

Merger synergies to play out in long term...

HDFC Life is among the most dominant players in the Indian life insurance industry with a healthy distribution network, 390 branches and additional customer touch points via partnerships and tie-ups, strong parentage and operating metrics. The company has a balanced product mix with focus on non-par and protection business and industry leading VNB margins of over 25%.

Event: HDFC Life has proposed a merger with Exide Life Insurance Company. Exide Life is currently owned by Exide Industries (100% stake) and has an embedded value of ₹ 2711 crore and AUM of ₹ 18780 crore as on June 2021.

Transactional aspect of merger: The acquisition of Exide Life would be done through a cash payout of ₹ 726 crore (mostly due to taxation impact, which Exide Industries has to pay) and a share consideration by allocating 8.7 crore shares at ₹ 685 per share. Thus, the total consideration for the merger comes to ₹ 6687 crore. Exide Industries will have a 4.1% stake in the merged entity.

Merger benefits for HDFC Life: Merger with Exide Life will complement the overall HDFC Life business as Exide has good reach, customer base (over 11.9 lakh) and a strong foothold in southern India, especially in the tier-II and tier-III cities. This also presents good cross sell opportunities with the addition of meaningful number of clients. The proposed merger will accelerate agency business of HDFC Life with addition of over 36700 advisors across 200+ branch network. This is expected to add ~40% to topline business via agency channel and around 35% to the agent base. Currently, HDFC Life's agency channel contributes ~15% of total business. Private market share is expected to get a boost of ~1.3% due to the merger.

Financial impact: Exide Life has an embedded value of ₹ 2711 crore, which will be added to HDFC Life, thus increasing HDFC Life's EV by ~10% to ₹ 30042 crore while total AUM will also increase ~10% to ₹ 200052 crore. Currently, as per management commentary, cost ratios of Exide Life are higher than HDFC Life but with branch rationalisation, optimisation of product mix and economies of scale kicking in, normalisation is expected to be achieved within 12-15 months from effective date of merger. No material impact is seen on the solvency ratio.

Valuation & Outlook

We believe with the acquisition of Exide Life, expansion in terms of geography (tier II and III regions), customers and distribution (agency channel) remains positive. Pre-override margin similar to HDFC Life is positive, though focus will be on improving cost matrix and persistency. Given low market share, flatish business and low persistency, cost of acquisition at ₹ 6687 crore i.e. ~2.5x EV is not cheap. Overall, we expect this merger to increase EVPS for FY23E by ~8% to ₹ 183 per share. Thus, we revise our target price from ₹ 800 to ₹ 850 per share by valuing the company at ~4.4x FY23E EV. We maintain our **BUY** rating on the stock.



Particulars

Particulars	Amount
Market Capitalisation	₹ 148884 crore
EV (Q1FY22)	₹ 27331 crore
AUM (Q1FY22)	₹ 181272 crore
VNB margin (Q1FY22)	26.2%
52 week H/L	776/ 556
Net worth	₹8970 crore
Face value	₹ 10
DII holding (%)	5.9
FII holding (%)	26.1

Key Highlights

- HDFC Life to acquire 100% stake in Exide Life at ₹6687 crore
- Merger to boost agency channel and increase geographical reach
- Maintain BUY recommendation with revised target price of ₹ 850

Key risk to our call

- Resurgence in Covid-19 cases remains a risk owing to probability of higher claims
- Interest rate volatility risk due to higher non-par business

