

HDFC Standard Life Insurance Company Ltd

HDFC Standard Life Insurance Co Ltd (HDFC Life) started as a JV between HDFC Ltd, India's largest Housing Finance Company and Standard Life Aberdeen Plc. HDFC Life is the country's third-largest private sector life insurance company with 16.5% share of total private sector premiums in FY2017. Based on the new business premium (NBP), it ranked second with a market share of 17.2%. It had robust NBP margin of 22% for FY2017 vis-à-vis 10-19% of peers.

Trusted brand name and diversified distribution network major catalysts: HDFC Life has pan India presence with 414 branches. Its bancassurance partners grew from 31 in FY2015 to 125 as on 2QFY2018 and top 15 bancassurance partners had over 11,200 branches across India as on 2QFY2018. NBP has been growing at healthy CAGR of 17.8% over FY2013-17 (SBI Life's & ICICI Pru's NBP grew at 9.2 & 9.1% respectively over same period). Market share of HDFC Life in NBP has improved by 547bps to 17.2% over FY2012-17 (PVT insurer).

Healthy financials & highest VNB margin – a positive: Over FY2015-17, overall total premium grew at CAGR of 14.5% to ₹19,445cr. It has reported healthy ROE of 23% and Operating Return on Embedded Value of 21.7% for FY2017. Moreover, it has also improved VNB (Value of New Business) margin by 350bps to 22% over FY2015-17, which is highest in the industry (ICICI Pru -10%, SBI Life 15.4%). We believe, owing to healthy VNB margin has kept the company self-sustained, and hence, it would not require diluting capital very often.

Balanced business mix makes HDFC Life's business more predictable: HDFC Life has a well balanced portfolio (ULIP – 35.2%, Non-participating – 50.4% and Participating – 14.3%) on NBP basis for FY2017 (ULIP contribution for SBI life and ICICI Pru is 50.5% and 79.1% respectively). Experienced management has categorically developed this mix, which will help to reduce volatility in business and impact on the embedded value (EV) and VNB.

Outlook & Valuation: At the upper band of ₹290 the issue is valued at 4.2x of 2QFY2018 embedded value (EV) of ₹14,011cr, bit higher than close listed player SBI Life and ICICI Pru which is trading at 3.6x and 3.3x of 2QFY2018 EV respectively. However, we believe slight premium is justifiable, considering, consistent growth across premium categories, improving dividend payout over last 4 years, strong parentage, trusted brand name, highest VNB margin (22% for FY2017) and well balanced business mix. **Based on the above positive factors we assign SUBSCRIBE rating to the issue.**

Key Financials

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17
Premium Income	11,446	11,976	14,762	16,179	19,275
% chg		5	23	10	19
PAT	447	725	786	817	887
% chg		62	8	4	9
AUM			67,047	74,247	91,742
Embedded Value			8,888	10,233	12,471
ROE	21	34	31	26	23
PE	130	80	74	71	66
P/BV	27	27	23	19	15
P/EV			6.6	5.7	4.7

Source: RHP, Angel Research; Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

Please refer to important disclosures at the end of this report

SUBSCRIBE

Issue Open: Nov 7, 2017
 Issue Close: Nov 9, 2017

Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹2,005cr

Offer for Sale: **29.98cr Shares

Fresh issue: --

Post Eq. Paid up Capital: ₹2,005cr

Issue size (amount): *₹8,245cr - **8,695cr

Price Band: ₹275 - ₹290

Lot Size: 50 shares and in multiple thereafter

Post-issue implied mkt. cap: *₹55,247cr - **₹58,260cr

Promoters holding Pre-Issue: 100%

Promoters holding Post-Issue: 85%

*Calculated on lower price band

** Calculated on upper price band

Book Building

QIBs	50% of issue
Non-Institutional	15% of issue
Retail	35% of issue

Post Issue Shareholding Pattern

Promoters	85%
Others	15%

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Company background

HDFC Life was established in the year 2000 as a joint venture between HDFC, one of India's leading housing finance, institutions, and Standard Life Aberdeen Plc, one of the world's largest investment companies, initially through wholly owned subsidiary The Standard Life Assurance Company and now through wholly owned subsidiary Standard Life Mauritius. HDFC held 61.21% stake and Standard Life Mauritius 34.75% as on the date of the Red Herring Prospectus.

