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Initiating Coverage
Max Financial Services Ltd.

24-November-2020

RETAIL RESEARCH

Max Financial Services Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Life Insurance	Rs.633	Buy at LTP and add on dips to Rs.564-568 band	Rs.684	Rs.718	2 quarters

HDFC Scrip Code	MAXFIN
BSE Code	500271
NSE Code	MFSL
Bloomberg	MAXF
CMP Nov 23, 2020	633
Equity Capital (Rsmn)	539
Face Value (Rs)	2
Equity Share O/S (mn)	269.6
Market Cap (Rs bn)	170.64
Book Value (Rs)	62.5
Avg. 52 Wk Volumes	2185962
52 Week High	647.5
52 Week Low	279.8

Share holding Pattern % (Sep, 2020)	
Promoters	22.33
Institutions	62.78
Non Institutions	14.89
Total	100.0

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Our Take:

We believe, over a long term period, India's highly underpenetrated life insurance space is attractively positioned to capture the huge growth opportunity. Large private players are in better placed to take advantage given their ability to push protection business by leveraging strong brand and existing network. They have access to adequate capital and can invest in online platforms. Also, insurance industry's inherent nature of long gestation period to break-even (9-10 years) and need for bancassurance partnership provides a very bleak visibility for a new entrant which in turn is extremely positive for well-established larger bancassurance players. We feel that COVID-19 situation could be blessing in disguise over the medium term for the industry as it will create renewed push for insurance coverage by Government and increase need for coverage felt by the general public.

A strategic partnership with Axis Bank provides long term distribution capability, ending uncertainty and market anxiety over the future of Max Life (MAXL) and Axis Bank's distribution arrangement. A diversified product portfolio and strong distribution reach has made MAXL fourth largest private life insurance player in India. Given the strong brand, leadership and tailwinds on the back of financialisation of savings, we remain optimistic on the future growth of the company.

Valuations & Recommendation:

Despite a difficult environment, MAXL delivered decent growth in H1FY21. A significant share of Non PAR savings in the mix drove margin higher by 320/710bps YoY/QoQ to 24.2% in H1FY21. We expect the margins to moderate in H2. We expect the company to deliver 4.2% CAGR for New Business Premium (NBP) and 6.5% CAGR for Value of New Business (VNB) over FY19 to FY22E. Embedded Value (EV) is estimated to grow by 13.8% CAGR over same time frame. The recent run-up in the equity and bond markets should aid in higher positive economic variance leading to a high EV growth in FY21E. Despite significant price appreciation from recent lows, it is still trading at significant discount to other peers like HDFC Life, ICICI Pru and SBI Life. For FY22E the company is trading at 2.4x Embedded Value.

Post the proposed restructuring of shareholding in Max Life and Max Financial, we think the holding company discount while valuing Max Financial will narrow and also lead to lower Holding company expenses. The agreement with Axis Bank will remove uncertainties on distribution side.

Max Financial Services Ltd.

We feel that investors can buy Max Financial Services Ltd. (MAXF) at the LTP and add on dips to Rs.564-568 band. The Base case fair value of Rs.684 (EV+NBV after 22% holdco discount) and the Bull case fair value of Rs.718 (EV+NBV after 18% holdco discount) over the next 2 quarters.

The stock price could rerate when the deal with Axis Bank goes through without any major changes. However any continued uncertainty on the deal could be a drag on the stock price.

Financial Summary

Particulars (Rsbn)	Q2FY21	Q2FY20	YoY-%	Q1FY21	QoQ-%	FY19	FY20	FY21E	FY22E
NBP	15.95	13.8	15.6	8.99	77.4	51.6	52.4	52.6	58.4
APE	11.54	10.45	10.4	6.61	74.6	39.5	41.5	41.7	45.7
VNB	3.25	2.3	41.3	1.13	187.6	8.6	9	9.2	10.3
VNB Margin (%)	28.2	22	615bps	17.1	1107bps	21.7	21.6	22.1	22.6
EV						89.7	99.8	114.7	132.2
ROEV (%)						27.5	16.7	14.9	17.9
P/BV						11.2	10.1	8.4	7.5
P/EV						3.5	2.3	2.7	2.4

(Source: Company, HDFC sec)

