Sharekhan by BNP PARIBAS

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Stock Update

Max Financial Services

Regulatory approval received; Business outlook positive

Banks & Finance	Sharekhan code: MFSL	Company 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. 889**	
Price Target: **Rs. 1,100**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

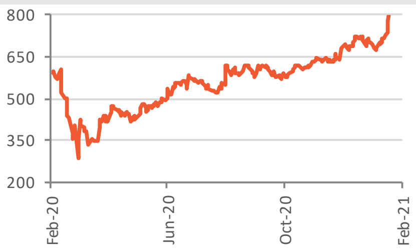
Company details

Market cap:	Rs. 30,683.7 cr
52-week high/low:	Rs. 939 / 280
NSE volume: (No of shares)	16.1 lakh
BSE code:	500271
NSE code:	MFSL
Free float: (No of shares)	28.5 cr

Shareholding (%)

Promoters	17.3
FII	20.3
DII	54.7
Others	7.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	30.7	39.5	43.5	51.1
Relative to Sensex	23.0	24.2	12.9	23.1

Sharekhan Research, Bloomberg

Summary

- The much-awaited IRDAI approval to the Max Financial Services (MFS) - Axis Bank deal is positive; removes the regulatory overhang on the transaction.
- Max Life Insurance (MLI) has evolved over the years (has best-in-class VNB margins, high ROEVs, diversified product portfolio, reduced dependency on PAR business etc.) and is an attractive player with strong capabilities.
- We see operating leverage benefits kicking in going ahead, as improving business mix would support VNB margins; we believe the Indian insurance market has attractive growth opportunities.
- Valuations are reasonable at 2.3x/2.0x its FY2022E/FY2023E EVPS; deal closure may provide further re-rating boost. We maintain our Buy rating with a revised PT of Rs. 1,100.

The much-awaited IRDAI approval to Max Financial Services (MFS) and Axis Bank transaction will be positive for the two entities. Since all other regulatory, shareholder, and board approvals are already in place, with this approval, the long-awaited joint venture transaction (first announced in April 2020) may proceed for conclusion. Moreover, with this the regulatory overhang of the transaction is also over. Max Life Insurance's (MLI) business has evolved over the years (and today has best-in-class VNB margins, high ROEVs, diversified product portfolio, and reduced dependency on PAR business). Hence, it is an attractive player with strong capabilities and business mix in the insurance space. MLI has strengths on proprietary channel (9% APE increase for 9MFY2021; positive for protection and traditional products), which make it an attractive franchise. The deal with Axis Bank should further add to its distribution strength, with sharper focus on banca-led products such as credit life. MLI has strong capabilities in its distribution network, with a strong agency channel that it has developed over the years. Overall bancassurance contribution increased from 65% in FY2020 to 70% in 9MFY2021 mainly as the agency channel was subdued due to the pandemic in 9MFY2021. Healthy traction in the high-margin protection (16% of APE as on 9MFY2021 compared to 14% in 9MFY2020) and non-PAR (33% of APE as of 9MFY2021) segments also augurs well for MLI. Sales of the proprietary channel witnessed growth, led by better show in the agency channel; and e-commerce channel's contribution will provide tailwind benefits to the company going forward. The Indian insurance market has significant growth opportunities. MLI, with its strong brand image and (now) stable bancassurance partnership, is well placed to benefit from the same. We believe MFS's strong business fundamentals make it attractive. With improving clarity on outlook, we have revised our target multiples. We maintain our Buy rating on MFS with a revised price target (PT) of Rs. 1,100.

Our Call

Valuation: At the CMP, MFS is available at 2.3x/2.x its FY2022E/FY2023E MCap/EV (considering MFS's present stake in MLI) and valuations appear reasonable. MLI's business has evolved over the years (and today has best-in-class VNB margins, high ROEVs, and diversified product portfolio) and is an attractive player with strong capabilities and business mix in the insurance space. The regulatory approvals put the overhang for the deal behind us, and focus will now shift to business performance and the possible synergy benefits for the entities. Axis Bank has been the MLI's strongest distribution partner, with ~60% contribution to APE and, hence, was a crucial partner for it. Moreover, MLI has been on-boarding newer bancassurance partners with banks and new-age digital players, which would not only help diversify the mix but also provide higher sales capacity for it. Hence, we believe business tailwinds may result in providing a positive trigger for improving metrics going forward. MLI generates healthy ROEV (18% in 9MFY2021) and has sufficient capital (solvency ratio of 208%; no exigency for capital dilution in the near term) and, hence, its strong fundamentals make it a strong candidate to benefit as the outlook improves further. We expect the stock to see further re-rating owing to deal closure and improvement in MLI's operating performance. We maintain our Buy rating on the stock with a revised PT of Rs. 1,100.

