

BUY

TP: Rs 701 | ▲ 31%

HDFC LIFE

| Insurance

| 19 July 2022

Sustainable growth, high visibility – BUY

- Q1 gross premium increased 23% YoY with NBP up 27% and renewal premium up 19%
- APE grew 22% YoY to Rs 19bn led by protection (+30%) and savings (+21%) products; VNB margin expanded 60bps YoY to 26.8%
- We assume coverage with BUY and a TP of Rs 701 (3.6x FY24E P/EV) given high growth and margins as well as a strong market position

Balanced product mix; protection share rises: HDFC Life is focused on a balanced product mix with par/non-par savings forming 24%/28% of APE, ULIP/protection at 20%/17% and annuity/group products at 7%/4% at end-Q1FY23. The company is targeting growth in the protection and non-par businesses and is less ULIP-heavy. This is evident from a decline in ULIP share in NBP from 21% in FY19 to 9% in Q1FY23.

Strong APE growth: APE grew 22% YoY to Rs 19bn in Q1 wherein protection APE, which constituted 17% of the total, grew 30%. Although challenges persist in individual protection products, group plans did fairly well. Savings products grew 21% YoY to Rs 15.8bn. Management expects continued momentum in the non-par savings and annuity business segments. Gross premium grew 23% YoY to Rs 94bn with NBP/renewal premium up 27%/19%. We factor in a 16% CAGR in APE to Rs 151bn by FY25.

VNB margins high: VNB increased 24% YoY to Rs 5.1bn in Q1 with a margin of 26.8%, up 60bps YoY. Expenses were high as costs absent during Covid returned and the company had MTM losses. However, this is historically a lukewarm quarter for the company and an annual margin increase is positive. We model for a 16% CAGR in VNB over FY22-FY25 to Rs 42bn and factor in margins of ~28% over our forecast period.

Channel mix largely stable: Based on individual distribution, the share of the bancassurance channel remained stable at 56% on an annual basis but saw a sequential decline. The direct channel dipped from 23% in the year-ago quarter to 22% but improved sequentially. Agency also saw traction with its share in individual business up from 15% last year to 16%.

BUY, TP Rs 701: The stock is trading at 2.7x FY24E P/EV. Given stronger growth, healthy solvency margins and high persistency, along with its positioning as a top-3 player, we value the company at 3.6x FY24E P/EV – ~1SD below the long-term mean. This translates to a TP of Rs 701, offering 31% upside potential – BUY.

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Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	HDFCLIFE IN/Rs 536
Market cap	US\$ 14.2bn
Free float	48%
3M ADV	US\$ 24.3mn
52wk high/low	Rs 776/Rs 497
Promoter/FPI/DII	52%/26%/8%

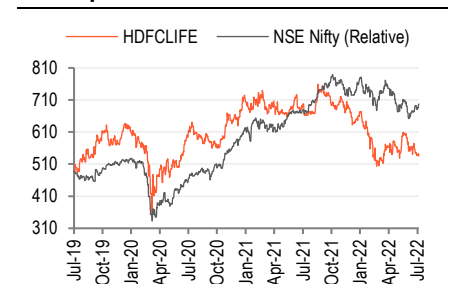
Source: NSE | Price as of 19 Jul 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
NBP (Rs mn)	2,41,548	2,82,071	3,27,829
APE (Rs mn)	97,580	1,14,362	1,31,606
VNB (Rs mn)	26,737	31,596	36,896
Embedded Value (Rs mn)	3,00,470	3,53,383	4,13,983
VNB margin (%)	27.4	27.6	28.0
EVPS (Rs)	146.8	172.6	202.2
EPS (Rs)	5.9	6.8	8.1
Consensus EPS (Rs)	5.9	8.3	9.9
P/EV (x)	3.7	3.1	2.6