Recent Developments

Q2FY21 highlights: Total Annualized Premium Equivalent APE came in at Rs 11.5bn (10.4/74.6% YoY/QoQ). The share of protection in the mix grew 362/-805bps YoY/QoQ to 17.0% as individual/group protection grew 69.6/7.4% YoY. Share of Non PAR savings in the mix shot up to 39.7% (1,632/2,169bps YoY/QoQ). The share of PAR and ULIP declined as customers chose protection and assured returns. Strong VNB margin at 28.2% (615/1,107bps YoY/QoQ) was driven by a significantly higher share of Non PAR savings. Persistency declined (on YoY basis) across all cohorts except for the 61st month. Sequentially persistency improved ~100bps across buckets except remaining flat for the 37th month. The share of Bancassurance channel grew 436bps YoY to 70.4% while declining for the proprietary channel to 29.6% (-342bps). AUM growth was healthy at 18.9/6.2% YoY/QoQ to Rs 732.5bn. Operating RoEV was at 17.5% for 1HFY21.

The company outperformed the private industry as well as top 3 private players in H1FY21. It grew 4%, while top 10 private players de-grew 10%. Market share improved in Q2 to 11.1% (118 bps YoY) as well as in H1 to 11.0% (162 bps YoY). New business sum assured written by the company is among the highest in industry with growth of 40%.

Even in this extreme stress scenario, MAXL is well capitalized with solvency ratio of 207% against the minimum requirement of 150%. It is strongly capitalized for future growth.

The company has done a good job with respect to underwriting its debt and equity portfolios. As per the management, as on H1FY21 ~92% of the fixed income portfolio was invested in sovereign papers and AAA corporate bonds. This represents their better risk-assessment standards and regulations for investment pattern for non-ULIP savings products.

Due to rising reinsurance rates, the company will try to keep premium rates competitive, which could pressurize VNB margins, but expected growth in business volume is likely to offset margin pressure and drive earnings. We also think that covid-19 and changes in personal taxation to cause significant disruption to insurance sales in FY21. Management highlighted that the demand for protection has been strong and overall, the company is also targeting good business volume in this segment.

We feel that Covid-19 could be blessing in disguise for the industry as it will create renewed push for insurance coverage by Government and increase need for coverage felt by the general public. Past pandemics show increased sales and lower persistency trends. A study of past pandemics such as SARS (CY 2002-04) and MERS (CY 2013-14) demonstrates increased sales of health insurance during the pandemics and life insurance post the pandemics. We expect similar trends to play out this time in India.

Long term Triggers

Highly underpenetrated insurance market

India has highly underpenetrated insurance market compared to the other parts of the world with a life insurance penetration of less than 3%. This presents immense opportunities to expand the life insurance business given the favorable demographics, rising prosperity, growing household income and the increasing awareness of the need for financial protection. We believe that the large private players especially sponsored by banks are better placed to take advantage from this as they have the ability to push protection business by leveraging strong brand. They have access to adequate capital and can invest in online platforms.

Sustainable nature of business

Life insurance is largely a retail focused business (MAXL- 92% Individual mix), high growth business (MAXL-APE: 5Yr CAGR 28%) which carries lower business volatility compared with banks and NBFCs. Unlike banks and NBFCs, where the shareholder is exposed to the entire credit and investment risk, life insurers remain largely protected from such risk since large portions of their balance sheet comprise linked and participating products. Life Insurance companies have to follow strict investment rules which ensures that credit risk (via corporate bond investments) are largely unaffected, unlike banks and NBFCs, as reflected in the low or nil gross NPA ratios of the former. Life insurers are low capital requirement businesses and don't have to come to the equity capital market for several years.

Diversified product portfolio

MAXL has gradually shifted its product portfolio from PAR Product to Non PAR and ULIPs. Now the company has a balanced and diversified product with a focus on profitability. Contribution of PAR/Non-PAR/ULIP/Protection is 18/31/31/20% respectively as of Q2FY21. For ULIP segment, AUM mix is also healthy with 52% in debt and 48% in equity. Within the private sector life insurance space, MAXL has one of the best-in-class VNB margins which as on FY20 stood at 21.6%. It consistently has been achieving these high margins on the back of a high share of participating products (FY20-30% of total APE) followed by Non-PAR Savings (FY20-18%) and pure protection products (FY20-13%). VNB Margin in these products is materially higher than those for linked products (ULIP-38% of total APE). In FY21, management has guided that focus will be on protection and non-par savings products because of rising demand after COVID-19 scare for protection plans and gaining popularity of guaranteed products over linked with declining interest rate.