The total net worth was ₹4460cr and the solvency ratio of 200.5% end September 2017 was above the regulatory minimum requirement of 150%. Total assets under management (AUM) were ₹99,530cr and Indian embedded value ₹14,010cr as on 2QFY2018.

The bancassurance partners include banks, non-banking financial companies, micro-finance institutions and small finance banks in India. The number of major bancassurance partners stood at 125 as on 2QFY2018. The top 15 bancassurance partners had over 11,200 branches across India. There were 66,372 individual agents as on 2QFY2018, comprising 6.8% of all private agents in the Indian life insurance industry.

The pan-India presence comprises 414 branches and spokes across India, supported by a dedicated workforce of 16,544 full-time employees.

A wholly-owned subsidiary, HDFC Pension, was set up in 2012 to operate the pension fund business under the National Pension System (NPS). HDFC Pension had approximately ₹1162.98cr of AUM from customers enrolled under the NPS as on 2QFY2018. HDFC Pension is the second-largest private pension fund management company in India by AUM and subscribers in FY2017.

Exhibit 1: Contribution of distribution channels to total NBP

	FY12	FY13	FY14	FY15	FY16	FY17
Bancassurance	55%	47%	50%	54%	51%	54%
Individual agents	12%	10%	10%	8%	8%	6%
Direct	28%	39%	37%	37%	40%	38%
Brokers and others	4%	4%	3%	2%	2%	2%
Total	100%	100%	100%	100%	100%	100%

Source: RHP

Issue details

The company is raising ₹8,245-₹8,695cr through a offer for sale of equity shares in the price band of ₹275-290. The promoters, HDFC Ltd and Standard Life will dilute 9.52% and 5.4% respectively in their joint venture HDFC Life. Currently, HDFC owns 61.21% in the joint venture, which will come down to 51.69%, while Standard Life's 34.75% shareholding will come down to 29.35% post the IPO.

The offer for sale would constitute 19.82% of the post-issue paid-up equity share capital of the HDFC Life.

As much as 0.11% of the issue is reserved for eligible HDFC Life employees, 0.04% for eligible HDFC employees and 1.49% for HDFC shareholders.

Exhibit 2: Pre and Post-IPO shareholding pattern

Particular	Pre-Issue		Post-Issue	
	No. of shares	%	No. of shares	%
Promoter group	2,00,89,73,222	100	1,70,91,45,404	85
Other			29,98,27,818	15
Total	2,00,89,73,222	100	2,00,89,73,222	100

Source: RHP, Angel Research; Note: Calculated on upper price band

Objects of the offer

- To achieve benefits of listing equity shares on stock exchanges and to carry out the offer for sale.
- Listing of equity shares will enhance HDFC Life's brand name and provide liquidity to existing shareholders. The listing will also provide a public market for the equity shares in India.

Key Management Personnel

Mr. Amitabh Chaudhry is the Managing Director and Chief Executive Officer of the Company and he has been with the Company since January 18, 2010. Mr. Chaudhry holds a bachelor's degree in engineering (electronics and electrical branch) from Birla Institute of Technology and Science, Pilani and post graduate diploma in management from Indian Institute of Management, Ahmedabad. He has also been associated with CLSA (formerly Credit Lyonnais Securities, Asia).

Ms. Vibha Padalkar is an Executive Director and Chief Financial Officer of the Company and she has been with the Company since August 4, 2008. Ms. Padalkar is qualified as member of the Institute of Chartered Accountants of England and Wales in 1992. She is also a member of the Institute of Chartered Accountants of India. Prior to her appointment with the Company, she has worked in varied sectors such as Business Process Outsourcing (WNS Global Services), FMCG (Colgate Palmolive (India) Limited) and Big 4 audit firms (Lovelock & Lewes (part of PricewaterhouseCoopers)).

