HDFC Life Insurance (HDFLIF)

ICICI direct Research

CMP: ₹ 705	Target: ₹ 820 (16%)	Target Period: 12 months	BUY

January 7, 2021

Initiating Coverage

ICICI Securities – Retail Equity Research

Attractive business franchise…

HDFC Life Insurance (HDFC Life) is among the dominant private players in the Indian life insurance space today. It was established in 2000, as a joint venture between HDFC Ltd and Standard Life. The company is one of the most profitable in the industry and has gradually shifted from Ulip heavy to a more balanced product mix. HDFC Life has a strong distribution network with partnerships ranging from banks (includes HDFC Bank), NBFCs, MFIs and new age distributors. Diversified product portfolio and focus on product innovation has enabled HDFC Life to be ahead of the curve.

Healthy, consistent business performance

HDFC Life is focused on delivering consistent profitability with steady growth. GWP has grown at 17.1% CAGR in FY15-20. Value of new business (VNB) saw growth at 26.6% CAGR in FY15-20 while VNB margin expanded ~740 bps to 25.9% in FY20 from 18.5% in FY15. PAT posted ~10.5% CAGR in the past five years to ₹ 1295 crore for FY20. The company has a healthy RoEV at 18.1% for FY20 and has remained at ~20% mark in the past few years. We expect PAT to grow at 8.9% CAGR to ₹ 1671 crore in FY20-23E.

Profitable, prudent product mix…

Continued focus has led to rebalancing of the portfolio in favour of high margin business, thus reducing concentration in any one category of product. As on September 2020, HDFC Life's product mix contribution is now at Ulip - 20%, par - 28%, non-par - 26%, term - 12%, annuity - 5%.

…along with focus on opex leads to superior margin

A prudent product mix with a substantial proportion of high margin products (protection, non-par) enables the insurer to consistently report margin improvement from 18.5% in FY15 to 25.1% in FY20. The steady improvement in persistency and control on opex can also attributed to sustained increase in margin and is seen stabilising at 25.2% by FY22.

Superior fundamentals to keep valuation at premium

We expect gross written premium (GWP) to grow at a CAGR of 10.1% in FY20-23E to ₹ 43703 crore. PAT is expected to grow at 9% CAGR over the same period to ₹ 1671 crore. VNB margins are expected to be in the region of ~25% by FY23E. **HDFC Life currently trades at ~4.3x FY23E embedded value (EV), which is at a premium compared to its peers. Given the superior business franchise and continued focus on profitability, valuations are expected to remain at a premium. Considering the current business franchise and building anticipated improvement in business momentum and profitability metric, we initiate coverage on the stock with a BUY rating and a target price of ₹ 820/share, valuing the company at 5.0x FY23E EV.**

HDFC Life — Sar utha ke jiyo!

Stock data & valuation summary

Particulars	Amount
Market Capitalisation	₹ 142410 crore
EV (Q2FY21)	₹ 23332 crore
AUM. calc (Q2FY21)	₹ 150622 crore
VNB margin (Q2FY21)	25.1%
52 week H/L	688 / 340
Net worth	₹7787 crore
Face value	₹ 10
DII holding (%)	4.5
FII holding (%)	8.4

	FY21E	FY22E	FY23E
P/E	99.0	89.7	85.1
Target P/E	115.2	104.4	99.1
P/IEV	5.8	5.0	4.3
Target P/IEV	6.7	5.8	5.0
RoNW %	19.1	18.1	17.0
RoEV %	17.5	17.5	17.7

Key Highlights

- Focus on product mix and product innovation remains the key catalyst
- Highest profitability among peers, led by focus on product mix
- Strong distribution network with over 300 partnerships

Risk to our call

- Interest rate risk due to increasing non-par business
- Higher mortality risk due to pandemic
- Impact of moderation of credit off-take on credit protection business

Research Analyst

- Kajal Gandhi
kajal.gandhi@icicisecurities.com

- Vishal Narnolia
vishal.narnolia@icicisecurities.com

- Sameer Sawant
sameer.sawant@icicisecurities.com

Key Financial Summary

(₹ Crore)	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
New business premium	8696	11350	14971	17238	17622	19468	21922	8%
APE	4085	5400	6049	7164	7356	8175	9196	9%
Total premium	19445	23564	29186	32707	34642	38401	43704	10%
PAT	892	1109	1277	1295	1437	1586	1672	9%
EV	12471	15216	18296	20655	24575	28598	33456	17%
P/E (x)	158	128	111	110	99	90	85	
P/BV (x)	36.7	29.9	25.1	20.9	17.3	15.4	13.6	
P/IEV (x)	11	9	8	7	6	5	4	
RoEV (%)	20.3	20.2	20.1	18.1	17.5	17.5	17.7	

Summary

Key investment thesis

- Consistent product innovation & balanced mix with focus on high margin – protection and non-par products
- Strong distribution network
- Industry leading margins
- Improving persistency ratio

Key risk

- Increased mortality risk due to Covid-19
- Interest rate risk persists due to increasing non-par business
- High share of group business in protection
- Restriction on credit life insurance remains a risk

Relative comparison

Exhibit 1: Peer comparison

Y/E Mar	RoA%			RoEV%			P/E			P/EV		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
HDFC Life	1.0	1.0	0.9	18.1	17.5	17.5	109.9	99.0	89.7	6.9	5.8	5.0
SBI Life	0.9	0.9	0.8	20.0	16.0	17.0	64.1	47.2	41.7	3.5	3.0	2.6
Max Life	0.2	0.6	0.7	20.0	19.0	18.0	125.0	55.0	44.0	2.4	2.1	1.8
ICICI Pru-life	0.7	0.7	0.7	15.2	14.9	15.9	68.1	82.6	55.4	3.1	2.6	2.3

Source: Company, ICICI Direct Research

Exhibit 2: Key valuation parameters

Y/E Mar	FY19	FY20	FY21E	FY22E	FY23E
EPS	6.3	6.4	7.1	7.9	8.3
BVPS	28.0	33.7	40.8	45.9	51.7
EVPS	90.7	102.3	121.7	141.7	165.7
RoA (%)	1.1	1.0	1.0	0.9	0.9
RoE (%)	24.5	20.8	19.1	18.1	17.0
RoEV (%)	20.1	18.1	17.5	17.5	17.7
P/E (x)	111.4	109.9	99.0	89.7	85.1
P/BV (x)	25.1	20.9	17.3	15.4	13.6
P/EV (x)	7.8	6.9	5.8	5.0	4.3

Source: Company, ICICI Direct Research

Valuation

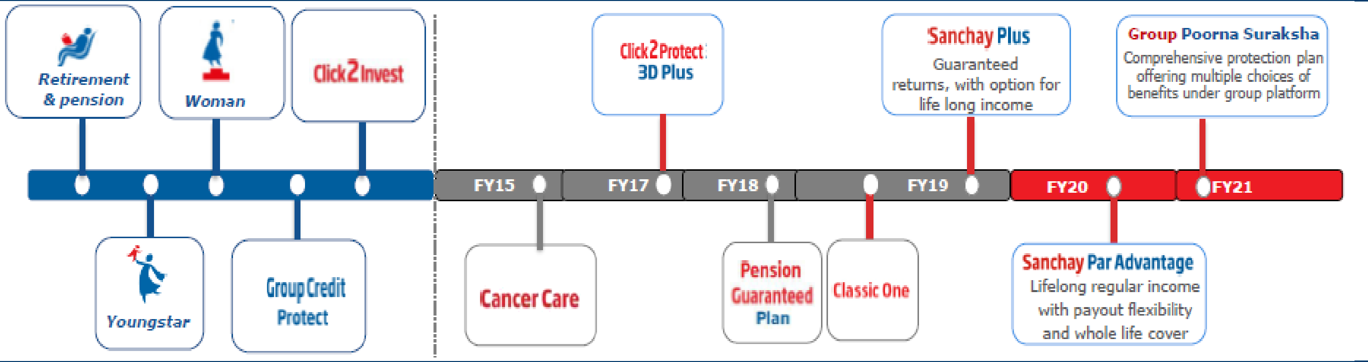
HDFC Life is the most profitable life insurer in the industry with a strong brand, associations, distribution network and performance in key metrics. Innovation in products and balanced mix in the portfolio make the company attractive. HDFC Life currently trades at ~4.3x FY23E embedded value (EV), which is at a premium compared to its peers. However, considering the overall business franchise that it has created, it will continue to maintain the same. Thus, we initiate coverage on the stock with a **BUY** rating and a target price of ₹ 820 /share, valuing the company at 5x FY23E EV.

