Life Insurance

Recommendation Summary

	Reco	Target	Upside
HDFCLIFE	BUY	900	20
SBILIFE	BUY	2,250	18
IPRU	BUY	890	17
LIC	BUY	1,300	22
Max	Neutral	1,080	-3

Concerns behind, strong outlook ahead

Top picks HDFCLIFE, SBILIFE

- **The life insurance sector has experienced a series of regulatory and taxation changes (ULIP taxation, non-linked products taxation, EOM regulations, and surrender charges) over the past few years, which have constrained the outlook of the industry. As a result, valuations in this sector have undergone significant corrections.**
- **Regulations pertaining to surrender charges have had the most profound impact. However, with the finalization of these regulations, the associated uncertainty has diminished. Management commentary on the implications of these changes has largely been neutral to marginally negative.**
- **Our discussions with agents and distribution partners indicate that the enhanced liquidity of products under new surrender charges regime has emerged as a compelling selling point, potentially facilitating an increase in the average ticket size.**
- **Moreover, we anticipate that any rate cuts by the Reserve Bank of India (RBI) will make long-term guaranteed products more attractive again. Notably, protection products—encompassing both credit protection and individual protection—are gaining traction, which should help mitigate any adverse effects stemming from surrender charges.**
- **Looking ahead, forthcoming regulations, such as risk-based solvency and IFRS, are expected to positively influence financials by releasing capital that can be utilized for growth and for retaining a larger share of business, particularly in the protection segment.**
- **In light of these insights, we maintain a positive outlook on the life insurance sector and recommend BUY ratings for HDFCLIFE, SBILIFE, IPRULIFE, and LIC, whereas we have a Neutral rating on MAXFIN.**

Surrender value regulations, managements guide for stability post some hit

IRDAI released a consultation paper on surrender charges in Nov'23, followed by a structure in Mar'24 and the final regulations in Jun'24. This sequence of events led to significant uncertainty regarding the final outcome and the impact of implementation. While the final regulations have been announced and implemented from Oct'24, the impact will depend on factors such as: 1) the share of non-linked business, 2) assumptions with respect to persistency built into the extant VNB, 3) changes in commission constructs post implementation, and 4) changes in IRRs post implementation. The key takeaways from management interactions on surrender charges are as follows:

HDFC Life

- Anticipate a gross impact of approximately 100 bp on the company's new business margin due to higher surrender value payable on early exit; impact is limited due to a balanced approach to business
- Deferment and clawback for commissions may be used for offsetting the impact of new surrender charges
- Product competitiveness will increase with new surrender charge norms; some calibration in IRRs can be expected
- Under the new surrender charges, instead of making the policy paid-up if a customer surrenders, the impact on HDFCLIFE's margin will be minimal

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- The actual experience of surrenders is negligible, based on which the assumptions factor in close-to-zero surrenders, implying that HDFC has not been factoring in any surrender profits after the customer pays the first renewal premium; additionally, the persistency experience is strong and improving across cohorts
- The only impact is in year one, where the experience is quite good, and the assumptions are also conservative for that year; the experience of lapse or exit in the first year is even lower than the assumption

SBI Life

- Under surrender charges, SBILIFE expects a very low impact (much lower than 1%), owing to its product mix and conservative assumption on surrenders
- For new products, SBILIFE is not planning any commission changes for distributors
- The impact of surrender charges will be more than offset by a favorable product mix (pick up in protection and annuity)

IPRU Life

- Even before the revised surrender value norms came into effect, IPRU launched ICICI Pru GPP Flexi with Benefit Enhancer, which provides customers the option to receive 100% money back of premiums paid any time. The commission structure in this product is more level-based, while keeping the overall lifetime payment at a similar level. The product has been well accepted in the market segments where it was launched.
- IPRU has also experimented with a trail-based commission on the ULIP platform, seeing acceptance by distributors in the market segment where it has been launched. It believes that by aligning the interests of all the three stakeholders, namely customers, shareholders, and distributors, it will be able to absorb any impact that may arise due to changes in regulations.
- There will not be any impact on margins due to surrender guideline changes from 1st October (that side of the business is only 17% of the portfolio).

