

BSE Code: 540133

NSE Code: ICICIPRULI

Reuters Code: ICIR:NS

Bloomberg Code: IPRU:IN

Best bet on life insurance sector...

ICICI Pru Life Insurance (ICICI Life) is a joint venture between ICICI Bank Ltd and Prudential Corporation Holdings Ltd, a part of Prudential Group. ICICI Life commenced its operations in FY01 and was among India’s first private sector life insurance companies. The company offers its customers vast and diversified products in life insurance, health insurance and pension products & services to cater to the specific needs of customers in different life stages, enabling them to meet their long-term savings and protection needs.

Investment Rationale

Strong brand and parentage: ICICI Life is a joint venture between ICICI Bank, India's second largest private sector bank in terms of assets, and Prudential Corporation Holdings (British multinational life insurance and financial services company). The ICICI brand and the bank’s wide distribution network, particularly among salaried and affluent individuals, gives ICICI Life a big competitive advantage in terms of acquiring new customers.

Well placed on distribution: ICICI Life has a more balanced premium sourcing mix with agency channel accounting for ~23% while bancassurance accounts for the rest ~57%. The company offers its customers an extensive multi-channel sales network to access its products and services across India which includes the branches of bank partners, individual agents, corporate agents, employees, offices and website. The company had a network of 521 offices with 10,663 employees and 121,016 advisors across India as of FY16. ICICI Life’s agency channel is the second largest in the private sector, after SBI Life. Overall, the strong distribution capability has thus enabled the company to maintain healthy momentum in new business growth despite facing the brunt of major regulatory changes in the past.

Key operational matrices on consistent uptrend: ICICI Life has shown positive traction in most of its operational parameters: 1) Value of new business grew by 61.7% YoY in FY17, 2) Persistency, a key parameter for gauging stickiness of the business, continues to rise and stood at 85.7% (13th Month) for FY17 vs. 79.0% in FY16, and is one of the best in industry, 3) High solvency ratio of 2.8x as of FY17, compared with the regulatory requirement of a minimum of 1.5x and 4) Cost and productivity ratios have also improved significantly in the past three years and are now one of the best among peers.

Valuation: ICICI Life remains outperformer in private life insurance space despite challenging business environment. The untapped opportunity and penetration in life insurance provides ample scope for the company to grow its portfolio at a rapid pace. As a result, ICICI Life will continue to deliver strong return ratios with RoE at 22% and return on embedded value (ROEV) at 15% in FY19E. Hence, we initiate coverage (IC) on ICICI Life and assigned BUY rating with a target price (TP) of Rs450/- where we value the company at 3.5x FY19E embedded value (EV). EV is a common valuation measure in the insurance industry which measures potential future profits from existing business.

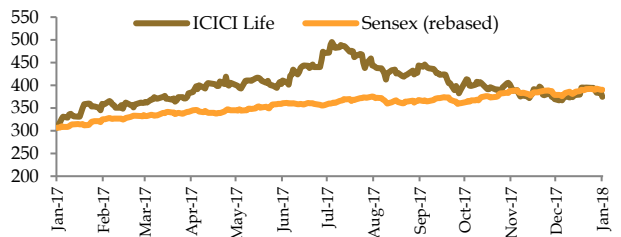
Market Data

Rating	BUY
CMP (Rs.)	375
Target (Rs.)	450
Potential Upside	20%
Duration	Long Term
Face Value (Rs.)	10.0
52 week H/L (Rs.)	508/302
Adj. all time High (Rs.)	508
Decline from 52WH (%)	26.2
Rise from 52WL (%)	24.0
Beta	0.8
Mkt. Cap (Rs.Cr)	53,801

Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Premium (Rs.Cr)	18,999	22,155	26,586	31,904
Net Profit (Rs.Cr)	1,650	1,682	1,748	1,843
EPS (Rs.)	11.5	11.7	12.2	12.8
P/E (x)	32.5	32.0	30.8	29.2
P/EV (x)	3.9	3.3	3.1	2.9
RoEV (%)	15.4	16.5	15.7	15.0

One year Price Chart



Shareholding Pattern

	Sep-17	Jun-17	Chg.
Promoters (%)	80.7	80.7	-
Public (%)	19.3	19.3	-

Company Overview

ICICI Pru Life Insurance (ICICI Life) is a joint venture between ICICI Bank Ltd and Prudential Corporation Holdings Ltd, a part of Prudential Group. ICICI Life commenced its operations in FY01 and was among India's first private sector life insurance companies. The company offers its customers vast and diversified products in life insurance, health insurance and pension products & services to cater to the specific needs of customers in different life stages, enabling them to meet their long-term savings and protection needs. It offers its customers access to its products and services through an extensive multi-channel sales network across India, including through the branches of bank partners, individual agents, corporate agents, its employees, offices and website.