We expect gross written premium (GWP) to grow at 10.1% CAGR in FY20-23E to ₹ 43703 crore while PAT is expected to grow at 9% CAGR in the same period to ₹ 1671 crore. Value of new business (VNB) margins are expected to be in the region of ~25% by FY23E. Near term premium growth can be a bit weak but we expect it to bounce back from FY22 onwards as unlocking progresses. With increase in credit offtake in housing and other segments, the credit protect business should pick up. RoEV is also expected to improve post a slight dip in FY21E.

Company Background

HDFC Life Insurance is among the leading and profitable life insurance companies in India, especially among private players. The company was established in year 2000 as a joint venture between HDFC Ltd and Standard Life Aberdeen PLC. Standard Life now has a 10.27% stake in HDFC Life via its subsidiary Standard Life Mauritius while HDFC Ltd holds 50.14%. Headquartered in Mumbai, the company has a strong and diversified distribution network with over 420 branches and more than 300 traditional partners comprising NBFCs, MFIs and new ecosystem distributors. HDFC Life has 36 individual and 13 group products in its portfolio along with seven optional rider benefits, to suit a diverse range of customer needs. The company has expanded its market share [individual weighted received premium (WRP)] from 12.7% in FY17 to 17.5% in H1FY21, through consistent product innovation and focusing on customer centricity and technology.

Exhibit 3: Continuous improvement in product profile



Source: Company, ICICI Direct Research

As of September 2020, HDFC Life had a new business margin (NBM) of 25.6%, which is among the highest in the industry and has shown an improving trend in the past few years. The company also has a balanced product mix based on individual APE with par, non-par, Ulip, non-par, protect and annuity contributing 33%, 30%, 23%, 9% and 5%, respectively.

Exhibit 4: Balanced product mix

Product Mix	FY18	FY19	FY20	H1FY21
Unit Linked	57%	55%	28%	23%
Par	28%	18%	19%	33%
Non-Par	7%	15%	41%	30%
Term	5%	7%	8%	9%
Annuity	2%	5%	4%	5%

Source: Company, ICICI Direct Research

Total premium for the company has grown at 18.9% CAGR in FY16-20. The new business premium has grown at 26% CAGR in the same period. The company has also improved upon its persistency (13 months) as it has jumped to 88% for H1FY21 from 81% in FY17. PAT has increased at 13.2% CAGR in FY16-20 while RoEV for FY20 was at 18.1%. HDFC Life has a comfortable capital position with solvency ratio of 203%, above regulatory requirement of 150%. The company has a market share of 8.2% based on total APE as on H1FY21.

Exhibit 5: Financial Metrics

₹ crore	FY18	FY19	FY20	H1FY21
Total Premium	23560	29186	32707	16050
Individual APE	4890	5200	6140	2830
PAT	1109	1277	1295	7772
AUM	106600	125550	127230	150620
RoE %	26.0	24.6	20.5	21.0
NBM %	23.2	24.6	25.9	25.1
Market Share % (APE based)	7.0	6.8	6.0	8.2

Source: Company, ICICI Direct Research

Shareholding Pattern (Q2FY21)

Shareholders	Holding (%)
Promoters	60.4
Instititional Investors	30.7
Others	8.9

Source: BSE

Top Shareholders

Top Shareholders	Holding %
HDFC ltd	50.1
Standard Life Mauritius	10.3
Europacific growth fund	3.1
Capital world growth and income fund	2.7
SBI ETF Nifty-50	1.1

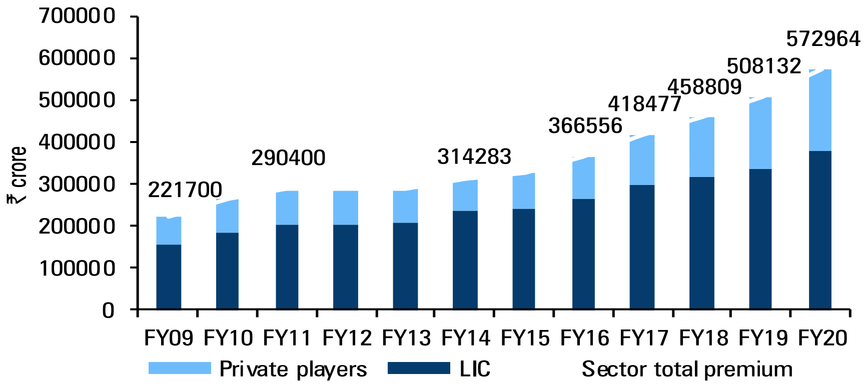
Source: BSE

Key industry trends

Snapshot of Indian life insurance industry

The Indian life insurance industry witnessed strong business growth of 25%+ CAGR in the first decade of this century (FY00-10). Regulatory changes and a slowdown in the economy affected this growth for a few years (FY12-17). However, it has again started to gain momentum from FY18 onwards. The Indian life insurance market size was ~₹ 6 lakh crore in FY20 with major contribution coming from state owned LIC while private players have been able to gain market share in the past decade.

Exhibit 6: Healthy growth in life insurance industry; private players gain market share



Source: IRDA, ICICI Direct Research

	FY19	FY20
LIC		
Total Premium	337505	379400
FYP - Premium	31326	54766
Renewal Premium	195169	201100
Single Premium	111010	105550
APE- New Business	42427	65321
No. of policies (Nos. in cr)	2.1	2.2
Average Ticket size	157470	173044
Private Players		
Total Premium	170627	193564
FYP - New Business Premium	41887	47000
Renewal Premium	97960	112654
Single Premium	30780	33845
APE- New Business	44965	50385
No. of policies	0.7	0.7
Average Ticket size	235218	278051

Source: IRDA, ICICI Direct Research

According to a report by Swiss Re, India's contribution to global premium volume is expected to increase from 1.7% in FY19 to 2.3% by FY30. This is also a good indicator of a potential rise in the insurance market in India. This would be on the back of a rising middle income population in India, large part of the population being in the working age category, which is most likely to either already have or go for some form of life insurance.

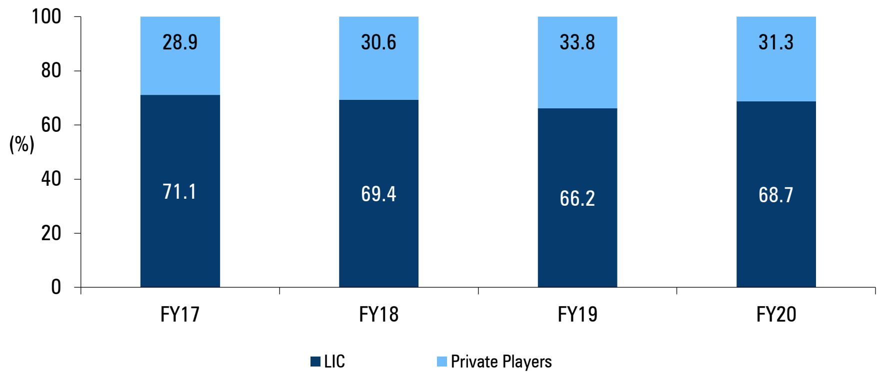
Exhibit 7: Global premium contributions

Share of Global premium volume	1980	2019	2030E
USA	46.0%	39.0%	36.0%
China	0.0%	10.0%	18.0%
Japan	15.0%	7.3%	6.1%
UK	6.9%	5.8%	4.0%
France	5.1%	4.2%	3.2%
Germany	8.0%	3.9%	3.2%
Brazil	0.4%	1.2%	0.9%
Tiwan	0.1%	1.9%	2.0%
India	0.4%	1.7%	2.3%

Source: IRDA, Swiss Re, ICICI Direct Research

In the past few years, private players have been very aggressive, innovative in launching and pushing new insurance product. Insurance Regulatory and Development Authority (IRDA) has also allowed banks to have multiple insurance tie-ups. This has also enabled private players to expand distribution reach effectively. This has enabled insurers like HDFC Life, SBI Life among others to steadily gain market share.