The company has one of the best levels of underwriting standards. This is evident from their relatively lower claims as a proportion of AUM. Last five years average is ~9% compared to 10-13% for the other key private sector peers.

Strengthening distributing reach

Over the years, the company has done significant investment for strengthening its distributing reach especially in the case of proprietary channels (32% of channel mix). This has resulted into better control over quality of business. Bancassurance contributes 67% of channel mix with Axis Bank and Yes Bank being major partners. After Axis deal, we expect, MAXL to lower its dependence on proprietary channels and the investment cost for these channels will also reduce. As on FY20, MAXL commission ratio stood at 6.8% which is much higher compared to other large life insurance companies operated by private sector banks.

Deal with Axis Bank

MAXF (Max Financial) recently announced its long awaited deal with Axis Bank for the stake sale in Max Life (MAXL) to Axis Bank; MAXL will become a JV between MAXF and Axis Bank. Valuation of stake is yet to be finalized. As per revised deal, Axis Bank now proposes to acquire 9% directly and 3% (+7% additional stake option) via its subs - Axis Securities and Axis Capital in MAXL. Further, these entities have the option to purchase additional 7% in 1-2 tranches. Thus, Axis Bank and its subsidiaries, can acquire a maximum of 19%. (Based on RBI's master directions - Banks shall not hold >10% stake and 20% along with its subs in a non-financial company). The deal is still subject to regulatory approvals. JV with Axis Bank provides long term distribution capability to the business and ends uncertainty and market anxiety on the future of the current partnership. Moreover, despite posting good growth numbers, MAXF was not able to get higher valuation because of its holding company structure. Now after merging MAXL with MAXF, the discount on valuation and holding company expenses will be reduced/removed. Axis Bank's newly appointed CEO, Mr. Amitabh Chaudhry is a life insurance veteran who was previously CEO of HDFC Life. He had previously decided to enter into an amalgamation agreement with Max Group and has, therefore, examined the Max Life asset from close quarters.

What could go wrong?

- We expect the savings business to face headwinds as lower business activity impacts savings levels. Companies with high dependence on ULIPs are likely to be impacted significantly. The company is more exposed to Market risk and credit risk due to high product share of ULIP segment (31% in product mix as of H1FY21).

- Indian life insurers are witnessing a hardening of term reinsurance premiums. Companies are reworking rates for end consumers while trying to ensure the least impact on their margins.

- Slow economic growth might impact the business both in terms of new business growth and persistency.

- Any adverse change of rules and regulations might impact the profitability of the business.

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

- Poor health outcomes related to Covid-19 may not remain limited to near-term deaths but also significantly negative impact on a variety of vital organs, leading to sub-optimal mortality outcomes for the general population over an extended period of time. This needs to be priced appropriately.

- High promoter pledging is one of the reason why stock has been given lower valuation multiple compared to other listed peers. Share of promoter pledges have increased from 71.5% in Dec-19 to 90.3% in Sep-20.

- The company is one of the few successful non-bank sponsored life insurers that partnered with Axis Bank. There was certain uncertainty pertaining company's relationship with Axis Bank but some of this has been addressed with the stake purchase plan. Any regulatory hurdle in the deal with Axis Bank might jeopardize the future relation between two and earnings visibility of the company which could ultimately lead to a valuation de-rating. The regulators have been asking for tweaks in the deal terms, which is an indication that the regulators are open to the deal but subject to some changes.

- Max Life has renegotiated the terms of bancassurance partnership with Axis Bank from July 2020; the details of the same are not shared as yet and hence its impact is difficult to calculate.

- If the corporate tax rate for MAXL is raised from the current 12.5% to 30%, it would lead to a fall in net profitability of the company.

Company Profile:

Max Financial Services Ltd. (MAXF) is the holding company (holds ~72.5% share) of Max Life Insurance (MAXL), a private life insurance company. MLI is a joint venture with a Japanese insurance partner- Mitsui Sumitomo Insurance Co. Ltd., which holds 25.5% share of MAXL, and is a global leader in life insurance. (Remaining 2% is held by Axis Bank.)

MAXL offers comprehensive protection and long-term saving solutions, through its multichannel distribution including agency and third distribution partners. Max Life has built its business over almost two decades through need-based sales process, a customer-centric approach to engagement and service delivery, and trained human capital. It is the fourth largest private life insurance player in India. In

April 2020, Max Life announced a strategic deal with India's third largest bank — Axis Bank to become a JV partner in the life insurance company.

