sub-debt:** Because HLIC had gone to 183% due to market fall in Q4 and hence it does not want to go slow on growth due to paucity of capital.
- **New term plan introduction by IRDAI:** IRDAI's standard term product is similar to HLIC's existing term product. The new product has 45-day waiting period, which is not allowed in other standard life products. So, choices increase for the customers. HLIC is positive about the new product, and believes the product will help penetration in Insurance products.
- **Reasons for the additional reserving:** Had done Rs. 41 crore reserving for COVID-19, was over and above the reserving for other exigencies. So far, claims have been much lesser than reserving. HLIC believe that it will be adequate for them for near/medium term.
- **Decline in Economic Variance:** Economic variance from Q1 has reduced in H1FY2021 due to change in the slope of the yield curve.
- **Rising share of single premium share:** Largely due to annuity and is a stated objective to capture the retiral space. Annuity is an accretive and attractive product to be selling to senior citizens.
- **Margins:** PAR replacing ULIP, annuity growth picking up, retail protection share also increasing. Thus, all contributing to margin improvement. Back book surplus grew at 10% y-o-y. HLIC sold higher protection business, thus contributing higher to the new business strain while PAR has less new business strain.
- **Business Mix:** Non-par versus a par product. "Sanchay Par Advantage" has done well due to features of cash back etc. Due to COVID-19 too, the attractiveness has increased. VNB margin impact is higher margin for PAR/Protection. The share of non-PAR and ULIP is reducing.
- **Client preferences:** Clients want to lock in rates available as FD rates are seen to be going down. So, demand for PAR products is going up. Overall market share in India has been consistent, but planning to increase the share. While PAR has little or no new business strain, every other business has some or other

new business strain. Hence, one should see that as function of new business numbers. HLIC has always been focused on protection and, hence, is now seeing anything new.

- **Credit Protect product:** Credit Protect sales traction is still down since some NBFC partners are still seeing slower credit offtake. HLIC expects this segment to perform better in Q3 and Q4.
- **ULIP outlook:** ULIP risk aversion with investor despite markets performing well. Insurance ULIP has a nine-month lag, saw this in 2009, 2013 when investors do not flock to ULIPs unless there is at least six months of good performance. Lesser lag in exiting, compared to entering in this product.
- **New products:** Customers looking to cover health and life. Realise the need for annuity, PAR and non-PAR also. Currently, these product segments are seeing improved acceptance.
- **Outlook for the products:** Going forward, see scope for all the products, as they serve different products.
- **Differential products offering:** Investment portfolio, for the entire industry over a longer period Equity should outperform the Fixed income investments. But investors may initially buy for a longer term, but may abandon due to risk aversion and other reasons. Hence, the PAR has good capital guarantee and also upside potential, hence can be an attractive product.
- **Opex decline:** Operating expenses as absolute amount, H1FY2020 versus H1FY2020 due to APE composition also matters. The cost from agency channel has higher fixed cost, hence the cost impact will vary for combination. Moreover, credit life growth will have impact on margins. HLIC also held back with focus on austerity measures, salary hikes, and promotion etc., which also helped in cost management.
- **Banca Channel:** In terms of banca mix, currently 60%-70% of the total Banca premium comes from HDFC Bank. HLIC has entered into banca partnership recently with Yes Bank. Bandhan is also another Banca partner. The rest of the Banca Partners (excluding HDFC bank) are also showing improving trends.

Results Rs cr

Particulars	Q2FY21	Q2FY20	Ch% YoY	Q1FY21	Ch% QoQ
Gross Written Premium	10,182.5	7,555.2	34.8	5,863.0	73.7
Net premium earned	10,045.4	7,453.7	34.8	5,721.8	75.6
Investment Income	6,318.8	1,135.1	456.7	8,749.1	(27.8)
Other Income	43.1	48.2	(10.6)	38.0	13.4
Total Income	16,414.8	8,658.1	89.6	14,508.9	13.1
Profit Before Tax	326.2	326.8	(0.2)	451.2	(27.7)
Tax Charge	0.1	18.1	(99.3)	0.1	9.1
PAT	326.1	308.7	5.6	451.1	(27.7)

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Long runway for growth, opportunity for strong players to gain

We believe the insurance sector has a huge growth potential in India with a large protection gap, expanding per capita income, etc. being the key long-term growth drivers for the sector. In this backdrop, we believe strong players such as HLIC, armed with the right mix of products, services, and distribution, are likely to gain disproportionally from the opportunity.

