Max Financial Services Limited

Q1FY19 Earnings Conference Call Transcript
August 7, 2018

Moderator

Ladies and Gentlemen, Good Day and Welcome to the Max Financial Services Limited Q1 FY19 earnings conference call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. I now hand over the conference to Mr. Mohit Talwar, Managing Director, at Max Financial Services Limited. Thank you and over to you, Sir.

Mohit Talwar

Thank you and welcome everybody on this quarterly earnings call. I would like to introduce my colleagues, Mr. Prashant Tripathy, CFO Max Life and Mr. Jatin Khanna who handles Investor Relations for the Group, so very briefly, I will just talk about MFS to start with before we get into Max Life's performance. We saw a 21% growth in Max Financial, revenues touched Rs.3,099 crore with consolidated PBT at Rs.51 crore, however, down by about 41% and that was due to some one-off expenses mainly relating to the IDBI Federal acquisition which we had bid for and then subsequently pulled out of, also lower profit has been due to higher protection business and a shift in product mix towards ULIPs. Moving onto Max Life, MCEV on an operating basis has grown 15% annualized to Rs.7,645 crore. Due to sales seasonality and investments made in proprietary channels, the impact of cost overrun is higher for Q1 leading to lower ROEV than last year, however, the full ROEV is expected to be in line with historical trends. NBM for Q1 is 23.5% before cost overruns and this has improved 130 basis points over the previous year and it is 18.1% post overrun. On a full-year basis, NBM is also expected to be in line with historical trends. Value of new business post-overrun has grown by 17% to Rs.101 crore. Individual APE has grown at a strong 17% to Rs.552 crore with a bias towards traditional and protection products.

While we have experienced a strong growth across channels, our proprietary channels growth at 19% has exceeded Banca growth at 16%. Continuing with our strong focus on digital, Online sales through website has also grown 93%. Online ULIP has been launched to gain further market share in the online market. Protection sales including individual and Group, has grown 48% year-on-year resulting in improvement in protection mix from 13% in Q1 FY18 to 16% in Q1 FY19. Individual protection mix improved from 6% to 7%, and group protection mix improved from 7% to 9% during the quarter. Gross Written Premium grew a strong 16% to Rs. 2,320 crore, 16% growth in renewal premium touched Rs.1,554 crore led by a record improvement in conservation ratio to 91%, which is one of the highest in the industry. Trends in expense ratios and conservation and persistency, all continue to show a healthy year-on-year improvement. Claim settlement ratio at 96.3% is best-in-class. Solvency surplus is at Rs.1,911 crore with solvency ratio at 262%. Asset under management as of June '18 stood at Rs. 53,940 crore which is a growth of 18% year-on-year.

Max Life recognized as being amongst India's best companies to work for in 2018, is # 1 in the Life Insurance companies; Top 15 in BFSI space, and among Top 50 companies in India.

Briefly, I will talk about the progress towards some of the strategic priorities. We have started investments in proprietary channels to build robust multi-distribution architecture. We plan to invest around Rs.170 crore as opex and around Rs.60 crore as capex during this year on expansion of proprietary and digital. We also plan to open 145 new agency offices during this year. Funding for all this expansion will be through internal accruals, so there will be no dilution. We plan to add 36,000 new agents every year over the next three years and increase our agency offices from 205 to 350 over the next 12 to 18 months. We will aspire to grow these channels, by around 35% CAGR over the next three years to get a more balanced channel mix and get a 35% to 40% contribution from these proprietary channels.

Max Life agency channel is one of the few agency channels that deliver positive margins. We will continue to strengthen our market leadership in online sales because of consistent pricing advantage powered by strong underwriting capabilities. We will continue our efforts of deeply integrating with our bancassurance partners and build capabilities across products, marketing and technology while continuously attempting to acquire new partners. There will be a focus to pursue a more balanced product portfolio with a bias towards protection segments, which you would have noticed in our product mix shift as well. With significant investment in proprietary channels, sustained improvement in cost ratios and improvement in protection mix, we are progressing towards aspirations of 25-25-25 target on EV, VNB, and growth over the next three years.

To sum up, Max Financial Services is on course to drive strong shareholder outcome via its new strategic plan. There is a three-pronged strategy in play on addressing channel concentration risk that we are playing in the mind of investors, aggressively grow our proprietary channels, retain and grow existing partners, and pursue inorganic opportunities to balance all the channel mix in a shorter timeframe. On that note, I would like to hand back to the moderator and open the floor for question and answers. Thank you.

Moderator Thank you very much, The first question is from the line of Madhukar Ladha from HDFC Securities. Please go ahead.

