

3Q: Strong growth; May benefit on growth from bank deposits seeking higher returns

Reiterate Rating: BUY | PO: 400.00 INR | Price: 353.85 INR

Equity | 26 January 2017

3Q: Strong growth vs. sector leads to a rise in market share

ICICI Prudential Life (I-Pru) reported 3Q17 net profit of Rs4.5bn, a small 3.3% yoy increase, but the trajectory of the operating indicators continues to be upward. Retail annualized premium equivalent (APE) grew by a healthy ~47% yoy (private sector average: 28% yoy), leading to a further increase in market share, to 13% (overall basis) vs. a 12.1% share yoy and 11.3% in March'16. Its share of the protection business (high margin and a focus for I-Pru) further rose to ~4% vs. 2.7% in March'16 and, in our opinion, still has room to grow, given that the share of the next few players in this business is ~7-9%. The solvency ratio was 294% vs. the requirement of 150%.

Ingredients for outperforming on growth stable to rising

Channel mix is well balanced, with banca, dominating at ~58%, contributing to the mix. Persistency, a key parameter for gauging stickiness of the business, continues to rise and stood at 81.4% in 3Q17 vs. 76.8% in 3Q16, while the 49th month was marginally low, at 56.9% vs. 58.5% in 3Q16. The cost-to-premium ratio was largely stable yoy, at ~16%, but up from March'16 levels of 14.5%, as I-Pru is underwriting more protection (highest margins) business, which also incidentally has a higher commission outgo. All of the above indicators either stable or rising has led to an increase in VNB margin to 9.4%.

Drivers in place for growth, supporting valuation; Raise PO

We think that I-Pru is better placed vs. peers in a falling rate environment to maintain its higher growth (new business growth at a 16%+ CAGR). Moreover, we believe that growth can positively surprise if our thesis, that eventually a good share of demonetized deposits that today are mostly in the CASA bucket seeks alternative higher returns, plays out. Hence, I-Pru, being a dominant 'market-linked' player, should see good growth in the medium term. We raise our PO to Rs400 (vs. Rs370) on the roll forward to December 2018 embedded value (EV). For market leaders like I-Pru, we believe that a further favorable shift in market share, faster growth, rising persistency and margin profile, and, hence, rising EV, supports our target multiples. We estimate that EPS (unchanged) will grow at an ~11% CAGR in FY16-19 from <5% CAGR in FY13-16. I-Pru's new business margins (NBP) are expected to rise to ~13-14% in the medium term. Its low-risk balance sheet is an added positive. We reiterate our Buy rating.

Estimates (Mar)

(Rs)	2015A	2016A	2017E	2018E	2019E
Net Income (W mn)	16,343	16,505	17,839	19,933	22,378
EPS	11	12	12	14	16
BVPS	34	35	39	46	54
DPS	6	8	7	6	6

Valuation (Mar)

	2015A	2016A	2017E	2018E	2019E
Price/Earnings ratio	30.9	30.7	28.5	25.5	22.7
Price/Book Value	10.4	10.0	9.1	7.7	6.5
Dividend Yield (%)	1.7	2.4	2.1	1.6	1.8

* For full definitions of *IQmethod*SM measures, see page 5.

Note: 2013A results reflect only nine months of results due to a change in fiscal year-end from March to December.

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Refer to important disclosures on page 6 to 8. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Key Changes

(Rs)	Previous	Current
Price Obj.	370.00	400.00

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Stock Data

Price	353.85 INR
Price Objective	400.00 INR
Date Established	26-Jan-2017
Investment Opinion	C-1-8
52-Week Range	271.00 INR-363.50 INR
Mrkt Val / Shares Out (mn)	7,451 USD / 1,435.3
Market Value (mn)	507,889 INR
Average Daily Value (mn)	9.58 USD
Free Float	13.3%
BofAML Ticker / Exchange	XIIF / NSI
Bloomberg / Reuters	IPRU IN / ICIR.NS
ROE (2017E)	32.0%
Net Dbt to Eqty (Mar-2016A)	NA