Investment Rationale

Life insurance industry is well poised for long term growth

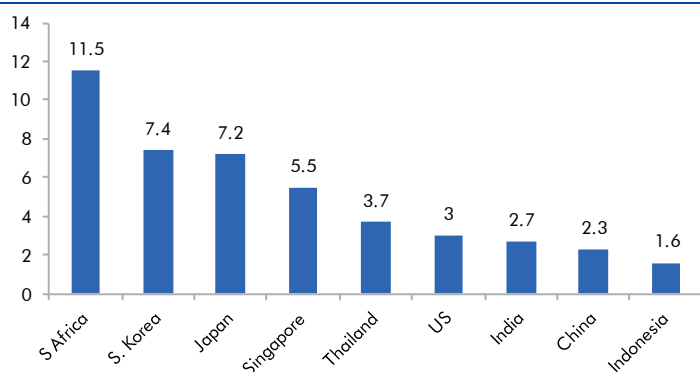
The size of Indian life insurance industry stood ₹4.2tn on a total premium basis in FY2017. The total premium grew at 17% CAGR over FY2001-17. In terms of total premium, the Indian life insurance industry is the 10th largest market in the world and the fifth largest in Asia based on Swiss Re, sigma No 3/2017 report

The penetration of life insurance in India remains low at 2.7% of GDP as of 2016, compared to 3.7% in Thailand, 7.4% in South Korea and 5.5% in Singapore in 2016. Insurance density at USD 47 in 2016 also remains low, compared with other developed and emerging countries.

We expect healthy growth for the industry going ahead owing to 1) Low penetration of insurance in India, 2) Focus on financial inclusion, 3) Increasing insurable population, 4) significant protection gap, 5) Rise in healthcare spending.

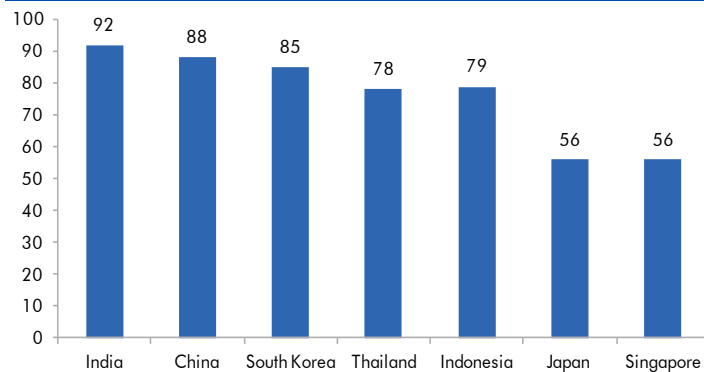
As per Swiss Re Institute sigma No 3/2017 report, the protection gap for India stood at \$8.5 trillion as of FY2017, which was much higher compared to its Asian counterparts. The protection margin (measured as ratio between protection gap and protection needs, as per Swiss Re Institute) for India at 92% was highest among all the countries in Asia Pacific, as per the report. This means that for \$100 of insurance protection requirement, only \$8 was actually insured as of FY2014. This indicates the absence of inadequacy of pure protection coverage (term insurance) for a large part of the population.

Exhibit 3: Premium as % of GDP - 2016



Source: RHP

Exhibit 4: Protection margin across key Asian countries (%)



Source: RHP, FY14

Trusted brand name and diversified distribution network major catalysts: HDFC life has pan India presence with 414 branches. Bancassurance remained most significant distribution channel, generating 50.4%, 53.5%, 50.7% and 54.1% of total new business premiums for FY2015, FY2016, FY2017 and 1QFY2018, respectively. HDFC Life has longstanding successful relationships with its bancassurance partners through corporate agency or master policyholder arrangements. The oldest bancassurance partner relationship was established in 2002. Its bancassurance partners grew from 31 in FY2015 to 125 as on 2QFY2018 and top 15 bancassurance partners had over 11,200 branches across India as on 2QFY2018. NBP has been growing at healthy CAGR of 17.8% over FY2013-17 (SBI Life's & ICICI Pru's NPB grew at 9.2 & 9.1% over same period respectively). Market share of HDFC Life in NBP has improved by 547bps to 17.2% over FY2012-17 (PVT Insurer).

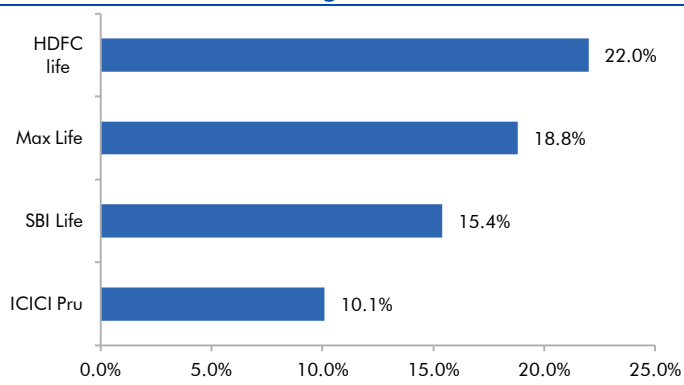
HDFC group is known as an investor for clear corporate governance, professional management and value creation for long term. These all positive/brand aspect of the HDFC group would help HDFC Life to garner higher market share into new business premium.