Madhukar Ladha My first question is regarding your Group business, can you break down between the various components of it, for the credit protect, group term insurance, and group fund's business?

Prashant Tripathy The answer to your question is if you look at the 9% that is coming from Group, about 1% of that which typically comes in form of single premium, so 1% is APE adjusted premium out of credit protect and the balance 8% comes from the retail business which is repeatable, and there is nothing that we do quite insignificant through funds business, so that's about it.

Madhukar Ladha Sir, second question more on Max Financial, we have paid out slightly over Rs.27 crore for arranging the funding for IDBI Federal, that seems a little bit on the higher side, can you explain that and probably also tell us whom did we pay this to, were there any bankers involved in between for this?

Jatin Khanna To organize this funding, we reached out to few lenders. Initially, we were trying to tie-up these funds from private equity investors, wherein the binding commitments require as part of the process were difficult to organise because an equity investor can really give a binding commitment only for an equity term sheet, which has complication in terms of pricing guidelines. Whereas this transaction's timeline were not very clear, so we had to reach out to few lenders to organize funds and we ended up organizing more than what was required. This fee is about 0.5% of what we could organize in terms of the funding requirement for the bidding.

Mohit Talwar Let me give it a little bit more color here, as part of the IDBI Federal deal, as you all know we were one of the two companies who got shortlisted. At the final stage what was required of the bidder was to actually confirm in writing with a fully binding, underwritten offer arranging for funds, so there was a syndicate which had given us a fully underwritten offer and as you know any underwritten offer will entail a fee and these are not very large amounts, but then the amount which was being raised was substantial, so that is the amount which is something which you anyway have to pay irrespective of whether a deal goes through or not. Had the deal gone through, this would have been adjusted against the overall pricing. Unfortunately, we pulled out of the deal and for right reasons of course, so this is something which is committed and had to be paid and surely a one-off.

Madhukar Ladha Sir, you reported 15% ROEV for the quarter and you also disclosed Rs.7,706 crore as MCEV for fourth quarter while the first quarter's EV number is actually down, I understand that there is a dividend adjustment in this, but there is a little bit of a gap and my calculation suggests that it is about Rs.153 crore, can you explain that, probably it is economic variance or other variance?

Prashant Tripathy Let me just give you a quick reconciliation, from the Rs.7,706 crore, we paid out Rs.197 crore of dividend, so even during the disclosure we had reported that with the dividend paid out, the number will be Rs.7,509 crore. As Rs.7,509 crore goes up to Rs.7,645 crore, but if you were to compute 15% then there will be deficit about Rs.137 crore, that comes predominantly because the movement which is mark-to-mark in nature in the shareholder account as well as in policyholder account and that was around Rs.50 crore in shareholder and the balance about Rs.90 crore in the policyholder fund, which is really non-operating in nature. Now, the big question is if we are making adjustment here, it should show up in the margins and just to very quickly update you that our methodology of VNB or margin computation is on the basis of period beginning curve now we all know that the curve has moved quite significantly during the quarter, so the beginning curve has been used for margin computation, however, for the computation of EV, we ended up using the period ending curve, which is exactly the methodology that we have always followed, so the good news is when we come to the next quarter and we start to pick up the new curve which has moved across the cohorts by about 60 to 80 basis points versus the margin numbers that we have disclosed, you should see an uplift of about 80 basis points to the margins that we have given, so just to explain to you clearly if we were to use the curve as of end of the period then the margin that we have shown is 18.1 would have been closer to 19, however, this is a methodology we have followed and it gets reconciled over a period of time.

Moderator Thank you. Our next question is from the line of Avinash Singh from SBICAP Securities. Please go ahead.

Avinash Singh Two questions, one on your protection, so if I just look at Slide 10, the number of policies on the individual side have gone up by 28%, but the premium growth on individual is 45%, so would like to just understand is it the effect of ticket sizes going up because of the sum assured or like also there is some sort of pricing effect, I mean if you can provide some color? Second question something I missed on the credit protect the Group part that 9% breakup what exactly was 1% and 8% because line was not clear to me? Thirdly, in terms of your expenses/investment in your digital/proprietary channel, opening of branches, if you can just again provide some numbers again and what sort of impact based on you assume sort of new business growth, what sort of margin impact you will see because of this?

