

BUY

TP: Rs 741 | ▲ 25%

HDFC LIFE

| Insurance

| 20 January 2023

Strong growth momentum; maintain BUY

- Robust momentum in gross premium to Rs 146bn in Q3; NBP market share climbs to 20.9%
- Exide Life merger guided to be VNB margin-neutral on full-year basis; we expect 28% margins through to FY25
- We raise estimates for the merged entity and increase our TP to Rs 741 (vs. Rs 691), based on 2.9x FY25E P/EV; retain BUY

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Strong quarter: At end-Q3FY23, HDFC Life’s gross premium post-merger with Exide Life stood at Rs 146bn (Rs 379bn at end-9MFY23). The combined entity will benefit from Exide Life’s branches in tier-2 and tier-3 cities of the southern region. Although there may be short-term costs, the long-term benefits of this merger look significant. We, therefore, raise our gross premium estimates by 1-2% over FY23-FY25. Combined EV stood at Rs 377bn as at end-9MFY23 and we expect a 17% CAGR over FY22-FY25 to Rs 549bn (vs. Rs 483bn projected earlier).

Balanced product mix: HDFC Life is focused on a balanced product mix with par/non-par savings forming 25%/33% of APE (merged entity), ULIP/protection at 18%/15% and annuity/group products at 8%/2% as at end-9MFY23. Although the company acknowledges weakness in retail protection (also an industry phenomenon), growth in its group credit life and annuity business has moved up.

VNB margins high: At end-9MFY23, VNB stood at Rs 21.6bn with a margin of 26.5%. Management believes the merger would be margin-neutral on a full-year basis. We now factor in a 19% CAGR in VNB over FY22-FY25 to Rs 45bn (Rs 41bn earlier), with margins of ~28% over our forecast period although FY23 may see some shortfall. The opex ratio remained high at 14.5% in Q3 and commission ratio stood at 4.8%.

Agency channel gains momentum: Based on individual APE, the agency channel had an 18% share in distribution whereas the direct channel looked low at 15%. Bancassurance share at 59% was stable with non-HDFC Bank partners generating strong business. The partnership with AU Small Finance Bank is also aimed at fortifying the bancassurance channel.

Retain BUY: HDFC Life is trading at 2.3x FY25E P/EV. We remain positive on the company owing to market share gains, high persistency ratios, and its positioning as a top-3 life insurer. Based on our revised estimates and rollover of valuations to FY25E, we have a new TP of Rs 741 (vs. Rs 691). Our target multiple at 2.9x P/EV (average of -1SD and -2SD) considers the growth prospects of the combined entity partially offset by the parent’s impending merger with HDFC Bank. BUY.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	HDFCLIFE IN/Rs 591
Market cap	US\$ 15.6bn
Free float	48%
3M ADV	US\$ 23.4mn
52wk high/low	Rs 647/Rs 497
Promoter/FPI/DII	52%/26%/8%

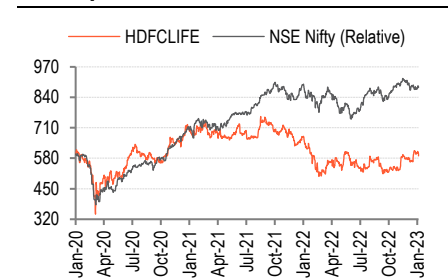
Source: NSE | Price as of 20 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
NBP (Rs mn)	2,41,548	2,74,798	3,16,670
APE (Rs mn)	97,580	1,19,601	1,37,709
VNB (Rs mn)	26,737	32,232	39,171
Embedded Value (Rs mn)	3,00,470	4,02,682	4,69,632
VNB margin (%)	27.4	26.9	28.4
EVPS (Rs)	146.8	187.3	218.5
EPS (Rs)	5.9	5.9	6.6
Consensus EPS (Rs)	5.9	7.7	9.7
P/EV (x)	4.0	3.2	2.7