ICICI Prudential Life Insurance (ICICI Life) is the market leader in private life insurance space since FY02 aided by its strong brand, distribution capabilities and product portfolio. The company has an overall market share of 12.0% and private market share of 22.3% in terms of retail weighted received premium (RWRP) in FY17. It has the highest assets under management (AUM) amongst the private insurers at Rs1,306bn (Rs601bn of equity AUMs) at the end of H1FY18. ICICI Life has also maintained its dominant position in the industry on the basis of new business premium earned by delivering steady business growth partly backed by its focus on ULIP products. It holds a market share of 11.3% in new business premium in terms of annual premium equivalent (APE) terms as of H1FY18 (23.5% amongst private players).

Trend in product mix on APE basis

Product Mix (%)	FY15	FY16	FY17	H1FY18
Savings	98.4	97.3	96.1	95.8
- ULIP	83.1	80.8	84.1	81.8
- Participating	13.2	14.1	9.6	12.3
- Non-participating	0.6	0.4	1.1	0.4
- Group	1.5	2.0	1.3	1.3
Protection	1.6	2.7	3.9	4.2

Source: Company, In-house research

It is hardly a secret that distribution is the king in the life insurance business as it is a category driven by push factors. In this aspect, the company has a leg up on most of its competition. ICICI Life offers its customers access to its products and services through an extensive multi-channel sales network across India including branches of its bank partners, individual agents, corporate agents, employees, offices and website. Notably, ICICI Life has a strong bancassurance channel because of its parent, ICICI Bank.

Trend in premium sourcing mix on APE basis

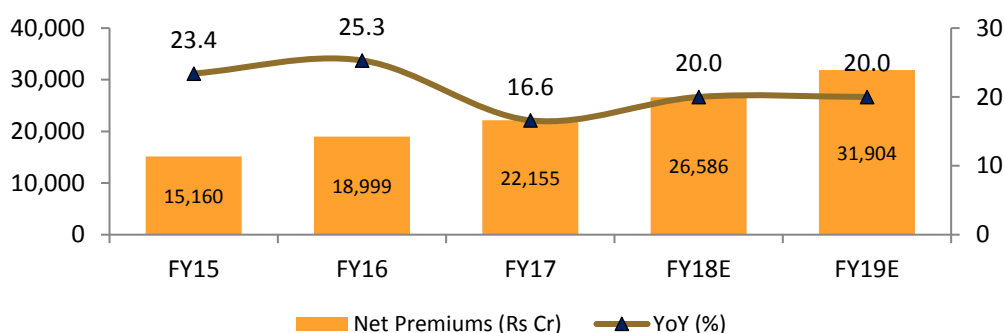
Distribution Channels	% of total retail APE			
	FY15	FY16	FY17	H1FY18
Bancassurance	58.4	57.4	57.0	51.2
Agency	24.4	23.8	23.3	27.1
Direct	8.8	9.9	12.0	14.4
Corp. Agency & Brokers	7.0	7.0	6.1	5.5
Group	1.4	1.9	1.6	1.8

Source: Company, In-house research

Premiums to grow at a healthy CAGR of 20% over FY17-19E

ICICI Life has delivered steady business growth of 22% CAGR over FY13-17 backed by high focus on selling unit-linked insurance products (ULIPs comprised 84% of its premiums as of FY17) to relatively high-income segments. This will continue to help the company to drive growth amid improving equity and debt market conditions. Apart from improving macro conditions and a stabilizing regulatory environment, the growth will be driven by ICICI Life's strong distribution franchise (including its relationship with ICICI Bank) and its focus on ULIPs in the relatively less penetrated higher income segment. Moreover, ULIPs have a strong customer proposition and compete well with mutual funds as they offer better returns over the medium term. Hence, we expect the company to deliver healthy CAGR of 20% over FY17-19E.