Key Financial Data & Bus Metrics (Mar)	2015A	2016A	2017E	2018E	2019E
(Rs Millions)					
Income Statement Data					
Net earned premium	151,605	189,987	219,517	251,082	289,348
Claims paid	-122,457	-124,087	-135,129	-164,349	-198,476
Operating expenses	(19,590)	(22,348)	(25,531)	(28,333)	(31,449)
Amortization of Deferred Acquisition Costs	NA	NA	NA	NA	NA
Increase in Policy Reserves	415	0	0	0	0
Net investment income	187,244	12,084	166,483	192,853	221,973
Other operating income (expenses)	NA	NA	NA	NA	NA
Operating income	197,919	56,174	225,339	251,253	281,396
Pre-tax income	15,853	17,716	19,821	22,148	24,865
Net income	16,343	16,505	17,839	19,933	22,378
Balance Sheet Data					
Invested assets	247,147	277,313	302,861	348,253	399,369
Cash & Cash Equivalents	NA	NA	NA	NA	NA
Fixed income	NA	NA	NA	NA	NA
Equity holdings	NA	NA	NA	NA	NA
Separate accounts	NA	NA	NA	NA	NA
Deferred acquisition cost	1	1	0	0	0
Other investments	247,147	277,313	302,861	348,253	399,369
Other Assets	494,164	468,830	621,496	766,801	928,169
Total Assets	990,610	1,025,651	1,229,414	1,465,502	1,729,102
Policy reserves	897,363	922,451	1,130,547	1,355,299	1,606,294
Total liabilities	941,961	974,912	1,173,719	1,399,471	1,651,466
Total shareholder's equity	48,649	50,738	55,694	66,031	77,635
Valuation (per Share)					
Price/ Earnings Ratio	30.9	30.7	28.5	25.5	22.7
Price/Book Value	10.4	10.0	9.1	7.7	6.5
Dividend Yield (%)	1.7	2.4	2.1	1.6	1.8

Company Sector

Insurance - Life

Company Description

ICICI Prudential Life Insurance Company (I-Pru) is the largest private-sector life insurer in India on total premiums in FY16. I-Pru is a joint venture between ICICI Bank and Prudential Corporation Holdings, a part of the Prudential Group, the UK's largest insurer based on market cap. I-Pru was one of the first private-sector life insurance companies in India and commenced operations in FY01. I-Pru offers customers a range of life insurance, health insurance and pension products and services.

Investment Rationale

We rate ICICI Pru a Buy. Market leadership position is likely to be retained led by bancassurance driven model. Business growth is likely to accelerate on the back of largely stabilized regulations. Importantly, we reckon improvement in margins driven by rising persistency, change in product mix and cost efficiencies. This should lift RoEV to 17% by FY18 vs. 8% in FY16.

Stock Data



Price objective basis & risk

ICICI Pru Life (XIIF)

We set our PO at Rs400. We peg fair value at 3.3x December 2018 embedded value (EV). Support for the target multiple stems from I-Pru's RoEV, estimated at 15-16% vs. Asian peers having RoEVs of 4-14%. We use the P/EV method to value I-Pru. This is based on our assumption of sustainable RoEV of 17%, long-term growth of nearly 10% (similar to the implied growth at Indian private banks) and cost of equity (CoE) of 12.2%. Downside risk are regulation change, which can set back the growth trajectory and risk-based capital norms.

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	Axis Bank - GDR	XBKSF	AXB LI	Veekesh Gandhi
	Bank of Baroda	BKBAF	BOB IN	Veekesh Gandhi
	HDFC	HGDF	HDFC IN	Veekesh Gandhi
	HDFC Bank	XHDF	HDFCB IN	Veekesh Gandhi
	HDFC Bank	HDB	HDB US	Veekesh Gandhi
	ICICI Bank	ICIJF	ICICIB IN	Veekesh Gandhi
	ICICI Bank - A	IBN	IBN US	Veekesh Gandhi
	ICICI Pru Life	XIIF	IPRU IN	Veekesh Gandhi
	Indiabulls Housing Finance Ltd.	XFOGF	IHFL IN	Veekesh Gandhi
	Indusind Bank	IDUBF	IIB IN	Veekesh Gandhi
	Kotak Mahindra Bank	XXRVF	KMB IN	Veekesh Gandhi
	LIC Housing Finance, Ltd.	LHFLF	LICF IN	Veekesh Gandhi
	PNB Housing Finance Limited	XMWKF	PNBHOUSI IN	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Veekesh Gandhi
	SBI -G	SBKFF	SBID LI	Veekesh Gandhi
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
UNDERPERFORM				
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	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	Mahindra and Mahindra Financial Services	XGDAF	MMFS IN	Veekesh Gandhi
	Power finance corporation Ltd	PWFEF	POWF IN	Veekesh Gandhi
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	Union Bank India	UBOIF	UNBK IN	Veekesh Gandhi

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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XIIF Price Chart



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Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2016)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	113	45.93%	Buy	87	76.99%
Hold	64	26.02%	Hold	41	64.06%
Sell	69	28.05%	Sell	36	52.17%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2016)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1590	50.64%	Buy	989	62.20%
Hold	702	22.36%	Hold	438	62.39%
Sell	848	27.01%	Sell	406	47.88%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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