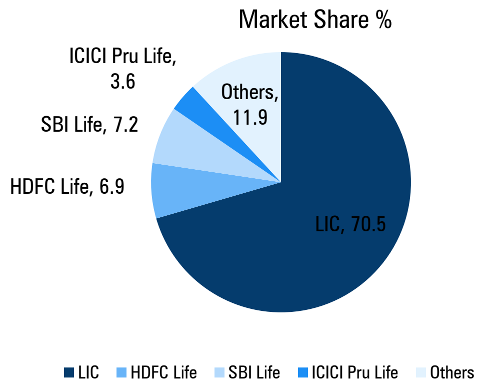
Exhibit 8: Increasing trend of private players gaining market share



Source: IRDA, ICICI Direct Research

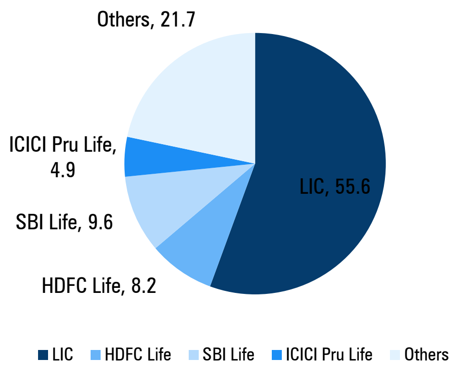
HDFC Life and SBI Life have the highest market share in the private space at ~7%. This is mainly on account of a strong distribution network that these companies have, primarily led by bancassurance. Though HDFC Bank does not have an exclusive tie-up with HDFC Life, it still it sources considerable business for the insurer.

Exhibit 9: Market share (NBP based) as on September 2020



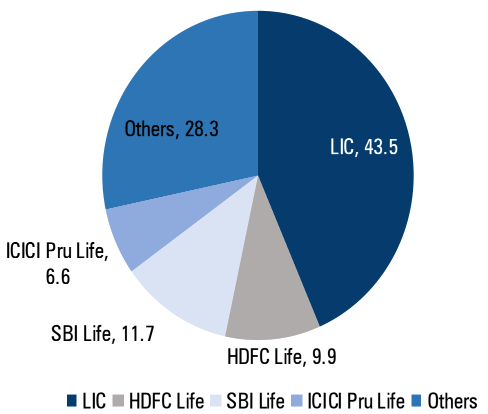
Source: Company, ICICI Direct Research

Exhibit 10: Market share (APE based) as on September 2020



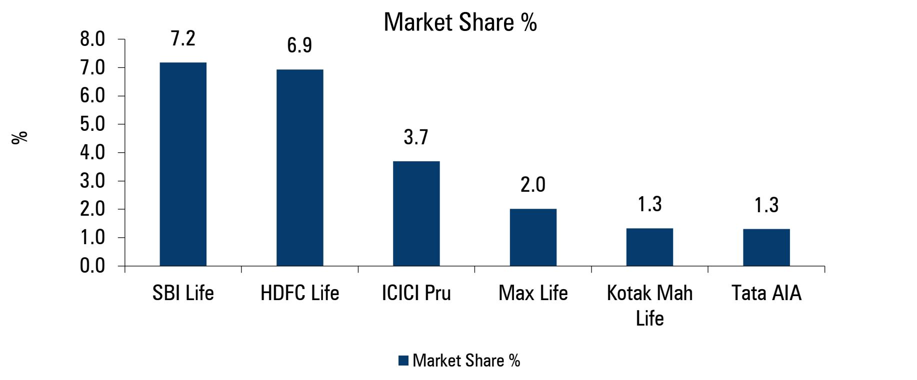
Source: Company, ICICI Direct Research

Exhibit 11: Individual APE market share as on Sep 2020



Source: IRDA, ICICI Direct Research

Exhibit 12: Private sector market share - company wise



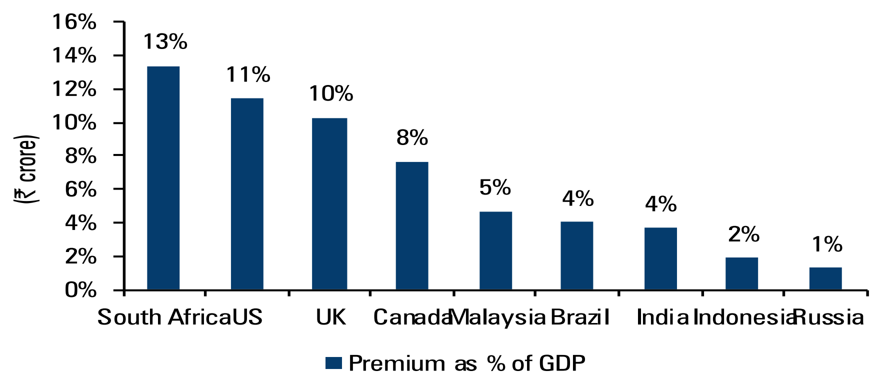
Source: IRDA, ICICI Direct Research

Huge addressable opportunity to drive growth ahead

India's insurance market is still underpenetrated given that India's premiums to GDP ratio is among the lowest in emerging economies while being well behind advanced economies. This could be largely because of low awareness and lower financial inclusion. This provides a good opportunity for insurance players to tap the untapped or under-tapped segments. Even in terms of per capita life insurance, India is lagging behind its emerging counterparts like Brazil and South Africa at $58.

Insurance under penetration in India has always been a concern as well as an opportunity. According to IRDA, penetration of life insurance is at a mere 2.74%; well below global average. Further, protection gap i.e. difference between requirement of financial resources on death of insured and available financial outlay, is at 83%, which is a worrying statistic.

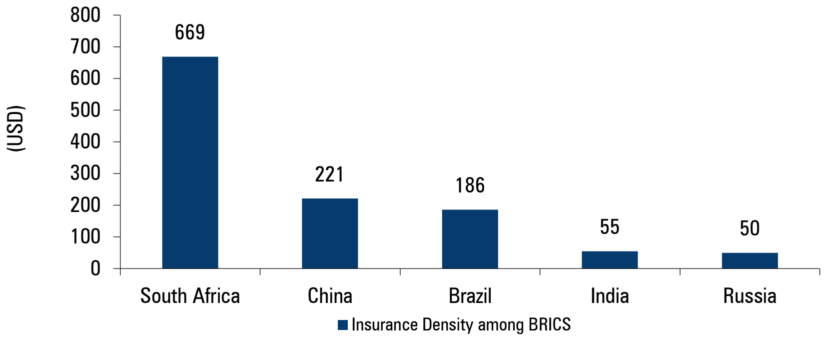
Exhibit 13: Premiums as percentage of GDP



Source: IRDA, ICICI Direct Research

Comparing with BRICS nations, developing economies, India has the lowest insurance density (premium/total population). According to this, there is enough room for improvement and, thus potential market opportunities.

Exhibit 14: Insurance density in India among lowest



Source: IRDA, ICICI Direct Research

Under penetration and under insurance provides long term sustainable opportunity

Considering population in age group of 15-65 years, ~40 crore or 43% are covered by some form of life insurance. Thus it provides an opportunity to cover a vast amount of new lives which can be insured. However, the main worry is substantial protection gap at ~83%, which indicates opportunity in terms of sustainable business growth ahead. Thus, with a large chunk of the population still to be tapped with a sizable proportion of the population below 35 years of age which also remains uninsured, the potential in the insurance market is huge.

Emergence of Covid has led to a jump in general awareness and acceptability of insurance. Such increase in awareness is expected to bring a structural shift in the minds of consumers from insurance as an expense to a necessity. High medical expense, demographics and increased digitisation will act as supporting catalyst. Thus, life, general insurance industry are on the cusp of sustained structural growth ahead.

A look at insurance products

Insurance products are broadly classified into two categories viz. savings and protection. Savings segment includes unlit linked insurance plan (Ulip), participating (par) and non-participating (non-par). Protection products include term life and credit protect products. Ulips or linked products offer a combination of protection and investment wherein an investor gets to choose the asset class for investment. Here, beneficiaries get unit linked AUM or sum assured, whichever is higher in case of death. In case of maturity, unit linked AUM is distributed.

Non-linked products comprise participating products where surplus is shared with policyholders in the form of bonuses though they are not guaranteed initially. However, once declared, bonus becomes guaranteed. Non-par savings offer guaranteed benefits, which are mentioned right at the beginning. Pure protection products only provide coverage and no-return on maturity. Hence, they have relatively lower premium.

From an insurer's perspective, savings segment usually has low margins compared to the protection business. However, non-par savings have VNB margins of 25-40%, which is better than the rest of products in its category.