The stake of Axis Bank (~20%) is lower than the initially agreed 30% stake of Axis in Max Life but higher than the 18% revised in the Aug'20 term sheet. Post this revised proposal getting all regulatory approvals and Mitsui swap-up & buy-back are completed, MAXF's ultimate eco interest in Max Life would be 80%. However, due to the Mitsui swap-up, there shall be a dilution of ~22% at MAXF.
Max financial services will do a share swap deal with Mitsui sumitomo (MSI). MSI will swap 20.6% stake that it holds in Max Life with a 21.9% stake in MFS.

During FY20, the company achieved gross written premium of Rs. 161.84 bn. As on March 31, 2020 the Company had Rs.684.71 bn of Assets Under Management (AUM) and a Sum Assured in Force of Rs. 9136.60 bn.

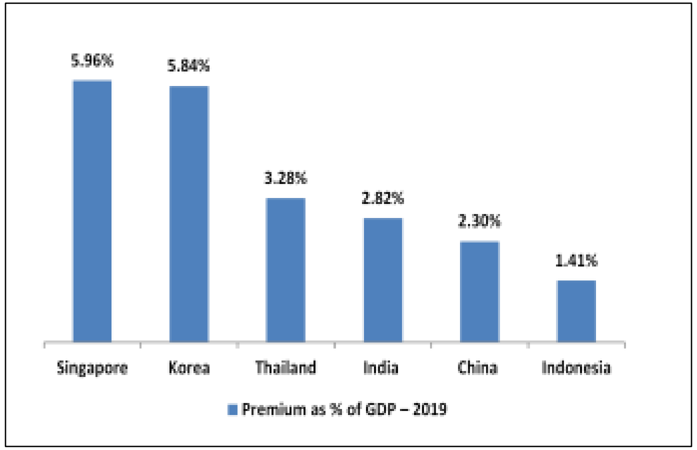
Peer Comparison:

	CMP	Market Share as of Sep-20	VNB Margin %	AUM (in Rs. Bn)	EV			P/EV			P/E		
					FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
IPRU	453	3.6	21.0	1655	160	180	204	2.8	2.5	2.2	56.8	45.0	37.4
MAXF	633	2.0	28.2	733	270	233	269	2.3	2.7	2.4	55.5	49.5	43.1
SBILIFE	832	7.2	18.8	1864	276	313	357	3.0	2.7	2.3	59.8	41.2	32.3
HDFCLIFE	661	6.9	25.1	1506	102	116	134	6.5	5.7	4.9	94.9	73.4	55.4

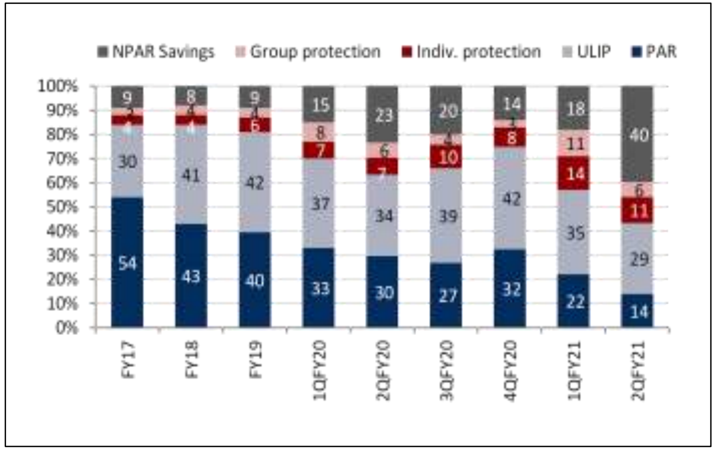
(Source: Company, HDFC sec)

Max Financial Services Ltd.