Exhibit 5: Select bancassurance partners



Source: RHP

Healthy financials & highest VNB margin – a positive: Over FY2015-17, overall total premium grew at CAGR of 14.5% to ₹19,445cr. It has reported healthy ROE of 23% and Operating Return on Embedded Value of 21.7% for FY2017. Moreover, it has also improved VNB (Value of New Business) margin by 350bps to 22% over FY2015-17, which is highest in the industry (ICICI Pru -10%, SBI Life 15.4%). We believe, owing to healthy VNB margin has kept the company self-sustained, and hence, it would not require diluting capital very often.

Exhibit 6: FY2017 VNB margin


Source: Company, Angel Research

Exhibit 7: Return Ratios – HDFC Life

	FY15	FY16	FY17
VNB (₹ cr)	590	740	920
VNB margin (%)	18.5	19.9	22
ROEV (%)	22.9	20.7	21.7
ROE (%)	31	26	23
Dividend Payout (%)	21	26	30

Source: Company, Angel Research

Balanced business mix makes HDFC Life's business more predictable: HDFC Life has a well balanced portfolio (ULIP – 35.2%, Non-participating – 50.4% and Participating – 14.3%) on NBP basis for FY2017 (ULIP contribution for SBI life and ICICI Pru is 50.5% and 79.1% respectively). Experienced management has categorically developed this mix, which will help to reduce volatility in business and impact on the embedded value (EV) and VNB.

Exhibit 8: Product Mix – New Business Premium (FY2017) (%)

	HDFC Life	ICICI Pru	SBI Life
Linked	35.2	79.1	50.5
Non-Linked			
Participating	14.3	7.9	10.8
Non - Participating	50.4	13.0	38.7

Source:

Outlook & Valuation: At the upper band of ₹290 the issue is valued at 4.2x of 2QFY2018 embedded value (EV) of ₹14,011cr, bit higher than close listed player SBI Life and ICICI Pru which is trading at 3.6x and 3.3x of 2QFY2018 EV respectively. However, we believe slight premium is justifiable, considering, consistent growth across premium categories, improving dividend payout over last 4 years, strong parentage, trusted brand name, highest VNB margin (22% for FY2017) and well balanced business mix. **Based on the above positive factors we assign SUBSCRIBE rating to the issue.**

Exhibit 9: Relative Comparison

	HDFC Life	SBI Life	ICICI Pru
Total Premium	19,460	21,020	22,350
APE	4,188	6,727	6,625
NBP (Cr)	8,700	10,150	7,860
Persistency			
13 months	81	81	86
61 months	57	67	56
NBP 5 yr CAGR	18	9	9
ROEV	21	23	17
VNB Margin %)	22	15	10
P/EV	4.2	3.6	3.3

Source: RHP, Company, EV-Embedded Value, Valuation as on 3/11/17

Key risks

Any termination of or adverse change in bancassurance arrangements

In FY2015, FY2016 and FY2017, the bancassurance channel contributed 50.4%, 53.5%, 50.7%, respectively, to New Business Premium from individual products. If there is any adverse change in this channel, it may impact the profitability of the company.

Abrupt change in interest rates

The profitability of certain insurance products and return on investment are particularly sensitive to interest rate fluctuations. As of Q2FY18, 58.2% of the company's investments were in debt securities. Changes in prevailing interest rates could reduce the investment returns and spread and thus materially and adversely affect the business and investment returns, financial condition and results of operations