Net premiums to grow at 20% CAGR over FY17-19E

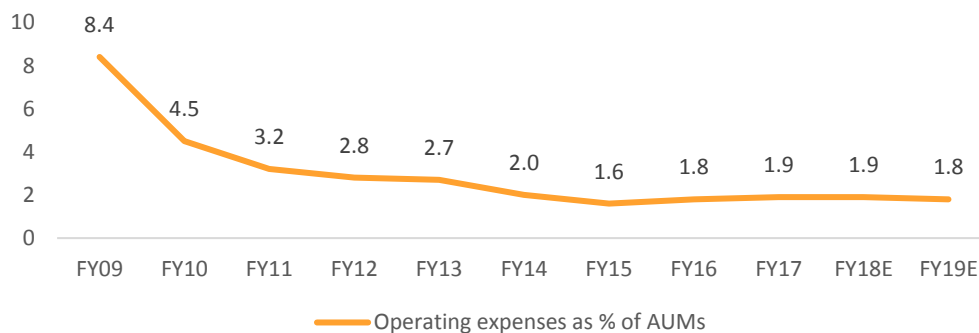


Source: Company, In-house research

Market leading cost ratio

ICICI Life is clearly the leader in cost management with the lowest total expense ratio amongst all the major private insurers after SBI Life. ICICI Life with its efficient operations has reduced its operating expenses as % of AUM from 3.2% in FY11 to 1.9% in FY17. Improvement in cost ratios was driven by strong premium growth coupled with enhanced use of technology. Further, given the high share of low-cost Bancassurance in the distribution channels, we expect the company to retain its cost-leadership amongst the private life insurers.

Operating expenses to remain broadly stable over FY17-19E



Source: Company, In-house research

Improving persistency ratios across buckets

Persistency in life insurance policies measures the number of policies (or premium amount) retained by an insurer across different time periods. ICICI Life has considerably improved its persistency ratios across buckets since FY15. The 13th month persistency ratio has gone up from 79.0% in FY15 to 85.7% in FY17 while the 61th month persistency has gone up from 14.5% to 56.2% during the same period which has also led to better profitability and higher embedded value (EV) growth. Higher persistency ratio would imply longer duration of premium payment by policyholders and hence more value accruing to the shareholders from higher customer retention rate. Notably, persistency in policies sold through the bancassurance channel has been better than through other channels. This, together with ICICI Life's continued focus on improving the sales process across channels, introductory calls, and the digitization of premium payments will continue to help the insurer to improve persistency benchmarks further.

Persistency ratios have improved across buckets over the last three years

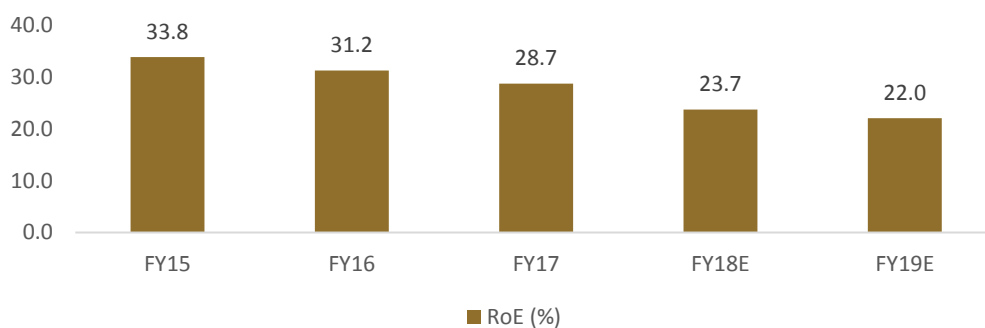
Month	% persistency			
	FY15	FY16	FY17	H1FY18
13th Month	79.0	82.4	85.7	87.0
25th Month	65.9	71.2	73.9	74.3
37th Month	64.3	61.6	66.8	68.2
49th Month	54.4	62.2	59.3	60.6
61th Month	14.5	46.0	56.2	55.6

Source: Company, In-house research

Delivery of superior returns to continue

Robust risk management, resilient balance sheet and focus on cost efficiency & persistency has enable ICICI Life to establish a track record of delivering superior returns to shareholders. The company has wiped out the accumulated losses and has been profitable since 2015 and is currently delivering healthy return ratios with RoE/RoIC of 29%/35%. we expect return ratios to remain healthy with RoE at 22% and return on embedded value (ROEV) at 15% in FY19E backed by consistent decline in cost over-runs.