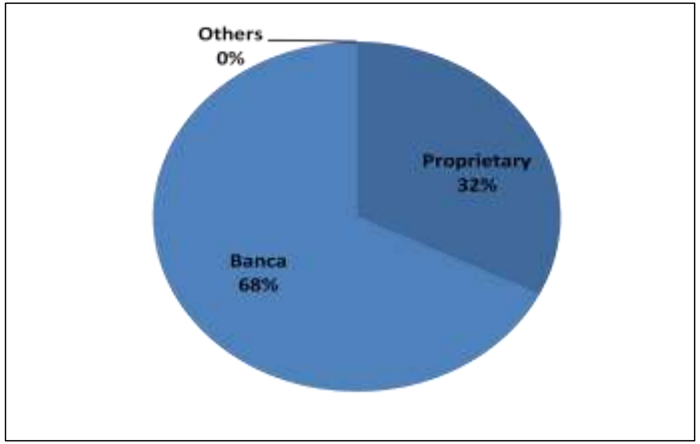
Under Penetration versus other Markets



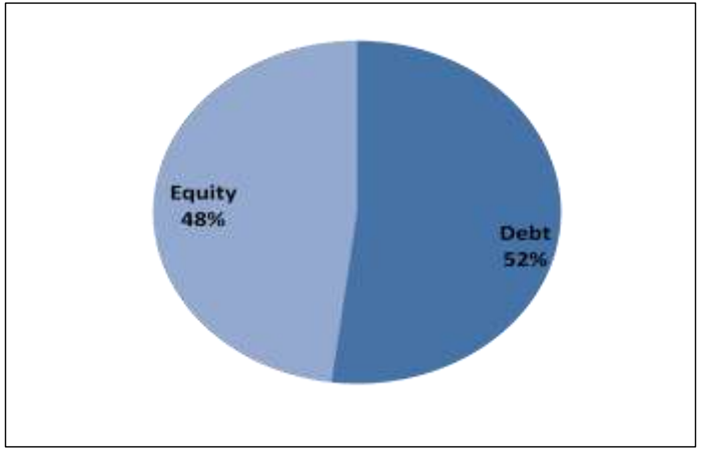
Product Portfolio mix%



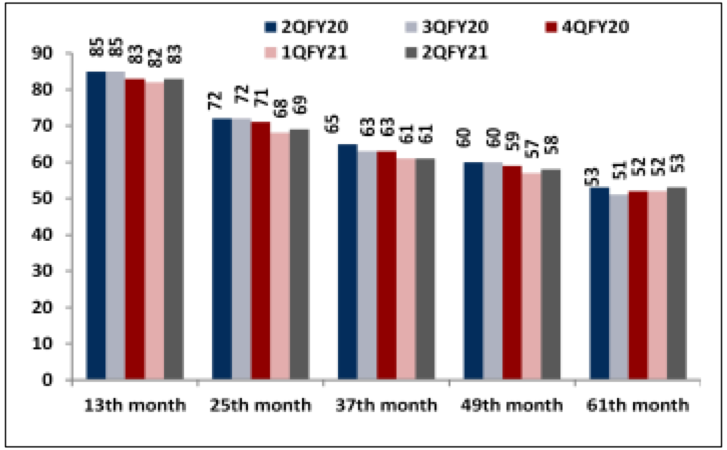
Distribution strength



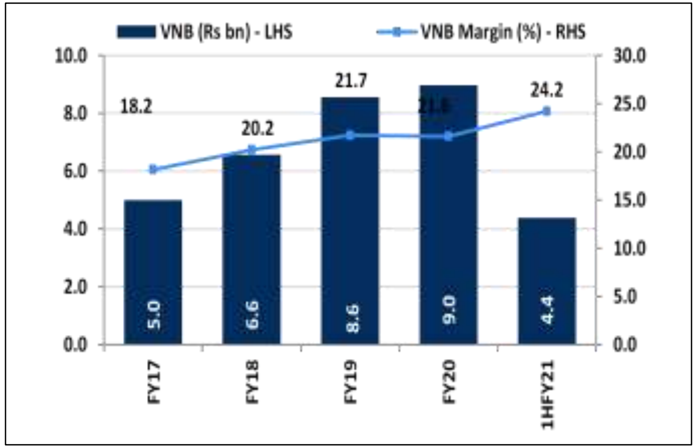
AUM Mix%



Persistency Trend



VNB Margin%



(Source: Company, HDFC sec)

RETAIL RESEARCH

Financials

Policyholder Account (in mn)

