

Weathering industry challenges through product innovation and distribution reach

FY25 APE growth at ~15%; stable VNB margins; Upgrade to Buy

We met with Ms. Vibha Padalkar, CEO & MD, and Mr. Kunal Jain, Head of IR and Business Planning, at HDFC Life, to discuss the company's growth outlook, the impact of regulatory changes, profitability goals, and other key focus areas. Here are the key takeaways from the discussion:

Industry premiums likely to grow 12-15%; HDFCLIFE to grow at higher end of the range

FY24 had its own set of challenges, wherein the INR0.5m+ ticket size saw a sharp decline. Additionally, amid strong equity market performance, customer demand shifted to ULIP products. FD rates remained high, while non-par savings products adjusted the returns as per the movement in the yield curve, reducing relative attractiveness vs. FDs. The eventual outcome of flat premium growth in FY24 on an actual basis (adjusted for the one-time spike in Mar'23, growth was in double digits) was better than earlier expected. For FY25, the company expects the industry to grow at a historical average rate of 12-15% and HDFCLIFE expects to grow at a higher end of that range. The election result and subsequent budgetary/regulatory announcements will bring clarity about the near-term growth outlook. In the medium term, the company continues to expect to double all the key metrics, including revenue and profitability, every four years.

Protection, annuity products will drive product mix in medium term

ULIPs: For 1HFY25, the share of ULIPs is expected to be on the higher side amid continued buoyancy in equity markets. For the industry, ULIPs have also picked up momentum across channels, especially the online channel.

Retail protection: The customer journey for protection begins with group term, credit protect, and then savings with higher protection cover (e.g., UL). For pure retail protection, customer mindset has been tilting toward getting return of premiums (ROP), driving up demand for ROP and limited-pay products. HDFCLIFE too has seen an increase in the share of ROP products to about 25-30% of retail protection. To further enhance the profitability of the product segment, the company has a targeted approach of increasing the attachment of riders, which resulted in strong growth of 47% in individual sum assured in FY24.

Credit protect: This has been a fast-growing segment and the company expects to sustain the momentum in the near term. At the industry level, there is sufficient scope for increasing attachment, and HDFCLIFE expects healthy disbursement growth.

Group term: Group term business has turned highly competitive in the recent past. HDFCLIFE continues to take a calibrated approach.

Annuities: Annuity and protection put together contributed to nearly half of overall new business premium in FY24. Given the strong growth in NPS customer base and increasing population at the superannuation stage, the annuities segment will continue to see robust growth. However, rates are very competitive, with some companies offering unsustainable rates in some cases.

HDFC Life Insurance



**Ms. Vibha Padalkar, MD
& CEO, HDFC LIFE**

Ms. Padalkar has been with HDFCLIFE since Aug'08. She qualified as a member of the Institute of Chartered Accountants of England and Wales in 1992, and is also a member of the ICAI. Prior to HDFC Life, she worked in various sectors, such as global business process management, global FMCG, and in an international audit firm.

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HDFC Life is strategically positioned to capitalize on market demand trends while balancing VNB margins. For FY25, HDFC Life aims to achieve synchronized growth in VNB alongside annual premium equivalent (APE), ensuring sustainable VNB margins. Profitability will also be cushioned with the focus on increasing the share of rider attachments, improving the long-term par products mix, and increasing the life cover in ULIPs.

Agency channel share to increase in the distribution mix amid focus on tier 2/3 cities

Agency: With granular premium growth, agency will be the bedrock of the company's distribution strategy. The aim is to increase the share of agency from one-fifth now to one-fourth in the medium term. In FY24, HDFCLIFE was the second largest private insurer in terms of gross agent additions (~83k for HDFCLIFE). About 80-90% of the new agent hiring is in tier 2 and tier 3 cities. The company has already invested in agent hiring and new branch openings, which will drive scale benefits and improve the channel's profitability. While the agency channel saw a decline of 9% in FY24 due to a high base of FY23 (non-par growth), HDFCLIFE registered APE growth in a high-single digit for less than INR0.5m ticket size. Also, the channel has seen robust growth of 14% on a two-year CAGR basis.