RoE to remain over 20% over FY17-19E

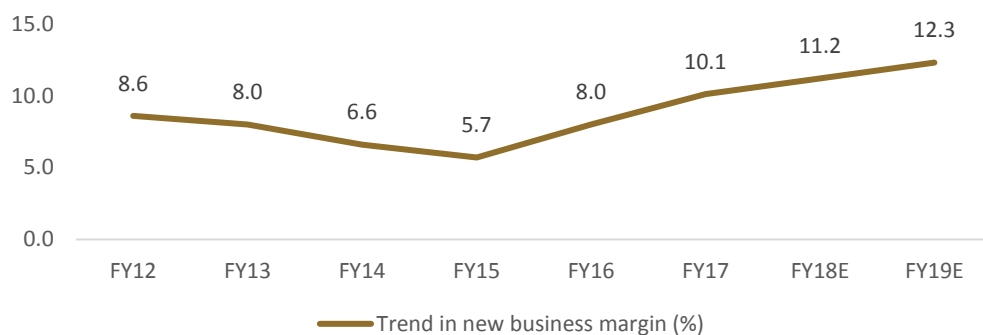


Source: Company, In-house research

Multiple levers for margin expansion

ICICI Life has increased its new business margin to 10.1% (post-overrun) in FY17 from 5.7% in FY15. Margins are lower than the peers as high surrender rate from the erstwhile ULIP policies have adversely impacted persistency and profitability of the company and also widened the gap between actual and pre-overrun new business margins. However, given the significant improvement in persistency rate at the shorter end of the curve we expect ICICI Life's persistency to improve at the longer end over the next few years. This would help narrow cost-overruns and improve margins. Besides, we reckon improvement in margins driven by rising persistency, change in product mix and cost efficiencies. We thus estimate ICICI Life's new business margins to improve to 11.2%/12.3% over FY18/19E. This will be driven by increasing shift to higher margin protection business to 6.0% of APE in FY19E from 3.9% in FY17. Currently the margins on participating products are typically in the range of 12-14%, ULIPs at 10%-14% while non-participating products have highest margins at >30% (>50% on protection products).

New business margin to improve to 12.3% in FY19E

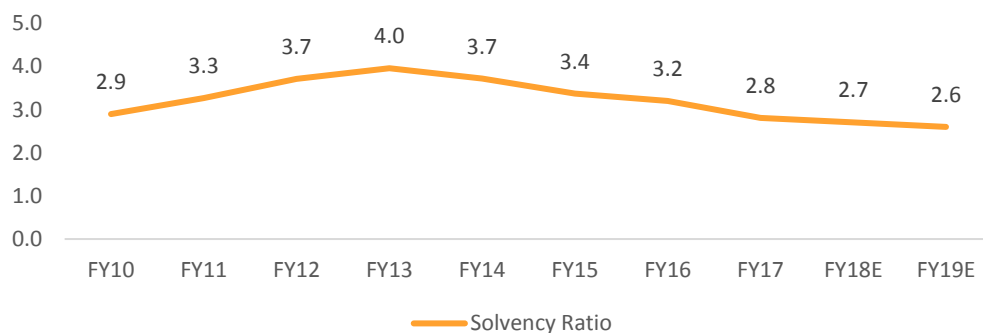


Source: Company, In-house research

Adequately capitalized for growth opportunities

ICICI Life is adequately capitalized and as it has a solvency ratio of 281% as on FY17 as against minimum requirement of 150%. Notably, the company has not required any equity capital infusion since FY09. In our view, it is unlikely to require additional capital in the medium term even if premium growth were to accelerate. This is because of its focus on ULIP, which is relatively a capital-light product. Besides, ICICI Life has been making high dividend pay-outs and we expect this trend to continue with gradual improvement in return ratios over next few years backed by controlled cost-ratios and steady uptick in new business margins. The company has paid cumulative dividends of Rs 38.9 per share (exclusive of dividend distribution tax) since FY12.

Solvency ratio to remain much higher than regulatory requirements over FY17-19E



Source: Company, In-house research

Outlook and Valuation

ICICI Life remains outperformer in private life insurance space despite challenging business environment. The untapped opportunity and penetration in life insurance provides ample scope for the company to grow its portfolio at a rapid pace. As a result, ICICI Life will continue to deliver strong return ratios with RoE at 22% and return on embedded value (ROEV) at 15% in FY19E. Hence, we initiate coverage (IC) on ICICI Life and assigned BUY rating with a target price (TP) of Rs450/- where we value the company at 3.5x FY19E embedded value (EV). EV is a common valuation measure in the insurance industry which measures potential future profits from existing business.