Prashant Tripathy All good questions, Avinash, I will just go one by one and answer your question. Your observation is correct. We are observing a ticket size, which is a bit higher than how it was last year, so from close to about Rs.11,000 to Rs.11,500 range of ticket sizes, this year we are writing more in the range of Rs.12,500 to Rs.13,000, so there is an upside on the ticket size and hence you will notice that on number of policies we have grown 28%, but on the total premium on protection, we have grown closer to about 45%, that is the first answer to your question. The second one was on the total protection business as you can see, we have declared this as a 16% number. Of that, 7% comes from Individual business which is the retail part, these are individual policies that we end up selling and then you will see on Group side about 9%. Now, Group actually has largely two different colors or policies that we end up selling. One is the credit protect part and the other one is Group term life. Now credit protect is an insurance for the people who are taking mortgage and retail is generally given to corporate for covering the employees or large groups, so the breakdown of 9% in group is actually 1% of credit protect and 8% of GTL.

The third question that you asked about the color on expenses, Yes, you are right even we began the year as a part of our last call, we did explain that we are embarking on a journey to expand our proprietary channels and we had carved out about Rs.170 crore of additional expenses towards ramping up our own channels. Now, our own channel means seven or eight different initiatives that we are trying to drive, some of them are agency like, but the investment also goes towards enhancing our presence in the digital space, experimenting as well as ramping up other channels which are non-agency like and as we speak there are eight different initiatives that we are pursuing. The first quarter expense that we have incurred is broadly in the range of about 10 to 15 Cr because we just began it in the month of April. As we move ahead, these expenses that we will incur, at a very high level of Rs.110 - Rs.120 crore will go towards setting up offices, hiring new people, and the frontline staff who will be responsible for sales. There is balance Rs.50 crore which has been carved out for driving protection as well as saving businesses through Internet as well as the cost that will come in form of marketing, in form of new things that we will be doing as well as additional expenses that you end up incurring while writing protection which is more like medical charges etc., so this Rs.170 crore is a breakdown of Rs.120 crore which is going towards agency like and the balance Rs. 50 crore towards driving digital as well as the new initiatives that we have picked up as a part of growth exercise.

Avinash Singh I mean of course this is a three-year plan, but as you highlighted that typically in the next 12 to 18 months, you will be setting up a branch and also the protection part will sort of frontloaded, so we can expect large part of this Rs.170 crore to expend over the next four to five quarters?

Prashant Tripathy I will say so in the range of about Rs.130 to Rs.150 crore most definitely. On your question the one that you asked saying what will be the impact on margin, like we gave you a kind of forecast which is really very hard to tell the exact number, but we are anticipating that with all these expenses incurred and its effect on overruns counted, our margins will be in the similar range as we kind of had last full year, so we are looking at a number which is closer to about 20%.

Jatin Khanna What is important to note here, Avinash, is that on a structural basis, our margins have expanded and as we start scaling up and growing faster, our expenses on expansion get absorbed. Then you will see a sharp margin improvement and the pathway to reach the structural margin is not like five years or a decade, it is over the next three years. So therefore, at least from a trend line standpoint, our structural margins have become very robust and we hope to get there very soon despite the expansion.

Prashant Tripathy Avinash, that links to the 25-25-25 strategy, so that is really the roadmap. We first get to 25 on structural basis and then we ramp up the business to make sure that we get the leverage, so that on net of overrun basis, we get to 25% within three years' time.

Avinash Singh Out of this again some investment because you will be opening branches, hiring more staff, so that there will be some again recurring part of cost. Of course, I am mindful of the fact that okay that will drive the business overall, so how much of this sort of will add to the recurring cost because out of this 170, eventually we will end up sort of paying rent for the offices and staff salaries, and on that I mean typically if we are going to end up for FY19 at again around somewhere 20%, so the three-year to 25 starts from March '19, am I right?

Prashant Tripathy Just to correct, some of these costs are going to be recurring because it is going towards rental, it is going towards hiring employees, the only thing that we are doing is to leverage our current infrastructure to a great extent, so of this 145 offices, about 60 of offices which are office units, they are being opened in our current offices by carving out space for the new office unit, so we will do whatever it takes to make sure that the expenses are minimized and it remains in the zone of variablizing the expenses as much as possible.

Jatin Khanna Avinash, these expenses will be what they are. I think what is important is that these expenses will produce sales and as that sales growth catches up, these expenses will get absorbed automatically within that sales growth, so then you will not see any overrun being thrown by these expenses.

Moderator Thank you. Our next question is from the line of Amit Thawani from Zenith Capital. Please go ahead.

Amit Thawani Sir, I was just seeing that in FY18 we did not have any cost overrun, but this quarter we have cost overruns, can you tell us what is the nature of this cost overrun and how long are they expected to continue?

