Stock Update

Max Financial Services Ltd.

06- September-2021

Max Financial Services Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Life Insurance	Rs.1067	Buy at LTP and add more at Rs.949	Rs.1162	Rs.1259	2 quarters

HDFC Scrip Code	MAXFIN EQNR
BSE Code	500271
NSE Code	MFSL
Bloomberg	MAXF
CMP Sep 3, 2021	1067
Equity Capital (Rs mn)	690
Face Value (Rs)	2
Equity Share O/S (mn)	345.1
Market Cap (Rs bn)	368.3
Adj. Book Value (Rs)	193
Avg. 52 Wk Volumes	2195972
52 Week High	1,147.9
52 Week Low	566.6

Share holding Pattern % (Jun, 2021)	
Promoters	14.72
Institutions	77.05
Non Institutions	8.23
Total	100.0

Retail Research Risk Rating:

Blue*		

* Refer at the end for explanation on Risk Ratings

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Our take

Indian life insurance space provides a multi decadal growth story. Despite healthy growth in past 20 years, it is still at a nascent stage. It is still under penetrated (Premium as % of GDP for 2020 stood at 3.2%) as compared to even other emerging countries; protection gap at 83% is also highest amongst peers. India's favourable demographics like high share of working population, rapid urbanization, rising affluence and focus on financial inclusion provide huge growth opportunities.

Max Life, a joint venture (JV) between Max Financial Services Limited (81.83%) and Axis Bank (12.99%), is India's largest non-bank and 4th largest private life insurance company. Axis Bank is the biggest bancassurance partner for the company which contributed 63% of total APE as on Q1FY22. Apart from this, the company also has a longstanding bancassurance partnership with YES Bank. Partnership channel grew by 52% in Q1FY22. It has diversified product portfolio and distribution mix. Also the agency channel is one of the most productive one in the industry. Management's strategy of increasing share of Non-PAR savings and protection plans while maintaining balance has resulted in continuous rise in VNB Margins. With consistent performance and uncertainties fading away regarding Axis Bank deal, the stock should gradually be able to get valuations in line with other peers.

We had issued Initiating Report on MFSL on 24th November, 2020 and recommended Buy at LTP and add on dips to Rs.564-568 band, for base case target of Rs.684 and bull case target of Rs.718 over the next two quarters. Our bull case target was achieved on 7th January, 2021. Below is the link for the report:
https://www.hdfcsec.com/hsl.research.pdf/Max%20Financial%20Services%20Ltd-%20Initiating%20Coverage-%2024112020.pdf

Valuation and recommendation:

Even during the weak economic scenario, the company has reported decent numbers in Q1FY22 with strong growth in APE. COVID-19 claims were 1.9x the level in FY21; however, these were within the anticipated loss reserves created in Q4FY21. Given the company's focus on raising its share of protection business coupled with better fixed cost absorption for the rest of FY22, we expect it to deliver a VNB margin of ~25% in FY22. We have estimated Max Life to deliver CAGR of 15% for Value of New Business (VNB), 14% New Business Premium (NBP) and 19% for Embedded Value (EV) over FY21 to FY23E. The company is trading at 2.75x FY23 Embedded Value, which is at

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sharp discount to peers. Given the high growth environment we believe that Indian life insurance companies will be keep on getting higher multiples. **We believe that investors can BUY MFSL at LTP of Rs.1067 (2.75xFY23E P/EV)and add on dips to Rs.949 band (2.45xFY23E P/EV) for Base case fair value of Rs.1162 (3xFY23E P/EV) and the Bull case fair value of Rs.1259 (3.25xFY23E P/EV) over next 6 months.**

Financial Summary

Particulars (Rsbn)	Q1FY22	Q1FY21	YoY-%	Q4FY21	QoQ-%	FY19	FY20	FY21	FY22E	FY23E
NBP	12.4	9	37.9	25.8	-52	51.6	55.8	68.3	77.6	88.2
APE	8.8	6.6	32.4	19.2	-54.4	39.5	41.5	49.6	57.3	64.8
VNB	1.72	1.13	52.2	4.61	-62.7	8.6	9	12.5	14.3	16.5
VNB Margin (%)	19.7	17.1	256bps	24	-439bps	21.7	21.6	25.2	25	25.5
EV						89.7	99.8	118.3	141.4	167.1
MCap/EV (x)						5.8	3.9	3.9	3.2	2.8
P/Adj. VNB (x)						67.3	43.5	28.7	23.7	19.2
ROEV						22.4	20.3	18.6	20.8	20.4