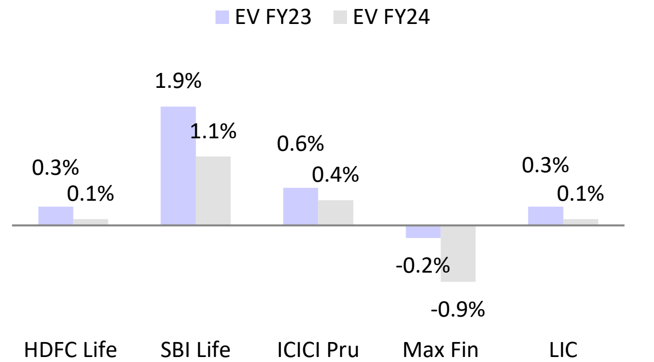
Max Financials

- Surrender charges are likely to impact VNB margins by 100-200bp for the company. Management will distribute the impact among all stakeholders, namely customers, distributors, and shareholders.
- On the margin front, management maintains the same VNB growth guidance despite surrender charges, as higher premium growth will offset the margin hit.
- Max believes that the entire life insurance industry will take 3-6 months to settle as the impact of surrender charges regulations on VNB margins remains dynamic.

LIC:

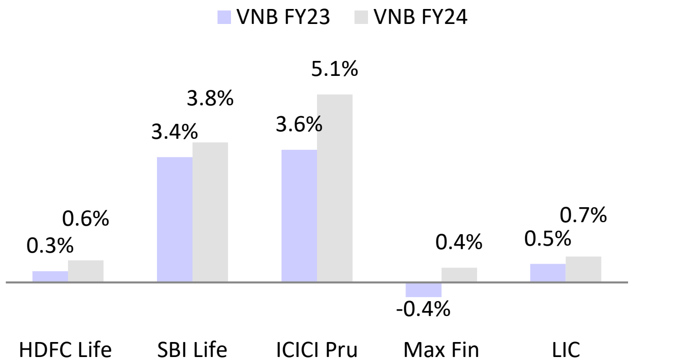
- The highest surrendering in policies is seen with small ticket sizes.
- The customer behavior under the new surrender charges regime cannot be predicted yet and, hence, deciding on specific measures is difficult.
- All measures are on the table, including altering commission structures (trail-based or clawback) and product constructs.

Exhibit 2: Impact of 10% reduction in persistency on EV



Source: Company, MOFSL

Exhibit 3: Impact of 10% reduction in persistency on VNB



Source: Company, MOFSL
For HDFC Life and LIC, the impact is on VNB Margin

Commission structures will be altered

While product constructs will undergo a change, the commission constructs will also need a rework. Managements have indicated that while individual agents can be shifted to trail-based structure vs. the current model of large upfront commissions, corporate agents (including banca partners) and brokers can have clawback clauses built into the contracts.

Our discussion with individual agents reveal the following:

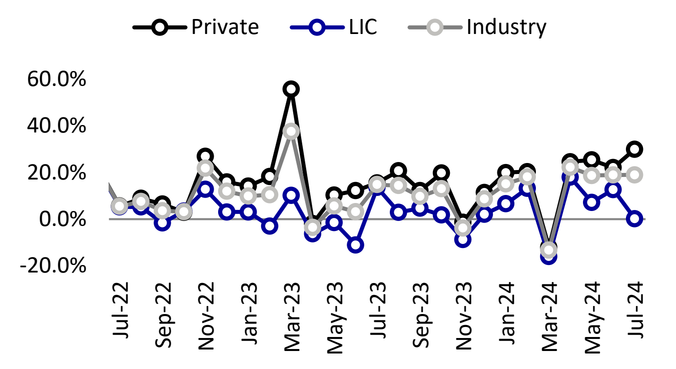
- The liquidity of the product enhances after the new surrender value norms, which will allow them to pitch for higher ticket sizes
- Unless trail-based commissions are significantly lower than the overall payout during the tenure of the product, agents will not be deterred from selling life insurance products.
- Trail commissions will drive them to work toward making customers persistent and offer better propositions, such as loan against policy and paid-up policy.