Exhibit 15: Type of product in life insurance industry

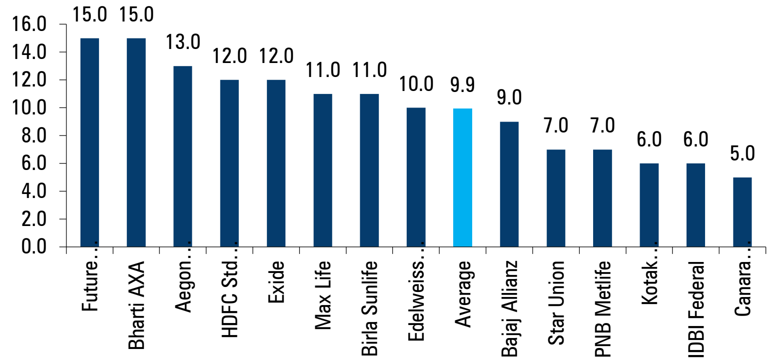
Product Type	Margin	Capital consumption
Linked	6-10%	Low
PAR	9-15%	Med
Non-PAR saving	25-40%	High
Individual Term	50%+	High
Credit Protect	50%+	High

Source: Companies, ICICI Direct Research

Long gestation period acts as entry barrier

Setting up a new business requires initial investment. The same is the case with the insurance business. Initial cost related to setting up of distribution network remains high. In addition, profitability from the business arrives later due to initial expense related to distribution and capital consumption in initial years. Therefore, the insurance business has a long gestation period (refer chart below), which acts as an entry barrier for new players and which may lead to consolidation ahead.

Exhibit 16: Number of years to arrive at profit since inception



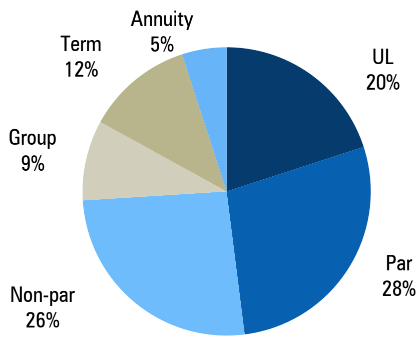
Source: Company, ICICI Direct Research

Investment Rationale

Profitable, prudent product mix

HDFC Life has been rebalancing its portfolio from a Ulip heavy business to a high margin one, thus reducing concentration in any one category of product. As on September 2020, HDFC Life's product mix contribution is now at Ulip - 20%, par - 28%, non-par - 26%, term - 12%, annuity - 5% and group at 9%. This has helped the company not only to improve margins but also keep the insurer less vulnerable to any regulatory or market changes and weather business cycles. Portfolio break-up as on September 2020 is:

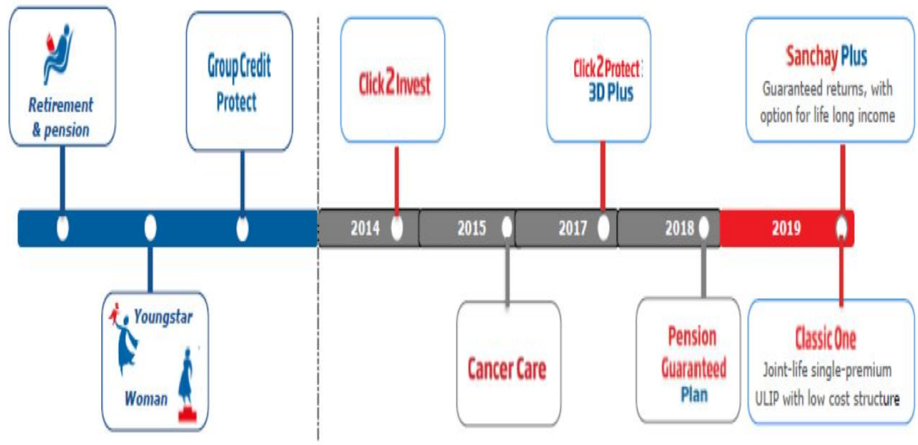
Exhibit 17: Business mix



Source: Company, ICICI Direct Research

HDFC Life has focused on using new technologies and methods to tap new market opportunities through product innovation. The company currently has 37 individual products, 11 group products in its kitty along with six riders. Over the past few years, there have been a lot of products that cater to the wider requirements of a large customer base. In FY21, the company launched a comprehensive group protection plan offering multiple choice of benefits. In FY20, the company launched Sanchay plus and Sanchay par advantage while other plans like Cardiac Care, group health shield have been launched earlier, among others. This shows that the insurer has been innovative in designing and launching products as per the prevalent environment.

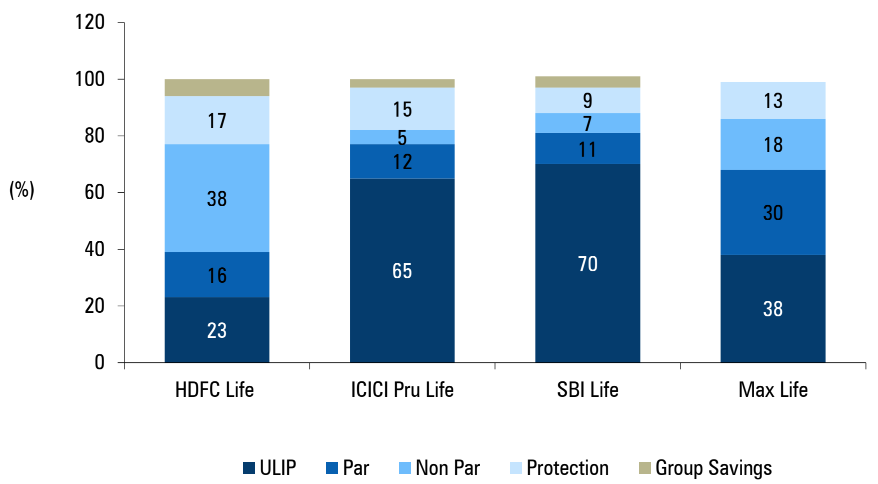
Exhibit 18: Continued focus on product innovation



Source: Company, ICICI Direct Research

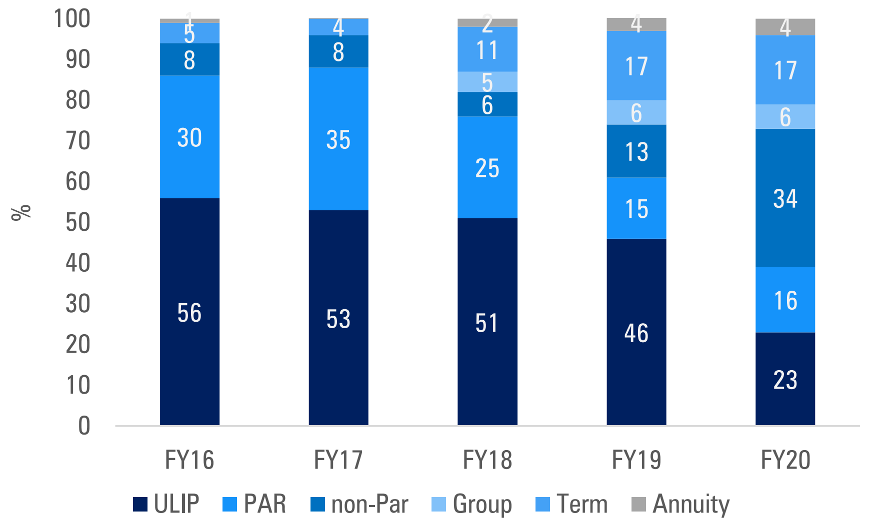
As compared to peers, HDFC Life has a balanced product mix instead of being skewed to a particular product. This enables the insurer to maintain healthy margins and safeguards it, to an extent, from market volatility.

Exhibit 19: Balanced product mix of HDFC Life compared to peers



Source: Company, ICICI Direct Research

Exhibit 20: Business mix trend over past five years as % of total APE

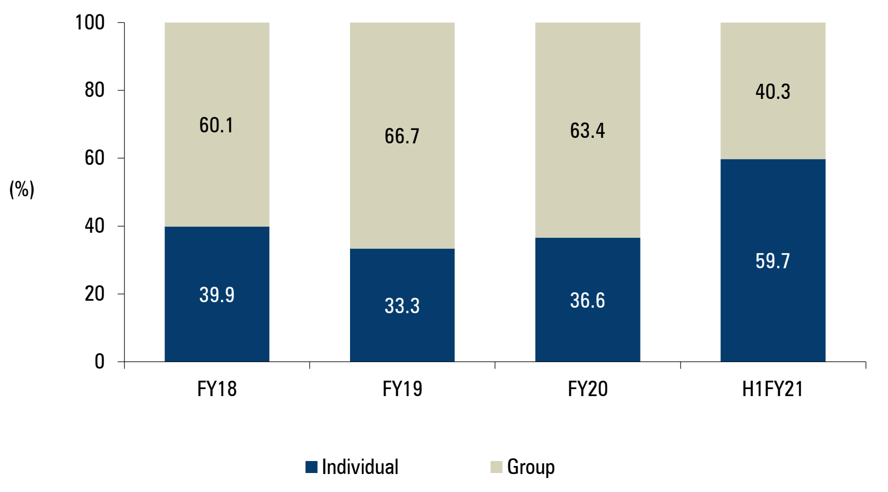


Source: Company, ICICI Direct Research

Protection, non-par to drive growth ahead

HDFC Life has shifted its focus to the protection business in the past few years and also increased its non-par mix, both of which are high yielding products for the company. Protection business has been largely driven by group business (primarily credit life) though share of individual protect has been improving. Non-par savings products offer guaranteed return with life cover, which remains an attractive proposition for customers in the current low interest rate environment. With focus on non-par and protection business, we expect its contribution to increase from 47.3% in FY20 to 57.4% by FY23E.