Income Statement

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17
Premiums earned - Net	11,446	11,976	14,762	16,179	19,275
% chg		5	23	10	19
Income from Investments	2,543	5,073	12,249	1,791	11,141
Other Income	28	241	79	97	139
Total Income (A)	14,016	17,291	27,091	18,066	30,554
Total Expenditure (B)	2,042	2,108	2,382	2,937	3,552
% chg		3	13	23	21
Commission	647	514	623	702	792
% chg		(21)	21	13	13
Operating Exp - Insurance	1,216	1,281	1,489	1,872	2,385
Provision for Doubtful Debts	179	313	270	363	374
Liabilities against life policies (C)	11,336	14,753	23,886	14,170	26,055
Benefits Paid (Net)	3,903	4,662	8,162	8,177	9,842
Interim Bonuses Paid	3	5	10	8	15
Terminal Bonuses Paid	16	28	62	57	143
Change in valuation of liab in respect of LP*	7,415	10,058	15,653	5,928	16,055
SURPLUS/ (DEFICIT) (D) = (A) - (B) - (C)	638	430	822	960	948
% chg		(33)	91	17	(1)

APPROPRIATIONS

Transfer to Shareholders' Account	390	765	671	718	786
Transfer to Other Reserves	-	-	-	-	-
Funds for future Appr - Prov for lapsed policy	(30)	(218)	(38)	(49)	-
Balance being Funds for Future Appropriations	218	(118)	190	290	161
Transfer to Balance	60	-	-	-	-
TOTAL (D)	638	430	822	960	948

Shareholder Accounts	390	765	671	718	786
Income from Investment					
interest, Dividend & Rent - Gross	48	100	151	166	187
Other Investment Income	23	16	53	5	44
Other Income	-	-	0	11	0
Total Income	461	881	874	900	1,017
% chg		91	(1)	3	13
Operating Expenditure	10	239	70	67	108
Profit / (Loss) Before Tax	451	643	805	833	909
Tax	4	(83)	19	17	22
PAT	447	725	786	817	887
% chg		62	8	4	9
EPS	2.2	3.6	3.9	4.1	4.4
% chg		62	8	4	9

Exhibit 10: Balance Sheet

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17
Source Of Fund					
Share capital	1,995	1,995	1,995	1,995	1,998
Reserves	186	168	546	1,108	1,828
Shareholders' funds	2,181	2,163	2,541	3,103	3,826
Borrowing	-	-	-	-	-
Policyholders fund					
Policyholders liabilities	10,077	14,371	19,340	24,454	32,781
Provisions for linked liabilities	27,795	32,736	42,140	42,754	50,806
Funds for discontinued policies	538	1,472	2,780	2,973	2,994
Funds for future appropriation	649	313	464	705	867
Total liabilities	41,240	51,054	67,266	73,990	91,274
Application of Fund					
INVESTMENTS:					
Shareholders'	856	1,614	2,195	2,554	3,231
Policyholders'	11,215	14,706	19,908	25,863	34,692
Assets held to cover Linked Liabilities	28,333	34,207	44,920	45,727	53,800
LOANS	78	48	126	93	48
FIXED ASSETS	282	290	352	347	353
CURRENT ASSETS:	1,154	1,411	1,807	1,960	2,972
Cash and Bank Balances	464	445	573	727	797
Advances and Other Assets	690	966	1,234	1,233	2,174
CURRENT LIABILITIES	1,493	1,428	2,009	2,513	3,775
PROVISIONS	29	27	33	42	47
NET CURRENT ASSETS (C) = (A - B)	(368)	(45)	(235)	(594)	(850)
Miscellaneous Expenditure	844	235	-	-	-
TOTAL	41,240	51,054	67,266	73,990	91,274
% Growth YoY		24	32	10	23

Exhibit 11: Key Ratio

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17
Per Share Data (₹)					
EPS	2.2	3.6	3.9	4.1	4.4
BV	11	11	13	15	19
IEV			8,888	10,233	12,471
Valuation Ratio					
PE (x)	130	80	74	71	66
P/BV (x)	27	27	23	19	15
P/EV (x)			7	6	5
ROE (%)	21	34	31	26	23
Solvency Ratio (%)	217	194	196	198	192
Opex Ratio (%)					
Operation Exp	5.7	4.3	4.2	4.3	4.1
Commission	10.6	10.7	10.1	11.6	12.4
Total Cost	16	15	14	16	16
Persistency Ratio					
13			73.3	78.9	80.9
25			64.0	67.5	73.3
37			65.1	60.1	63.9
49			64.2	63.4	58.3
61			39.8	50.0	56.8

Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

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