Additionally, based on past experience with MF and other financial products where trail commissions have been implemented, we have not seen any material impact in volumes.

Strong growth in YTDFY25, granular strategy driving NOP growth

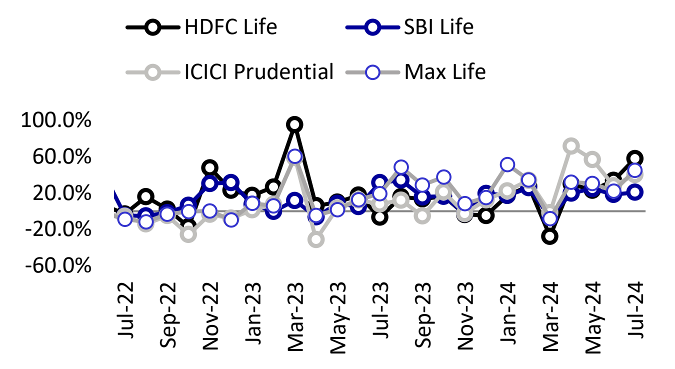
- HDFCLIFE/SBILIFE/IPRU/MAXLIFE/LIC have reported total APE growth of 29%/15%/17%/28%/16%, respectively. Although the growth has been on a low base of FY24, it has been higher than street estimates built at the beginning of the fiscal.
- The growth momentum is expected to sustain over the medium to longer term, given the investments in distribution built over the past couple of years to deepen the reach. We note that the agency count of HDFCLIFE/SBILIFE/IPRU/MAXLIFE/LIC have been higher by 58%/78%/7%/81%/9% since Mar'22.
- The investments have resulted in a strong individual non-single policy count in YTDFY25 with HDFCLIFE/SBILIFE/IPRU/MAXLIFE/LIC reporting growth of 26%/1%/13%/28%/6%, respectively.