Source: Company, Bloomberg, BOBCAPS Research

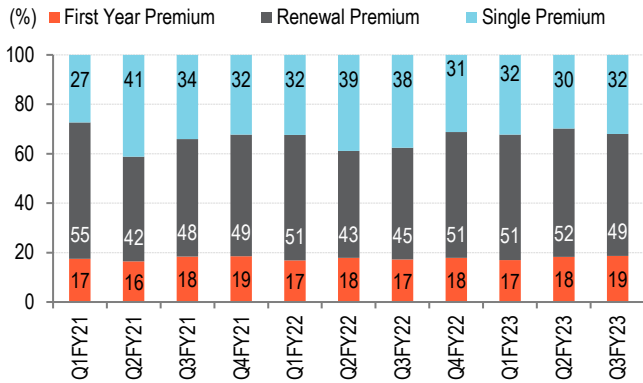
Stock performance



Source: NSE

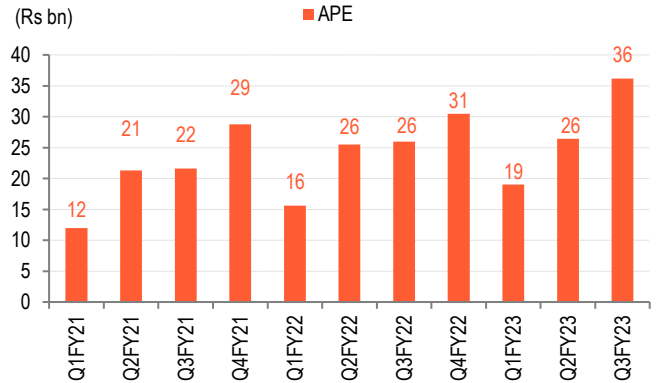


Fig 1 – Q3FY23 gross premium stable post-merger



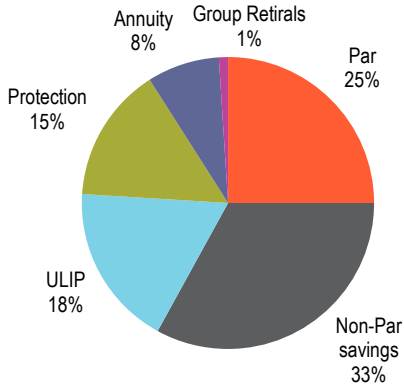
Source: Company, BOBCAPS Research Note: 9MFY23 is post-merger with Exide Life and hence not comparable

Fig 2 – APE ended 9M at Rs36bn



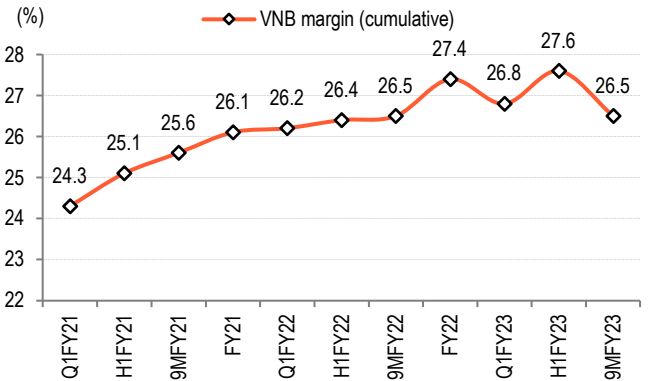
Source: Company, BOBCAPS Research Note: 9MFY23 is post-merger with Exide Life and hence not comparable

