ICICI Prudential Life Insurance

BUY

Feb 19, 2021

ICICI Prudential Life Insurance: In Q3 APE grew sequentially by 13.8% to Rs.16.66bn, but was down 18.2% Y-o-Y mainly due to supply side constraints in conducting the necessary testing required for new policies to be issued. ULIPs which tend to be cyclical products took a hit in the pandemic scenario, however we can see sequential recovery with 20% Q-o-Q growth in the category which suggests APE growth might return in the next fiscal year. VNB margins jumped significantly to 26% for 9MFY21 due to the higher share of protection plans, while VNB growth was down by 9% for 9MFY21. The company has taken measures to improve cost efficiency with operating expense ratio down by 140Bps Y-o-Y. Solvency ratio improved in Q3 to 226%. Persistency across all time periods improved sequentially, however only 61st month persistency has improved Y-o-Y. AUM for 9MFY21 stood at Rs.2,048bn.

Improving product mix led to margin expansion:

Retail protection business (pure term insurance) is more profitable and better in terms of persistency. Despite being the market leader in retail protection, ICICI prudential historically lagged behind its private peers in regards to its product mix which led to it having lower margins. The company has realigned its focus towards expanding the share of health & protection plans across both retail and group lines of business. While market linked savings plans (ULIPs) continue to dominate the overall share of the company's APE, the contribution of protection plans has improved from 5.7% in FY18 to 17.8% in 9MFY21. As a result, the company's VNB margins have improved from 16.5% in FY18 to 26% in 9MFY21.

FDI Cap increased for insurance companies.

In the Union Budget 2021-22, the finance minister proposed to increase FDI investment limits in Indian insurance companies to 74% from 49%. This will allow more avenues for the company to raise capital and is expected to bring in a wave of transformation in the insurance business.

Distribution channels expanding:

The company has partnered with IIB, RBL Bank, AU SFB, IDFC First Bank & NSDL Payments Bank to enhance its bancassurance network and increase its reach beyond ICICI bank client base. Along with expanding its reach the bancassurance channel has increasingly focused more on protection plans over ULIPs, allowing the company to further improve its product mix.

Outlook and Valuation:

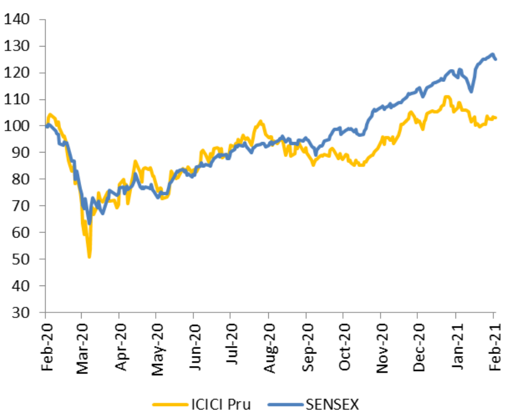
APE growth is expected to stay muted in the near term as ULIPs are subdued in current market conditions, however sequential improvements can be witnessed in Q3. VNB margins expanded to 26% in 9MFY21 as a direct result of the company's focus on protection business above savings. Cost efficiency and persistency both improved in recent quarters leading to improving profitability. We believe ICICI Pru will continue to improve its product portfolio and enhance distribution to achieve their goal of doubling VNB by FY23. AT CMP of Rs.484.75 the stock is trading at TTM P/EV of 2.7x, whereas the industry average is 3.8x. We value the company at P/EV of 2.4x on FY23E basis to arrive at our **TP of Rs.573** and assign a **"BUY"** rating.

Rating Matrix	
CMP	Rs.484.75
Rating	**BUY**
Target price	Rs.573
Upside	18.2%
52 week H/L	Rs.537 / 221
Face value	Rs.10
Mar. Cap.	Rs.696,080 mn
Category	Large cap
Sector	Life insurance

Shareholding pattern

	Mar-20	Jun-20	Sep-20	Dec-20
Promoters	74.98%	73.48%	73.48%	73.48%
FIIs	13.34%	15.06%	15.78%	16.28%
DIIs	5.54%	5.23%	4.63%	4.71%
Non Inst.	6.14%	6.23%	6.11%	5.53%