Exhibit 4: Strong industry growth despite a series of regulations



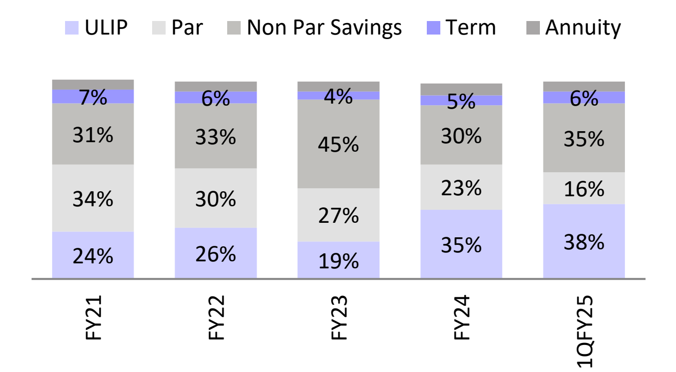
Source: IRDAI, MOFSL

Exhibit 5: Private players continued to report strong outperformance



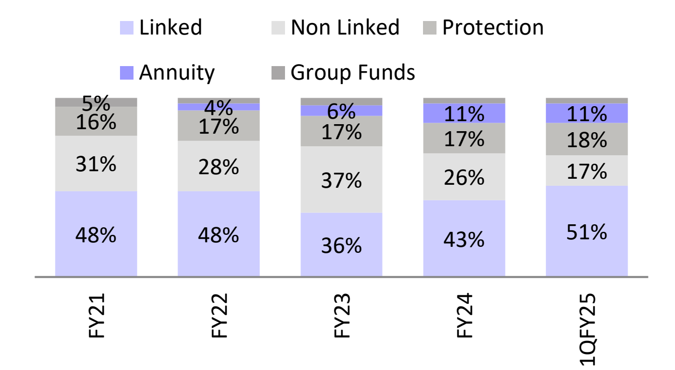
Source: IRDAI, MOFSL

Exhibit 6: HDFCLIFE product mix



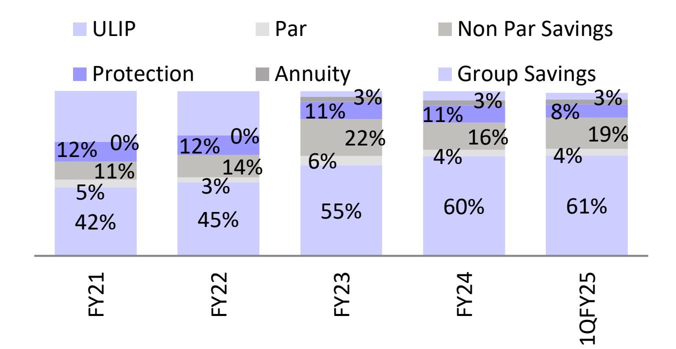
Source: IRDAI, MOFSL

Exhibit 7: ICICIPRU product mix



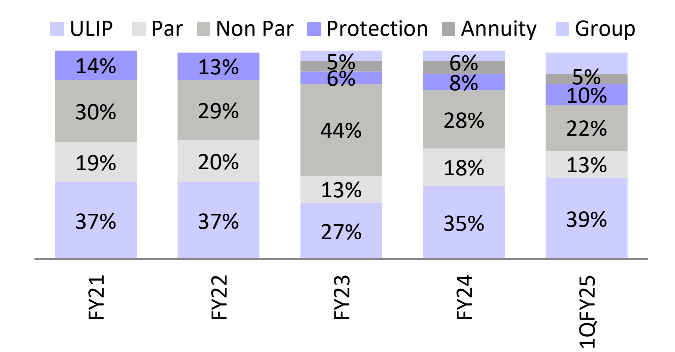
Source: IRDAI, MOFSL

Exhibit 8: SBILIFE product mix



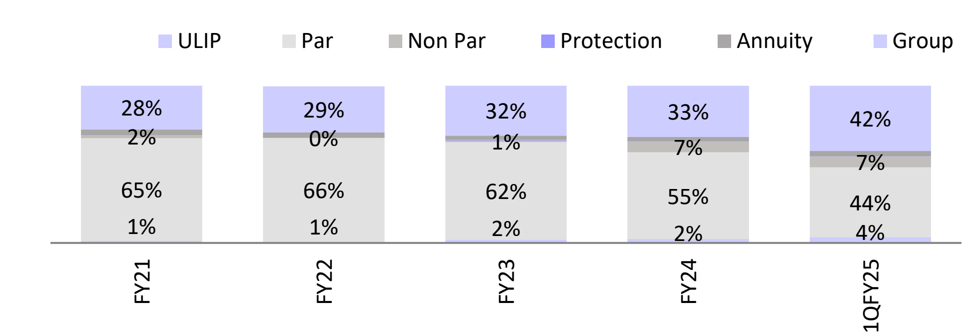
Source: IRDAI, MOFSL

Exhibit 9: Max Life product mix



Source: IRDAI, MOFSL

Exhibit 10: LIC product mix

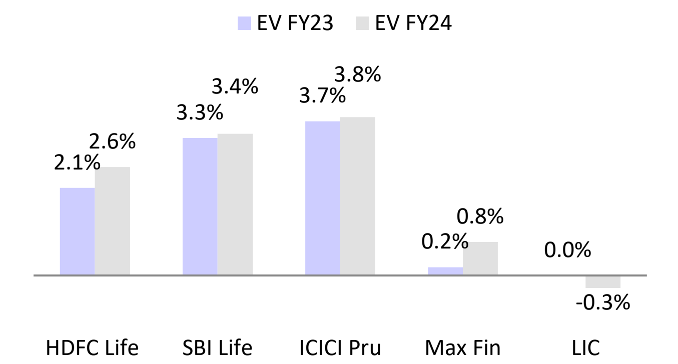


Source: IRDAI, MOFSL

Interest rate cuts drive multiples for life insurers

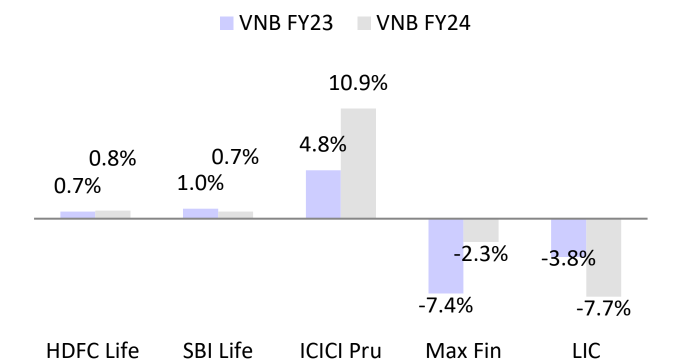