(Source: Company, HDFC sec)

Q1FY22 Result Update

MFSL reported consolidated revenues of Rs 34.2 bn, a growth of 27% from the year-ago period. The consolidated Net profit declined by 80% to Rs 360 mn YoY, as the base quarter had one-off tax refund, lower operating expenses and lower death claims due to COVID-19 induced lockdown.

Max Life has reported strong performance. During the quarter total Industry grew by 16%, while private players grew by 26% and LIC by 4%. Max Life (APE) not only grew at 32.4% but also outperformed industry on 2 year CAGR basis as well. Market share was improved by 63 bps to 11.3%. VNB stood at Rs.1720 mn, a growth of 52.2% YoY. VNB Margins have also expanded on a YoY by about 256 bps to about 19.7%. However it was lower by 439bps on sequential basis mainly due to higher fixed cost. Management has informed that this was due to seasonality and overall in FY22, they expect margins to be better than last year.

Gross Written Premium (GWP) grew by 21% in Q1FY22 mainly due to high growth in first year/single premium. 14% growth was reported in Renewal Premium. The net profit of Rs.1.1 bn was down 54% YoY due to increased claim paid and rise in provisions for covid. Assets under Management (AuM) grew by 28% to Rs.936.97 bn with debt-equity mix of 78:22. Commission ratio was at 3.2% and Operating Expense was 7.2% for Q1FY22.

July 2021 business update

Life insurance industry as a whole has witnessed a revival in July month. The sector was hit hard in Q1FY22 due to second wave of COVID-19. The number of policies sold grew by 16.5% YoY and Individual APE was up by 15% for the overall insurance industry. Max life has shown the decent recovery, with individual APE up 16% YoY. Number of individual policies sold declined by 13% YoY while APE per policy increased by 33% YoY. YTD number is healthy with 27% YoY growth in APE.

Long term Triggers

Deal with Axis Bank

On April 6, 2021, Axis Bank Limited, India's third-largest private sector bank, together with its subsidiaries Axis Capital Limited and Axis Securities Limited (collectively referred to as "Axis Entities") became the co-promoters of Max Life. This was after completion of the acquisition of 12.99% stake collectively by the Axis Entities in Max Life. Under the deal, the Axis Entities have a right to acquire an additional stake of up to 7% in Max Life, in one or more tranches, subject to regulatory approvals. Stake acquisition from Mitsui Sumitomo Insurance (MSI) (5.2%) at Rs.85 per share is expected to be closed by Q3FY22 (the application is pending with IRDAI).

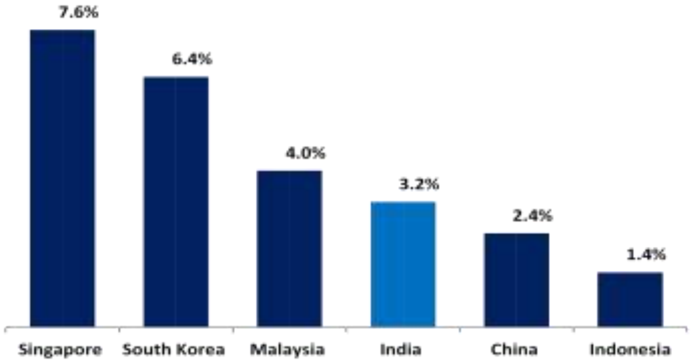
The deal with Axis bank has put the pause on uncertainties and market anxiety on the future of the current partnership. It will provide long term distribution capability and like other leading peers parent from banking sector will give it access to large distribution footprint. Just to understand the importance of the deal: the last four year's average of banca distribution in of the individual APE was around 70% and contribution of Axis bank was ~60%. So this strategic deal with Axis bank will strengthen the relationship further.