Key Risks

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
Net Earned Premium	14,418	15,968	18,375	21,236	24,527
Net Profit	555.2	539.6	540.9	685.3	850.5
EPS (Rs)	2.9	2.8	2.8	3.6	4.5
ROA (%)	0.9	1.0	0.6	0.7	0.8
ROE (%)	20.3	20.2	18.0	19.2	20.5
EV / Share (Rs)	48	52	62	74	87
P / EV (x)	18.5	17.2	14.3	12.1	10.2
Dividend Yeild (%)	0.3	0.3	0	0.1	0.1

Source: Company; Sharekhan estimates

Last regulatory hurdle cleared, paves way for the deal to proceed

As per the proposed transaction, Axis Entities have the right to acquire up to 19% stake in MLI, of which, Axis Bank proposes to acquire up to 9% and Axis Capital Limited and Axis Securities Limited together propose to acquire up to 3%, with Axis Entities having the right to acquire an additional stake of up to 7% in MLI. The deal removes distribution overhang and Axis Bank JV can help in structural improvement in growth and margins outlook.

As per the agreement between Axis and Max, Axis Bank and its subsidiaries have the right to acquire up to 19% stake in MLI. While there will be 12% stake sale to Axis group (9% stake sale to Axis Bank and 3% stake sale to the 100% subsidiaries of Axis Bank) and subsequently stake sale of 7% in MLI over the next few years.

Management had indicated that the consideration of the transaction is likely to be linked to the book value of MLI. MFS will eventually look to use the proceeds of the stake sale to acquire the balance 5% stake in MLI from Mitsui Sumitomo, taking the final shareholding of MFS to be ~80% in MLI.

Margins of MLI are strong and expected to sustain

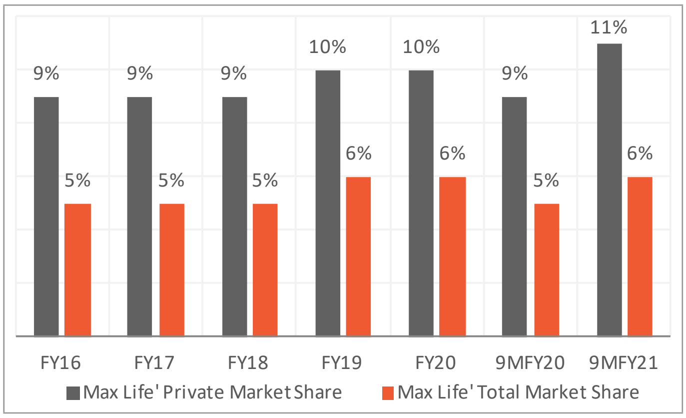
MLI reported strong 65% growth in Q3FY2021 post-overrun VNB, which was driven by strong 22% growth in APE, significant reduction in over-runs, and a robust 270 bps pre-overrun VNB margin expansion to 26.5%. The shifting product mix towards non-par savings (at 36% versus 19% earlier) was the key driver behind strong margin performance. Management has indicated that owing to operating leverage and improving business mix, VNB margins are likely to hold at present levels for the long term. Even though the drag on ULIP was seen, going forward, management commentary indicates ULIP traction is improving (generally takes at a lag of six months to market performance). Going froward, management has indicated a balanced mix of business with non-PAR at 30%-35% of APE, while protection is at 35%-40% of APE.

Agency channel to improve contribution as business normalises

Strong individual adjusted sales were recorded at Rs. 1,210.6 crore in Q3FY2021, being 21% higher than last year, spurred by 27% growth in bancassurance channel sales, which in turn was a result of a 32% increase in Axis Bank sales. Overall bancassurance contribution has increased from 65% in FY2020 to 70% in 9MFY2021 mainly as the agency channel was subdued due to the pandemic during 9MFY2021. Hence, proprietary channels sales grew by 9% in Q3FY2021, led by the agency channel's performance. The e-commerce channel grew by 54% y-o-y due to protection tailwinds, higher claims paid ratio, and competitive pricing.