Tier 2/tier 3 strategy: For the low-tier cities, the strategy is fairly nuanced, with a focus on the higher end of the income bracket. During FY24, HDFCLIFE opened 75 branches, of which the majority of branches were opened in tier 2 and tier 3 cities. Two-thirds of HDFC Life's new business in FY24 (vs. 58% in FY21) came from non-tier 1 cities (overall unadjusted growth was 1%; growth from tier 2/3 was 13%). On NOP basis, tier 2/tier 3 markets contributed to three-fourths of business in FY24. Following HDFC Bank's expansion into semi-urban and rural areas, HDFC Life has increased its focus on volume growth, as evidenced by an 11% YoY increase in the number of policies in FY24. This is ~5x the overall industry growth.

HDFC Bank: APE from the bancassurance channel for HDFC Life grew 17% YoY in FY24. A strong pickup in ULIPs has supported growth in the channel. The counter share was strong at HDFC Bank (~63%), and other banca partners' contributions remained steady. HDFC Bank's life insurance premium to retail deposits was ~2% in FY24. Restricting life insurance will not solve the problem of the credit deposit ratio that the bank is facing currently. Hence, this would not pose a challenge for future growth.

Regulatory moves likely to be favorable

Surrender charges: The interactions between regulators and insurance companies with regards to surrender charges have been increasing in recently and some changes can be expected in the near term. Considering the consultative process, it is expected that the impact of the final regulations, if any, is likely to be absorbed by the industry. In terms of the tax change (INR0.5m+ taxation), the impact on HDFC Life's VNB margins was much lower than that on the industry, and the same scenario is expected to pan out even this time, considering the conservative actuarial assumptions and higher special surrender values. While trail-based commission products can be used to offset the impact of surrender charges, acceptance from the distributors is still low.

RBC: Risk-based capital has been a priority for IRDAI and the company expects its implementation in 12-18 months. As and when this is implemented, it should result in the release of some capital for future growth.

Investment regulations: Some relief has come in the recently announced regulations. However, the movement of investment regulations to the purview of the regulator vs. them being embodied in the Insurance Act, as they are currently, will help speed up the pace of changes.

Other takeaways:

- HDFC Life is implementing its Project INSPIRE, a comprehensive technological transformation. This project is aimed at enhancing the overall experience for customers, distributors and employees while increasing operational efficiency.

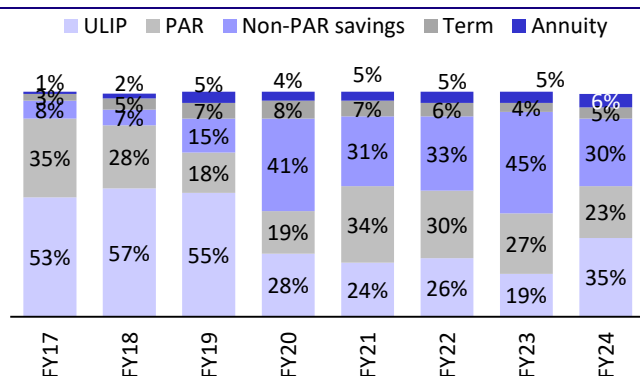
- The company will continue to invest in branch expansion, technology, and head count additions at HDFC Bank, which will continue to increase costs.
- HDFC Life will raise funds if solvency goes below 180%. It has space to raise sub debt, which is more cost effective than equity.

Valuation and view: Upgrade to BUY; surrender charges risk priced in more than adequately

HDFCLIFE has corrected 20% in the past five months, while all other private listed players have been range-bound. We note that the de-rating of the stock has been steeper after the announcement of the exposure draft on surrender charges and more recently when media reports about the same. The key reason for HDFCLIFE's premium to other players has been its ability to weather adverse regulations relatively better than other players through its product innovation and a strong distribution network. In terms of valuations, the one-year forward P/EV of HDFCLIFE at 2.2x has been the lowest since Jan'23. We believe the company will wade through these changes positively. Over FY24-26, we expect HDFCLIFE to report a CAGR of 15.2/16% in APE/VNB. **We upgrade our rating to BUY with a one-year price target of INR700.**