Source: Company, Bloomberg, BOBCAPS Research

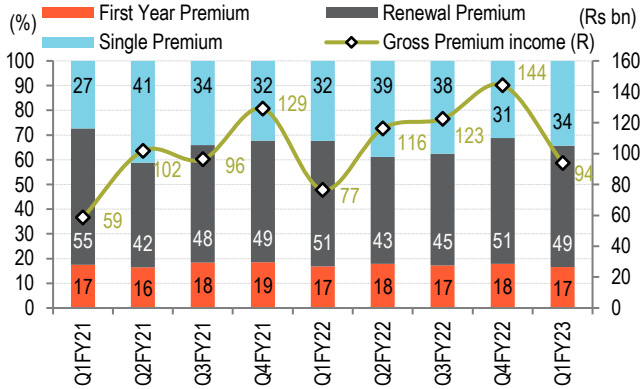
Stock performance



Source: NSE

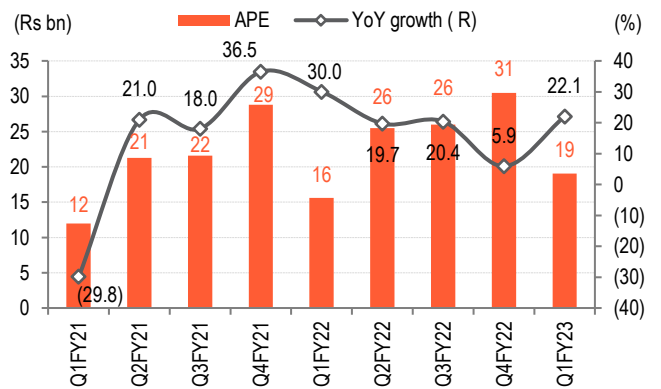


Fig 1 – Gross premium grew 23% YoY



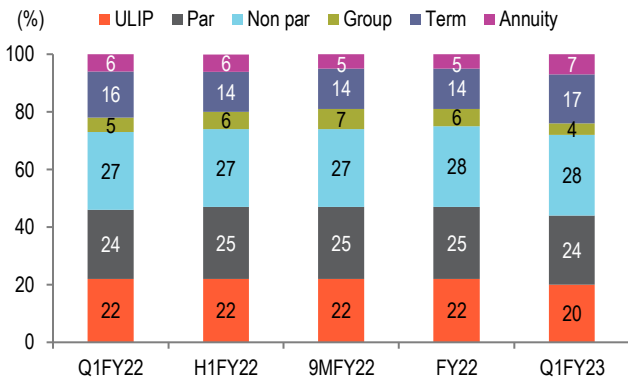
Source: Company, BOBCAPS Research

Fig 2 – APE grew 22% YoY



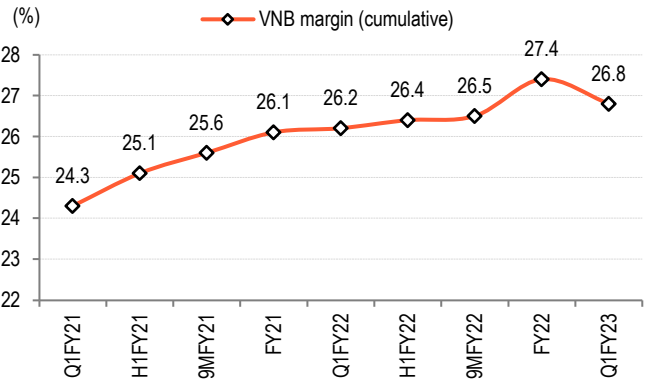
Source: Company, BOBCAPS Research

Fig 3 – Product mix – Protection share increasing



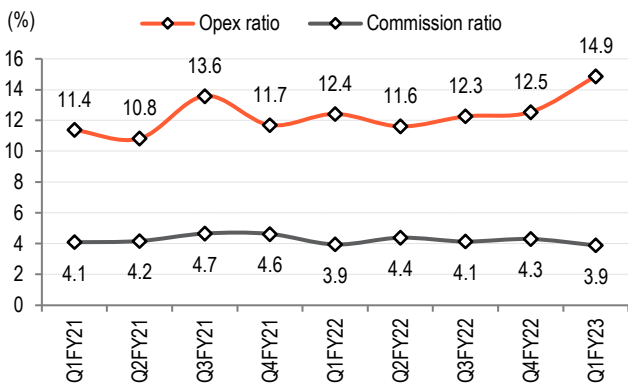
Source: Company, BOBCAPS Research Note: The data is based on APE basis

