

HDFC Life Insurance

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Exide Life acquisition: Premium valuation for a sub-par business

CMP	Target Price
Rs 759 as of (September 3, 2021)	Rs 870 (■) 12 months
Rating	Upside
BUY (■)	14.6 %

- **HDFC Life to acquire 100% of Exide Life:** HDFC Life today announced the acquisition of 100% shareholding in Exide Life from Exide Industries for a total consideration of Rs66.87bn. HDFC Life will issue ~87mn new shares at ~Rs685/share to Exide Industries and will pay Rs7.26bn in cash. After the deal completion, HDFC Ltd. will hold a 47.9% stake in the resultant entity and Exide Industries will hold 4.1%. In terms of most key metrics, the size of Exide Life is ~10% of HDFC Life (**Exhibit 1**).
- **At ~2.5x Jun'21 EV, the valuation paid for Exide Life far exceeds the quality of franchise:** The Indian life insurance market has been difficult for smaller players, and the players below the Top-8 have been struggling for many years. In particular, the smaller players without any meaningful bancassurance distribution have been battling to grow and manage their high fixed costs. Exide Life has been no different. It has been struggling on the expense front and its retail business has recorded poor persistency. In this context, the ~2.5x P/EV (Jun'21) paid to Exide Life appears to be at a significant premium over its intrinsic value. The three listed peers of HDFC Life currently trade at ~3.5x Jun'21 EV. It is worth noting here that these listed peers have a very strong brand, massive economies of scale, formidable bancassurance distribution and sustained high operating return EV.
- **Agency augmentation, cost synergy and increasing geographic footprints among the key rationales behind the deal:** Management highlighted that Exide Life's strong agency network should help HDFC Life improve its agency channel growth and productivity. Additionally, Exide Life is a reasonably strong and well-known name in Tier-2/3 towns in the Southern states (AP, Telangana, Karnataka and Tamil Nadu). This should help HDFC Life improve its presence in these geographies. Exide Life, given its smaller size, has been struggling with fixed costs. For Exide Life, the acquisition brings in cost synergies and addresses the issue of fixed cost overrun. This should improve profitability (on actual expense) of the new business of Exide Life materially.
- **Life insurance market dynamics do not justify valuation:** The share of current Top-8 private life insurers (SBI Life, IPRU Life, HDFC Life, Max Life, Bajaj Allianz Life, Tata AIA Life, Kotak Life and Birla Sun Life) in the private sector new business WRP has gone up to 83% in FY21 from 71% in FY14 (**Exhibit 2**). So, these Top-8 players are not really facing real competition from the smaller players. On the other hand, the smaller players, especially the ones without material bancassurance, have been struggling. All these factors point to the fact that there are many smaller players up for sale and there are not many suitors for the firms without sizeable bancassurance distribution. In this background, the premium valuation paid for Exide Life looks unwarranted.
- **In the overall context, the valuation premium means little for HDFC Life but might delay consolidation in the sector:** The valuation premium of ~Rs40bn over the EV of Exide Life means ~3% of HDFC Life's current market cap. However, the valuation of ~2.5x P/EV for a franchise without any material banca distribution sets an expectation benchmark for other such struggling companies. Given that not many of the sector leaders would be keen on paying such a premium valuation for a weaker franchise, this would delay the consolidation process in the sector.
- **Size of acquisition small, but operational challenges of acquisition and integration to be watched closely over the next 3-5 quarters:** HDFC Life management expects to complete the acquisition process in the next 6-9 months and complete the integration in the next 12-15 months. Despite the small size of Exide Life, the integration process, including system integration, management and employee rationalization, branch rationalization and agency integration, could be a daunting task. It is to be seen closely if this process becomes a material distraction for HDFC Life management over the next 3-5 quarters.