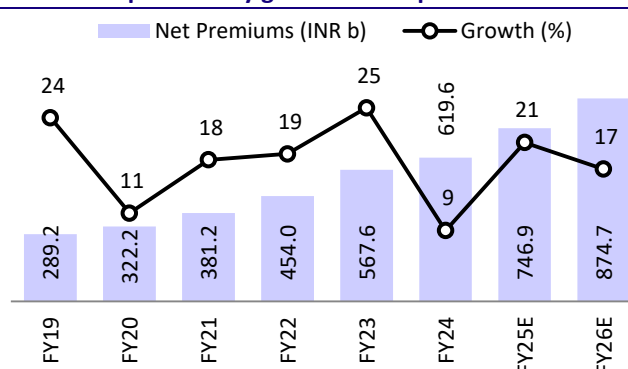
Story in charts

Exhibit 1: Product mix in Individual APE



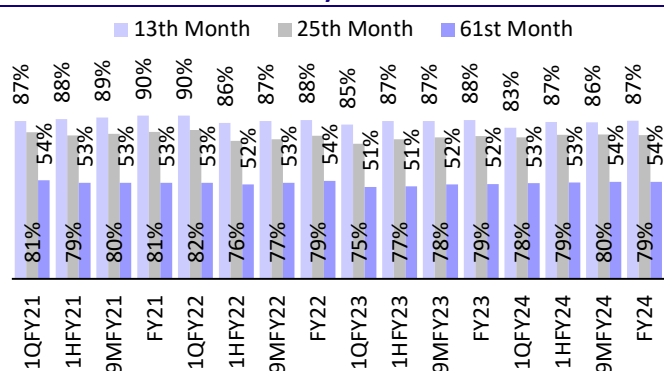
Source: MOFSL, Company

Exhibit 2: Expect steady growth in net premium



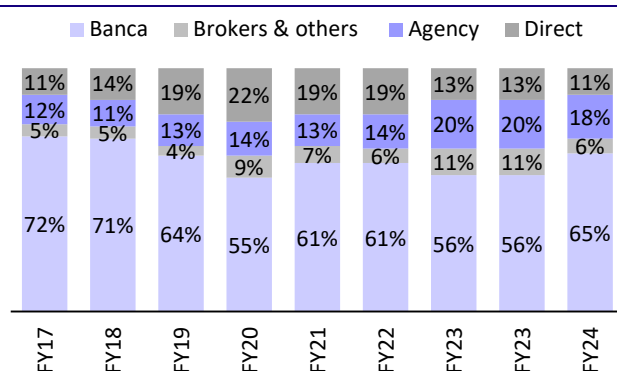
Source: MOFSL, Company

Exhibit 3: Trend in Persistency ratios



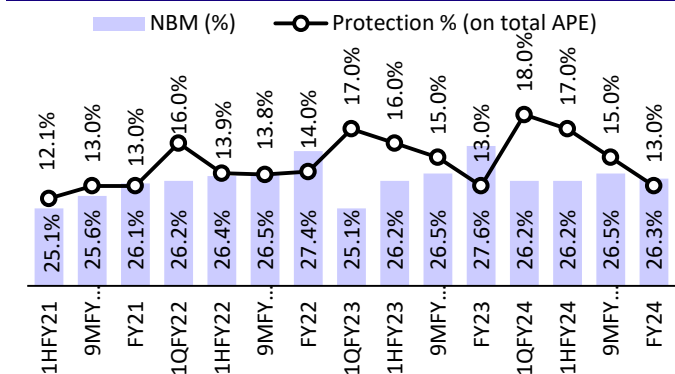
Source: MOFSL, Company

Exhibit 4: Trend in Distribution mix



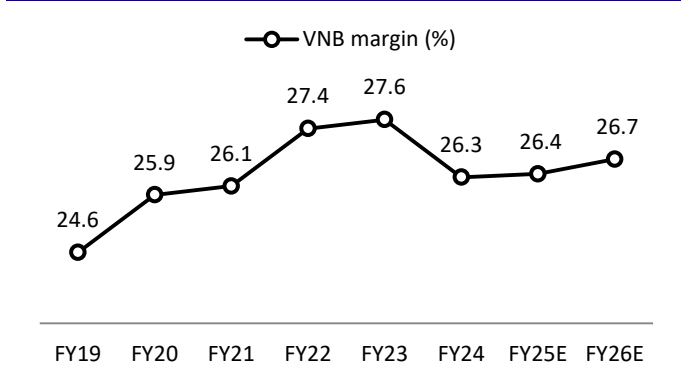
Source: MOFSL, Company

Exhibit 5: VNB margin at 26.3% for FY24



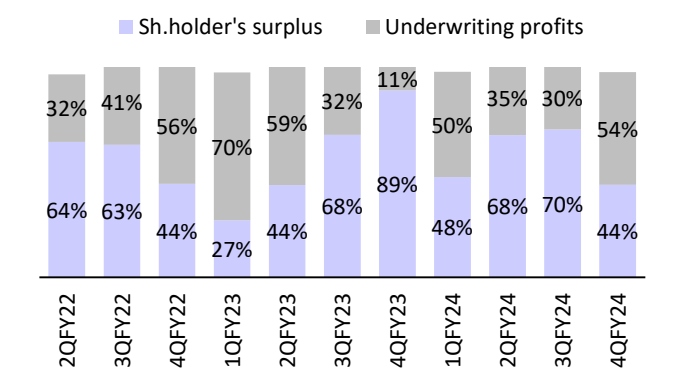
Source: MOFSL, Company

Exhibit 6: Expect VNB margins to remain stable



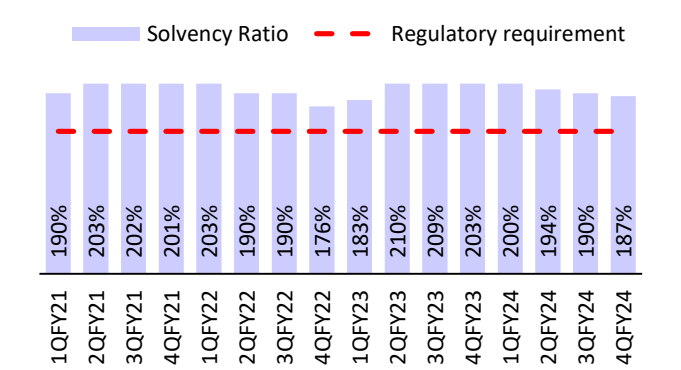
Source: MOFSL, Company

Exhibit 7: Trend in underwriting profit and shareholders' surplus



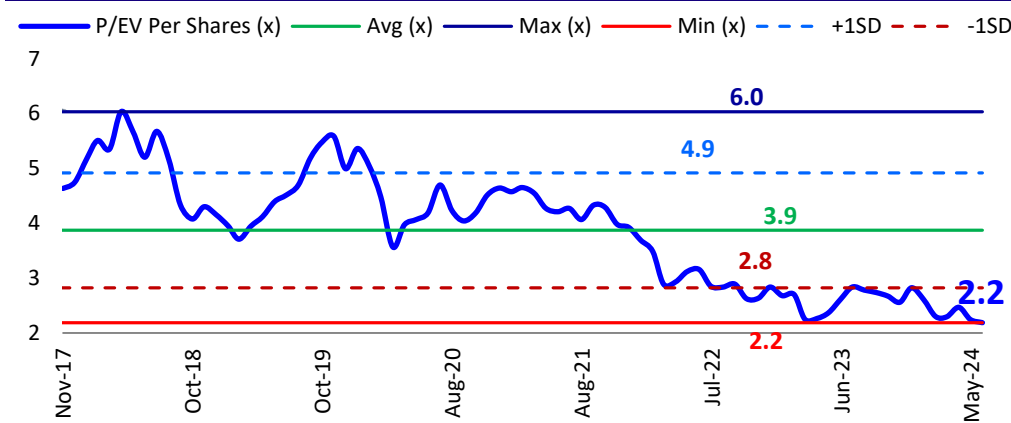
Source: MOFSL, Company

Exhibit 8: Trend in Solvency ratio



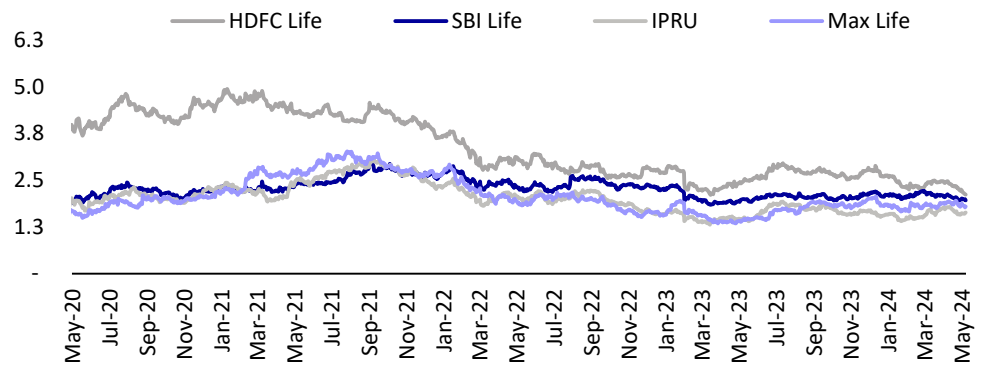
Source: MOFSL, Company

Exhibit 9: One-year forward P/EV