Fig 4 – VNB margin remains high



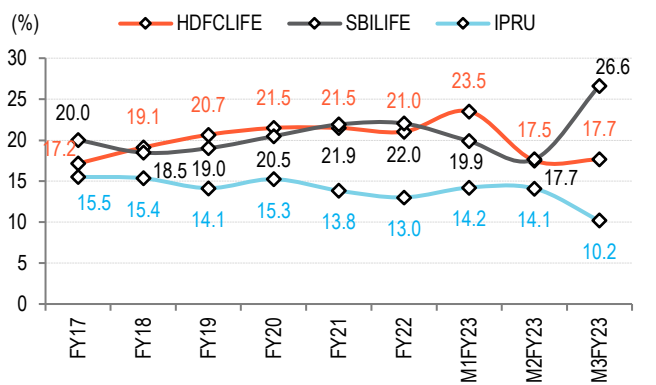
Source: Company, BOBCAPS Research

Fig 5 – Opex ratio elevated



Source: Company, BOBCAPS Research

Fig 6 – Market share volatile but expected to bounce back

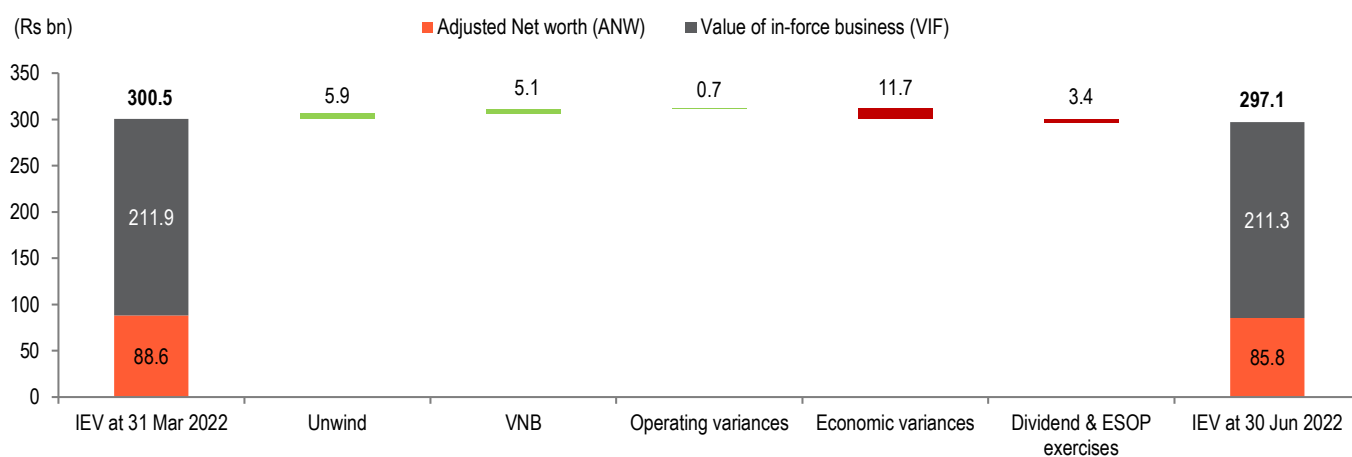


Source: Company, BOBCAPS Research

Fig 7 – Bancassurance and agency gaining traction whereas direct channel faltering

Distribution mix (%)	Q1FY21	H1FY21	9MFY21	FY21	Q1FY22	H1FY22	9MFY22	FY22	Q1FY23
Individual APE									
Bancassurance	59.0	60.0	63.0	61.0	56.0	60.0	61.0	60.0	56.0
Brokers and Others	5.0	6.0	6.0	7.0	6.0	6.0	6.0	6.0	7.0
Agency	12.0	13.0	12.0	13.0	15.0	13.0	14.0	14.0	16.0
Direct	24.0	21.0	19.0	19.0	23.0	21.0	19.0	19.0	22.0

Source: Company, BOBCAPS Research

Fig 8 – Embedded value – Operating variances positive but negative economic variances on faltering capital market and rising rates