Fig 3 – Product mix post-merger (APE-based) – Non-par savings at 33% in 9MFY23



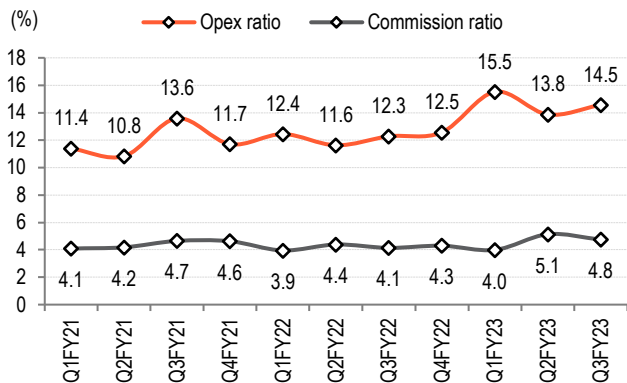
Source: Company, BOBCAPS Research

Fig 4 – 9MFY23 VNB margin includes Exide Life’s numbers and hence the dip



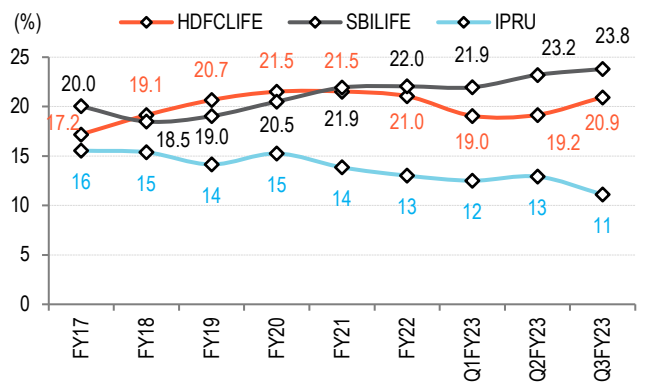
Source: Company, BOBCAPS Research | Note: 9MFY23 is post-merger with Exide Life and hence not comparable

Fig 5 – Opex ratio high; commission ratio tapers down



Source: Company, BOBCAPS Research

Fig 6 – NBP market share improved during the quarter

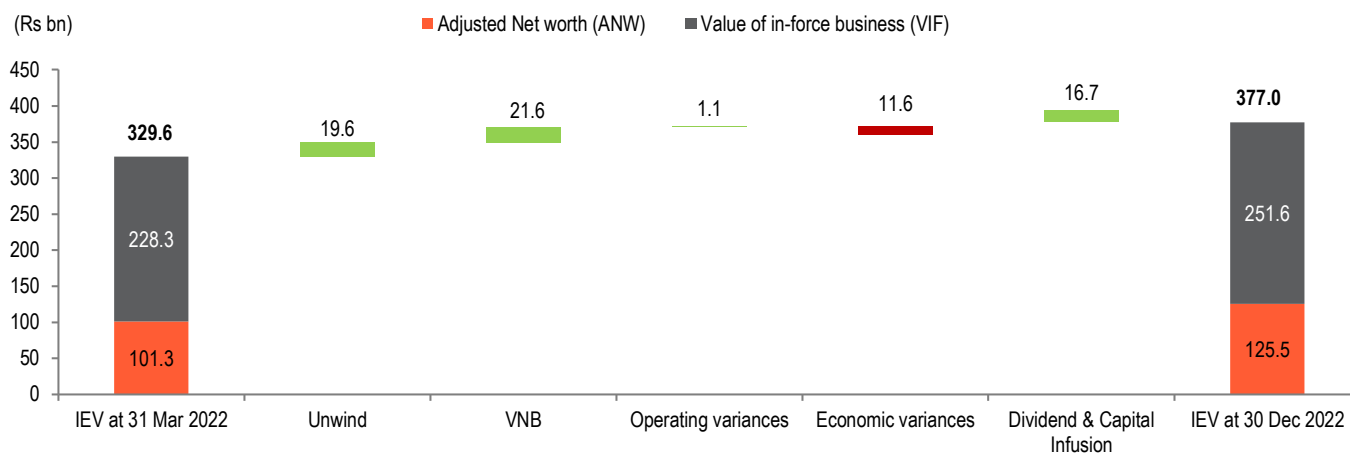


Source: IRDA, BOBCAPS Research

Fig 7 – Distribution mix based on Individual APE: Agency gaining traction but direct channel on lower side

(%)	Q1FY21	H1FY21	9MFY21	FY21	Q1FY22	H1FY22	9MFY22	FY22	Q1FY23	H1FY23	9MFY23
Bancassurance	59.0	60.0	63.0	61.0	56.0	60.0	61.0	60.0	56.0	61.0	59.0
Brokers and Others	5.0	6.0	6.0	7.0	6.0	6.0	6.0	6.0	7.0	7.0	9.0
Agency	12.0	13.0	12.0	13.0	15.0	13.0	14.0	14.0	16.0	15.0	18.0
Direct	24.0	21.0	19.0	19.0	23.0	21.0	19.0	19.0	22.0	17.0	15.0

Source: Company, BOBCAPS Research | Note: 9MFY23 data is post-merger with Exide Life and hence not comparable

Fig 8 – Embedded value – Operating variances positive but economic variances negative

Source: Company, BOBCAPS Research | Note: Data for the merged entity; IEV – Indian Embedded Value