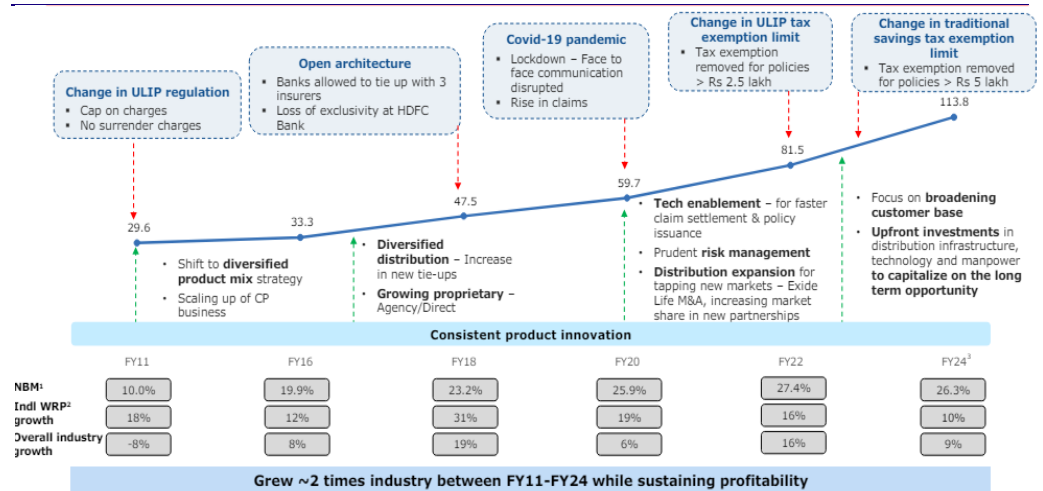
Source: MOFSL, Company

Exhibit 10: P/EV comparison of private insurers



Source: MOFSL, Company

Exhibit 11: Consistent performance across business cycles



Source: MOFSL, Company

Financials and valuations

Technical account (INR b)	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Gross Premiums	291.9	327.1	385.8	459.6	575.3	630.8	760.3	890.4
Reinsurance Ceded	(2.6)	(4.8)	(4.6)	(5.7)	(7.7)	(11.2)	(13.5)	(15.8)
Net Premiums	289.2	322.2	381.2	454.0	567.6	619.6	746.9	874.7
Income from Investments	90.3	(33.1)	326.8	192.2	126.0	383.5	284.8	328.7
Other Income	4.8	3.5	4.4	7.5	13.4	9.3	7.7	8.5
Total income (A)	384.4	292.6	712.4	653.6	707.1	1,007.7	1,039.4	1,211.9
Commission	11.2	14.9	17.1	19.4	28.9	52.6	52.6	61.9
Operating expenses	38.1	42.7	45.9	56.1	84.4	69.0	90.1	105.8
Total commission and opex	49.3	57.6	63.0	75.5	113.2	121.6	142.7	167.7
Benefits Paid (Net)	139.9	190.2	225.7	318.6	388.7	397.0	453.5	542.5