Source: Company, BOBCAPS Research | Note: IEV – Indian Embedded Value

Fig 9 – Policyholders' account

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Gross premium income	93,961	76,559	22.7	1,44,213	(34.8)	4,59,628	3,85,835	19.1
First Year Premium	15,560	12,856	21.0	25,749	(39.6)	80,544	68,584	17.4
Renewal Premium	46,203	38,893	18.8	73,412	(37.1)	2,18,080	1,84,769	18.0
Single Premium	32,198	24,811	29.8	45,052	(28.5)	1,61,005	1,32,482	21.5
Reinsurance	1,242	1,175	5.8	1,316	(5.6)	5,664	4,612	22.8
Net premium income	92,719	75,385	23.0	1,42,897	(35.1)	4,53,965	3,81,223	19.1
Income from investments (Net)	(34,866)	69,636	NA	13,972	NA	1,92,159	3,26,776	(41.2)
Other income	449	218	106.6	631	(28.8)	1,765	1,551	13.8
Contribution of funds from Shareholders' A/c	0	805	(100.0)	3,050	(100.0)	5,694	2,868	98.5
Total	58,302	1,46,043	(60.1)	1,60,549	(63.7)	6,53,584	7,12,418	(8.3)
Commission on								
First Year Premium	2,404	2,171	10.8	4,289	(43.9)	13,681	12,661	8.1
Renewal Premium	671	497	35.1	1,090	(38.4)	3,301	2,771	19.1
Single Premium	533	284	87.8	698	(23.7)	2,062	1,330	55.0
Rewards	51	72	(29.3)	131	(61.2)	359	342	5.0
Net Commission	3,659	3,023	21.0	6,207	(41.1)	19,403	17,104	13.4
Expenses of Management	17,612	12,535	40.5	24,297	(27.5)	53,591	43,974	21.9
Provision for taxes	1,066	848	25.6	2,511	(57.6)	5,541	6,311	(12.2)
Benefits Paid (Net)	68,752	58,014	18.5	96,435	(28.7)	3,18,637	2,25,748	41.1
Change in actuarial liability	(31,834)	76,082	NA	31,734	NA	2,46,815	4,08,296	(39.5)
Surplus/Deficit	2,473	592	317.6	5,524	(55.2)	9,597	10,984	(12.6)

Source: Company, BOBCAPS Research

Fig 10 – Shareholders' account

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Transfer from Policyholders' Account	2,616	1,249	109.4	5,000	(47.7)	10,093	9,909	1.9
Investment Income	1,006	2,593	(61.2)	1,475	(31.8)	7,894	6,476	21.9
Expenses other than those related to insurance business	186	145	28.3	216	(13.8)	825	354	132.7
Transfer of funds to Policyholders' Account	0	805	(100.0)	3,050	(100.0)	5,694	2,868	98.5
Provisions for diminution in value of investments ⁶	(227)	(175)	29.8	(6)	3,815.5	333	373	(10.7)
Profit before tax	3,663	3,067	19.4	3,216	13.9	11,801	13,535	(12.8)
Provisions for tax	10	44	(76.7)	(360)	(102.8)	276	66	316.8
Profit after tax and before Extraordinary items	3,653	3,024	20.8	3,575	2.2	12,077	13,601	(11.2)