Max Life and Yes Bank had also renewed their Corporate Agency agreement in FY20 thereby extending their 15 years long strategic bancassurance relationship for five more years. Through this renewal of their bancassurance partnership, both the companies have reaffirmed their commitment to invest in building a digitally enabled ecosystem that will provide a seamless experience for customers in their financial planning and protection journey.

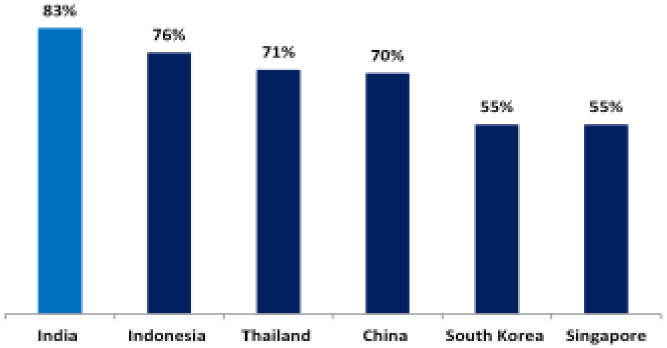
Uniquely positioned to tap the vast potential in India's life insurance sector

India is a 10th largest life insurance market worldwide and 5th largest in Asia with Rs.4.6 trn in total premium business. The total premium grew at CAGR of 17% in last 20 years. Still India continues to be under penetrated as compared to countries like China, Thailand and Korea. Premium as % of GDP for 2020 stood at 3.2% for India; protection gap at 83% is also highest amongst peers. In terms of life insurance density, India has recently shown improvement but still hovers near the per capita premium levels seen a decade ago. Increase in disposable income coupled with pandemic-induced awareness of protection products will increase penetration level. Swiss Re estimates protection gap to rise from US$16.5 trn in 2019 to US$35.6 trn in 2030. Combination of a high share of working population (One of the highest young population nations with median age of 28 years), rapid urbanization (Growth in urban population at 2.4% CAGR between FY15-FY20), rising affluence and focus on financial inclusion to propel the growth of Indian life insurance sector. Protection is the most profitable part of business; and this market could double in 5 years as penetration of protection is low at 10% of addressable population.

Premium as % of GDP – 2020



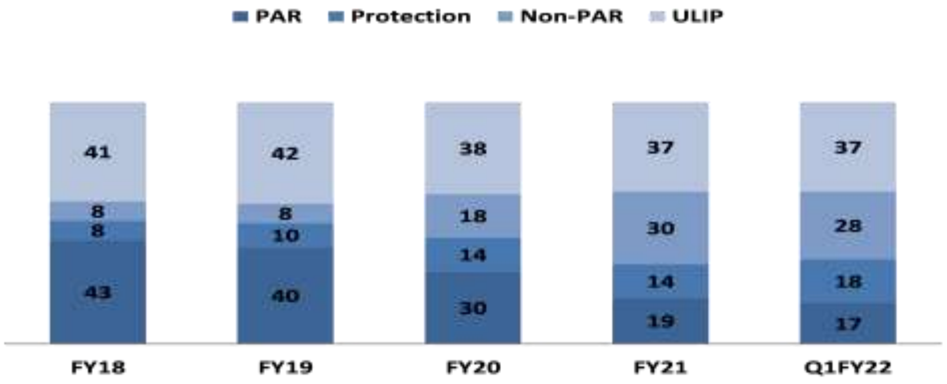
Protection gap



Better product mix to drive higher margins

It is noteworthy that the VNB margin has consistently increased in the last five years to 25.2% in FY21 from 18.2% in FY17. This was achieved management's conscience strategy of driving healthy growth in the higher-margin non-par and protection businesses. The current portfolio product bouquet is effectively diversified into ULIPs (37%), PAR (17%), protection plans (18%) and Non-PAR savings (27%). For ULIP segment, AUM mix is also healthy with 43% in debt and 57% in equity. The strategy ahead will be increasing in Non-PAR savings and protection plans while maintaining balance. MFSL is also planning to tap into new growth opportunities like health and retirements. New protection product (Smart Secure) was launched in Q1FY22.