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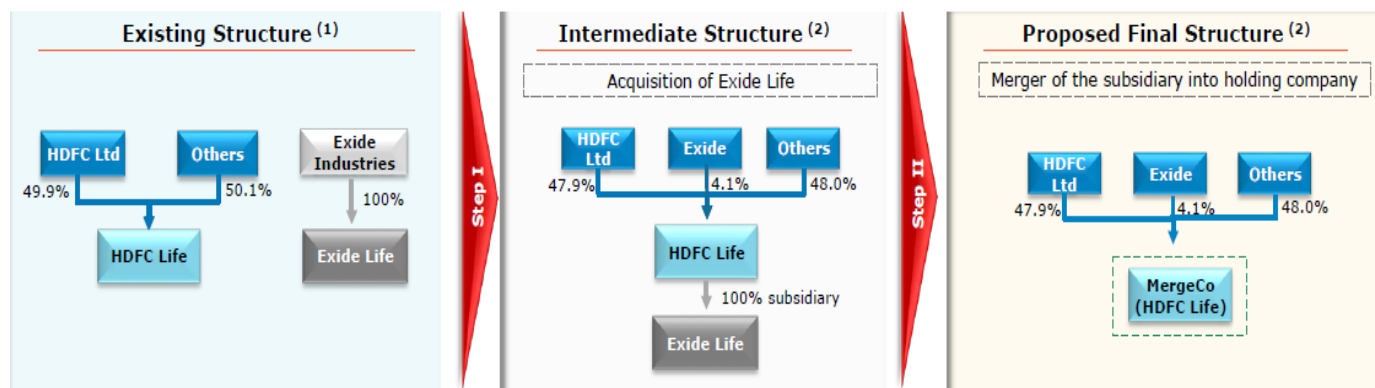
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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	4 year CAGR (FY17 - FY21)	FY22E	FY23E	2 year CAGR (FY21-23E)
New business premium	14971	17238	20107	23%	24416	31124	24%
APE	6049	7164	8183	19%	10198	13287	27%
Total premium	29186	32707	38584	19%	45952	58263	23%
PAT	1277	1371	1360	11%	1585	1904	18%
EV	18296	20655	26625	21%	31038	38592	20%
P/E (x)	116.1	108.2	109.1		93.7	81.4	
P/BV (x)	26.2	21.8	17.2		15.5	9.2	
P/IEV (x)	8.1	7.2	5.6		4.8	4.0	

Exhibit 1: Proposed structure



Source: Company, ICICI Direct Research

Exhibit 2: Merged entity details

Parameter	HDFC Life	Exide Life	Merged Entity
Total Premium	38583	3325	41908
Renewal Premium	18477	2544	21021
Individual Weighted Received Premium (WRP)	6998	591	7589
Individual WRP private market share	15.5%	1.3%	16.8%
Agency new business	937	358	1295
No. of agents	107895	36710	144605
Embedded Value	27331	2711	30042
AUM	181272	18780	200052

Source: Company, ICICI Direct Research

Financial summary

Exhibit 3: Policyholders Account

(₹ Crore)	FY19	FY20	FY21	FY22E	FY23E
Premiums earned - Net	28924.0	32223.6	38122.3	45010.5	57024.3
Interest, Dividends & Rent	9027.5	6845.3	32677.6	13449.4	16362.1
Others income (incl. MTM)	484.0	-9807.5	442.0	660.6	820.1
Total Revenue	38,436	29,261	71,242	59,121	74,207
Commission	1117.7	1491.18	1710.40	1967.0	2531.2
Operating expenses	3813.6	4266.9	4587.4	6018.2	7982.7
Change in valuation of policy liabilities	17507.5	2440.8	40829.6	24937.4	32664.2
Provision for tax	226.8	149.0	274.4	476.9	-662.4
Surplus/(deficit) after tax	1350.7	971.4	1098.4	1327.3	1850.8
Transfer to Shareholders' account	1,207	1,191	991	1,204	1,481

Source: Company, ICICI Direct Research

Exhibit 4: Shareholders Account

(₹ Crore)	FY19	FY20	FY21	FY22E	FY23E
Amounts transferred from Policyholders' account	1206.9	1191.4	990.9	1203.9	1480.6
Income from investments	408.4	437.8	647.6	759.8	867.4
Total	1,636	1,648	1,638	1,964	2,348
Total expenses	62.6	99.1	285.0	346.5	260.4
Profit before Tax	1289.9	1387.4	1353.5	1633.6	1963.0
Provision for tax	13.1	16.5	-6.6	49.0	58.9
PAT	1,277	1,371	1,360	1,585	1,904