Change in reserves	175.1	24.4	408.3	246.8	185.9	484.2	424.1	479.3
Prov for doubtful debts	0.9	5.7	(1.9)	(2.5)	0.3	(0.9)	0.3	0.4
Total expenses (B)	365.2	277.9	695.1	638.4	688.1	1,001.8	1,020.6	1,189.9
(A) - (B)	19.2	14.7	17.3	15.1	18.9	5.9	18.7	22.0
Tax (incl GST)	5.7	5.0	6.3	5.5	5.3	(1.8)	5.1	5.7
Surplus / Deficit	13.5	9.7	11.0	9.6	13.6	7.8	13.6	16.3

Shareholder's a/c (INR b)	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Transfer from technical a/c	12.1	11.9	9.9	10.1	14.7	8.0	18.1	21.0
Income From Investments	4.1	4.4	6.5	7.9	7.2	10.0	8.2	9.8
Total Income	16.4	16.5	16.4	18.0	22.5	18.1	26.4	30.9
Other expenses	0.3	0.3	0.6	0.8	1.2	1.2	1.3	1.5
Contribution to technical a/c	3.1	1.0	2.6	5.7	8.8	1.3	3.1	3.4
Total Expenses	3.5	3.4	2.8	6.2	9.8	2.5	4.4	4.9
PBT	12.9	13.1	13.5	11.8	12.7	15.6	22.0	26.1
Tax	(0.1)	(0.2)	0.1	0.3	0.9	0.1	(0.3)	(0.4)
PAT	12.8	13.0	13.6	12.1	13.6	15.7	21.7	25.7
Growth	15%	1%	5%	-11%	13%	15%	38%	18%

Balance sheet (INR b)	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Sources of Fund								