NBP channel mix



Strong fundamentals

Max Life's private market share stood at 11%. It is fourth largest in the private Industry. The VNB CAGR growth during FY17-21 stood at 25.8%. The company has been reporting consistent increase in VNB margin. The embedded value for FY21 stood at Rs. 118.34 bn. Max Life also has healthy RoE trend. Since last five years it has remained well above 20% mark.

Persistency ratio: Max Life's superlative customer service has created one of the best-in-class persistency ratio. During Q1FY22, the company reported strong growth in persistency ratios due to focus on improving the quality of business and customer retention. 13th

Month and 61st Month persistency was 85.1% (+320bps) and 54% (+160bps) respectively. In the medium term, the management expects persistency to reflect an upward trajectory. The 13th month persistency can reach up to 86%.

Solvency: High growth in business underwritten and high dividend payouts has impacted the solvency over last few years. However, it has remained well above regulatory mandate of 1.50. As of Q1FY22, it stood at 1.97. During recent management call, they have informed that they see no need to declare a heavy dividend and in fact they will retain most of the capital for the business to expansion.

COVID claims:

The life insurance industry has witnessed a tremendous pressure due to COVID-19 second wave as the death rates were high this time. There was a 1.43x growth in number of deaths in India from FY21 to Q1FY22. The company has also seen 2.1X increase in gross claims from first peak in Q3FY21. Total number of COVID Claims in Q1FY22 was 13,492. Against the COVID-19 reserves of Rs. 5bn as of Mar'21, net COVID-19 claims came in at Rs.2.34bn (1.9x FY21 claims), and the company still carries Rs. 2.7bn additional reserves to cover late reporting of claims. Against this backdrop, the company has taken price hikes in the range of 4-8% in retail protection plans and much higher in the group life plans during Jul'21, driven by price hardening by the reinsurer.

Risks and concerns

- Low interest rates are the biggest challenge for the growth of life insurers. Low interest rate attracts lower customers especially in the saving business. The company has 37% of product mix is coming from ULIP. Further, insurers derive majority of their profits from investment income. The erosion of investment returns from low interest rates, tightening spreads and inverted yield curves will not only undercut this critical source of profitability, but also potentially put ratings at risk.

- Any adverse change of regulations by IRDA might impact the business.

- Higher than expected claims paid due to covid or otherwise could also hurt the profitability.

- Insurance business is highly competitive business. There has been intense competition from other private life insurers and since last few quarters, LIC has also become aggressive and has been gaining market share. Rising competition especially via digital disruptors poses pricing risk.

- High promoter pledging is one of the reason why stock has been given lower valuation multiple compared to other listed peers. As of June-21, 62.17% of the promoter’s holding has been pledged to lenders.

- A change in the bancassurance relationship with Axis Bank, the company's key distribution channel could impact the growth in business severely.

Company Background:

Max Financial Services Limited (MFSL) is part of India’s leading business conglomerate – the Max Group. Focused on Life Insurance, MSFL owns and actively manages an 81.83% majority stake in Max Life Insurance.

Launched in 2000, Max Life provides life insurance, savings, investment and annuity to individuals and groups. The products are offered under the protection, participating, non-participating and unit-linked lines of business with a presence across the country through its multichannel distribution including agency and third distribution partners.

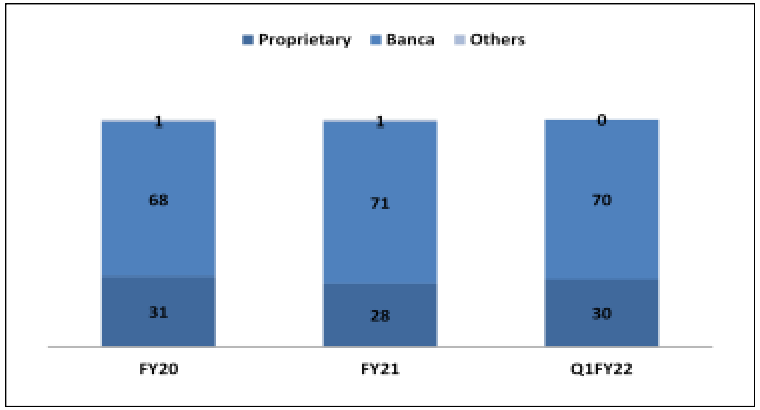
Max Life is a joint venture (JV) between Max Financial Services Limited (81.83%) and Axis Bank (12.99%), as on June 30, 2021. It is India’s largest non-bank and 4th largest private life insurance company. Post Axis raising stake in Max Life to 20%, MFSL will hold 80% stake therein.