- During the previous interest rate cycle (Jan'19 to May'20 repo rate cut of 250bps), the average growth rate for the Life Insurance industry until May'22 (repo rate was stable for two years) was 14% (considering a period of sharp decline in times of COVID and taxation change of ULIPs). Within the same period, the deposit growth was 10%.
- We note that during this period, the valuations of life insurers went through a re-rating with peak 1-year forward P/EV for HDFCLIFE/SBILIFE/IPRU/MAXLIFE/LIC at 5.6x/3.0x/2.9x/3.3x vs. 4.0x/2.2x/1.8x/1.9x at the beginning of the rate cut cycle.

Exhibit 11: Impact of 100bp rate cut on EV



Source: Company, MOFSL

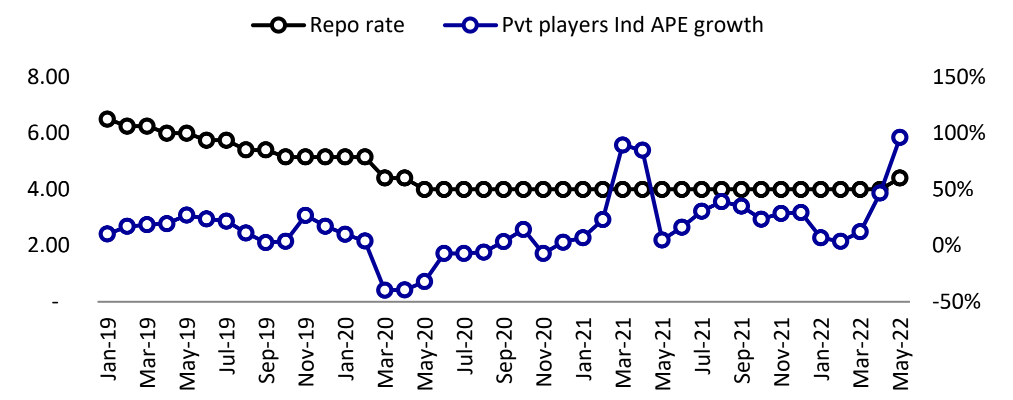
Exhibit 12: Impact of 100bp rate cut on VNB



Source: Company, MOFSL

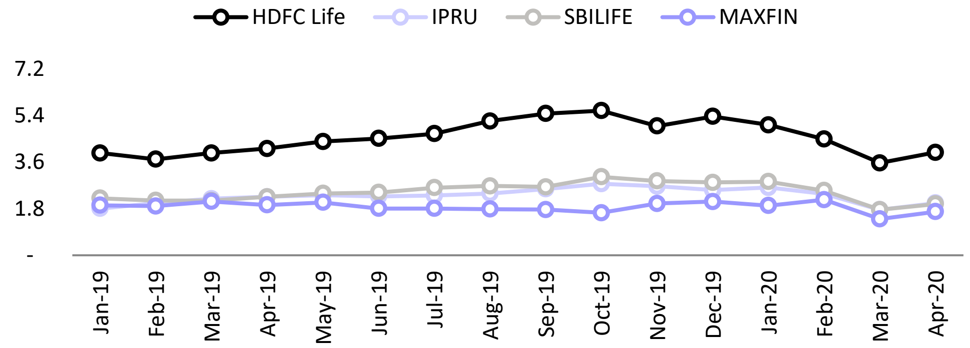
For HDFC Life and LIC, the impact is on VNB Margin