Source: Company, BOBCAPS Research

Fig 11 – Balance sheet

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Shareholders' funds:								
Share Capital	86,900	25,400	242.1	21,126	311.3	21,126	20,209	4.5
Share application money received pending allotment of shares	0	0	NA	33	(100.0)	33	20	68.3
Reserves and Surplus	67,300	62,300	8.0	1,32,852	(49.3)	1,32,852	64,074	107.3
Credit / (Debit) Fair Value Change Account	(300)	1,800	NA	848	NA	848	2,074	(59.1)
Sub-Total	1,54,000	89,700	71.7	1,54,859	(0.6)	1,54,859	86,377	79.3
Borrowings	9,500	6,000	58.3	6,000	58.3	6,000	6,000	-
Policyholders Funds								
Credit / (Debit) Fair Value Change Account	8,900	23,400	(62.0)	21,697	(59.0)	21,697	25,550	(15.1)
Policy Liabilities	10,81,300	8,97,200	20.5	10,43,425	3.6	10,43,425	8,55,230	22.0
Provision for Linked Liabilities	6,94,500	7,40,200	(6.2)	5,64,484	23.0	5,64,484	5,43,054	3.9
Add: Fair value change	0	0	NA	2,00,706	(100.0)	2,00,706	1,66,581	20.5
Funds for discontinued policies								
(i) Discontinued on account of non-payment of premium	41,900	41,500	1.0	40,854	2.6	40,854	37,762	8.2
(ii) Others	0	0	NA	172	(100.0)	172	198	(13.1)
Funds for Future Appropriations	9,300	9,200	1.1	9,409	(1.2)	9,409	9,906	(5.0)
TOTAL	19,99,400	18,07,200	10.6	20,41,605	(2.1)	20,41,605	17,30,658	18.0
Application Of Funds								
Investments:								
Shareholders'	1,57,100	89,700	75.1	1,52,379	3.1	1,52,379	85,421	78.4
Policyholders'	11,07,600	9,41,300	17.7	10,83,110	2.3	10,83,110	9,05,378	19.6
Asset held to cover Linked Liabilities	7,36,500	7,81,800	(5.8)	8,06,215	(8.6)	8,06,215	7,47,595	7.8
Loans	7,000	4,800	45.8	6,428	8.9	6,428	4,240	51.6
Fixed Assets	3,500	3,400	2.9	3,427	2.1	3,427	3,401	0.8
Net Current Assets	(12,300)	(13,800)	(10.9)	(9,955)	23.6	(9,955)	(15,378)	(35.3)
Total	19,99,400	18,07,200	10.6	20,41,605	(2.1)	20,41,605	17,30,658	18.0

Source: Company, BOBCAPS Research

Fig 12 – Key ratios and growth metrics

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
NBP	47,758	37,666	26.8	70,801	(32.5)	2,41,548	2,01,066	20.1
APE	19,040	15,600	22.1	30,500	(37.6)	97,580	83,700	16.6
VNB	5,090	4,090	24.4	8,960	(43.2)	26,737	21,846	22.4
Opex ratio (%)	14.9	12.4	243bps	12.5	231bps	12.2	11.9	33bps
Commission ratio (%)	3.9	3.9	(5bps)	4.3	(41bps)	4.2	4.4	(21bps)
Expense ratio (%)	18.7	16.4	237bps	16.8	190bps	16.4	16.3	11bps
VNB margin (%)	26.8	26.2	60bps	NA	NA	27.4	26.1	130bps
Solvency ratio (%)	178.0	203.0	(2,500bps)	176.0	NA	176.0	201.1	(2,513bps)
Persistence ratio (Regular Premium / Limited Premium Payment under Individual category)								
13th month (%)	88.0	86.0	200bps	NA	NA	87.0	85.0	200bps
61st month (%)	54.0	51.0	300bps	NA	NA	54.0	49.0	500bps

Source: Company, BOBCAPS Research

Earnings call highlights

VNB margin

- HDFC Life's retail protection business continues to struggle though the overall protection segment is doing well along with the non-par segment. However, margins were impacted by MTM costs and other operational costs which are returning post-Covid. Expenses were a 0.6% drag on Q1FY23 margins.
- In a positive, VNB margin expanded 60bps YoY in Q1FY23. Typically, the company does 15% of the entire year's business in the first quarter and expenses are front-ended for areas such as manpower and technology.

VNB walk

- The operating assumption change is positive (excluding Covid impact). HDFC Life has also raised its mortality assumption this year.

Embedded value (EV)

- HDFC Life sets an unwind rate for its investment assets at the start of the year and keeps this rate unchanged for the entire fiscal year. Any change is reflected in the investment variance through the rest of the year. The company expects to earn an ~8% unwind rate on assets.
- The company saw an economic variance of Rs 11.7bn in Q1FY23 due to a loss of ~Rs 4bn in volatile equity markets and ~Rs 7bn from higher interest rates (due to a 130bps rise in the short end of the yield curve).

Return on embedded value (ROEV)

- ROEV was ~16.5% in Q1FY23, after normalising the impact of Covid. The interest rate environment will determine whether this metric reaches the earlier band of 17-18%.

Solvency margin

- The company intends to beef up the solvency margin from the current 178% and is evaluating options, including raising of equity. The aim is to reach a comfort zone of 200-220%.