Peer Comparison:

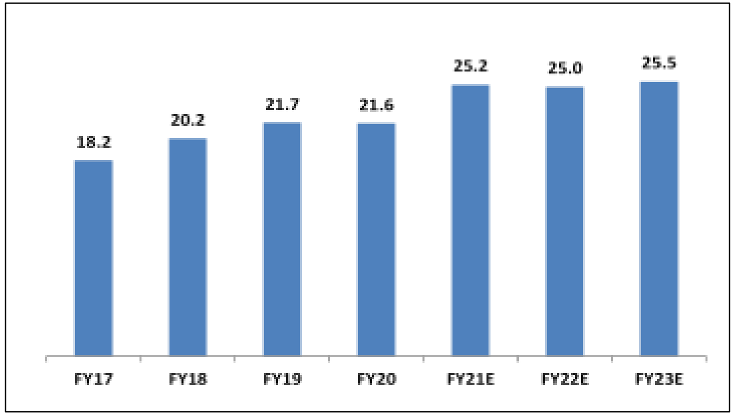
	CMP	Market Share as of Jun-21	VNB Margin %	ROE%	EV (Rs. bn)			P/EV			P/E		
					FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
IPRU	697	5.1	25.1	12.0	291.1	315.5	359.4	3.4	3.2	2.8	104.0	99.6	87.1
MAXF	1067	2.5	25.2	24.0	118	141	167	3.9	3.2	2.8	71.2	63.7	45.8
SBILIFE	1243	7.0	23.2	15.3	351	406	471	3.5	3.1	2.6	85.1	81.8	76.3
HDFCLIFE	734	7.2	26.2	17.6	266	305	360	5.6	4..8	4.1	109.6	101.9	86.4

Max Financial Services Ltd.

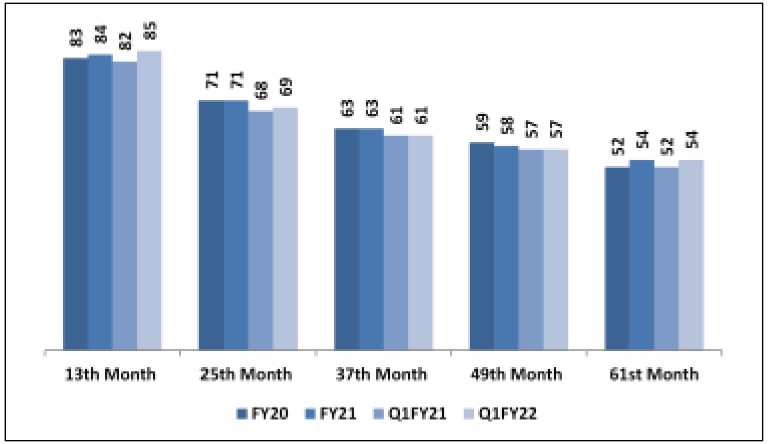
Channel Mix(%)



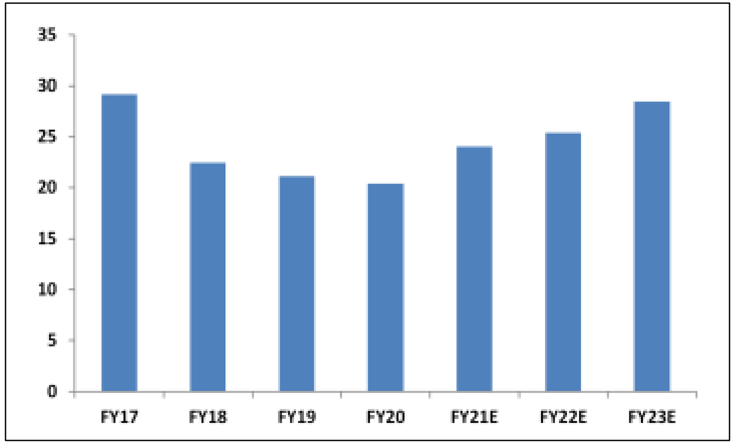
VNB margin (%)