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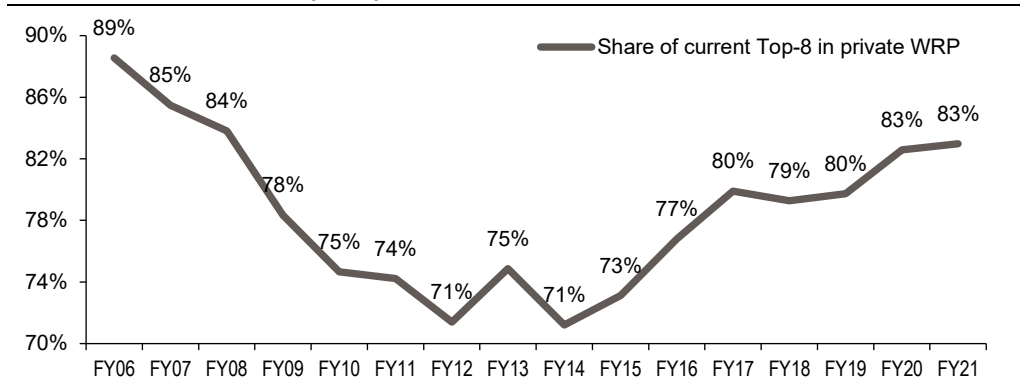
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Exhibit 1: FY21 key numbers at glance

Rs bn	HDFC Life	Exide Life	HDFC Life & Exide Life
Total Premium	385.8	33.3	419.1
Renewal Premium	184.8	25.4	210.2
Individual WRP	70.0	5.9	75.9
Individual WRP private market share	15.5%	1.3%	16.8%
Agency new business	9.4	3.6	13.0
No. of agents	1,07,895	36,710	1,44,605
Embedded Value	273.3	27.1	300.4
AUM	1,812.7	187.8	2,000.5

Source: Company, Emkay Research

Exhibit 2: Share of current Top-8 in private WRP

Source: Company, Emkay Research

Exhibit 3: Deal information

Rs bn	Deal info
EV of Exide Life as of Jun'21	27.1
Multiple	2.5
Valuation (Buy out Price)	66.9
Cash Consideration	7.3
Equity Issuance to Exide Industries	59.6
Issuance of shares (mn) @ Rs685/share	87.0

Source: Company, Emkay Research

Exhibit 4: Proposed Final Shareholding in Merged Entity

Shareholders	
Exide Industries	4.1%
HDFC Ltd	47.9%
Others	48.0%

Source: Company, Emkay Research

Con-Call highlights

- HDFC Life has announced the acquisition of 100% of the share capital of Exide Life Insurance Company Limited for a total consideration of Rs66.87bn.
- The proposed transaction will strengthen distribution and access to a wider product suite. The company sees synergies around the cost structure and expects VNB accretion from day 1.
- HDFC Life has remained focused on building a high-quality agency channel by acquiring new agents and improving the productivity of old agents.
- The agency channel grew 45% in Q1 and contributed 15% to the overall business with 13M persistency of 90%.
- Exide will contribute 40% to the topline of the agency business and 35% to the agent base; it will benefit from other distribution channels, including broker, corporate and direct.
- The acquisition complements HDFC Life's geographical presence as Exide Life has a strong foothold in South India, especially in tier 3 towns, which will give HDFC Life access to a wider customer base.
- Tier 2 & Tier 3 cities contribute more than 60% to Exide Life's business.
- Exide Life's distribution channel - Agency 60%; broker 23%; corp agents 7%; direct 10%
- The protection-focused business will augment the protection business EV by 10%.
- HDFC Life's private market share will rise by 1%.
- Deal - 35% discount to market multiple of three listed peers
- The deal will not have any material impact on EV. HDFC Life expects only 1-5% adjustment to EV.
- Exide Life has a pre overrun margin similar to HDFC Life's and a cost ratio 60% higher than HDFC Life's.
- Exide Life's persistency has been steadily increasing, especially 13M persistency which is currently at ~73%.
- Expecting 6 month timeline for all regulatory approvals; day zero – on Jan/Feb; margins to come to HDFC Life's level 12-15 months after approval.

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

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