Fig 9 – Policyholders' account

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Gross premium income	1,45,750	1,22,548	18.9	1,32,826	9.7
First Year Premium	27,249	21,160	28.8	24,231	12.5
Renewal Premium	71,870	55,430	29.7	69,066	4.1
Single Premium	46,632	45,958	1.5	39,528	18.0
Reinsurance	1,957	1,304	50.1	1,717	14.0
Net premium income	1,43,794	1,21,244	18.6	1,31,109	9.7
Income from investments (Net)	49,280	19,818	148.7	97,826	(49.6)
Other income	722	467	54.5	650	11.0
Contribution of funds from Shareholders' A/c	3,137	694	352.3	149	2,004.2
Total	1,96,933	1,42,222	38.5	2,29,735	(14.3)
Commission on					
First Year Premium	4,887	3,566	37.0	4,088	19.5
Renewal Premium	1,177	864	36.3	1,939	(39.3)
Single Premium	699	597	17.2	685	2.0
Rewards	165	47	250.3	109	51.2
Net Commission	6,928	5,074	36.6	6,822	1.6
Expenses of Management	28,132	20,098	40.0	25,215	11.6
Provision for taxes	(315)	1,116	NA	1,164	NA
Benefits Paid (Net)	86,623	80,813	7.2	1,17,308	(26.2)
Change in actuarial liability	79,201	38,500	105.7	83,507	(5.2)
Surplus/Deficit	3,300	1,842	79.1	2,470	33.6

Source: Company, BOBCAPS Research

Fig 10 – Shareholders' account

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Transfer from Policyholders' Account	4,161	1,825	128.0	2,182	90.7
Investment Income	2,437	1,791	36.0	1,599	52.4
Expenses other than those related to insurance business	318	229	38.6	370	(14.0)
Transfer of funds to Policyholders' Account	3,137	694	352.3	149	2,004.2
Provisions for diminution in value of investments ⁶	0	(66)	(100.0)	(12)	(100.0)
Profit before tax	3,142	2,759	13.9	3,273	(4.0)
Provisions for tax	(10)	23	(143.6)	11	(191.6)
Profit after tax and before Extraordinary items	3,152	2,737	15.2	3,262	(3.4)

Source: Company, BOBCAPS Research

Fig 11 – Balance sheet

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Shareholders' funds:					
Share Capital	58,600	26,800	118.7	21,491	172.7
Share application money received pending allotment of shares	0	0	NA	1	(100.0)
Reserves and Surplus	67,400	63,700	5.8	1,01,329	(33.5)
Credit / (Debit) Fair Value Change Account	1,000	1,400	(28.6)	648	54.2
Sub-Total	1,27,000	91,900	38.2	1,23,469	2.9
Borrowings	9,500	6,000	58.3	9,500	-
Policyholders Funds					
Credit / (Debit) Fair Value Change Account	25,000	25,300	(1.2)	19,875	25.8
Policy Liabilities	13,51,200	9,98,600	35.3	12,77,425	5.8
Provision for Linked Liabilities	7,80,300	7,76,300	0.5	5,88,413	32.6
Add: Fair value change	0	0	NA	1,85,171	(100.0)
Funds for discontinued policies			NA		NA
(i) Discontinued on account of non-payment of premium	40,500	43,000	(5.8)	41,628	(2.7)
(ii) Others	0	0	NA	164	(100.0)
Funds for Future Appropriations	12,500	8,900	40.4	13,335	(6.3)
TOTAL	23,46,000	19,50,000	20.3	22,58,979	3.9
Application Of Funds					
Investments:					
Shareholders'	1,29,300	89,800	44.0	1,24,753	3.6
Policyholders'	13,88,300	10,38,300	33.7	13,08,885	6.1
Asset held to cover Linked Liabilities	8,20,800	8,19,300	0.2	8,15,376	0.7
Loans	15,100	5,900	155.9	14,433	4.6
Fixed Assets	3,700	3,400	8.8	3,648	1.4
Net Current Assets	(11,200)	(6,700)	67.2	(8,116)	38.0
Total	23,46,000	19,50,000	20.3	22,58,979	3.9

Source: Company, BOBCAPS Research

Fig 12 – Key ratios and growth metrics

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
NBP	73,880	67,117	10.1	63,760	15.9
APE	36,200	26,000	39.2	26,460	36.8
Opex ratio (%)	14.5	12.3	229bps	13.8	70bps
Commission ratio (%)	4.8	4.1	61bps	5.1	(38bps)
Expense ratio (%)	19.3	16.4	290bps	19.0	32bps
VNB margin (%) - Cumulative	26.5	26.5	0bps	27.6	(110bps)
Solvency ratio (%)	209.0	190	1900bps	210.0	(100bps)