Persistency (%)



RoE%



(Source: Company, HDFC sec Research)

Financials

Policyholder Account (in mn)

	FY19	FY20	FY21E	FY22E	FY23E
Total Premium earned	1,44,184	1,59,788	1,88,468	2,16,961	2,50,584
Income from investments and other income	48,963	22,031	57,545	68,109	80,242
Transfer from shareholders AC	120	410	-	-	-
Total Income	1,93,267	1,82,228	2,46,014	2,85,070	3,30,826
Commission	9,888	10,244	12,184	14,126	16,319
Operating expenses	19,274	23,441	26,815	30,869	35,653
Provisions	1,317	2,773	1,544	2,988	1,702
Total Expenses	30,479	36,458	40,543	47,984	53,674
Benefits Paid	57,178	66,222	75,012	89,133	1,05,317
Change in valuation of liabilities	97,365	66,394	1,22,787	1,40,724	1,61,998
Total	1,54,544	1,32,616	1,97,799	2,29,857	2,67,316
Surplus	8,244	13,154	7,671	7,229	9,836
Transfer to shareholders AC	4,402	4,690	6,137	5,783	7,869

(Source: Company, HDFC sec Research)

Shareholders account (in mn)

As at March	FY19	FY20	FY21E	FY22E	FY23E
Transfer from policyholders' a/c	4,402	4,690	6,137	5,783	7,869
Investment income	2,202	1,990	2,281	3,582	5,038
Total income	6,604	6,680	8,418	9,365	12,907
Expenses	257	292	292	292	292
Contribution to policyholders' a/c	120	410	-	-	-
Profit before tax	6,226	5,978	8,126	9,073	12,615
Taxes	662	585	795	887	1,234
PAT	5,564	5,394	7,331	8,186	11,381

Max Financial Services Ltd.

Balance Sheet (in mn)

	FY19	FY20	FY21E	FY22E	FY23E
Source					
Share capital	19,188	19,188	19,188	19,188	19,188
Reserve and surplus	8,478	6,806	14,137	19,323	27,405
Net worth	27,666	25,994	33,325	38,511	46,593
Credit/debit balance in fair value a/c	-57	-255	-281	-309	-340
Policyholders' a/c	5,85,765	6,40,747	7,63,534	9,04,258	10,66,257
Funds for future appropriation	22,498	30,962	42,612	58,644	80,708
Total Liabilities	**6,35,872**	**6,97,448**	**8,39,191**	**10,01,105**	**11,93,218**
Application					
Shareholders' Investments	35,187	32,581	51,167	71,971	1,01,682
Policyholders' investments	3,94,173	4,60,484	-	-	-
Asset to cover linked liabilities	1,98,619	1,91,642	7,74,913	9,15,637	10,77,635
Loans	3,265	4,264	4,264	4,264	4,264
Fixed assets + DTA	1,921	2,187	2,242	2,298	2,355
Net current assets	2,706	6,290	6,604	6,934	7,281
Total Assets	**6,35,872**	**6,97,448**	**8,39,191**	**10,01,105**	**11,93,218**

Performance metrics

	FY19	FY20	FY21E	FY22E	FY23E
Performance metrics (Rs mn)					
NBP	51,604	55,835	68,260	77,617	88,158
APE	39,500	41,490	49,570	57,348	64,849
VNB	8,560	8,970	12,490	14,337	16,536
EV	89,730	99,780	1,18,340	1,41,436	1,67,053
EVOP	16,790	18,130	18,510	24,596	28,917
Rs/share					
EPS	11.3	11	14.9	16.7	23.2
BV	56.3	52.9	67.8	78.4	94.8
Expense ratios (%)					
Commissions/premium	20.1	110.6	-44.3	93.6	-43
Opex/premium	16.7	19.6	11.2	18.4	11.9
Total expenses/premium	21.1	22.8	21.5	22.1	21.4
Effeciency ratios (%)					
RoAA	1	0.9	1	1	1.1
RoE	21.1	20.4	24	25.4	28.5
ROEV return	27.5	16.7	22.4	22.1	20.4
Valuation					
P/E (x)	94.2	97.2	71.2	63.7	45.8
P/BV (x)	18.9	20.2	15.7	13.5	11.2
P/EV (x)	5.8	3.9	3.9	3.2	2.8