	FY19	FY20	FY21E	FY22E
Total Premium earned	1,44,184	1,53,694	1,68,766	1,87,527
Income from investments and other income	48,963	51,701	59,946	68,982
Transfer from shareholders AC	120	-	-	-
Total Income	1,93,267	2,05,395	2,28,712	2,56,509
Commission	9,888	10,545	11,160	12,469
Operating expenses	19,274	21,868	24,012	26,681
Provisions	1,317	1,382	1,452	1,524
Total Expenses	30,479	33,795	36,624	40,675
Benefits Paid	57,178	68,185	79,519	91,844
Change in valuation of liabilities	97,365	98,549	1,07,165	1,18,292
Total	1,54,544	1,66,735	1,86,684	2,10,136
Surplus	8,244	4,865	5,404	5,698
Transfer to shareholders AC	4,402	3,892	4,323	4,558

(Source: Company, HDFC sec Research)

Shareholders account (in Mn)

As at March	FY19	FY20	FY21E	FY22E
Transfer from policyholders' a/c	4,402	3,892	4,323	4,558
Investment income	2,177	2,639	2,986	3,805
Total income	6,579	6,531	7,310	8,363
Expenses	257	257	257	257
Contribution to policyholders' a/c	120	-	-	-
Profit before tax	6,202	6,274	7,052	8,106
Taxes	662	667	750	862
PAT	5,540	5,607	6,302	7,244

Max Financial Services Ltd.

Balance Sheet (in mn)

	FY19	FY20	FY21E	FY22E
Sources of funds				
Share capital	19,188	19,188	19,188	19,188
Reserve and surplus	8,478	11,510	17,812	22,057
Net worth	27,666	30,698	37,001	41,245
Credit/debit balance in fair value a/c	(57)	(63)	(69)	(76)
Policyholders' a/c	5,85,765	6,84,314	7,91,479	9,09,771
Funds for future appropriation	22,498	27,131	32,719	39,458
Total Liabilities	**6,35,872**	**7,42,081**	**8,61,130**	**9,90,398**
Application of funds				
Shareholders' Investments	35,187	42,663	54,356	65,132
Policyholders' investments	3,94,173	-	-	-
Asset to cover linked liabilities	1,98,619	6,91,342	7,98,507	9,16,799
Loans	3,265	3,265	3,265	3,265
Fixed assets + DTA	1,921	1,969	2,018	2,069
Net current assets	2,706	2,842	2,984	3,133
Total Assets	**6,35,872**	**7,42,081**	**8,61,130**	**9,90,398**

Performance metrics

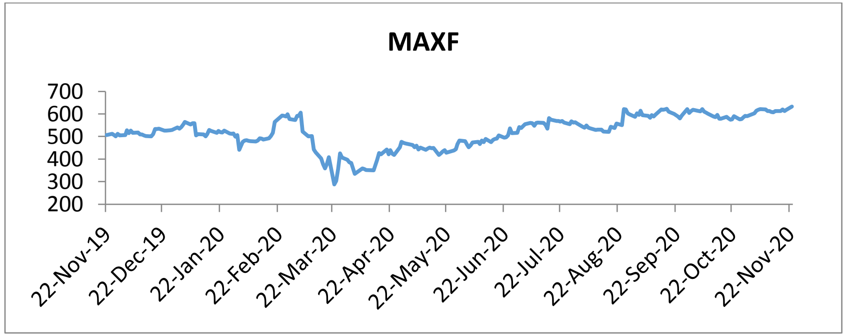
	FY19	FY20	FY21E	FY22E
Performance metrics (Rs mn)				
NBP	51,604	52,376	52,638	58,428
APE	39,500	41,490	41,697	45,738
VNB	8,560	8,970	9,215	10,337
EV	89,730	99,780	1,14,679	1,32,190
EVOP	16,790	18,130	14,899	20,511
Rs/share				
EPS	11.3	11.4	12.8	14.7
BV	56.3	62.5	75.3	84.0
EV	183	270	233	269
Growth (%)				
Premium growth	16.5	6.6	9.8	11.1
Total income growth	19.5	6.3	11.4	12.2
Commissions growth	10.7	6.6	5.8	11.7
Opex growth	19.7	13.5	9.8	11.1
PAT growth	15.6	19.3	16.6	15.5
Valuation				
P/E	56.0	55.5	49.5	43.1
P/BV	11.2	10.1	8.4	7.5
P/EV	3.5	2.3	2.7	2.4
Efficiency ratios (%)				
RoAA	1.0	0.9	0.8	0.8
RoE	21.0	19.5	19.5	20.1
ROEV return	27.5	16.7	14.9	17.9
VNB Margin	21.7	21.6	22.1	22.6

(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.

One Year Price Chart



Disclosure:

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