Prashant Tripathy You may note, Amit, that this is the first time we are disclosing the number on a quarterly basis, otherwise typically you would see our disclosure at the end of first half year. The way life insurance business works is about 15% of sales comes in the first quarter, that is the nature of the business, it is quite seasonal and large part actually comes in Q3 and Q4, so the proportion of sales in Q1 is lower, however, large part of our cost other than the commission cost is fixed in nature because you have people deployed, agency etc. and we typically end up incurring 21% of our total management expenses in the first quarter itself, so generally there is a gap in Q1 because seasonality issues and hence Q1 will generally have an overrun, so we do have an overrun, it was there even last year first half, so just to compare, we had about Rs.20 crore of overrun in the first quarter last year and we have about Rs.30 crore of overrun this year. The additional Rs.10 crore is happening predominantly because of the additional expenses that we are incurring towards the growth, the one that we described because in agency-lite channels, you have to make the investment up front and they start to actually get ramped up in six to nine months, so as we move along through the year, some of these overruns will get auto corrected as sale starts to pick up and the seasonality moves in this zone of higher sales quarters.

Amit Thawani This Rs.170 crore that we are expected to spend, that will be over three years, so I am guessing it is about Rs.60 crore a year, this will be included in cost overrun?

Prashant Tripathy First of all, your observation that it is going to be over three years that is not correct, actually this will be pretty much yearly cost, so in Year 1 will be out looking something like Rs.120 crore, which will progressively increase. They will of course be a part of overrun, but you must remember that as sales start to pickup, you have more sales come up which produces allowable, so overruns actually reduce.

Amit Thawani This does not affect our VNB margin pre-cost overrun, this will come post the cost overrun margin, this Rs.170 crore a year?

Prashant Tripathy Part of that which is not covered by the sales, so in the initial year and like I always mention that in Year 1, we will as per our business plan we were hoping margin to be in the range of 19-20% because these additional expenses that we are incurring. It appears to me at this point of time that will be more towards 20% than 19%, so we will maintain our margin while we continue to incur these expenses to drive the growth for the business.

Amit Thawani So 20% post cost overrun margin is what we are guiding for?

Prashant Tripathy Sitting today, yes.

Moderator Thank you. We take our next question from the line of Prakhar Agarwal from Edelweiss Services. Please go ahead.

Prakhar Agarwal Sir, three questions from my side, first is in terms of VNB margins that we are talking about maintaining it over 20%, what will be the key driver especially given the fact that we are spending on these channels? Second is in terms of your protection mix that is being contributed by your own channel force as of now, what is the current proportion and how do you aim to take it forward? Third is in terms of when you are talking about diversification in your overall channel network and you are talking about inorganic opportunities as of now, what exactly do we have in mind right now?

Prashant Tripathy On your first question, we had VNB of 20% as we finished last year. We are hoping that the structural margins will go up as we are ramping up the protection mix. Now, the real protection generator is the penetration through individual business in protection. When we finished last year, our protection mix for the full year was around 4.2%. For the quarter, we are 7%, we are hoping that we will be somewhere in the range of about 5% to 6% or closer to 6%, which will be 200 basis points improvement in the penetration of protection. Generally, that gives a lift in the structural margin, so the margin without these investments that we are incurring would have gone up by closer to about 150-200 basis points, because of these investments, margins will be reduced by some bit of overrun, but we may still land up at the same margin level where we were last year. The second one is on protection, how much do we get from our own channels, so of this 7% individual protection sales that we have delivered closer to about 5% comes from our own channels and balance 2% come from the third party distribution channels. Around 3%, of the 5% comes from digital channels and balance 2% comes from the rest of channels like agency or direct channels etc

In terms of diversification of course that is an agenda that we have been very aggressively driving and some of these investments that we are making are because of our intent to diversify especially make investments in our own channels and we are hoping that as a result of all the investments that we are making at the end of Year 3, we will target to have our own channels go somewhere in the range of about 35% to 40% and hence the other channels Axis Bank included should be in the range of about 60% to 65%, which is currently about 10% point off, so I guess all the investment that we make will make our overall channel dynamics more diversified. You would also have noticed that there is a significant effort which has been made over last two years to also diversify our product mix. We were significantly par oriented about two years ago and our par mix used to be more than 60%, we have now balanced it and you notice that in the quarter, our mix on product on par was 38% and equally the mix on ULIP has gone up to about 40% and as we have repeated multiple times, this is a very well thought through planned move, so that on product basis, we have diversified to make sure that the concentration risks are minimized, so to summarize efforts are underway to diversify both on products and/or channels.