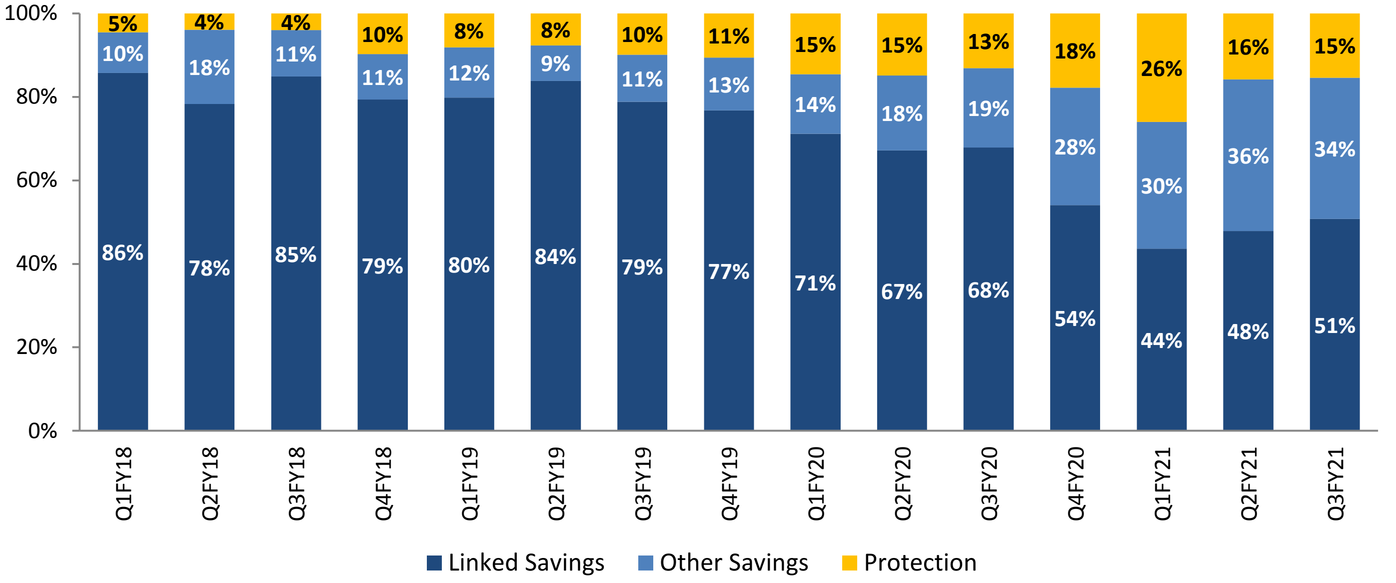
Relative Capital Market Strength



Key Financials Consolidated (Rs.bn)

Particulars	FY20	FY21E	FY22E	FY23E
APE	73.8	57.0	68.4	76.6
VNB	16.1	14.5	17.1	18.5
VNB margin (%)	21.7%	25.5%	25.1%	24.2%
EV	230.3	263.5	301.5	343.3
EVoP	32.9	33.2	38.1	41.9
AUM	1523	2142	2249	2518
RoEV (%)	15.2%	14.4%	14.4%	13.9%
P/EV (x)	3.0	2.6	2.3	2.0
VNB multiple (x)	29.0	29.8	23.0	19.1
MCAP/AUM (x)	0.46	0.33	0.31	0.28

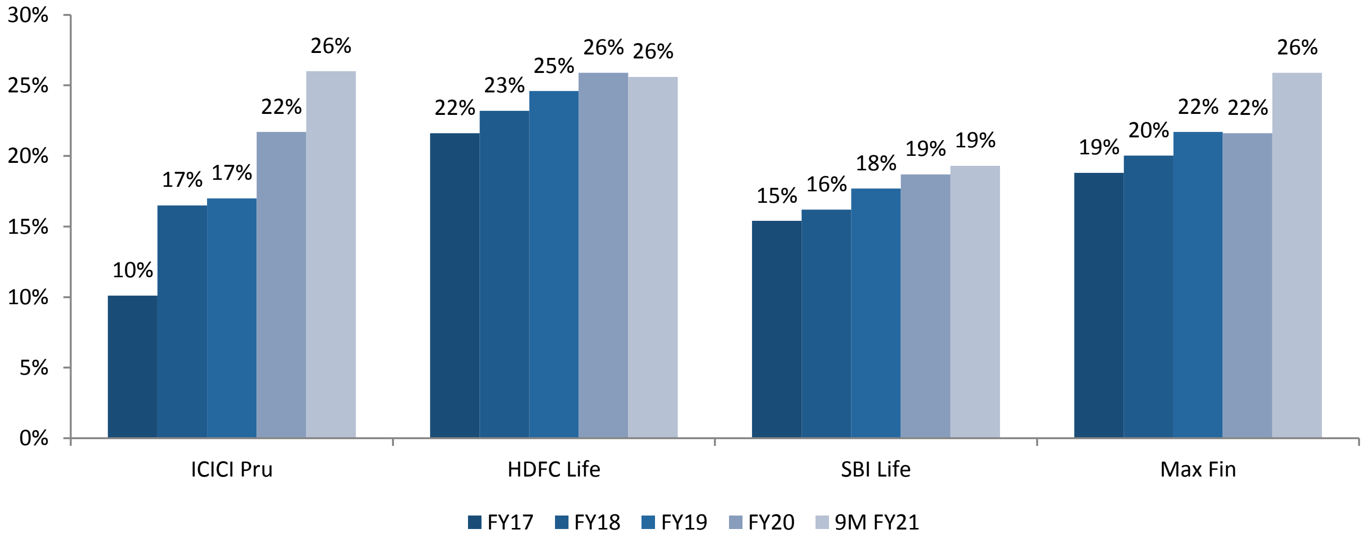
Fig. 1: Product mix as percentage of total APE