Source: Company, BOBCAPS Research

Earnings call highlights

Business highlights

- HDFC Life grew 17% YoY in Q3FY23 and 13% in FY23 YTD in terms of individual WRP (weighted received premium), which is ahead of the industry. On YTD basis, the company's market share was at 15.8% amongst private peers. Despite intense competition, it has consistently ranked amongst the top three life insurers across individual and group businesses.
- APE stood at Rs 81.7bn at end-9MFY23, of which 84% or Rs 68.7bn comprised individual APE. APE for Q3 was at Rs 36bn, of which Rs 30.8bn or 85% was from the individual segment.
- NBP stood at Rs 187.1bn at end-9MFY23 whereas renewal premium totalled Rs 191.9bn. In Q3, these numbers were Rs 74bn and Rs 72bn respectively.
- The company formed a corporate partnership with AU Small Finance Bank which has a customer base of over 3mn. Moreover, earlier partnerships with Yes Bank, IDFC First Bank and Bandhan Bank have scaled up to its satisfaction.

VNB margin

- Management was reasonably confident that the merger with Exide Life will be margin-neutral on a full-year basis. VNB margin of 26.5% for 9MFY23 includes Exide Life numbers.
- HDFC Life has maintained a diversified product mix. Based on individual APE, the share of ULIP products has dipped significantly from 26% in FY22 to 21% at end-9MFY23, replaced largely by non-par business (33% to 39%). Annuity increased from 5% to 6% and par products remained stable at 29%.
- VNB stood at Rs 21.6bn at end-9MFY23 (post-merger). Although not comparable on YoY basis, the company indicated that VNB was hit by Rs 1.5bn of fixed cost absorption due to (a) a difference in the operating expense ratios of Exide Life and HDFC Life, and (b) an increasing cost of acquisition in the open architecture environment.

Protection business

- Supply-side constraints have eased and product innovation is driving growth. Growth in retail protection plans remained tepid YoY, but was up 13% sequentially in Q3.
- Overall protection APE grew by over 20% in 9MFY23 and the company expects individual protection to see high demand in the coming quarters.
- Credit protect segment grew 52% YoY to Rs 52.3bn at end-9MFY23

Embedded value (EV)

- EV stood at Rs 377bn as on 31 Dec 2022 with an operating return on embedded value of 17.5% for 9MFY23.

- EV had a negative economic variance of Rs 11.6bn due to (i) an increase in the yield curve, and (ii) equity volatility because of the lower equity returns during the nine-month period.

Others

- About 45-47% of APE was generated by HDFC Bank.
- Within the non-par segment, the shorter tenure product 'Sanchay Fixed Maturity Plan (FMP)' continues to do well and now forms about a sixth of the segment.
- The solvency ratio was 209% as on Dec'22.
- Regulator IRDA introduced certain positive regulations recently, such as (a) allowing certain categories of products to be launched through the use-and-file approach, (b) dematerialization of insurance policies, (c) allowing insurance companies to raise alternative investments such as subordinated debt and preference shares without seeking prior approval of the regulator.

Valuation methodology

HDFC Life is trading at compelling valuations of 2.3x FY25E P/EV. We remain positive on the company owing to its healthy solvency margins, high persistency ratios, and positioning as a top-3 life insurer. The company has also expanded NBP market share from 19.2% in Q2FY23 to 20.9% in Q3FY23. We see strong momentum in the merged entity from a significant number of Exide branches, especially in smaller cities in the south region. On a merged basis as well, persistency ratios remain stable and high (13th month persistency at 87% and 61st month at 52% in 9M).

Post-merger, we raise our gross premium estimates by 1-2% over FY23-FY25. Combined EV stood at Rs 377bn as at end-9MFY23 and we expect a 17% CAGR over FY22-FY25 to Rs 549bn (vs. Rs 483bn projected earlier). We now factor in a 19% CAGR in VNB over FY22-FY25 to Rs 45bn (Rs 41bn earlier), with margins of ~28% over our forecast period.

Based on our revised estimates and rollover of valuations to FY25E, we have a new TP of Rs 741 (vs. Rs 691), offering 25% upside. Our target multiple at 2.9x P/EV (average of -1SD and -2SD) considers the growth prospects of the combined entity partially offset by the parent's impending merger with HDFC Bank. Retain BUY.