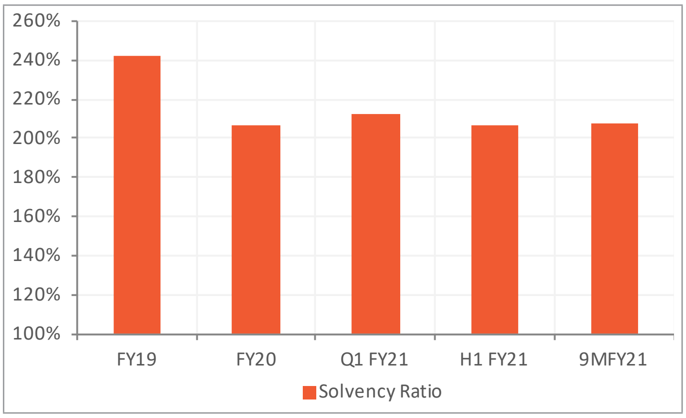
Financials in charts

Max LIfe's Market share trajectory



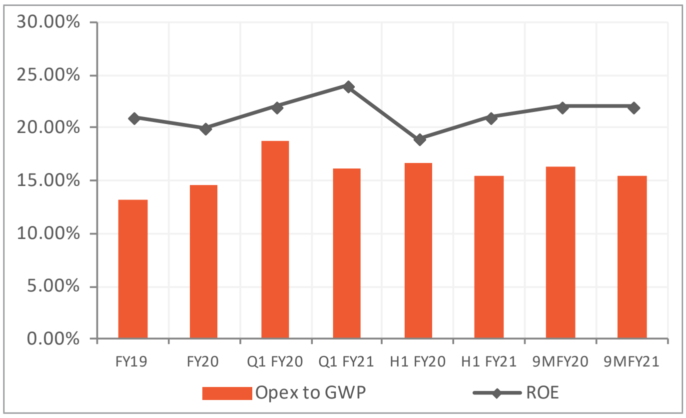
Source: Company, Sharekhan Research

Solvency Ratio



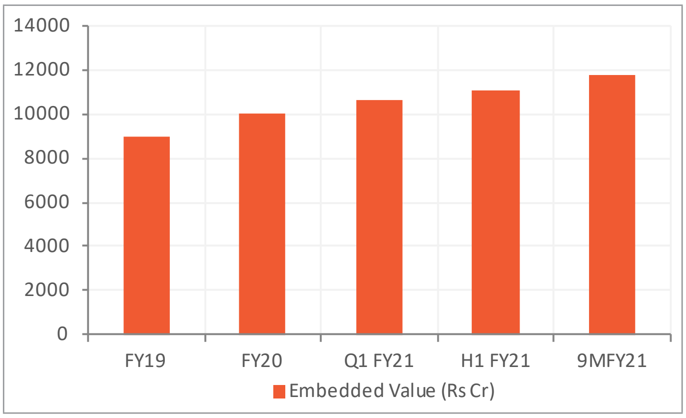
Source: Company, Sharekhan Research

ROE & Opex



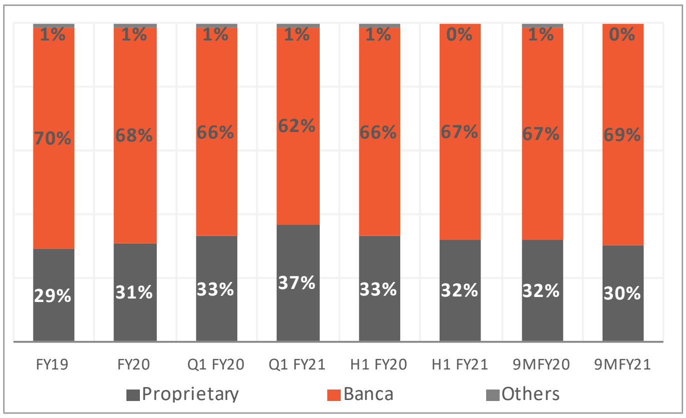
Source: Company, Sharekhan Research

Embedded Value



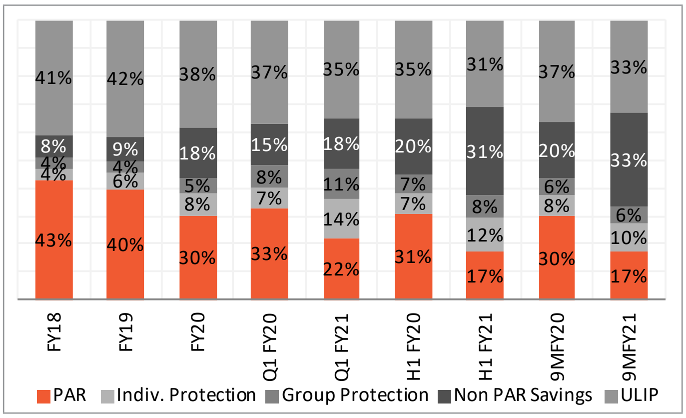
Source: Company, Sharekhan Research

Channel Mix



Source: Company, Sharekhan Research

Product Mix



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view – Insurance has long runway for growth in India, strong players to gain