Source: Choice international research, Company

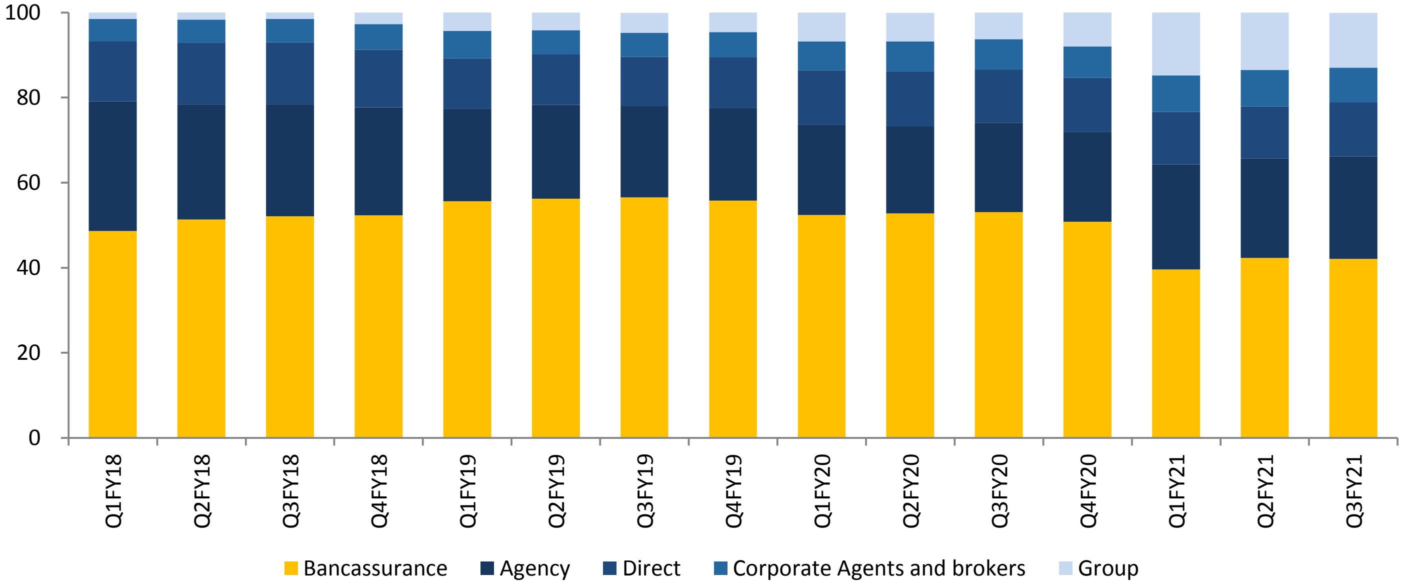
ICICI pru had made a conscious effort to increase the share of protection plans in its portfolio, which led to the contribution of protection plans towards the APE from 6% in FY18 to 15% in FY20. We can see the outcome of the company's efforts in the figure below where the VNB margins of ICICI pru have risen to competitive levels in relation to its private peers. Going ahead we expect the company to continue its focus on protection products.