Source: Company, ICICI Direct Research

Exhibit 5: Balance Sheet

(₹ Crore)	FY19	FY20	FY21	FY22E	FY23E
Sources of Funds					
Share capital	2017	2019	2021	2021	2108
Reserve and surplus	3641	4968	6407	7340	14544
Credit/(debit) fair value change account	-3	-192	207	216	226
Networth	5656	6800	8638	9577	16878
Policyholders' funds	118124	119502	162818	179253	228256
Funds for Future Appropriations	1103	883	991	1114	1484
Total Liabilities	124883	127185	173066	189944	246619
Applications of Funds					
Shareholders' investments	5050	5855	8542	8695	11565
Policyholders' investments	57124	67189	90538	93717	124779
Asset held to cover linked liabilities	63377	54182	74760	79648	95577
Loans	80	299	424	424	957
Fixed assets - net block	333	330	340	347	354
Net current assets	-1082	-670	-1538	7113	13387
Total Assets	124883	127185	173066	189944	246619

Source: Company, ICICI Direct Research

Exhibit 6: Key Ratios

(Year-end March)	FY19	FY20	FY21	FY22E	FY23E
Valuation					
No. of Equity Shares (Crore)	201.7	201.9	201.9	202.1	210.8
Diluted EPS (₹)	6.3	6.8	6.7	7.8	9.0
BV (₹)	28.0	33.7	42.8	47.4	80.1
EV per share	90.7	102.3	131.9	153.6	183.1
P/E	116.1	108.2	109.1	93.7	81.4
P/BV	26.2	21.8	17.2	15.5	9.2
P/IEV	8.1	7.2	5.6	4.8	4.0
Efficiency Ratios (%)					
Commission expenses as a % of Gross Premium	3.8	4.6	4.4	4.3	4.3
Management expenses as a % of Gross Premium	16.9	17.6	16.3	17.4	18.0
Return Ratios and capital (%)					
Return on Net worth	24.5	22.0	17.6	18.0	17.5
Operating RoEV	20.1	18.1	18.5	18.4	18.2
Key Ratios (%)					
VNB Margin	24.6	25.9	26.1	26.4	26.0
NBP APE (proportion %)					
Participating	14.4%	15.9%	14.6%	16.5%	18.9%
Non participating	38.5%	59.5%	53.5%	60.1%	57.7%
Unit Linked	47.1%	24.5%	21.7%	23.4%	23.3%

Source: Company, ICICI Direct Research

Exhibit 7: Key parameters

(Year-end March)	FY19	FY20	FY21	FY22E	FY23E
NBP	14,971	17,238	20,107	24,416	31,124
Growth (%)	32	15	17	21	27
Linked	11,322	11,192	11,055	12,593	14,822
Growth (%)	10	-1	-1	14	18
Non Linked	17,864	21,514	24,281	33,360	43,441
Growth (%)	34	20	13	37	30
APE	6,049	7,164	8,183	10,198	13,287
Growth (%)	12	18	14	25	30
VNB	1,540	1,919	2,190	2,754	3,534
Growth (%)	20	25	14	26	28
EV	18,296	20,655	26,625	31,038	38,592
Growth (%)	20	13	29	17	24
AUM	1,25,552	1,27,226	1,73,839	1,82,060	2,31,921
Growth (%)	18	1	37	5	27
PH Funds	57,124	67,189	90,538	93,717	1,24,779
Growth (%)	26	18	35	4	33
SH Funds	5,050	5,855	8,542	8,695	11,565

Source: Company, ICICI Direct Research

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Buy: > 15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: < -15%



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