Fig 13 – Revised estimates

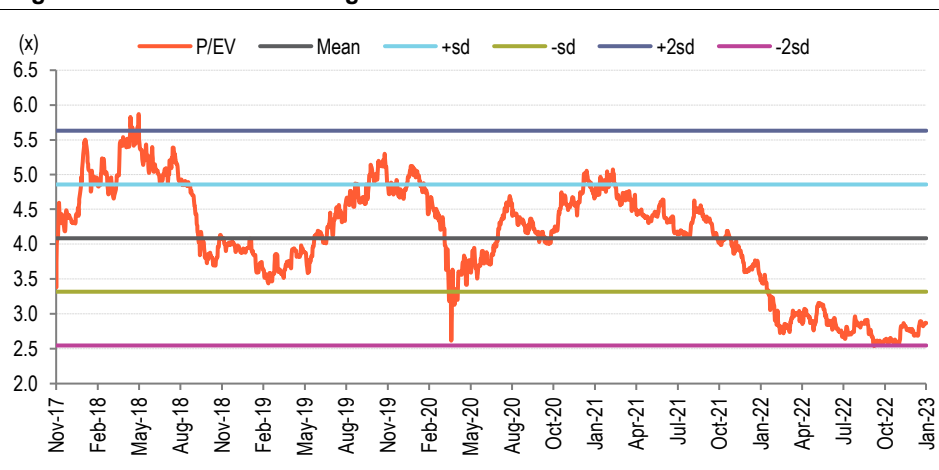
(Rs bn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Gross Premium	532	621	725	525	612	709	1.2	1.5	2.2
Net Premium	524	612	714	517	603	699	1.3	1.5	2.3
VNB	32	39	45	31	36	41	3.8	8.0	9.8
APE	120	138	160	112	129	148	6.4	6.5	7.9
Embedded Value (EV)	403	470	549	353	413	483	14.1	13.8	13.6
VNB Margin (in %)	26.9	28.4	28.4	27.6	28.0	28.0	(68bps)	41bps	49bps

Source: BOBCAPS Research

Fig 14 – Valuation summary

Particulars	
Embedded Value (FY25E) (Rs bn)	549
PV of Future business (Rs bn)	1,044
Total value (Rs bn)	1,593
Current P/EV (FY25E) (x)	2.3
Implied P/EV (FY25E) (x)	2.9
Implied Target Price (Rs)	741
Current Price (Rs)	591
Upside (%)	25.4

Source: Company, BOBCAPS Research

Fig 15 – 1Y fwd P/EV – Trading between -1SD and -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.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HDFC Life	HDFCLIFE IN	15.6	591	741	BUY
ICICI Prudential Life	IPRU IN	8.4	471	601	BUY
SBI Life	SBILIFE IN	16.0	1,296	1,512	BUY

Source: BOBCAPS Research, NSE | Price as of 20 Jan 2023

Glossary

Glossary			
APE	Average Premium Equivalent	ULIP	Unit Linked Insurance Plan
EV	Embedded Value	VNB	Value of New Business
IRDA	Insurance Regulatory and Development Authority	WRP	Weighted Received Premium
NBP	New Business Premium		

Financials

Revenue Account (Technical)

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Gross premium income	3,85,835	4,59,628	5,31,615	6,20,884	7,24,822
First year premium	68,584	80,544	1,01,082	1,16,357	1,34,974
Renewal premium	1,84,769	2,18,080	2,56,816	3,04,214	3,57,486
Single premium	1,32,482	1,61,005	1,73,716	2,00,312	2,32,362
Net written premium	3,81,223	4,53,965	5,23,930	6,11,964	7,14,435
Income from investments	3,26,776	1,92,159	1,59,846	2,36,349	2,73,281
Other Income	4,420	7,460	8,477	9,026	9,614
Total income	7,12,418	6,53,584	6,92,252	8,57,338	9,97,330
Commissions	17,104	19,403	24,142	27,794	32,074
Operating expenses	43,974	53,591	72,932	73,398	85,705
Benefits and bonuses paid	2,25,748	3,18,637	3,53,865	4,55,409	5,30,289
Change in liabilities (net)	4,08,296	2,46,815	2,23,612	2,78,050	3,23,316
Others	0	0	0	0	0
Total expenses	6,95,122	6,38,446	6,74,550	8,34,651	9,71,384
Surplus before tax	17,296	15,137	17,703	22,687	25,946
Provision for tax	6,311	5,541	6,610	8,859	10,322
Surplus after tax	10,984	9,597	11,093	13,828	15,623
Trf to shareholders' a/c	9,910	10,093	9,961	12,089	13,575
Balance being FFA	1,075	(497)	1,131	1,739	2,048