Prakhar Agarwal Sir, couple of follow-ups if I may, in terms of your credit protect policy, so that contribution is only 1%, what is our thought process on that and are you open to expose that road because some of the other peer companies are using that route aggressively in terms of growing that part of the book, so what is our thought process regarding the same and if at all we are not planning to grow it, why is that so? Second is in terms of when I was talking about your channel distribution, I was more alluding to the fact that wherein he mentioned a line saying that we are open to inorganic opportunities, we are evaluating, what exactly that inorganic opportunities after this IDBI Federal is?

Prashant Tripathy On your question on Group protection on credit protect, I think we will be tactically interested in ramping up the group protection bit, however, it is not a part of our large strategy because we believe that there may be some regulatory issues that would come our way with respect to the credit protect business, so our first priority is to ramp up the individual protection mix and as we mentioned in three years' time, we will see this number to go up to closer to about 10% or 11% because that we believe is sustainable, that we believe is retail, that we believe really drives the behavior and hence we are more biased and more keen to work on and try to drive individual business. On diversification as we mentioned and it is quite obvious from all the things that you read and heard from us, we are quite keen to look at opportunities inorganic space and that is defined by two different opportunities, one will be signing up as many as Banca partners as possible in addition to all the expenses and investments that we are making to drive our own channels. There are some market opportunities that we are currently working on and we are hoping that some of them will work and the second one is to really look at acquiring the company while there is nothing obvious which is there in the landscape just now, but we do want to keep this being pursued because we believe that over next two to three years, there will be consolidation opportunities that we will try to leverage quite aggressively. You saw it from the move that we made with respect to IDBI and we were very keen, except how the overall structure and discussion went. So, as any opportunity comes our way, we will definitely come back and discuss with you; however, the percentages that I mentioned to you, the desired percentage, is without considering any inorganic opportunities.

Prakhar Agarwal Just one clarification, you mentioned about the regulatory issues in credit protect, if you could just elaborate some part on that?

Prashant Tripathy The credit protect business, it is something where the market is still evolving. We have to see the regulatory posture with respect to which way it goes, we find that there may be arbitrage opportunities, for example, with respect to margins in the GTL side of the business or one part of group business versus this part of business. Historically, we have found that wherever within the group business, there are unreasonable margins than regulator comes and tries to adjust, so that is what I meant by regulatory, I do not have any reason to believe that there is something obvious which is going to happen, but as a Group, as I mentioned to you our belief in the individual business is more than on the credit protect business.

Moderator Thank you. Our next question is from the line of Nidhesh Jain from Investec. Please go ahead.

Nidhesh Jain Sir, on credit protect your share is just 1%, is that correct?

Prashant Tripathy Of the 9, that is 1%.

Nidhesh Jain So 8% is group risk business?

Prashant Tripathy Yes.

Nidhesh Jain Sir, on the cost overrun if I look at the opex growth this year for Q1, it seems like the opex growth will be low single digit, so where exactly is this cost overrun is reflected in our statutory P&L?

Prashant Tripathy Generally, it is very hard actually to link the statutory P&L to the valuation P&L or overruns because it is a combination of multiple things including the product mix. I think the biggest driver is product mix and you would notice that our product mix has altered quite significantly versus the first quarter of last year, we had 51% par, now it has gone down 38%. We have 28% ULIP last year, now it has gone up to 41%, so when these things happen actually overrun gets altered and hence the overrun actually is happening because the higher expenses that we are incurring in building our own channels as well as the change in product mix.

Nidhesh Jain Lastly, on this protection, we are noticing that all the companies are reporting very strong growth in protection and numbers like 15%, 16% share of protection was never thought about or talked about two years back, so is it structurally something happening in the ground level that customers are more willing to take protection or it is because that companies are driving that growth?

Prashant Tripathy I think the real movement I see is on individual, we had reached 7%, about three to four years ago this number used to be 1%, so we are making conscious efforts to drive the individual business and so is everybody else. It is a result of new channels developing, digital as well as awareness which is being created and suffice to say that the overall margins in this particular category of product is higher, so I expect this to continue to ramp up. However, I think the companies have started to report protection business in a particular manner only over last couple of years; the GTL business is truly a protection business, however, counting GTL versus individual and credit protect is like comparing apples to oranges, so some of this has to be seen at a far more detailed level and I explained to you what is the delta between GTL business and credit protect business, so GTL business has historically been for us about 6%-7% so if we were to for example represent this number three years ago or two years ago, we were close to about 10%-11%, now we have moved to 16%, but what we are really tracking at a company level is what is the delta that we are getting on individual business and if possible at credit protect business and our desire is to drive those two more.