Key Risks:

- **Product concentration risk:** Over 85% of RWRP was in ULIPs as of FY17. This makes the company prone to cyclicalities of the stock markets, as retail investors generally purchase ULIPs during stock market booms and vice-versa. This could impact new business premiums as well as margins. Additionally, the company has a low share of non-participating business, which is a high-margin segment.
- **Regulatory risk:** Regulatory changes can be a key risk to the insurance industry and regulator has been tough in last few years to safeguard policyholder interest especially on mis-selling, commission pay-outs and expense capping.
- **Termination of bancassurance agreement:** Banks which have entered into bancassurance agreements with the company are ICICI Bank, Standard Chartered Bank and Capital Small Finance Bank Limited. These are the main distribution channels for company's insurance products. Currently, both ICICI Bank and Standard Chartered Bank exclusively distribute company's insurance products in India. Thus, any termination of, disruption to, or any other adverse change in relationship with the banks could significantly reduce product sales and growth opportunities.
- **Interest rate risk:** Given the company's substantial portion of investments is held in debt securities, the interest rate fluctuations can affect investment income.

Shareholders' Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Transfer from Technical A/c	1,208	1,132	1,261	1,287
Investment Inc.	600	665	636	715
Total Income	1,807	1,825	1,897	2,002
Other Expenses	36	38	42	46
Contribution to Technical A/c	0	2	0	0
Total Expenses	36	40	42	46
PBT	1,772	1,785	1,855	1,956
Tax	121	103	107	113
<i>Tax Rate (%)</i>	<i>6.8</i>	<i>5.8</i>	<i>5.8</i>	<i>5.8</i>
Reported PAT	1,650	1,682	1,748	1,843
Adjustments	-	-	-	-
Adj PAT	1,650	1,682	1,748	1,843
No. of shares (cr)	143	144	144	144
Adj EPS (Rs)	11.5	11.7	12.2	12.8
DPS (Rs)	10.1	4.7	7.3	5.1

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Share Capital	1,432	1,435	1,435	1,435
Reserves & Surplus	3,642	4,700	5,662	6,847
Fair Value Change	251	273	273	273
Shareholders' Fund	5,325	6,408	7,371	8,555
Policyholders' Fund	96,578	114,894	124,977	141,322
Funds for Future Appropriations	662	604	651	1,275
Total Liabilities	102,565	121,906	132,999	151,152
Investments	96,811	114,946	125,315	141,950
Shareholders'	6,216	6,640	7,497	8,385
Policyholders'	21,516	27,067	31,396	35,528
Assets held to cover linked liabilities	75,296	87,878	93,919	106,422
Loans	44	81	89	98
Fixed Assets	220	214	214	214
Net Current Assets	(726)	26	(116)	506
Total Assets	102,565	121,906	132,999	151,152

Policyholders' Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Net Premium	18,999	22,155	26,586	31,904
Income from Inv.	1,208	14,977	14,296	15,902
Total Income	20,228	37,193	40,929	47,853
Commission	620	759	916	1,099
Operating Expenses	1,888	2,357	2,789	3,347
Other Expenses	364	434	533	640
Operating Profit	17,355	33,648	36,694	42,770
Benefits Paid (Net)	12,427	14,998	17,694	21,233
Change in Reserves	3,515	17,498	17,650	20,150
Tax	70	79	89	100
<i>Tax Rate (%)</i>	<i>5.0</i>	<i>6.8</i>	<i>6.6</i>	<i>7.2</i>
Surplus/Deficit	1,342	1,074	1,261	1,287

Key Ratios (Consolidated)

Y/E	FY16	FY17	FY18E	FY19E
Per Share (Rs)				
EPS	11.5	11.7	12.2	12.8
DPS	10.1	4.7	7.3	5.1
EV	97.3	112.8	120.7	128.6
Earnings (%)				
RoE	31.2	28.7	23.7	22.0
RoEV	15.4	16.5	15.7	15.0
Div. Yield	2.7	1.3	1.9	1.4
Valuation (x)				
P/E	32.5	32.0	30.8	29.2
P/EV	3.9	3.3	3.1	2.9
Expenses (% of premium)				
Commission	3.2	3.4	3.4	3.4
Operating Expenses	9.9	10.5	10.5	10.5
Total Expenses	13.1	13.9	13.9	13.9
Margin (%)				
New Business	8.0	10.1	11.2	12.3
Solvency (%)				
Solvency	320	281	270	260

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	Buy	More than equal to 15%
Hold	Upside or downside is less than 10%	Accumulate*	Upside between 10% & 15%
Reduce	Less than equal to -10%	Hold	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* ICICI Life is a large-cap company.

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