Exhibit 13: Sans the impact of COVID, premium growth has been strong in interest rate cut trends



Source: RBI, IRDAI, MOFSL

Exhibit 14: Until COVID, life insurers went through a significant re-rating (1-yr fwd P/EV)



Source: Bloomberg, Company, MOFSL

Maintain positive stance on the industry, HDFCLIFE & SBILIFE top picks

- We remain constructive on the Life Insurance industry given the positive tailwinds from regulatory actions. Both IFRS and risk-based solvency would be favorable and release capital for further growth of the industry.
- We upgraded our recommendation on HDFCLIFE in May'24, and since then, the stock has delivered 32% return, outperforming Nifty by 20%. We believe HDFC LIFE is well poised for strong growth ahead, led by 1) product innovation; 2) push in the HDFC Bank channel, especially with new branches; 3) significant agency count additions over the past two years; and 4) strong RoEV of 16-17%. We upgrade our target FY26 P/EV multiple to 3.0x and value the stock at INR900, maintaining BUY.

Exhibit 15: HDFCLIFE valuation summary

INR b	FY21	FY22	FY23	FY24	FY25E	FY26E
APE	83.7	97.6	133.4	132.9	157.7	186.1
% YoY	13.0	16.6	36.7	(0.3)	18.6	18.0
VNB	21.9	26.7	36.7	35.0	40.6	48.5
% YoY	13.9	22.4	37.4	(4.7)	16.0	19.5
VNB Margin (%)	26.1	27.4	27.5	26.3	25.8	26.1
EV	266.2	329.4	395.1	474.5	553.9	645.0
RoEV (%)	28.9	12.9	31.5	20.1	16.7	16.5
EV/Share (INR)	266.2	329.4	395.1	474.5	553.9	645.0
P/EV	6.1	4.9	4.1	3.4	2.9	2.5
VNB/Share (INR)	10.2	12.4	17.1	16.3	18.9	22.5
P/VNB	74.1	60.5	44.1	50.0	39.9	33.3
Solvency (%)	201.1	175.6	203.2	186.6	179.7	179.1

Source: Company, MOFSL

- SBILIFE continues to be a consistent performer and remains one of our top picks, considering 1) deep penetration expected in SBI channel; 2) least impact of surrender charges, given the low dependence on non-linked business; 3) best-in-class expense ratio with limited risk from higher commissions to SBI; and 4) best-in-class RoEV. We maintain a BUY rating with a 1-yr Fwd P/EV multiple of 2.7x to reach a fair value of INR2,250.

Exhibit 16: SBILIFE valuation summary

INR b	FY21	FY22	FY23	FY24E	FY25E	FY26E
APE	114.7	142.9	168.4	197.5	229.9	271.3
% YoY	6.9	24.6	17.9	17.3	16.4	18.0
VNB	26.6	37.0	50.7	55.5	63.5	76.1
% YoY	19.8	39.1	37.0	9.5	14.3	19.9
VNB Margin (%)	23.2	25.9	30.1	28.1	27.6	28.1
EV	333.8	396.1	460.4	582.5	710.4	856.2
RoEV (%)	27.0	18.7	16.2	26.5	21.9	20.5
EV/Share (INR)	364.0	396.3	460.4	582.6	710.4	856.3
P/EV	5.2	4.8	4.1	3.3	2.7	2.2
VNB/Share (INR)	26.6	37.0	50.7	55.5	63.5	76.1
P/VNB	71.7	51.6	37.6	34.4	30.1	25.1
Solvency (%)	214.7	204.8	215.4	196.5	188.6	181.1

Source: Company, MOFSL

- ICICIPRU is witnessing strong growth in premiums, albeit on a low base of FY24. Sustaining this growth, especially from agency and ex-ICICI banca partners, will drive significant re-rating. Further, the company has been a pioneer in exploring new product and commission constructs. We maintain our BUY rating with 1-year price target of INR890 on 2.1x FY26E P/EV.