Nidhesh Jain Sir, lastly on the surrender, we have also noticed that surrender especially on the ULIP product has been coming down quite steadily over last few years, so structurally is the longevity of a ULIP product is improving or is it just one off because of the current market scenario?

Prashant Tripathy You say that only for us or for the industry?

Nidhesh Jain That observation is correct for you as well and for some of the other companies who have reported as of now, I do not have the data for industry but for four to five companies who have reported as of now, this observation holds?

Prashant Tripathy Historically, we have always been low, if you look at our numbers which is there on Page Number 12, we were 21% in FY17, we were 20% in FY18, we are 24% in Q1FY19, now though we had given comparison, but on a run rate basis we are pretty flat, so I do not have data to really say that it has been coming down very significantly, more or less it is stabilizing, but it is not as if it has gone away.

Moderator Thank you. Our next question is from the line of Adarsh P. from Nomura. Please go ahead.

Adarsh P. Sir, question on your persistency, 37 month has seen a pretty sharp improvement if you can just elaborate on that?

Prashant Tripathy I mean three percentage point improvement, this generally happens because of tranches moving along, so you see about three years ago, we were around 80% and now we have moved to 83%, if we were to perhaps go back, we will be more like 78-79, so as the persistency of 13 month improves, they kind of perpetuate and go forward, so I do not have a big reason or specific reason to say. The collection efforts are currently much stronger and we have seen reasonable enhancement if you see all across at least in the 13^{th} month, the 37^{th} month, the 49^{th} month, we have seen improvement anywhere between 100 to 300 basis points.

Adarsh P. Second question relates to product committee recommendations that came out in December last year, one of your peers has quantified the effect on the margins implemented as and wherein basis today, so anything that you can talk about as to you know the certain recommendations made and what would be the impact if any of those get implemented?

Adarsh P. They were talking about capping surrender in the traditional business, so I know that you can workaround different combinations of what the surrender rates could be and then that can be to different outcomes on margins, but if say in the next six to 12 months, there are caps on surrender then how does that, obviously our product mix have moved a little favorably towards ULIP at least from the regulatory standpoint, so just wanted your sense on how you would look at either your margin guidance in the context of any regulatory changes that side?

Prashant Tripathy I understand your question now, thanks Adarsh for explaining. It is very hard actually to say because surrender scale has to be trued up and we do not know what it will be. The recommendation is quite open in terms of how it could be constructed, suffice to say however that the cash value that we provide already and the scale that we follow is for us is quite superior and higher than what the current regulatory requirement is on par, so we are already on the higher side than what basic minimum that the regulator requires, and hence depending on what it comes, you will see which way it goes, however, we must like to keep in mind that these changes are while the product committee has given this recommendation, we must know that participating policies currently form close to about 60% of total industry sales as of today including LIC and hence any recommendation that is either proposed by the committee or viewed by the IRDA will be reviewed with enough caution and enough practical approach, so we will see when it comes. Currently, very hard for me to give you a guidance in terms of what will be the margin impact, because I do not know what scale will get pursued.

Adarsh P. My last question, any progress on discussions with Axis in terms of elongating your distribution tie-up, obviously it has been three months since the last call, but if you can just talk about any movement or status quo?

Mohit Talwar The truth is we are all waiting as they are for the new CEO to join, however, we have had some informal discussions with them, whilst nobody can confirm but at this point in time all I can say is that both sides are kind of well disposed in terms of how this relationship has panned out over the last so many years and if you really look at it from their point of view, you know this is probably really a solid annuity kind of a fee business which they have been getting for all these years and so it is beneficial for them and from our perspective also, it has been a sustained source of growth and revenues for us, so this relationship has stood about eight years or so and frankly, I would be surprised if this arrangement is kind of shaken up for just for the sake of actually trying to do something which is somewhat different. As far as their manufacturing aspirations and all of that is concerned, I think whilst there is no formal communication from Axis' side, but indication seems to suggest that is something which I do not think there are going to pursue at this point in time. I know that this is a long winded answer, but this is where we really are, so we will have to just wait till the incumbent comes onboard to commence our dialogue all over again.

Moderator Thank you. Our next question is from the line of Neeraj Toshniwal from Emkay Global. Please go ahead.

Neeraj Toshniwal Sir, so protection as a segment is increasing for the industry as a whole, so there was a bump up in your protection first quarter of last year as well as at 13% and now it is 16%, so any relation I mean to typically to first quarter having a higher share of protection mix?