Protection products

- Protection products typically formed 1-2% of individual APE a few years ago and a further uptick was seen during Covid. However, with the rise in premiums and stricter underwriting standards, this segment has softened. Higher premiums coupled with inflationary pressure is causing customers to either lower the sum assured or postpone their purchase entirely. While the next 6-7 months could be weak, management sees a large opportunity over the longer term due to the wide protection gap. The company believes in a calibrated approach with respect to managing balance sheet risks arising out of the business.

- The credit protect business is expected to be high based on partner loan disbursement. The company has a large presence across mortgage and MFIs, and is not overly dependent on any medium.
- ROP (return of premium) is an important product and contributes one-third to one-fourth of the retail protection business. However, it is ultimately dependent on the needs of the customer and the company doesn't push any particular product.
- The group term insurance business has seen an uptick as pricing is more reasonable now.

Non-par business

- HDFC Life had earlier introduced innovative 'Sanchay Plus' and 'Sanchay Par Advantage' plans in the non-par segment. The annuity business has grown by ~10% when the market has declined by 9% (NBP terms).
- Sanchay FMP (fixed maturity plan) is at least 100-130bps more attractive than fixed deposits at the highest marginal tax bracket.

New products

- HDFC Life has been selling its 'Victor Protect Optima' product for some time now, whereas HDFC Ergo has just launched a new health indemnity product called 'Optima Secure' – this will form a new combination product for the company.

Distribution channel

- Agents are able to sell non-par products fairly easily.
- The company has observed a dip in Google searches but is making efforts in terms of digital marketing and expects enquiries to pick up over a period of time.

Number of Policies (NOP)

- Growth in NOPs has declined over the past three years in the term business. Excluding term, NOP growth has been high. Some of the products launched on the non-par and par side have higher average ticket size. Moreover, the company has exited certain cohorts with low ticket size because of the quality of business, either in terms of low persistency or high mortality claims.

Change in promoter

- Due to the Exide Life acquisition, HDFC's stake in HDFC Life has come down to 47.8%. Post the HDFC-HDFC Bank merger, the bank would be the company's new promoter. While there are concerns that the regulator may cap promoter holding at 30%, it will still be a material investment for the bank. Management also highlighted that HDFC Bank has expressed a desire to remain the promoter, subject to regulatory approval.

Valuation methodology

The stock is trading at 2.7x FY24E P/EV. Given strong growth, healthy solvency margins and high persistency ratios, along with its positioning as a top-3 life insurer, we value the company at 3.6x FY24E P/EV – ~1SD below the long-term mean. This translates to a TP of Rs 701, offering 31% upside potential. We have incorporated the Exide Life deal into this valuation at 1.25x FY24E EV.

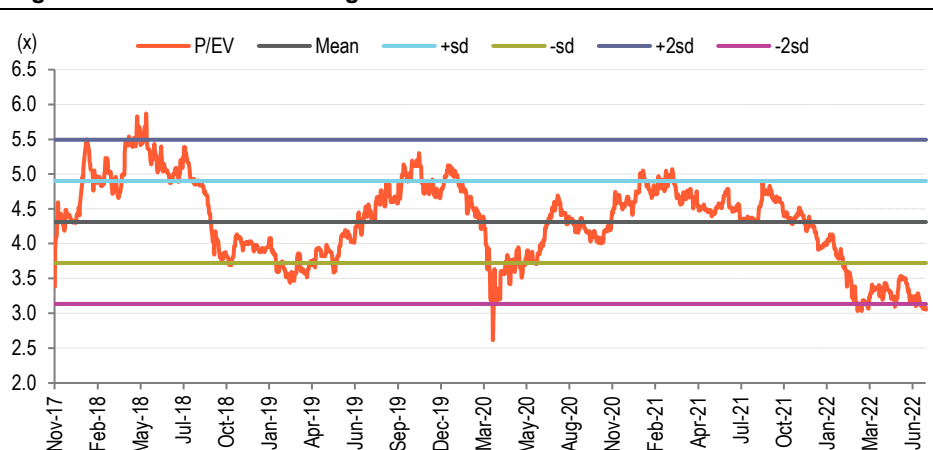
We assume coverage of HDFC Life with a BUY recommendation. The company is a market leader with 21% share at end-FY22, has strong brand equity and parentage, and is known for introducing innovative products. It is focused on maintaining a balanced product mix and has a healthy VNB margin (26.8% in Q1FY23, 27.4% in FY22). Sales are supported by an extensive distribution network comprising ~0.1mn agents, 383 branches and over 300 distribution partners. However, the cost ratios are on the higher side as compared to private peers (opex ratio at 14.9% in Q1FY23 and commission ratio of 3.9%).