Exhibit 21: Protection mix % based on APE



Source: Company, ICICI Direct Research

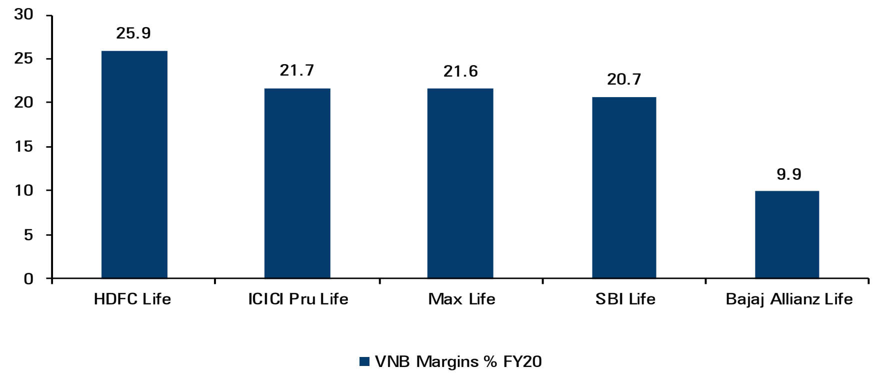
Note: Group business predominantly consist of credit protect

Prudent business mix, control on opex to favour margins

The company is among the most profitable insurance companies in the private sector space and has industry leading VNB margin of 25.1%. HDFC Life, like its group companies, has acute focus on profitability. Over the past few years, the company has focused on improving its margins. This was achieved through a rise in contribution from high yielding protection business, annuity and also non-par savings. The share of term, annuity and non-par savings has increased from 5%, 2% and 7% in FY17 to 9%, 5% and

30% in H1FY20, respectively. In the medium term, we expect margins to remain around 25%+ levels.

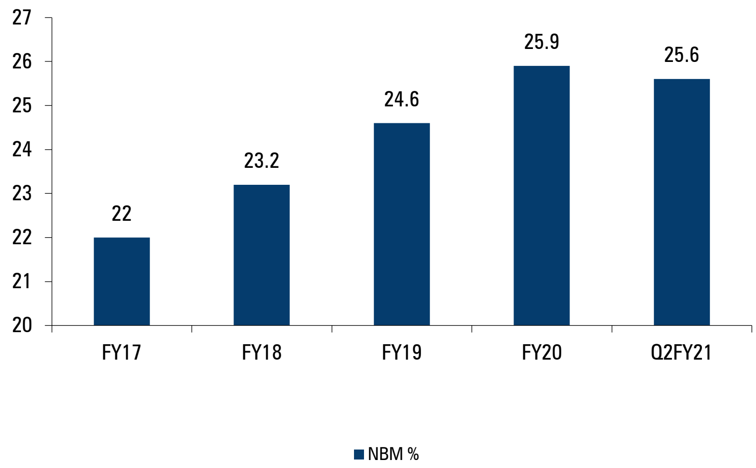
Exhibit 22: VNB margin - Peer comparison



Source: Company, ICICI Direct Research

Among peers, HDFC Life has among the best margins, mainly aided by re-balancing of the business mix in favour of high yielding segments. Part of the improvement in new business margins can also be attributed to improving persistency (13th month, 61th months) that increases the value of new business and, thus, margins along with a steady decline in opex ratio.

Exhibit 23: Improving trajectory of NBM

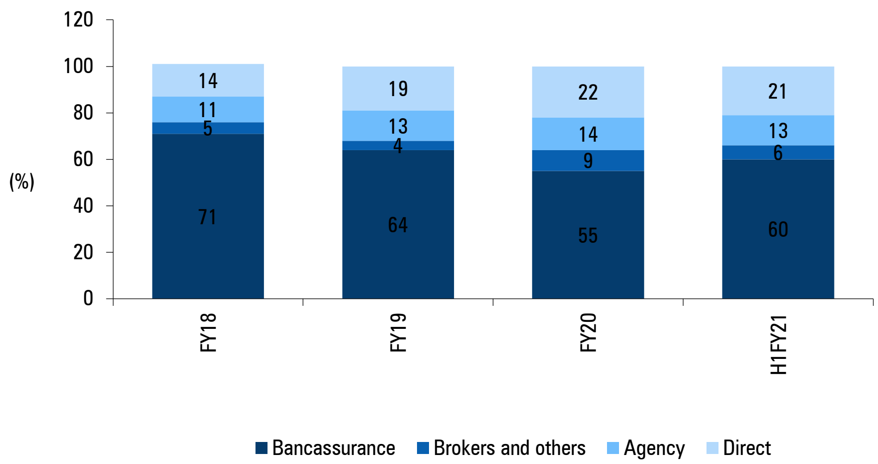


Source: Company, ICICI Direct Research

Strong distribution network

The company is focused on developing a multi-channel for distribution to drive need based selling. Over the past few years, HDFC Life has been focusing on increasing contribution from proprietary channels like agency and direct to reduce dependency on any one of them. However, bancassurance still remains the largest contributor (60% as of H1FY21). Though HDFC Bank has gone for an open architecture structure and sources business for other companies like Tata AIA and Birla Sun Life Insurance, it remains a key partner to HDFC Life. In terms of individual APE, total contribution to bancassurance sourcing from HDFC Bank is at 85%.

Exhibit 24: Distribution mix – HDFC Life



Source: Company, ICICI Direct Research

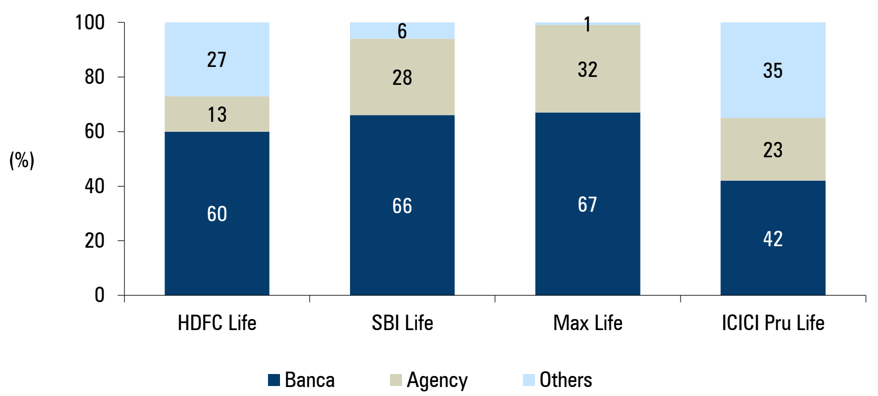
HDFC Life continues to strengthen its diversified distribution by adding more partnerships. The company currently has over 300+ partners including 250+ traditional partners like banks, NBFCs and over 50 other emerging partnerships like fintech firms. These relationships have also helped in the development of innovative product and delivery solutions for customers. The company's proprietary channel witnessed growth of 26% YoY in FY20. In this, the online channel has seen growth of 73% YoY in FY20.

Exhibit 25: Enlarging distributor base with new fintech on boarded

Source: Company, ICICI Direct Research

HDFC Life, like other peers, depends heavily on bancassurance partnerships for its product distribution. However, the company has also developed other channels to source its business and has over 300+ partnerships for the same.