Income Statement (Non-technical)

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Trf from policyholders' a/c	9,909	10,093	9,961	12,089	13,575
Income from investments	6,476	7,894	10,057	9,966	11,598
Contr. to policyholders' fund	2,868	5,694	5,979	6,278	6,592
Others	19	(492)	(1,028)	(1,191)	(1,374)
PBT	13,535	11,801	13,012	14,586	17,207
Provision for taxation	(66)	(276)	325	365	430
PAT	13,601	12,077	12,686	14,221	16,777
Dividend+Interim div.+DDT	4,085	4,135	4,300	6,449	6,449

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Equity	86,377	1,54,859	1,62,365	1,70,137	1,80,464
Policyholders' funds	15,90,416	18,30,312	20,53,923	23,31,973	26,55,289
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	23,50,855	26,57,353	30,16,713
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	8,077	(38,778)	(92,185)
Total assets	17,95,817	21,03,892	23,50,855	26,57,353	30,16,713

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	2,74,798	3,16,670	3,67,337
APE (Rs mn)	83,700	97,580	1,19,601	1,37,709	1,59,743
VNB (Rs mn)	21,846	26,737	32,232	39,171	45,438
VNB margin (%)	26.1	27.4	26.9	28.4	28.4
Embedded value (Rs mn)	2,66,200	3,00,470	4,02,682	4,69,632	5,48,540
ROEV (%)	18.5	16.6	18.3	18.2	18.2
ROE (%)	17.6	10.0	8.0	8.6	9.6
Opex ratio (%)	11.9	12.2	14.4	12.4	12.4
Cost ratio (%)	16.3	16.4	18.9	16.9	16.8
Solvency ratio (%)	201.1	175.7	200.5	208.2	212.5
EPS (Rs)	6.7	5.9	5.9	6.6	7.8
BVPS (Rs)	42.7	75.7	75.5	79.1	83.9
EVPS (Rs)	131.6	146.8	187.3	218.5	255.2

Source: Company, BOBCAPS Research

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Disclaimer

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

BUY – Expected return >+15%

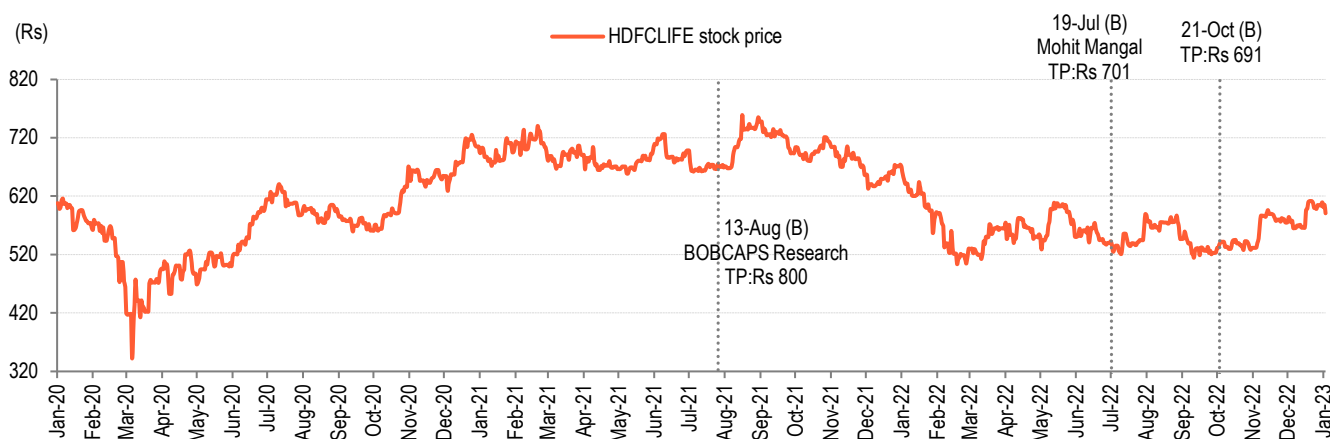
HOLD – Expected return from -6% to +15%

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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