Fig 13 – Valuation summary

Particulars	
Embedded Value (FY24E) (Rs bn)	414
PV of Future business (Rs bn)	1,025
Total value (Rs bn)	1,439
Exide EV (FY24E) - 1.25x (Rs bn)	42
Total (including Exide) Rs bn	1,481
Current P/EV (FY24E) (x)	2.7
Implied P/EV (FY24E) (x)	3.6
Implied Target Price (Rs)	701
Current Price (Rs)	536
Upside (%)	30.9

Source: Company, BOBCAPS Research

Fig 14 – 1Y fwd P/EV – Trading at -2SD



Source: Company, BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- **Change in regulatory framework:** Any unfavourable change in regulations can impact business growth. For example, currently ULIP proceeds are taxed to the extent the yearly premium exceeds Rs 0.25mn. Similarly, any change in income tax rate of insurance companies can adversely impact profitability.
- **Losses from capital and bond markets:** Prolonged weakness in capital markets could hamper the growth of ULIPs. Although insurance companies are opting for a balanced product mix, many of them have sizeable business coming from ULIPs.
- **Increasing interest rates:** The guaranteed return businesses can be affected by an increase in interest rates as other financial instruments (e.g. deposits) become more attractive. HDFC Life had ~28% share of non-par in the total APE mix as of FY22.
- **Adverse economic events:** A significant economic decline may result in financial difficulties or defaults by issuers of bonds in the company's investment portfolios. The shareholders' equity and earnings and policyholders' funds may be affected by fair value re-valuation of bonds held in investment portfolios.
- **High surrender of policies:** Life insurance companies face the risk of surrendered policies. In ULIPs, customers can withdraw policies after five years even if they have been taken for longer durations. Policies can also be surrendered in case of job loss, monetary requirements, etc., which lowers the persistency ratios.

Financials

Revenue Account (Technical)

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Gross premium income	3,85,835	4,59,628	5,32,915	6,21,379	7,20,301
First year premium	68,584	80,544	94,509	1,08,401	1,23,658
Renewal premium	1,84,769	2,18,080	2,50,844	2,93,550	3,41,658
Single premium	1,32,482	1,61,005	1,87,563	2,19,428	2,54,985
Net written premium	3,81,223	4,53,965	5,25,081	6,12,266	7,09,751
Income from investments	3,26,776	1,92,159	1,59,846	2,36,349	2,73,281
Other Income	4,420	7,460	7,921	8,317	8,733
Total income	7,12,418	6,53,584	6,92,847	8,56,931	9,91,765
Commissions	17,104	19,403	24,200	27,792	31,831
Operating expenses	43,974	53,591	59,907	69,213	79,515
Benefits and bonuses paid	2,25,748	3,18,637	3,22,757	4,08,767	4,70,696
Change in liabilities (net)	4,08,296	2,46,815	2,66,834	3,26,131	3,80,813
Others	0	0	0	0	0
Total expenses	6,95,122	6,38,446	6,73,698	8,31,903	9,62,854
Surplus before tax	17,296	15,137	19,149	25,028	28,911
Provision for tax	6,311	5,541	6,682	8,803	10,214
Surplus after tax	10,984	9,597	12,467	16,226	18,697
Trf to shareholders' a/c	9,910	10,093	11,279	14,552	16,784
Balance being FFA	1,075	(497)	1,188	1,674	1,913

Income Statement (Non-technical)

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Trf from policyholders' a/c	9,909	10,093	11,279	14,552	16,784
Income from investments	6,476	7,894	1,59,846	9,966	11,598
Contr. to policyholders' fund	2,868	5,694	5,979	6,278	6,592
Others	19	(492)	(590)	(701)	(825)
PBT	13,535	11,801	14,766	17,538	20,965
Provision for taxation	(66)	(276)	369	438	524
PAT	13,601	12,077	14,397	17,100	20,441
Dividend+Interim div.+DDT	4,085	4,135	4,223	6,335	6,335