Share Capital	20.2	20.2	20.2	21.2	21.5	21.5	21.5	21.5
Reserves And Surplus	36.4	49.7	64.1	132.9	108.1	120.5	136.6	156.7
Shareholders' Fund	56.6	68.0	86.4	154.9	129.9	146.5	162.6	182.7
Policy Liabilities	536.7	652.7	855.2	1,043.4	1,432.7	1,753.5	2,137.3	2,530.7
Prov. for Linked Liab.	605.2	508.4	709.6	765.2	753.8	921.1	988.0	1,087.6
Funds For Future App.	39.5	42.2	47.9	50.4	50.5	46.4	55.2	65.8
Current liabilities & prov.	51.2	49.8	65.2	62.3	83.0	87.8	114.1	148.3
Total	1,300.3	1,321.6	1,795.8	2,103.9	2,479.2	3,025.1	3,457.2	4,015.2
Application of Funds								
Shareholders' invt	50.5	58.6	85.4	152.4	131.3	148.8	178.6	214.3
Policyholders' invt	571.2	671.9	905.4	1,083.1	1,464.5	1,818.0	2,201.0	2,601.8
Assets to cover linked liab.	633.8	541.8	747.6	806.2	792.0	955.4	949.6	1,039.9
Loans	1.1	3.0	4.2	6.4	15.9	19.0	23.5	29.2
Current assets	40.4	43.1	49.8	52.3	71.7	79.7	99.7	124.6
Total	1,300.3	1,321.6	1,795.8	2,103.9	2,479.2	3,025.1	3,457.2	4,015.2