We believe the Indian insurance sector has a huge growth potential with facilitating factors such as a large gap in protection products (under-insured), expanding per capita income (savings products), and increasing life expectancy (retirement products) being key structural long-term growth drivers. India has high underinsurance in life insurance premiums at ~2.8% of GDP in 2020, as compared to the world average of over 3%. Moreover, India has ~92% of the protection gap (addressable population, which does not have insurance coverage), which is estimated to be at $8.56 trillion. Even though the share of life insurance funds in household financial savings has increased from 20.3% in FY2017 to 23.3% in FY2018, we believe it has a long way to go as compared to international peers. We believe the Indian life insurance industry is likely to have a strong growth potential due to the above-mentioned factors. In this backdrop, we believe strong private players armed with the right mix of products, services, and distribution mix, backed by strong and stable bancassurance partnerships, are likely to gain disproportionally from the opportunity.

■ Company outlook - Strong metrics; Sustainable growth business

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 company's strategy to achieve a balanced product mix and focus on non-PAR savings with the protection segment will be margin accretive and is achievable. Going forward, management indicated a balanced mix of business with non-PAR at 30%-35% of APE, while protection at 35%-40% of APE. We view cost management, re-balancing of product mix, and further diversification of distribution channels are key levers for profitability improvement and add to business sustainability. Going forward, as operating leverage benefits kick in, due to lesser pressure on investing in own channels, there will be positive support for margins, which will help in ongoing times of impacted sales and volatile markets. Despite challenges, sales growth for MLI are seeing impressive bounce-back in revenue, which is encouraging. MLI, with its strong proprietary channel, and riding on stable bancassurance partnership (further strengthened with the final regulatory approval of the deal with Axis Bank) appears well placed on most parameters.

■ Valuation - Maintain Buy with a revised PT of Rs. 1,100.

At the CMP, MFS is available at 2.3x/2.x its FY2022E/FY2023E mcap / EV (considering MFS' present stake in MLI) and valuations appear reasonable. Regulatory approvals put the overhang for the deal behind us, and the focus will shift to business performance and the possible synergy benefits for entities. Axis Bank has been MLI's strongest distribution partner with ~60% contribution to APE and, hence, was a crucial partner for it. Moreover, MLI has been on-boarding newer bancassurance partners with banks and new-age digital players, which would not only help diversify the mix but also provide higher sales capacity for it. Hence, we believe business tailwinds may result in providing a positive trigger for improving metrics going forward. MLI generates healthy ROEV (18% in 9MFY2021) and has sufficient capital (solvency ratio of 208%; no exigency for capital dilution in the near term) and, hence, its strong fundamentals make it a strong candidate to benefit as the outlook improves further. We expect the stock to see further re-rating owing to the deal closure and because of improvement in the operating performance of MLI.

About company

MFS is the holding company (holds ~72.5% share) of 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 multi-channel distribution partners. The company has a strong customer-centric approach focused on advice-based sales and quality service delivered through its superior human capital. The company is the fourth largest private life insurance player in India with ~11% private market share.

Investment theme

MFS holds MLI, which is among the leading private sector insurers. The company 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

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

Additional Data

Key management personnel

Mr Mohit Talwar	Managing Director
Mr V Krishnan	Company Secretary
Mr Jatin Khanna	Chief Financial Officer
Mr Dilbagh S Narang	Dir:Taxation
Mr Patnam Dwarakanath	Head:Human Capital

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Mirae Asset Global Investments Co	5.42
2	ICICI Prudential Asset Management	3.87
3	MONEYLINE PORT INV LTD	3.49
4	Nippon Life India Asset Management	3.42
5	HDFC Asset Management Co Ltd	3.22
6	WF ASIAN SMALLER CO FUND	3.12
7	Kotak Mahindra Asset Management Co	2.85
8	New York Life Insurance Co	2.79
9	Baron Capital Inc	2.74
10	BARON EMERGING MRKTS FUND	2.53

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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