Exhibit 26: Channel mix peers

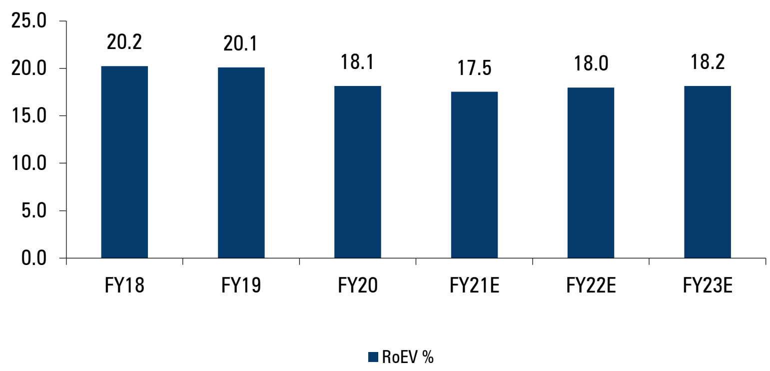


Source: Company, ICICI Direct Research

Stable earnings, return ratios

HDFC Life witnessed healthy RoEV in the past few years (18%+) riding on an improving opex and product mix. In FY21E, there may be some dip in RoEV owing to the pandemic affecting business momentum. However, in the next couple of years, returns are expected to improve as the situation normalises. A balanced product mix helps to soak volatility in terms of growth and margin stability. We expect GWP to grow at 10.1% CAGR in FY20-23E to ₹ 43703 crore while PAT is expected to grow at 9% CAGR over the same period to ₹ 1671 crore. VNB margin is expected at ~25% by FY23E.

Exhibit 27: Stabilising trend of RoEV

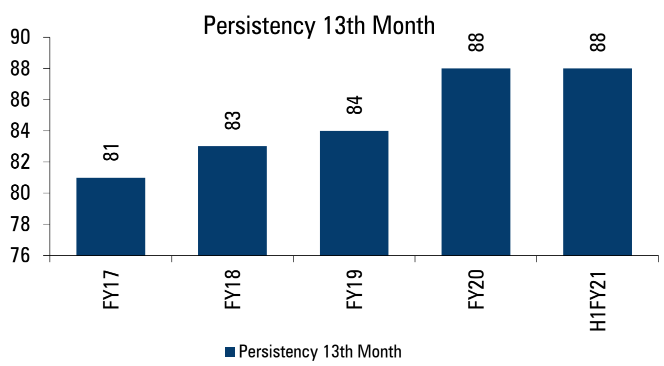


Source: Company, ICICI Direct Research

Improving persistency ratio

Persistency is a key parameter for any insurance company to gauge business profitability and control costs. HDFC Life has seen continuous improvement in its persistency, which has partly benefitted margins and, thus, profitability. The 13th month persistency for HDFC Life has improved from 81% in FY17 to 88% as on September 2020. As the insurance business has a substantial proportion of premium apportioned to distribution and operational expense in the initial period, higher persistency enables the insurer to improve margins and profitability.

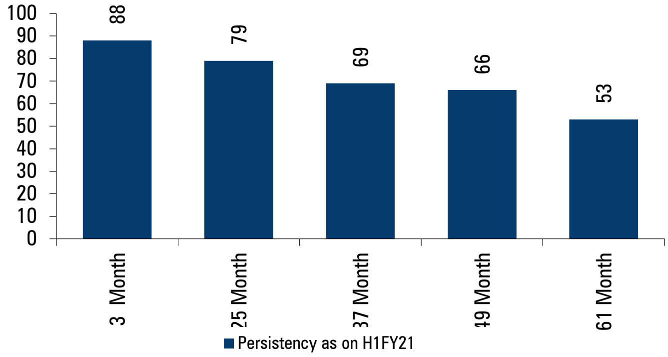
Exhibit 28: 13th month persistency



Source: Company, ICICI Direct Research

The company has achieved the same on the back of continuous customer engagement, use of technology to smoothen the enrolment process and customer service for customers. Persistency in the direct and agency channel has been meaningfully higher than banca. This can be explained by improved productivity of its employees and well-defined policies meeting customer requirements.

Exhibit 29: Persistency across various tenors



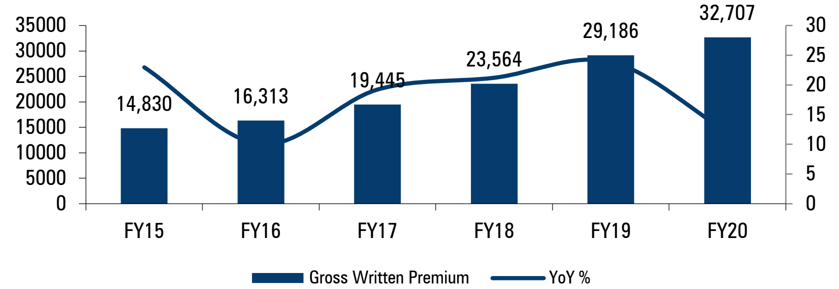
Source: Company, ICICI Direct Research

Financials

HDFC Life has shown an improving performance on various parameters over the years. AUM growth for FY15-20 has grown at 13.7% CAGR while gross written premium (GWP) has seen growth at 17.1% CAGR over the same period. With increasing proportion of high margin protection business, HDFC Life has witnessed healthy VNB growth of 26.6% CAGR in FY15-20 while the VNB margin has expanded by ~740 bps to 25.9% in FY20 from 18.5% in FY15. PAT reported ~10.5% CAGR in the past five years at ₹ 1295 crore for FY20. The company had healthy RoEV at 18.1% for FY20. It has remained at the ~20% mark for the past few years. On the back of continued healthy performance, EV has seen strong CAGR of ~18.6% for FY15-20.

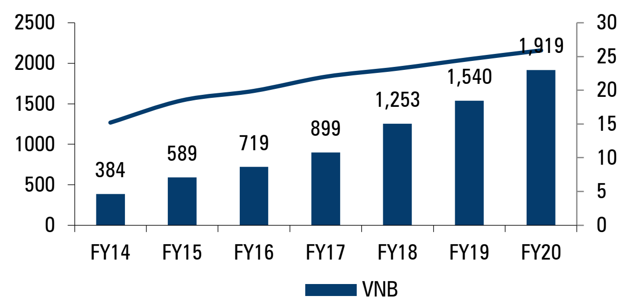
For FY15-20, HDFC Life has shown healthy APE CAGR of 18.4%

Exhibit 30: Healthy premium growth



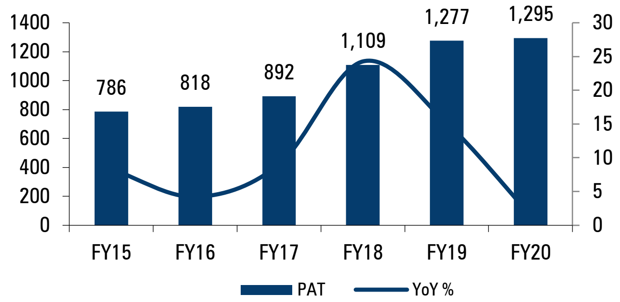
Source: Company, ICICI Direct Research

Exhibit 31: Rising trend in VNB margins……



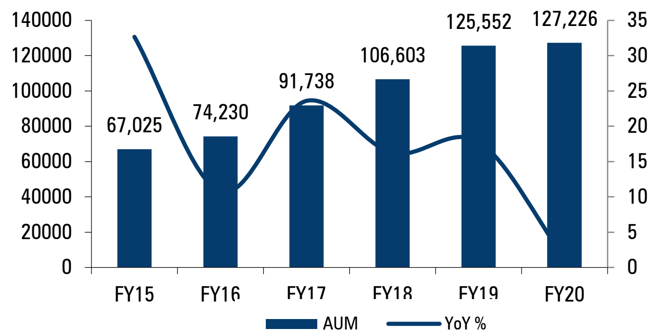
Source: Company, ICICI Direct Research

Exhibit 32: …leading to superior profitability



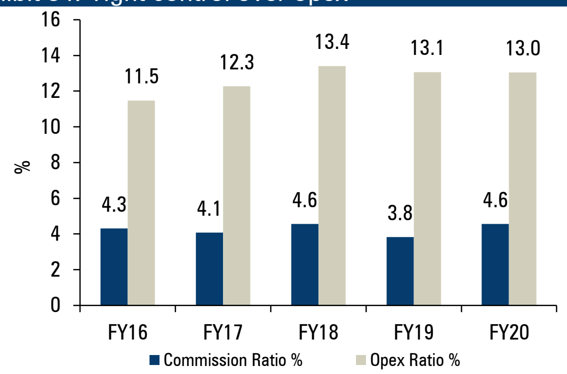
Source: Company, ICICI Direct Research

Exhibit 33: AUM growth healthy



Source: Company, ICICI Direct Research

Exhibit 34: Tight control over opex



Source: Company, ICICI Direct Research

Risks and concerns

High share of group business in protection

HDFC Life has witnessed an increasing trend of business margins owing to a consistent increase in contribution of protection business in the mix. However, the protection business of HDFC Life is considerably contributed (~63%) by the group business. Thus, if the group protection business gets impacted, profitability may be impacted.