Financials and valuations

Premium mix (%)	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
New business - un weighted								
- Individual mix	51.1%	48.8%	49.9%	48.0%	50.3%	49.3%	66.0%	66.0%
- Group mix	48.9%	51.2%	50.1%	52.0%	49.7%	50.7%	34.0%	34.0%
Indi premium sourcing mix (%)	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Individual agents	13.8%	13.3%	12.3%	13.2%	16.5%	16.7%	19.0%	19.0%
Corporate agents-Banks	46.7%	41.8%	45.8%	44.5%	44.3%	50.0%	44.9%	44.9%
Direct business	31.8%	35.0%	32.9%	32.9%	26.0%	23.5%	28.5%	28.5%
Others	7.8%	9.9%	9.0%	9.4%	13.1%	9.8%	7.6%	7.6%

Operating ratios (%)	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Investment yield	7.5%	-2.7%	19.8%	10.2%	5.6%	13.8%	9.0%	9.0%
Commissions / GWP	3.8%	4.6%	4.4%	4.2%	5.0%	8.3%	6.9%	7.0%
- first year premiums	15.5%	17.9%	18.5%	17.0%	17.9%	28.4%	22.7%	23.1%
- renewal premiums	1.5%	1.6%	1.5%	1.5%	1.8%	1.6%	1.5%	1.5%
- single premiums	1.2%	1.3%	1.0%	1.3%	1.6%	8.5%	8.0%	8.0%
Operating expenses / GWP	13.1%	13.0%	11.9%	12.2%	14.7%	10.9%	11.8%	11.9%
Total expense ratio	16.9%	17.6%	16.3%	16.4%	19.7%	19.3%	18.8%	18.8%
Claims / NWP	46.4%	56.4%	57.1%	66.3%	64.9%	64.1%	56.7%	57.9%
Solvency ratio	188%	184%	201%	176%	203%	187%	190%	190%

Profitability ratios (%)	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
VNB margin (%)	24.6%	25.9%	26.1%	27.4%	27.6%	26.3%	26.4%	26.7%
RoE (%)	24.5%	20.8%	17.6%	10.0%	9.6%	11.4%	14.0%	14.9%
Operating ROEV	20.1%	18.2%	18.5%	16.5%	19.7%	17.5%	16.8%	16.3%
RoEV (%)	20.3%	12.9%	28.9%	23.8%	19.9%	20.1%	16.4%	16.0%

Persistency ratios (%)	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
13th Month	87.2%	90.1%	90.0%	87.5%	87.5%	87.1%	86.9%	86.9%
25th Month	80.5%	80.2%	81.0%	78.8%	78.7%	79.2%	79.0%	78.9%
37th Month	72.0%	73.8%	71.0%	67.5%	72.4%	73.2%	73.4%	73.3%
49th Month	67.7%	67.2%	67.0%	63.2%	64.0%	69.7%	71.0%	71.9%
61st Month	52.3%	55.0%	53.0%	54.0%	52.3%	53.5%	57.3%	58.5%

Valuation & key data	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Total AUMs (INRb)	1,256	1,272	1,738	2,042	2,388	2,922	3,429	3,972
- of which equity AUMs (%)	38%	29%	36%	37%	30%	33%	40%	40%
Dividend %	16%	0%	0%	17%	19%	20%	26%	26%
Dividend payout ratio (%)	31%	0%	0%	0%	0%	0%	26%	22%
EPS, INR	6.3	6.4	6.7	5.7	6.3	7.3	10.1	11.9
VNB (INRb)	15.40	19.18	21.85	26.74	36.74	35.01	40.1	47.1
Embedded Value (INRb)	182.7	206.3	266.2	329.4	395.1	474.5	552.2	640.6
EV per share (INR)	84.9	95.8	123.6	153.0	183.5	220.4	256.6	297.6
VIF as % of EV	68%	65%	66%	64%	68%	69%	71%	72%
P/VIF (%)	9.9	9.1	6.9	5.8	4.6	3.7	3.1	2.7
P/AUM (%)	98%	96%	70%	60%	51%	42%	36%	31%
P/EV (x)	6.7	5.9	4.6	3.7	3.1	2.6	2.2	1.9
P/EPS (x)	89.7	88.6	84.5	99.7	90.1	78.0	56.4	47.7
P/EVOP (x)	40.0	36.9	32.0	27.8	18.9	17.7	15.4	13.6
P/VNB (x)	79.5	63.8	56.1	45.8	33.3	37.8	30.5	26.0

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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