Fig. 2: VNB margins across listed life insurance companies



Source: Choice international research, Company

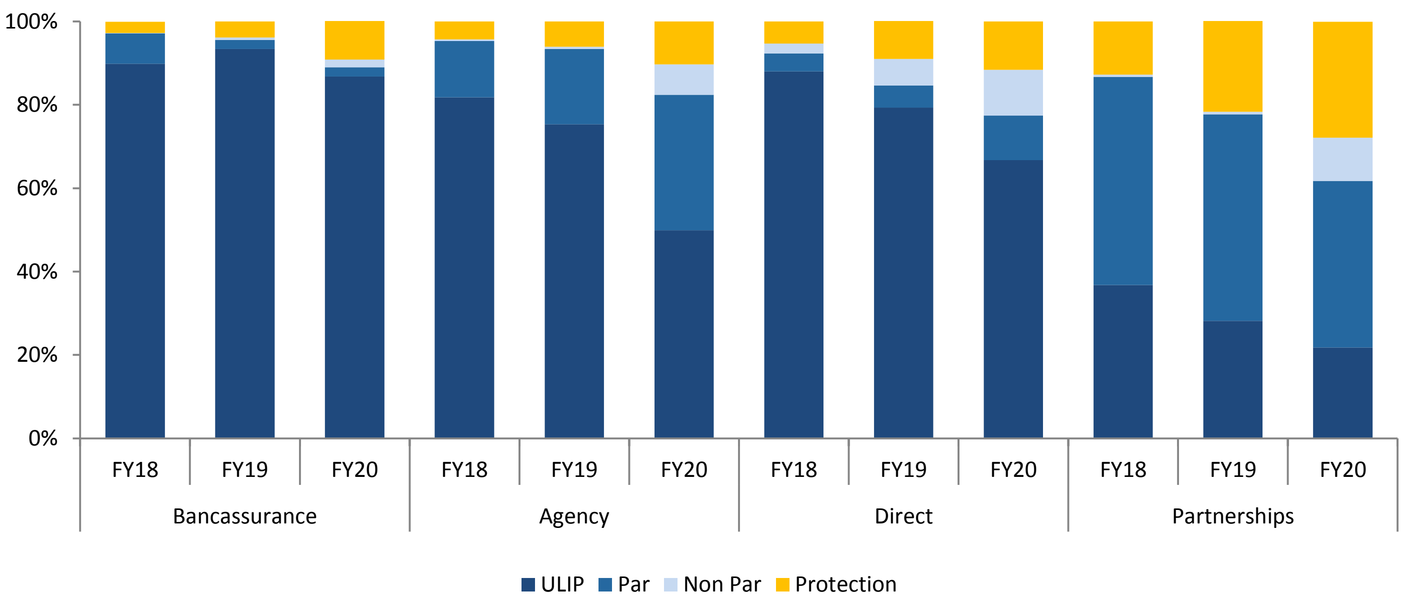
Fig. 3: Distribution channel mix



Source: Choice international research, Company

The company has seen expansion in its bancassurance channel over the years, to extend beyond ICICI bank. The pandemic has resulted in the banca channel slowing down, however we envision it will be a key driving force for the future and ICICI Prudential's efforts to expand partnerships will be beneficial in gaining market share. Not only has the banca channel expanded but also has been pivoting away from being a ULIP dominated source, in the figure below we can see that the overall mix of protection in various channels is in an increasing trend. This will aid the company in growing its margins further.

Fig. 4: Channel wise product mix



Source: Choice international research, Company

Important terms to understand in the insurance business:

- **Embedded Value (EV)**: Is a measure of the value of an insurance Company. It represents the sum of present value of all future profits from the existing business and shareholders' net worth. EV is computed as the sum of the adjusted net worth (ANW) and the discounted value of profits from in-force policies (VIF).

- **Embedded Value Operating Profit (EVoP):** Is a measure of the increase in the EV during any given period.

- **Annualized Premium Equivalent (APE):** Is the sum of the annualized first year premiums on regular premium policies, and 10% of single premium policies signed during the period in question. It is a valuable tool to normalize one time premiums into annual figures.

- **Value of New Business (VNB):** The incremental addition to EV arising out of new business signed during the period in question. VNB tells us the value of an insurance company on the basis of the new business the insurer wrote in the period.

- **Unwind:** Is the return on in force business, it is accounted in the EV calculation.

- **VNB margin:** Indicated the profit margins of the insurance company, we arrive at VNB margin by dividing the VNB by the APE.

- **Available Solvency Margin (ASM):** The value of the company's assets over liabilities.

- **Solvency ratio:** Is a measure of the financial condition of the insurance company. We arrive at the value by dividing the ASM by the Required Solvency Margin (RSM) which is set as per IRDAI guidelines.

- **Persistency ratio:** It measures the stickiness of a customer, i.e. how long they continue with the policy. If a company has 61st month persistency of 50% that means after 5 years only 50% of the customers continue with their policies.

- **Price to Embedded Value (P/EV):** Calculated by dividing the market cap of the company with its embedded value, it is a valuation ratio commonly used to understand how the market rates an insurance company.

- **VNB multiple:** Another valuation metric, we arrive at this by first subtracting the EV from the market cap of the company then dividing the figure by the VNB. It represents how many years the company would need to earn back its premium valuation at its current rate of profit.

Choice's Rating Rationale

The price target for a large cap stock represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as Outperform (Buy), the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as Underperform (Reduce, Sell), the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as Neutral (Hold).

BUY	Absolute Return >15%
Hold	Absolute Return Between 0-15%
Reduce	Absolute Return 0 To Negative 10%
Sell	Absolute Return > Negative 10%

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Disclaimer

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