Prashant Tripathy We did notice a bump up in the first quarter of last year and we reached about 6%, but by the time we have finished the year, we came at 4.2% which means for the rest of the quarters, we did not do quite well and it so happens that as the year passes by, the sales team are quite motivated to do more and more sales and hence the focus on balancing the product mix and you know trying to drive protection per se actually goes down amongst distributors, so we have made some changes this year, which means we have now adjusted the overall targets in a manner that it is more frontloaded and the good part is that some of these numbers of 7% etc., if I look at the number in July for example one month after the quarter has ended are sustaining, so they are not falling back to 4%, so I have reasons to believe that the structural changes that we have made will definitely get us reasonably higher than where we finished the full of last year and like I told you, I am expecting at this point of time to have anywhere between 150-200 basis point increase in the protection mix on individual basis of full year versus last year, which will give the kicker in the margin for us to absorb additional expenses that we are incurring towards driving our own channels.

Neeraj Toshniwal Any NPV analysis you have done in terms of the kind of return would get on the investments are getting because looking at the data, we are not able to actually make out how is the overrun is impacting your numbers, because it is not coming into the P&L?

Prashant Tripathy I think we will just wait to see how it pans out because we just began the journey, so I think it will be relevant question to review past 9-12 months, we just began, so we have not made very significant investments.

Neeraj Toshniwal But the impact on the overrun has been higher, in fact we have not done only just Rs.10- 15 crore we have spent it and the impact has been on the overruns have been on the higher side, so just wanted to have some color, how we are seeing it is panning it out, how to actually see the numbers post overrun for this year because you are sticking to your target, so that is what I am not able to actually sum it up, how actually it will, because you will be spending some Rs.120 crore in this year itself and what would be the repeat cost in future years and next year, new CAPEX plan over the next three years?

Prashant Tripathy I think two or three points actually, one is the overrun as I mentioned to you in the previous question also is simply not because of the investments that we are making, it is more out of the seasonality and I think we are the only company of perhaps unique in terms of exactly telling you what overruns we saw for the quarter, I notice that some of the peers are not even talking about it, they simply talk about their full year expectation of margin, so we are pretty transparent to tell you that we have this kind of overrun, but suffice to say that because the discrepancy between the expense and revenue on your sales, for the first quarter generally most of the companies have overrun. As I mentioned to you, we have only 15% of sales that has come in the first quarter which is true of the industry also, however, we end up incurring 21%-22% of expenses because of the fixed nature of the business. Now, as the further quarters come, sales actually ramps up because that is how the industry stood up and hence the overruns actually go away. To answer your question like I mentioned to you on a structural basis, our margins, I am expecting should come more in the range of 20% to 23% and net overrun number should be closer to the margin that we declared last year, so that is the impact of the additional investment that we make to our overrun numbers.

Neeraj Toshniwal In terms of recurring, how much would that be in the next year?

Prashant Tripathy These are generally recurring and the overall expenses actually have increased because we are adding capacity, but you must remember that when you add capacity this generates new sales and new revenues, so there is generally a blip in terms of expenses going up, but they start to support themselves as the sales gets generated from those offices. Also, I have been highlighting since last time that the model that we are following for agency is a bit different from the typical agency where we will go and start a large office etc., and we will have lot of fixed cost, a very significant part of this is variable in nature. Like Mohit just mentioned to you that for us to start 145 offices, we are out looking a Capex only Rs.60 crore, which means a large part of that is very small units and this includes all the IT spends that we will incur and all facilities and everything, so we are not going to significantly incur expenses or fixed cost to setup these offices. On an average, every office is going to cost me close to about Rs.30 lakhs, so we are looking at a model which is self-sustaining, which is more variable in nature, and as it generates more sales, the overruns will start to go away.

Neeraj Toshniwal This will take to your number of 350, I mean that is the beginning so number of offices 145 will take your total to 350?

Prashant Tripathy That is correct. Our agency offices will increase from 205 to 350 over the next 12 to 18 months.

Neeraj Toshniwal In terms of broader mix will be now stable, I mean 40% at ULIP and par somewhere around again 40% and balance 20% coming from the savings and protection, non-par saving and non-par protection?

Prashant Tripathy Yes, I think we will be on ULIP between 40% to 45% and on par we will be more like 35%, the balance will come from non-par.

Moderator Thank you. Our next question is from the line of Avinash Singh from SBICAP Securities. Please go ahead.