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Equity	86,377	1,54,859	1,64,152	1,74,917	1,89,023
Policyholders' funds	15,90,416	18,30,312	20,97,146	24,23,277	28,04,090
FFA	9,906	9,409	10,820	12,443	13,937
Others	1,09,119	1,09,313	1,23,747	1,42,799	1,67,023
Total liabilities	17,95,817	21,03,892	23,95,865	27,53,437	31,74,073
Shareholders' funds	85,421	1,52,379	1,82,855	2,15,769	2,48,134
Policyholders' funds	9,05,378	10,83,110	13,13,398	15,91,510	19,27,469
Assets to cover linked liab.	7,47,595	8,06,215	8,46,526	8,88,853	9,33,295
Others	57,423	62,188	53,086	57,305	65,175
Total assets	17,95,817	21,03,892	23,95,865	27,53,437	31,74,073

Key Metrics

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
AUM (Rs mn)	17,38,390	20,41,704	23,34,127	26,80,410	30,91,492
NBP (Rs mn)	2,01,066	2,41,548	2,82,071	3,27,829	3,78,643
APE (Rs mn)	83,700	97,580	1,14,362	1,31,606	1,50,600
VNB (Rs mn)	21,846	26,737	31,596	36,896	42,095
VNB margin (%)	26.1	27.4	27.6	28.0	28.0
Embedded value (Rs mn)	2,66,200	3,00,470	3,53,383	4,13,983	4,84,932
ROEV (%)	18.5	16.6	19.0	18.9	18.7
ROE (%)	17.6	10.0	9.0	10.1	11.2
Opex ratio (%)	11.9	12.2	11.8	11.7	11.6
Cost ratio (%)	16.3	16.4	16.3	16.1	16.0
Solvency ratio (%)	201.1	175.7	198.4	205.3	209.4
EPS (Rs)	6.7	5.9	6.8	8.1	9.7
BVPS (Rs)	42.7	75.7	80.2	85.5	92.3
EVPS (Rs)	131.6	146.8	172.6	202.2	236.9

Source: Company, BOBCAPS Research

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

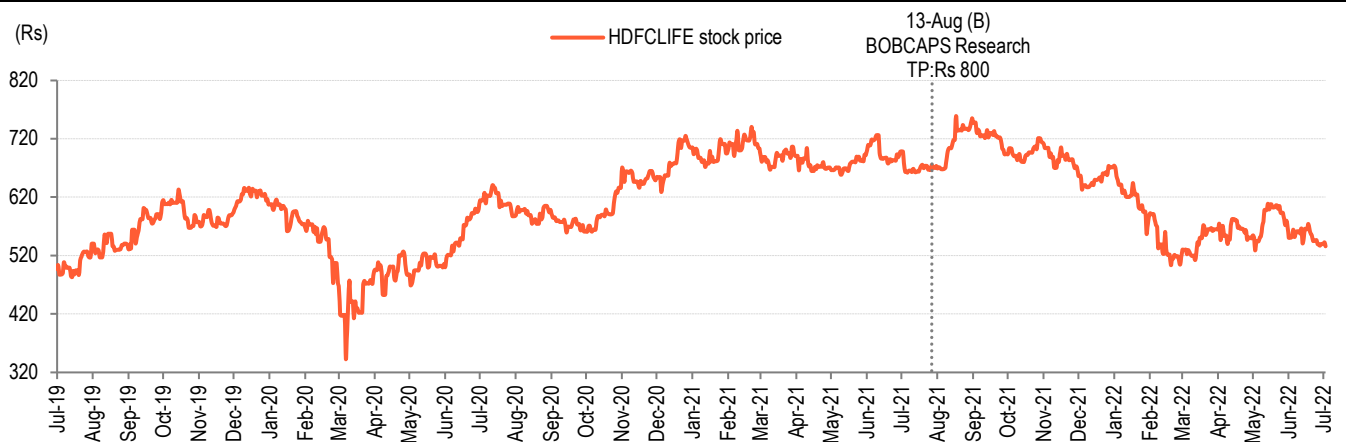
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): HDFC LIFE (HDFCLIFE IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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