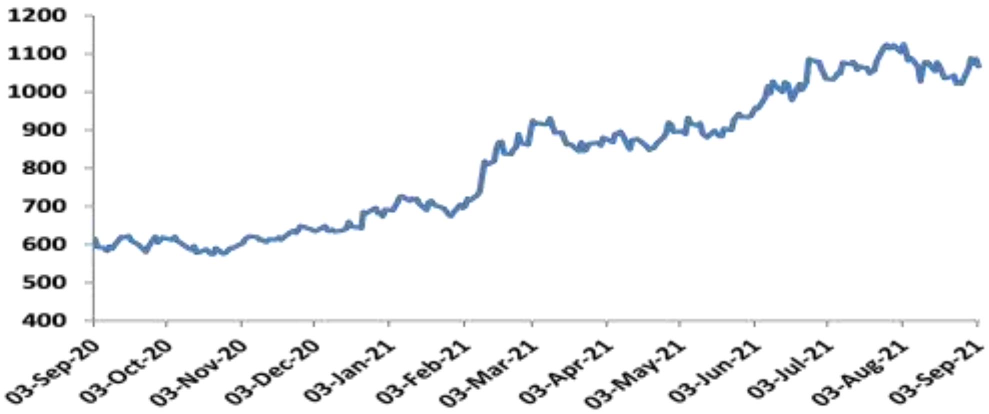
(Source: Company, HDFC sec Research)

Definitions, abbreviations and explanatory notes:

- **New Business Premium (NBP):** Insurance premium that is due in the first policy year of a life insurance contract or a single lump sum payment from the policyholder.
- **Annualized Premium Equivalent (APE):** The sum of annualized first year premiums on regular premium policies, and 10% of single premiums, written by the Company during the fiscal year from both retail and group customers.
- **Renewal Premium:** Life insurance premiums falling due in the years subsequent to the first year of the policy.
- **Embedded Value:** Insurance is a long-term business. You buy a policy today but continue to pay premiums for several years. It is from this future income that the insurers make profits. So the value of a life insurance company is assessed by future profits that the current business is able to generate. This is captured by the embedded value (EV) that represents the sum of present value of all future profits from the existing business and shareholders' net worth. Embedded value simply represents the value generated from the business sold by the company, if it were to stop writing anymore business.
- **Value of New Business (VoNB):** VoNB is the present value of expected future earnings from new policies written during a specified period and it reflects the additional value to shareholders expected to be generated through the activity of writing new policies during a specified period.
- **Value of New Business Margin / VoNB Margin:** VoNB Margin is the ratio of VoNB to New Business Annualized Premium Equivalent for a specified period and is a measure of the expected profitability of new business.
- **Solvency Ratio:** Solvency ratio means ratio of the amount of Available Solvency Margin to the amount of Required Solvency Margin as specified in form-KT-3 of IRDAI Actuarial Report and Abstracts for Life Insurance Business Regulations.
- **Persistency:** The proportion of business renewed from the business underwritten. The ratio is measured in terms of number of policies and premiums underwritten.
- **PAR:** With participating insurance, a portion of the risk is shared among the policyholders and the company. As part of this risk-sharing relationship, par policyholders may also share in certain rewards when their policies perform better than originally expected. This reward may come in the form of a policyholder dividend, which is a portion of the earnings from the par account where the investments, expenses and other items related to the company's par policies are tracked.
- **Non-PAR:** A non-participating life insurance plan is one where the policyholder does not receive any bonuses or add-ons in the form of dividends declared by the insurer from time to time. As the name suggests, the insurer does not "participate" in the insurance company's business.

Max Financial Services Ltd.

One Year Price Chart



HDFC Sec Retail Research Rating description

Green rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Blue Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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