Avinash Singh First one is follow-up that you mentioned that individual protection ticket size increased of 10% to 15% in nature, so my question around that is it that sum assured going up or also you have sort of re-priced your product, and related to that if I see your slide, it is saying that number of policies protect and that share has now gone to 32% on the individual side, so I know that over pie will keep on increasing, but how much this share 32% in terms of number of policy can go up because I mean eventually because of the small ticket that your overall premium share is capped, so I mean already we are at 32% in number of policies here, so much further it can go up? Secondly, I mean it is a bit of a I would say question with less information, if I look at your IDBI Federal acquisition attempt at least from the public sources, the kind of valuation and whatever embedded value multiple that was being talked, now we have one or more companies also coming out for IPO, do you think that valuation that was at least talked or being reported in media was justified for IDBI Federal?

Prashant Tripathy Let me just give you the answer on the first one, so it is true that one in three policies have now become from protection and I would not quite count this percentage as a percentage of total number of policies we are selling predominantly because the level of penetration that we have around protection is very, very low in India, so even if it becomes 50% or 60%, I would not quite be surprised, those things are quite possible and as we mentioned, the ticket size is small anyways. The second is you asked whether we have re-priced any products, the answer to that is no, not yet. We may be looking at it as we go along, but no re-pricing has happened. This is happening out of our chosen strategies that we are following to go to high income segments, which is the attempt that we are making across all the channels. As a result of that, we have seen about 10% to 15% increase in the ticket sizes.

On IDBI Federal, I guess between Jatin and I both of us will try to give you an answer, maybe I will give you an answer from the company perspective and then Jatin could also chip in with respect to how he sees it as shareholder, but when we did the valuation of company internally for ourselves with respect to the growth numbers and everything, a valuation which is closer to three multiples was possible, however, it was coming on several conditions with respect to product mix, conditions with respect to how long the relationship should last etc. and as you know the valuation in multiple is dependent on some of these factors of what kind of product mix, what kind of margin and how long is the relationship, how productive those channels are, and those exactly are the terms that we started to negotiate and when we found that some of those terms were not agreed to, we decided to come out of the discussion going forward because we believe that the valuation which we were discussing was not being supported by the assumptions which gone behind it, but for a company which is in perpetuity which is running long-term etc., if you do a DCF method and the companies add good product mix, good margin, getting valuation 2.5 to 3 times is not a big deal actually.

Mohit Talwar All I want to say is that I would urge you guys to not believe the press that much, all they will put is a number without really putting the terms, conditions, and caveats and all of that. I mean one of the most critical items in our discussions of IDBI Federal was about the fact that this tenure should actually be in perpetuity. Now, that does not get captured anywhere. Number two, what happens in the event of a change of control, what happens when you say that you want exclusivity and you are not getting it, so when you look at all of these things and you start putting your caveats and then, then to come with a multiple of three is fairly justifiable I would say, but you just look at our number in isolation which is there in the media, I do not think you should just rely on that.

Jatin Khanna Like Prashant said, it was a DCF of what was being offered to us, now as you step-by-step takeaway, what is on offer, and automatically the valuation of 2.5–3 times has no meaning because we look at it from a DCF standpoint and not 2.5-3 multiples.

Moderator Thank you. Our next question is from the line of Amit Thawani from Zenith Capital. Please go ahead.

Amit Thawani Just wanted a follow up on, so we said Rs.170 crore will be the additional cost on improving the distribution channels and assuming that we do new premiums of Rs.4000 crore, it is about 4.3%, so Rs.170 divided by Rs.4000 crore, so is it fair to say that in FY19, our cost overrun will be 170 divided by 4000 which is 4.3%?

Prashant Tripathy It is not that straight Amit and maybe it is a question that you should discuss individually with me, but the way it works is you have to look at how the accounting of these expenses happen, what of that comes to the shareholder because how do we compute is something that has to be seen, so it is not as straightforward, my sense will be it will be closer to about 2%-2.5%.

Amit Thawani Okay, 2% to 2.5% hitting the shareholders?

Prashant Tripathy Yes, just to clarify one more time this Rs.170 crore number is a combination of two things about close to Rs.120 crore towards building our own offices etc. and the balance Rs.50 crore is towards driving protection, higher marketing cost, and investment in channels which could give us higher growth, so it is broken into these two parts.

Amit Thawani So cost overrun totally is about 2.5% of the APE in your estimates?

Prashant Tripathy Sitting today that is the ballpark number that I will talk about, but as we come closer and we finish the year we will continue to come back and continue to update you as to what those numbers are.

Moderator Thank you. Ladies and Gentlemen, that was the last question. I now hand the conference back to the management for closing comments. Over to you, Sir.

Mohit Talwar Thank you very much for sparing time off to be on the call, and we will be doing this consistently over the next quarter or so, so thank you for sparing time. Goodbye.