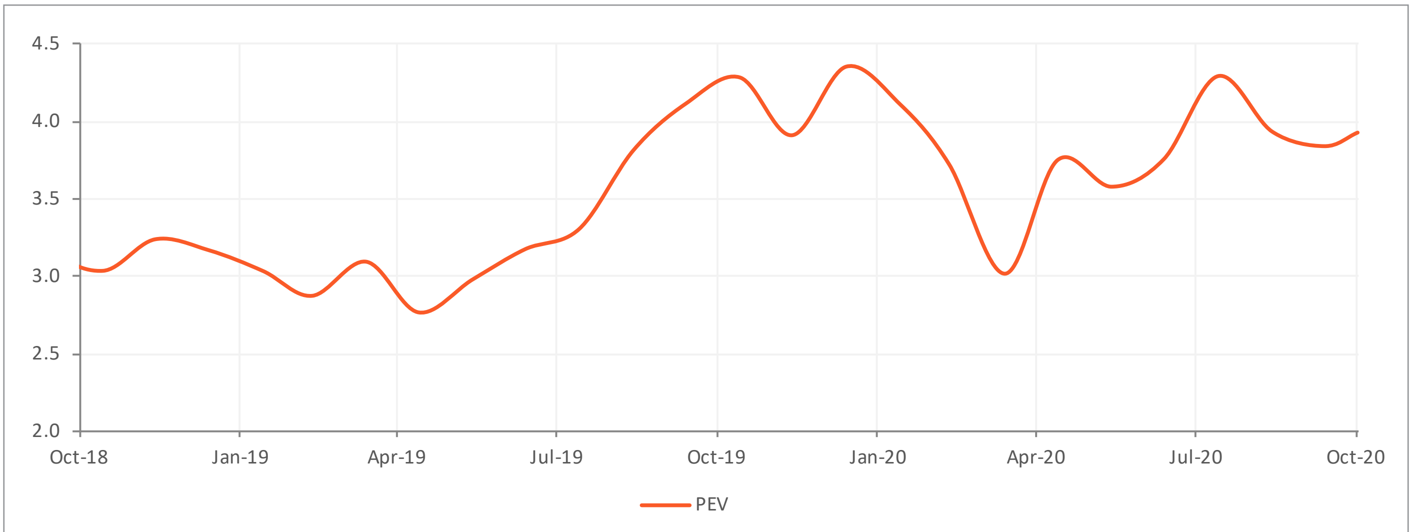
■ Company Outlook – Superior metrics and balanced mix make business sustainable

HLIC is well placed with healthy capitalisation and a favourable business mix. With a high proportion of protection and savings-related products, we believe HLIC is better-placed in the present environment, but near-term credit protect and ULIPs may take time to pick up. The company's sustained high persistency ratio indicates client service and quality of products offered, which are critical for long-term sustainability. While the solvency ratio is at a comfortable 203%, the augmented solvency ratio will provide for growth capital support in the protection business as and when the opportunity for growth presents itself. We believe even though the medium term may see pandemic-related slowdown, HLIC is a strong and attractive business franchise and the Indian insurance space is an attractive sector for the long term. Structurally, we expect HLIC to deliver ~24% VNB margins over the next 2-3 years (on a normalised basis) and its calibrated risk management has resulted in low EV and VNB sensitivity in the non-par segment, which is a positive support for valuations.

■ Valuation – Premium valuations to sustain

The stock is at a valuation of 4.1x/3.4x its FY2022E/FY2023E EVPS. HLIC has a better diversified product bouquet (no segment contributing to more than 30% of the APE) as compared to other players, best-in-class branding, and strong metrics, which make us believe that the company is well-placed to deliver strong and sustainable long-term APE growth. Aided by strong fundamentals (robust balance sheet and consistent profitability) and high long-term growth potential for the Indian insurance industry in general and HLIC, in particular, we find HLIC an attractive long-term bet. We recommend Buy with a PT of Rs. 671.

One year forward P/EV chart



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs/Share)	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HDFC Life	574	14.5	12.7	84.3	72.6	0.90	0.90	17.2	17.5
ICICI Pru Life	423	7.1	5.4	51.5	43.3	0.84	0.84	14.8	16.1

Source: Company, Sharekhan research

About company

Established in 2000, HLIC is a leading long-term life insurance solutions provider. The company offers a range of individual and group insurance solutions that meet various customer needs such as protection, pension, savings, investment, and health. HLIC continues to benefit from its increased presence across the country. The company has a wide reach with 400+ branches and additional distribution touch points through several new tie-ups and partnerships, including own sister concern bank. The company also has 270+ partnerships, comprising traditional partners such as NBFCs, MFIs and SFBs, and includes more than 40 new ecosystem partners. The company has a strong base of financial consultants.

Investment theme

HLIC stands out among its peers with its strong parentage, robust brand recall, along with advantages that come with an industry leader sister concern bank, which has an attractive retail business and gives deep client penetration and arguably the best means to channelise growth for the insurance business. HLIC is among the top private insurers in India and enjoys 21.5% (was 20.7% in FY2019) market share (in total new business) as of FY2020. We believe HLIC's sustained product leadership will help it maintain superior VNB margins and operating RoEV, relative to peers, which provide support to its valuations. We believe the insurance market has significant growth opportunities and HLIC is well placed to capture them. HLIC, by virtue of its bancassurance partnerships, digital strength and industry-leader status, should be able to deliver steady VNB and EVOP CAGR over the long term (aided by high margins in the protection business and improving persistency) in a normalised state of business, which will be support for valuations.

Key Risks

Persistency across middle cohorts declined on a y-o-y basis mainly due to the pandemic, adverse market conditions, and weak customer sentiment in ULIPs etc. categories.

Additional Data

Key management personnel

Ms. Vibha Padalkar	Managing Director & Chief Executive Officer
Mr. Niraj Shah	Chief Financial Officer
Mr. Parvez Mulla	Chief Operating Officer
Mr. Srinivasan Parthasarathy	Senior Executive Vice President, Chief Actuary & Appointed Actuary
Mr. Prasun Gajri	Chief Investment Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group Cos Inc/The	7.0
2	JPMorgan Chase & Co	2.8
3	FIL Ltd	1.3
4	Vanguard Group Inc/The	1.2
5	SBI Funds Management Pvt Ltd	1.2
6	BlackRock Inc	1.1
7	Motilal Oswal Asset Management Co	0.9
8	Axis Asset Management Co Ltd/India	0.9
9	Nomura Holdings Inc	0.7
10	Mirae Asset Global Investments Co	0.6

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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