Exhibit 17: ICICI Pru valuation summary

INR b	FY21	FY22	FY23	FY24E	FY25E	FY26E
APE	64.6	77.3	86.4	90.5	111.6	129.5
% YoY	(12.5)	19.7	11.7	4.7	23.4	16.0
VNB	16.2	21.7	27.6	22.3	27.4	31.7
% YoY	1.3	33.5	27.7	(19.5)	22.8	16.0
VNB Margin (%)	25.1	28.0	32.0	24.6	24.5	24.5
EV	291.1	316.3	356.4	423.3	507.1	609.0
RoEV (%)	26.4	8.7	12.7	18.8	19.8	20.1
EV/Share (INR)	202.3	219.8	247.7	294.3	352.5	423.3
P/EV	3.7	3.4	3.1	2.6	2.2	1.8
VNB/Share (INR)	11.3	15.1	19.2	15.5	19.0	22.1
P/VNB	67.2	50.4	39.4	49.0	39.9	34.4
Solvency (%)	216.8	204.5	208.9	192.0	185.0	178.5

Source: Company, MOFSL

- MAX FIN will be the worst hit in terms of surrender charges, given their relatively higher dependence on the non-par segment. Additionally, with five partners at Axis Bank channel and a challenging C/D ratio at Axis Bank, future growth will need to be driven primarily through the agency channel. We believe these factors will keep the valuation under check. We maintain a neutral stance with a 1-year price target of INR1,080 (2.1x FY26E P/EV).

Exhibit 18: Max Fin valuation summary

INR b	FY21	FY22	FY23	FY24	FY25E	FY26E
APE	49.6	55.9	62.5	74.3	88.5	104.4
% YoY	19.5	12.7	11.8	19.0	19.0	18.0
VNB	12.5	15.3	19.5	19.7	21.2	26.1
% YoY	39.2	22.3	27.6	1.2	7.6	22.9
VNB Margin (%)	25.2	27.3	31.2	26.5	24.0	25.0
EV	118.4	141.8	162.6	194.9	232.4	277.9
RoEV (%)	18.6	19.8	14.7	19.9	19.2	19.6
EV/Share (INR)	274.3	328.6	377.0	451.9	538.8	644.2
P/EV	5.1	4.2	3.7	3.1	2.6	2.2
VNB/Share (INR)	36.2	44.3	56.5	57.2	61.5	75.6
P/VNB	48.2	39.4	30.9	30.5	28.4	23.1
Solvency (%)	202.2	200.5	192.7	172.0	195.0	190.0

Source: Company, MOFSL

- LIC has returned to reporting growth in premiums and expects a double digit growth in FY25. This growth is driven by new product launches in the non-par, protection, and ULIP segments. Investments in technology continue with the launch of Ananda 2.0. VNB Margins increased YoY and the company expects to reach 20% margins in the medium term. We maintain our BUY rating with a 1-year price target of INR1,300 on SOTP with life insurance business valued at 0.8x FY26E P/EV.

Exhibit 19: LIC valuation summary

INR b	FY21	FY22	FY23	FY24	FY25E	FY26E
APE	455.9	503.9	566.8	569.7	660.4	713.2
% YoY	(5.0)	10.5	12.5	0.5	15.9	8.0
VNB	41.7	76.2	91.8	95.8	112.3	128.4
% YoY		82.8	20.5	4.4	17.1	14.4
VNB Margin (%)	9.1	15.1	16.2	16.8	17.0	18.0
EV	956.1	5,414.9	5,822.7	7,273.7	8,107.3	9,024.2
RoEV (%)	105.6	466.4	7.5	24.9	11.5	11.3
EV/Share (INR)	151.2	856.1	920.6	1,150.0	1,281.8	1,426.7
P/EV	7.1	1.2	1.2	0.9	0.8	0.7
VNB/Share (INR)	6.6	12.0	14.5	15.2	17.7	20.3
P/VNB	162.3	88.7	73.6	70.6	60.2	52.7
Solvency (%)	154.6	176.2	184.5	187.2	197.6	201.4

Source: Company, MOFSL

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

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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