Increased mortality risk due to Covid-19

The Covid-19 pandemic has already spread worldwide and seen a sharp rise in the number of cases in India as well. If the pandemic gets extended, it can prove detrimental to the overall health of the society. This can have a direct impact on life expectancy and mortality rates. Such an impact may lead to a rise in the number of claims. In turn, this may impact profitability.

Interest rate risk persists

HDFC Life has scaled up its non-par book meaningfully in the overall business mix in the past few years. The non-par business as of September 2020 now forms 26% of the total mix compared to only 6% in FY18. Though HDFC Life has hedging mechanism in place which is indicated in sensitivity, however, any adverse movement remains a risk as non-par is a guaranteed return business. If interest rate changes significantly and moves south then the bottomline can be directly impacted.

Risk from volatility in equity markets

HDFC Life has tried to maintain a balanced mix in its overall portfolio. As a result, Ulip now forms 20% of the mix though its contribution has been on a decline in the past few years. Ulip has been always susceptible to volatility in the equity markets and sees a sharp drop in inflows in case of dull markets. As a result, this can slow down overall growth, to an extent, if equity markets do not perform well.

Restriction on credit life insurance remains a risk

Recently, as per media reports, insurance regulator IRDA is considering a proposal to ban credit-linked group health policies that are usually bundled with home loans. To avoid mis-selling of these products to home buyers as health covers, IRDA is considering banning the same. If a similar sort of ban or restriction or any kind of directive is taken up for the credit life segment, it could materially have an impact on the sector and especially, HDFC Life.

Valuation

Valuation premium to sustain ahead

HDFC Life is the most profitable life insurer in the industry with a strong brand, associations, distribution network and performance on key metrics. Innovation in products and balanced mix in the portfolio makes the company attractive. HDFC Life currently trades at ~4.3x FY23E embedded value (EV), which is at a premium compared to its peers. However, considering the overall business franchise that it has created, it will continue to maintain the same. Thus, we initiate coverage on the stock with a **BUY** rating and a target price of ₹ 820/share, valuing the company at 5x FY23E EV.

We expect GWP to grow at a CAGR of 10.1% in FY20-23E to ₹ 43703 crore while PAT is expected to grow at 9% CAGR over the same period to ₹ 1671 crore. VNB margins are expected to be in the region of ~25% by FY23E. Near term premium growth can be a bit weak but we expect it to bounce back from FY22 onwards as unlocking progresses. With an increase in credit offtake in housing and other segments, the credit protect business should pick up. RoEV is also expected to improve post a slight dip in FY21E.

Exhibit 35: Key valuation parameters

Y/E Mar	FY19	FY20	FY21E	FY22E	FY23E
EPS	6.3	6.4	7.1	7.9	8.3
BVPS	28.0	33.7	40.8	45.9	51.7
EVPS	90.7	102.3	121.7	141.7	165.7
RoA (%)	1.1	1.0	1.0	0.9	0.9
RoE (%)	24.5	20.8	19.1	18.1	17.0
RoEV (%)	20.1	18.1	17.5	17.5	17.7
P/E (x)	111.4	109.9	99.0	89.7	85.1
P/BV (x)	25.1	20.9	17.3	15.4	13.6
P/EV (x)	7.8	6.9	5.8	5.0	4.3

Source: Company, ICICI Direct Research

Exhibit 36: Peer comparison - key valuation parameters

₹ crore	FY18				FY19				FY20			
	HDFC Life	ICICI Pru	Max Life	SBI Life	HDFC Life	ICICI Pru	Max Life	SBI Life	HDFC Life	ICICI Pru	Max Life	SBI Life
APE	5530	7790	3250	8540	6260	7800	3950	9700	7410	7380	4150	10740
YoY Growth	33%	18%	22%	27%	13%	0%	22%	14%	18%	-5%	5%	11%
APE Mix												
ULIP	51%	82%	41%	67%	46%	80%	42%	71%	23%	65%	38%	70%
PAR	25%	11%	43%	24%	15%	9%	40%	19%	16%	12%	30%	11%
Non Par savings	8%	1%	8%	1%	17%	1%	9%	0%	38%	5%	18%	7%
Protection	11%	6%	8%	5%	17%	9%	10%	7%	17%	15%	13%	9%
Group Savings	5%	1%		3%	6%	1%		3%	6%	3%		4%
VNB	1280	1290	660	1390	1540	1330	820	1720	1920	1610	900	2010
VNB Margin	23%	17%	20%	16%	25%	17%	22%	18%	26%	22%	22%	19%
EV	15220	18790	7550	19080	18300	21630	8980	22400	20620	23030	9980	26270
RoEV	19%	23%	21%	17%	18%	20%	22%	16%	17%	15%	20%	19%
AUM	106600	138500	52000	116300	125600	159000	63000	141000	127200	151300	68000	160400
Opex Ratio	13%	8%	13%	7%	13%	8%	13%	6%	13%	9%	15%	6%
Acquisition Expens	18%	14%	20%	9%	16%	16%	18%	8%	18%	17%	17%	8%

Source: Company, ICICI Direct Research

Exhibit 37: Peer comparison

Y/E Mar	RoA%			RoEV%			P/E			P/EV		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
HDFC Life	1.0	1.0	0.9	18.1	17.5	17.5	109.9	99.0	89.7	6.9	5.8	5.0
SBI Life	0.9	0.9	0.8	20.0	16.0	17.0	64.1	47.2	41.7	3.5	3.0	2.6
Max Life	0.2	0.6	0.7	20.0	19.0	18.0	125.0	55.0	44.0	2.4	2.1	1.8
ICICI Pru-life	0.7	0.7	0.7	15.2	14.9	15.9	68.1	82.6	55.4	3.1	2.6	2.3

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 38: Policyholder's account

(₹ Crore)	FY19	FY20	FY21E	FY22E	FY23E
Premiums earned - Net	28924.0	32223.6	33996.1	37535.9	42670.8
Interest, Dividends & Rent	9027.5	6845.3	7589.2	10210.8	12637.8
Others income (incl. MTM)	484.0	-9807.5	11782.1	556.2	629.5
Total Revenue	38,436	29,261	53,367	48,303	55,938
Commission	1117.7	1491.2	1610.3	1657.8	1879.2
Operating expenses	3813.6	4266.9	4505.8	5113.6	5816.6
Benefits paid (Net)	13988.9	19021.5	18231.1	19546.3	21735.7
Change in valuation of policy liabilities	17507.5	2440.8	26917.8	20071.6	24431.5
Provision for tax	226.8	149.0	561.6	212.1	203.9
Surplus/(deficit) after tax	1350.7	971.4	1085.6	1288.7	1422.7
Transfer to Shareholders' account	1,207	1,191	1,231	1,314	1,347

Source: Company, ICICI Direct Research

Exhibit 39: Shareholder's account

(₹ Crore)	FY19	FY20	FY21E	FY22E	FY23E
Amounts transferred from Policyholders' account	1206.9	1191.4	1231.1	1313.7	1347.4
Income from investments	408.4	437.8	525.4	651.8	711.1
Total	1,636	1,648	1,757	1,966	2,058
Total expenses	62.6	99.1	168.7	346.5	336.0
Profit before Tax	1289.9	1311.7	1481.6	1635.6	1723.5
Provision for tax	13.1	16.5	44.4	49.1	51.7
PAT	1,277	1,295	1,437	1,586	1,672

Source: Company, ICICI Direct Research

Exhibit 40: Balance sheet

(₹ Crore)	FY19	FY20	FY21E	FY22E	FY23E
Sources of Funds					
Share capital	2017	2019	2019	2019	2019
Reserve and surplus	3641	4968	6405	7418	8587
Credit/[debit] fair value change account	-3	-192	-186	-179	-171
Networth	**5656**	**6800**	**8238**	**9258**	**10435**
Policyholders' funds	**118124**	**119502**	**148056**	**168561**	**193490**
Funds for Future Appropriations	1103	883	738	713	788
Total Liabilities	**124883**	**127185**	**157031**	**178531**	**204713**
Applications of Funds					
Shareholders' investments	5050	5855	6441	7407	8889
Policyholders' investments	57124	67189	73378	83214	95673
Asset held to cover linked liabilities	63377	54182	56891	62011	67592
Loans	80	299	50	60	60
Fixed assets - net block	333	330	337	343	350
Net current assets	-1082	-670	19935	25495	32148
Total Assets	**124883**	**127185**	**157031**	**178531**	**204713**

Source: Company, ICICI Direct Research

Exhibit 41: Key Ratios

(Year-end March)	FY19	FY20	FY21E	FY22E	FY23E
Valuation					
No. of Equity Shares (Crore)	201.7	201.9	201.9	201.9	201.9
Diluted EPS (₹)	6.3	6.4	7.1	7.9	8.3
DPS (₹)	1.6	0.0	0.0	2.4	2.1
BV (₹)	28.0	33.7	40.8	45.9	51.7
EV per share	90.7	102.3	121.7	141.7	165.7
P/E	111.4	109.9	99.0	89.7	85.1
P/BV	25.1	20.9	17.3	15.4	13.6
P/IEV	7.8	6.9	5.8	5.0	4.3
Efficiency Ratios (%)					
Commission expenses as a % of Gross Premium	3.8	4.6	4.6	4.3	4.3
Management expenses incl	16.9	17.6	17.7	17.6	17.6
Return Ratios and capital (%)					
Return on Net worth	24.5	20.8	19.1	18.1	17.0
Opearating RoEV	20.1	18.1	17.5	17.5	17.7
Key Ratios (%)					
Conservation Ratio	83.85	80.26	79.12	81.48	84.25
VNB Margin	24.60	25.90	24.5	25.2	25.9
Benefits paid as a % of Opei	4.03	35.47	-3.10	7.28	11.34
NBP APE (proportion %)					
Paticipating	14.4%	15.9%	16.3%	16.1%	15.8%
Non participating	38.5%	59.5%	59.6%	59.0%	58.8%
Unit Linked	47.1%	24.5%	24.1%	24.9%	25.4%

Source: Company, ICICI Direct Research

Exhibit 42: Key parameters

(Year-end March)	FY19	FY20	FY21E	FY22E	FY23E
NBP	14,971	17,238	17,622	19,468	21,922
Growth (%)	32	15	2	10	13
Linked	11,322	11,192	10,753	10,953	11,628
Growth (%)	10	-1	-4	2	6
Non Linked	17,864	21,514	23,890	27,448	32,076
Growth (%)	34	20	11	15	17
APE	6,049	7,164	7,356	8,175	9,196
Growth (%)	12	18	3	11	12
VNB	1,540	1,919	1,863	2,130	2,463
Growth (%)	20	25	-3	14	16
EV	18,296	20,655	24,575	28,721	33,732
Growth (%)	20	13	19	17	17
AUM	1,25,552	1,27,226	1,36,710	1,52,633	1,72,154
Growth (%)	18	1	7	12	13
PH Funds	57,124	67,189	73,378	83,214	95,673
Growth (%)	26	18	9	13	15
SH Funds	5,050	5,855	6,441	7,407	8,889

Source: Company, ICICI Direct Research

Glossary of Terms – Life Insurance

Individual business premium

Insurance contracts that cover the life of an individual and premium earned from the same

Group business premium

Insurance contracts that cover a defined group of people and premium earned from the same

Single premium

Those contracts that require only a single lump sum payment from the policyholder. Single premium include top up premium, which refers to additional amounts of premium over and above the contractual basic premium received during the term of unit linked insurance contract.

Weighted received premium (WRP)

The sum of first year premium received during the year and 10% weighted single premiums including top-up premiums.

Indian Embedded Value (IEV)

IEV consists of Adjusted Net Worth (ANW) and Value of in-force (VIF) covered business. ANW is market value of assets attributable to shareholders, consisting of Required Capital (RC) and Free Surplus (FS).

Value of in-force covered business (VIF)

VIF is present value of future profits; adjusted for time value of financial options and guarantees; frictional costs of required capital; and cost of residual non-hedgeable risks.

Required Capital (RC)

The level of required capital is set equal to the amount required to be held to meet supervisory requirements. It is net of the funds for future appropriation (FFAs).

Free Surplus (FS)

Free surplus is market value of any assets allocated to, but not required to support, the in-force covered business.

Unit linked business (Ulip)

Non participating insurance contracts that are investment cum protection plans that provide returns directly linked to the market performance.

New business premium (NBP)

The premium earned on new insurance policies written in a financial year.

Net premium earned

The difference between total premium and benefits paid (gross of reinsurance).

Renewal premium

Premium received or receivable on regular premium paying contracts in the years subsequent to the first year of the contract.

New business margin (NBM)

A measure of profitability computed as the present value of future profits on the business sourced in a particular period and denoted as a percentage of APE.

Non participating business (Non-PAR)

Insurance contracts that do not participate in profits of the company.

Participating business (PAR)

Insurance contracts that participate in the profit of the participating business of the insurance company during the term of the contract.

Annualised premium equivalent (APE)

Sum of annualised first year premium and 10% weighted single premiums including top-up premiums.

Annuity benefits

A series of payments payable at regular intervals in return for a certain sum paid up-front, under an annuity contract.

Assets under management (AUM)

Total value of investment of shareholders & policyholders that is managed by the insurance company as prescribed by Insurance Regulatory and Development Authority of India (IRDA) under investment regulations. AUM includes investments disclosed in the balance sheet under Schedule 8, 8A, 8B and loans in the nature of investments included in Schedule 9.

Conservation ratio

Ratio of renewal premium of the current financial year to sum of first year premium and renewal premium of the previous financial year.

Contribution from shareholders' account

The amount transferred from shareholders' account to policyholders' account to make good the deficit arising in non-participating funds as per requirement of the Insurance Regulatory and Development Authority of India (preparation of Financial statements and auditor's report of insurance companies) Regulations, 2002.

Death benefit

The contractual amount as specified in policy document, payable on occurrence of death of the life assured.

Fair value change account

Unrealised gains/losses (net) on mark to market securities pertaining to shareholders and non-linked policyholders' funds, as required by the Insurance Regulatory and Development Authority of India (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002.

First year premium (FYP)

Premium received or receivable on regular premium paying contracts in the first year of the contract.

Free-look period

A period of 15 days or 30 days, allowed to a new policyholder, from the date of receipt of policy documents, to enable him to review the terms and conditions of the policy and cancel the policy, if it does not meet his requirement.

Funds for discontinued policies

The liability of the discontinued unit linked policies, which are within the lock in period of five years from the date of issue, is held in this fund.

Investment yield

The income earned/received from an investment based on the price paid for the investment. Investment yield is disclosed as a percentage.

Market consistent embedded value (MCEV)

The present value of shareholders' interests in insurance business, using market consistent methodology, where explicit allowance is made for risk in business.

Maturity benefit

The contractual amount, as specified in the policy documents, which is payable at the end of the term of policy.

Mortality and morbidity risk

Mortality is the term used for the number of people who died within a population. Mortality risk means the fluctuations in the timing, frequency and severity of death insured, relative to that expected at the time of underwriting (at the inception of the contract). Morbidity refers to the state of being diseased or unhealthy within a population. Morbidity risk means fluctuations in timing, frequency and severity of health claims, relative to that expected at the time of underwriting (at the inception of the contract).

Net asset value (NAV)

The market value of each unit of a fund. NAV is declared on all business days, reflecting the combined market value of the investments/securities (as reduced by allowable expenses and charges) held by a fund on any particular day.

Persistency ratio

The proportion of business retained from the business underwritten. The ratio is measured in terms of number of policies and premiums underwritten.

Policy liabilities

The amount held by the insurance company for meeting the expected future obligation on existing policies.

Reinsurance premium ceded

Premium paid or payable by the insurance company to a reinsurance company in lieu of reinsurance protection.

Solvency ratio

The ratio of available solvency margin (ASM) to the required solvency margin (RSM). ASM is defined as the available assets in excess of liabilities in the Shareholders' and Policyholders' funds and RSM is the required solvency margin that an insurance company is required to hold as per the guidelines prescribed by the IRDAI.

Sum assured

The benefit amount, which is guaranteed to become payable on a specified event of the life assured as per the terms and conditions specified in the policy.

Surrenders

Termination of the policy at the request of the policyholder before maturity of policy.

Terminal bonus

An additional bonus payable to participating policyholders on maturity and may also be payable on death or surrender, provided the policies have completed the minimum duration at death/surrender.

Transfer to shareholders' account

The amount of surplus transferred from policyholders' account to shareholders' account based on the recommendation by the appointed actuary.

Present value of future profits

Present value of projected distributable profits to shareholders arising from in-force covered business. Projection carried out using 'best estimate' non-economic assumptions and market consistent economic assumptions. Distributable profits are determined by reference to statutory liabilities.

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

Pankaj Pandey | Head – Research | pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093

research@icicidirect.com

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